

CEO Strategic Playbook for Tomorrow

**Independent Bankers Association
of Texas**

October 12, 2009

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How Much (%) of Each of the Following Does the U.S. Government Own?

➤ Citigroup	34%
➤ AIG	80+%
➤ Fannie Mae	100%*
➤ Freddie Mac	100%*
➤ GM	61%
➤ Chrysler	16%

* To be independent, both firms must repay government investments plus interest; they are not close to profitability and it will likely take 75 + years after profits appear

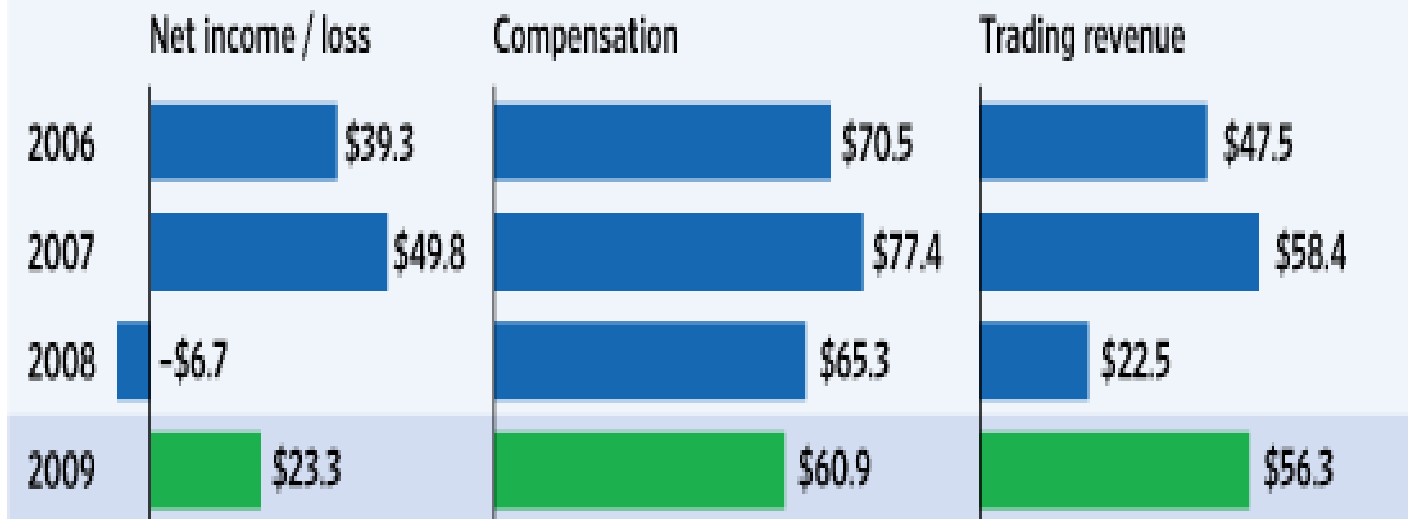
Not All Banks are the Same

- ❖ **Too Big to Fail (TBTF) Banks:** the largest financial institutions whose primary business may be lending, investment banking (securities underwriting, asset management and proprietary trading) or insurance.
- ❖ **Large Regional Banks:** large financial institutions that operate in limited geographic markets and offer fewer banking services than TBTF Banks; Banking services include deposits, loans, leases, credit cards, securities underwriting and brokerage, market making, asset management and insurance sales.
- ❖ **Community Banks:** the smallest commercial banking organizations that typically operate within a relatively small trade area, offer banking services that emphasize loans and deposits, generate the bulk of earnings from net interest income and emphasize personal relationships between customers, stockholders and managers.

❖ **Shadow Banks:** non-commercial bank financial institutions that were actively involved in financial intermediation by which funds were transferred from investors to borrowers. They might originate loans but did not want to hold the loans in portfolios. They might securitize loans and place them with investors. They may be insurance companies, pension funds, hedge funds, money market funds, mortgage banks or off-balance sheet entities with names like ‘structured-investment vehicles (SIVs)’.

Bouncing Back | The state of recovery for major U.S. banks

Financial metrics for top five Wall Street banks – Bank of America, Citigroup, Goldman Sachs, J.P. Morgan and Morgan Stanley – for the first six months of 2006 through 2009. All figures in billions



Note: For 2006-08, net income and total compensation includes the top five firms as well as the four financial institutions they've acquired (Merrill Lynch, Bear Stearns, Washington Mutual and Countrywide). For trading revenue, 2006-08 includes contributions of Bear Stearns and Merrill Lynch.

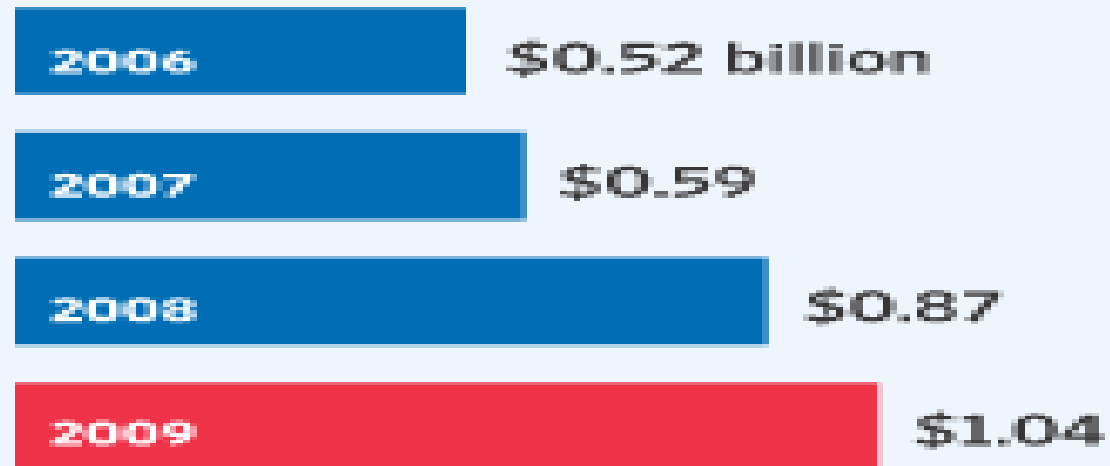
Source: Bank regulatory filings

Enrich & Paletta, op cit.

