

# The Impact of Standardized Basel II on Tennessee Banks

Prepared for Tennessee Bankers Association



# Executive Summary

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

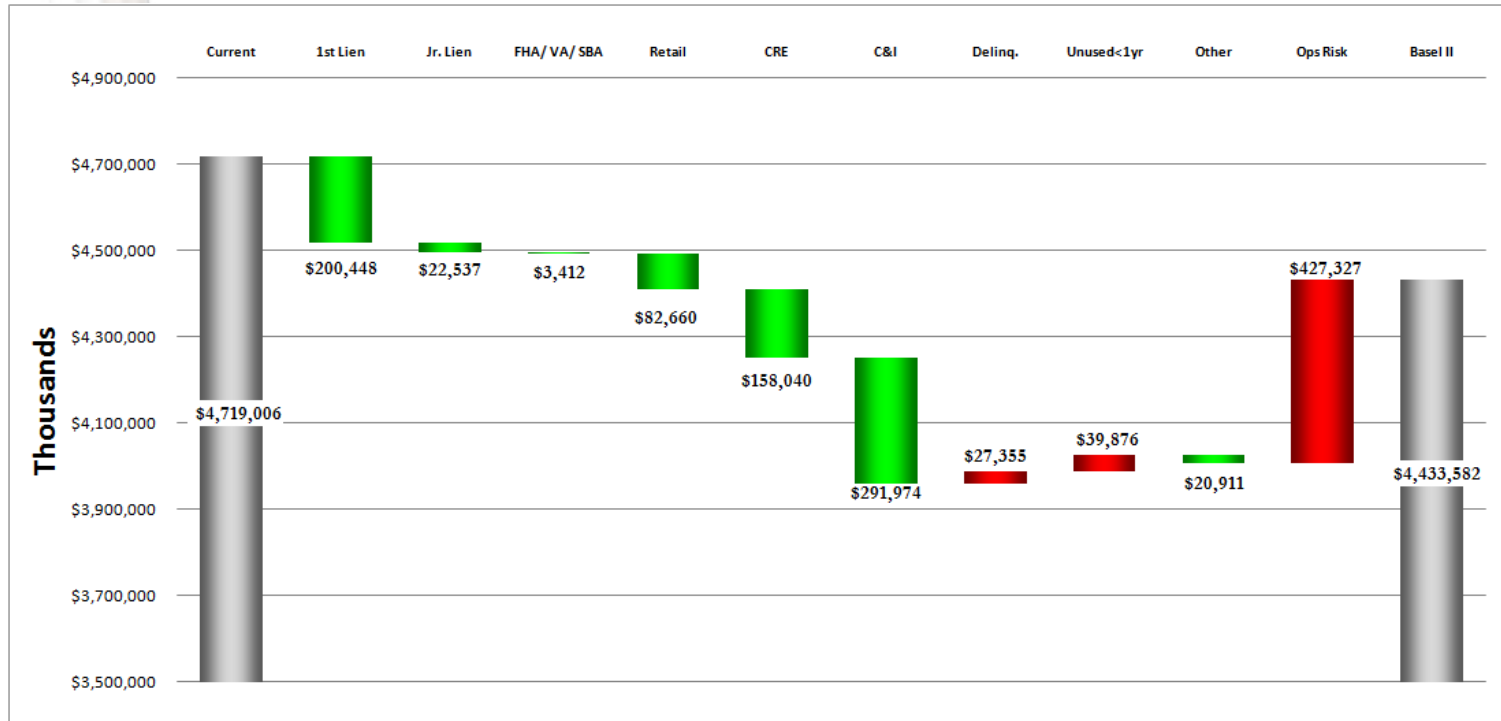


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 86.3% of 184 Tennessee banks and thrifts
  - Aggregate potential capital savings for all 184 banks of \$285 million
  - The median Tennessee bank would save \$1.2 million or 5.1% of their existing Tier 1 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

# Tennessee Banks can save up to \$285 million in required capital under Standardized Basel II and improve risk management

## Capital savings estimate and asset category contribution

Regulatory Capital Requirement

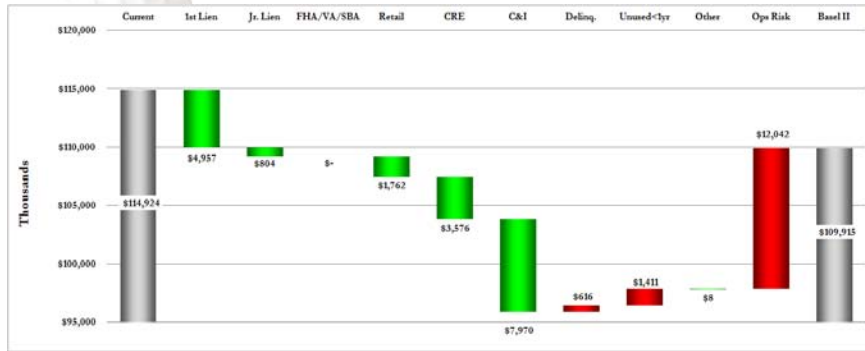


Source: 2008Q3 Call Reports; SPC estimates

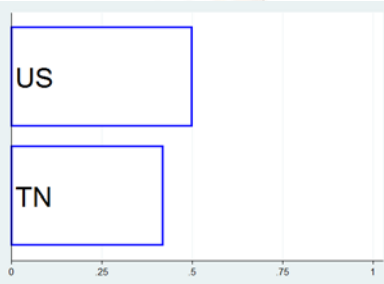
# For First Security Group, Inc., a representative Tennessee bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$5.0 million or 4.0%

