

## **Where Do We Go From Here?**

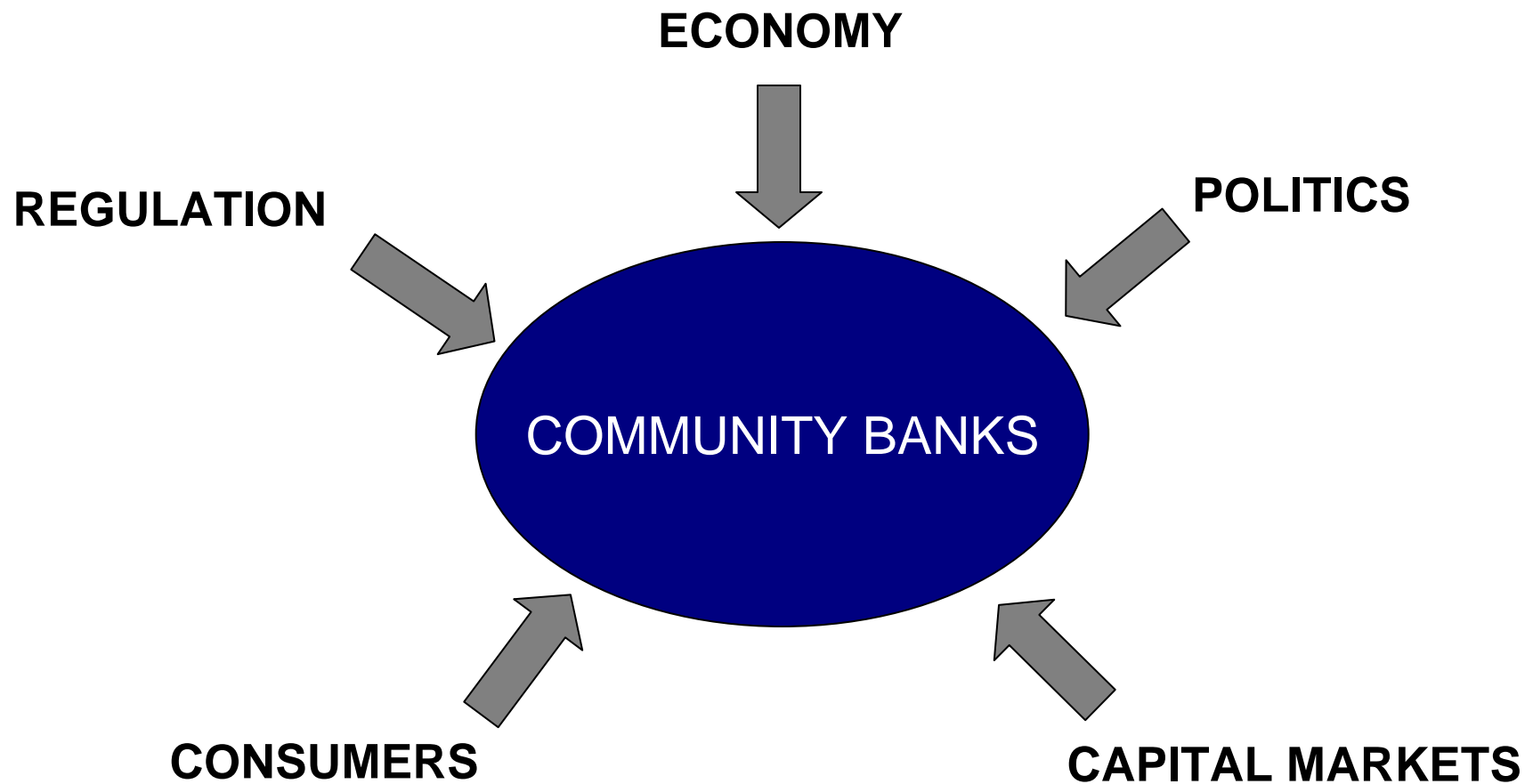
ABA National Conference for Community  
Bankers and Denovo Forum

Donald J. Musso  
**FinPro, Inc.**

February 21 – 24, 2010

## Community Banks are under siege . . .

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# ECONOMY



The FinPro primary economic indicators include:

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1. Employment and personal income
2. Real estate values and affordability
3. Credit availability and demand
4. Government borrowing and spending

To measure employment and personal income . . .

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***Primary Economic Indicators***

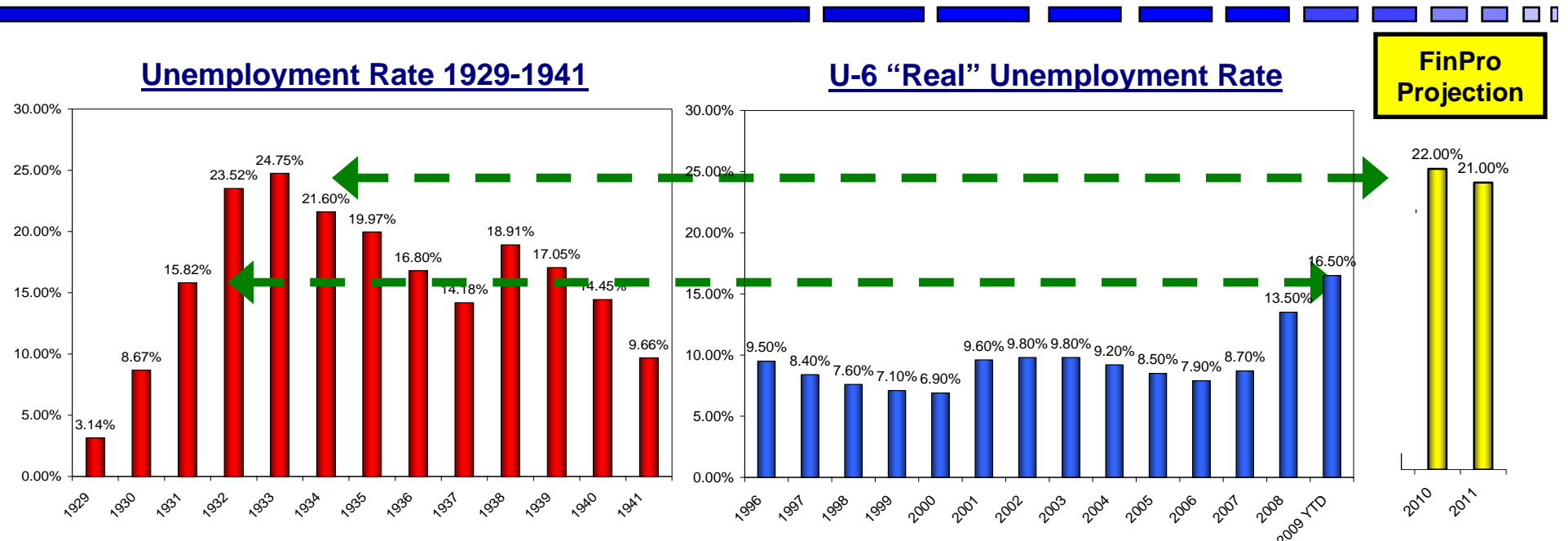
1. Employment and personal income
2. Real estate values and affordability
3. Credit availability and demand
4. Government borrowing and spending

***Key indicators:***

U-6 Unemployment; Median Duration of Unemployment

# 1. Employment and personal income

The current “true” unemployment rate and trend as measured by the U-6 definition of unemployment is close to mirroring unemployment in the Great Depression years . . .



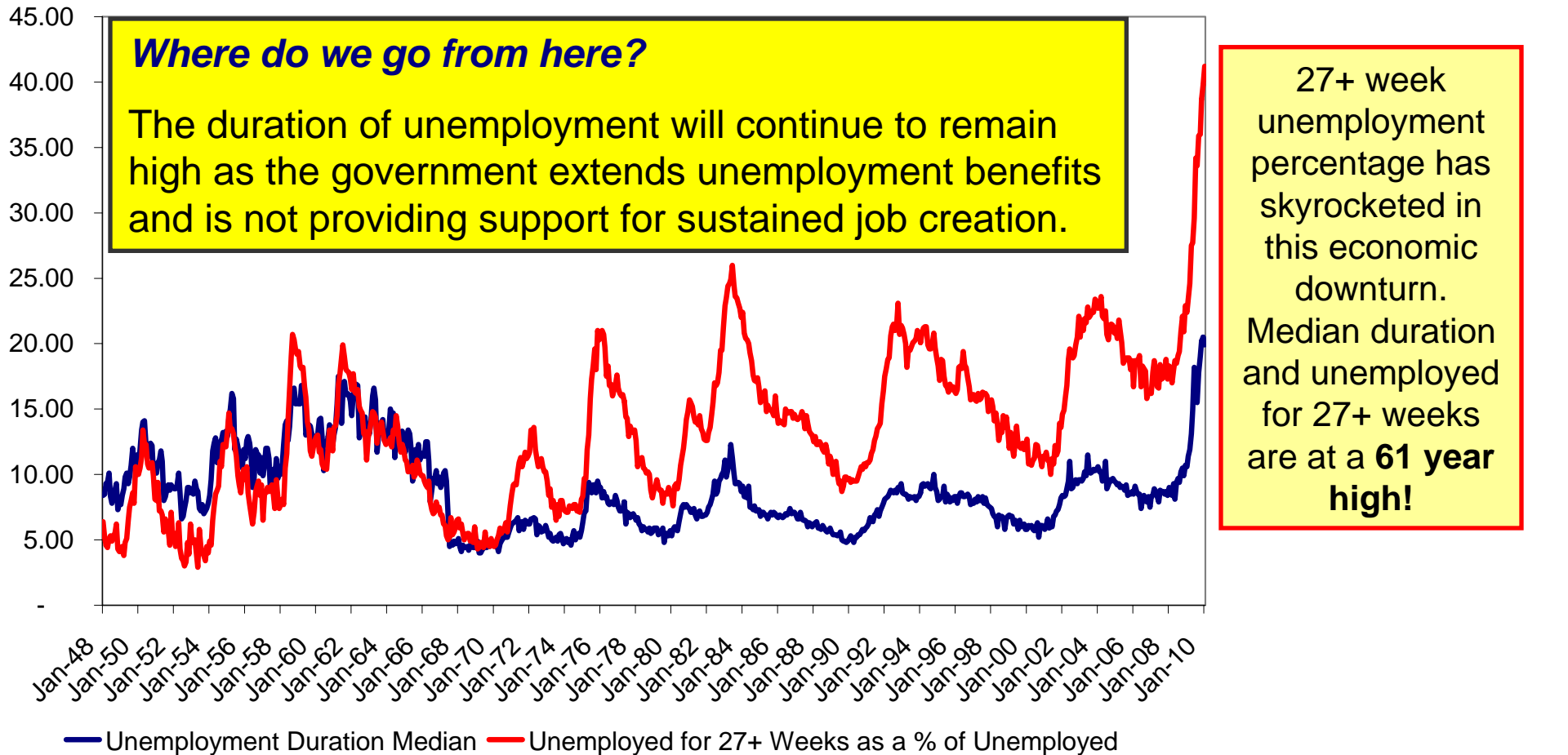
**FinPro  
Projection**

**Where do we go from here?**  
 Although we predict U-6 to peak in late 2010 and/or early 2011, we do not see where **sustained job creation** will come from. For example, bankrupt states will need to reduce headcount. We likely will have systemically high unemployment for a long time.

## 1. Employment and personal income

There is no indication that organizations have begun hiring again . . .

### Unemployment Duration Trends



To measure real estate values and affordability . . .

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***Primary Economic Indicators***

1. Employment and personal income
2. Real estate values and affordability
3. Credit availability and demand
4. Government borrowing and spending

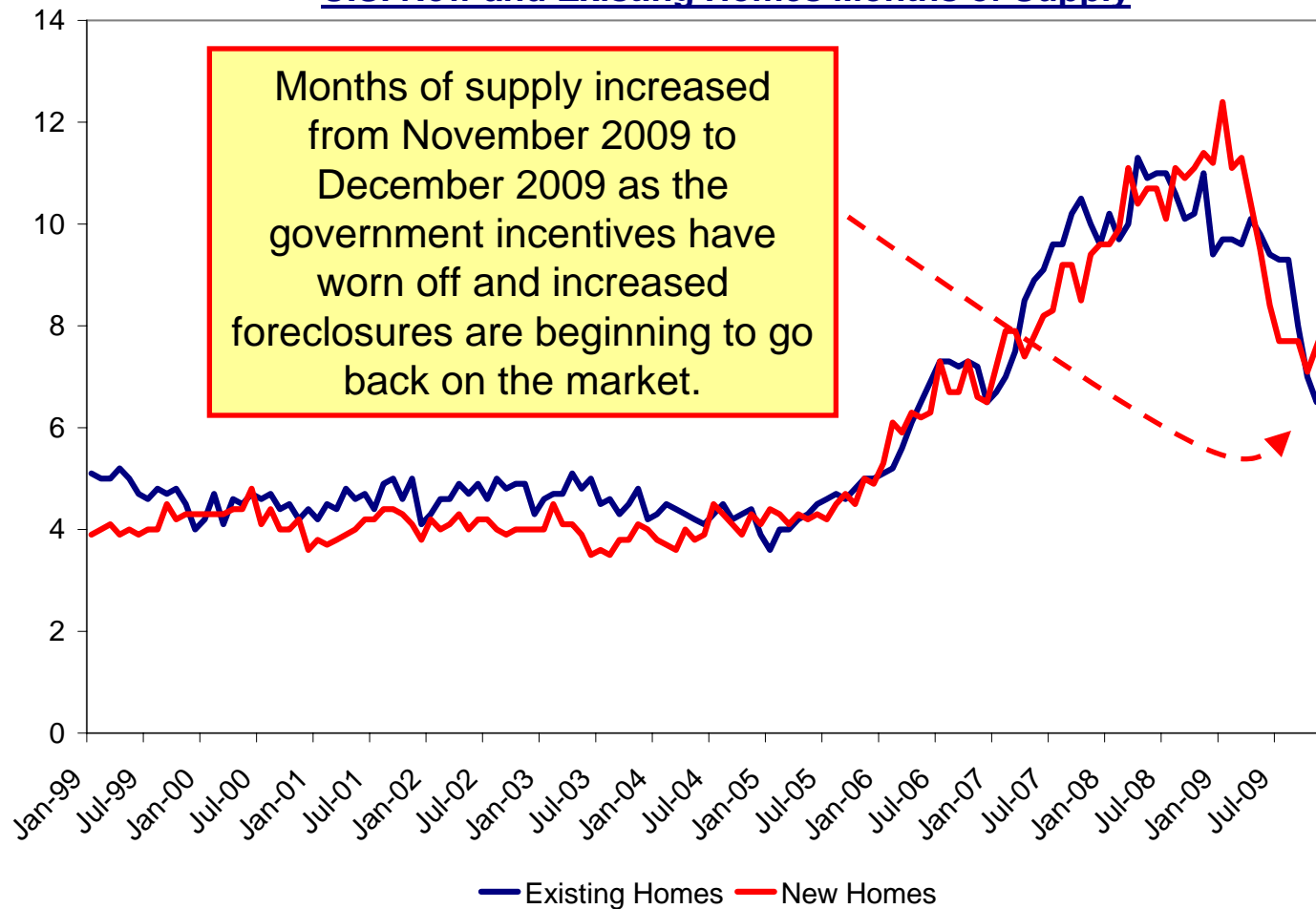
***Key indicators:***

Months of Housing Supply; Home Price to Median Income Ratio

## 2. Real estate values and affordability

The supply of homes remains well above the historical rate of 4-5 months . . .

