

---

*The Financial Stability Plan of 2009*  
*What is It and*  
*What Does It Mean to Community Banks?*



**GRIFFIN** FINANCIAL  
GROUP LLC

*Information as of 2/17/09*

---

***For more information regarding the material which follows,  
please contact:***

***Joseph M. Harenza***  
*CEO and Senior Managing Director*  
*Griffin Financial Group LLC*  
*(610) 478-2160*  
*jmh@go2griffin.com*

***Richard A. Vader***  
*Senior Managing Director*  
*Griffin Financial Group LLC*  
*(610) 205-6119*  
*rav@go2griffin.com*

***Samuel A. McCullough***  
*President and CEO*  
*Griffin Holdings Group LLC*  
*(610) 478-2151*  
*sam@go2griffin.com*

***Jeffrey P. Waldron***  
*Senior Managing Director*  
*Griffin Financial Group LLC*  
*(610) 205-6028*  
*jpw@go2griffin.com*

***Mark R. McCollom***  
*Senior Managing Director*  
*Griffin Financial Group LLC*  
*(610) 478-2016*  
*mrm@go2griffin.com*



**GRIFFIN** FINANCIAL  
GROUP LLC

---

# Goodbye TARP, Hello FSP!!

*Please note that FSP is currently a proposal on a “plan to have a plan” – we will update this as developments occur*

	<u>Page</u>
◆ Glossary of Terms	5
◆ Summary of FSP	6-17
◆ Q&A on FSP	18-27
◆ Impact of FSP on TARP 1 – Have Community Banks been “Tarped and Feathered” and also A Minute on the Dodd Amendment to the Stimulus Legislation	28-30
◆ Our Take: What Does All Of This Mean to Community Banks?	31-34
◆ Our Overall Take	35
◆ About Griffin and its New Additions	36-42

*This is the fifth in a series of publications designed to help community banks keep abreast of the challenges and opportunities created first by the Bush Administration’s response to the nation’s credit crisis (TARP in 2008) and now by the Obama Administration in 2009*

# Glossary of Terms

---

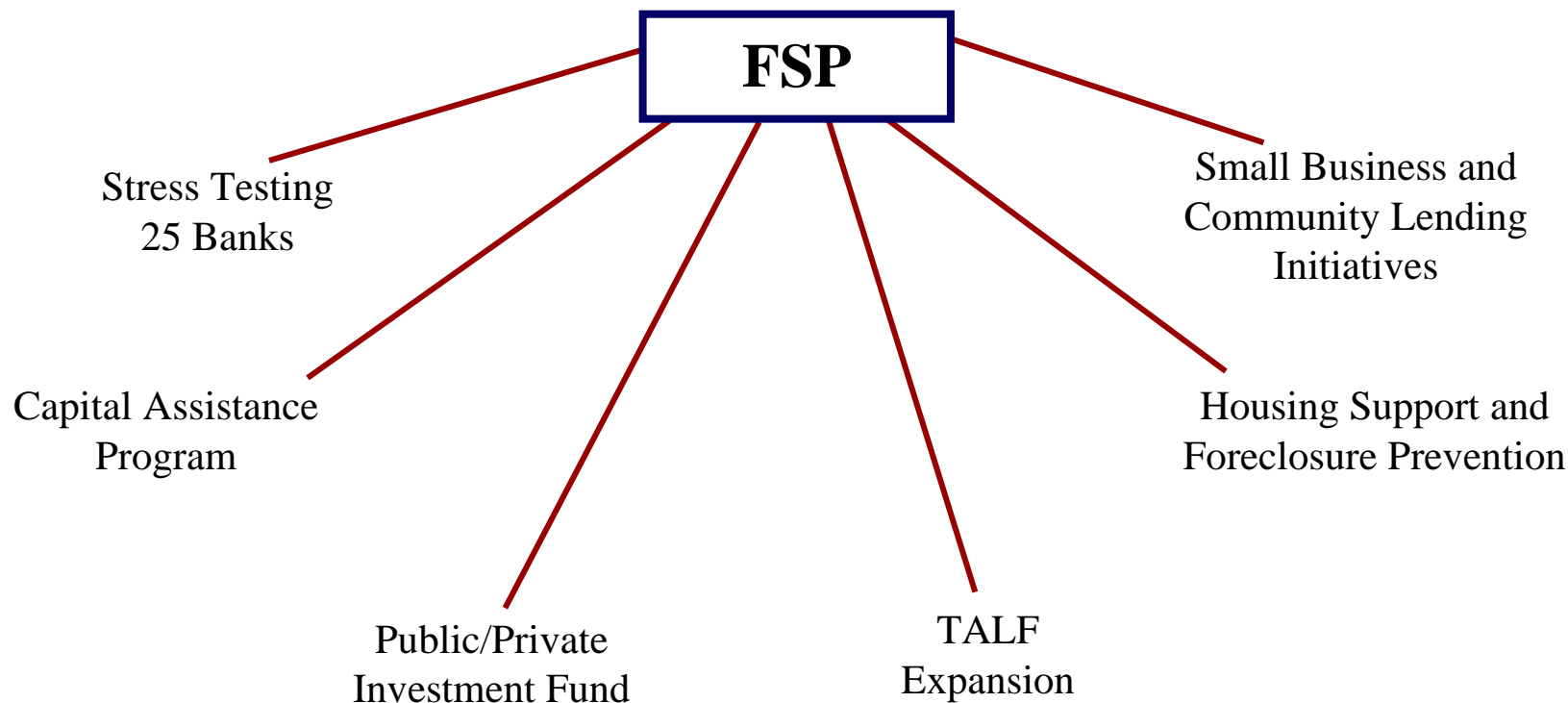


<i>AB</i>	<i>Asset Backed (normally credit card, student loan and auto loan securities)</i>	<i>GSE</i>	<i>Government Sponsored Equity</i>
<i>BV</i>	<i>Book Value, In the case of loans or securities, carrying value net of reserves</i>	<i>MBS</i>	<i>Mortgage-Backed Securities</i>
<i>CAP</i>	<i>The Capital Assistance Program of the FSP</i>	<i>OTTI</i>	<i>Other-Than-Temporary Impairment</i>
<i>CPP</i>	<i>The Capital Purchase Program under TARP</i>	<i>PEG</i>	<i>Private Equity Group</i>
<i>CMBS</i>	<i>Commercial Mortgage Backed Securities</i>	<i>PPIF</i>	<i>FSP's Private Public Investment Fund Program</i>
<i>CDS</i>	<i>Credit Default Swap</i>	<i>TARP</i>	<i>Troubled Asset Relief Program</i>
<i>CRE</i>	<i>Commercial Real Estate</i>	<i>TALF</i>	<i>Term Asset Backed Securities Loan Facility</i>
<i>FAS 157</i>	<i>GAAP fair value accounting</i>	<i>TCE</i>	<i>Tangible Common Equity</i>
<i>FSP</i>	<i>Financial Stability Plan of 2009</i>	<i>TRUPS</i>	<i>Trust Preferred Securities (usually pooled)</i>
<i>FV</i>	<i>Fair Value – What a willing buyer would pay a willing seller at any point in time</i>	<i>UST</i>	<i>United States Treasury</i>

