

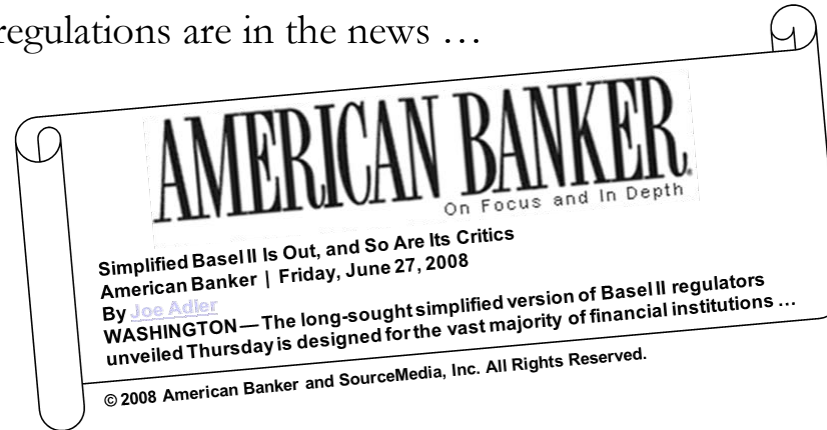
# The Impact of Standardized Basel II on Kentucky Banks

Prepared for Kentucky Bankers Association



# Executive Summary

- Basel II bank capital regulations are in the news ...

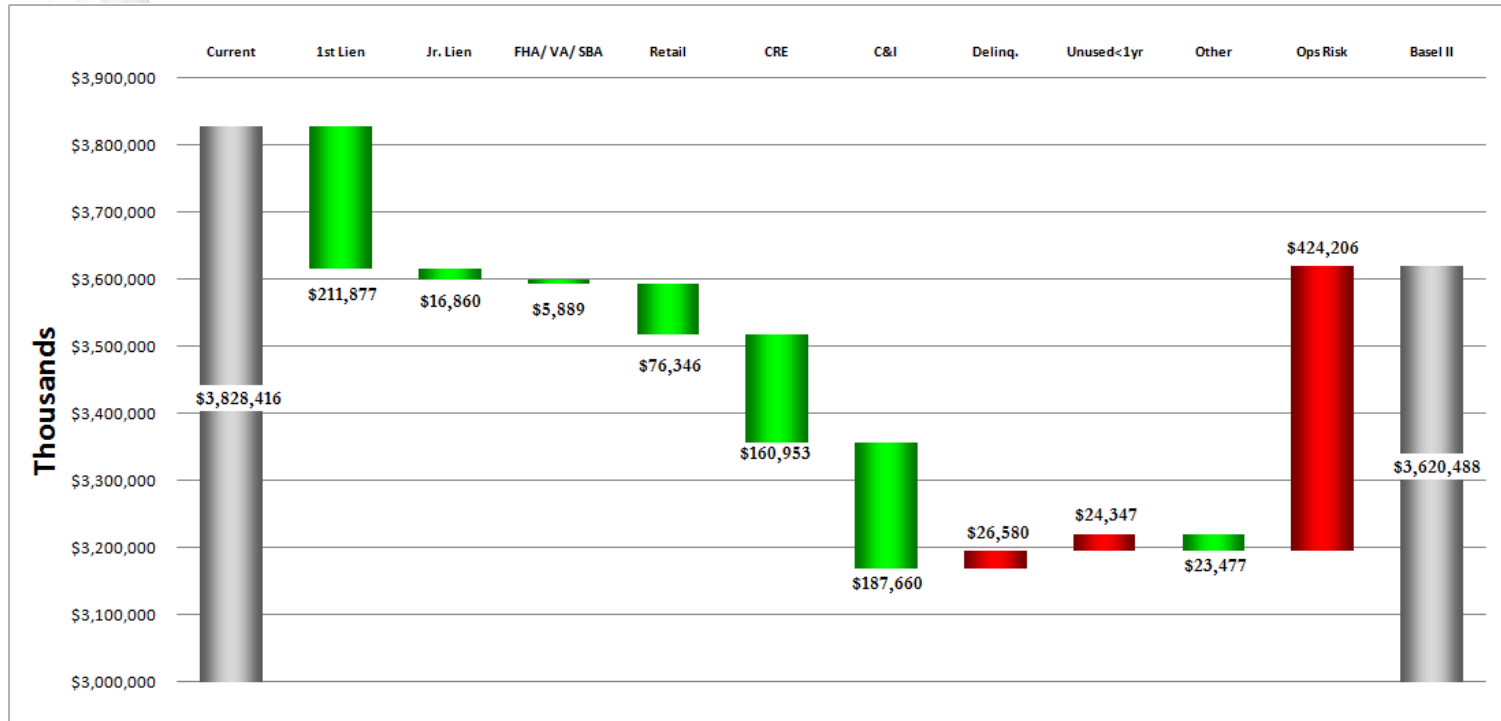


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 79.3% of 179 Kentucky banks and thrifts
  - Aggregate potential capital savings for all 179 banks of \$208 million
  - The median Kentucky bank would save \$0.8 million or 4.1% of their existing Tier 1 capital requirement
- Implementation is not without its challenges
  - Pillar II reporting can be complex and costly
  - Compliance requires demonstrated capital management capabilities
- Are your members aware of and prepared for these changes?
  - Second Pillar Consulting is uniquely positioned to help banks comply with Pillar II and obtain the capital relief they deserve