**U.S. New and Existing Homes Months of Supply**



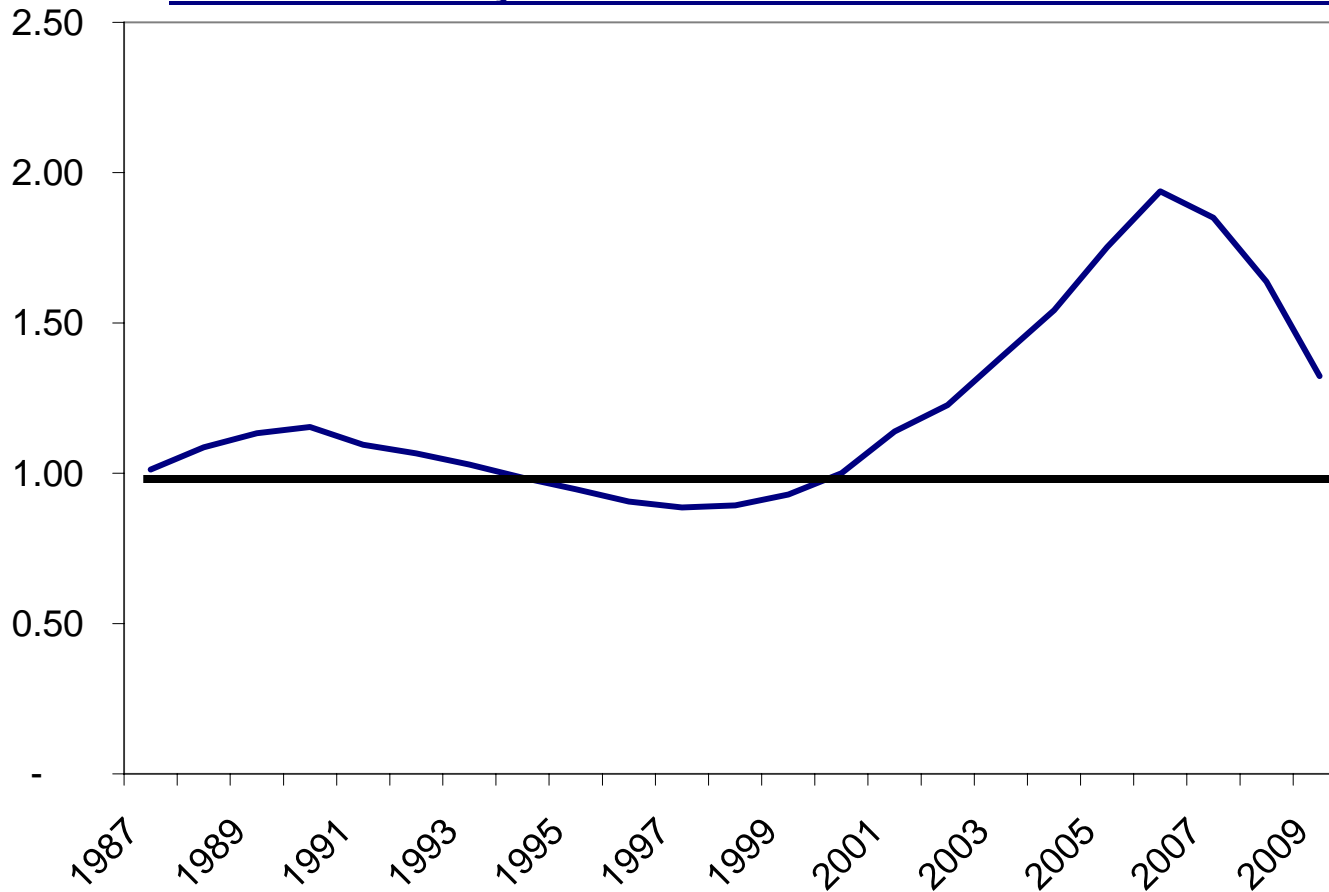
***Where do we go from here?***

Housing supply will remain high due to the continued foreclosures. The pace of new foreclosures hasn't abated and institutions are holding a record amount of OREO on the balance sheet and thus, off the market.

## 2. Real estate values and affordability

The home price to median income ratio is still well above the pre-2000 historical trend . . .

Case Shiller 10 City Home Price Index / Median Household Income



***Where do we go from here?***

Homes are still not affordable based on the most recent Case Shiller price survey. Prices should continue to fall until the price/income index level is inline with pre-2000 levels.

To measure credit availability and demand . . .

**Primary Economic Indicators**

1. Employment and personal income
2. Real estate values and affordability
3. Credit availability and demand
4. Government borrowing and spending

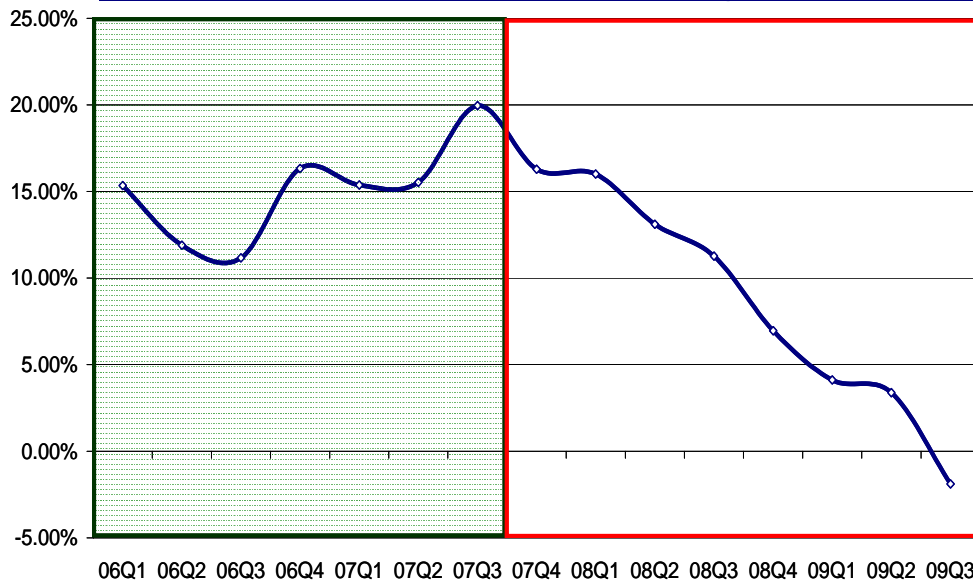
**Key indicator:**

Outstanding loans at U.S. banks;  
consumer debt to income ratio

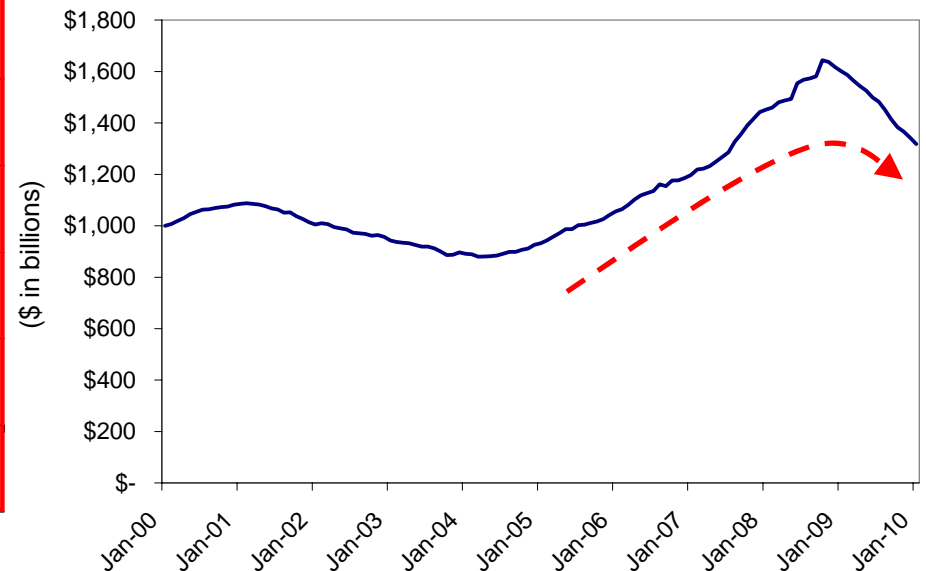
### 3. Credit availability and demand

Loan growth at U.S. banks has declined since 2007 led by the decline in real estate values . . .

#### Growth in Gross Loans Outstanding at U.S. Banks



#### Commercial and Industrial Loans at U.S. Banks

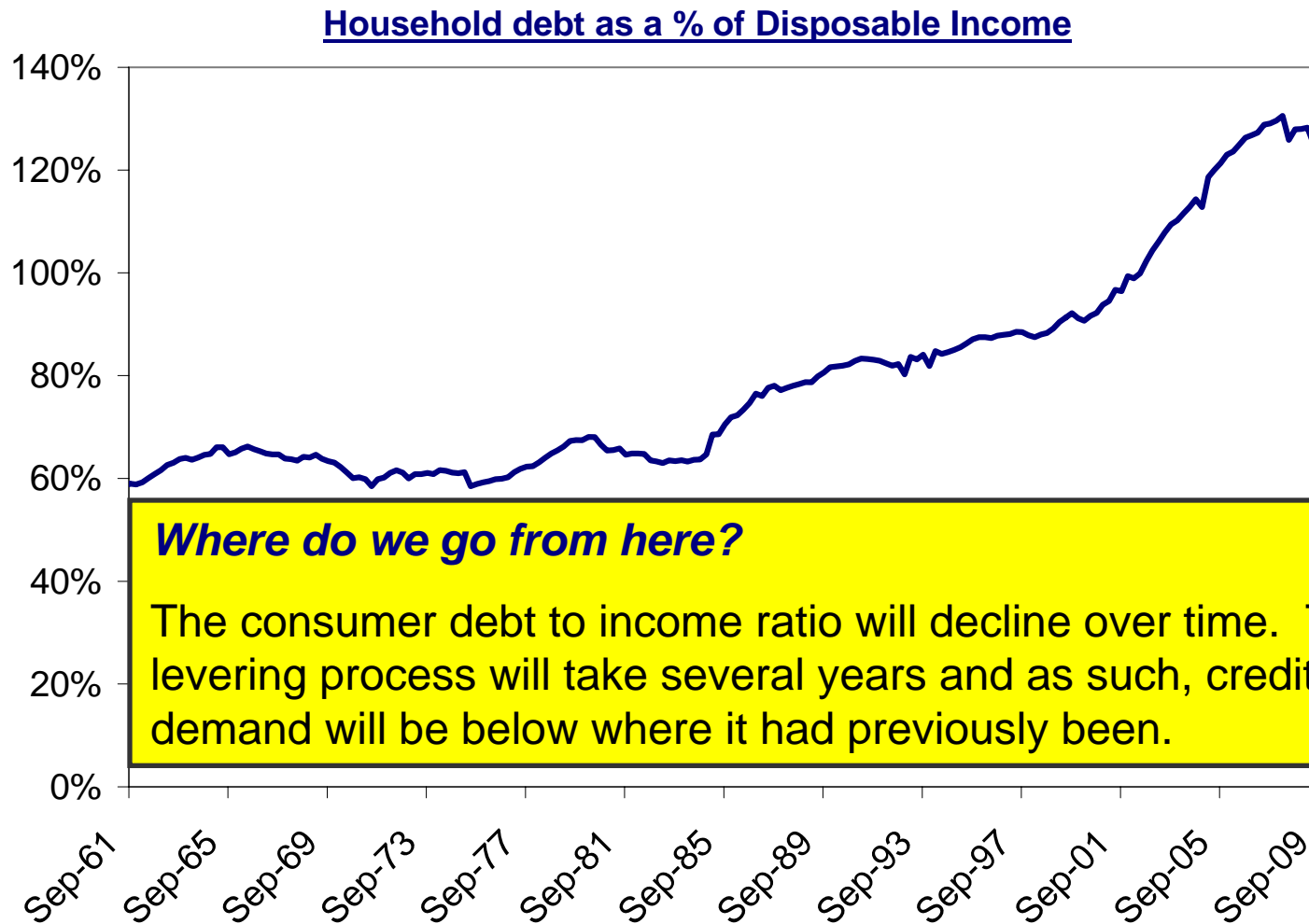


#### *Where do we go from here?*

Loan growth will continue to decline as consumers and businesses are **demanding less** credit and as financial institutions face many financial, regulatory and political obstacles that are **inhibiting their willingness and ability** to lend.

### 3. Credit availability and demand

Consumers are accumulating less debt. The debt to income ratio has peaked at 131% . . .



#### ***Where do we go from here?***

The consumer debt to income ratio will decline over time. The de-levering process will take several years and as such, credit demand will be below where it had previously been.

To measure government borrowings and spending . . .

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***Primary Economic Indicators***

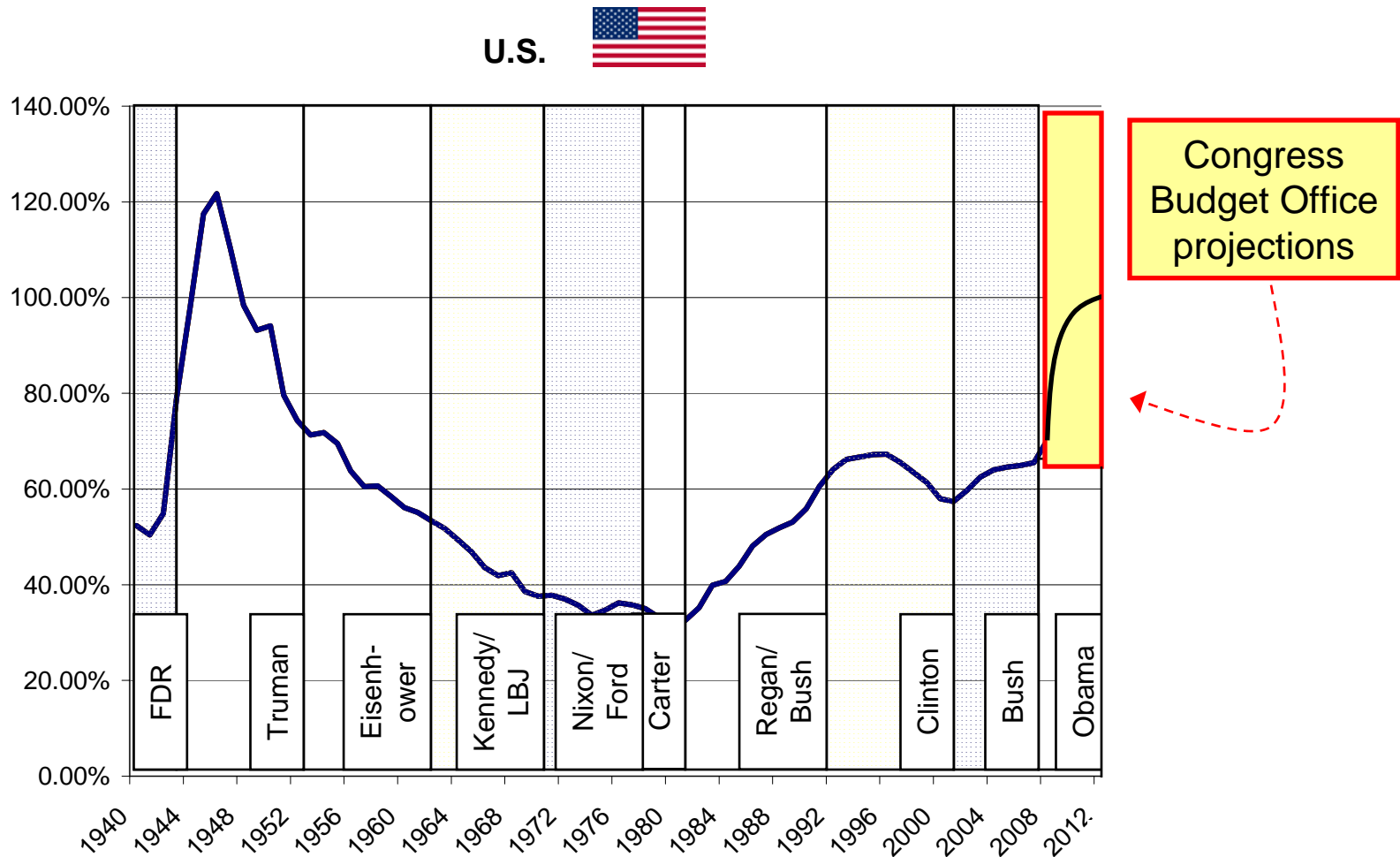
1. Employment and personal income
2. Real estate values and affordability
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***Key indicators:***

