THE FEDERAL RESERVE BANK OF RICHMOND

Credit Markets Symposium:
"Setting the Bar for Bank Capital"

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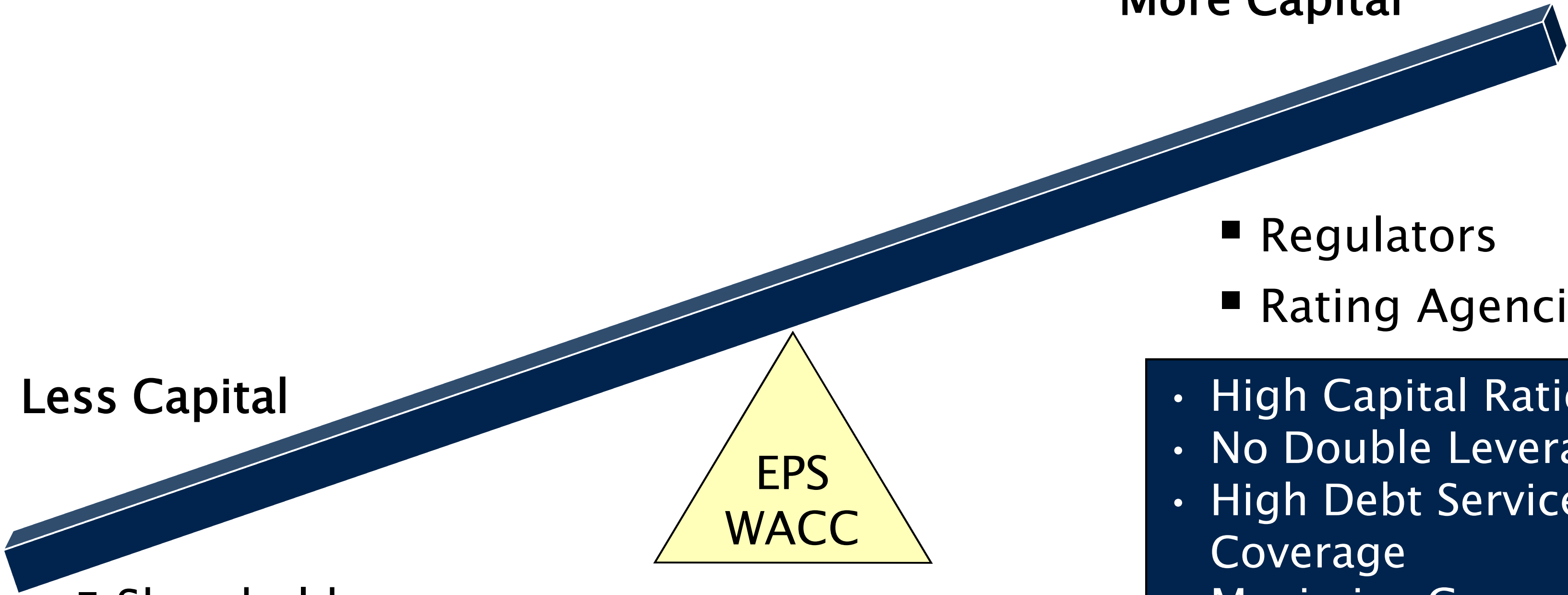
Thomas W. Killian
Principal

Different Stakeholders Vary In Their Expectations for Capital Levels

More Capital

- Regulators
- Rating Agencies

- High Capital Ratio
- No Double Leverage
- High Debt Service Coverage
- Maximize Common
- Higher WACC