Regulatory Capital Requirement



Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$1,282	
Gross Income Margin	4.7%	
Tangible Common Equity	9.5%	
Leverage Ratio	9.2%	
Capital Estimates	Current	Basel II
Tier 1 RBC	10.3%	10.7%
Total RBC	11.5%	11.9%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$0.30	
Share Repurchase (7/29/2008 price)		
Number of Shares	875,651	
Change in EPS	\$0.04	
Organic Asset Growth (millions)	\$49	

## First Security Group, Inc. Chattanooga, TN Highlights

- *Stockpile.* Under Basel II, total RBC increases from 11.5% to 11.9%, an amount equal to \$5.0 million or 4.0% 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 \$0.30 per share
  - Repurchase 875,651 shares, increasing EPS \$0.04 or 5.3%
  - Organically grow assets by \$49 million

Upon request, Second Pillar Consulting can provide similar information for all 184 Tennessee banks free of charge

# Tennessee 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
First National Bank of Pikeville	Pikeville	\$ 88,308	\$ 1,771	20.8%
Tennessee Commerce Bancorp, Inc.	Franklin	\$ 1,106,058	\$ 16,702	19.4%
Traditions First Bank	Erin	\$ 87,342	\$ 1,393	19.3%
Independent Holdings, Inc	Memphis	\$ 663,128	\$ 10,567	18.8%
CedarStone Bank	Lebanon	\$ 147,709	\$ 1,693	16.6%
CapitalMark Bank & Trust	Chattanooga	\$ 304,414	\$ 4,372	15.0%
Nashville Bank and Trust Company	Nashville	\$ 151,186	\$ 2,844	14.9%
First Freedom Bank	Lebanon	\$ 185,191	\$ 2,543	14.8%
Franklin County United Bank	Decherd	\$ 88,725	\$ 1,578	14.7%
Security Federal Savings Bank of McMinnville	McMinnville	\$ 135,058	\$ 1,933	14.6%
Putnam 1st Mercantile Bank	Cookeville	\$ 75,073	\$ 1,307	14.5%
Bank of Tullahoma	Tullahoma	\$ 62,233	\$ 1,559	14.5%
Bank of Perry County	Lobelville	\$ 131,413	\$ 1,762	14.2%
Heritage Community Bank	Greeneville	\$ 113,531	\$ 1,261	14.2%
Landmark Community Bank	Collierville	\$ 68,011	\$ 1,297	13.8%
American Security Bank and Trust Company	Hendersonville	\$ 168,742	\$ 3,084	13.8%
First Vision Bank of Tennessee	Tullahoma	\$ 93,199	\$ 1,861	13.8%
Cumberland Bank & Trust	Clarksville	\$ 113,091	\$ 1,252	13.7%
Community Bank of the Cumberlands	Jamestown	\$ 127,704	\$ 1,212	13.4%
Peoples Bank	Clifton	\$ 131,670	\$ 1,423	13.1%
<b>Averages</b>		<b>\$ 202,089.30</b>	<b>\$ 3,070.73</b>	<b>15.4%</b>

Source: 2008Q3 Call Reports; SPC estimates

# Tennessee 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
Citizens Bank of East Tennessee	Rogersville	\$ 134,212	\$ (64)	-0.5%
First Citizens Bancshares, Inc.	Dyersburg	\$ 927,887	\$ (392)	-0.5%
Citizens Tri-County Bank	Dunlap	\$ 477,359	\$ (235)	-0.5%
Farmers Bank	Portland	\$ 441,062	\$ (326)	-0.7%
Highland Federal Savings & Loan Associat	Crossville	\$ 69,453	\$ (118)	-0.9%
Citizens Bank	New Tazewell	\$ 138,282	\$ (164)	-1.2%
Tennessee State Bancshares, Inc.	Pigeon Forge	\$ 683,728	\$ (860)	-1.4%
Evolve Financial Group, Inc	Cordova	\$ 94,165	\$ (159)	-1.5%
First Community Bank of Bedford County	Shelbyville	\$ 254,645	\$ (781)	-2.5%
Union Bank & Trust Company	Livingston	\$ 79,261	\$ (229)	-2.5%
Bank of Ripley	Ripley	\$ 166,279	\$ (858)	-3.1%
Citizens Bank of Blount County	Maryville	\$ 325,212	\$ (2,184)	-3.7%
Bank of Gleason	Gleason	\$ 93,423	\$ (762)	-3.7%
Tri State Bank of Memphis	Memphis	\$ 122,569	\$ (634)	-3.7%
Citizens Bank and Trust Company of Grair	Rutledge	\$ 158,128	\$ (1,211)	-4.2%
McKenzie Banking Company	McKenzie	\$ 104,078	\$ (607)	-4.3%
First Horizon National Corporation	Memphis	\$ 32,805,263	\$ (204,441)	-4.6%
Sevier County Bank	Sevierville	\$ 415,538	\$ (2,467)	-4.8%
Bank of Bradford	Bradford	\$ 37,948	\$ (215)	-5.7%
Tennessee Central Bancshares, Inc.	Parsons	\$ 672,024	\$ (10,889)	-17.5%
<b>Averages</b>		<b>\$ 1,910,026</b>	<b>\$ (11,380)</b>	<b>-3.4%</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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