

# 90 Day Note

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## Evaluation Requirements According to Final Guidance on Appraisals and Evaluations

By: Rob Grope, Senior Consultant

The *Interagency Appraisal and Evaluation Guidelines* was issued December 2010 and is now the working “framework” for appraisals and evaluations. The following guidance documents have been incorporated in the Guidelines and are now being rescinded: (1) the 1994 Interagency Appraisal and Evaluation Guidelines, (2) the 2003 Interagency Statement on Independent Appraisal and Evaluation Functions, and (3) the Interagency Statement on the 2006 Revisions to the Uniform Standards of Professional Appraisal Practice.

As part of this change, the Guidance has greatly enhanced the evaluation process and what is required for a bank to perform an internal evaluation. According to past guidance statements, banks were able to use tax cards or internal assumptions as part of their evaluation processes. While this appeared to be effective during times of stable and, in many cases, increasing real estate values, it is no longer an acceptable method of evaluating a property on its own merit. Banks are now required to perform a more in-depth analysis that helps to support the overall value of the evaluation. Based on the final Guidance, banks are required to go through a more extensive process in determining the value for their subject property.

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### Kenneth Koher Joins Young & Associates, Inc. as Senior Consultant

Young & Associates, Inc. would like to welcome Ken Koher as a Senior Consultant. At Young & Associates, Ken's time and expertise will be shared between the lending and the management consulting divisions. In addition, he will facilitate educational seminars and workshops and assist on product development.

Ken brings to the company vast industry experience, including 35 years in community banking, and has served in a variety of positions including Chief Executive Officer. Most recently, he spent 2 years as the Deputy Superintendent in the Division of Financial Institutions of Ohio, as well as served as the Stark County Ohio Treasurer.

Please join us in welcoming Ken to Young & Associates, Inc. He can be reached at 1.800.525.9775 and kkoher@younginc.com.

### Neighborhood Data

The beginning part of the evaluation process includes banks providing an overall description of the subject's neighborhood and its local market conditions. This can include, but is not limited to, the local growth patterns, foreclosure rate, recent sales data, etc. The neighborhood support data should correlate and help support the final value conclusion (i.e., if the current market area shows a higher than normal foreclosure rate and/or a declining sales price, a higher than typical property value would not be warranted).

### Property Inspection

Next in the overall evaluation process, the bank needs to perform an overall inspection of the property.

↓ (continued on next page)

This is done by:

- Identifying the location of the property
- Providing a description of the property along with its current and projected use
- Showing an estimate of the property's market value in its current condition

The evidence of a property inspection is to be completed by the preparer through the use of a detailed write-up combining the above points along with the identification of any limiting conditions that may have been used in determining the overall value. In addition, the preparer is to identify whether an internal or external inspection was used. The preparer will then support the overall type of inspection and condition of the property through the use of photographs of the subject property, taken on the date that the inspection was completed.



## Supporting Data

The write-up, completed by the reviewer, should contain supporting documentation that includes a description of the type of analysis that was performed and any other information that was used by the preparer to determine the final value. This type of analysis can be, but is not limited to, the use of automated value models, additional analytical methods, or any other type of technological software. In addition, if the preparer uses any type of tax assessment data, comparable sales information, previous sales data, comparable sales, public tax records, etc., this needs to be identified and an explanation of how it was used and how it impacted the final value conclusion should be provided.

## Signatures

All completed evaluations must include, at a minimum, information on the preparer when an evaluation is performed by a person, such as their name, contact information, and signature.

## Conclusion

While banks have been using internal evaluations for a number of years, the requirements, as a result of the recent real estate crisis, have changed the way banks show their due diligence in evaluating real estate when using internal evaluations. This change in the requirements places additional responsibility on banks and their preparers to document and support what they feel is the most appropriate value of the subject real estate. Therefore, it is recommended that banks review and determine if their overall appraisal policy meets or exceeds the current regulatory requirements as described in final Guidelines issued December 2010.

For more information on this article, or to receive information on Young & Associates, Inc.'s customizable appraisal policy (see page 12), please contact Rob Grope at 1.800.525.9775 or [rgrope@younginc.com](mailto:rgrope@younginc.com). □

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## FDIC Lawsuits Target Bank Execs Caught in Risky CRE Lending

### A Roadmap for Bank Directors and Officers Facing Problem Real Estate Loans

*By: Mitchell Cohen, Esq., Loan Workout Consultant*

The fallout from the ongoing bank failures has continued into 2011. Facing mounting losses to its deposit insurance fund, the FDIC recently filed a series of lawsuits against bank officers and directors attempting to hold them personally liable for negligence and breach of duties that arguably led to the banks' failure and resulting FDIC losses. In the last six months alone, the FDIC has initiated four so-called "Professional Liability Lawsuits" personally naming

individual bank executives. These four suits are at the forefront of an expected wave of litigation coming on the heels of the recent financial crisis. With so many banks still in financial distress, bank executives can look to these cases as a roadmap on how they should conduct themselves to avoid being similarly named as a defendant in a future FDIC suit.