U.S. debt to GDP ratio; 10 year U.S. Treasury bond yield

## 4. Government spending and borrowing

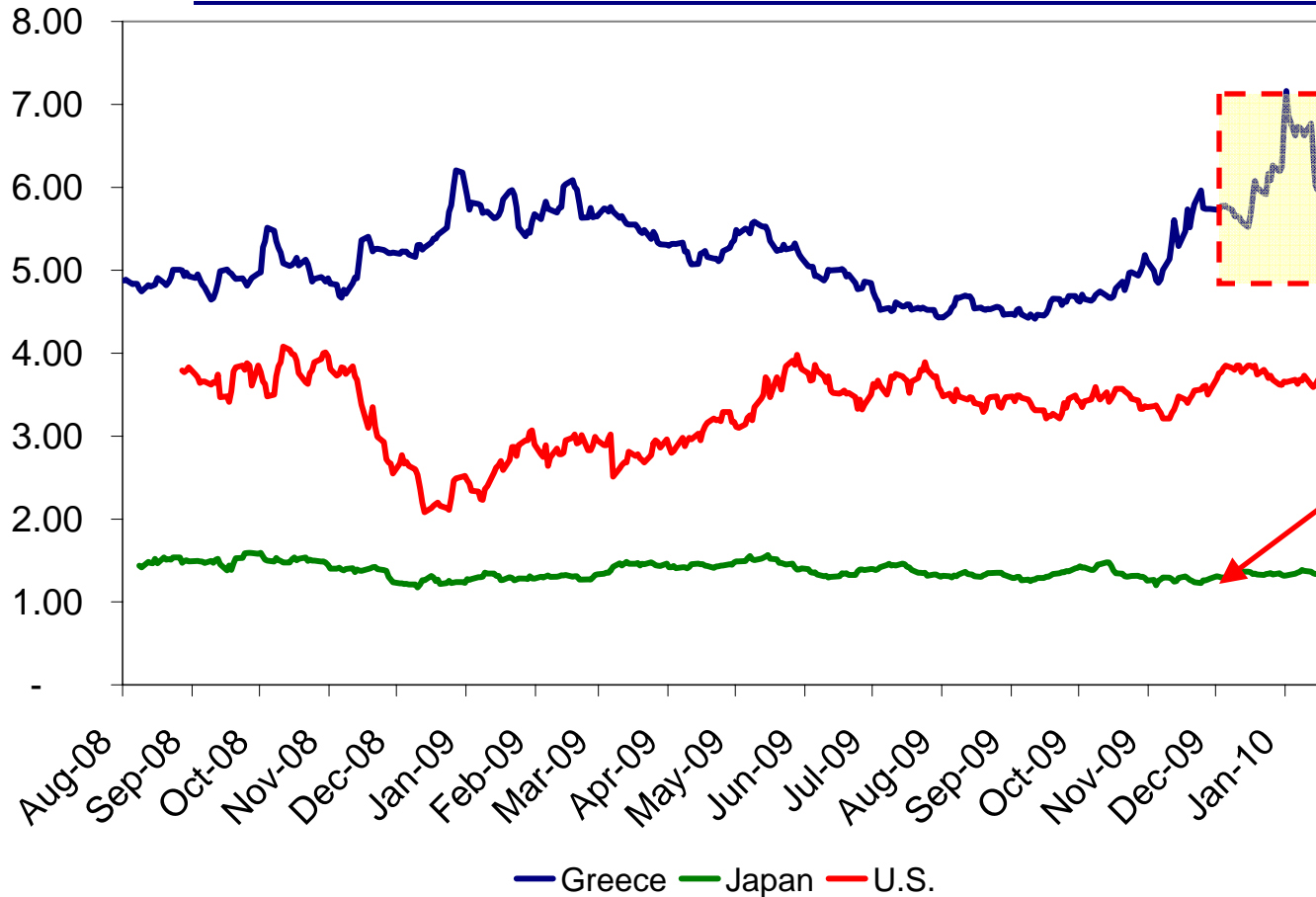
The projected Gross Debt to GDP ratio could be back at levels not seen since World War II . . .



#### 4. Government spending and borrowing

The ten year government bond rate directly effects many financial products. The rate on the ten year is a primary indicator of where economies are heading . . .

**10 Year Government Bond Yield Trends – October 2008 - Present**



Greece has been plagued by fears of default. Who's next?

Reflective of Japan's deflation.

**Where do we go from here?**  
The 10 year rate will measure the economic indicators for each country.

The government has been trying to enact policies that through monstrous levels of spending are directly inhibiting the country's economic recovery. As a result, the government and economy are on a collision course . . .



## ECONOMY



A weak economy should drive rates down. The slow moving train will impact rates in long term.

## GOVERNMENT

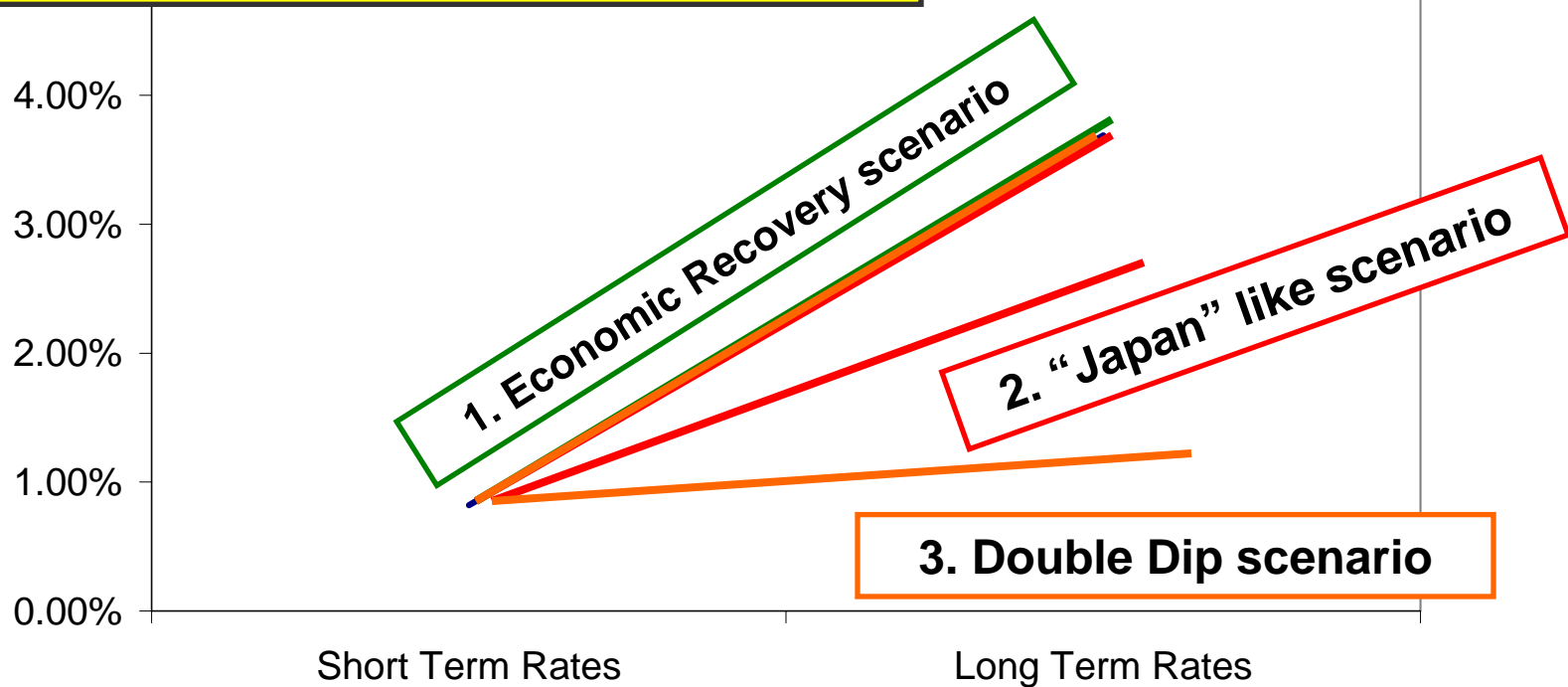


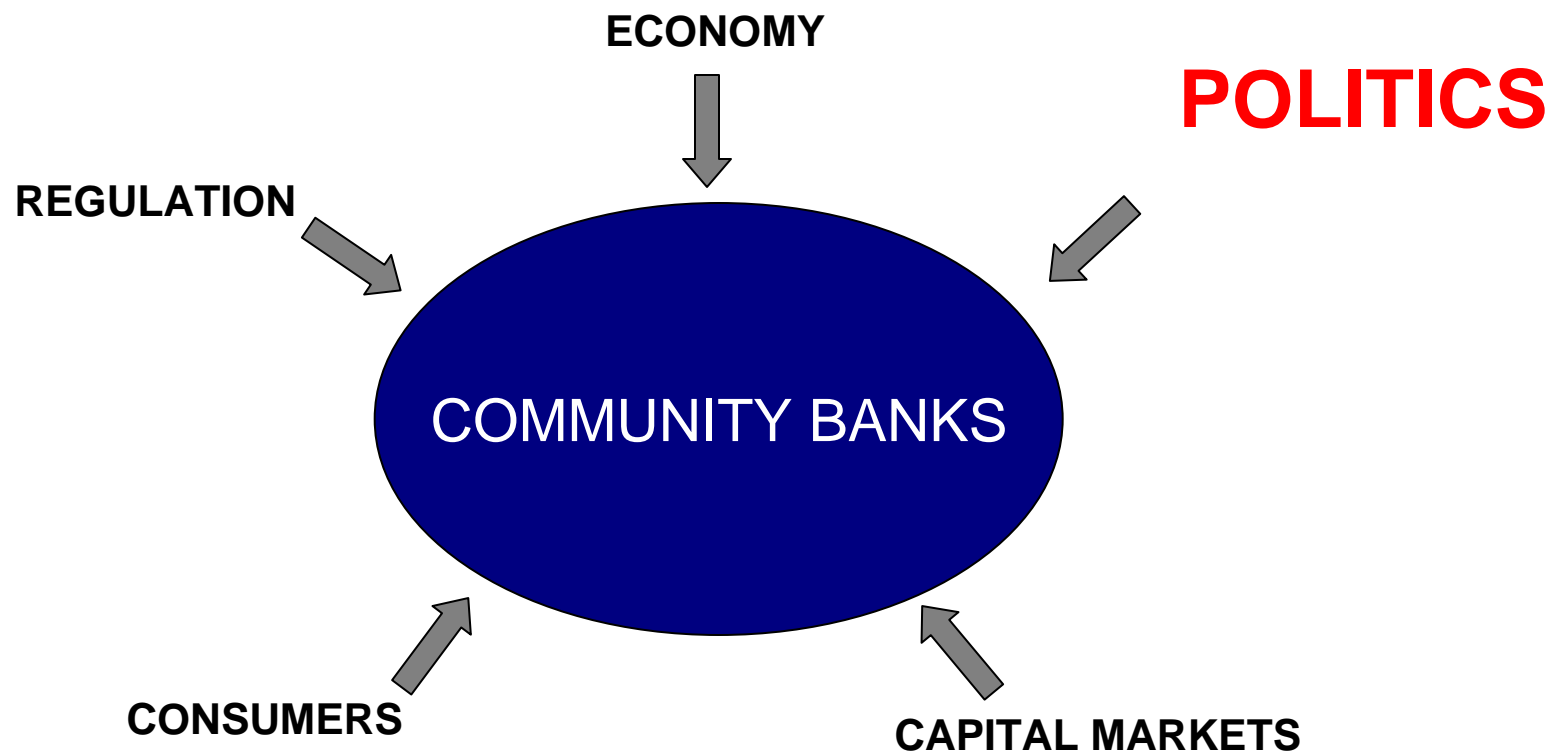
Out-of-control spending should drive rates up. The fast moving train will impact rates in short term.

All of the economic indicators will lead us to one of three rate scenarios . . .

**Where do we go from here?**

Banks need to plan and compile ALM analytics assuming multiple rate environments. Banks should also review IRR guidelines issued 1/6/2010.





As many of the major reform policies of the current administration face possible defeat, the issue of financial institution regulatory reform will move to the forefront . . .

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### ***For the Obama Administration:***

- If Cap and trade dies;
- And Healthcare now faces a major re-write at best, outright defeat at worst;
- Then, regulatory reform will become a focal point as the administration needs a victory. The reform:
  - Will go after large banks and “Too big too fail”.
  - Will press on consumer protection issues.
  - Will demonize need for government bailout.
  - Will push TARP 2.0 to foster more lending.

Even though  
given the g

#### ***Where do we go from here?***

The battle between the government and private sector over who should create jobs will dictate the level and timing of economic recovery.



In addition to regulatory reform, the administration and Treasury are advocating TARP 2.0 . . .

- The public perception (reality?) of TARP 1.0 was that it was a bailout and thus those who had it were weak.
- The government's desire to continuously impose additional measures on institutions that accepted TARP 1.0 lead to the expedited repayment of TARP funds by many of the institutions involved.
- The second offering of TARP capital will primarily be offered to institutions under \$1.0 billion in total assets.

***Where do we go from here?***

Unless the government eliminates the problems that caused TARP 1.0 to be repaid quickly, TARP 2.0 will never be accepted by the banks. It's not the rate, it's the terms!

2.0, the administration failed to address the key prohibitive issue – **the ability to alter the terms of the contract at their discretion.**

In addition to the current political environment, the FASB proposal to force mark-to-market of the entire balance sheet would have significant adverse consequences on the community banking industry . . .

- FASB 5 and 114 have wreaked havoc on the ALLL front – everyone is struggling with the new benchmarks caused by this change.
- FASB 141R has wreaked havoc on the M&A market and has changed the financial performance materially.
- Stock option accounting is still a farce.
- Transparency? Yeah Right!
- And now FASB wants total balance sheet mark-to-market. I want whatever it is that they are smoking.

***Where do we go from here?***

We all understood the ALLL methodology that was created over the past 10 years. Does anyone really get the new one? Let's put non accountants on the FASB Board to avoid continuation of self-perpetuating rules.

