

# The Impact of Standardized Basel II on Vermont Banks

Prepared for Vermont Bankers Association



# Executive Summary

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

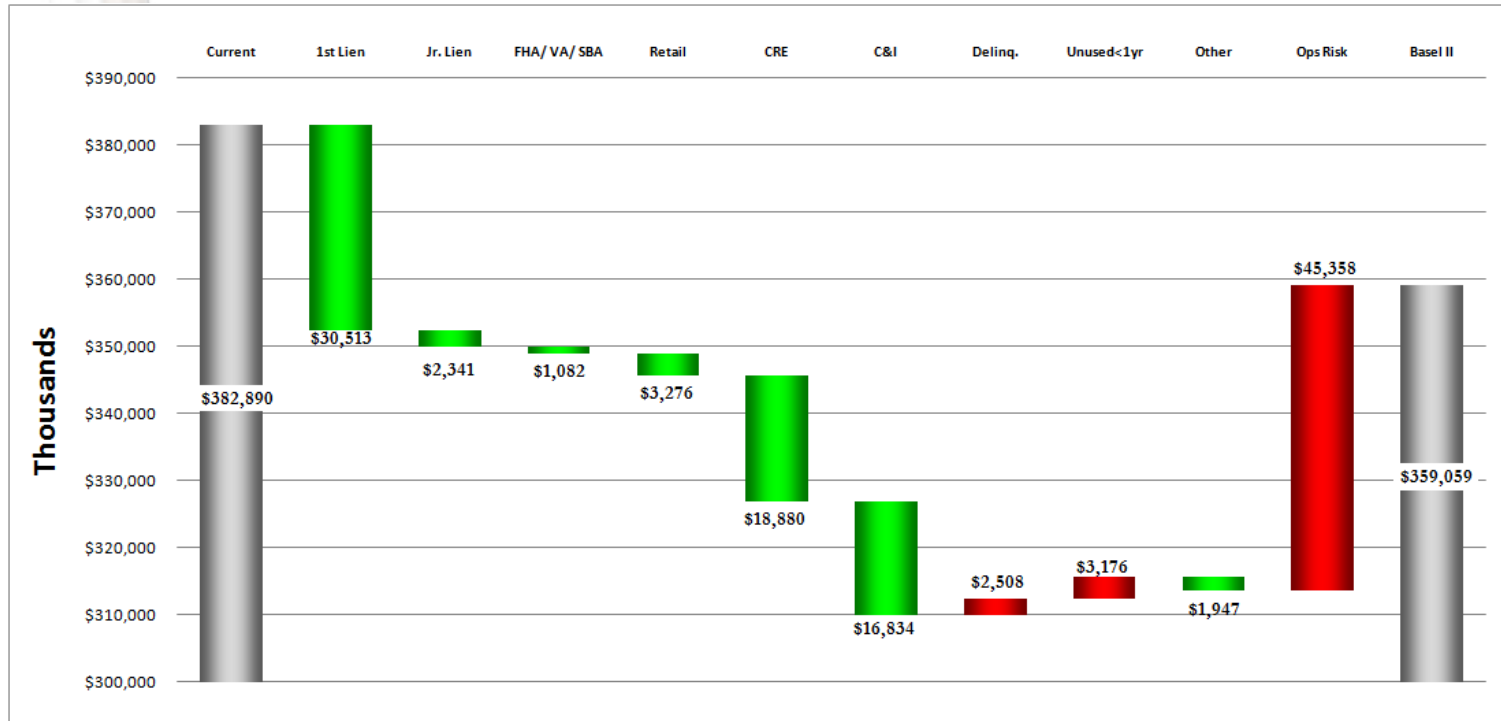


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 92.3% of 13 Vermont banks and thrifts
  - Aggregate potential capital savings for all 13 banks of \$24 million
  - The median Vermont bank would save \$1.8 million or 7.0% of their existing Tier 1 capital 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

