

BANK DIRECTOR WORKSHOP



HOSTED BY:

***NATIONAL ASSOCIATION OF CORPORATE DIRECTORS
AMERICAN ASSOCIATION OF BANK DIRECTORS***

LIQUIDITY RISK

***CHARLES J THAYER
CHARTWELL CAPITAL LTD &
CHAIRMAN, AABD***

***FORT LAUDERDALE, FLORIDA
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TODAY'S BANKING ENVIRONMENT

ASSET QUALITY PROBLEMS IMPACT

EARNINGS & CAPITAL

CAPITAL IS KEY TO MARKET CONFIDENCE

CONFIDENCE IS KEY TO LIQUIDITY

LIQUIDITY IS KEY TO SURVIVAL

WHY THE PUBLIC/LIQUIDITY CRISIS?

- ***GOVERNMENTAL FOCUS ON HOME OWNERSHIP (WORLDWIDE)***
LOW INTEREST RATES
NEW HOME CONSTRUCTION
- ***NEW MORTGAGE INSTRUMENTS***
SUB-PRIME – NO DOC & LOW DOC LOANS
WORLD-WIDE SALES OF TOXIC TRANCHES
- ***LOAN DEFAULTS INCREASE***
VARIABLE RATE LOANS “STEP UP”
MISSED LOAN PAYMENTS & FORECLOSURES
- ***MARKET LEVERAGE & PANIC***
EXCESSIVE FINANCIAL LEVERAGE
AUGUST 2007 – BEAR STEARNS HEDGE FUNDS
- ***FAIR VALUE ACCOUNTING (“FAIL” VALUE)***
EXPANDED APPLICATION DURING MARKET TURMOIL
LACK OF CONFIDENCE IN REPORTED VALUES (LEVEL 3)
- ***MEDIA COVERAGE***
24 HOUR TV & INTERNET (WORLDWIDE)
- ***STOCK PRICE COLLAPSE /INVESTOR IMPACT***
LIMITED ACCESS TO NEW CAPITAL

WHAT HAPPENED ON "WALL STREET"?
(EXHIBITS ATTACHED)

#1 > EXCESSIVE CONFIDENCE IN "MODELS"

WARREN BUFFET: "Beware of Geeks Bearing Formulas"

#2 > LEVERAGED PORTFOLIOS

BANK SIVs & HEDGE FUNDS (Bear Stearns – 2007)

#3 > UNTESTED FINANCIAL INSTRUMENTS

CREDIT DEFAULT SWAPS (AIG, etc)

BANK LIQUIDITY - WHAT'S DIFFERENT TODAY?

- ***MORE VISIBLE ASSET QUALITY PROBLEMS***
1990'S > COMMERCIAL PROPERTIES (Donald Trump, Not Your Neighbor)
TODAY > HOUSING VALUES, MORTGAGES, BUILDERS & COMMERCIAL
- ***LIMITED LOAN LOSS RESERVES***
1980'S > BANKS HAD "EXCESS" RESERVES TO COVER LOSSES
1990'S > SEC ATTACKS "EXCESS" RESERVES (SUNTRUST)
TODAY > RESERVES FULLY ALLOCATED (INCLUDES FDIC FUND)
- ***EXCESS CAPITAL & FUNDING LEVERAGE***
TRUST PREFERRED POOLS – COMMUNITY BANKS
FHLB & OTHER NON-DEPOSIT FUNDING
ACQUISITIONS - PURCHASE ACCOUNTING & GOODWILL
INCREASED HEDGING & COUNTERPARTY RISK
- ***FAIR VALUE ACCOUNTING***
IMPACTS WIDE RANGE OF ASSETS (Freddie & Fannie)
GOODWILL IMPAIRMENT - MEDIA COVERAGE
- ***EXPERIENCE FACTOR***
BANKS – WALL STREET – REGULATORS - MEDIA
1970'S & 1980'S > FREQUENT CREDIT/BANKING PROBLEMS
Mid 1990'S TO 2007 > 15 GOOD CREDIT/BANKING YEARS
MEDIA UNDER 40 > "NEVER EXPERIENCED A MARKET THIS BAD"

LIQUIDITY RISK > WHEN THINGS GO WRONG

BANK REGULATORY ACTIONS & CASCADING EVENTS

***FDICIA 1991: "PROMPT CORRECTIVE ACTION"
(A WORLD OF DIFFERENCE BETWEEN 10.1% & 9.9%)***

- ***ASSET QUALITY DETERIORATION***
- ***OPERATING LOSS > CAPITAL RATIOS DECLINE***
- ***EXAMINATION > REGULATORY MOU OR C&D***
- ***HIGHER COSTS > RISK BASED FDIC PREMIUM***
- ***CUSTOMER IMPACT > LIMITATION ON GROWTH***
- ***BANK LIQUIDITY > BROKER CDS SUSPENDED***
- ***HC LIQUIDITY > NO BANK DIVIDENDS TO HC***
- ***HC LIQUIDITY > INABILITY TO SERVICE HC DEBT***
- ***MANAGEMENT > INDEPENDENT ASSESSMENT?***
- ***LIQUIDITY & CAPITAL PLAN (HC & BANK)***

