

The Impact of Standardized Basel II on Nebraska Banks

Prepared for Nebraska Bankers Association



Executive Summary

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

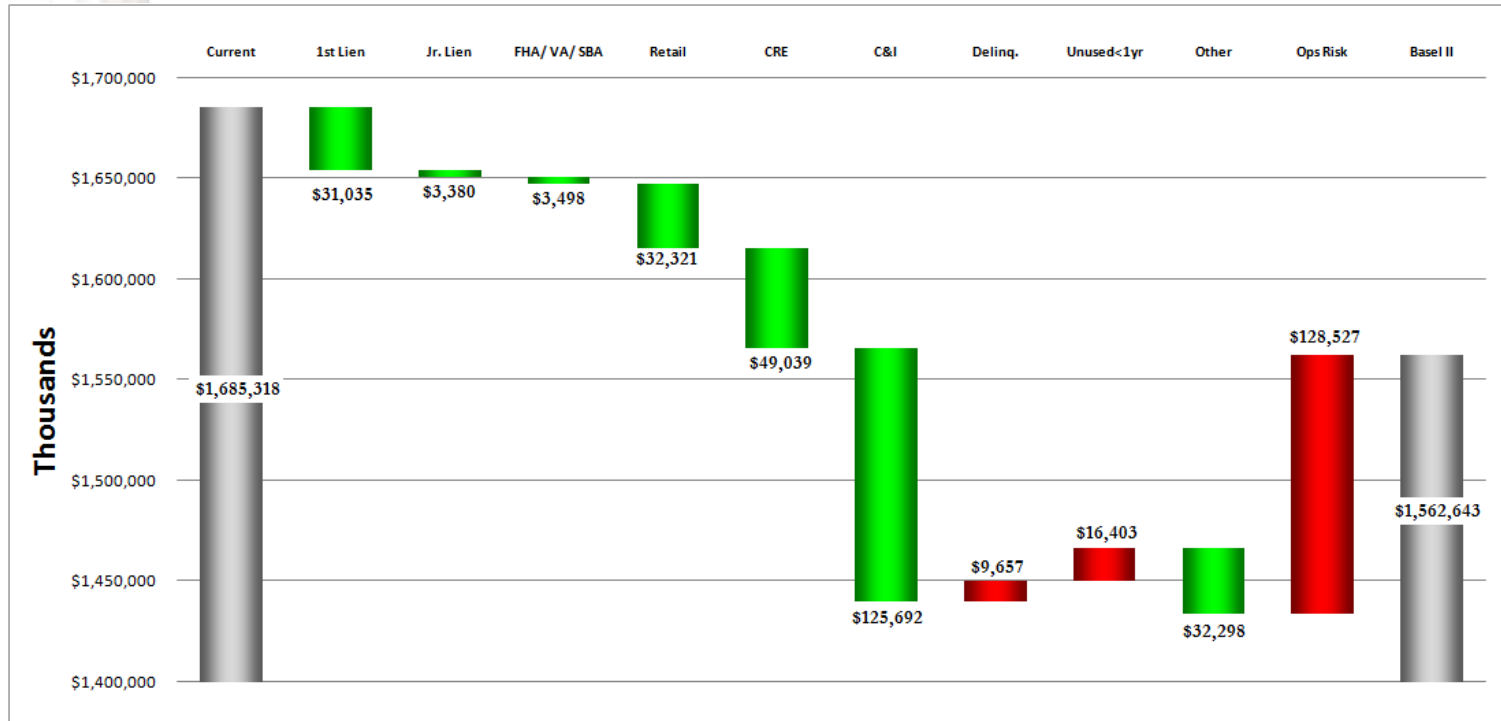


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 45.5% of 233 Nebraska banks and thrifts
 - Aggregate potential capital savings for all 233 banks of \$123 million
 - The median Nebraska bank would save \$0.4 million or -0.5% of their existing Tier 1 capital 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

Nebraska Banks can save up to \$123 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 TierOne Bank, a representative Nebraska bank, Basel II regulatory capital savings can be stockpiled or deployed

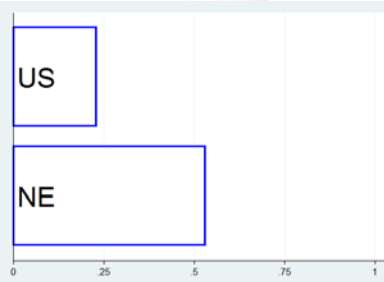
Capital Savings: \$-0.5 million or -0.1%