# Summary of FSP



- ◆ Last week the Treasury announced a “plan for a plan” designed to deal with the crisis. The plan – called the “Financial Stability Plan” should be viewed preliminarily, as big on concept and short on detail
- ◆ The key conceptual components of this preliminary plan are as follows:



- ◆ **Stress Test:** Proposal to strengthen larger banks so as to (i) attract public and private capital, and (ii) increase bank lending effort
  - Comprehensive “Forward Looking Stress Test” of bank asset quality/and capital and earning power
  - Target: Banks with \$100 billion + in assets (and other banks who volunteer to undergo “stress test”)
- ◆ **Capital Assistance Program (CAP):** Banks who have undergone a stress test will have access to capital from the US Treasury in the form of preferred securities convertible into common necessary to provide the capital necessary to weather the stress
- ◆ **Additional “Governance,” “Transparency,” and “Accountability” Requirements for Banks participating in CAP:**
  - Requires banks to show how assistance will expand lending
  - Restricts dividends, stock repurchases, cash acquisitions and executive compensation. Dividend payments to common equity limited to \$0.01 quarterly for firms receiving “exceptional assistance”
  - Commits participation banks to mortgage foreclosure mitigation
  - Creating greater transparency in bank financial disclosures, as well as ease of comparability among peer banks
- ◆ **Public/Private Investment Fund:** Provide a means for banks to sell bad assets (loans and securities) for cash
  - Public-Private Capital: Plan to use a “partnership” approach consisting of both private capital and government funding (in the form of debt or equity) to acquire up to \$500 billion of assets with the potential to increase up to \$1 trillion
  - Private sector pricing of assets – methodology and parameters federal participation and assistance yet to be determined

- ◆ **TALF Expansion:** Goal is to support securitized lending:
  - Purchase up to \$1 trillion of assets versus previous target of \$200 billion
  - Expands scope to include commercial mortgage backed and other securities
  - Release highlights potential further expansion to non-agency residential mortgage backed securities and assets collateralized by corporate debt
- ◆ **Housing Support and Foreclosure Prevention:** Plan includes a reaffirmed commitment by Treasury and Fed to acquire up to \$600 billion of GSE mortgage-backed securities and GSE debt as well as an additional \$50 billion to help prevent avoidable foreclosures. All FSP/CAP recipients must now participate in foreclosure mitigation plans consistent with Treasury guidance
- ◆ **Small Business and Community Lending Initiatives:** Supports small business lending by proposing to increase SBA loan guarantees from as low as 75% to as high as 90%, and reducing SBA loan fees
- ◆ **Regulatory Reform:** The Treasury also reaffirmed its commitment to regulatory reform

***A primary problem which the FSP seeks to address is investor confidence in large banks which is keeping investors away from the sector as a whole***

- ◆ Reserve adequacy and integrity of carrying values of securitized and whole mortgage, consumer and CRE loans, especially in a recessionary economy
- ◆ Future OTTI charges for MBSs, CMBSs, GSEs, pooled TRUPSs, CDSs, obligations of state and local government
- ◆ Adequacy of regulatory capital
- ◆ Adequacy of Tangible Common Equity
- ◆ The continuing belief that many of the top 25 banks are insolvent
- ◆ Lack financial statement transparency and difficulty in comparing peer banks

**Carrying  
Values of  
Assets**

**Overstated**

**Earnings  
and  
Capital**

**Overstated**

**TCE**

**Inadequate  
to protect  
holders of  
common  
equity**

## *Bank Investors are sitting on the sidelines*



### Capital Raises for Banks & Thrifts <\$1 Billion in Assets

	2007 (000)	2008 (000)
Senior Debt	N/A	2,700
Senior Debt TLGP	N/A	N/A
Sub Debt	24,628	40,445
Trust Preferred	556,241	75,850
Preferred Equity	38,281	61,628
Preferred Equity - CCP	N/A	917,382
Common Equity	671,393	228,966
Total without CCP; TLGP	1,290,543	409,589

### Capital Raises for Banks & Thrifts \$1-10 Billion in Assets

	2007 (000)	2008 (000)
Senior Debt	500,403	200,000
Senior Debt TLGP	N/A	N/A
Sub Debt	145,000	188,009
Trust Preferred	1,812,364	390,717
Preferred Equity	129,266	371,840
Preferred Equity - CCP	N/A	6,383,223
Common Equity	1,727,343	1,174,498
Total without CCP; TLGP	4,314,376	2,325,064

- ◆ Total non-CCP or TLGP bank debt and equity issued in Q4 2008 for banks \$1-\$10 billion in assets was \$614 million in 2008 compared to \$1.1 billion in 2007

***The Treasury perceives that investors lack of confidence can be solved and private capital will return to the sector:***

- ◆ **If** investors believe the nation’s top 25 banks (those with assets over \$100 Billion) have been “stress tested” and given a passing grade on a forward-looking basis by regulators presumably to ascertain:
  - The spread between market values and carrying values of problem assets
  - The bank’s earning power and ability at different severity levels of economic stress, to survive with those assets and different levels of regulatory capital and TCE
  
- ◆ **If** banks “cleanse” their balance sheets of bad assets under the PPIF and the government “fills up” the capital hole created by the sale of those assets with preferred stock (Tier 1 capital) convertible into common (common equity) under the CAP
  
- ◆ **If** the government mandates increased transparency and financial statement comparability between banks and “better governance”