# Kentucky Banks can save up to \$208 million in required capital under Standardized Basel II and improve risk management

## Capital savings estimate and asset category contribution

Regulatory Capital Requirement

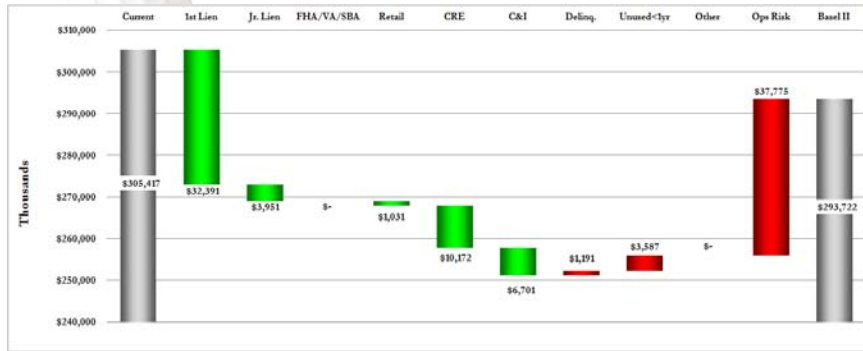


Source: 2008Q3 Call Reports; SPC estimates

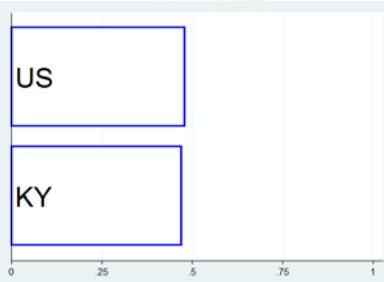
# For Republic Bancorp, Inc., a representative Kentucky bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$11.7 million or 3.8%

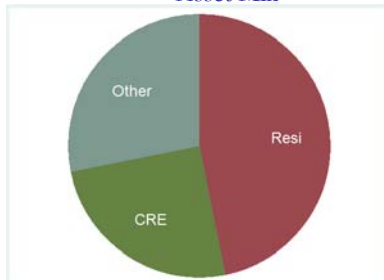
Regulatory Capital Requirement



Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$3,045	
Gross Income Margin	4.3%	
Tangible Common Equity	8.8%	
Leverage Ratio	10.2%	
Capital Estimates	Current	Basel II
Tier 1 RBC	15.4%	16.0%
Total RBC	16.1%	16.7%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$0.58	
Share Repurchase (7/29/2008 price)		
Number of Shares	527,972	
Change in EPS	\$0.03	
Organic Asset Growth (millions)	\$111	

## Republic Bancorp, Inc. Louisville, KY Highlights

- *Stockpile.* Under Basel II, total RBC increases from 16.1% to 16.7%, an amount equal to \$11.7 million or 3.8% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 16.1% total RBC ratio:
  - Issue a special dividend of \$0.58 per share
  - Repurchase 527,972 shares, increasing EPS \$0.03 or 2.6%
  - Organically grow assets by \$111 million

Upon request, Second Pillar Consulting can provide similar information for all 179 Kentucky banks free of charge

# Kentucky banks with the highest percentage changes in regulatory capital under Standardized Basel II

Name	City	Asset Size (\$000's)	Basel II Capital Impact	
			Dollar Change (\$000)	Percent Change
1st Trust Bank, Inc.	Hazard	\$ 85,588	\$ 1,803	22.4%
Victory Community Bank	Fort Mitchell	\$ 129,230	\$ 1,875	17.7%
Peoples Bank & Trust Company of Clinton	Albany	\$ 24,212	\$ 518	17.0%
Hyden Citizens Bank	Hyden	\$ 118,848	\$ 1,372	16.1%
United Citizens Bank of Southern Kentucky	Columbia	\$ 125,952	\$ 1,762	16.1%
Citizens First Bank	Bowling Green	\$ 359,536	\$ 4,100	14.8%
United Community Bank of West Kentucky	Morganfield	\$ 117,706	\$ 1,562	14.0%
Hometown Bank of Corbin, Inc.	Corbin	\$ 125,381	\$ 1,303	14.0%
First & Farmers National Bank, Inc.	Somerset	\$ 422,607	\$ 4,905	13.7%
Peoples Bank & Trust Company of Hazard	Hazard	\$ 284,868	\$ 2,658	13.0%
Bank of Lexington, Inc.	Lexington	\$ 102,393	\$ 1,534	12.8%
Bank of Henderson, Inc.	Henderson	\$ 45,750	\$ 564	12.6%
Hancock Bank & Trust Company	Hawesville	\$ 290,921	\$ 2,862	12.5%
Murray Bank	Murray	\$ 181,643	\$ 1,674	12.5%
First Federal Savings Bank of Frankfort (M)	Frankfort	\$ 132,417	\$ 1,871	11.9%
Town Square Bank, Inc.	Ashland	\$ 149,844	\$ 1,595	11.5%
Bank of Buffalo	Buffalo	\$ 59,189	\$ 609	11.4%
Citizens Bank of Cumberland County	Burkesville	\$ 79,294	\$ 791	10.8%
First Security Bank of Owensboro, Inc.	Owensboro	\$ 151,102	\$ 1,497	10.7%
First United Bank and Trust Company	Madisonville	\$ 190,324	\$ 1,636	10.5%
<b>Averages</b>		<b>\$ 158,840.25</b>	<b>\$ 1,824.61</b>	<b>13.8%</b>