A populist movement has encapsulated the angst and resentment of working class America towards the country's politicians . . .

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- The elections in Virginia and New Jersey gubernatorial races as well as the Massachusetts senate race reflects an anti-incumbent attitude.
  - The movement supports a fiscally conservative policy.
  - The movement continues to grow in strength as it rejects the inability of incumbent, career politicians to effectively address the needs of their constituents.

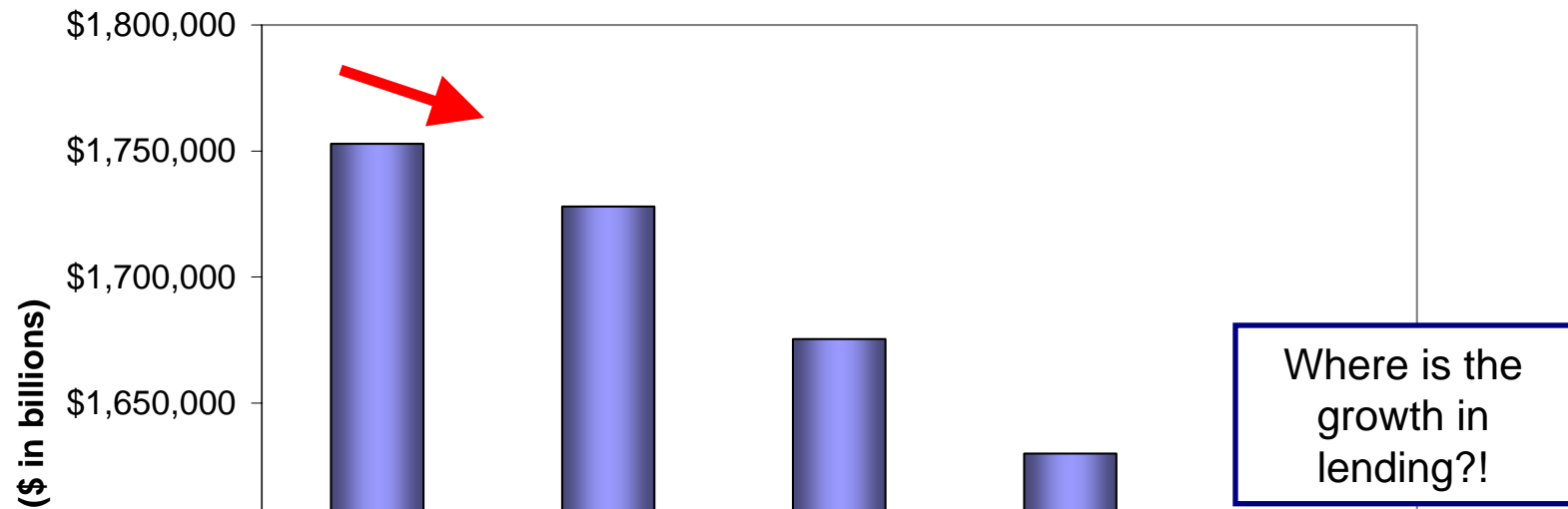
***Where do we go from here?***

Let's bet on the people, not the parties. The parties will not go down without a fight however.

Senator Bayh has it right – Washington is too political to be effective.

Outstanding loans at the 22 largest TARP participants has declined significantly since 2008 . . .

### Outstanding Loans at 22 Largest TARP Participants

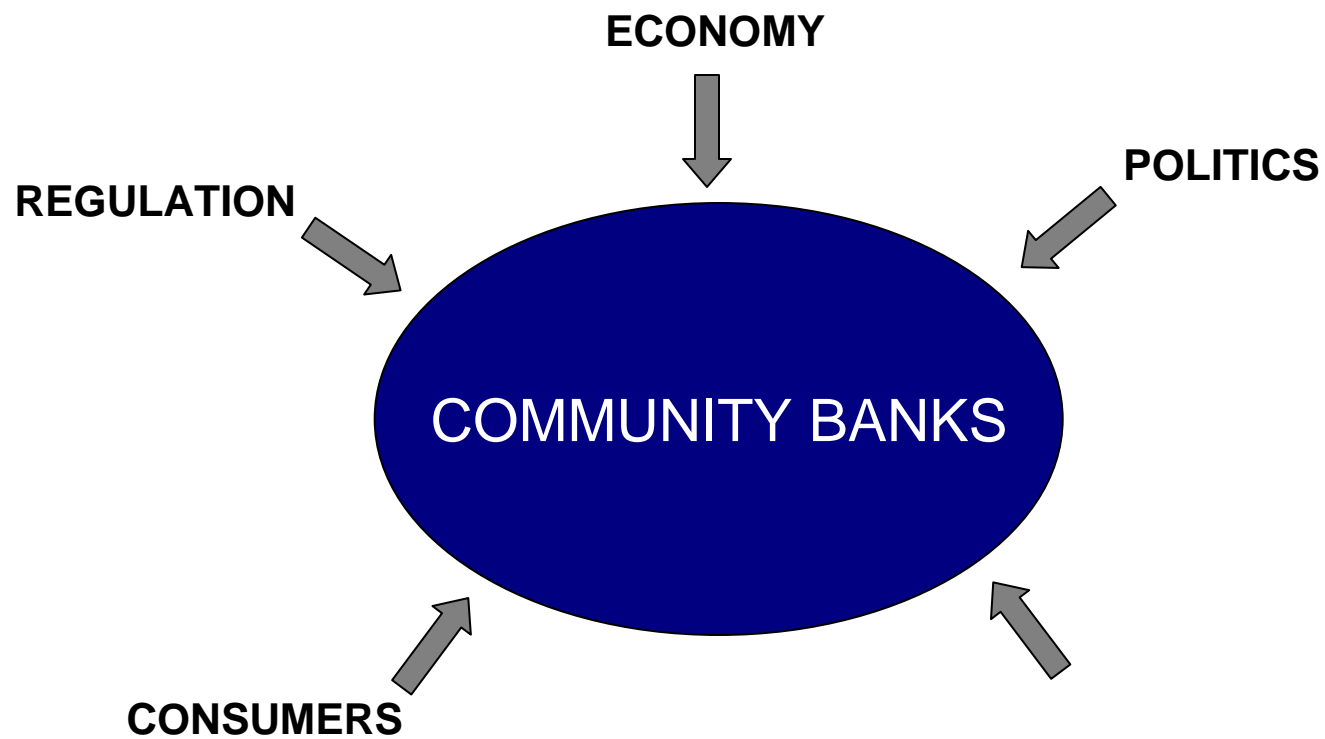


#### *Where do we go from here?*

TARP 1.0 obviously did not spur lending. It simply shored up weak capital levels **at big banks**. We do not need TARP 2.0, we have sufficient capital under the current guidelines to support loan growth. This would cost the government nothing.

Meanwhile, most community banks did not accept government money . . .



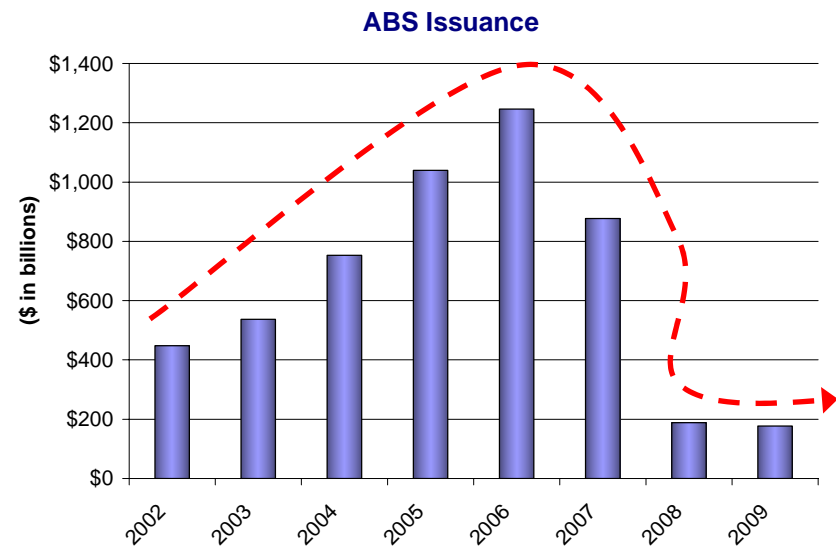
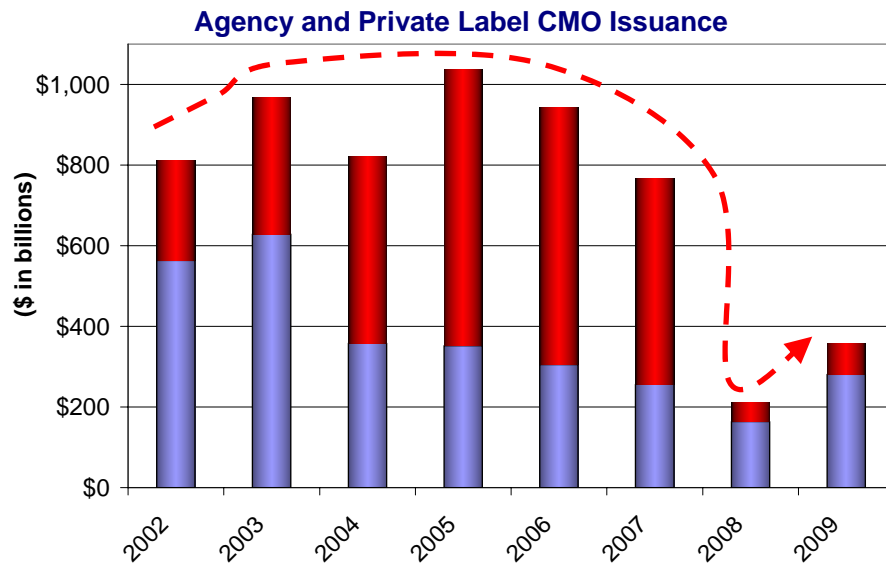


## **CAPITAL MARKETS**

Agency mortgage backed security (MBS) issuance has been volatile . . .



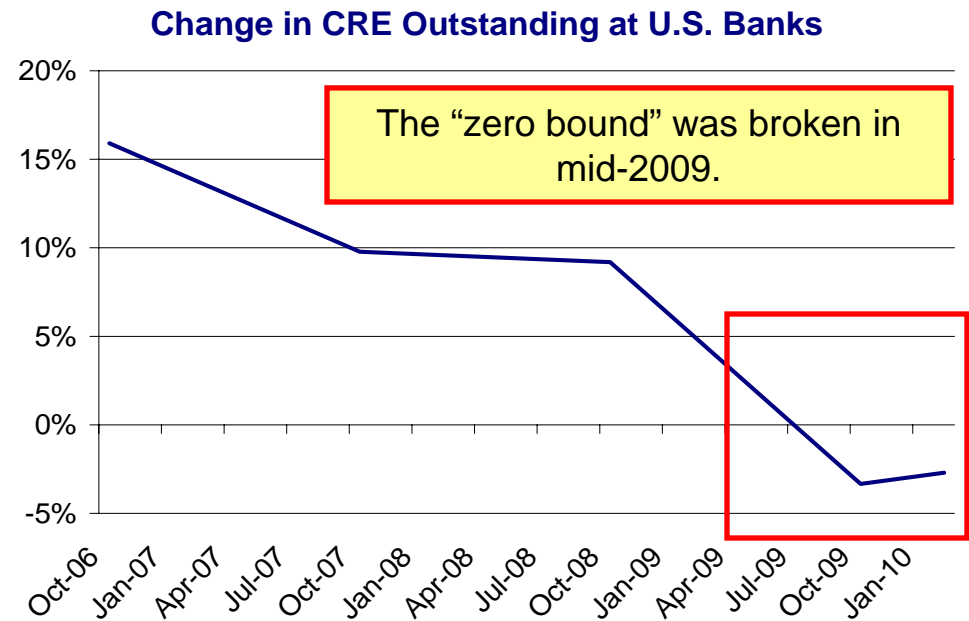
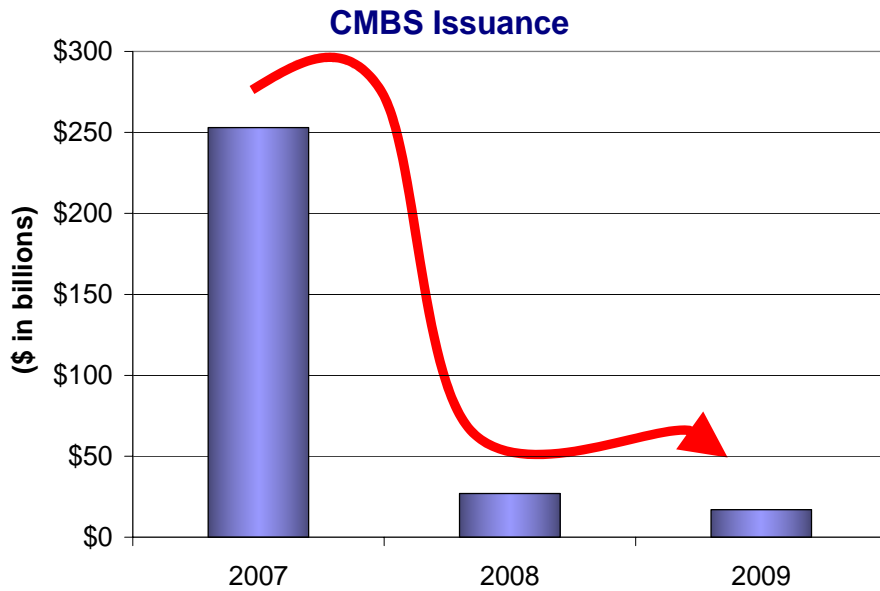
## Secondary markets for private label CMOs and ABS have also declined . . .



### ***Where do we go from here?***

The absence of the secondary markets has a diminishing effect on bank liquidity.

Without active secondary markets, CRE borrowers won't be able to refinance or take out new mortgages . . .



***Where do we go from here?***

There are an estimated \$400 billion of CRE loans maturing or refinancing in the next 3 years. The regulatory agencies “bright line in the sand approach” toward application of FFIEC CRE guidelines has exacerbated the ability to finance commercial real estate.

The proposed regulations for banks to keep up to 10% of the loans they sell on the balance sheet is shortsighted . . .

(000's)	Current rules	Proposed rules
Loans originated by the bank:	\$ 25,000	\$ 25,000
Loans securitized and sold:	25,000	22,500
Gain on sale (1% of loans sold, 40% tax impacted):	150	135

*Less income due to more loans being held on the balance sheet.*

**Capital and lending impact:**

Total assets before sale:	\$ 500,000	\$ 500,000
less sale of loans:	25,000	22,500
<b>Pro forma total assets</b>	<b>475,000</b>	<b>477,500</b>
Existing capital:	\$ 47,500	\$ 47,500
+ gain on sale	150	135
<b>Pro forma total capital</b>	<b>47,650</b>	<b>47,635</b>

*The proposed rules would result in greater pro forma total assets and lower pro forma*

***Where do we go from here?***

Another brilliant idea. This policy will restrict banks' ability to lend and will decrease fee income. The whole reason we sell the loans is to eliminate the risk.

## The market for capital raising is challenging . . .

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- 10% is the new 8%. Risk based capital targets are now 12%.
- Regulators prefer common equity to interest bearing capital.
- Trust preferred and preferred instruments are costly and will be a limited part of the core capital structure going forward.
- Capital for the large, “too big to fail” institutions has increased since the beginning of 2009, but many community banks are still finding capital raising difficult.