The cases demonstrate that the most dominant reason for the high number of bank failures are losses associated with commercial real estate (CRE) lending, particularly residential construction and land development. It should come as no surprise then that in determining which bank failures and which officers to pursue, FDIC is targeting banks that were overexposed to CRE lending concentrations without adequate measures to mitigate those risks. Examiners expect banking organizations to have in place effective policies, systems, and internal controls to monitor and manage concentration risk. Particularly with high CRE concentrations, where the principal source of repayment of the loan is collateral-dependent, an even greater level of scrutiny is required. The bank's board of directors is responsible for evaluating the methods used by management to control and manage this risk. With collateral values a long way off from recovery and an estimated \$1 trillion in CRE loans scheduled to mature over the next two years, boards of directors are scrambling to find ways to deal with underperforming and maturing loans. With so many options ranging from foreclosure, extend and pretend, forbearance, modification, troubled debt restructuring, recapitalization, and more, it's difficult to know which strategy to use when.

For those looking for ways to best protect themselves against future liability claims, be vigilant in your efforts to look for solutions to deal with problem CRE loan portfolios. Key lessons for bank executives are:

- **Be proactive.** Do not wait until problems begin to spiral, but if and when they do, take aggressive action to mitigate risks.
- **Be responsive.** Respond to changes in market conditions and all regulatory criticisms.
- **Be consistent.** Have loan policies and administration procedures in place, and where exceptions are made, keep track.
- **Document your efforts.** Keep documentation of your efforts to deal with problem loan portfolios and your implementation of potential workout strategies.

### Banks Fail: FDIC Losses Mount

The stock market over the past few quarters may be showing signs of an economic recovery, but the banking sector continues to face challenges in 2011. In the month of January alone, an additional eleven bank failures occurred, bringing the total number of failures since January 1, 2008, to 334 and counting. The FDIC reports that more than 800 other banks are listed as "problem institutions." The financial impact of those failed institutions and anticipated additional losses to the FDIC are now estimated to exceed \$50 billion dollars.

### FDIC Goes On the Offensive

Facing critical Deposit Insurance Fund levels and exposures to losses, FDIC first attempted to stop the bleeding back in 2009 when it called upon the banks to prepay three years of FDIC insurance assessments totaling \$46 billion. Now, with continued bank failures and exposures from loss share agreements, the FDIC is going on the offensive with aggressive pursuit of liability from individual bank directors and officers for failing to properly discharge their duties. In fact, according to FDIC records, as of January 18, 2011, the FDIC has already initiated lawsuits against 119 individuals for D&O liability with damage claims of approximately \$2.5 billion.

More FDIC litigation is expected. With no end in sight to the bank failures, it's certainly reasonable to expect the professional liability suits will continue. While many of those suits will settle before trial (frequently with proceeds funded from D&O insurance coverages) if the FDIC prevails, case precedent may send a chilling effect on directors' and officers' willingness to serve on



bank boards and loan committees.

### The Law

Under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989, when a bank is closed, the FDIC immediately steps in the shoes of and acquires the rights of the failed institution as Receiver. Charged with the responsibility of recovering the losses suffered from the bank's failure, the FDIC acquires a group of legal rights and privileges (sometimes called "Professional Liability Claims"), which includes claims for losses caused by the wrongful acts of directors and officers, among others, who provided service to the failed institution.

Officers and directors serving on the bank's board are subject to both federal and state statutory laws which impose certain duties such as the duty of care and loyalty. The federal statute 12 U.S.C. § 1821(k) permits the FDIC, as Receiver, to sue directors and officers for gross negligence, or for simple negligence if applicable state law allows. Variances in such state laws are beyond the scope of this article but it's worth noting, under the common law, directors and officers are held to a higher common-law standard of care and loyalty than non-bank corporations on grounds that bank directors are in a trust or fiduciary relationship with bank depositors and shareholders.

Fortunately, there are defenses available and other steps that boards can take to shield themselves from liability. Bank directors are usually shielded from any personal liability by the "business judgment rule." The business judgment rule generally requires directors to perform their duties in good faith, after reasonable inquiry and as an ordinarily prudent person in a like circumstance would. It provides that directors are entitled, as a matter of law, to rely on certain information prepared by others which may include reports from other bank officers, loan committees, or attorney opinions.

But there is a catch. While bank executives may rely on the recommendations of others, such reliance is defensible only if that reliance was "reasonable." In other words, it is not reasonable to rely on management after management has been severely criticized at prior exams and the board does nothing to make sure management has addressed the criticism. What is or may be reasonable is left to the courts and that takes time, sometimes years. The law provides that the FDIC, as Receiver, has up to three years to file for any tort claims and six years for breach of contract claims after a bank is closed. Waiting is not an option.