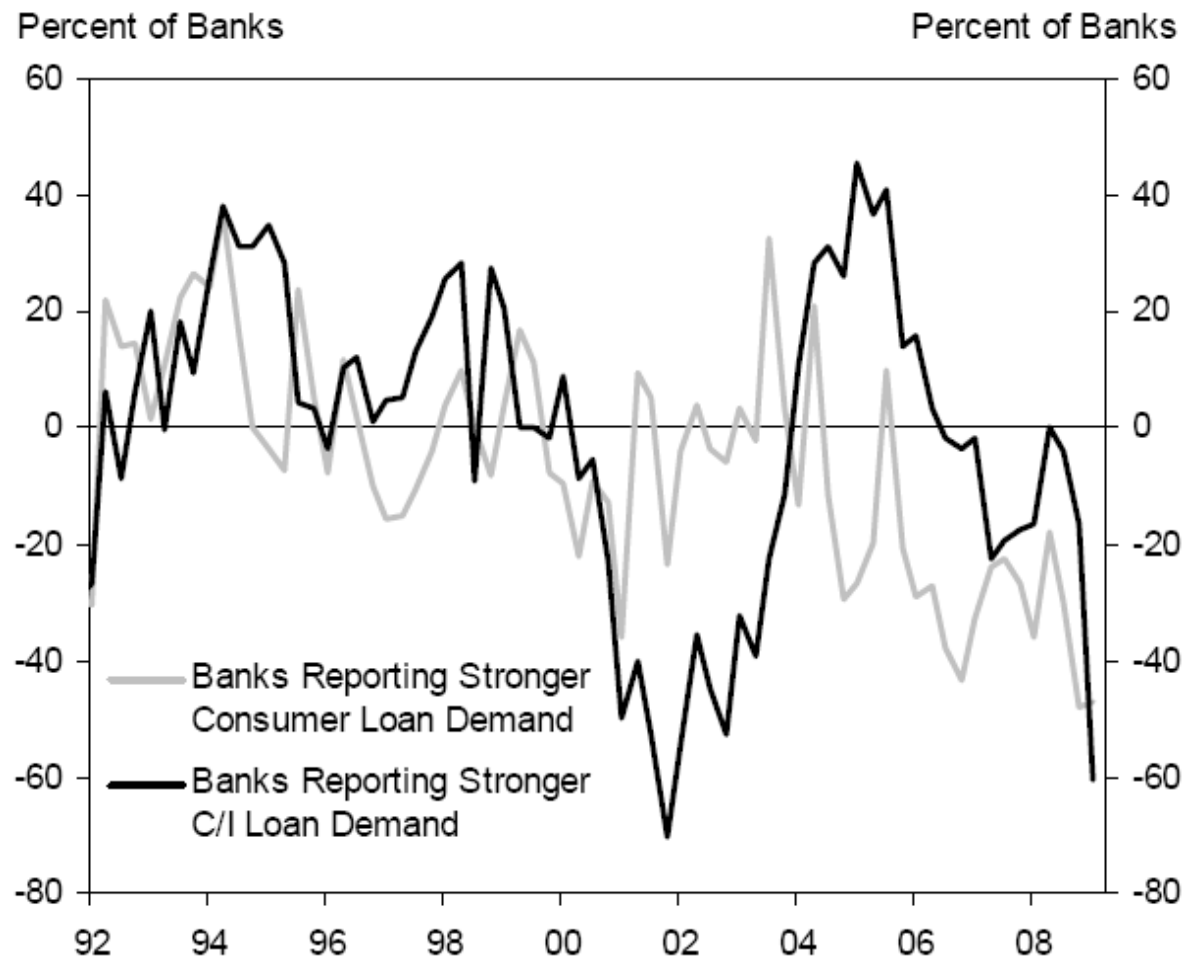
**Another primary problem which the FSP seeks to address is the perception of Treasury and the Congress that banks are not lending**

	<u>Yesterday</u>	<u>Today</u>		
<b>The US Consumer</b>			<b>US Business</b>	
◆ Income	↑	↓	◆ Consumer Spending	↓
◆ 401 K	↑	↓	◆ Business Sales and EBITDA	↓
◆ Disposable Income	↑	↓	◆ New Investment by Business in PPE, etc.	↓
◆ Non-discretionary spending	↑	↓	◆ Demand for New Business credit	↓
◆ Home equity	↑	↓		
◆ Leverage	↑	↓		
◆ Consumer Defaults	↓	↑		
◆ Savings	↓	↑		

***Demand for consumer credit is DOWN***

***Demand for business credit for other than refinancings or by troubled companies is DOWN***

## *Even Though Consumer and Business Demand for Credit is Down...*

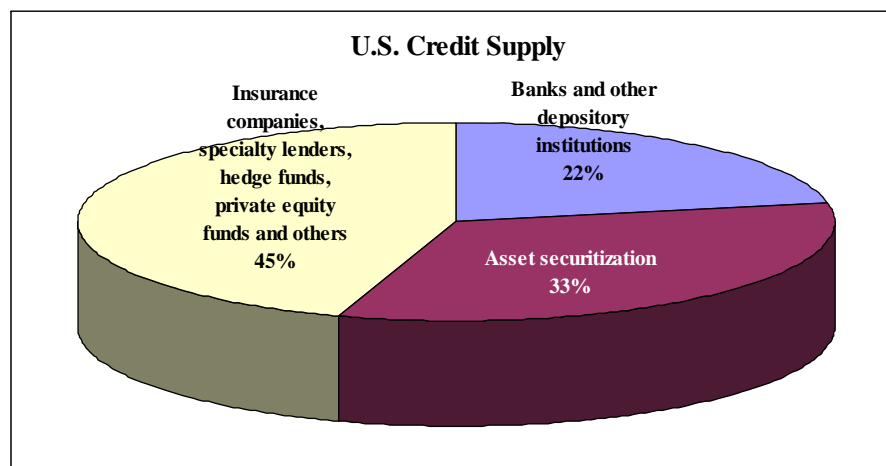


Source: Federal Reserve Board.