Source: 2008Q3 Call Reports; SPC estimates

# Kentucky banks with the lowest or negative percentage changes in regulatory capital under Standardized Basel II

Name	City	Asset Size (\$000's)	Basel II Capital Impact	
			Dollar Change (\$000)	Percent Change
First National Bank of Brooksville	Brooksville	\$ 62,064	\$ (164)	-2.2%
Farmers Bank and Trust Company Princeton	Princeton	\$ 89,623	\$ (426)	-2.3%
Grant County Deposit Bank	Williamstown	\$ 99,399	\$ (263)	-2.3%
Citizens Union Bancorp of Shelbyville, Inc.	Shelbyville	\$ 775,792	\$ (2,783)	-2.4%
Citizens Bank	Hickman	\$ 91,756	\$ (278)	-2.5%
Deposit Bank of Carlisle	Carlisle	\$ 73,906	\$ (447)	-2.6%
Farmers National Bank	Bowling Green	\$ 208,658	\$ (1,060)	-2.9%
United Citizens Bank & Trust Company	Campbellsburg	\$ 82,040	\$ (338)	-3.0%
Citizens National Bank of Somerset	Somerset	\$ 305,036	\$ (1,132)	-3.0%
Peoples Bank & Trust Company	Owenton	\$ 74,886	\$ (375)	-3.3%
First Community Bank	Clinton	\$ 67,849	\$ (433)	-4.1%
First Breckinridge Bancshares, Inc.	Irvington	\$ 609,752	\$ (4,557)	-4.4%
Bank of Caneyville	Caneyville	\$ 42,680	\$ (200)	-4.6%
Louisville Community Development Bank	Louisville	\$ 32,816	\$ (267)	-4.7%
Peoples Bank	Mount Washington	\$ 85,091	\$ (707)	-5.8%
Clinton Bank	Clinton	\$ 44,515	\$ (607)	-6.5%
Citizens Bank	Hartford	\$ 21,218	\$ (298)	-6.5%
Peoples Bank of Bullitt County	Shepherdsville	\$ 194,816	\$ (2,299)	-7.4%
Kevil Bank	Kevil	\$ 28,004	\$ (395)	-9.4%
Bankers' Bank of Kentucky, Inc.	Frankfort	\$ 64,735	\$ (2,369)	-20.1%
<b>Averages</b>		<b>\$ 152,732</b>	<b>\$ (970)</b>	<b>-5.0%</b>

Source: 2008Q3 Call Reports; SPC estimates

## But banks must be prepared to answer the tough risk management questions posed by Basel II compliance

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- Do you have a well-functioning risk oversight structure?
- Do you have clear risk management policies and procedures?
- Have you identified the important risks faced by your institution?
- Have you articulated an institutional appetite for risk-taking?
- Do you have accessible data on the risk characteristics of your existing portfolio?
- Do you have accessible data on the past performance of your portfolio?
- Do you have personnel that can fill critical risk assessment gaps?
- Do you actively manage and plan your capital position?
- Are you committed to enhancing your overall risk and capital management?

# Second Pillar Consulting can help banks prepare for Basel II compliance

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- Our principals have over thirty years of experience in enterprise risk management, regulatory capital compliance, and regulatory relations
  - Supported International Basel II compliance at a top-ten bank
    - Developed analytical and reporting capabilities
    - Created governance structure and supporting policies
    - Led regulatory exams for approval
  - Managed risk in retail banking, commercial banking, and insurance
  - Focused on building strong regulatory relationships
    - Active participants in several Basel II industry and regulatory forums that facilitated drafting the new rules
    - Frequent speakers at industry and regulatory conferences on Basel
    - Several Basel II academic papers written jointly with regulators

## Summary

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- Second Pillar Consulting is uniquely positioned to help banks comply with Basel II and get the capital relief they deserve
  - Services
    - Detailed Capital Savings Estimate
    - Gap Analysis
    - The Internal Capital Adequacy Assessment Process or ICAAP
  - Education
    - We conduct seminars for institutions and organizations on topics including Basel II compliance, Enterprise Risk Management, Capital Management, and Balance Sheet Strategy
  - Facilitation
    - We are currently coordinating the NPR response for the Risk Management Association and can help organizations and institutions with their response

## Contact Information

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