### The Role of the Board in Problem Loan Workouts

Loan workouts have become an integral part of a bank's ability to mitigate known risks. Countless numbers of financial institutions are currently undergoing the task of loan restructuring and determining how best to clean up their problem loans. How the bank's board of directors deals with its distressed portfolios will impact both the banks survival and potentially the board members' personal liability.

It no longer matters whether the decision to make the original loan was prudent. Discussing historical underwriting and blaming others for bad loans are time-consuming and counterproductive. Focusing on forward-looking corrective measures is what matters. The FDIC's focus on the more serious mistakes shown by the four cases cited to glaring omissions and cover-ups that were made by bankers after the loans went into default. A bank's failure to aggressively pursue various solutions will increase exposure to potential liabilities.

No two workout situations are alike, and no single strategy can be implemented for every workout situation. Every institution will have its own unique set of challenges when developing restructuring or workout plans: the culture and direction of the bank, the workload of individual officers, and the degree of supervision that a particular credit appropriately requires (which may be a product of the size of the credit, the nature of the default, and how the loan is classified on the bank's books with its regulators). Every borrower will have its own unique factors at play, such as whether the borrower has a sustainable core

### Mitchell Cohen to Perform Loan Workout Services

Young & Associates, Inc is pleased to announce that we have teamed up with Mitchell Cohen to perform loan workout services for community banks. Mitchell is a licensed attorney with over 15 years experience in the commercial real estate finance and debt restructuring industries. As an outsourced loan workout consultant, Mitchell's services include borrower negotiation, structuring and documenting the workout and coordinating with outside legal counsel as needed for litigation, foreclosure, bankruptcy and related matters. In addition, he is able to advise clients on the internal loan workout policies and procedures necessary to be in line with regulatory requirements and to minimize risks and optimize recovery rates.

For more information on Young & Associates, Inc.'s Loan Workout Services, [CLICK HERE](#). To contact Mitchell, call 1.800.525.9775 or [mcohen@younginc.com](mailto:mcohen@younginc.com).

"Hiring an outside consultant can maximize efficiency and success of the workout process."

"The role of directors should be to act as advisors, set the policies, and direct the institution."

business, the strength of management, cash flows, industry health, the value of collateral, and how any other credit guarantors or bankruptcies may affect the workout strategy.

Being a bank director is obviously much more than showing up for a monthly meeting. Typically, smaller community banks bring on directors because members bring a wide array of sophisticated business knowledge and insight. Some have extensive experience directly in the banking and financial services industry, others have their own businesses with particular industry knowledge, or may be close personal friends with knowledge of the borrower's history and current financials. That kind of knowledge can be very valuable to identify problem loans early on in the process and to find solutions to offset risks from loan defaults. By using this information, a board member can and should take an active role in providing direction and leadership.

### Hiring an Outside Consultant

Taking an active role, however, does not mean exerting any influence on the decision-making of borrower's business that may expose the bank to claims of lender liability. Finding the right balance can be tricky. It's no surprise that lender liability claims only come in times of loan workouts. To avoid any such claims or assertions that could derail an otherwise possible successful workout, hiring an outside consultant is a worthwhile option for many banks, particularly where the bank may be understaffed, have conflicts of interest, or require expertise in evaluating and/or structuring the workout.

Hiring an outside consultant can maximize efficiency and success of the workout process. Many banks, particularly those without a special assets department, will often have the same originating loan officer continue to deal with the borrower even after major loan problems have been identified. This is problematic on two levels. First, this situation fails to provide much needed checks and balances. Consultants are objective and are able to avoid or neutralize prior "personal relationships." Consultants also help existing loan officers avoid the embarrassment and the difficulty involved when a previously friendly relationship becomes adversarial. Secondly, the originating loan officer may not have the experience and knowledge necessary for the workout. Consultants add valuable depth to the negotiation strategies and skills in structuring the workout.

Experienced consultants are well-versed in the nuances of the October 2009 "Guidance on Prudent Loan Workouts," which spelled out a variety of measures available to banks in structuring workouts, including troubled debt restructurings and A/B note structures. The Guidance also provided that, "Financial institutions that implement prudent loan workout arrangements after performing comprehensive reviews of borrowers' financial conditions will not be subject to criticism for engaging in these efforts, even if the restructured loans have weaknesses that result in adverse credit classifications." This is the reason for the absence of any failed workouts being the subject of the complaint allegations in the four professional liability cases discussed above. Bank boards can rely on the 2009 Guidance as a safe haven for exhausting efforts, including hiring outside consultants to assist with problem loan workouts. The role of the directors should be to act as advisors, set the policies, and direct the institution. When it comes to individual loan workouts, the directors should leave the detailed decision-making up to senior management. I frequently recommend establishing a minimum threshold dollar amount or risk exposure below which directors have only limited oversight, and anything above the threshold requires directors' direct involvement. The key is to make sure loan policies and procedures are well-documented, reviewed at least annually, and remain flexible to adjust strategies to adapt to changes in market condition or other factors.

