

The Impact of Standardized Basel II on Virginia Banks

Prepared for Virginia Bankers Association



Executive Summary

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

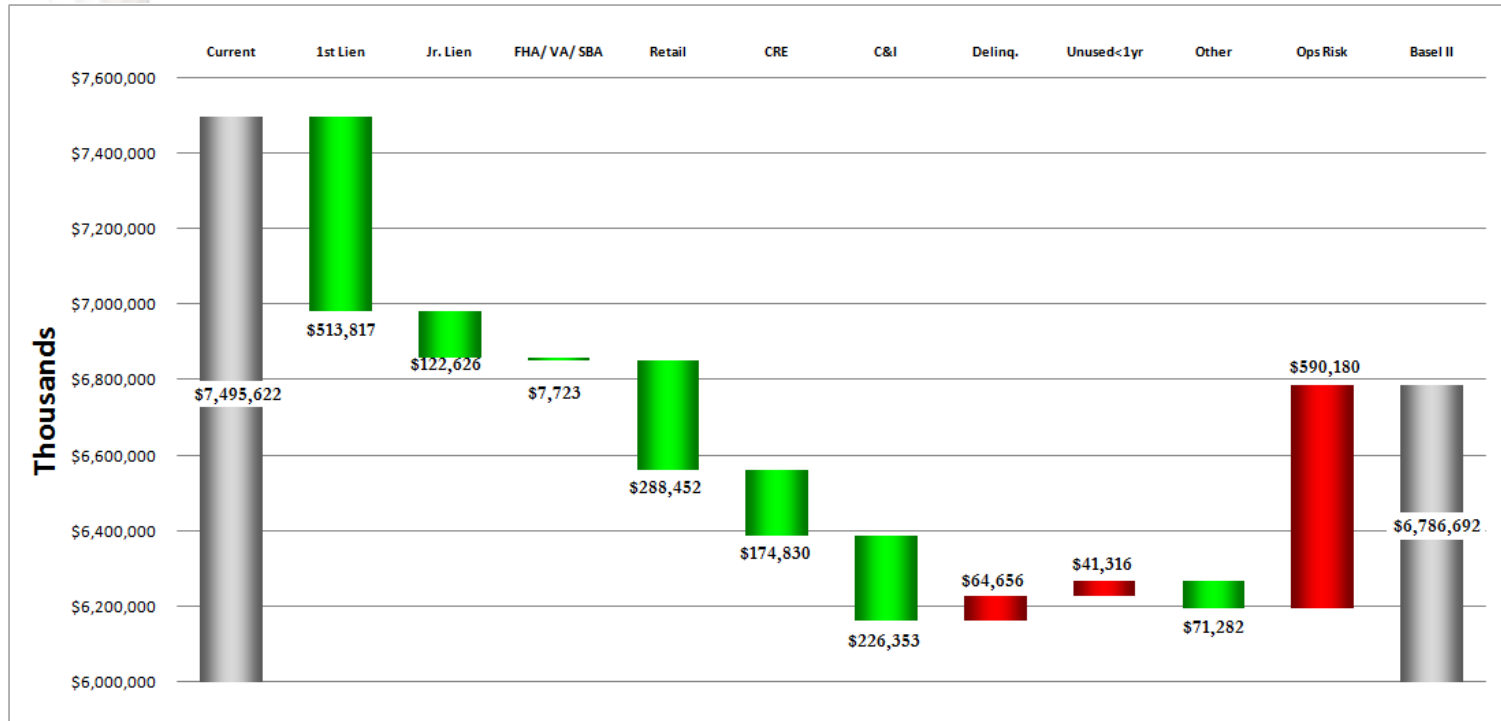


- We estimate that Standardized Basel II compliance will improve the regulatory capital ratios of 91.6% of 108 Virginia banks and thrifts
 - Aggregate potential capital savings for all 108 banks of \$709 million
 - The median Virginia bank would save \$1.5 million or 6.2% of their existing Tier 1 capital 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

Virginia Banks can save up to \$709 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

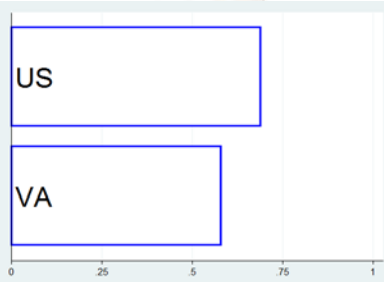
For Highlands Bankshares, Inc., a representative Virginia bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$3.6 million or 7.2%

Regulatory Capital Requirement



Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$675	
Gross Income Margin	3.4%	
Tangible Common Equity	5.6%	
Leverage Ratio	7.1%	
Capital Estimates	Current	Basel II
Tier 1 RBC	10.0%	10.7%
Total RBC	11.0%	11.8%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$0.70	
Share Repurchase (7/29/2008 price)		
Number of Shares	330,830	
Change in EPS	\$0.06	
Organic Asset Growth (millions)	\$45	