### ***Where do we go from here?***

To limit the type of capital is simply another way to prevent capital from entering the system.

Banks should compile detailed capital plans, even if they don't need capital today. The types and sources of capital are constantly changing and need continual observation.

The Federal Reserve balance sheet illustrates the changing role of the Fed . . .

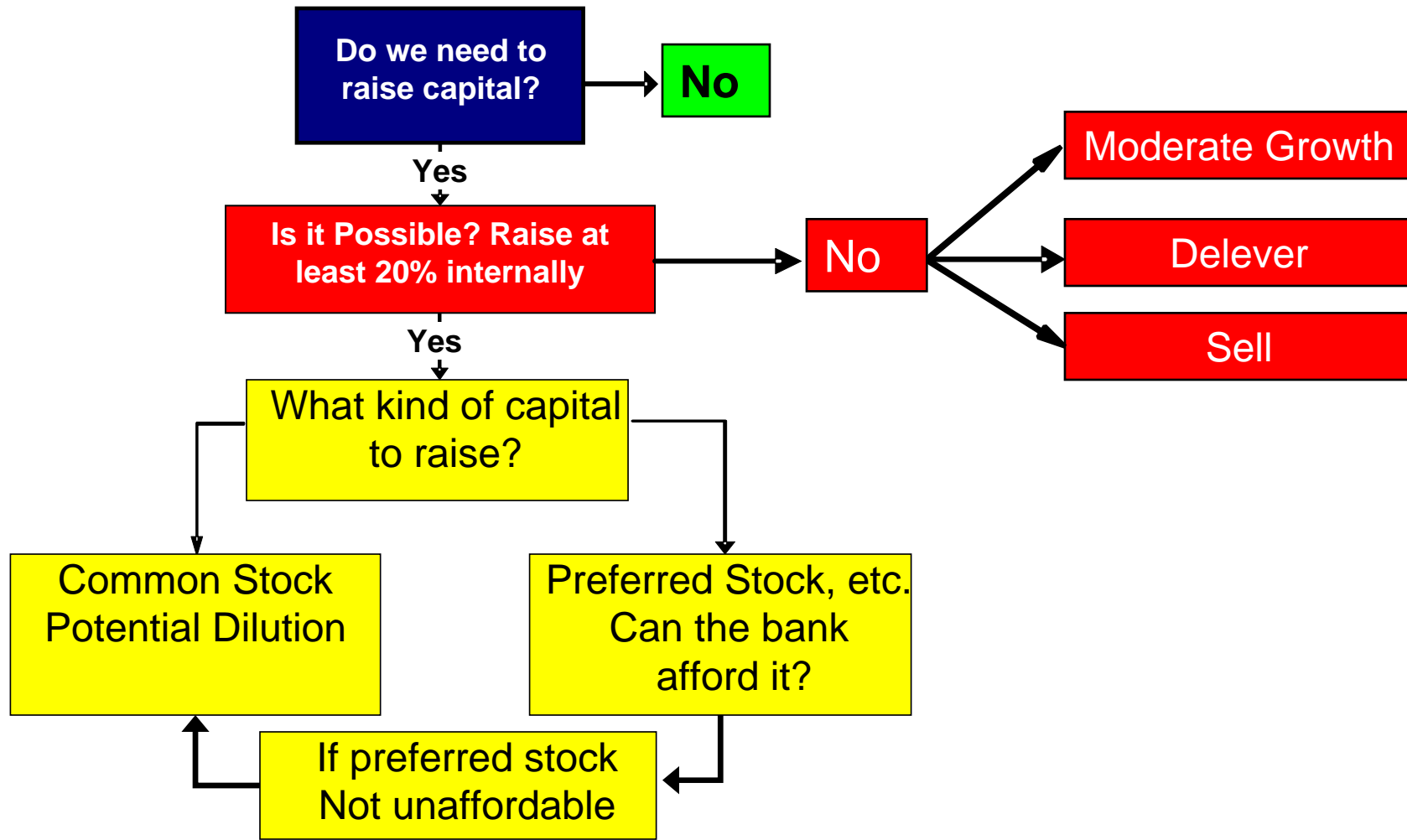
## Federal Reserve Balance Sheet (\$000) As of 2/10/2010

Total Assets	\$	2,259,949
Traditional <sup>(1)</sup>		17,868
TAF		38,531
Term Asset-Backed Sec Lending		46,403
AIG		90,538
Currency swaps		100
Mortgage-backed securities		976,865
Federal agency debt		941,540
Other		148,104

***Where do we go from here?***

This will depend on where regulatory reform goes.

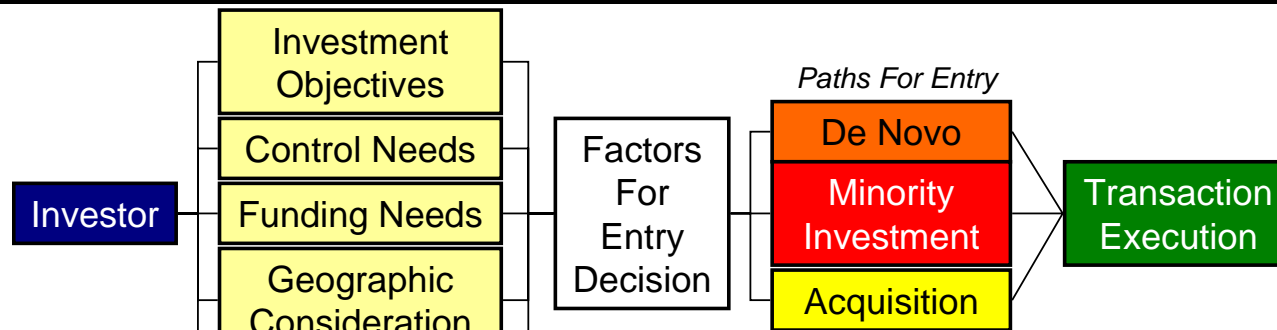
Community banks must compile a detailed capital plan. A sample Decision Matrix to utilize as a guideline looks like . . .



Regulators have limited private equity investment into the banking industry . . .

- The major completed deals so far were structured as either wealthy individual or transactions where multiple PE firms form a Bank Holding Company, but keep their individual ownership interests low enough to avoid the individual fund or person from becoming a Bank Holding Company.

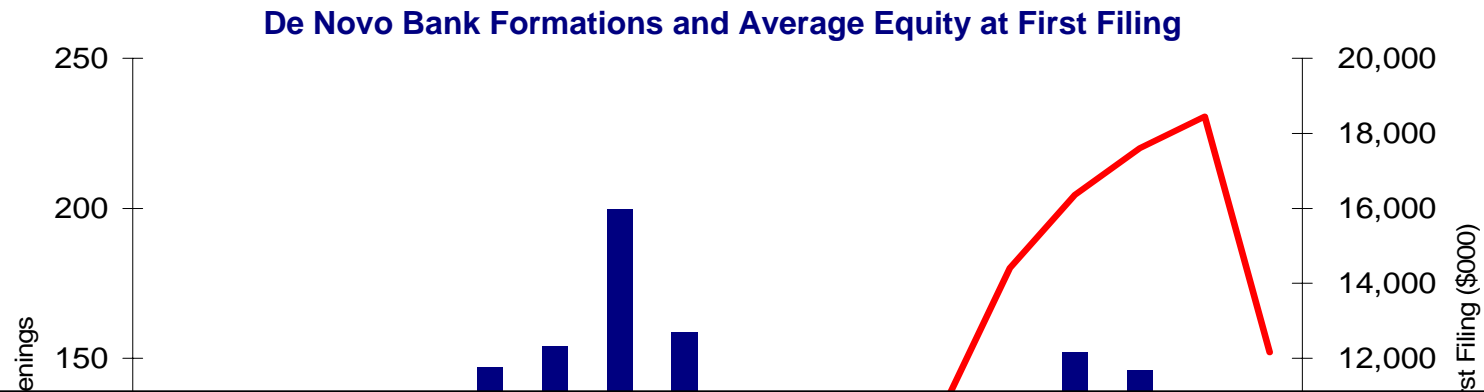
### FinPro's Decision Process for Investment In Financial Institutions



***Where do we go from here?***

We should be encouraging new capital not discouraging it. We should welcome Private Equity, let's stop putting obstacles in their way.

Although there is not an official moratorium on de novo institution applications, there have not been many approved recently . . .

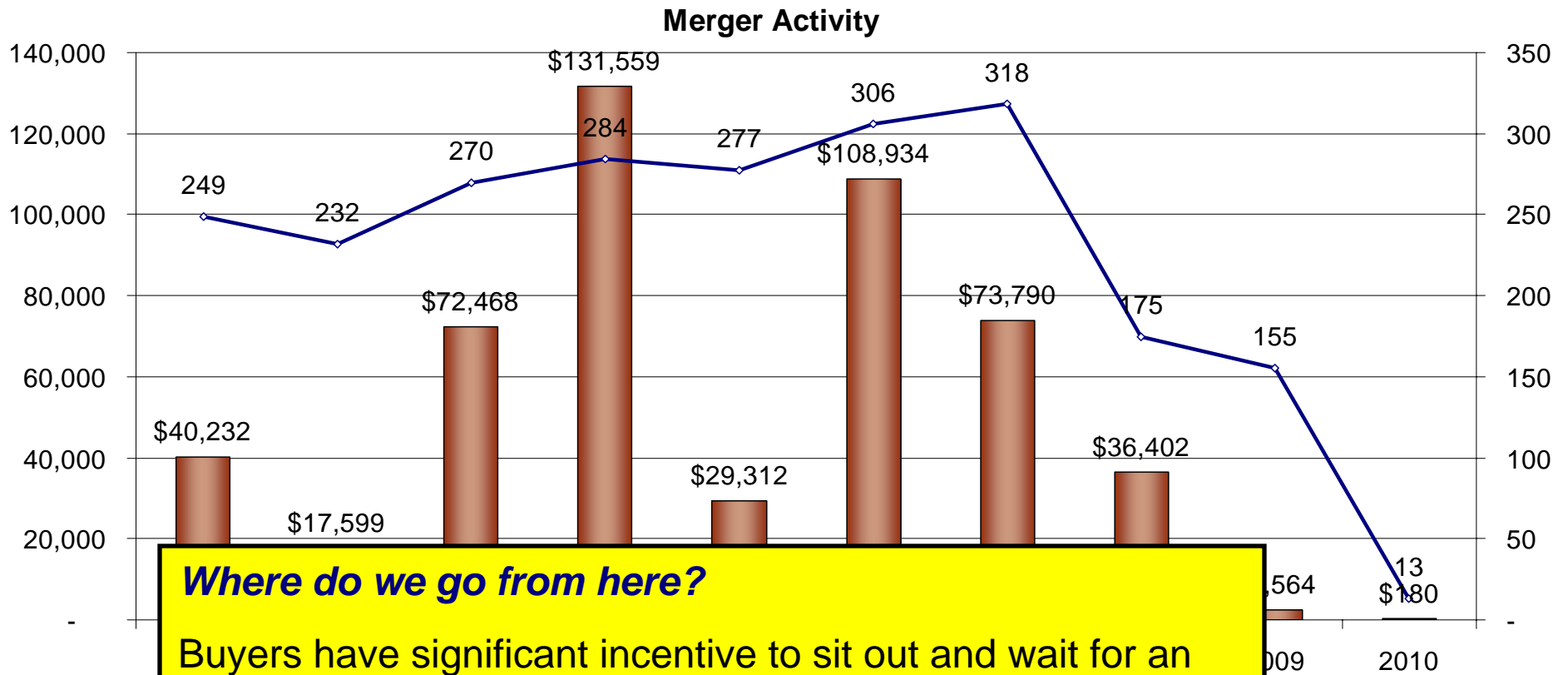


***Where do we go from here?***

FinPro is currently assisting several de novo groups in various stages of the application process. We believe a strong management team and business plan in an acceptable geographic area will still have the ability to get approved. However, if the de novo group is located in an economically depressed area, the group should explore other strategic paths to gaining a charter. We have several groups in areas around the country that have begun to look at closed and troubled bank transactions as the primary way to acquire a banking charter.

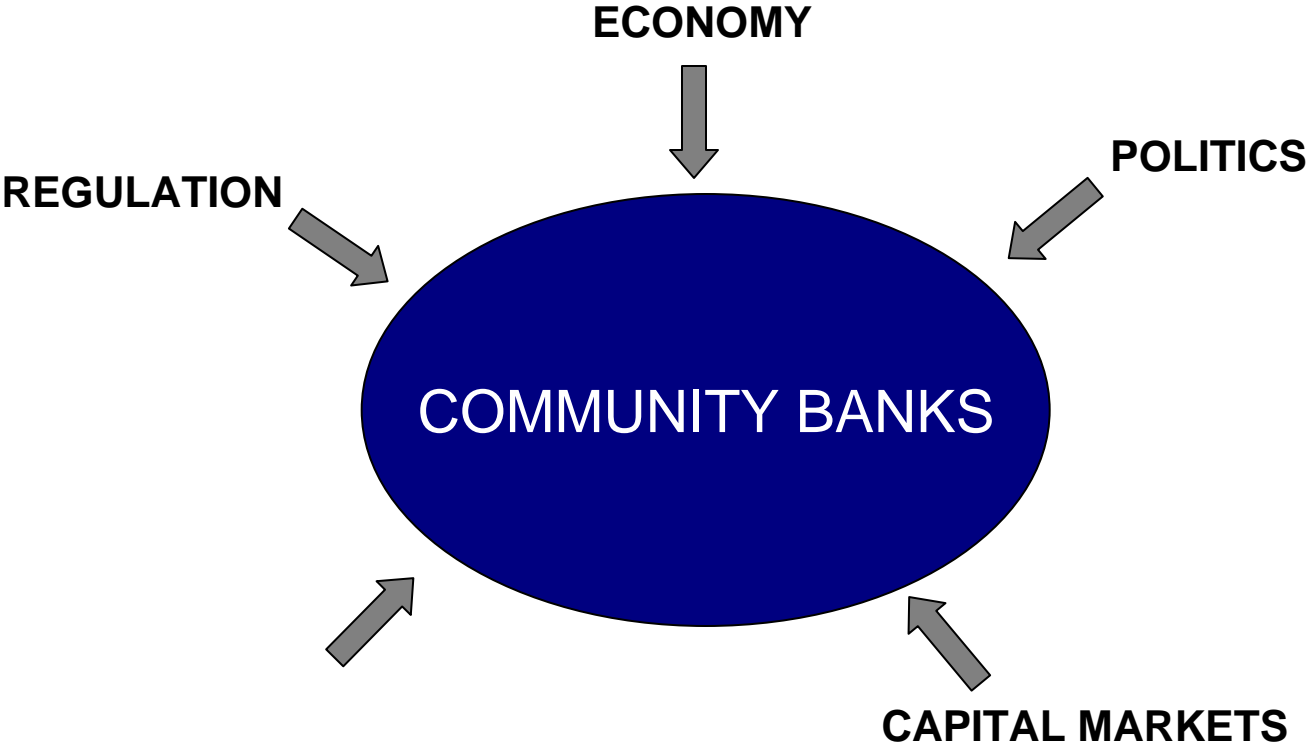
■ Total Openings    — Average Equity at First Filing