*...And even though bank loans and leases across the nation were up in 2008 demand was down*

	Total Loans 12/31/07	Total Loans 12/31/08
Top 257	\$ 4.4 trillion	\$ 4.7 trillion

*Did the Treasury and Congress forget that banks supply only 22% of the nation's credit?*



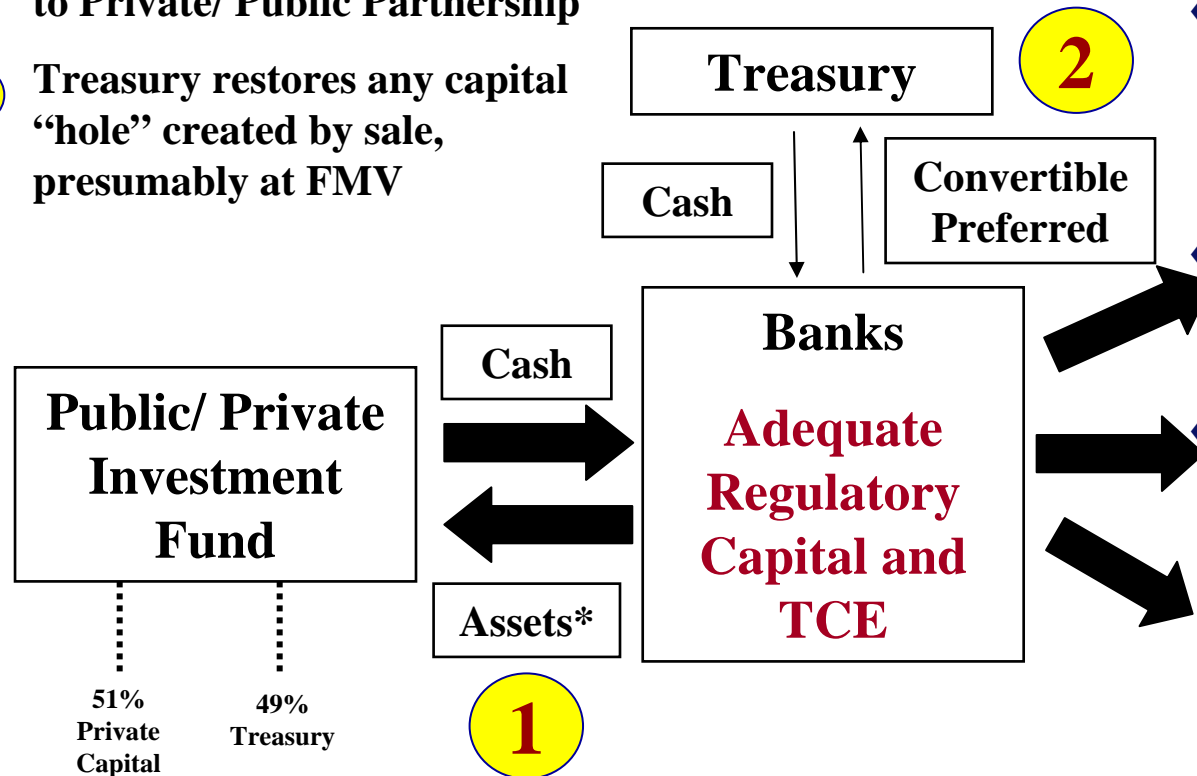
*Are Banks being asked to make up for the collapse of the securitization specialty lending and hedge fund markets?*

***Based on its erroneous perception, the Treasury believes that Banks will lend more...***

- ◆ **If** the Banks sell bad assets (including MBSs, CMBSs, ABSs, and CDSs) for cash and the banks replace these assets with new loans to Main Street leveraged from the proceeds of convertible preferred stock issued to the government
- ◆ **If** the Treasury jumpstarts and supports now dormant securitization channels, including securitized ABSs backed by credit card, auto and student loan receivables, CMBSs and MBSs
- ◆ **If** the Treasury establishes a program to support the SBA programs and increase loans to small businesses under the program

## Goals of FSP – New Lending by Banks

- 1 Bank sells problematic assets to Private/ Public Partnership
- 2 Treasury restores any capital “hole” created by sale, presumably at FMV



### Goals

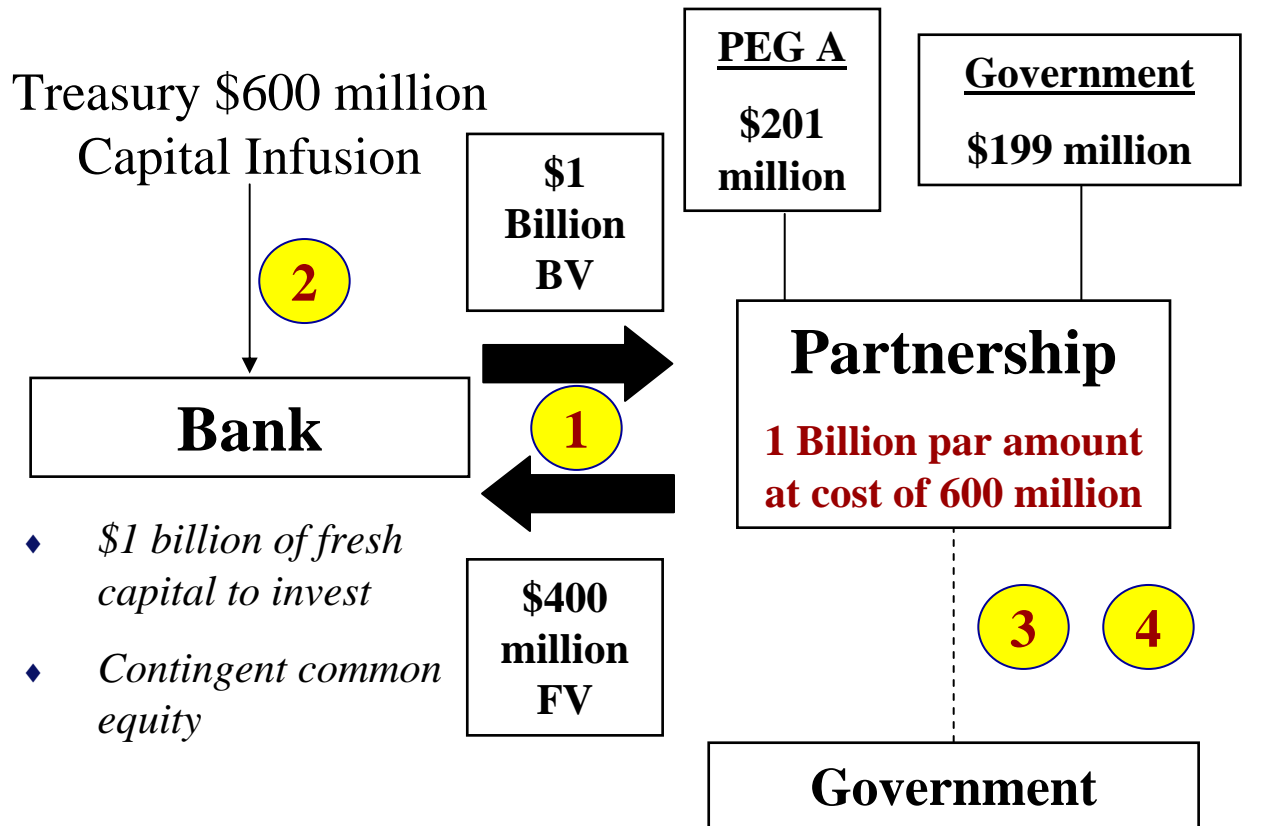
- ◆ Bank managements become comfortable with their own asset quality +
- ◆ Bank then increases loans to Main Street
- ◆ Investors return to banks because they are comfortable with asset quality, know “real TBV” and believe the banks have the regulatory and TCE to weather the recession ++
- ◆ Bank valuations increase +