Have We Learned Our Lesson?

Still Betting Big

Potential daily trading losses at major firms, second quarter



Average 'Value at risk' is an estimate of the total amount a bank stands to lose on an average day if its trading bets sour.

Source: Bank regulatory filings

Enrich & Paletta, "Finance Reform Falters as Shock of '08 Fades," WSJ, September 9, 2009

Recent Regulatory Directives

- FDIC will not release information on unsuccessful bids for failed banks; will not release information on TARP bids not closed
- Reserves in the DIF amount to 0.22% of insured deposits (statutory minimum is 1.15%); proposal to prepay \$45 billion in premiums for next 3 years
- FDIC announces more intensive supervision and higher capital requirements for newly chartered banks for up to 7 years
- FDIC now discloses formal ‘notices of charges’ when a bank’s management dissents from signing a Cease & Desist order
- Senate Banking Committee displays renewed interest in a single federal regulator for financial institutions and a systemic risk council

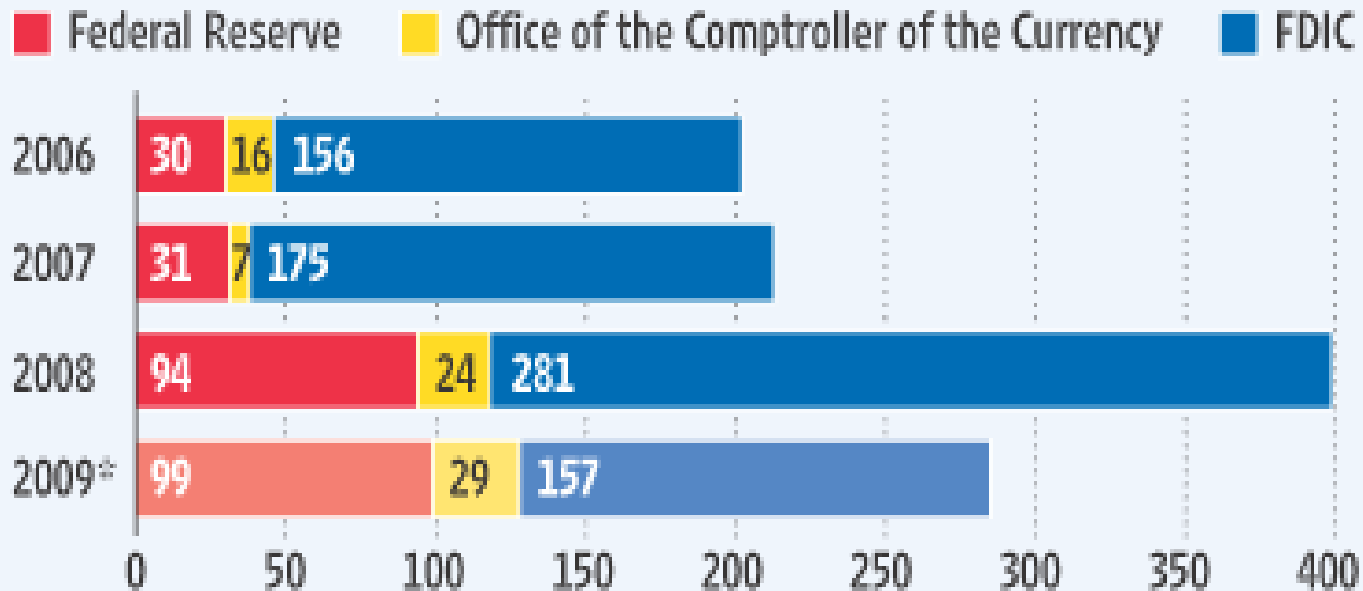
Critical Issues Facing Community Banks

- ❖ When do we get a floor on housing values?
- ❖ How will commercial real estate be treated as loans come due in the next 6 months to 2 years?
- ❖ Will deposit insurance premiums wipe-out bank earnings?
- ❖ Where do we get capital?
- ❖ How do we improve our liquidity position and not kill earnings?
- ❖ How do we best work with the regulators?

Trends in Enforcement Actions

On Probation

Number of banks hit with memorandums of understanding, by regulator. **The 2009 crackdowns are on pace to exceed 2008.**



*For 2009, Fed figures are as of June 30, OCC as of July 27 and FDIC as of June 1
Sources: FDIC, Federal Reserve and OCC

CAMELS

- Routinely estimate a CAMELS rating for the bank
- Regularly perform stress tests (pro forma calculations) to assess the various risks that the bank faces
- Modify your strategic plan as necessary (2 and 3 year plans aren't very useful)

Strategies For Positioning Your Bank

- Take Advantage of Deposit Insurance and Federal Government Liquidity Facilities
- Review and Upgrade Your Bank's Capital Plan