For those credits where the board is actively involved, directors should be vigilant in getting at least the minimum requirements needed for a workout, including full and comprehensive reports of borrowers, guarantors' financials, current appraisals on collateral, and periodic reports on workout negotiations with the borrower. That is not to say that all information will always be available, as borrowers in distress frequently will refuse to provide current financials and reject a lender's attempts to obtain important project information. Loan

For more information,  
on this article, contact  
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workouts are only an option with a cooperative borrower and no concessions should be made where there is a refusal to cooperate. A lender's only option in this scenario is simply to document all reasonable efforts attempted and then to pursue available remedies.

When negotiations are productive and it comes time for directors' approval of any workouts, approval cannot be arbitrary and must demonstrate activity consistent with the banks goals and policies. Boards are well-advised to document all efforts to finding solutions, including notation in board minutes, correspondence, and communications with counsel or outside advisors.

### Conclusion

These are difficult times for banks and lenders alike, particularly those that have a substantial market and history with concentrations in commercial real estate. Regulators are watching closely and as the cases demonstrate, they will pursue individual liability where bank directors and officers fail to take an active role in problem loan management. Loss mitigation efforts must be heavily documented, including needed updates to loan and workout policies and regular tracking efforts to workout problem loans. Banks with inadequate staffing levels, inexperienced lenders, and mounting regulatory pressures are well-advised to avail themselves of all available resources, including engaging independent and experienced advisors. Taking a proactive approach will afford banks the greatest chance for success in reducing losses, maximizing returns from problem loans, and afford directors and officers the greatest protection in defending future potential liability actions. □

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## 2011 Compliance Challenges

*By: Bill Elliott, Senior Consultant and Manager of Compliance*

Being behind is going to become a familiar theme for all of us in the compliance world over the next few years. Dodd-Frank has already begun to impact banks, and this impact will accelerate during the second half of 2011, and most especially in 2012.

### Durbin Amendment

There are a few bright spots. There appears to be serious discussion regarding the Durbin Amendment, the amendment that requires the Federal Reserve to set interchange fee limits. The Federal Reserve Board made a proposal about interchange fees, and it quickly became obvious that this type of price fixing would face tremendous opposition. Perhaps Congress will once again reverse course, as they have with several other items over the last year, or the Federal Reserve will restructure their proposed regulation.

### How Should You Respond?

The rest of the Dodd-Frank bill is here to stay, and bankers need to be ready. The primary issue that compliance professionals will face is resistance from bank staff. Compliance officers can respond in one of two ways – become aggressive and force feed the staff, or (preferably) help lead the staff to find the appropriate response.

The fact is that staff will probably have to react quickly to a wide variety of changes in a short time period. I teach many compliance-related seminars for our company. Part of the title in our current seminar series is “Preparing for the Upcoming Compliance Storm.” The storm, at least in the short term, does not appear to be close at hand. In early February 2011, the Federal Reserve Board announced that many of their proposed changes to Regulation Z would not become final, as Regulation Z will become the province of the new Consumer Financial Protection Board.

This action does not mean that the proposed changes are “dead.” Rather, the

## Tamara Simms Bolin Returns to Young & Associates, Inc.

We are pleased to announce that Tamara Simms Bolin has returned to Young & Associates, Inc. as a consultant in the compliance division. With valuable experience in the areas of the Secondary Mortgage Market, QC, and regulatory compliance, Tamara returns to the company with a focus on on-site compliance reviews, in-bank monitoring systems, and compliance training. She will also assist in the areas of quality control, secondary market systems, and loan review, and will develop manual materials and articles for corporate newsletters.

Tamara is an alumnus of Walsh University and holds the designations of Certified Bank Compliance Officer (CBCO), Certified Regulatory Compliance Manager (CRCM), Certified Review Appraiser, and is a Registered Mortgage Underwriter.

Tamara can be reached at 1.800.525.9775 and by e-mail at [tbolin@younginc.com](mailto:tbolin@younginc.com).

industry should view them as “delayed.” If they are finally released, along with a number of other changes, the time period for mandatory compliance is likely to appear very short. I have reminded students in recent seminars that the implementation time for the RESPA changes was about 14 months, and everyone complained about being “rushed.”

The key to compliance success will be for compliance professionals to work with staff and management in a manner that avoids the “force feed” approach, and focuses on the “how to implement” approach. Spending large amounts of time complaining about “why do we have to do this?” while human, is counterproductive and will unnecessarily delay implementation of concrete and useful solutions.

