

The Impact of Standardized Basel II on North Carolina Banks

Prepared for North Carolina Bankers Association



Executive Summary

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

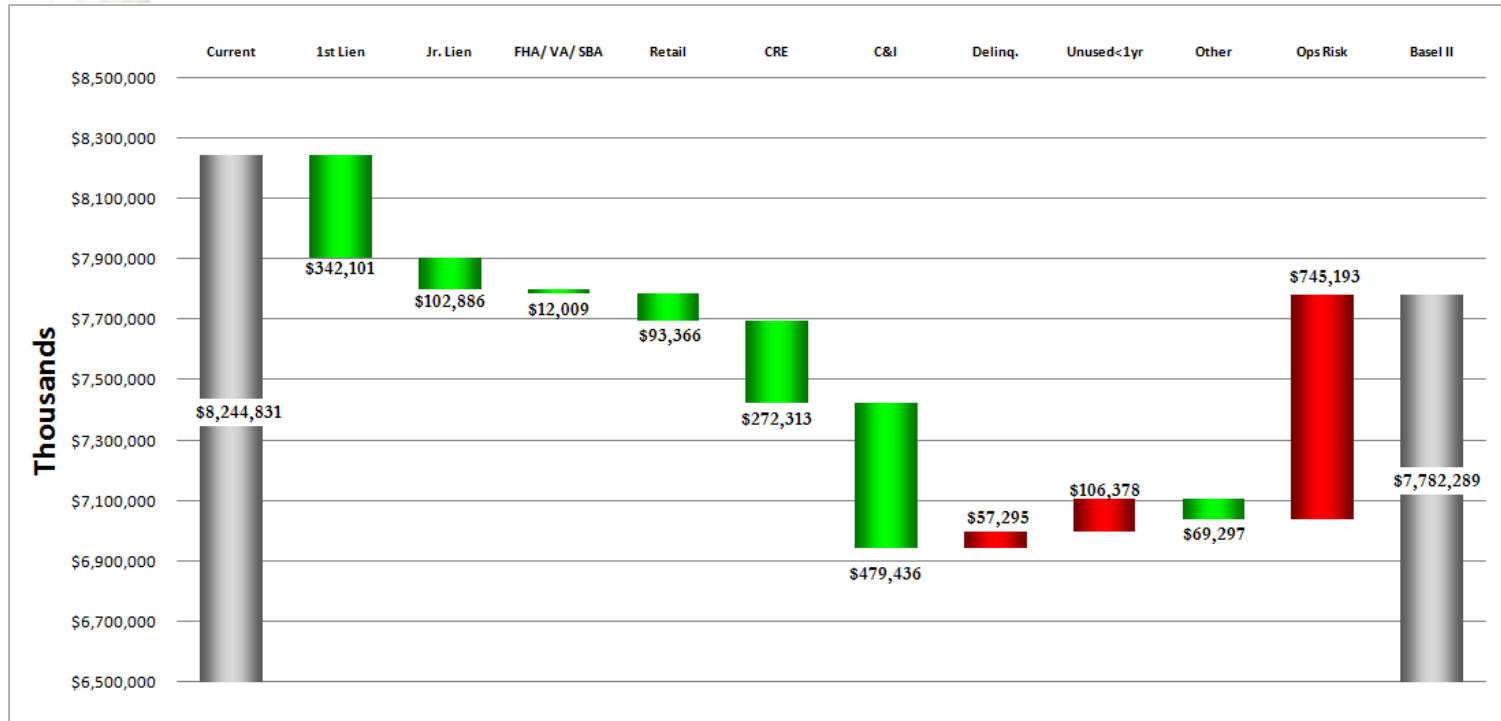


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 95.1% of 102 North Carolina banks and thrifts
 - Aggregate potential capital savings for all 102 banks of \$463 million
 - The median North Carolina bank would save \$2.0 million or 6.7% of their existing 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

North Carolina Banks can save up to \$463 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

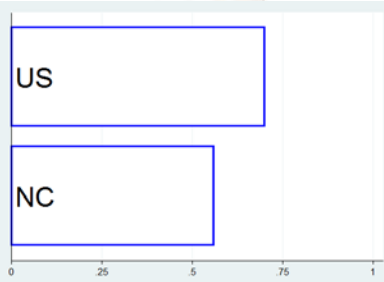
For Southern Community Financial Corporation, a representative North Carolina bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$10.8 million or 7.4%

Regulatory Capital Requirement



Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$1,798	
Gross Income Margin	3.1%	
Tangible Common Equity	5.3%	
Leverage Ratio	7.8%	
Capital Estimates	Current	Basel II
Tier 1 RBC	9.3%	10.0%
Total RBC	10.7%	11.5%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$0.62	
Share Repurchase (7/29/2008 price)		
Number of Shares	3,072,881	
Change in EPS	\$0.09	
Organic Asset Growth (millions)	\$121	