UPDATE YOUR STRATEGIC PLAN

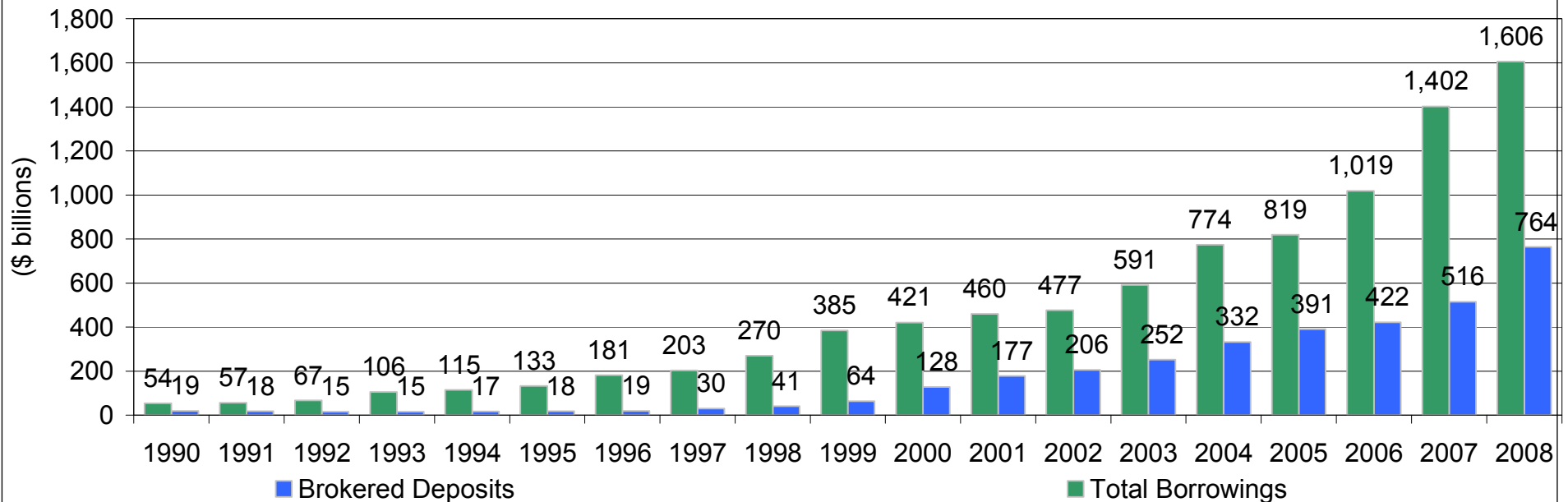
New Liquidity Realities

- Deposit insurance premiums are rising (and will continue to increase)
- Must pay penalty premiums for ‘excessive’ brokered deposit financing and FHLB financing
- Collateral requirements are rising
- Government liquidity programs will eventually go away
- As rates increase, core deposits (especially non-interest bearing DDA) will be harder to get

The FDIC does not like borrowing and brokered deposit levels to exceed 20% of total assets; institutions are seeing an increasing need for the alternative funding sources

- Collateralized assets cannot be sold should an institution be brought into receivership and borrowings will face a prepayment penalty if they are paid back early. Both issues make life harder for the FDIC if they are forced to step in and take over an institution.

Total Borrowing and Brokered Deposit Levels



FDIC Deposit Insurance Fund, Assets and Estimated Costs

■ Quarterly DIF Assets
 — Cumulative DIF Costs



<http://www.calculatedriskblog.com/>

How Might We Replenish the Deposit Insurance Fund?

- Special assessment?
 - Prepay future deposit insurance assessments?
 - Borrow from Treasury?
-
- Do any of these preclude future assessments?

A Critique of Prepaid Deposit Insurance

- Why use insured deposits and not assets minus tangible equity as the base for assessments?
- With many banks being criticized for inadequate liquidity (consider the non-core funding dependence), doesn't prepayment seriously reduce liquidity?
- Suppose that your bank has seen its CAMELS rating lowered from '2' to '3' because of liquidity or capital issues that are readily correctable. If you prepay premiums based on the '3' rating which is subsequently raised to a '2,' do you get a rebate?

New Liquidity Realities, cont.

- Will publicity regarding overdraft fees help or hurt community banks?
 - clarify what fees you charge and when (no fees if overdraft is < \$5?; limit number of charges per day?)
- How do you plan to offset the increased cost of deposit insurance?
 - monthly account maintenance fee?
 - required minimum balance for checking?
 - move customers to debit cards?
 - move customers to online banking?

Take Advantage of Deposit Insurance

- Everyone wants to be a bank to access low-cost, stable core deposits.
- Large institutions will price up deposits in every market they enter
- Community banks must compete with relationships and service as it is difficult to match pricing
- Focus: obtain more deposit (operating) accounts from customers with loan relationships – incent your lenders on retained core deposit growth
- Focus: offer new ‘signature savings’ accounts that migrate rate-sensitive customers from retail time

Time deposits have typically been the largest individual source of funding for most institutions

Deposits	2008		Unprepared 2009	
	(\$000s)	Rate (%)	(\$000s)	Rate (%)
Non Interest Bearing				
<i>Traditional Non Interest Bearing Accts</i>	35,000	0.00%	35,000	0.00%
<i>Operating Accounts</i>	-	0.00%	-	0.00%
Transaction Accounts	105,000	0.50%	105,000	0.50%
Savings				
<i>Personal Savings</i>	105,000	1.50%	105,000	1.50%
<i>New Signature Savings</i>	-	0.00%	-	0.00%
Money Market	105,000	2.00%	105,000	2.00%
Retail Time Deposits	315,000	3.00%	315,000	3.25%
Brokered Deposits	35,000	3.25%	35,000	3.50%
Total Deposits	700,000	2.11%	700,000	2.24%

Playing the “pricing game” will keep time deposits from running off and deposit levels steady, but this comes with a 13 bps increase in the cost of deposits.

Banks need to focus on shifting the mix toward core deposits by introducing new and attractive core deposit accounts . . .

Deposits	2008		Unprepared 2009		Prepared 2009		Prepared 2009	
	(\$000s)	Rate (%)	(\$000s)	Rate (%)	(\$000s)	Rate (%)	(\$000s)	Rate (%)
Non Interest Bearing								
<i>Traditional Non Int.Bearing Accts</i>	35,000	0.00%	35,000	0.00%	35,000	0.00%	35,000	0.00%
<i>Operating Accounts</i>	-	0.00%	-	0.00%	10,000	0.00%	10,000	0.00%
Transaction Accounts	105,000	0.50%	105,000	0.50%	105,000	0.50%	105,000	0.50%
Savings								
<i>Personal Savings</i>	105,000	1.50%	105,000	1.50%	105,000	1.50%	90,000	1.25%
<i>New Signature Savings</i>	-	0.00%	-	0.00%	-	0.00%	85,000	2.50%
Money Market	105,000	2.00%	105,000	2.00%	105,000	2.00%	105,000	2.00%
Retail Time Deposits	315,000	3.00%	315,000	3.25%	315,000	3.00%	270,000	3.00%
Brokered Deposits	35,000	3.25%	35,000	3.50%	25,000	3.25%	-	3.25%
Total Deposits	700,000	2.11%	700,000	2.24%	700,000	2.07%	700,000	2.00%

The strategies of 1) obtaining operating accounts from loan relationships and 2) introducing a “signature savings” account can lower the cost of funds.

