

The Impact of Standardized Basel II on Montana Banks

Prepared for Montana 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 68.6% of 70 Montana banks and thrifts
 - Aggregate potential capital savings for all 70 banks of \$58 million
 - The median Montana bank would save \$0.5 million or 1.7% 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

Montana Banks can save up to \$58 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 Glacier Bancorp, Inc., a representative Montana bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$9.1 million or 1.6%

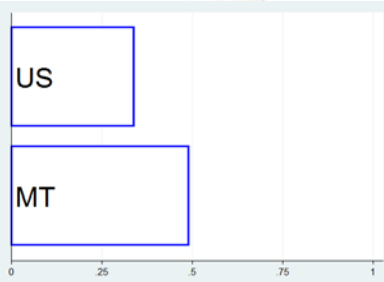
Regulatory Capital Requirement



Glacier Bancorp, Inc. Kalispell, MT Highlights

- *Stockpile.* Under Basel II, total RBC increases from 13.7% to 13.9%, an amount equal to \$9.1 million or 1.6% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 13.7% total RBC ratio:
 - Issue a special dividend of \$0.17 per share
 - Repurchase 510,947 shares, increasing EPS \$0.01 or 1.0%
 - Organically grow assets by \$78 million

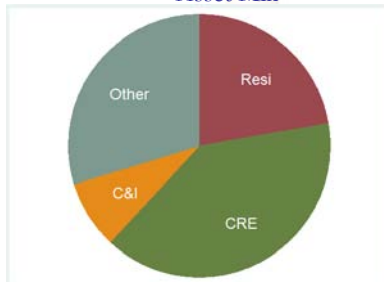
Capital Savings Percentile



Capital Metrics and Management

Total Assets (millions)	\$5,173	
Gross Income Margin	4.8%	
Tangible Common Equity	8.1%	
Leverage Ratio	10.8%	
Capital Estimates	Current	Basel II
Tier 1 RBC	12.4%	12.6%
Total RBC	13.7%	13.9%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$0.17	
Share Repurchase (7/29/2008 price)	510,947	
Change in EPS	\$0.01	
Organic Asset Growth (millions)	\$79	

Asset Mix



Upon request, Second Pillar Consulting can provide similar information for all 70 Montana banks free of charge

Montana 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
Prairie Mountain Bank	Great Falls	\$ 62,213	\$ 996	18.0%
Freedom Bank	Columbia Falls	\$ 65,589	\$ 829	14.0%
Eagle Bank	Polson	\$ 17,552	\$ 314	13.1%
Beartooth Bank	Billings	\$ 52,314	\$ 1,134	13.1%
First Valley Bank	Seeley Lake	\$ 47,277	\$ 465	12.8%
West One Bank	Kalispell	\$ 61,510	\$ 696	12.8%
First Citizens Bank of Butte	Butte	\$ 65,805	\$ 808	12.4%
Flint Creek Valley Bank	Philipsburg	\$ 53,938	\$ 566	11.2%
First Security Bank of Helena	Helena	\$ 41,925	\$ 318	10.9%
Pioneer Federal Savings & Loan Associatio	Deer Lodge	\$ 76,385	\$ 1,175	10.9%
First Madison Valley Bank	Ennis	\$ 91,169	\$ 780	10.8%
American Federal Savings Bank (MHC)	Helena	\$ 278,633	\$ 2,384	10.4%
Treasure State Bank	Missoula	\$ 87,046	\$ 936	9.7%
Citizens Bank & Trust Company	Big Timber	\$ 93,670	\$ 727	9.6%
Bank of Baker	Baker	\$ 81,657	\$ 617	8.6%
First Boulder Valley Bank	Boulder	\$ 31,214	\$ 218	8.5%
Bitterroot Valley Bank	Lolo	\$ 203,095	\$ 1,221	7.3%
Three Rivers Bank of Montana	Kalispell	\$ 97,929	\$ 794	7.2%
First Security Bank of Deer Lodge	Deer Lodge	\$ 26,502	\$ 189	6.7%
First National Bank of Montana, Inc.	Libby	\$ 283,948	\$ 1,480	6.0%
Averages		\$ 90,968.55	\$ 832.33	10.7%

Source: 2008Q3 Call Reports; SPC estimates

Montana 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
Valley Bank of Glasgow	Glasgow	\$ 30,631	\$ (25)	-0.8%
First State Bank of Malta	Malta	\$ 105,654	\$ (129)	-0.8%
Bank of the Rockies, National Association	White Sulphur Springs	\$ 132,380	\$ (121)	-1.1%
Belt Valley Bank	Belt	\$ 57,962	\$ (102)	-1.4%
First State Bank of Forsyth	Forsyth	\$ 73,103	\$ (168)	-1.7%
Stockman Financial Corporation	Miles City	\$ 1,532,060	\$ (2,770)	-1.7%
First Community Bank	Glasgow	\$ 199,681	\$ (303)	-1.8%
Peoples Bank of Deer Lodge	Deer Lodge	\$ 29,698	\$ (53)	-1.9%
State Bank of Townsend	Townsend	\$ 38,339	\$ (109)	-2.4%
American Bank	Bozeman	\$ 463,739	\$ (1,623)	-2.5%
Farmers State Bank of Denton, Montana	Denton	\$ 17,092	\$ (65)	-2.9%
First State Bank of Shelby	Shelby	\$ 98,102	\$ (645)	-3.7%
Little Horn State Bank	Hardin	\$ 66,879	\$ (271)	-3.7%
Montana State Bank	Plentywood	\$ 56,004	\$ (257)	-4.5%
Western Bank of Wolf Point	Wolf Point	\$ 61,353	\$ (309)	-4.9%
Dutton State Bank	Dutton	\$ 22,154	\$ (140)	-5.4%
Garfield County Bank	Jordan	\$ 33,074	\$ (302)	-5.6%
First Security Bank of Roundup	Roundup	\$ 41,236	\$ (317)	-6.1%
Community First Bank of Glendive	Glendive	\$ 41,797	\$ (382)	-7.9%
Davidson Trust Company	Great Falls	\$ 5,105	\$ (1,266)	-23.8%
Averages		\$ 155,302	\$ (468)	-4.2%

Source: 2008Q3 Call Reports; SPC estimates

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

- 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

- 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

- 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

Bill Nayda

bnayda@secondpillar.com

(804) 432-1629

Geoffrey Rubin

grubin@secondpillar.com

(703) 403-9488

www.secondpillar.com