Southern Community Financial Corporation Winston-Salem, NC

Highlights

- *Stockpile.* Under Basel II, total RBC increases from 10.7% to 11.5%, an amount equal to \$10.8 million or 7.4% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 10.7% total RBC ratio:
 - Issue a special dividend of \$0.62 per share
 - Repurchase 3,072,881 shares, increasing EPS \$0.09 or 21.1%
 - Organically grow assets by \$121 million

Upon request, Second Pillar Consulting can provide similar information for all 102 North Carolina banks free of charge

North Carolina 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
TriStone Community Bank	Winston-Salem	\$ 151,479	\$ 2,598	20.3%
Bank of Oak Ridge	Oak Ridge	\$ 310,482	\$ 4,285	19.0%
Forest Commercial Bank	Asheville	\$ 39,154	\$ 2,837	18.7%
First Federal Savings Bank of Lincolnton	Lincolnton	\$ 255,008	\$ 6,262	18.4%
Union Bank & Trust Company	Oxford	\$ 123,473	\$ 1,760	17.7%
1st Financial Services Corporation	Hendersonville	\$ 670,167	\$ 7,990	16.9%
Security Savings Bank, SSB	Southport	\$ 436,687	\$ 7,316	16.5%
Carolina Premier Bank	Charlotte	\$ 47,345	\$ 2,072	14.7%
First Savings and Loan Association	Mebane	\$ 51,495	\$ 1,195	13.8%
KeySource Commercial Bank	Durham	\$ 123,598	\$ 2,124	13.6%
Piedmont Federal Savings Bank	Winston-Salem	\$ 842,437	\$ 23,178	13.4%
Square 1 Financial Incorporated	Durham	\$ 1,054,211	\$ 12,180	13.0%
CapStone Bank	Raleigh	\$ 141,632	\$ 2,799	12.9%
VantageSouth Bank	Burlington	\$ 102,452	\$ 1,033	12.8%
Aquesta Bank	Cornelius	\$ 171,941	\$ 2,266	12.1%
OldTown Bank	Waynesville	\$ 28,199	\$ 1,204	11.8%
Park Sterling Bank	Charlotte	\$ 387,115	\$ 4,888	11.7%
Hertford Savings Bank, SSB	Hertford	\$ 16,108	\$ 182	11.6%
HomeTrust Bank	Clyde	\$ 1,409,492	\$ 15,806	11.5%
AF Bank (MHC)	West Jefferson	\$ 280,021	\$ 2,772	11.4%
Averages		\$ 332,124.80	\$ 5,237.31	14.6%

Source: 2008Q3 Call Reports; SPC estimates

North Carolina 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
Parkway Bank	Lenoir	\$ 125,133	\$ 386	2.6%
Mount Gilead Savings & Loan Association	Mount Gilead	\$ 10,178	\$ 41	2.6%
First National Bank of Shelby	Shelby	\$ 1,027,103	\$ 2,766	2.5%
Roanoke Rapids Savings Bank, SSB	Roanoke Rapids	\$ 49,879	\$ 151	1.9%
Lumbee Guaranty Bank	Pembroke	\$ 231,118	\$ 426	1.6%
Bank of Granite Corporation	Granite Falls	\$ 1,160,977	\$ 1,656	1.5%
Mechanics & Farmers Bank	Durham	\$ 273,876	\$ 351	1.4%
Southern Bancshares (N.C.), Inc.	Mount Olive	\$ 1,228,129	\$ 1,902	1.3%
ECB Bancorp, Inc.	Engelhard	\$ 767,768	\$ 836	1.2%
Macon Bancorp	Franklin	\$ 1,073,576	\$ 1,191	1.1%
FNB United Corp.	Asheboro	\$ 2,071,126	\$ 1,882	1.0%
High Point Bank Corporation	High Point	\$ 791,939	\$ 883	0.9%
Cape Fear Bank	Wilmington	\$ 490,452	\$ 237	0.6%
Four Oaks Fincorp, Inc.	Four Oaks	\$ 884,094	\$ 417	0.5%
First Federal Bank	Dunn	\$ 182,174	\$ 76	0.3%
BB&T Corporation	Winston-Salem	\$ 137,000,000	\$ (28,540)	-0.2%
Bank of Currituck	Moyock	\$ 178,024	\$ (128)	-0.6%
Cooperative Bankshares, Inc.	Wilmington	\$ 982,379	\$ (778)	-1.0%
Wake Forest Federal Savings and Loan Ass	Wake Forest	\$ 108,963	\$ (543)	-2.5%
First South Bancorp, Inc.	Washington	\$ 896,698	\$ (4,584)	-4.3%
Averages		\$ 7,476,679	\$ (1,069)	0.6%

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

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