Offer Signature Savings Accounts

- Jan. – May 2009: Increase in average balances nationally
 - Avg. savings account grew to \$6,600 (46%)
 - Avg. MMA balances grew to \$39,000 (20%)
 - Avg. Non-interest DDA grew to \$3,050 (11%)
 - Avg. interest checking grew to \$7,550 (5%)
- Data suggest that any change in fees $> 10\%$ produces a response via reduced balances and account closings

Source: Banc Investment Daily, PCBB

Structured or Specialty Savings

- Attractive tiered interest rates
 - rates increase with amount deposited and term
- Other services
 - free telephone and internet banking
 - one-half price safety deposit box
 - debit card or ATM card
 - no charge for cashiers checks, money orders or travelers checks
 - free box of checks at account opening

Open these accounts for a special purpose (college, vacation, automobile,)

Net Non-core Funding Dependence

$$\text{NCFD} = \frac{\text{Non-core liabilities} - \text{ST investments}}{\text{Long-term Assets}}$$

What is a non-core liability?

- \$2 million CD owned by a director and held at the bank for the past 4 years?
- \$50,000 time deposit with a 7-mth maturity paying an above market rate – held by a rate shopper?

Increased Savings Helps Build Core Deposits

- What is a core deposit?
 - non-interest bearing DDA
 - time deposit held by a retiree paying 2% (6-mth);
2.5% (1-yr); 3.5% (5-yr) ???
- Tell your best customers ‘Thank You for doing business with us.’
- Commercial borrowers should have their primary deposit relationship with your bank
- Do you incent loan officers to bring in commercial deposits?

Funding Options

- No Collateral Needed
 - Federal Funds
 - Rate Board – www.qwickrate.com
 - Brokered Deposits
 - CDARS – www.promnetwork.com
 - IDC Deposits – www.idcdeposits.com

Sample Rate Board Information

View Rates [A](#) [B](#) [C](#) [D](#) [E](#) [F](#) [G](#) [H](#) [I](#) [J](#) [K](#) [L](#) [M](#) [N](#) [O](#) [P](#) [Q](#) [R](#) [S](#) [T](#) [U](#) [V](#) [W](#) [X](#) [Y](#) [Z](#) [All](#)

Portfolio:

Filters:

[Find Institution](#) | [Quick Entry](#) | [Help](#)

View Open:

Rows per page:

Time: 06/08/2009 03:36 PM EDT

Posting: 353

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Show All Terms:

| [Merge Letters](#)

#		Institution	State	270 Dys	↓ 1Yr	1.5 Yrs	2 Yrs	2.5 Yrs	3 Yrs	
1	<input checked="" type="checkbox"/>	Georgian Bank (57151) ^{SP}	GA	2.151	2.502	2.756	2.761	2.771	3.051	7 Dys - 180 Dys
2	<input checked="" type="checkbox"/>	Community Bank of Nevada (34043)	NV	2.050	2.501	2.600	2.760	2.710	3.010	270 Dys - 3 Yrs
3	<input checked="" type="checkbox"/>	Meridian Bank, NA/dba Margbank (22644)	AZ	2.150	2.500	2.550	2.730	2.730		3.5 Yrs - SP Term
4	<input checked="" type="checkbox"/>	Community Bank of West Georgia (57436)	GA	1.000	2.370	2.440	2.720			← Pages →
5	<input type="checkbox"/>	State Bank of Texas (27074)	TX		2.345					
6	<input type="checkbox"/>	Frontier Bank (22710)	WA		2.341	2.441	2.721			
7	<input type="checkbox"/>	Bank of the Cascades (22407)	OR		2.340	2.490	2.680	2.751	2.950	
8	<input type="checkbox"/>	Midwest Bank and Trust Company (18117)	IL	1.880	2.260		2.450		2.650	
9	<input type="checkbox"/>	Great Southern Bank (29546)	MO	1.700	2.251	2.215	2.500	2.285	2.513	
10	<input type="checkbox"/>	Orion Bank (22427)	FL		2.250	2.350	2.550	2.600	3.050	
11	<input type="checkbox"/>	Nexity Bank (19794)	AL	1.760	2.240					
12	<input type="checkbox"/>	AmericanWest Bank (22441)	WA	1.890	2.230					
13	<input type="checkbox"/>	Amboy Bank (6423)	NJ		2.210	2.351	2.600		2.650	
14	<input type="checkbox"/>	Evergreen Bank (20501)	WA	1.881	2.201	2.401	2.671			
15	<input type="checkbox"/>	Advanta Bank Corp (33535)	UT	1.450	2.200	2.300	2.500		2.700	

These rates are quoted for QwickRate customers only and cannot be republished without the consent of the listing financial institution.

^{SP} Indicates a Special Rate Term is available

← 1 2 3 4 5 6 7 8 9 10 11 →

Records: 1 - 15 of 353

Provided by Karl Nelson, KPN Consulting

Issuer Benefits

- Non-brokered core deposits (time deposits <100k)
- CDs can be very stable
- No collateral requirements
- Can be used for one-time liquidity or pre-funding
- Reduce interest rate risk
- Open a virtual branch at a fraction of the cost of brick and mortar
- Prevent balance sheet re-pricing (cannibalization)

Provided by Karl Nelson, KPNConsulting

Deposit Classification

The FDIC classifies a rate board as a “non-brokered deposit listing service” if the rate board meets the following criteria:

Charge subscription fees only

- *Fees not charged on number or dollar value of CDs placed*
- *Performs no services except gathering and transmission of information*
- *The listing service is not involved in placing deposit*

Deposits obtained directly as a result of a bank listing rates on a rate board will be classified as non-brokered.

“Time deposits less than \$100,000” on schedule RC-E of the call report

Included in the UBPR calculation of core deposits

Does not affect your bank’s dependency on non-core funding liquidity ratios.