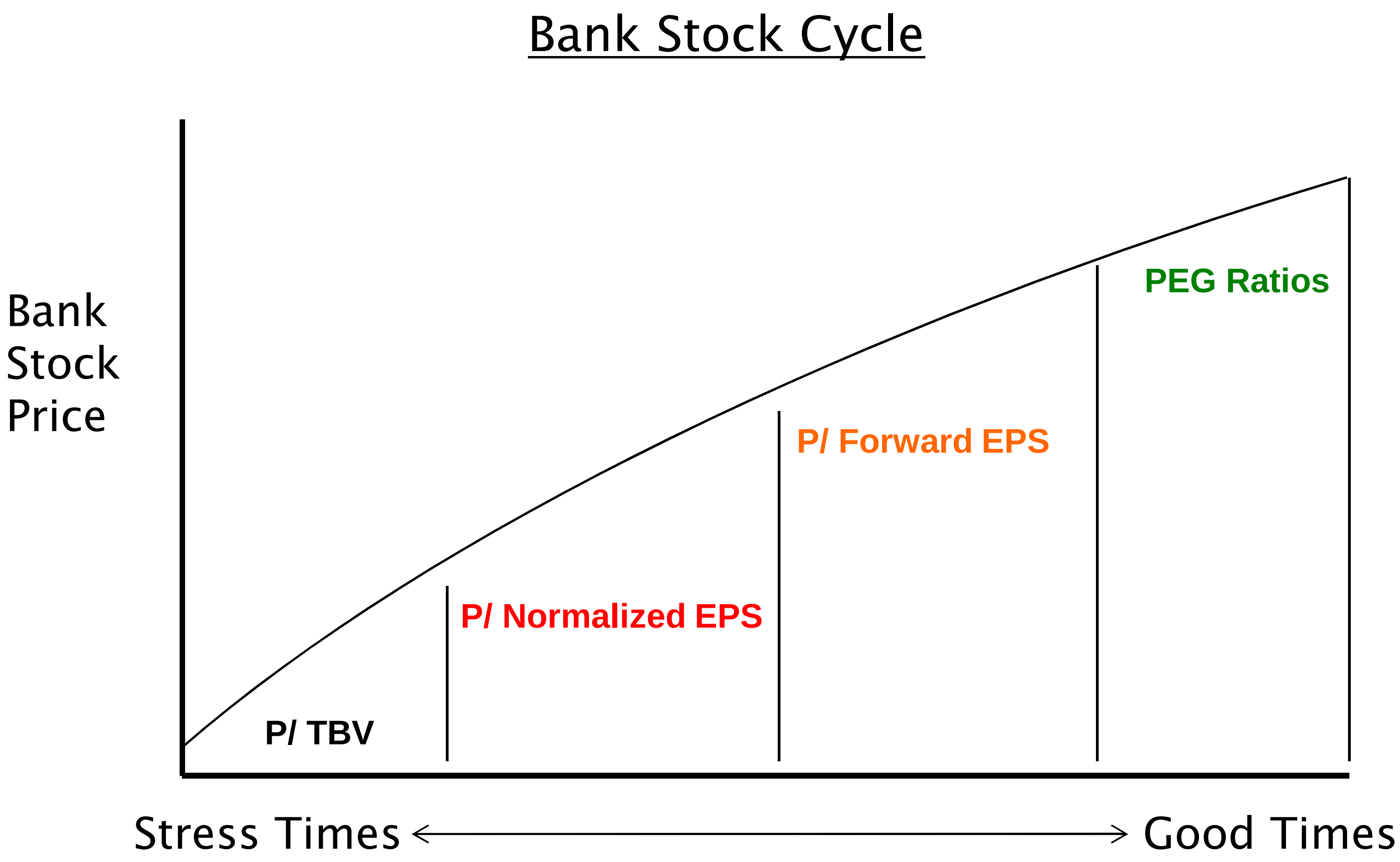


Less Capital

- Shareholders
- Analysts

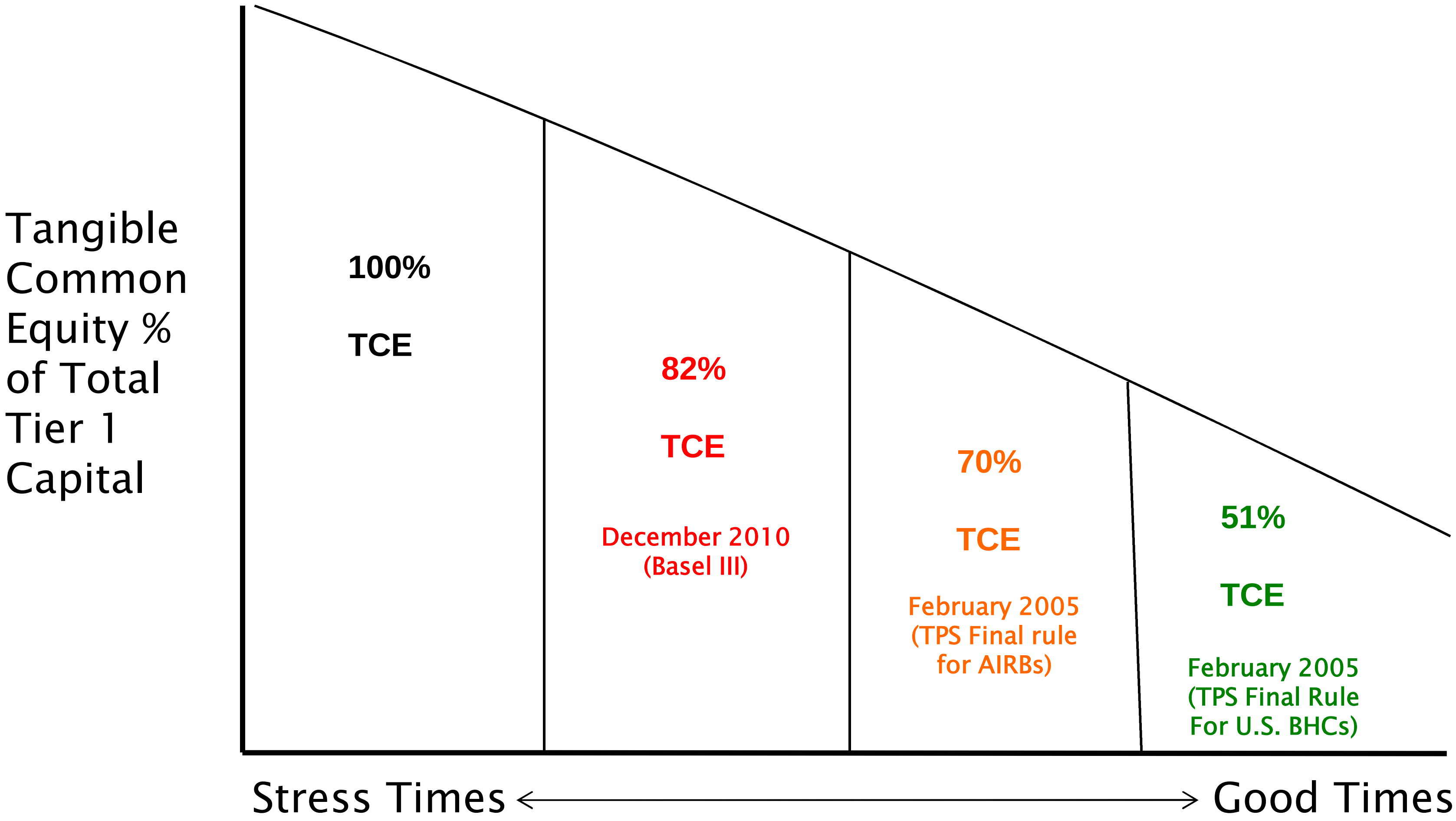
- High EPS Growth
- High Leverage
- Adequate Debt Service Coverage
- Minimize Common
- Lower WACC

Valuation Metrics Vary Based on “Good” Times Relative to “Stress” Times



Capital Priorities Vary Based on “Good” Times Relative to “Stress” Times

Bank Equity Capitalization



Deductions for Unrealized Gains and Losses Could Significantly Impact Capital Ratios In a Rising Interest Rate Environment

- Currently, unrealized gains and losses of AFS securities are EXCLUDED from regulatory capital, but INCLUDED in GAAP and tangible equity
- However, under Basel III, unrealized losses would now be deducted from Tier 1 Common Equity, and unrealized gains may be added back
- We can readily measure the potential impact of this rule on bank capital ratios if interest rates rise:

Asset Size	Total Number of Banks	Total Assets	Total Risk-Weighted Assets	Total AFS Securities	Total Tier 1 Common Equity	Tier1 Common Equity Ratio	Change in MV of Securities +300	+300 Tier 1 Common Equity	+300 Tier 1 Common Equity Ratio	Change in Tier 1 Common Equity Ratio
$15 billion - $50 billion	28	758,061,259	503,292,556	129,797,098	61,540,429	12.2%	(13,628,695)	47,911,734	9.5%	-2.7%
$10 billion - $15 billion	27	338,907,132	216,887,606	73,169,159	32,171,022	14.8%	(7,682,762)	24,488,260	11.3%	-3.5%
$500 million - $10 billion	1,181	1,803,660,765	1,206,645,226	344,915,689	155,816,335	12.9%	(36,216,147)	119,600,188	9.9%	-3.0%
< $500 million	5,767	875,182,864	577,738,399	168,048,296	88,715,908	15.4%	(17,645,071)	71,070,837	12.3%	-3.1%
Total	**7,003**	**3,775,812,020**	**2,504,563,787**	**715,930,242**	**338,243,694**	**13.5%**	**(75,172,675)**	**263,071,019**	**10.5%**	**-3.0%**

- We assume a duration of 3.5 years for the AFS securities portfolio, based on empirical evidence
- Using this assumption, the aggregate Tier 1 Common Equity Ratio for all banks less than $50 billion in assets would decline by 3% if interest rates rise 300bp – not unlikely given that we are at historic lows in rates

Bank Stock Valuations Currently Driven by ROAE

Higher Common Equity Ratios Complicate Achieving Acceptable ROAE

Nationwide	
LTM ROAE	Median Price / TBV
> 12%	165%
10%-12%	144%
8%-10%	128%
5%-8%	111%
2%-5%	88%
0% - 2%	72%
< 0%	63%

- Higher capital ratios reduce returns on equity.
- Lower returns translate to lower stock prices.
- We think any adjustment to the risk premium paid for banks (given the theoretical de-risking of the business through higher capital ratios) will take a long time to be seen in multiples and valuation.

Note: Includes nationwide banks and thrifts traded on the Nasdaq, NYSE, or NYSE Amex
Financial data for the last twelve months ending December 31, 2011; market data as of March 26, 2012
Source: SNL Financial

Excess Tangible Common Equity Can Negatively Impact Valuation Multiple

Market Valuation Relative to TCE Ratio

TCE Ratio	Median Price / TBV
> 8%	106%
7% – 8%	138%
6% – 7%	93%
5% – 6%	76%
4% – 5%	70%
< 4%	65%

Notes: Includes all nationwide banks and thrifts traded on the NASDAQ, NYSE or NYSE Amex; excludes mutuals and MHCs
Financial data for the last twelve months ending December 2011; market data as of March 26, 2012
Source: SNL Financial

Higher Common Equity Levels Increase After-Tax Cost of Tier 1 Capital

Basel III Capital Requirements Will Dramatically Increase the Common Equity Component of Tier 1 Capital

Illustrative Cost Under Current Rules

	Pre-Tax Cost	After-Tax Cost	Percentage of Tier 1	Weighted Average Cost of Capital
Common Equity	15.00%	15.00%	51%	7.65%
Trust Preferred Securities	8.00%	5.20%	25%	1.30%
Non-Cumulative Perpetual Preferred	10.00%	10.00%	24%	2.40%
			100%	11.35%

Illustrative Cost of Capital Under Basel III

	Pre-Tax Cost	After-Tax Cost	Percentage of Tier 1	Weighted Average Cost of Capital
Common Equity	15.00%	15.00%	82%	12.30%
Trust Preferred Securities	8.00%	5.20%	0%	0.00%
Non-Cumulative Perpetual Preferred	10.00%	10.00%	18%	1.80%
			100%	14.10%