Management and compliance professionals should spend some time during this period of less change, and determine if the bank has the appropriate infrastructure in place to weather the storm that is coming. This time of delay is the perfect time to get the job done. Proper preparation and bridge building between the compliance division and the rest of the bank’s staff now will reap dividends for the bank in the future. If there is anything that Young & Associates, Inc. can do to assist with this process, feel free to contact me at 1.800.525.9775 or via e-mail at [compliance@younginc.com](mailto:compliance@younginc.com). □

## Capital Market Commentary

*By: Stephen Clinton, President,  
Capital Market Securities, Inc.*

### 2010 in Review

At the beginning of 2010 we wrote to bankers about various items that we felt deserved watching. We felt that these identified items might be at the forefront of issues impacting banking. We noted:

- *Politics* – We were concerned about the political climate that banking faced. We noted that President Barack Obama, calling bankers “fat cats,” set the stage for growing tension between the banking industry and politicians. We are pleased that the banking industry was able to achieve some favorable resolution to many of the punitive proposals as the Dodd-Frank legislation became law.

On the heels of the Dodd-Frank legislation, the negative publicity for banking continued as the problems with the foreclosure activities of larger mortgage services become known. Banking analysts have also provided huge estimates for potential mortgage loan put-back exposure for the banking industry, which adds to the uncertainty surrounding banks.

The banking industry has significantly repaid TARP funds, with approximately 85% of TARP funds provided to banks and thrifts being repaid by the end of 2010, providing a handsome return to the Treasury. Despite the success of the TARP program, many continue to call the program a “bank bailout” and seek to further punish banks.

- *Commercial Real Estate* – We wrote that “declining values on commercial real estate looms as the next risk to banking.” This was certainly true in 2010 as banks continued to record loan charge offs and added to their loan loss provisions.
- *Interest Rate Risk* – We predicted that the Fed would remain accommodative for some time. We cautioned bankers to properly position their balance sheets for the inevitable rise in interest rates.
- *FDIC Insurance Premiums* – We noted our concern that the high number of

bank failures might cause additional special assessments to strengthen the insolvent FDIC insurance fund. We have been pleased that the industry has been able to avoid additional insurance premium costs.

- *Freddie Mac and Fannie Mae* – We expected the Obama administration to unveil its proposal for the GSEs in 2010. Fannie Mae and Freddie Mac continue to be wards of the government since moving into conservatorship in September 2008. Borrowers and bankers have come to rely on an efficient secondary mortgage market. We worry about the impact on home prices and the availability of mortgage funding should GSE resolution plans increase the cost to borrowers for home loans or should the secondary market become less active.

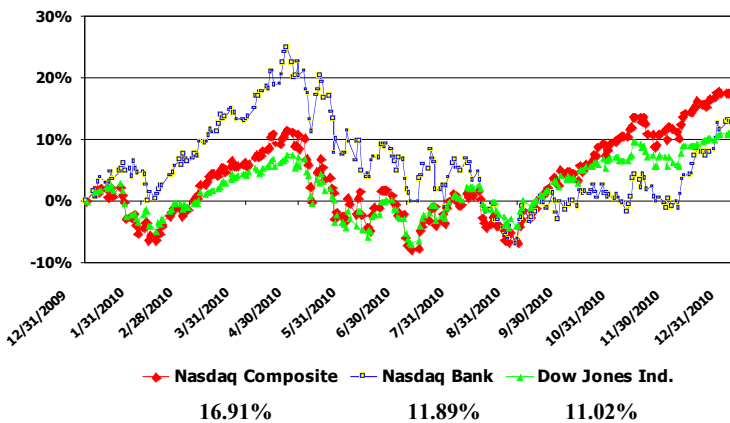
We believe that bankers should continue to keep abreast of the issues noted above. We would add that regulation should be added to the list. It has been reported that the Dodd-Frank legislation is the most extensive overhaul for

the U.S. financial system since the 1930s. The law includes nearly 500 required regulatory rulemakings, 81 studies, and 93 Congressional Reports. We are concerned about the added cost of regulatory compliance that banks will face as the rules and regulations are enacted and the new consumer protection agency unfolds. We also hear from many bankers that field examiners continue to take arbitrary positions in the examination process. Finally, we sense that the accounting world is determined to enact rules that could be harmful to bankers and their shareholders.

### Market Update

The general stock market recorded improvement in 2010. The Dow Jones Industrial Index rose 11.0% in 2010, compared to the Nasdaq Composite Index's increase of 16.9%. The improvement in the stock market helped advance the net worth of U.S. households to \$54.9 trillion at September 30, 2010. However, this value reflects a 15% loss in net worth held at mid-2007 before the Great Recession began.