Regulatory Capital Requirement

TierOne Bank Lincoln, NE Highlights

- *Absorb.* Under Basel II, total RBC decreases from 11.4% to 11.4%, an amount equal to \$-0.5 million or -0.1% of the existing capital base.
- *Compensate.* A variety of balance sheet actions would be needed to restore the current 11.4% total RBC ratio:
 - One-time dividend reduction of \$0.03 per share
 - Issue 158,088 shares, reducing EPS \$-0.01 or 0.9%
 - Reduce assets by \$5 million

Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$3,215	
Gross Income Margin	3.9%	
Tangible Common Equity	8.9%	
Leverage Ratio	9.0%	
Capital Estimates	Current	Basel II
Tier 1 RBC	10.1%	10.1%
Total RBC	11.4%	11.4%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$-0.03	
Share Repurchase (7/29/2008 price)		
Number of Shares	-158,088	
Change in EPS	\$0.01	
Organic Asset Growth (millions)	\$-5	

Upon request, Second Pillar Consulting can provide similar information for all 233 Nebraska banks free of charge

Nebraska 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
Mid City Bank, Inc.	Omaha	\$ 220,819	\$ 5,439	16.6%
Battle Creek State Bank	Battle Creek	\$ 28,303	\$ 356	15.5%
Mutual of Omaha Bank	Omaha	\$ 3,952,191	\$ 45,813	15.1%
North Loup Valley Bank	North Loup	\$ 18,043	\$ 244	14.9%
Home Federal Savings and Loan Association	Grand Island	\$ 170,100	\$ 2,166	14.0%
Centennial Bank	Omaha	\$ 43,851	\$ 1,045	13.6%
Exchange Bank	Gibbon	\$ 161,513	\$ 1,771	13.6%
United Republic Bank	Omaha	\$ 31,462	\$ 1,152	12.5%
Enterprise Bank, NA	Omaha	\$ 162,945	\$ 1,725	12.4%
Security State Bank	Ansley	\$ 58,916	\$ 533	12.2%
Horizon Bank	Waverly	\$ 112,599	\$ 1,174	12.1%
Heartland Community Bank	Bennet	\$ 50,787	\$ 396	11.9%
Equitable Bank (MHC)	Grand Island	\$ 203,149	\$ 2,007	11.8%
Home Federal Savings and Loan Association	Lexington	\$ 64,328	\$ 904	11.2%
Commercial State Bank	Wausa	\$ 58,365	\$ 684	10.6%
First State Bank	Randolph	\$ 33,921	\$ 565	10.3%
Custer Federal Savings & Loan Association	Broken Bow	\$ 57,966	\$ 482	10.2%
Bank of Hartington	Hartington	\$ 52,894	\$ 427	10.2%
Valley Bank & Trust Company	Scottsbluff	\$ 304,067	\$ 2,369	9.3%
First State Bank	Lincoln	\$ 241,783	\$ 1,683	9.2%
Averages		\$ 301,400.10	\$ 3,546.89	12.4%

Source: 2008Q3 Call Reports; SPC estimates

Nebraska 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
Commercial State Bank	Republican City	\$ 53,529	\$ (720)	-6.8%
Ashton State Bank	Ashton	\$ 11,110	\$ (113)	-6.8%
Sutton State Bank	Sutton	\$ 24,490	\$ (190)	-7.3%
First State Bank	Hordville	\$ 25,354	\$ (283)	-7.4%
First National Bank of Friend	Friend	\$ 36,707	\$ (325)	-7.4%
Farmers & Merchants Bank	Axtell	\$ 5,766	\$ (50)	-7.4%
Oak Creek Valley Bank	Valparaiso	\$ 51,839	\$ (415)	-7.5%
Nebraska State Bank	Lynch	\$ 10,108	\$ (168)	-7.6%
Tri Valley Bank	Talmage	\$ 4,995	\$ (146)	-7.6%
Franklin State Bank	Franklin	\$ 42,414	\$ (735)	-7.9%
Cedar Rapids State Bank	Cedar Rapids	\$ 26,069	\$ (237)	-8.0%
Lauritzen Corporation	Omaha	\$ 1,450,556	\$ (40,009)	-8.3%
Farmers State Bank	Humphrey	\$ 24,173	\$ (306)	-9.6%
Bank of Paxton	Paxton	\$ 14,871	\$ (248)	-9.6%
Purdum State Bank	Purdum	\$ 18,076	\$ (305)	-10.5%
First National Bank of Holdrege	Holdrege	\$ 84,838	\$ (2,486)	-10.5%
Commercial Bank	Bassett	\$ 34,565	\$ (427)	-10.6%
Nebraska State Bank	Oshkosh	\$ 42,094	\$ (458)	-10.9%
Scribner Bank	Scribner	\$ 52,267	\$ (803)	-11.2%
Farmers State Bank	Fairmont	\$ 7,195	\$ (144)	-14.7%
Averages		\$ 101,051	\$ (2,428)	-8.9%

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