# Merger activity in 2009 hit its lowest point in nearly a decade . . .



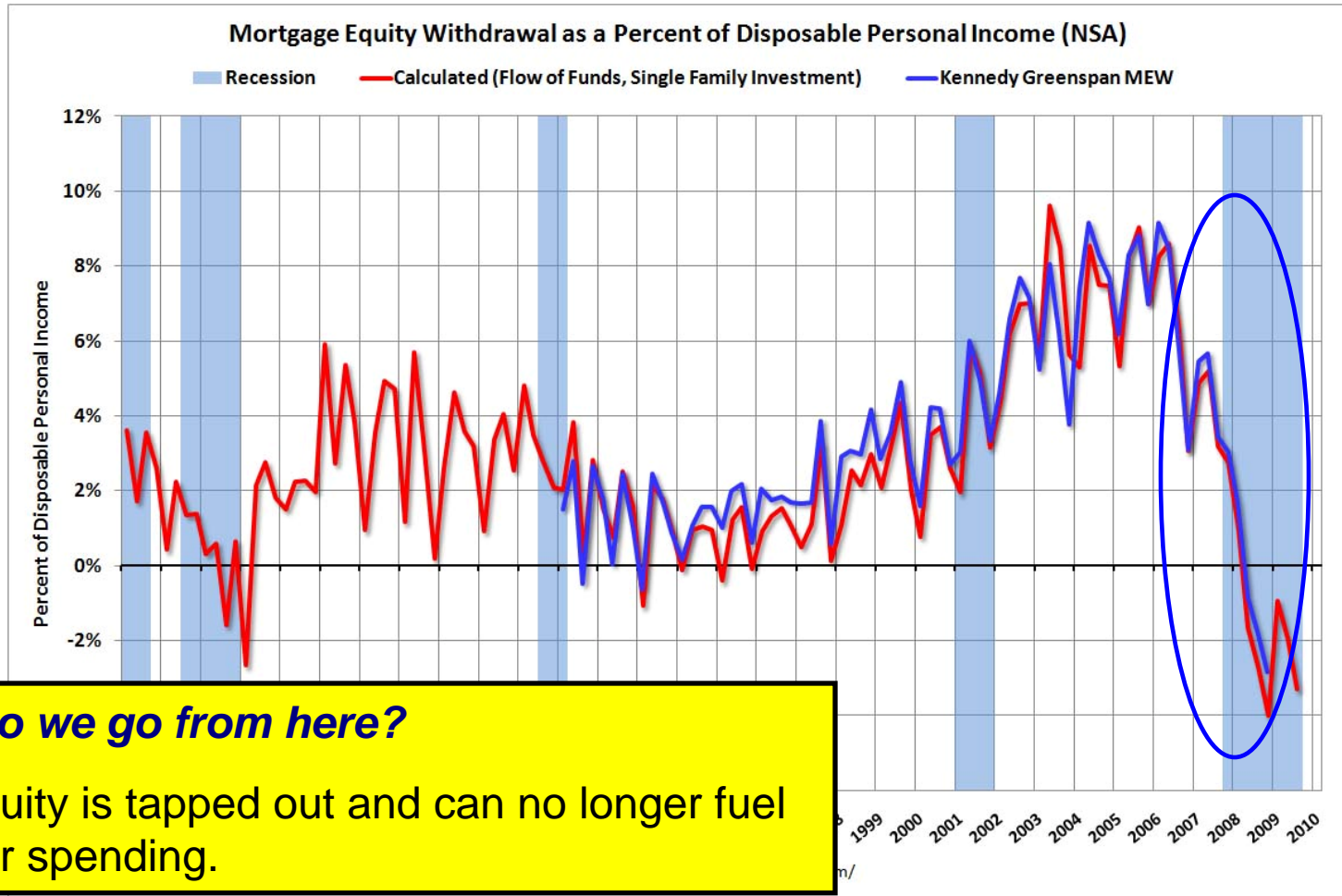
***Where do we go from here?***

Buyers have significant incentive to sit out and wait for an FDIC-assisted transaction scenario to occur. The return of multiples may be two to three years away.



**CONSUMERS**

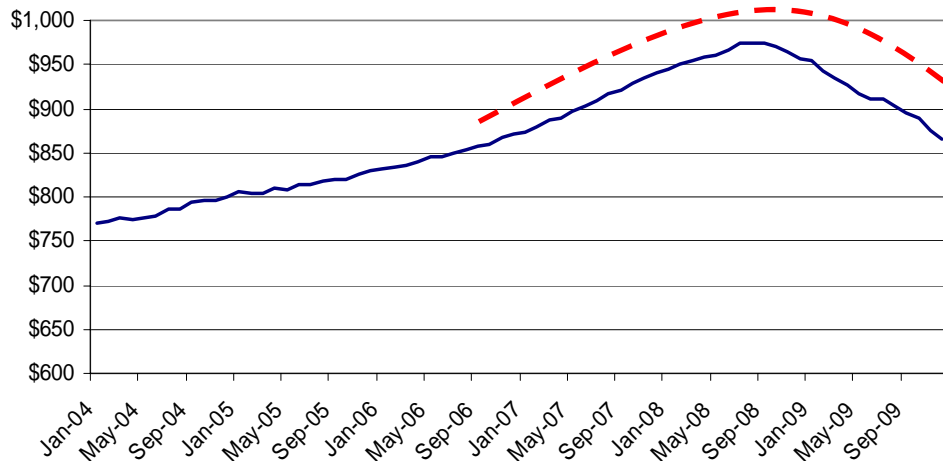
Consumers no longer have the ability to use the equity in their homes to fund their lifestyle . . .



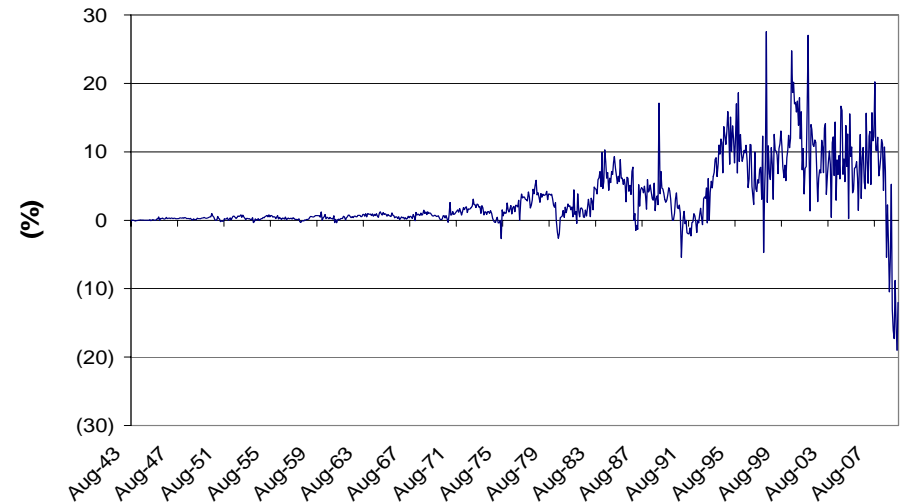
And consumers are paying down credit card and other revolving debt at a dramatic rate . . .



**Consumer Credit Card & Revolving Debt  
Outstanding in Billions**



**Monthly Change in Consumer Credit**

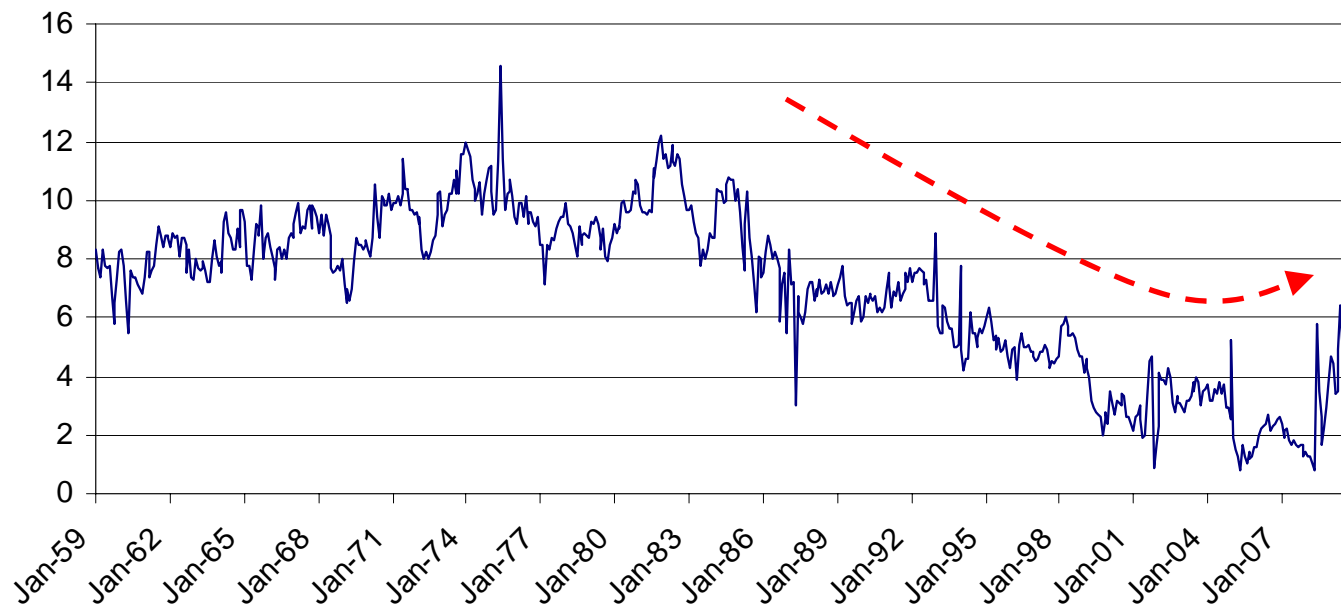


***Where do we go from here?***

Consumer credit demand will be weak for the foreseeable future as consumers de-lever. As consumers fortress their balance sheets, loans will be hard to come by.

After a 23 year decline, consumers are beginning to save more as they fortress their balance sheets . . .

Personal Savings as Percent of Income



***Where do we go from here?***

The personal savings rate is expected to increase, but may not reach late 70's and early 80's levels. But the Great Recession has caused a psychological shift in consumer saving behavior.

Consumers are beginning to “vote with their feet” and moving from high tax / high cost states to more favorable locations . . .

- Boston College’s Center on Wealth and Philanthropy reported on February 4, 2010:
  - “More than \$70 billion in wealth left New Jersey between 2004 and 2008 as affluent residents moved elsewhere ...”
  - “The wealth is not being replaced ... its above and beyond the general trend that is affecting the rest of the northeast.”
  - “... the state actually saw an influx of \$98 billion in the five years preceding 2004. The exodus of wealth, then, local experts of changes in the state’s tax structure and ‘millionaire’ taxes.”
- The Boston College report notes that
  - About 302,800 households left NJ between 2004 and 2008, only slightly more than the 323,350 households that moved into the state.
  - However, the average net worth of the departing households was about 70 percent higher, at \$618,330.

***Where do we go from here?***

Red state banks should fare better than blue state banks unless blue state governments change their tax policies.

And its not just New Jersey. Consumers are fleeing other high tax states . . .

**Table 1: Net Domestic Migration, 2000-08**

	Total	Rank	Rate*	Rank
Alabama	75,285	14	1.7%	22
Alaska	-8,217	29	-1.3%	34
Arizona	700,679	3	13.6%	2
Arkansas	67,805	16	2.5%	16
California	-1,359,270	50	-4.0%	44
Colorado	158,867	10	3.7%	12
Connecticut	-95,887	43	-2.8%	40
Delaware	41,278	18	5.2%	8
District of Columbia	-43,457	37	-7.6%	50
Florida	1,249,709	1	7.8%	4
Georgia	525,071	5	6.4%	7
Hawaii	-22,199	33	-1.8%	37
Idaho	111,513	13	8.6%	3
Illinois	-566,897	49	-4.6%	45
Indiana	-17,524	31	-0.3%	29
Iowa	-47,071	39	-1.6%	35
Kansas	-65,769	41	-2.4%	39
Kentucky	73,023	15	1.8%	21
Louisiana	-317,978	45	-7.1%	49
Maine	27,784	23	2.2%	18
Maryland	-85,855	42	-1.6%	36
Massachusetts	-295,288	44	-4.6%	46
Michigan	-469,549	48	-4.7%	47
Minnesota	-44,500	38	-0.9%	32
Mississippi	-27,272	34	-1.0%	33
Missouri	37,317	19	0.7%	27
Montana	36,238	20	4.0%	11
Nebraska	-37,132	35	-2.2%	38
Nevada	364,953	6	18.1%	1
New Hampshire	29,490	21	2.4%	17
New Jersey	-430,250	47	-5.1%	48
New Mexico	28,283	22	1.6%	23
New York	-1,538,274	51	-8.1%	51
North Carolina	580,286	4	7.2%	5
North Dakota	-19,396	32	-3.0%	42
Ohio	-338,667	46	-3.0%	41
Oklahoma	23,182	24	0.7%	26
Oregon	157,631	11	4.6%	9
Pennsylvania	-49,193	40	-0.4%	31
Rhode Island	-41,728	36	-4.0%	43
South Carolina	271,449	7	6.7%	6
South Dakota	5,459	27	0.7%	24
Tennessee	239,847	8	4.2%	10
Texas	701,065	2	3.3%	14
Utah	47,896	17	2.1%	20
Vermont	-1,919	28	-0.3%	30
Virginia	152,897	12	2.2%	19
Washington	199,180	9	3.4%	13
West Virginia	12,787	26	0.7%	25
Wisconsin	-11,403	30	-0.2%	28
Wyoming	15,721	25	3.2%	15

\* Net migration as a percentage of 2000 population  
Source: US Bureau of the Census

← California: Net Migration Out -1.4 mil.

← Illinois: Net Migration Out -600,000

← Mass: Net Migration Out -300,000

← Michigan: Net Migration Out -500,000

← New Jersey: Net Migration Out -400,000

← New York: Net Migration Out -1.5 mil.



**Where do we go from here?**

Clearly, structural changes are needed in the fiscal policies of these states. If “social experiments” are failing at a state level, how can they succeed at a national level?

Budget gaps appear to be correlated with high unemployment and foreclosure rates. Of the states with the top ten largest budget gaps, six are states with the highest unemployment and/or foreclosure rates . . .