Price History – Nasdaq Bank Index Compared to General Market Indexes

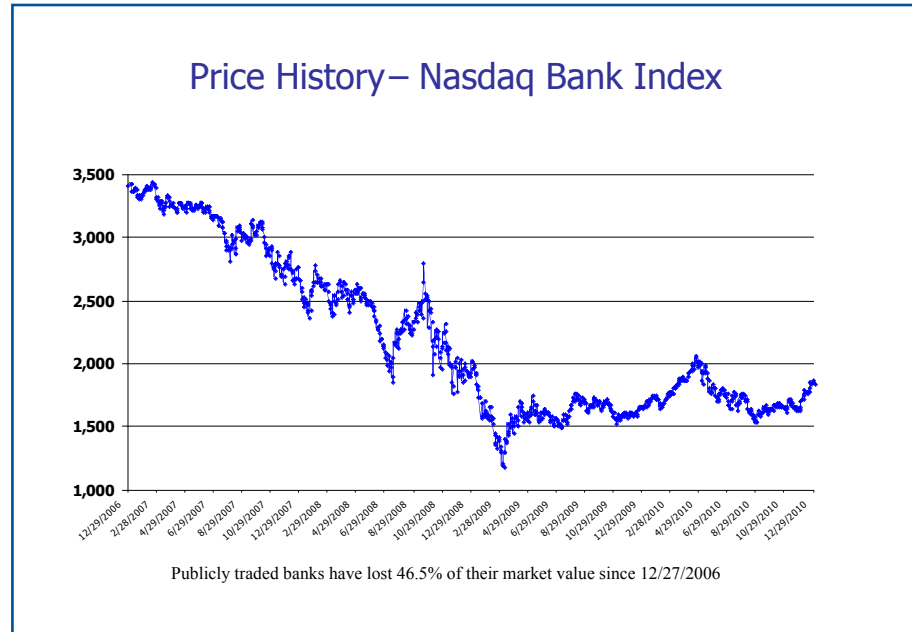


Many factors have come into play contributing to the stock market's performance in 2010. Specifically:

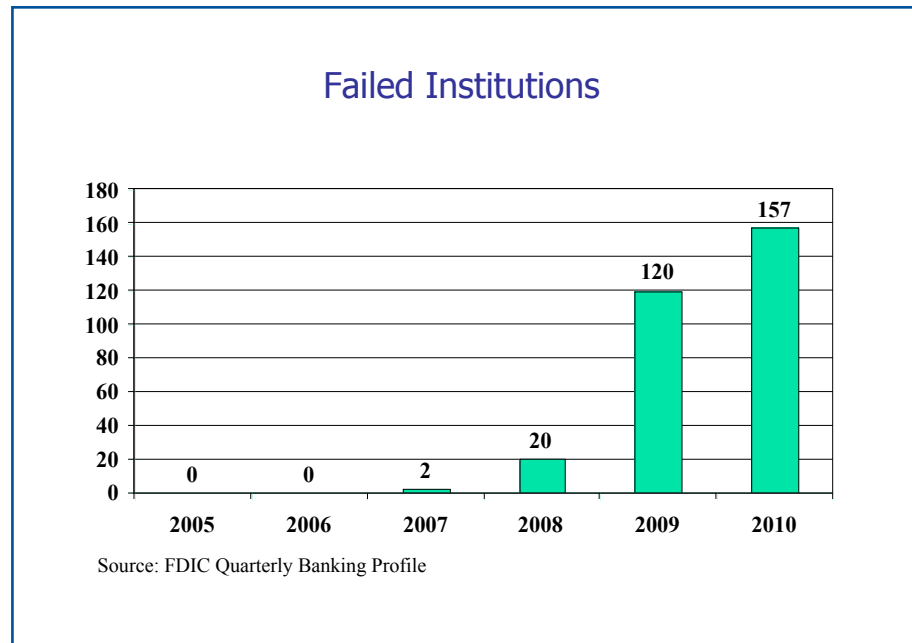
- The economic recovery, although weak, continued.
- Low interest rates continued and the rate of inflation has been low.
- The Fed continued to actively support the economy. In 2010 the Fed began a program to buy \$600 billion in longer-dated government bonds ("quantitative easing").
- Government spending continues at nearly an all-time high with the U.S. budget deficit in fiscal 2010 (ending in September) reaching \$1.294 trillion. This was the second-highest ever, behind the record 2009 deficit of \$1.416 trillion.
- Market pricing for the banking sector recorded a double-digit improvement in 2010. The Nasdaq Banking Index posted an increase of 11.9%. Smaller banks, those with assets of less than \$500 million, recorded a lower price gain, but still were up 7.6%. From a regional perspective, banks in the Southwest recorded the largest price increase, moving up 28.0%, followed by Midwest banks at 22.7%. The chart on the left provides market pricing history for the banking industry compared to selected general stock market indices for 2010.

**Note:** We recognize that many of our readers may not be affiliated with publicly-traded financial institutions. We do think that managers of privately-traded banks should be aware of market pricing conditions as the market factors impacting the pricing of publicly-traded banks also influence the market value of all banks.

Although banking experienced positive pricing trends for 2010, bank prices are significantly lower than when they reached their highs in late 2007. The following chart reflects the dramatic price decline in bank stocks that has occurred since then.



