

# **The Impact of Standardized Basel II on North Dakota Banks**

**Prepared for North Dakota 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 54.3% of 92 North Dakota banks and thrifts
  - Aggregate potential capital savings for all 92 banks of \$69 million
  - The median North Dakota bank would save \$0.5 million or 0.7% 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 Dakota Banks can save up to \$69 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

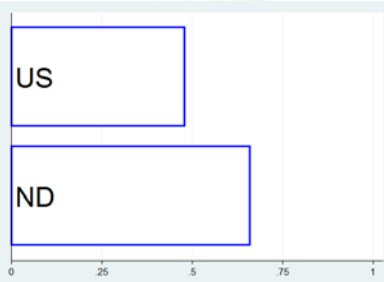
# For Starion Bancorporation, a representative North Dakota bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$2.2 million or 3.8%

Regulatory Capital Requirement



Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$605	
Gross Income Margin	N/A%	
Tangible Common Equity	7.8%	
Leverage Ratio	9.1%	
Capital Estimates	Current	Basel II
Tier 1 RBC	10.2%	10.6%
Total RBC	11.3%	11.7%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$N/A	
Share Repurchase (7/29/2008 price)		
Number of Shares	N/A	
Change in EPS	\$N/A	
Organic Asset Growth (millions)	\$23	

## Starion Bancorporation Bismarck, ND Highlights

- *Stockpile.* Under Basel II, total RBC increases from 11.3% to 11.7%, an amount equal to \$2.2 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 11.3% total RBC ratio:
  - Issue a special dividend (per share information unavailable for private entity)
  - Repurchase shares (number of shares and impact on EPS unavailable for private entity)
  - Organically grow assets by \$23 million

Upon request, Second Pillar Consulting can provide similar information for all 92 North Dakota banks free of charge

# North Dakota 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
Turtle Mountain State Bank	Belcourt	\$ 7,099	\$ 520	22.7%
Kirkwood Bank & Trust Company	Bismarck	\$ 148,281	\$ 1,687	15.1%
Peoples State Bank, Fairmount, North Dak	Fairmount	\$ 18,723	\$ 200	14.9%
Gate City Bank	Fargo	\$ 1,011,392	\$ 15,193	13.4%
American Federal Bank	Fargo	\$ 336,389	\$ 2,935	13.4%
Western State Bank	Devils Lake	\$ 385,850	\$ 4,046	12.0%
Union State Bank of Fargo	Fargo	\$ 47,942	\$ 458	11.7%
First Western Bank & Trust	Minot	\$ 493,249	\$ 3,964	10.0%
McKenzie County Bank	Watford City	\$ 55,966	\$ 445	9.5%
First National Bank & Trust Company of W	Williston	\$ 225,910	\$ 1,534	9.1%
Security First Bank of North Dakota	New Salem	\$ 110,737	\$ 887	8.8%
Harwood State Bank	Harwood	\$ 28,558	\$ 239	8.6%
United Valley Bank	Cavalier	\$ 151,391	\$ 1,050	8.4%
Security State Bank, Wishek, North Dakota	Wishek	\$ 52,144	\$ 488	8.3%
Cornerstone Bank	Enderlin	\$ 341,923	\$ 2,538	7.9%
United Community Bank of ND	Leeds	\$ 170,989	\$ 943	7.1%
Union Bank	Beulah	\$ 58,703	\$ 320	6.8%
Farmers and Merchants National Bank of I	Hatton	\$ 28,150	\$ 147	6.6%
First State Bank	Buxton	\$ 121,242	\$ 710	6.3%
First State Bank of Cando	Cando	\$ 47,944	\$ 260	6.2%
<b>Averages</b>		<b>\$ 192,129.10</b>	<b>\$ 1,928.18</b>	<b>10.4%</b>

Source: 2008Q3 Call Reports; SPC estimates

# North Dakota 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 State Bank of Wilton	Wilton	\$ 29,700	\$ (106)	-3.5%
Kindred State Bank	Kindred	\$ 19,832	\$ (65)	-3.5%
Liberty State Bank	Powers Lake	\$ 37,867	\$ (244)	-3.6%
Quality Bank	Fingal	\$ 25,735	\$ (68)	-3.8%
Commercial Bank of Mott	Mott	\$ 56,600	\$ (203)	-4.0%
Rolette State Bank	Rolette	\$ 31,666	\$ (146)	-4.0%
CountryBank USA	Cando	\$ 44,170	\$ (180)	-4.1%
First State Bank of Munich	Munich	\$ 88,666	\$ (392)	-4.1%
Dakota Heritage Bank	Gackle	\$ 40,276	\$ (164)	-4.1%
Strasburg State Bank	Strasburg	\$ 48,275	\$ (220)	-4.5%
First State Bank of Sharon	Aneta	\$ 42,023	\$ (191)	-4.6%
Farmers & Merchants State Bank of Tolna	Tolna	\$ 47,684	\$ (276)	-4.8%
McIntosh County Bank	Ashley	\$ 67,826	\$ (428)	-5.1%
Heartland State Bank	Edgeley	\$ 50,816	\$ (309)	-5.4%
Bank of Glen Ullin	Glen Ullin	\$ 39,911	\$ (231)	-5.7%
Stock Growers Bank	Napoleon	\$ 44,247	\$ (373)	-6.5%
Peoples State Bank	Westhope	\$ 55,069	\$ (371)	-6.7%
Grant County State Bank	Carson	\$ 23,975	\$ (264)	-7.9%
Bank of Hamilton	Hamilton	\$ 14,966	\$ (270)	-8.9%
Farmers State Bank of Crosby, North Dakota	Crosby	\$ 45,994	\$ (730)	-10.5%
<b>Averages</b>		<b>\$ 42,765</b>	<b>\$ (261)</b>	<b>-5.3%</b>

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](mailto:bnayda@secondpillar.com)

(804) 432-1629

**Geoffrey Rubin**

[grubin@secondpillar.com](mailto:grubin@secondpillar.com)

(703) 403-9488

[www.secondpillar.com](http://www.secondpillar.com)