*The Big Question is pricing—Rating agencies and others in the know believe it will be FV per FAS 157*

*Some think that the Treasury may make non-recourse loans to the public/private investment fund in lieu of or in addition to cash for equity thereby creating a form of loss sharing. Floor pricing guarantees and other subsidies by the Treasury are also in the cards*

# Summary of FSP

## An Illustrative Transaction...



- ◆ \$1 billion of fresh capital to invest
- ◆ Contingent common equity

1. Bank X sells \$1 billion BV of loans to Private Equity Group for \$400 million (FV)

2. Treasury buys \$600 million of convertible preferred from Bank so no loss of capital

3. PEG A and Gov't form limited partnership (51%-49%) and/or Gov't lends money to partnership with recourse limited to purchased loans and securities

4. Partnership, managed by PEG A, slices, dices and sells some assets and holds others to maturity – concept is \$400 million yields \$800-\$1 billion or more at end of 5 years or less (25 plus IRR)

*Possibility of \$100 million non-recourse loan to reduce equity investment to \$300 million and improve IRRs for recalcitrant PEGS; possibility of loss sharing*

## ◆ **THE STRESS TEST**

- Who has to or may take it?
  - Banks over \$100 billion in assets. These are the nation's 25 largest institutions
- *In order to qualify for capital assistance going forward, banks below \$100 billion may voluntarily participate in the stress test program or in a similar supervisory review process*
- If a bank “passes” the stress test – will it get a valuation bump – some think so
- We understand regulators are considering mandatory stress tests for smaller banks which meet certain criteria

## ◆ **WHICH CARDIOLOGIST WILL ADMINISTER IT?**

- It will be administered by the bank's principal federal regulator (“in coordination” with other regulators) using common processes, procedures, etc. to mitigate against inconsistent results

## ◆ **WHEN WILL THESE TESTS TAKE PLACE?**

- We understand that they will start almost immediately – even though no legislation – and are scheduled to be completed within 4-8 weeks

## ◆ **WHAT FORM WILL THE STRESS TEST TAKE?**

- We think the stress test will be similar to the stress tests presently used by Moody's and S&P, which focuses on a bank's assets and earnings and the susceptibility of banks to a deterioration in capital base during different, increasing levels of recession using multiple interest rate and credit loss scenarios
- The concept is to ascertain the amount of capital that a given bank needs to absorb future losses in different economic and recessionary environments
- We think that the test will be model and not FV driven and will produce values higher than current depressed market valuations. These values if somehow publicly available will be more credible than a bank's own model-driven values so that higher valuation should result

## ◆ **UNANSWERED QUESTIONS**

- Frequency of testing?
- Will the stress test be made public?
- What happens if bank, "too big to fail" flunks test? Breakup? Mandatory merger? Creeping nationalization?
- *Will the test for banks below the top 25 be different from the top 25 test?*
- How long will it really take to develop and implement this initiative?
- Is this a movement away from prompt corrective regulatory action towards incredible subjectivity with political undertones?

## ◆ THE SALE OF BAD ASSETS TO A PRIVATE/PUBLIC PARTNERSHIP

### • **Who can sell assets?**

- Any bank – it is not limited to Banks who have been “stress tested” or undergone prescribed supervisory reviews – only the capital injection program is limited to “stress tested” or reviewed banks

### • **What assets can be sold?**

- Consumer mortgage, HELOC, CRE and C&I Loans
- Securities of all types including ABSs (credit card, student loans, SBA loans, etc. ), CMBSs, MBSs and according to some, CDSs as well. (Not clear on pooled TRUPS)
- ***How will this work with complex securitized products or CDSs?***
- ***Note – most of the targeted assets are very complex, difficult for a seller to gather and sell, let alone value (fixed rate, floating rate, auction rate, prime, subprime), each with its own default rates and performance characteristics. Most are subject to servicing and trustee arrangements and each issue is held by different investor classes all over the world***
- CDSs pose their own set of well-publicized valuations issues

- ◆ THE PURCHASE OF BAD ASSETS VIA A PRIVATE/PUBLIC PARTNERSHIP
  - **What form will it take?**
    - We think it will take the form of old RTC private/public partnership used to acquire and optimize value in the early 1990s
  - **How much?**
    - The Treasury says it will invest \$500 billion to \$1 trillion
    - If the private/public partnership is a 50%-50% partnership – \$1 trillion becomes \$2 trillion
    - Estimates on the amount needed to clean up the “assets” of the industry range from \$2 to \$3 trillion, without CDS and 2 plus times those numbers with CDS
  - **What form will the UST investment take? Possibilities include?**
    - Minority equity only
    - Non-recourse debt
    - Minority equity and non-recourse debt
    - Some form of guarantees loss sharing with one or more of the above

## ◆ PRICING OF ASSETS

- **At what price? Almost everybody thinks that they need to be and will be at FV today**
  - Reason #1 – Congress and the public will require it
  - Reason #2 – Private capital will require it. *Note also that private capital is looking for 2-4x return on money and a 25% - 40% IRR on distressed assets so FV or a discount to FV will be the rule, not the exception*
  - Reason #3 – The Treasury has said that private capital would bear “1st loss”
  - Note – the Treasury wants as *high a price as possible* to support Bank balance sheet and private capital wants the *lowest possible price* to increase IRRs
- **Will Banks sell at FV if it is lower than BV?** Only if they have a whole lot of capital. Otherwise no because:
  - Reason #1 – It creates a loss which flows through the income statement and creates a capital hole. As we all know, capital is scarce and very expensive
  - Reason #2 – Why “give away” assets, whose values using credit and interest rate marks and model based life of loan valuation methods are more than FV in an illiquid market in the middle of a recession?