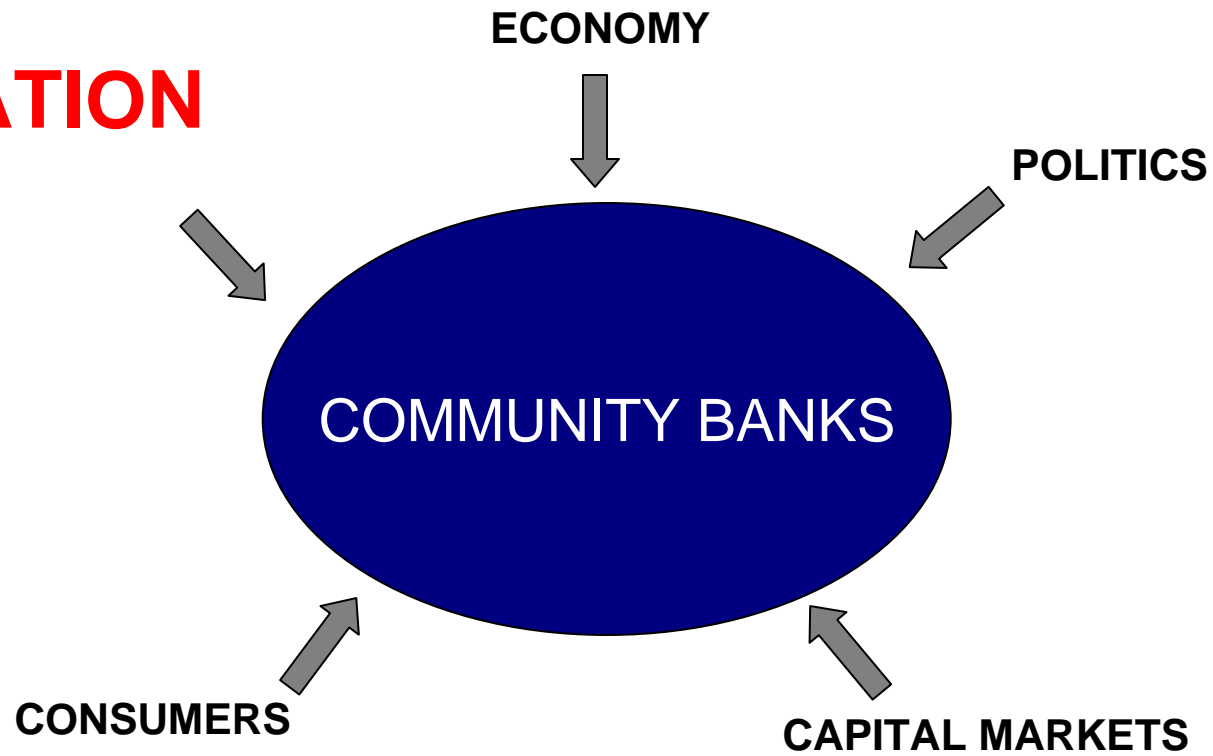
Largest FY 2010 Budget Gaps By State (in millions)					
State (\$ millions)	Before Budget		Total Gap	Total % of General Fund Budget	
	Adoption	Mid Year Gap			
California	\$ (45,500)	\$ (1,100)	\$ (46,600)		50.50%
New York	\$ (17,900)	\$ (3,000)	\$ (20,900)		37.70%
Illinois	\$ (13,200)	\$ -	\$ (13,200)		37.70%
New Jersey	\$ (8,800)	\$ -	\$ (8,800)		29.90%
Florida	\$ (5,900)	\$ (147)	\$ (6,047)		23.30%
Massachusetts	\$ (5,000)	\$ (600)	\$ (5,600)		20.00%
Pennsylvania	\$ (4,800)	\$ -	\$ (4,800)		18.00%
Connecticut	\$ (4,200)	\$ (500)	\$ (4,700)		26.70%
Arizona	\$ (3,200)	\$ (1,500)	\$ (4,700)		47.80%

***Where do we go from here?***

These states will need to follow New Jersey's lead by cutting spending and taking on the unions. California is where the USA is heading. We must face the fact that we can't carry the freight anymore! Community Banks should be selective in investing in Municipals.



**REGULATION**

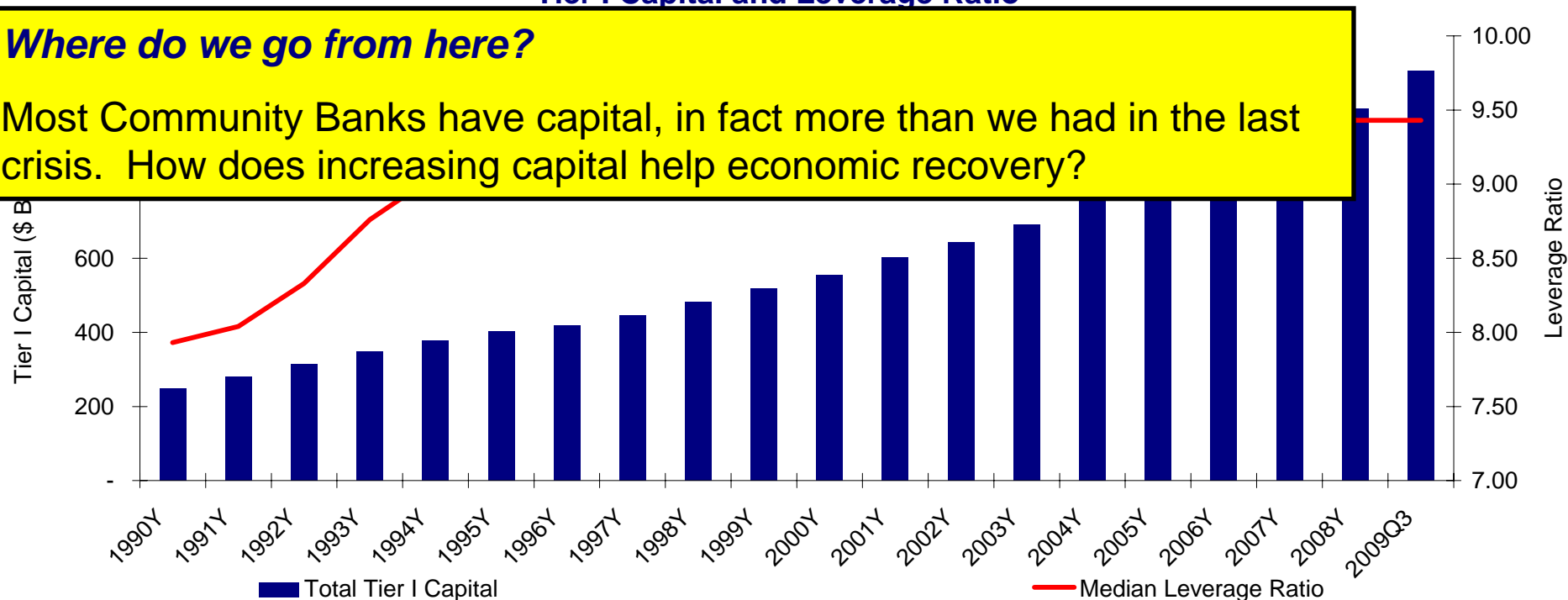


For every 10 basis point increase required by the regulators in Tier 1 Capital, at least an additional \$7.1 billion of Tier 1 capital or a reduction of total assets by \$75.4 billion would be required . . .

### Tier I Capital and Leverage Ratio

#### Where do we go from here?

Most Community Banks have capital, in fact more than we had in the last crisis. How does increasing capital help economic recovery?



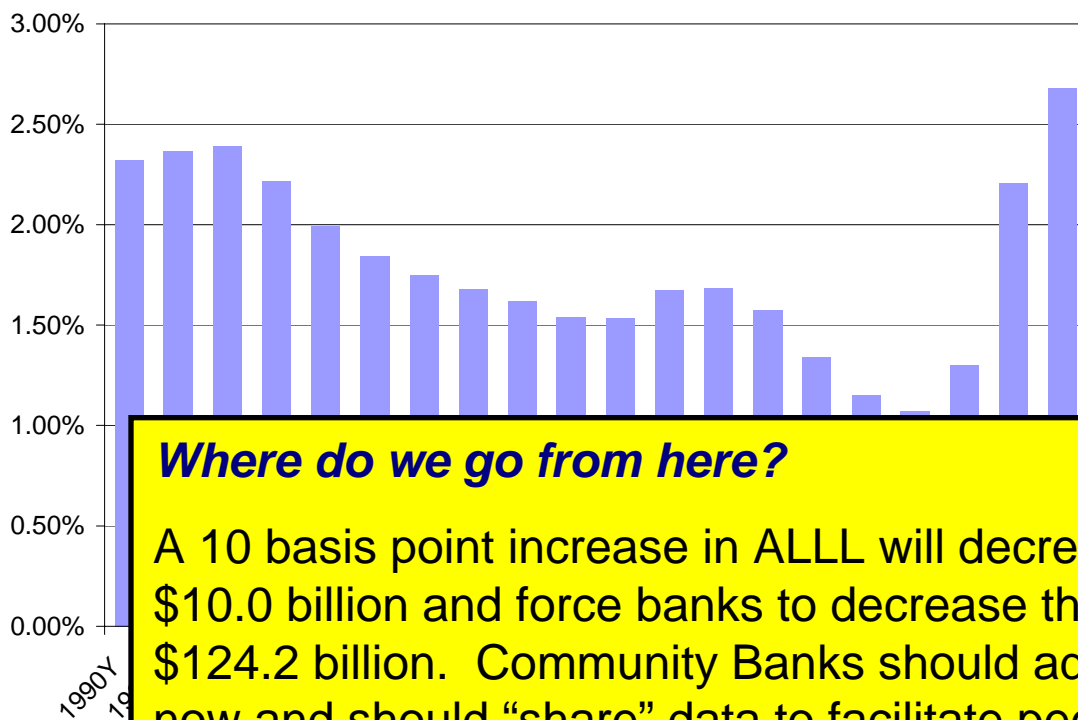
### Impact of Increasing Leverage Ratio Requirement Once all Institutions are Above 8.0%

(\$thousands)	+10 bps	+50 bps	+100 bps
(a) Additional Tier I needed to comply with increase	\$ 7,091,800	\$ 39,319,425	\$ 86,909,908
(b) Reduction in Total Assets needed to comply with increase	\$ 75,387,981	\$ 404,618,319	\$ 856,179,683

# Changing ALLL accounting has resulted in an uncertain and volatile level of loan loss reserves . . .



**Allowance for Loan Losses as a Percentage of Total Loans**



**Impact of a 10 basis point Increase in ALLL**

	(\$ Millions)
Current Industry Allowance for Loan Losses	\$ 265,593
Current Industry ALLL / Total Loans	2.678%
New Industry ALLL / Total Loans	2.778%
New Industry Allowance for Loan Losses	275,529
Change in Industry ALLL	9,936
Change in Industry capital	(9,936)
Decrease in Industry Total Assets Necessary to Maintain an 8% Leverage Ratio	\$ 124,201

*Note: Data is aggregate for industry*

**Where do we go from here?**

A 10 basis point increase in ALLL will decrease industry capital by nearly \$10.0 billion and force banks to decrease their combined total assets by \$124.2 billion. Community Banks should address their ALLL methodologies now and should “share” data to facilitate peer comparisons.

Forcing disposition of non performing loans immediately decreases capital due to the selling expense and distressed sale discount . . .

**Where do we go from here?**

Being forced to sell loans in a distressed market will cost the bank, in this example, \$210 thousand. Additionally, it will drive real estate values down resulting in every other institution having to write down its loans accordingly.

Opportunity Cost per year (6% of Net NPLs)	90,000
Distressed Sale Investor Discount (20% of Net NPLs)	300,000

Sell Nonperforming Loans Now	
NPL Balance	2,000,000
Credit Loss	(500,000)
Selling Expenses	(150,000)
Distressed Sale Investor Discount	(300,000)
<b>Net</b>	<b>\$ 1,050,000</b>

Hold Nonperforming Loans for 2 years	
NPL Balance	2,000,000
Credit Loss	(500,000)
Opportunity Cost for 2 years	(180,000)
Maintenance Cost (4% of Net NPLs)	(60,000)
<b>Net</b>	<b>\$ 1,260,000</b>

**-\$210,000**

Institutions with CRE concentration levels of above 300% are receiving significant regulatory scrutiny . . .

**CRE + Construction Loan Concentration Analysis (\$000s)**

*\*Calculation includes NOO and OO*

# of reporting institutions	7,339
# of institutions in excess of threshold	2,523

**For institutions in excess of the regulatory threshold:**

CRE (OO and NOO), Multi, Const	713,513,225
Risk based capital	161,899,377

**A Tale of Two Commercial Real Estate Loans**

\$5,000	Loan Value (\$000s)	\$5,000
6.5%	Interest Rate	6.5%
\$98	Monthly Payment (\$000s)	\$98
<b>105.0%</b>	<b>Debt Service Coverage Ratio</b>	<b>150.0%</b>
\$103	Cash Available to Cover Debt	\$147
\$79	Cash to Available Debt (\$25,000)	\$122
		<b>124.4%</b>
		<b>65.0%</b>
		\$7,692
		\$6,154
		<b>81.3%</b>

**Where do we go from here?**

For the 2,523 institutions above the 300% threshold to reach compliance, they would need to increase capital by \$75.9 billion or de-lever by a combined \$227.8 billion.

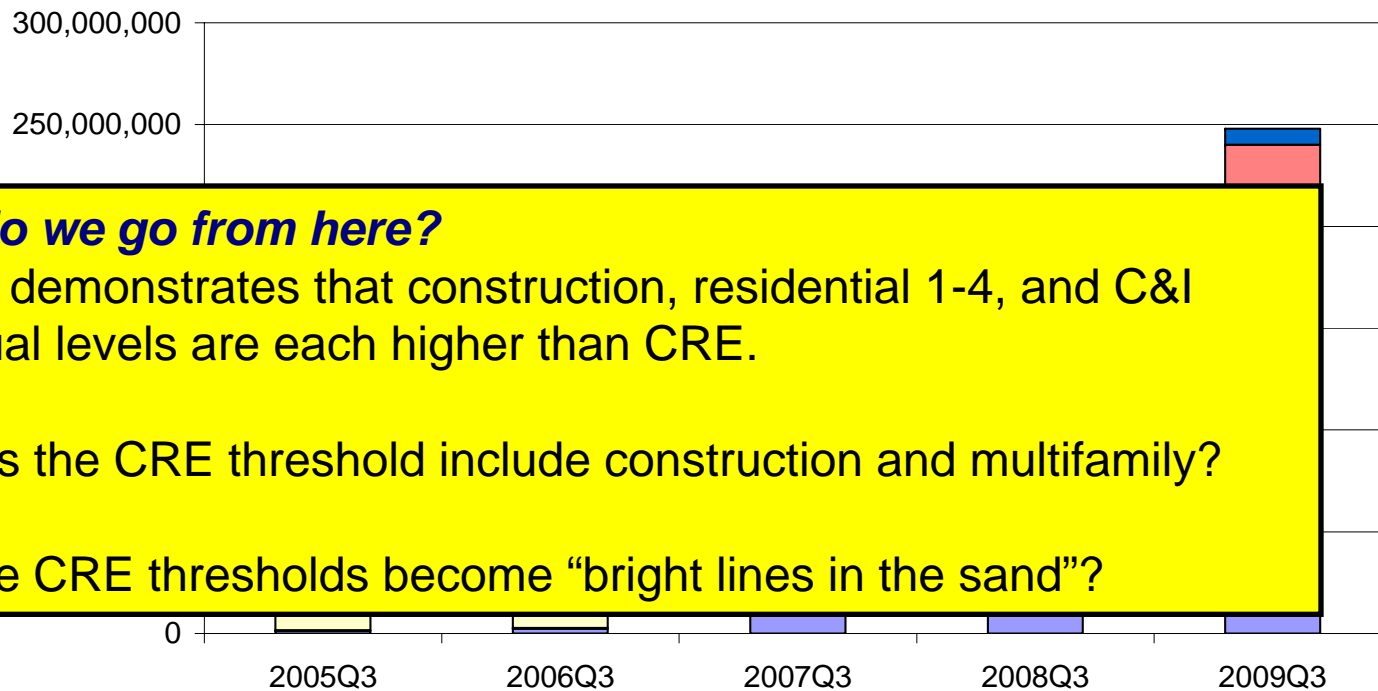
As shown on the right however, CRE loans cannot be treated equally. Well underwritten loans should not be treated the same as poorly underwritten loans.

