

The Impact of Standardized Basel II on South Dakota Banks

Prepared for South Dakota Bankers Association



Executive Summary

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

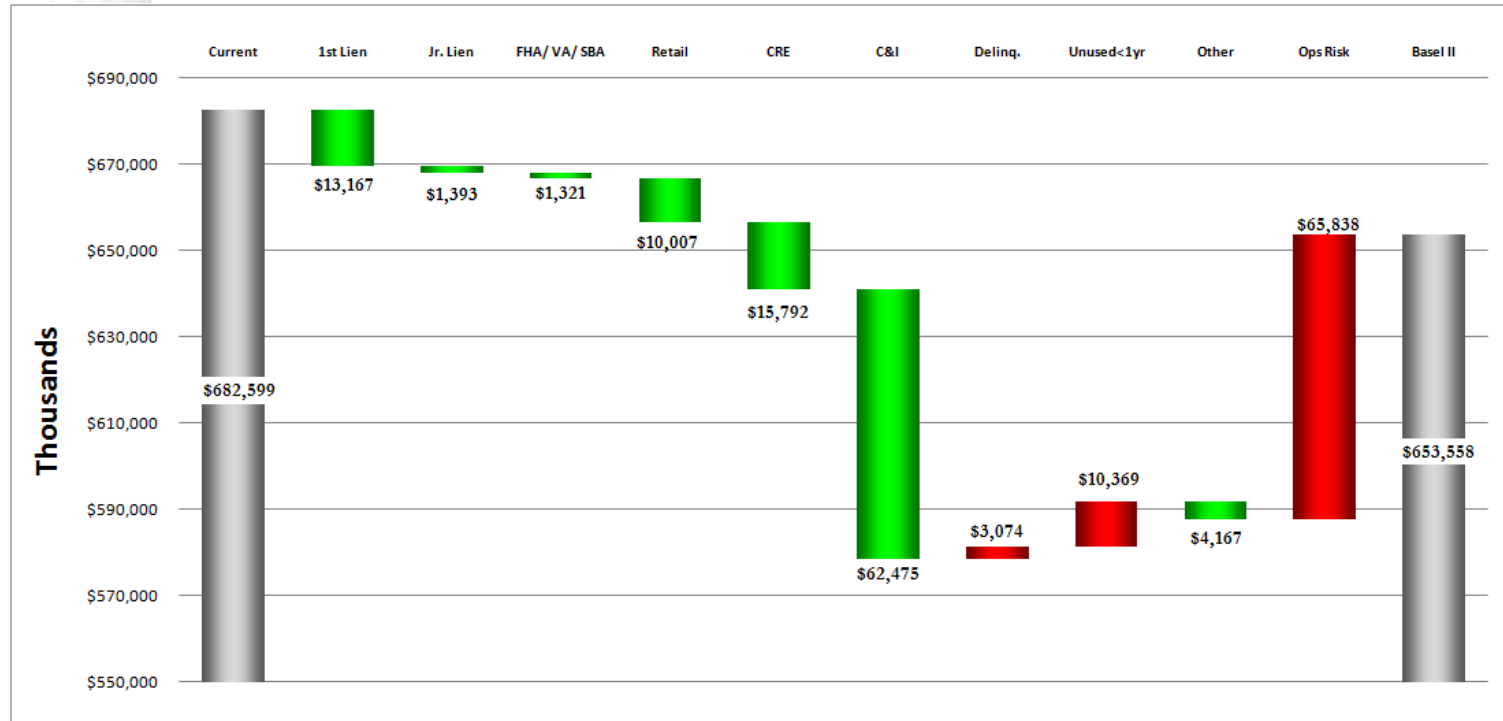


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 35.6% of 73 South Dakota banks and thrifts
 - Aggregate potential capital savings for all 73 banks of \$29 million
 - The median South Dakota bank would save \$0.2 million or -2.4% of their existing Tier 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

South Dakota Banks can save up to \$29 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 Dacotah Banks, Inc., a representative South Dakota bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$4.9 million or 3.5%

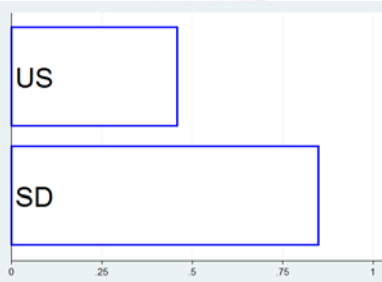
Regulatory Capital Requirement



Dacotah Banks, Inc. Aberdeen, SD Highlights

- Stockpile.** Under Basel II, total RBC increases from 11.5% to 11.9%, an amount equal to \$4.9 million or 3.5% of the existing capital base.
- Deploy.** Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 11.5% total RBC ratio:
 - Issue a special dividend of \$4.43 per share
 - Repurchase shares (number of shares and impact on EPS unavailable for private entity)
 - Organically grow assets by \$51 million