## ◆ PRICING OF ASSETS

- **If pricing is at FV, how will the Treasury induce the banks to participate?**
  - By filling up the hole with capital
  - Some have stated that the Treasury might consider the issuance of regulatory “net worth certificates” or forbearance agreements to the banks similar to those issued first by the FHLB in the early 80s. We hope not – Recollect that the government reneged and litigation is still pending more than 20 years later.
- **If pricing is higher than FV, how will the Treasury induce private capital to buy:**  
Possibilities include
  - The target for private capital will be 3-4 x money with an implicit IRR of 25%-30%. This may be too expensive for the industry and taxpayers
  - Providing non-recourse loans or engaging in loss sharing or guarantees in order to permit private capital to realize their 25%-30% IRR targets – the key to their participation
  - How about direct sales of assets at a premium to FMV coupled with warrants from Selling Bank? How about the government guaranteeing a floor price?

## ◆ CAP

- **What are terms of the CAP Preferred?**
  - Preferred, convertible, at the election of the Bank into common. Dividend rate not yet specified. Conversion rate to be market based as of February 9, 2009

## ◆ Securitization Channels

- **What?**
  - Previously announced TALF, originally designed to use \$20 billion to leverage \$200 billion of loans (on a non-recourse basis) to purchasers of newly issued Aaa-rated ABSs (backed by credit card securities, auto and student loans) will now be expanded to support CMBSs, non agency residential MBSs, and SBA loans
  - Expanded to use of up to \$100 billion leveraged on 10x basis to up to \$1 Trillion in non-recourse loans to these sellers
  - *Goal – Entice large banks back into securitization aggregation businesses by assuring them that buyers will be there. In other words, if you originate them, you can sell them*
  - *This is a big one from the perspective of the Treasury's goal of increasing lending. This is where credit emphasis should be placed*

## ◆ Governance, Transparency and Accountability

- **What?**
  - Improve public disclosures of asset exposures on bank balance sheets
  - Improve comparability between and among banks with respect to accounting treatment and disclosure
  - Restrictions on dividends, stock repurchases and cash acquisitions
  - Restrictions on compensation for those who take federal dollars
- **Who?**
  - Treasury to work with bank regulators, the accounting profession and SEC on this project
- **Other?**
  - No other details, as yet

- ◆ CAP Required Governance – Other

- **Who?**

- Banks which receive “exceptional assistance”\* must show how the capital they get generates new lending compared to what would have been possible without UST capital
- All banks that get UST capital under CAP must submit a plan for how they intend to use the capital to support lending. These plans will be made public
- All banks that get UST capital under CAP must make monthly reports which break out loans by category and show how many new loans they made and how many ABS and mortgage-backed securities they purchased, with a comparison to an estimate of what activity would have been without such capital
- *Banks who received assistance under TARP/CPP will get a letter from TARP Inspector requesting information on use of TARP proceeds and specific plan addressing executive compensation and other information*

---

\* Exceptional assistance means assistance in excess of normal TARP/CPP or normal FSP/CAP program

- ◆ CAP Required Governance – Other (cont'd)
  - All banks who receive UST capital under FSP/CAP must commit to participate in the Treasury's mortgage foreclosure mitigation programs
  - Banks who receive “exceptional assistance” may only pay common stock dividends of \$0.01 per quarter until the Treasury is repaid
  - Banks who receive capital under the FSP's CAP will be subject to the same limit unless it is waived by the Treasury and their primary regulator
  - All banks who receive UST capital under FSP/CAP may not purchase privately held shares without approval of the Treasury and their primary regulator until the UST is redeemed
  - All banks who receive UST capital under FSP/CAP can't do cash acquisitions until the UST is repaid

- ◆ CAP Required Governance – Other (cont'd)
  - *Under the new executive compensation restrictions announced on February 4, 2009, until the UST is repaid, banks who received “exceptional assistance” may not pay senior executive more than \$500,000 in total annual compensation except for restricted stock payable when the gov’t is repaid*
  - *Banks who receive capital under the FSP’s CAP may not pay senior executives more than \$500,000 in total annual compensation, except for restricted stock until the USST is repaid*
  - *Until the UST is repaid, these restrictions also require shareholder “say on pay” votes, require clawbacks for executives found to have engaged in deceptive practices, limit golden parachutes, and require board approval and disclosure of a luxury expenditures policy*
  - *Stimulus plan further tightened these rules – more to follow later*
- ◆ Housing Support and Anti-Foreclosure Matters
  - **What?**
    - Commitment to allocate \$600 million to purchase GSE mortgage-backed securities and debt and \$50 billion to prevent foreclosures

# Impact of FSP on TARP I – Have Community Banks Been “Tarped and Feathered”?



Treasury Secretary Geithner told Congress that the Treasury would not be seeking additional money to fund the FSP and the old TARP from the \$700 million allocated in October

- ◆ ***TARP Capital Purchase Program (TARP CPP)***
  - \$195.6 billion has been distributed to financial institutions
  - \$59.4 billion (est.) has been approved and is pending distribution
- ◆ ***Systemically Failing Institutions Program***
  - \$40 billion to AIG
- ◆ ***Targeted Investment Program***
  - \$20 billion to Citi (in addition to investment under TARP CPP)
  - \$20 billion to B of A (in addition to investments under TARP CPP)
- ◆ ***Automotive Industry Financing Program***
  - \$24.9 billion has been allocated to automakers and their financing arms
- ◆ ***Temporary Asset Liquidity Fund (TALF)***
  - \$100 billion to fund purchases under TALF
- ◆ ***Aid to Homeowners***
  - \$50 billion under a program to be announced on Wednesday

**\$190.2  
Billion for  
TALF,  
TARP/ CPP  
pipeline  
FSP/CAP and  
FSP/PPIF  
programs and  
Systemically  
Failing Bank  
Program**

# Impact of FSP on TARP I – Have Community Banks Been “Tarped and Feathered”?



- ◆ **What impact will FSP have on banks (including Sub S institutions) which have already applied to participate in TARP CPP, but have not yet received approval?**
  - This program continues, but Treasury's focus will be on funding the FSP/CAP, TALF, and PPIF and providing aid to homeowners and other Obama driven initiatives
  - We think approvals will be more difficult to obtain in the future
  
- ◆ **What impact will FSP have on entities looking to use TARP funds to help finance acquisitions under the Systemic Failing Institution, Targeted Investment and TARP CPP programs?**
  - WSJ reported that Treasury and FDIC declined to facilitate a bid for BankUnited (BKUNA), by the Carlyle Group, W.L. Ross, and John Paulson
    - This is a bad signal to private capital, including private equity and hedge funds. BKUNA, with \$14 Billion in assets in one of Florida’s most attractive demographic areas, may be close to failure. The gov’t must believe that BKUNA is not “systemically important” and that an FDIC resolution process will be better for the FDIC and taxpayers
  - To date, at least four large insurance companies – Hartford, Genworth, Lincoln National and Aegon- have not yet received approval to participate in TARP CPP in connection with their respective acquisitions of thrifts and Treasury. Will they?