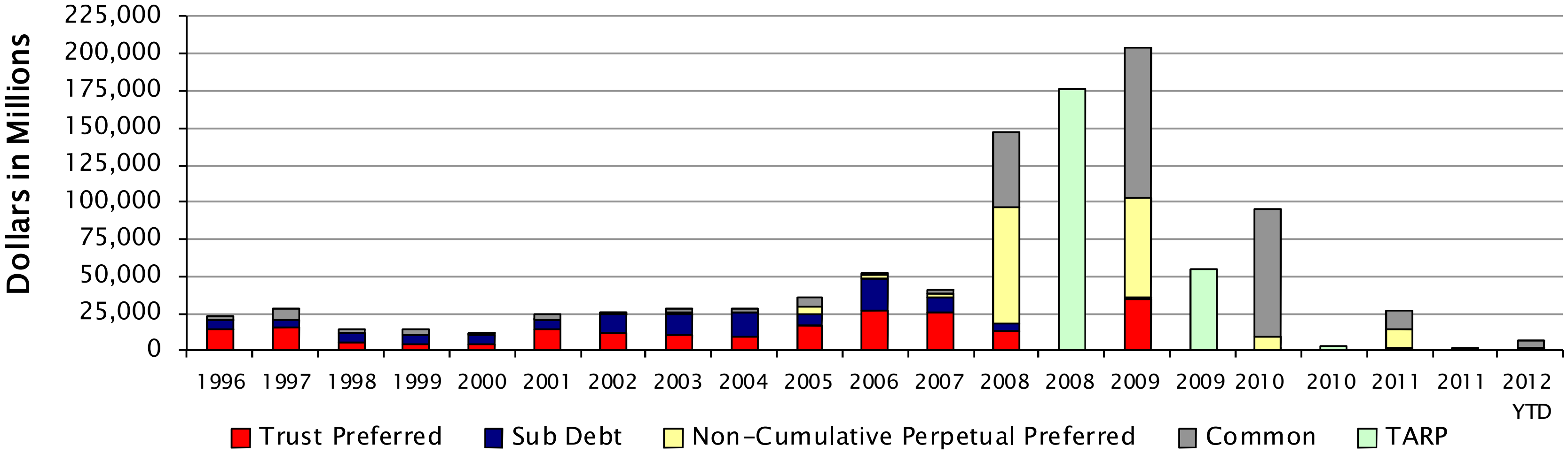
Potential 24% Increase in After-Tax Cost of Tier 1 Capital

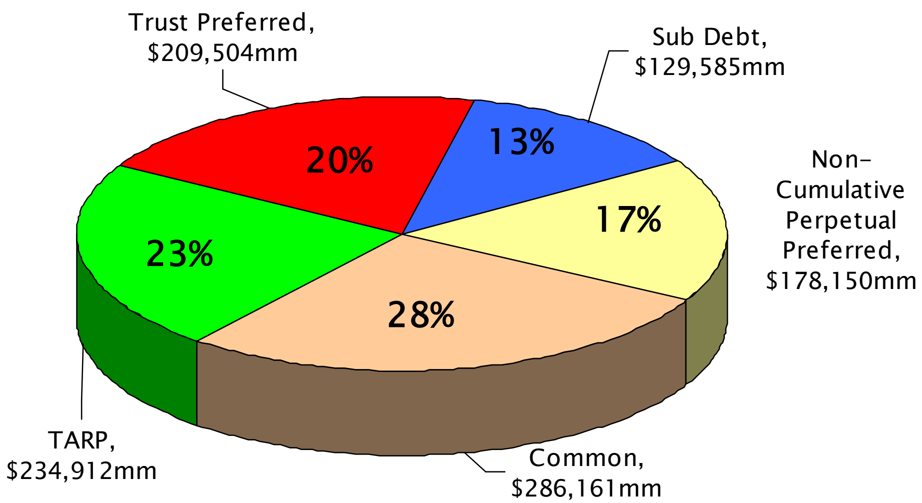
- Prior to Basel III, common equity had to be the dominant component of Tier 1 capital (i.e. >50%)
- The balance of Tier 1 could consist of qualifying Tier 1 components such as TPS and non-cumulative perpetual preferred stock
- With common equity now required to be 82% of Tier 1 capital and no ability to use TPS after the phase-out period for tax deductible Tier 1 capital, the after-tax cost of Tier 1 capital will increase 24%
- Higher cost of capital in the banking industry would be expected to ultimately impact ROE for banks and the valuation and trading of bank stocks