Taxpayers Now Own GMAC

GMAC Attack

Past and potential future government contributions to support 'auto-centric' bank GMAC LLC

December 2008

\$5 billion

In nonvoting, nonconvertible preferred securities paying 8% per annum. From the Treasury's TARP funds.

\$1 bil.

Lent to GM, invested back into GMAC via a rights offering.

May 2009

\$4 bil. (est.)

Used to plug a capital hole after the transfer of Chrysler Financial's business over to GMAC.

By November 2009

Up to \$9.1 bil.

In new capital necessary to meet the government 'stress test.' GMAC will try to raise money from private sources first.

Sources: Company filings; WSJ research

Berman, Dennis, "Get Ready: You Will Own GMAC, Too," WSJ, May 12, 2009

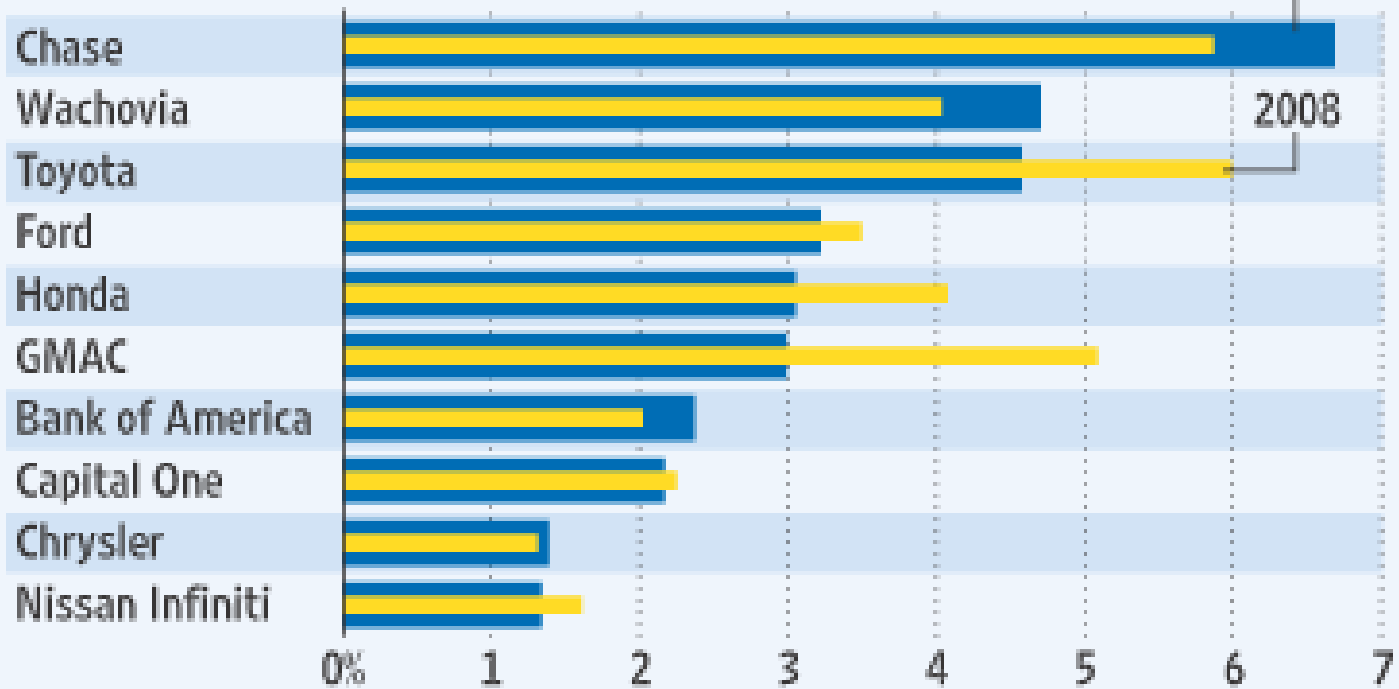
GMAC Issues \$4.25 Billion TLGP Debt

- Authorized to issue \$7.4 billion in FDIC-insured debt
- June 3 - issued \$3.5 billion in fixed-rate notes
 - (2.25% rate) maturing Dec. 2012
 - issued \$0.75 billion in floating rate notes
 - (3-mth LIBOR at 0.64%) maturing Dec. 2012
 - AAA rated by Fitch due to FDIC guarantee
- What will GMAC do with the proceeds?

Who is Financing Automobiles?

Power Shift

Top 10 auto-loan companies' market share



Note: Data for first half of year

Source: Experian

Ally Bank (Ally.com – Oct. 8, 2009)

- 1.80% Online Savings Account – linked to customer's current checking account – no minimum balance, no monthly fees
- 1.70% MMDA rate – no minimum balance
- 2.05% CD rate – 1 year
 - 2.75% - 3 years
 - 3.40% - 5 years
- No Penalty CD – 9-mth APY is 1.85% (no fee for early withdrawal)
- Check (Debit) Card – 4 free transactions from non-GMAC Bank ATMs

Ally's Aggressive Advertising

“Is not saying something a lie?”

In banking, there's profit and there's integrity. It shouldn't be a choice between the two. At Ally Bank, we value integrity as much as deposits. That's why we'll send an email alert if money sitting idle in your account could be working harder and earning more. It's jus the right thing to do.