# Impact of FSP on TARP I – A Few Words on Dodd Amendment to American Recovery and Reinvestment Act of 2008



## ◆ What about institutions which are already participating in TARP CPP?

- Senior executives and highly-compensated employees of TARP/CPP recipients are not only subject to the \$500,000, but also now become *at-will employees* because the institution is prohibited from making any payments to the employee upon their departure from the institution, regardless of the reason
- If you return TARP CPP investment, you are free of the rule, but will have to communicate a coherent strategy to your regulators and investors on how you intend to fill this capital hole
  - The reason cannot be the “executive compensation restrictions are too onerous”
  - Practically, given the downturn in the economy and asset quality issues at most banks, will the regulators let you return capital?
- Incentive compensation awards will take the form of restricted stock going forward.  
*Vesting appears onerous*
- If you are keeping TARP CPP investment, be prepared for requests for information from TARP Special Inspector General regarding use of TARP funds and executive compensation
- Meet with your advisors in order to determining whether your compensation programs encourage “unnecessary and excessive risk” or the manipulation of reported earnings
- *Some of the CEOs of the Banks that did not take the cheap TARP/CPP capital last October said that they were afraid that if they did so, the policies of government, especially given the then possible change in administration and in composition of the Congress would create unreasonable burdens on banks and their management. Unfortunately, they were right!*

## ◆ Stress Test of Big Banks

- FSP should *help* community banks to the extent it brings investors back into bank stocks generally – community bank valuations are clearly impacted by low, but appropriate Big Bank valuations
- FSP will *hurt* community banks competitively to the extent investors and depositors flock to the Big Banks because they have been “stress tested,” and pronounced “healthy” by the government
  - The fact that the Treasury throws additional capital at them also might be viewed as a government stamp of approval
  - The fact investors and depositors think the Big Banks are “too big to fail” also should hurt community banks competitively
- FSP will *hurt* larger regional community bank who may have been M&A targets of the Big Banks. With depressed valuations and currency and the inability to use cash to fund acquisitions, the Big Banks will sit on the M&A sidelines for some time
- FSP will *hurt* community banks to the extent Big Banks fail the stress test and CAP is not feasible. There is a real possibility that further consolidation among the top 25 will result. This will increase concentration and be adverse to competition in more than a few local banking markets

# Our Take – What Does All of This Mean to Community Banks?

---



## ♦ CAP

- The condition precedent - - stress test may be more stressful than some community banks would like
- Same as under “Stress Tests” previous, both pros and cons
- CAP helps if a community bank sells assets to the private/public partnership and needs capital to fill up the hole and/or grow the bank’s assets
- CAP may also help community bank valuations if the banks take the test, pass it, and the results are publicly disclosed
- Taking CAP capital will trigger dividend, stock repurchase, cash M&A and executive compensation restrictions and anything else the Treasury and Senator Dodd want to visit on banks who take capital at some time in the future
- The competition for the remaining \$190 billion means that applications in pipeline for public, private and Sub S Banks will be considered, but we think on a much more vigorous and restrictive basis
- Why apply for and take it unless you really need it?

## ◆ *Purchase of Bad Assets via Private/Public Partnership*

- Big Bank sales to PPIF – To the extent the gov’t fills up the capital hole and props up the Big Banks, community banks will be hurt competitively sooner in their quest for deposits and loans!
- Community bank sales to PPIF – if at a premium to carrying value – community banks will need capital which is scarce and expensive
- If existing capital is sufficient or reasonably available or if a community bank is stress tested and applies for and accepts capital – a sale should spur investor confidence and result will be more liquid market and better valuations
- *But, if life of loans valuations support existing carrying value - - why sell at an economic loss UNLESS YOU REALLY NEED TO, especially in light of existing deployment yields and risks???*

## ◆ *Support of Securitizations*

- IF anything in FSP will increase credit availability – this is it
- It should also result in a funding source, increased bank liquidity and fee income for banks
- It should also result in better execution and better pricing of assets stranded on bank balance sheets per FAS 157 by helping create higher “observable input” pricing in the market

# Our Take – What Does All of This Mean to Community Banks?

---



## ◆ *Increase in Governance and Transparency*

- Transparency will have a significant direct and indirect cost to community banks, including internal and external audit, regulation, examination and supervisory expense, and legal expense
- Compensation restrictions are onerous and become more so under stimulus bill
- Regulatory revamp will be paid for somehow by community banks
- Transparency should help bring investors back to the market

## ◆ *Housing Support and Anti-Foreclosure Measures*

- Also comes with an economic hit for community banks

## ◆ *Small Business Initiatives*

- Should help community bank customers who need SBA support
- This is another very good step forward in increasing lending
- Should help bank-sponsored SBICs
- Should help those banks which have SBA lending units

- *There is no “panic” concerning the soundness of most Community Banks which justifies FSP. The problems are with the 25 or so large banks subject to FSP’s “stress test”*
- *The primary beneficiaries of this 2nd bailout will be those 25 or so large banks*
- *The Government is again rewarding the poorly managed Big Banks and punishing well run community banks who are not stressed and who did not create or perpetuate the banking crisis*
- *Community banks will pay, directly or indirectly, for this “industry” problem. The UST will not “parse” the industry between large banks and community banks or stressed banks and non-stressed banks and allocate costs based on fault or federal benefit*
- *The Treasury has failed to convince the market that FSP works. Too little detail. “A plan to have a plan”*
- *CAP does not inject sufficient capital into the banking system to cover stress. The industry needs a combination of public and private investors*
- *We think the PPIF (the private/public sector partnership), as proposed, does not work. Private capital will require at least 3 to 4x money (25-30% or higher IRRs) on purchased assets to participate. In many cases they will not be able to get private capital to buy at FV without a discount, loss sharing or non-recourse financing. Private capital IRR targets may be too expensive for the industry to follow*

