

The Impact of Standardized Basel II on Washington Banks

Prepared for Washington 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 70.5% of 88 Washington banks and thrifts
 - Aggregate potential capital savings for all 88 banks of \$207 million
 - The median Washington bank would save \$1.2 million or 2.7% 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

Washington Banks can save up to \$207 million in required capital under Standardized Basel II and improve risk management

Capital savings estimate and asset category contribution

Regulatory Capital Requirement

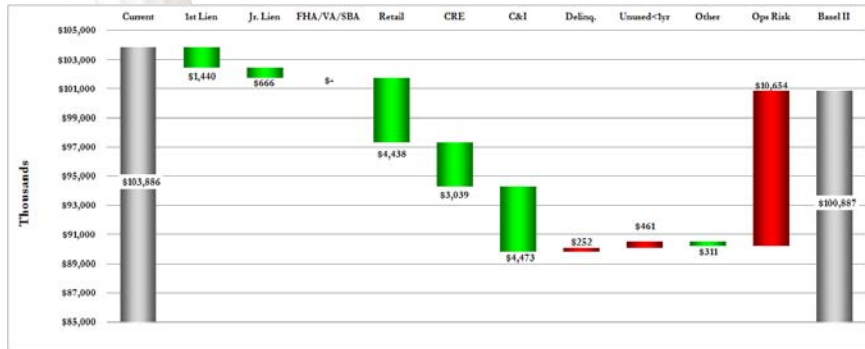


Source: 2008Q3 Call Reports; SPC estimates

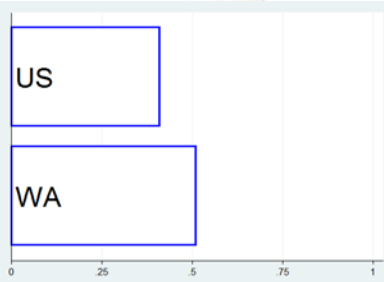
For Washington Banking Company, a representative Washington bank, Basel II regulatory capital savings can be stockpiled or deployed

Capital Savings: \$3.0 million or 2.7%

Regulatory Capital Requirement



Capital Savings Percentile



Asset Mix



Capital Metrics and Management

Total Assets (millions)	\$913	
Gross Income Margin	4.9%	
Tangible Common Equity	8.6%	
Leverage Ratio	11.7%	
Capital Estimates	Current	Basel II
Tier 1 RBC	11.8%	12.1%
Total RBC	13.1%	13.4%
Potential Use of Basel II Capital Savings		
Special Dividend (\$/share)	\$0.32	
Share Repurchase (7/29/2008 price)		
Number of Shares	357,006	
Change in EPS	\$0.04	
Organic Asset Growth (millions)	\$24	

Washington Banking Company Oak Harbor, WA Highlights

- *Stockpile.* Under Basel II, total RBC increases from 13.1% to 13.4%, an amount equal to \$3.0 million or 2.7% of the existing capital base.
- *Deploy.* Incremental capital can be deployed with a variety of balance sheet actions that preserve the current 13.1% total RBC ratio:
 - Issue a special dividend of \$0.32 per share
 - Repurchase 357,006 shares, increasing EPS \$0.04 or 3.9%
 - Organically grow assets by \$24 million

Upon request, Second Pillar Consulting can provide similar information for all 88 Washington banks free of charge

Washington 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
Sound Community Bank (MHC)	Seattle	\$ 291,091	\$ 4,166	19.5%
Washington Business Bank	Olympia	\$ 66,849	\$ 1,274	19.2%
Commencement Bank	Tacoma	\$ 80,240	\$ 3,082	17.5%
Fortune Bank	Seattle	\$ 69,443	\$ 3,065	16.0%
Plaza Bank	Seattle	\$ 84,203	\$ 2,119	14.6%
Yakima National Bank, National Association	Yakima	\$ 89,710	\$ 1,284	14.6%
Summit Bank	Burlington	\$ 121,115	\$ 1,457	13.4%
Northwest Commercial Bank	Lakewood	\$ 73,946	\$ 1,008	12.9%
Twin River National Bank	Clarkston	\$ 53,185	\$ 682	12.5%
Puget Sound Bank	Bellevue	\$ 153,981	\$ 2,413	12.3%
Hometown National Bank	Longview	\$ 33,351	\$ 370	10.8%
Raymond Federal Bank	Raymond	\$ 57,841	\$ 512	10.8%
Community First Bank	Kennewick	\$ 116,819	\$ 1,179	10.4%
Olympia Federal Savings & Loan Association	Olympia	\$ 443,423	\$ 6,234	10.1%
Thurston First Bank	Olympia	\$ 93,096	\$ 847	9.9%
Foundation Bank	Bellevue	\$ 406,518	\$ 3,415	9.4%
First Sound Bank	Seattle	\$ 266,958	\$ 2,723	9.2%
Bank Reale	Pasco	\$ 34,132	\$ 454	8.8%
Riverbank	Spokane	\$ 129,305	\$ 1,143	8.5%
Banner Corporation	Walla Walla	\$ 4,650,259	\$ 34,785	8.3%
Averages		\$ 365,773.25	\$ 3,610.52	12.4%

Source: 2008Q3 Call Reports; SPC estimates

Washington 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
Skagit State Bancorp, Inc.	Burlington	\$ 572,687	\$ (607)	-1.0%
Riverview Community Bank	Vancouver	\$ 887,446	\$ (1,091)	-1.3%
American Marine Bank	Bainbridge Island	\$ 407,995	\$ (790)	-2.0%
HomeStreet Bank	Seattle	\$ 2,835,476	\$ (6,962)	-2.4%
Horizon Financial Corp.	Bellingham	\$ 1,451,299	\$ (4,024)	-2.8%
Security State Bank	Centralia	\$ 386,549	\$ (1,718)	-3.5%
Timberland Bancorp, Inc.	Hoquiam	\$ 681,883	\$ (2,766)	-3.5%
First Independent Investment Group, Inc.	Vancouver	\$ 1,052,647	\$ (5,899)	-3.5%
First Heritage Bank	Snohomish	\$ 197,745	\$ (766)	-3.5%
Rainier Pacific Financial Group, Inc.	Tacoma	\$ 840,688	\$ (3,715)	-3.8%
Bank of Fairfield	Fairfield	\$ 138,024	\$ (622)	-4.1%
Anchor Mutual Savings Bank	Aberdeen	\$ 644,578	\$ (2,912)	-4.2%
Farmington State Bank	Farmington	\$ 7,303	\$ (79)	-4.8%
Frontier Financial Corporation	Everett	\$ 4,244,963	\$ (22,329)	-5.1%
Venture Financial Group, Inc.	Du Pont	\$ 1,167,933	\$ (5,316)	-6.3%
Lamont Bank of St. John	Saint John	\$ 26,000	\$ (313)	-7.4%
City Bank	Lynnwood	\$ 1,324,334	\$ (19,718)	-8.1%
Pacific Crest Savings Bank	Lynnwood	\$ 145,959	\$ (1,613)	-8.7%
Westsound Bank	Bremerton	\$ 396,841	\$ (9,814)	-16.9%
Seattle Savings Bank	Seattle	\$ 665,967	\$ (23,916)	-22.5%
Averages		\$ 903,816	\$ (5,749)	-5.8%

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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