Kiplinger (back of cover), November 2009

Ally Bank is Growing

- Total deposits increased 46% over the last 12 months (2009 Q1 vs 2008 Q1) from \$15.4 bn to \$22.5 bn
- Net income in 2009 Q1 was -\$133 million (loss)
- Bank argues that it is ‘better capitalized than many ABA members’ (CNNMoney.com, June 11, 2009)

[Of course, the federal government owns 35.4% of GMAC]

Know Your Core Deposits

- What are you doing to attract and protect these types of deposits?
- Know what Ally, ING, Emigrant, AMEX, Capital One, etc. are doing

Wholesale Borrowings Should be Used Primarily to Fund Shortfalls in Deposit Growth and/or to Mitigate Interest Rate Risk

- Will long-term funding be available from the Federal Home Loan Bank?
- Wholesale funding will be increasingly difficult to obtain; its use will be punished by the FDIC
- Rates are at historic lows; lock-in longer-term rates where available

Take Advantage of the Government's Term Auction Facility (TAF)

- Established December 12, 2007
- Bi-weekly auctions
 - 28-day Discount Window credit
 - Introduced an 84-day TAF loan in July 2008
 - October 5, 2009 offered 70-day credit
- Same collateral as for primary credit
- Competitive bid process with highest bid rates being awarded – if undersubscribed all borrowers pay the lowest bid (stop-out) rate
- Recent stop-out rate has been 0.25% (All of 2009)
- \$50 Billion auctioned currently
- In place at least until market conditions improve

TAF Auction: October 5, 2009

- \$50 billion available; \$24.83 billion bid/accepted
- 0.25% stop-out rate
- 75 bidders
- Awarded loans settle on Oct. 8; mature on Dec. 17
- Auction schedule:
 - Oct. 19 28 days \$75 billion
 - Nov. 2 70 days \$25 billion
 - Nov. 16 28 days \$75 billion
 - Nov. 30 42 days \$25 billion
 - Dec. 14 28 days \$75 billion

Some New Capital Realities

- Capital preservation is paramount
- More is better
- Be prepared to operate with more capital
- Is 8%, 9% or 10% the new leverage capital standard? Is 12% or 14% risk-based capital the new standard? Is this adequately-capitalized or well-capitalized?
- Capital is difficult to get today
 - TARP
 - Private equity firms
 - Bank capital merger partners
 - Existing shareholders, directors, friends & family

Review and Upgrade Your Capital Plan

- Increased focus on Tangible Common Equity
- Market for trust preferred stock is gone
- Identify reasonable growth objectives
 - organic growth and contribution of retained earnings
 - acquisition opportunities
- What sources of external tier 1 capital can be tapped?
- How much external capital is available?
 - rights offerings will increase (non-dilutive)
 - common stock offerings; bonds convertible into stock
 - private equity
- Should you shrink the bank?

Quick Critique of TARP Capital Purchase Program

- Can obtain up to 3% of risk-weighted assets
- Preferred stock pays 5% dividend for 5 years; thereafter it increases to 9% (non-voting stock)
- Treasury gets warrants up to 15% of funds committed as preferred stock
- Negatives
 - Government ownership; can change rules anytime
 - warrants represent common stock
- Positives
 - Use capital to make loans or expand operations
 - Be a buyer not a seller of branches and banks

Government's Return on TARP for 10 Banks Approved to Repay TARP

Amt Invested	Dividends	Warrant Value	ROI*
\$68.3 billion	\$2.24 bn	\$4.65 bn	10.1%
BB&T: \$3.1 bn	\$0.10 bn	\$0.53 bn	4.0%
AMEX: \$3.4 bn	\$0.09 bn	\$0.40 bn	14.2%

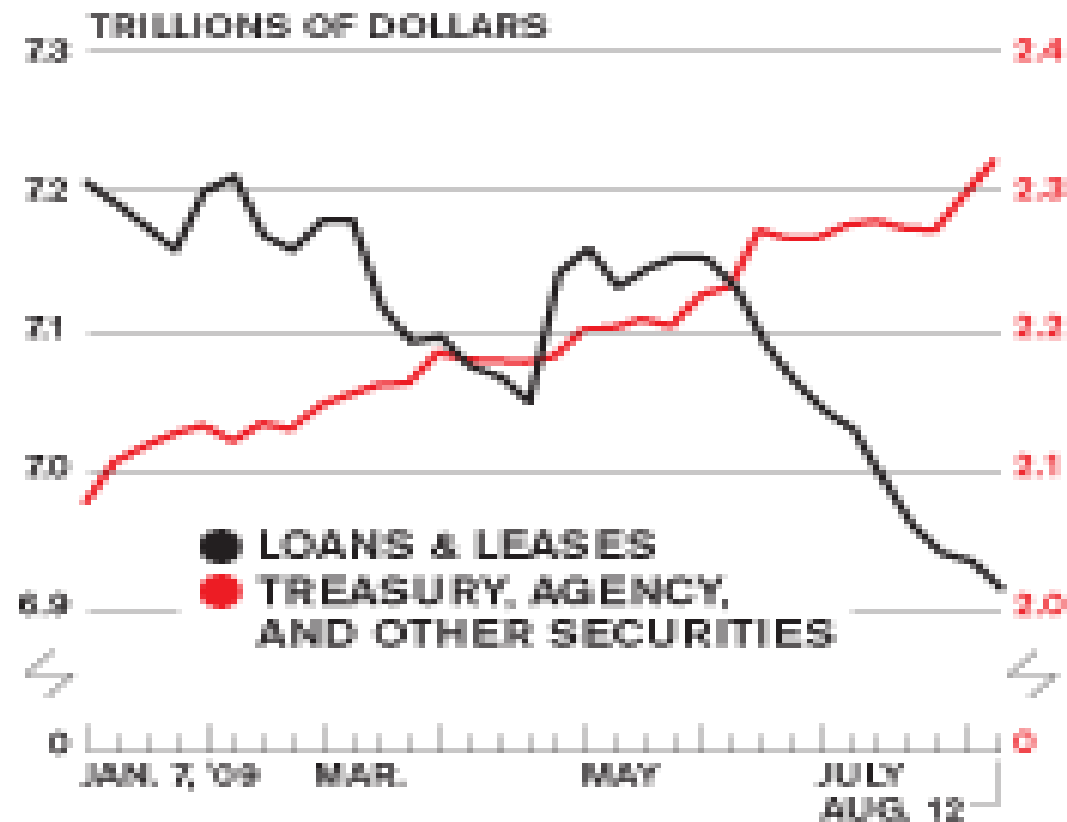
* Annualized: 17.8%, 7.3% and 36.2%, respectively, through
May 2009

Source: Hill-Townsend Capital, LLC, Gary Townsend

Are Banks Lending?