BANK REGULATORS ALSO UNDER PRESSURE

- ***CONGRESSIONAL HEARINGS & PUBLIC CRITICISM***
- ***NEED TO ANTICIPATE “WORST CASE” CREDIT SCENARIO***
- ***ABILITY FOR BANKS TO SURVIVE UNTIL NEXT EXAM***
- ***“PROMPT CORRECTIVE ACTION” REQUIREMENTS***
- ***C&D PUBLICATION & BANK REPUTATIONAL RISK***
- ***MEDIA COVERAGE & BANK LIQUIDITY RISK***
- ***LIQUIDITY CRISIS – NOW A MATTER OF DAYS!***
BEAR STEARNS - INDYMAC BANK – COMMUNITY BANKS

PAST > REGULATORS MANAGED THE CLOSURE PROCESS

TODAY > REGULATORS REACTING TO MARKET CONDITIONS

TODAY > BANKING STRATEGIES HAVE CHANGED

PAST 10 YEARS > LEVERAGE WAS "KING"

"GOAL WAS TO UTILIZE EXCESS CAPITAL"

AT THE HOLDING COMPANY LEVEL

ACQUISITIONS & SHARE REPURCHASE PROGRAMS

FUNDED WITH: > TRUST PREFERRED

> HOLDING COMPANY DEBT

RESULT: > INCREASED ASSETS & GOODWILL

> REDUCED TANGIBLE CAPITAL RATIOS

> INCREASED DEBT SERVICE REQUIREMENTS

AT THE BANK LEVEL

LOANS FUNDED WITH NON-CORE DEPOSITS

LOANS & SECURITIES FUNDED WITH FHLB ADVANCES

REDUCED LIQUIDITY AT BANK LEVEL

TODAY > CAPITAL & LIQUIDITY ARE "KING"

CAPITAL MARKETS ARE "FROZEN"

CBS 60 MINUTES: MARCH 15, 2009

***BEN BERNANKE, CHAIRMAN
FEDERAL RESERVE SYSTEM***

WHEN ASKED WHAT THE FIRST SIGNS OF RECOVERY WILL BE:

***"Well, I think that one sign would be that a large bank
is successful in raising private equity."***

***"Right now, all the private money is sitting on the sidelines saying,
'We don't know what these banks are worth.
We don't know that they're stable.'"***

"And they're not willing to put their money into the banks."

BANKS WILL REMAIN IN MEDIA SPOTLIGHT

- ***NATIONAL INCREASE IN PROBLEM LOANS***
- ***RISK OF MORE ASSET WRITEDOWNS***
- ***MORE BANK FAILURES***
- ***MORE NEGATIVE PUBLICITY***
- ***ALL BANKS PAINTED WITH THE SAME BRUSH?***
- ***UNCERTAIN DEPOSITOR REACTION (LIQUIDITY)***
- ***DEPOSITS REQUIRED FOR FUTURE GROWTH***
- ***BANK CAPITAL = COMPETITIVE ADVANTAGE***

AABD REGULATORY MEETINGS

Washington DC – 2007

KEY RISKS WHEN A BANK GETS IN TROUBLE

- *Bank & Holding Company Financial Risk*
- *Board Risk > Add Experienced Qualified Board Members?*
- *Management Risk > Add Experienced Qualified Management?*
- *Board Role Expands > Increased Time Commitment*
- *Management Recruiting Risk > New People Must Resign Current Job
Prior to Receiving Regulatory Approval*
- *Bank Reputation Risk > C&D Publication (Negative Media Reports)*
- *Bank Liquidity Risk > Result of Negative Publicity*
- *Holding Company Liquidity Risk > Bank Dividend Restrictions*
- *Increased Deposit Insurance Premium > Risk Rated*
- *Increased Regulatory Reporting > Time & Paperwork*

COST OF MANAGEMENT DISTRACTION

BANKS NEED "GOOD CUSTOMER" FOCUS

TODAY'S FOCUS IS THE "BAD BANK" (PROBLEM LOANS)

***REGULATORY FOCUS ON BANK CAPITAL LIMITS GROWTH
(TARP-CPP WAS STRUCTURED TO HELP)***

ECONOMIC GROWTH DEPENDS ON NEW BANK CREDIT

***BUSINESS NEEDS CREDIT TO EXPAND & HIRE PEOPLE
PEOPLE NEED MORTGAGES TO BUY HOUSES***

"GOOD BANK" IS KEY TO FUTURE GROWTH

BOARDS NEED TO INSURE MANAGEMENT HAS

"GOOD BANK" TEAM TO SERVE GOOD CUSTOMERS

CHARLES J THAYER

Thayer was named Chairman of the American Association of Bank Directors in 2007. He is Chairman of Chartwell Capital Ltd., a private investment firm that provides specialized advisory services to board members and executive management of commercial banks, corporations and institutional investment clients.