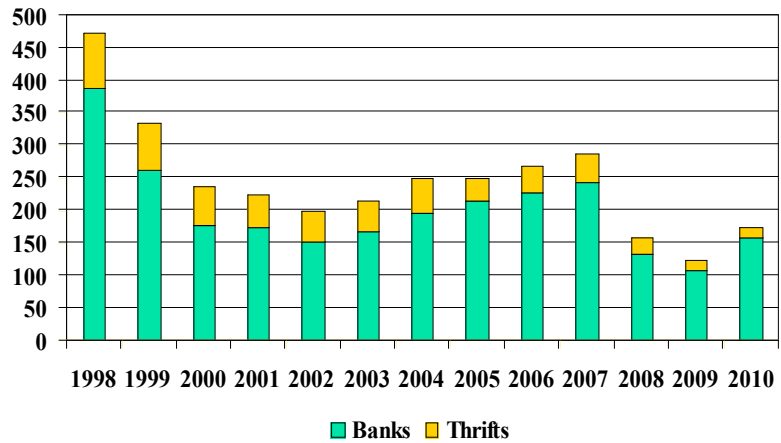
The problems facing banks in the last several years have been well chronicled. We have not seen bank failures occurring at this level since the thrift crisis. Below is a chart reflecting the level of bank closings.



### Merger and Acquisition Activity

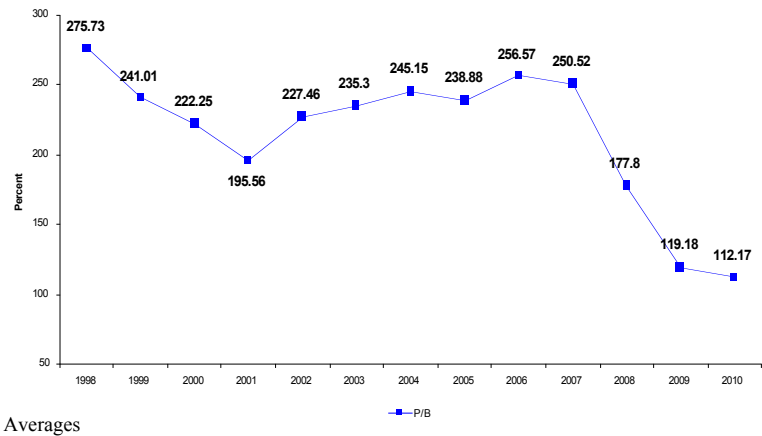
Bank merger activity slowed over the last three years. The depressed pricing for bank stocks made acquisitions less affordable for healthy banks. As the credit crisis stressed most bank loan portfolios, potential buyers have focused on dealing with their loan portfolios rather than adding other banks' problems to theirs. For the bank sales that have occurred, a majority fall into the "distressed" category. Bank sellers in 2010 averaged a negative return on average assets of 83 basis points compared to a positive 94 basis points in 2007. The following chart shows annual bank and thrift merger activity since 1998.

## Merger Activity



The average price to tangible book multiple for transactions involving bank sellers was 112% in 2010, a slight decline from 119% in 2009. This sale pricing is significantly lower than the 251% recorded in 2007. The following chart provides historical information on bank merger pricing.

## Bank Merger Pricing Multiples



## Capital Market Services

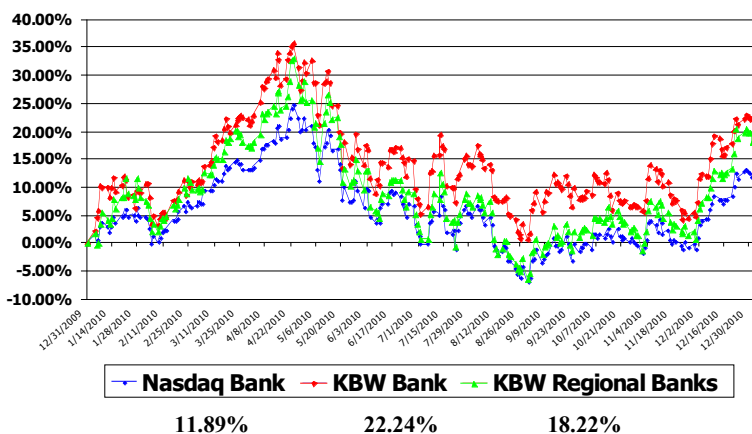
Young & Associates, Inc. has a successful track record of working with our bank clients in the development and implementation of capital strategies. Through our affiliate, Capital Market Securities, Inc., we have assisted clients in a variety of capital market transactions. For more information on our capital market services, please contact Stephen Clinton at 1.800.376.8662 or [scClinton@younginc.com](mailto:scClinton@younginc.com). □

By: *Stephen Clinton, President,*  
*Capital Market Securities, Inc.*

The capital markets provided bank investors some relief in 2010. As shown in the chart in the previous article, bank investors have lost almost one-half of their market value since year-end 2006 (as measured by the broad Nasdaq Bank Index). The early optimism for bank stocks that occurred in April was doused by concerns over the foreclosure mess. The late year-end rally in bank stocks propelled bank pricing towards its year-end gain of 11.9%.

