

# **The Impact of Standardized Basel II on Rhode Island Banks**

**Prepared for Rhode Island Bankers Association**



# Executive Summary

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

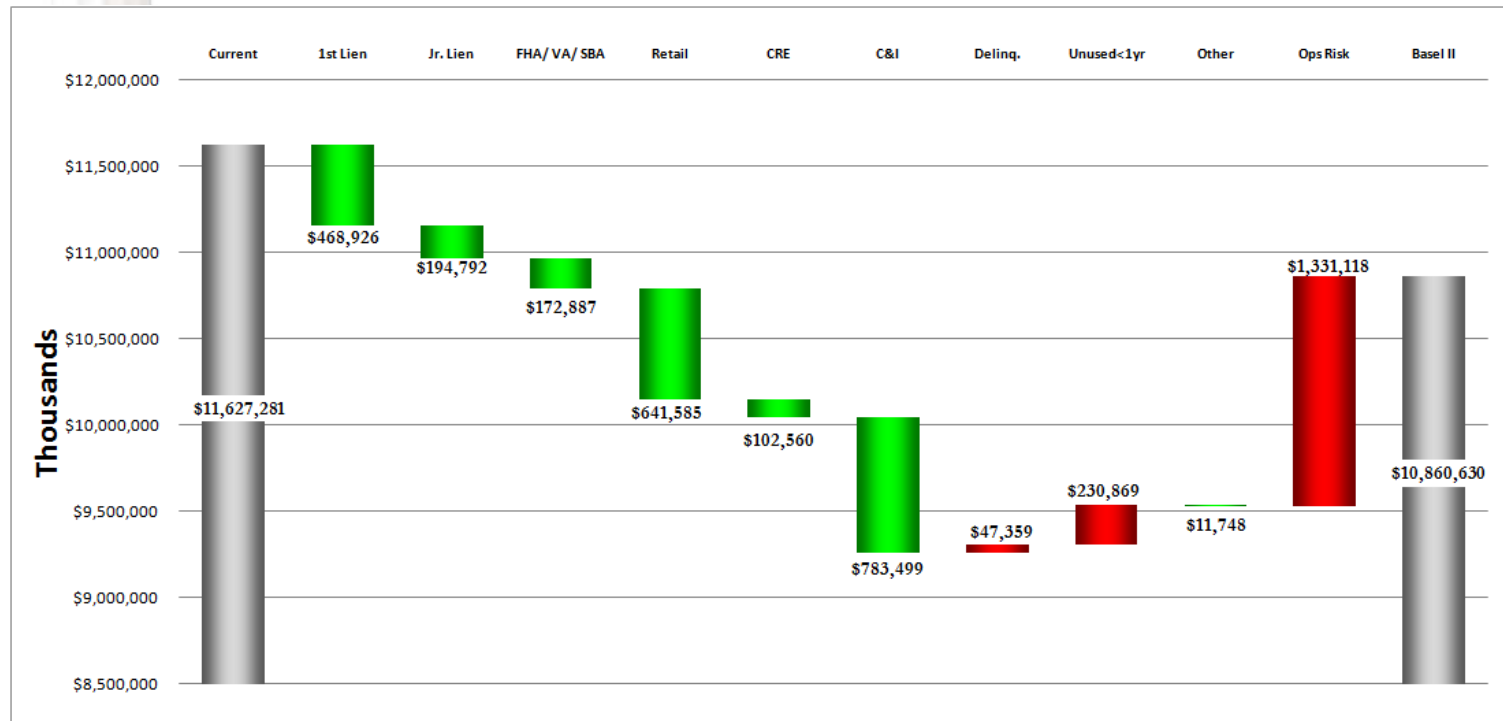


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 83.3% of 12 Rhode Island banks and thrifts
  - Aggregate potential capital savings for all 12 banks of \$767 million
  - The median Rhode Island bank would save \$5.2 million or 6.9% of their existing Tier 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

# Rhode Island Banks can save up to \$767 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 Bancorp Rhode Island, Inc., a representative Rhode Island bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$7.2 million or 5.8%

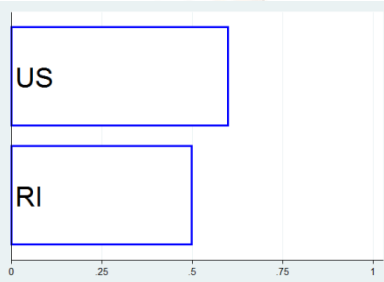
Regulatory Capital Requirement



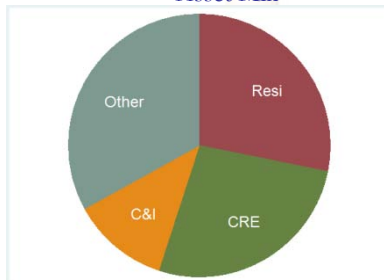
## Bancorp Rhode Island, Inc. Providence, RI Highlights

- *Stockpile.* Under Basel II, total RBC increases from 12.7% to 13.4%, an amount equal to \$7.2 million or 5.8% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 12.7% total RBC ratio:
  - Issue a special dividend of \$1.57 per share
  - Repurchase 315,414 shares, increasing EPS \$0.13 or 6.9%
  - Organically grow assets by \$81 million

Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$1,490	
Gross Income Margin	3.5%	
Tangible Common Equity	6.9%	
Leverage Ratio	7.9%	
Capital Estimates	Current	Basel II
Tier 1 RBC	11.4%	12.1%
Total RBC	12.7%	13.4%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$1.57	
Share Repurchase (7/29/2008 price)	315,414	
Number of Shares	\$0.13	
Change in EPS	\$81	
Organic Asset Growth (millions)	\$81	

# Standardized Basel II capital implications for a sample of Rhode Island banks

Name	City	Asset Size (\$000's)	Basel II Capital Impact	
			Dollar Change (\$000)	Percent Change
Freedom National Bank (MHC)	Greenville	\$ 75,408	\$ 996	16.9%
Independence Bank	East Greenwich	\$ 66,497	\$ 552	10.5%
Newport Federal Savings Bank	Newport	\$ 404,490	\$ 3,783	10.3%
Domestic Bank	Cranston	\$ 250,491	\$ 2,236	9.3%
OceanPoint Financial Partners, MHC	Newport	\$ 1,090,288	\$ 6,654	8.1%
Bancorp Rhode Island, Inc.	Providence	\$ 1,489,872	\$ 7,173	5.8%
Citizens Financial Group, Inc.	Providence	\$ 163,800,000	\$ 708,355	5.6%
Washington Trust Bancorp, Inc.	Westerly	\$ 2,768,253	\$ 7,122	4.0%
Centreville Savings Bank	West Warwick	\$ 846,475	\$ 3,293	1.6%
<b>Averages</b>		<b>\$ 18,976,863.78</b>	<b>\$ 82,240.36</b>	<b>8.0%</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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