- In the aggregate, credit is less available.
 - The Shadow Banking system has closed down (The Originate-to-Distribute Model is broken such that securitizations have fallen sharply)
 - Many banks are cautious about lending due to uncertainty about asset quality, viability of commercial and real estate business, regulatory sanctions, and limited access to capital
- Everyone is de-leveraging (save more, reduce debt)

HOW BANKS ARE USING THEIR FUNDS



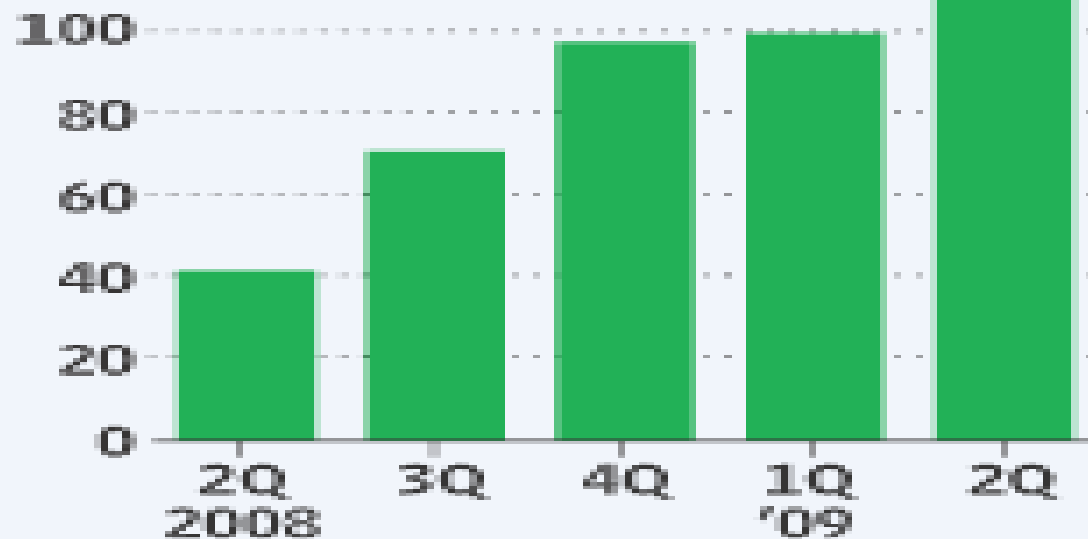
Data: Federal Reserve, IHS Global Insight

Cooper, James,
 "Neither
 Borrowers Nor
 Lenders Be,"
 Business Week,
 Sept. 7, 2009

Which Securities are Preferred?

Loading Up

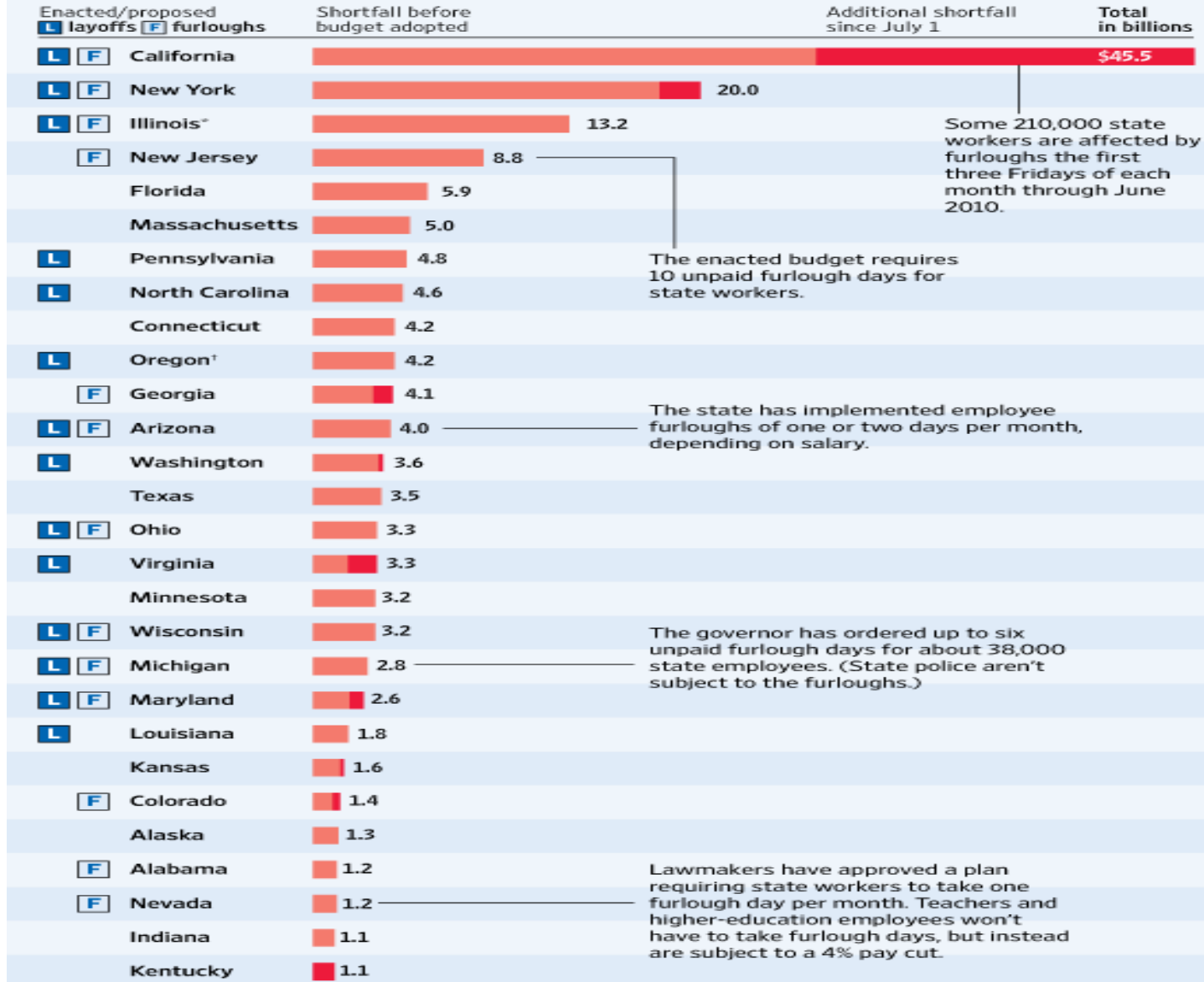
Total U.S. bank and thrift holdings of Ginnie Mae securities
\$120 billion