The chart below provides a comparison of three bank indexes and their performance in 2010. The chart tracks the market price change for three bank indexes:

Price History – Banking Indexes



- Nasdaq Bank Index – Tracks the performance of approximately 450 Nasdaq listed bank stocks
- KBW Bank Index – Tracks the pricing on 24 geographically diverse stocks representing national money center banks and leading regional institutions
- KBW Regional Bank Index – An equal-weighted index that includes stocks of 50 publicly-traded companies that do business as regional banks or thrifts

As the chart shows, the three indexes followed a similar pattern in 2010. The banks with the largest improvement in 2010 were the larger banks (KBW Bank Index). The more diverse regional banks (KBW Regional Bank Index) were close behind. The broader bank index (Nasdaq Bank Index) showed the lowest improvement of the group.

Many investors that followed the bank market in 2010 took advantage of the bank market’s volatility

to enhance their returns above those shown above. Investments in companies that were strategic acquirers during the credit crisis performed well in 2010. Certain banks located in the Midwest found investor favor in 2010. Banks that identified their asset quality issues early and moved them toward resolution were rewarded in 2010. Banks that repaid TARP also performed well in 2010.

Young & Associates Inc.’s affiliate, Capital Market Securities, Inc., assumed the management of Financial Institution Partners, LLC, in 2008. Financial Institution Partners principally invests in publicly-traded financial institutions. Financial Institution Partners was able to provide an unaudited annual return to its members of 31.9% in 2010. We provide this example of an above-average market return as evidence that investing in bank stocks remains a good strategy for investors despite the dismal view of the financial services sector that many hold.

We anticipate that 2011 will continue to see bank pricing improvement. Bank earnings are expected to continue to improve as banks are not expected to face the same level of loan losses as economic conditions improve. We expect a number of banks to announce higher dividends once the Fed approves their business plans. For smaller banks, we think the market’s search for undervalued companies will move them higher as well. We expect merger and acquisition activity to accelerate in 2011. Merger announcements tend to push up prices.

Bank investors are encouraged to thoroughly evaluate prospective bank investments. There are risks in the sector. Some banks have conducted stock offerings to repay their TARP that were highly dilutive to their current shareholders. Interest rate risk exposure could create problems for some banks when interest rates rise. Regulatory constraints could depress other bank stocks. In our investing strategies, we place a high value on strong management teams. We look for banks that have a good market position. We currently favor banks that have moved up from their lows but not banks that have high price to earnings or price to tangible book multiples. □

### Liquidity Cash Flow Planning and Stress Testing Model (#271) – \$950\*

Perform quantitative liquidity assessments as required by the *Interagency Guidance on Funding and Liquidity Risk Management*.

- Forecast funding sources, funding needs, and cash flow gaps
- Monitor availability of contingent liquidity
- Monitor funding concentrations and dynamic cash flow ratios
- Perform liquidity stress testing and multiple-scenario what-if analyses

\* Includes 1 year of technical support.

**System Requirements: Microsoft® Excel**

### Liquidity Contingency Funding Plan (#272) – \$275

Provides a written contingency funding plan as required by the *Interagency Guidance on Funding and Liquidity Risk Management*. Delineates strategies and actions addressing potential liquidity shortfalls in emergency situations. Includes identification of stress events, stress levels, early warning indicators, parameters for liquidity stress testing, sources of funds and funding strategies, lines of responsibility and communication, as well as a detailed crisis action plan.

### Liquidity Toolkit (#273) – \$1,250\*

Includes:

- Liquidity Cash Flow Planning and Stress Testing Model (above)
- Liquidity Contingency Funding Plan (above)
- Customizable Liquidity Management Policy

\* Save \$150 when you purchase the Liquidity Toolkit!



### Audit Tracking System (#269) – \$295

Designed to track multiple bank audits/exams (management, compliance, lending), the Audit Tracking System will help you monitor your bank's exception items so that repeat findings become a thing of the past.

Easy-to-use and interpret, the Audit Tracking System will:

- Track the progress of remediating exception items from recommendation to implementation to remediation testing.
- Provide management with easy-to-read reports on new, open, past-due, and closed exception items.
- Assign accountability for exception items to individual people or departments.
- Provide alerts in Outlook once an estimated implementation date has passed.

**System Requirements: Microsoft® Access 2000 and above**

### Appraisals and Evaluations Policy (#124) – \$225

Young & Associates, Inc. has recently updated our Appraisal and Evaluations Policy to incorporate the requirements of the *Interagency Appraisal and Evaluation Guidelines* released on 12/10/10.

This customizable policy template covers:

- Appraiser and Evaluator Qualifications and Selection
- Engagement Letters
- Appraisals From Other Financial Institutions (including purchased participations)
- Third Party Arrangements
- Useful Life of Appraisals
- Appraiser/Evaluator/Lending Staff Independence
- Appraisal/Evaluation Review
- Appraisal Audits for Loans Sold on the Secondary Market
- Reappraisals or Reevaluations of Collateral
- Representations and Warranties

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