# Vermont Banks can save up to \$24 million in required capital under Standardized Basel II and improve risk management

## Capital savings estimate and asset category contribution

Regulatory Capital Requirement

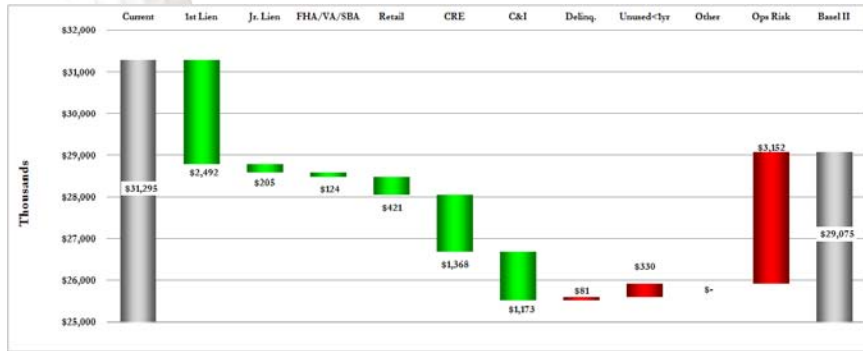


Source: 2008Q3 Call Reports; SPC estimates

# For Community Bancorp., a representative Vermont bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$2.2 million or 7.0%

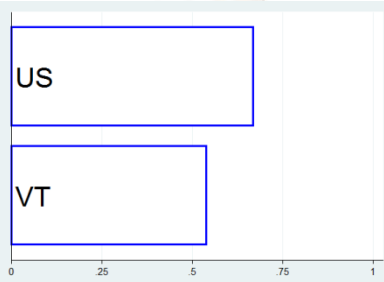
Regulatory Capital Requirement



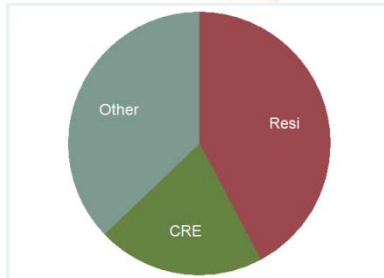
## Community Bancorp. Derby, VT Highlights

- *Stockpile.* Under Basel II, total RBC increases from 10.4% to 11.2%, an amount equal to \$2.2 million or 7.0% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 10.4% total RBC ratio:
  - Issue a special dividend of \$0.50 per share
  - Repurchase 230,573 shares, increasing EPS \$0.04 or 5.6%
  - Organically grow assets by \$31 million

Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$490	
Gross Income Margin	N/A%	
Tangible Common Equity	4.2%	
Leverage Ratio	6.6%	
Capital Estimates	Current	Basel II
Tier 1 RBC	9.5%	10.2%
Total RBC	10.4%	11.2%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$0.50	
Share Repurchase (7/29/2008 price)		
Number of Shares	230,573	
Change in EPS	\$0.04	
Organic Asset Growth (millions)	\$31	

Upon request, Second Pillar Consulting can provide similar information for all 13 Vermont banks free of charge

# Standardized Basel II capital implications for a sample of Vermont banks

Name	City	Asset Size (\$000's)	Basel II Capital Impact	
			Dollar Change (\$000)	Percent Change
Bank of Bennington (MHC)	Bennington	\$ 248,863	\$ 3,400	15.7%
Brattleboro Savings & Loan Association, F.	Brattleboro	\$ 168,120	\$ 1,614	12.8%
Passumpsic Bancorp	Saint Johnsbury	\$ 563,961	\$ 3,930	11.3%
Connecticut River Bank, NA	Springfield	\$ 229,613	\$ 1,992	10.1%
Wells River Savings Bank	Wells River	\$ 134,501	\$ 1,206	7.9%
Randolph National Bank	Randolph	\$ 140,452	\$ 1,024	7.7%
Community Bancorp.	Derby	\$ 489,546	\$ 2,220	7.0%
National Bank of Middlebury	Middlebury	\$ 251,301	\$ 1,232	6.1%
Northfield MHC	Northfield	\$ 579,720	\$ 3,550	4.9%
First National Bank of Orwell	Orwell	\$ 34,945	\$ 146	4.5%
Merchants Bancshares, Inc.	South Burlington	\$ 1,317,254	\$ 2,762	2.7%
Union Bank	Morrisville	\$ 422,311	\$ 755	1.7%
Peoples Trust Company of St. Albans	Saint Albans	\$ 216,939	\$ (30)	-0.1%
<b>Averages</b>		<b>\$ 369,040.46</b>	<b>\$ 1,830.85</b>	<b>7.1%</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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