---

## About Griffin and Our Recent Additions

*For Additional Information About Griffin,  
Please Visit Our Website:*

*[www.go2griffin.com](http://www.go2griffin.com)*



# Our Platform – How We Are Different

---



- ◆ Our Griffin Financial Institutions Group is part of an integrated professional services firm consisting of:
  - A FINRA licensed investment bank focusing on the financial services sector
  - A full service AmLaw 200 law firm focusing on the financial services sector
  - An SEC registered money manager focusing on the community bank sub-sector, with exceptional sector insights and exceptional track record
  - A private equity placement and due diligence business which understands the intersection between the financial institutions and private equity sectors
  - A D&O and E&O insurance risk consulting business focusing on the financial institutions sector
  - A swap and other derivative advisory business
  - A tax consulting business which assists financial institutions manage its tax provision
  - Strong federal and state government affairs and several other businesses which focus on financial institutions and complement and expand our platform

# Our Platform – How We Are Different

---



- ◆ Our Griffin Platform consists of over 240 multidisciplinary professionals covering the Northeastern U.S. from 17 offices
  - Our platform stresses the value of occupational and educational diversity and sector experience
  - In addition to sector experienced investment bankers, lawyers, placement agents, government affairs and investment professionals, our team members include former senior executive officers, accountants, tax professionals, risk managers, regulatory compliance officers, economists, swap advisors, and research analysts
    - *The inclusion of in-house, industry specific financial accounting and tax capabilities in Griffin is unique among investment banks specializing in the financial institutions sector*
- ◆ Our Griffin Platform also stresses the value of understanding sector needs from its clients' perspective
  - Our staff includes many former senior executive officers of both large and small depository institutions, specialty lenders and others in the sector with hands-on operating and transactional experience
    - *Our professionals have managed and built multi-billion enterprises growing them organically as well as via acquisition. These capabilities are in addition to those of any other investment bank which generally lack professionals with any meaningful operating experience in the sector*
  - We are committed to developing proactive solutions for your challenges and opportunities and leveraging our relationships for your benefit
- ◆ Our sector experience coupled with our occupational and educational diversity, multi-disciplinary approach and commitment to anticipation and innovation combine to deliver exceptional value to our clients

## Recent Additions to Our Griffin Group

---



***Recent Additions to our Griffin Financial Institutions Group enhance both our ability to focus on your business from your perspective and our strength in financial accounting and tax as they apply to banks and thrifts***



**Mark McCollom** – Former CFO at Sovereign Bancorp and Sovereign Bank where at different times he had primary responsibility for the corporate development and M&A treasury, financial accounting, SEC compliance, risk management, investor relations, tax and strategic planning functions. Before joining Sovereign, Mark, a CPA, worked in corporate development at the former Meridian Bancorp and was formerly with a Big 4 accounting firm. While at Sovereign, he was instrumental in executing Sovereign’s successful acquisition and capital markets programs, which permitted Sovereign to grow to \$90 billion in assets



**Richard Vader** – 30 years of investment banking and commercial banking experience with niche, major and regional investment banks, brokers / dealers and banks Experience includes senior responsibility for about 45 mergers and acquisitions, and 25 securities offerings, including bank and insurance companies’ mutual-to-stock conversions Professional experience includes tenures with bank boutiques Keefe, Bruyette & Woods, Inc. and Alex Sheshunoff & Co., Inc., major and regional securities firms of Kidder, Peabody & Co., Inc., The First Boston Corporation and Advest, Inc., and niche firm of McColl Partners LLC. ‘Corporate Finance Director’ of a multi-billion community bank

## Recent Additions to Our Griffin Group

---



***Recent Additions to our Griffin Financial Institutions Group enhance both our ability to focus on your business from your perspective and our strength in financial accounting and tax as they apply to banks and thrifts***



**Tom Bowen** – Former tax director at Ernst & Young where Mr. Bowen served as a primary outside tax consultant to a number of financial institutions. Assists financial institutions managing its tax provision and conducts due diligence reviews on potential targets to quantify state and local income, non-income tax liabilities and provision reduction potential. Certified Public Accountant and a lawyer



**Keen Turner** – Former Senior Audit Manager for Ernst & Young having responsibility for managing and coordinating audits and SOX 404 implementation for large and small cap banks, specialty lenders and private equity firms. Significant auditing and accounting experience including accounting for investment securities and OTTI, investment valuation techniques (including illiquid or privately held investments), derivatives and hedging activities, purchase accounting and related valuation, mortgage banking activities, goodwill impairment and other asset impairment/valuation considerations, securitization accounting and valuation, and foreign currency translation

# What Griffin Does to Help Our Banking Clients



## Interest Income

- Exposure to our senior debt and mezzanine placements for C&I and RE clients to help you grow assets
- Loss modeling to help you predict losses on loan portfolios; monitor portfolios and enhance credit quality
- SWAP Program to permit you to offer fixed rate product in competition with bigger banks
- Diversification of Net Interest Income through introduction of various asset originators (consumer finance, commercial finance, commercial real estate and other asset classes) looking to partner with banks

## Interest Expense

- We place debt (including private placement TLGP debt), equity, TRUPS and other securities to lower effective borrowing cost and provide capital

## Provisions

- We can refinance problem credits with asset based and mezzanine lenders

## Non-Interest Income

- We help you find fee producing businesses to buy and help you in structuring and negotiating

## Non-Interest Expense

- We assist in optimizing head count and payroll and reducing employee benefit expense. We also help you reduce your D&O liability insurance expense while enhancing your coverage

## Tax Provision Mitigation

- We offer products to assist you in reducing your tax provision, including BOLI related product and state tax mitigation programs

## Strategic

- We do detailed industry and bank specific landscape assessments and strategic alternative studies
- We assist you in understanding the M&A landscape and in buying and selling banks, including due diligence and modeling

*This presentation is not considered complete without the accompanying oral presentation made by Griffin Financial Group (“Griffin”).*

*The observations, takeaways and other information contained herein involve many assumptions regarding trends, industry-specific operating characteristics, financial market perceptions and the general state of the economy.*

*The information contained in this presentation have been obtained from sources that are believed to be reliable. Griffin makes no representations or warranties as to the accuracy or completeness of the information herein.*

*The information contained herein does not constitute legal or financial advice.*