Highlands Bankshares, Inc. Abingdon, VA Highlights

- *Stockpile.* Under Basel II, total RBC increases from 11.0% to 11.8%, an amount equal to \$3.6 million or 7.2% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 11.0% total RBC ratio:
 - Issue a special dividend of \$0.70 per share
 - Repurchase 330,830 shares, increasing EPS \$0.06 or 6.8%
 - Organically grow assets by \$45 million

Upon request, Second Pillar Consulting can provide similar information for all 108 Virginia banks free of charge

Virginia 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
Virginia Heritage Bank	Fairfax	\$ 215,584	\$ 5,859	22.6%
Old Dominion National Bank	North Garden	\$ 29,771	\$ 919	19.3%
Virginia Company Bank	Newport News	\$ 95,847	\$ 1,523	18.2%
John Marshall Bank	Falls Church	\$ 110,427	\$ 4,616	17.0%
Freedom Bank of Virginia	Vienna	\$ 151,713	\$ 3,558	16.4%
River City Bank	Mechanicsville	\$ 148,970	\$ 2,109	15.3%
Bank of Virginia	Midlothian	\$ 201,729	\$ 2,558	15.2%
Highlands Community Bank	Covington	\$ 78,656	\$ 1,135	15.0%
SuffolkFirst Bank	Suffolk	\$ 169,759	\$ 2,359	14.9%
E*TRADE Bank	Arlington	\$ 45,620,388	\$ 413,437	14.7%
River Community Bank, N.A.	Martinsville	\$ 78,924	\$ 1,045	13.9%
Community Bankers Trust Corporation	Glen Allen	\$ 695,272	\$ 13,771	13.4%
Citizens National Bank	Windsor	\$ 44,027	\$ 918	13.4%
First Sentinel Bank	Richlands	\$ 143,719	\$ 1,378	13.2%
Virginia Business Bank	Richmond	\$ 151,916	\$ 1,521	12.9%
Sonabank NA	Charlottesville	\$ 443,931	\$ 6,548	12.4%
Powell Valley National Bank	Jonesville	\$ 224,629	\$ 3,842	11.9%
StellarOne Corporation	Charlottesville	\$ 2,986,054	\$ 36,054	11.6%
Eastern Virginia Bankshares, Inc.	Tappahannock	\$ 1,031,193	\$ 9,622	11.3%
Carter Bank & Trust	Martinsville	\$ 2,749,174	\$ 22,517	11.1%
Averages		\$ 2,768,584.15	\$ 26,764.56	14.7%

Source: 2008Q3 Call Reports; SPC estimates

Virginia 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
Farmers & Miners Bank	Pennington Gap	\$ 122,329	\$ 310	2.1%
Fauquier Bankshares, Inc.	Warrenton	\$ 499,761	\$ 1,003	2.0%
Cardinal Financial Corporation	McLean	\$ 1,638,192	\$ 2,309	1.4%
Community Bankers' Bank	Midlothian	\$ 199,749	\$ 121	1.0%
United Medical Bank, FSB	Arlington	\$ 235,120	\$ 194	0.8%
Union Bankshares Corporation	Bowling Green	\$ 2,449,598	\$ 1,720	0.8%
Bank of Fincastle	Fincastle	\$ 162,316	\$ 180	0.7%
Burke & Herbert Bank & Trust Company	Alexandria	\$ 1,631,069	\$ 1,048	0.6%
Virginia Commerce Bancorp, Inc.	Arlington	\$ 2,661,687	\$ 1,352	0.5%
Commonwealth Bankshares, Inc.	Norfolk	\$ 1,019,742	\$ 572	0.4%
Pioneer Bank	Stanley	\$ 156,719	\$ 48	0.3%
TowneBank	Portsmouth	\$ 3,015,581	\$ (422)	-0.1%
First Bancorp, Inc.	Lebanon	\$ 972,065	\$ (609)	-0.6%
Bank of Floyd	Floyd	\$ 204,083	\$ (150)	-0.7%
Alliance Bankshares Corporation	Chantilly	\$ 552,819	\$ (619)	-1.2%
Capital One Financial Corporation	McLean	\$ 154,800,000	\$ (321,096)	-1.8%
Access National Corporation	Reston	\$ 656,461	\$ (1,446)	-2.1%
C&F Financial Corporation	West Point	\$ 846,294	\$ (4,382)	-4.9%
First State Bank	Danville	\$ 27,819	\$ (119)	-5.2%
Millennium Bankshares Corporation	Reston	\$ 321,354	\$ (2,648)	-7.0%
Averages		\$ 8,608,638	\$ (16,132)	-0.7%

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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