Source: WSJ analysis of Federal Deposit Insurance Corp. data

Enrich, "Banks Load Up on Mortgages, in New Way," WSJ, Sept. 10, 2009

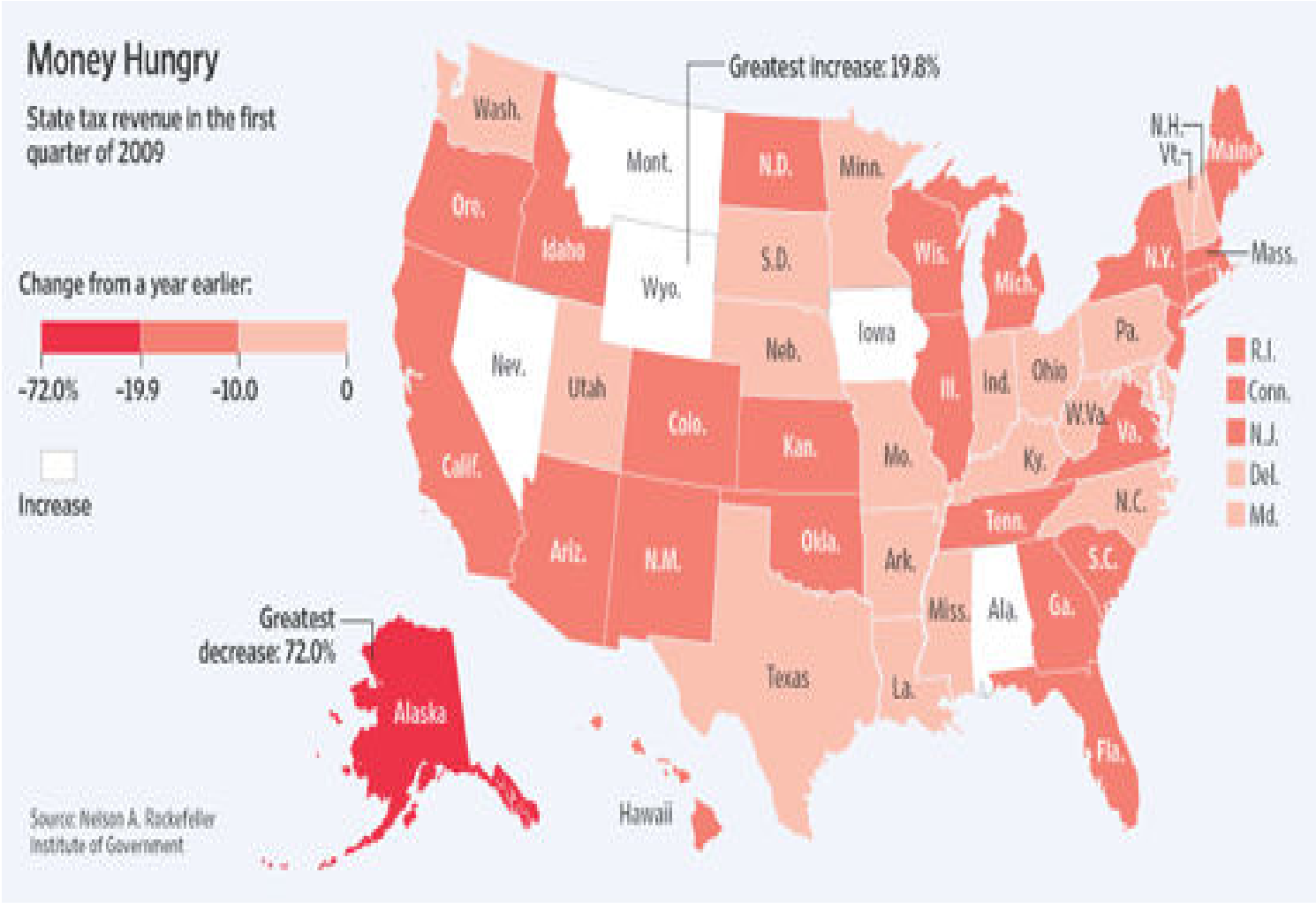
Tough Choices | States with budget gaps of more than \$1 billion



Note: All figures are for fiscal 2010, which started July 1 for most states; some or all of the pre-budget shortfalls have already been addressed. Pennsylvania, Arizona and Michigan haven't yet adopted 2010 budgets.
 *At least \$3.2 billion of the \$13.2 billion gap has not been closed †State has a two-year budget; the size of the projected shortfall is shown
 Sources: Center on Budget and Policy Priorities (budget gaps); National Conference of State Legislatures (layoffs/furloughs)

WSJ, Sept.
4, 09

Change in State Tax Revenue from 2008



Dougherty, Conor, "States and Towns Lean on Taxpayers," WSJ, Sept. 26, 2009

Do You Own Municipals?

What credit analysis do you do on the issuing states, local governments and their political subdivisions?

Recent Municipal Bond Defaults

- High for Community Development Districts which are quasi-government enterprises.
- Assess homeowners for the costs of housing related services (roads, sewers, utility lines, amenities, etc.)
- What happens when housing (new building) disappears?
- At least 109 CDDs in Florida have defaulted on \$2.8 billion in bonds issued from 2004 – 2008.

Source: Forbes, Oct. 5, 2009

How Do you Resolve TBTF?

- If bank cannot raise required capital, it is placed in conservatorship
- New management for any bank getting assistance
- Bank's debt to bondholders is converted into equity
- Eliminate dividends and stock buybacks
- All compensation contracts of existing management are declared null and void
- Include banks, insurance companies, finance companies, hedge funds

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