Finally, is owner occupied in or out of the equation? The regulation, as written, excludes it, so why are some examiners including it?

There is no debate that nonaccrual loans are increasing, however, there is debate over what types of loans are driving this increase . . .



Nonaccrual Loans by Loan Type

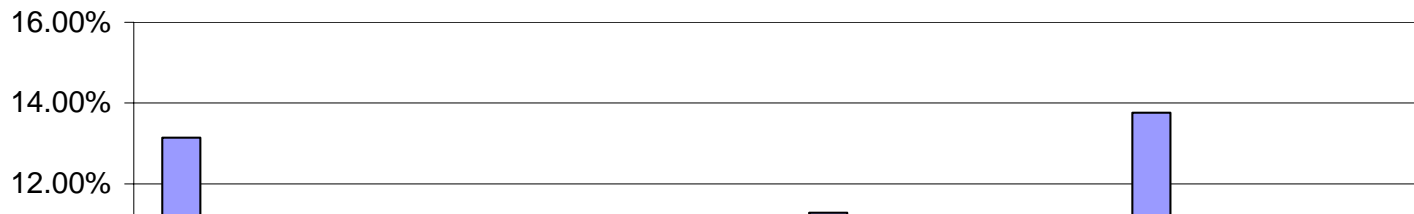


**Where do we go from here?**  
 The data demonstrates that construction, residential 1-4, and C&I nonaccrual levels are each higher than CRE.  
 Why does the CRE threshold include construction and multifamily?  
 Why have CRE thresholds become “bright lines in the sand”?

- Construction and land development
- Secured by 1-4 family residential properties
- Secured by nonfarm nonresidential properties
- Consumer Loans
- Secured by farmland
- Secured by multifamily residential properties
- Commercial and industrial loans

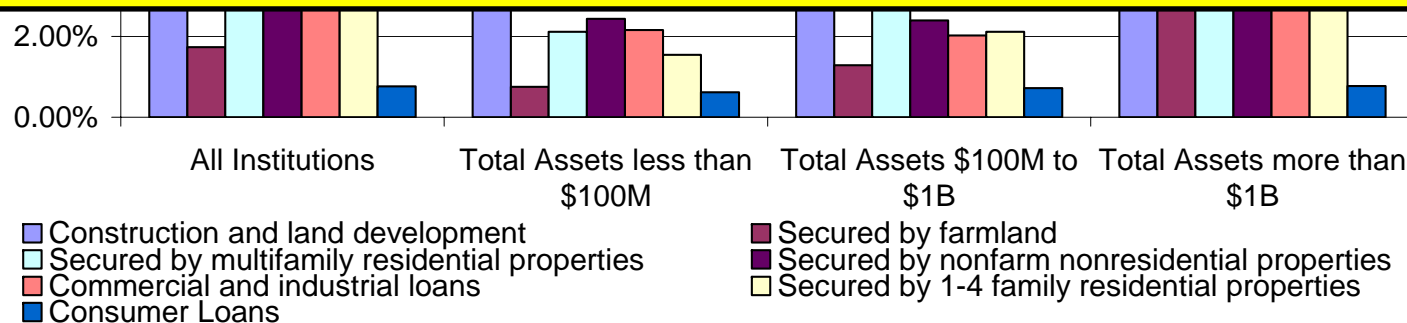
It is clear that construction stands out as the riskiest loan category . . .

Nonaccrual Loans Percentage by Loan Category as of 9/30/2009



**Where do we go from here?**

Concentration limits should be based upon the Call Report categorizations. While there is no disagreement that there should be concentration limits, they should not be set in absolute terms. Both objective and subjective criteria should be allowed.



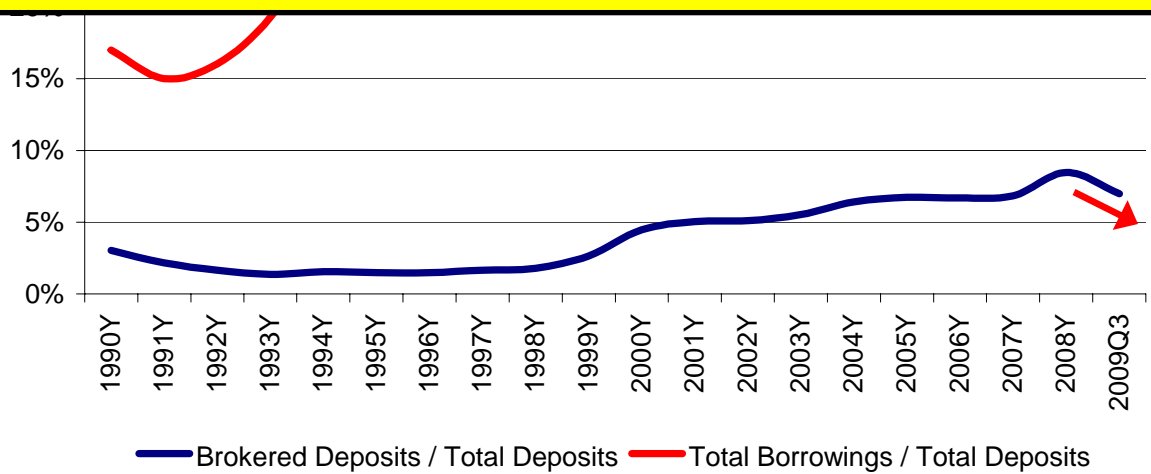
Both borrowings as a percentage of deposits and brokered deposits as a percentage of deposits have decreased significantly in past year . . .



**Where do we go from here?**

The reliance on borrowings and brokered deposits as sources of funding will likely continue to decrease as a result of regulatory pressure and higher FDIC premiums on wholesale funding.

Banks should run maturity schedules on their wholesale funding and look to replace them with core deposits as they mature.



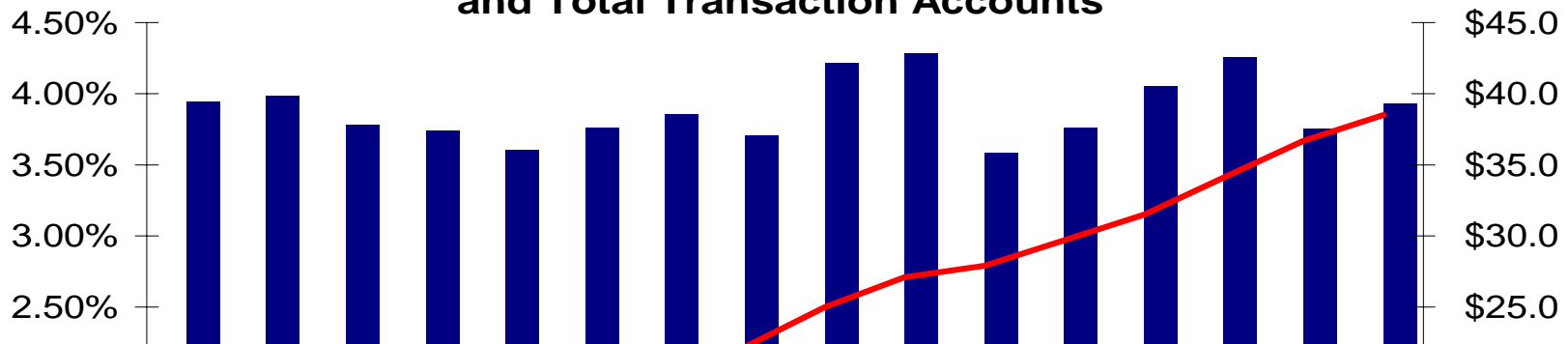
		<b>threshold</b>
		672
Total borrowings	\$	1,834,860,150
Total deposits	\$	4,184,851,655
Aggregate ratio		43.85%

<b>Institutions above the 10% brokered threshold</b>		
# of Institutions		1377
Total brokered deposits	\$	485,088,588
Total deposits	\$	1,293,634,638
Aggregate ratio		37.50%

If you take a myopic look at overdraft fee income, it would appear that the amount of fees being collected has risen dramatically . . .



**Overdraft and NSF Fees as a Percentage of Total Deposits and Total Transaction Accounts**



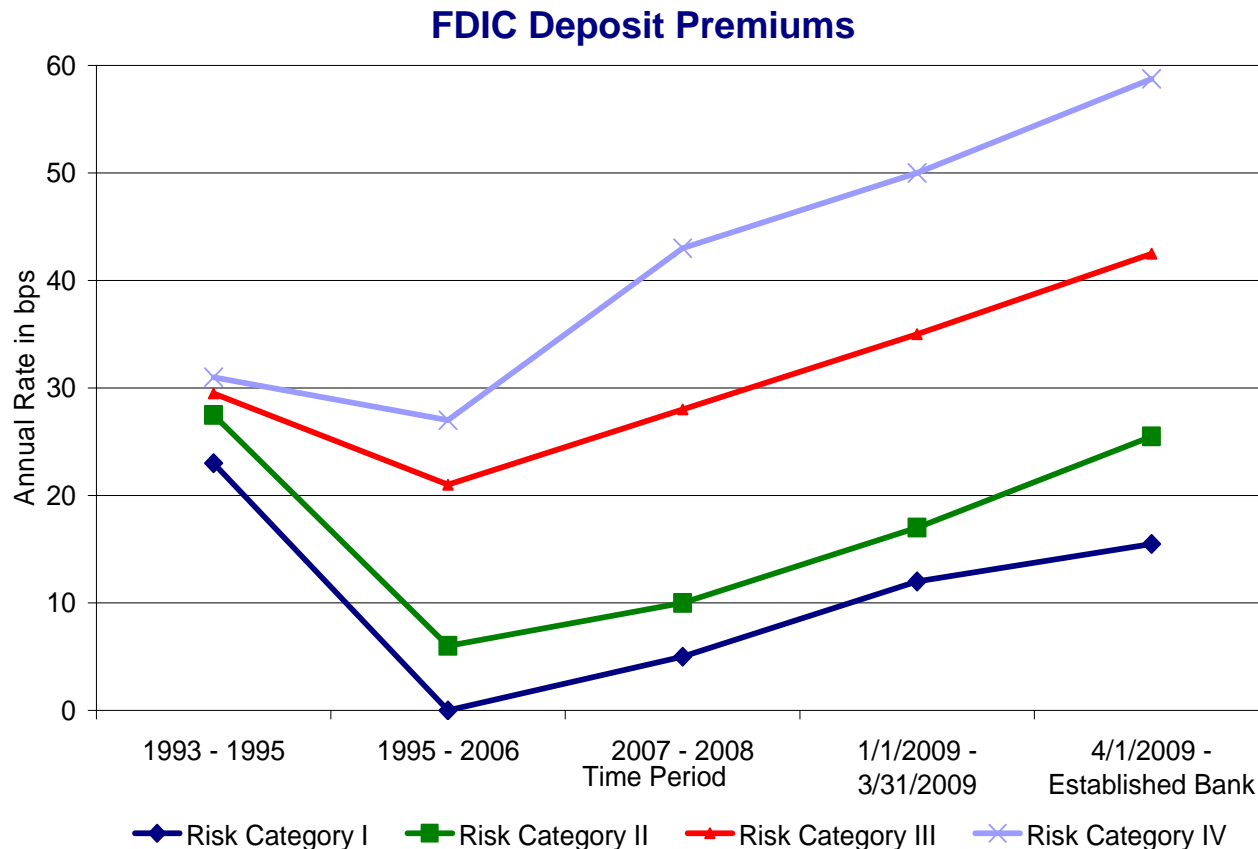
**Where do we go from here?**

A thorough analysis shows that overdraft fees have grown commensurate with deposit growth. In fact, total deposits have increased at a faster rate than overdraft fees from 1994 to 2009. Overdraft fees as a percentage of transaction deposits has remained relatively flat throughout the same period.

1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009

■ Fees / Total Deposits   ■ Fees / Tot Transactions Accts   — Overdraft and NSF Fees

And from the expense side, rising FDIC premiums have materially hurt the bottom line . . .



***Where do we go from here?***

FDIC premiums have increased dramatically in the past year, becoming a significant part of non interest expense.

More bad news – if Chairman Bair’s forecast of expected losses is accurate, the FDIC is likely to need to increase the assessment again.

Can anyone explain why the resolutions are costing the fund so much?



**Community Banks are not the  
problem, we are the solution.**

To meet the challenges associated with the elements of siege . . .

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- EVERYONE MUST UPDATE THEIR STRATEGIC PLANS TO INCORPORATE:
  - Multiple interest rate scenarios
  - New regulatory initiatives
  - Stress testing
  - Asset quality and ALLL
  - Capital planning
  - Contingency funding plan

***Where do we go from here?***

Most plans FinPro looks at are wholly inadequate. Plans must contain decision tree methodologies with documented trigger points to ease decision making. As regulators monitor adherence to plans more closely, the need for materially better planning will ensue.

FinPro has been scarily accurate in its prognostications over the past few years, so. . .



# Some parting thoughts

## Economy . . .

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- The direction of the FinPro identified economic indicators will dictate interest rates.
- Prepare for a slow, drawn out recovery.
- GSEs will need further material government capital, i.e. taxpayer bailout.
- Banks are being viewed more like utilities than growth stocks.

## Politics . . .

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- Huge battle between Socialists and Capitalists, can you believe this?
- Senator Bayh was right, we need to throw all the incumbents out and replace them with pragmatic problem solvers, not career politicians.
- Lets push for TERM LIMITS.
- Republicans and Democrats need to remember that they are Americans first, party affiliated second.

## Capital Markets . . .

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- Pure economics will force us to get more creative in bringing new capital into the banking industry.
- The secondary markets may not return. Plan on more on balance sheet lending.
- If the proposed FASB mark-to-market rules are accepted, consolidation will double and so will failures.
- Banks need to update and maintain capital plans.
- Industry consolidation will accelerate. But, FDIC assisted transactions are limited both geographically and in count.

## Consumers . . .

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- Consumer de-levering will create a loan shortage.
- As consumers age, their borrowing and savings patterns will shift.
- Demographic changes will benefit some states and groups and hurt others.

## Regulation . . .

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- Regulatory Reform will be a disaster, lots of unintended consequences that should have been thought through.
- Financial supermarkets are dead – either Glass Steagall gets re-invoked or Companies will pay to be in diverse businesses.
- Compensation will be limited by CZAR fiat.
- Regulators will realize that their current policies on portfolio limits and ALLL don't add up – unless they are attempting to drive consolidation.
- FDIC will have to consider creative resolutions, some of which are currently statutorily prohibited.

Thank you for your attention. Please go to the FinPro Solutions portion of our website at [www.finpronj.com](http://www.finpronj.com) for this presentation and other FinPro presentations on solutions and recommendations regarding the banking industry . . .

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**Wednesday, November 3rd, 2010**

**Overview**

FinPro, Inc. was established in 1987 as a full service management consulting firm specializing in providing advisory services to the financial institutions industry.

FinPro is a proven leader in strategic planning, market feasibility, de novo bank formation, corporate finance, M&A, asset/liability management, and regulatory consulting.

FinPro maintains close contact with the bank regulatory agencies and departments to stay current with upcoming policies and rules.

FinPro principals are frequent speakers and presenters at financial institution trade association functions and regulatory conferences and moderate over fifty board retreats each year.

FinPro combines its entrepreneurial problem solving skills to maximize value, while working within the regulatory framework.

In addition, FinPro shares its industry expertise by teaching at:

- Stonier Graduate School of Banking
  - strategic planning

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