Capital Savings Percentile



Capital Metrics and Management

Total Assets (millions)	\$1,511	
Gross Income Margin	4.0%	
Tangible Common Equity	8.9%	
Leverage Ratio	9.1%	
Capital Estimates	Current	Basel II
Tier 1 RBC	10.5%	10.9%
Total RBC	11.5%	11.9%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$4.43	
Share Repurchase (7/29/2008 price)		
Number of Shares	33,553	
Change in EPS	\$/N/A	
Organic Asset Growth (millions)	\$51	

Asset Mix



Upon request, Second Pillar Consulting can provide similar information for all 73 South Dakota banks free of charge

South 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
Black Hills Community Bank, N.A.	Rapid City	\$ 41,580	\$ 2,197	20.8%
Home Federal Bank	Sioux Falls	\$ 1,126,453	\$ 10,603	12.8%
First Midwest Bank	Centerville	\$ 153,449	\$ 970	7.7%
First State Bank of Warner	Warner	\$ 41,945	\$ 226	6.7%
First State Bank of Roscoe	Roscoe	\$ 68,326	\$ 482	6.7%
Dakota Prairie Bank	Presho	\$ 33,051	\$ 229	6.1%
Fulton State Bank	Fulton	\$ 40,655	\$ 253	5.1%
Western Dakota Bank	Timber Lake	\$ 24,829	\$ 75	4.2%
Peoples State Bank	Summit	\$ 45,561	\$ 168	3.9%
Reliabank Dakota	Estelline	\$ 141,176	\$ 534	3.8%
Dacotah Banks, Inc.	Aberdeen	\$ 1,511,268	\$ 4,932	3.5%
Quoin Financial Bank	Miller	\$ 120,579	\$ 367	3.3%
Minnehaha Bانشares, Inc.	Sioux Falls	\$ 1,151,984	\$ 3,094	2.4%
American State Bank of Pierre	Pierre	\$ 114,556	\$ 268	2.1%
First National Bank of Volga	Volga	\$ 36,251	\$ 81	2.1%
Fishback Financial Corporation	Brookings	\$ 1,518,603	\$ 2,049	1.5%
Bank 360	Beresford	\$ 42,626	\$ 70	1.3%
State Bank of Alcester	Alcester	\$ 81,579	\$ 107	1.3%
Great Plains Bank	Eureka	\$ 69,220	\$ 91	1.2%
Stockmens Financial Corporation	Rapid City	\$ 680,223	\$ 594	1.0%
Averages		\$ 352,195.70	\$ 1,369.54	4.9%

Source: 2008Q3 Call Reports; SPC estimates

South 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
Mansfield State Bank	Mansfield	\$ 11,390	\$ (93)	-4.4%
Community Bank	Avon	\$ 37,359	\$ (346)	-5.0%
Miner County Bank	Howard	\$ 34,624	\$ (241)	-5.1%
Farmers State Bank	Faith	\$ 40,343	\$ (212)	-5.4%
Menno State Bank	Menno	\$ 28,589	\$ (200)	-5.5%
DNB National Bank	Clear Lake	\$ 68,346	\$ (377)	-5.6%
Campbell County Bank	Herreid	\$ 83,356	\$ (582)	-5.9%
State Bank of Eagle Butte	Eagle Butte	\$ 31,485	\$ (308)	-6.3%
Farmers State Bank	Marion	\$ 63,190	\$ (459)	-6.4%
Andes State Bank	Lake Andes	\$ 19,018	\$ (159)	-6.4%
Farmers State Bank of Turton	Turton	\$ 19,620	\$ (202)	-6.6%
Roberts County National Bank of Sisseton	Sisseton	\$ 43,893	\$ (653)	-6.9%
First National Bank in Philip	Philip	\$ 139,656	\$ (1,541)	-7.1%
Dakota State Bank	Blunt	\$ 28,723	\$ (243)	-7.5%
First National Bank of Frederick	Frederick	\$ 13,108	\$ (189)	-7.7%
CorTrust Bank National Association	Mitchell	\$ 528,514	\$ (5,959)	-9.5%
First Fidelity Bank	Burke	\$ 243,933	\$ (4,330)	-12.1%
Richland State Bank	Bruce	\$ 33,118	\$ (1,108)	-13.7%
Bryant State Bank	Bryant	\$ 19,620	\$ (552)	-16.8%
Capitol Bancorporation, Inc.	Britton	\$ 595,076	\$ (29,254)	-20.1%
Averages		\$ 104,148	\$ (2,350)	-8.2%

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

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