He was elected to the board of Republic Bank (NASDAQ) in Florida in 1999 and served as a board member of BB&T Bank (Florida) for two years following BB&T's 2004 acquisition of Republic Bank. He currently serves as a board member of the Louisville Community Development Bank in Kentucky and for the national Cystic Fibrosis Foundation. He is also a founding board member of the National Association of Corporate Directors Florida Chapter.

Previous board service includes CogenAmerica (NASDAQ) (1996-1999), an independent multi-state cogeneration power producer headquartered in Minnesota, and Sunbeam Corporation (NYSE) (1990-1997), an international consumer products company. He served as Chairman and interim CEO of Sunbeam in 1993. John A. Byrne (Business Week) described Thayer as Sunbeam's "most knowledgeable director". Thayer also served as an advisory board member of Keefe Managers (1990-2002); a New York based bank stock hedge fund founded by Harry V. Keefe.

Prior to organizing Chartwell Capital in 1990, Thayer had a twenty year career in commercial banking serving as Executive Vice President and Chief Financial Officer of Citizens Fidelity Corporation (NASDAQ), Kentucky's largest bank holding company until its acquisition by PNC Financial (NYSE). Following the acquisition in 1986 he was elected Executive Vice President of PNC with management responsibility for finance, merger and acquisitions, investor relations, strategic planning, and PNC's capital markets subsidiary, serving as Chairman of PNC Securities Corp.

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EXHIBIT 1

EXCESSIVE CONFIDENCE IN "MODELS"
(Warren Buffet: "Beware of Geeks Bearing Formulas")

EXAMPLE > SUB-PRIME MORTGAGE SECURITIZATION

CREDIT RATINGS BASED ON HISTORICAL CASH FLOW ASSUMPTIONS
3 TRANCHE EXAMPLE > 7% FIXED RATE LOANS

Securitization	Amount	Rate	Income
Originations	\$100,000,000	7%	\$7,000,000
Tranche 1	\$60,000,000	5%	\$3,000,000
Tranche 2	\$30,000,000	8%	\$2,400,000
Tranche 3	\$10,000,000	16%	\$1,600,000

TRANCHE 1 RECEIVES FIRST CASH FLOW: Rated AAA & LEVEL 1

TRANCHE 2 RECEIVES NEXT CASH FLOW: Not Rated & LEVEL 2

TRANCHE 3 RECEIVES LAST CASH FLOW: Not Rated & LEVEL 3

WALL STREET CREATED VERY COMPLEX STRUCTURES
UNCLEAR WHO OWNS THE ACTUAL MORTGAGE
SOLD MULTIPLE VARIATIONS

EXHIBIT 2

LEVERAGED PORTFOLIOS

INVESTMENT BANKS & INVESTORS

BUY 'MIX' OF SUB-PRIME	\$10,000,000 @ 8% =	\$ 800,000
BORROWED FUNDS	<u>\$ 9,000,000 @ 5% =</u>	<u>\$ 450,000</u>
INVESTED CAPITAL	\$ 1,000,000	\$ 350,000 (35% ROI)

MARKET PRICE COLLAPSE

MARKET FOR SUB-PRIME	\$ 10,000,000 @ 80% =	\$ 8,000,000
BORROWED FUNDS	<u>\$ 9,000,000 @ 100% =</u>	<u>\$ 9,000,000</u>
INVESTED CAPITAL	\$ 1,000,000	(\$ 1,000,000)

SUB-PRIME SECURITIES ARE NOW "TOXIC WASTE"

INVESTORS "UNWINDING" LEVERAGED POSITIONS

INVESTMENT BANKS HOLDING UNSOLD POSITIONS

MERRILL LYNCH SOLD POSITIONS FOR 22%! (7/2008)

EXHIBIT 3

UNTESTED FINANCIAL INSTRUMENTS

CREDIT DEFAULT SWAPS

**INVESTOR BUYS CREDIT PROTECTION FROM COUNTERPARTY
COUNTERPARTY ASSUMES CREDIT RISK OF DEFAULT
INVESTOR RETAINS OWNERSHIP OF ASSET
UNREGULATED GLOBAL MARKET**

INVESTOR BUYS SUB-PRIME TRANCHE	\$100,000,000	@ 8%
INVESTOR BUYS CDS PROTECTION (AAA FROM AIG)		@ 1%
NET RETURN TO INVESTOR		7%

**COUNTERPARTY SELLS PROTECTION @ 1% = \$1,000,000 FEE
COUNTERPARTY INVESTS NO CAPITAL
CDS BASED ON COUNTERPARTY CREDIT RATING (AAA)**

**PROBLEM: CDS SWAPS ARE ALSO DONE BETWEEN COUNTERPARTIES
CREATES A CHAIN OF SWAPS WITH UNIDENTIFIED PARTIES
POTENTIAL GLOBAL 'CRISIS' IF SOMEONE BREAKS THE CHAIN**