Note: Assumes a 35% tax rate; Actual cost of trust preferred securities and non-cumulative perpetual preferred will vary according to institution and market conditions

Common Equity Is Now the Largest Source of Bank Capital

Historical Issuance Trends



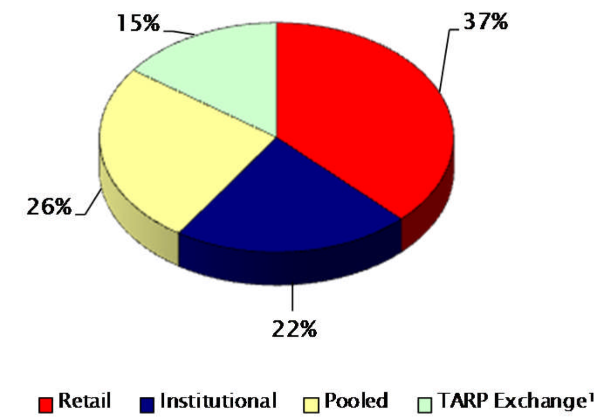


- TARP represented about 23% of the $1,038 billion of total capital raised from 1996 to 2012
- Since 2008, $210 billion of common was issued in 893 transactions comprised of 815 public and 78 private deals with an average offering amount of $296 million and median amount of $21 million
- 98% of gross offering amount of $210 billion was by 453 public issuers with market capitalization > $100 million

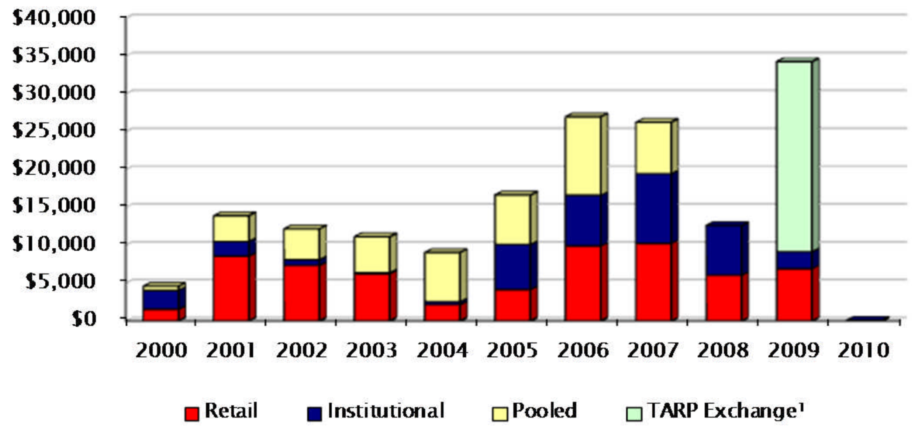
Source: SNL Securities, issuance data as of March 26, 2012

Limited Market Access to Hybrid Capital for Non-rated Banks

Issuance by Type (2000-2010)



Issuance by Type ($mm)



- Limited market for fixed income hybrid capital securities issued by BHCs without investment grade ratings
- Rating agencies reluctant to grant investment grade ratings to BHC with less than $10 billion in assets due to size, regional concentration and lack of diversification
- Pooled TPS market helped address this limitation by using structure to enhance credit rating
- With no pooled TPS issuance since 2007; hybrid capital access is very limited for smaller banks
- U.S. Treasury auction of CPP this week may help establish new benchmark yields for non-rated preferred stock

[1] Includes $27 billion of Citigroup's TARP funds that were converted to Trust preferred securities
Data Source: SNL Securities, Bloomberg Financial and Sandler O'Neill calculation

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