Bank Modeling Program

Bank Industry Primer

Corporate structure of a bank

Bank holding company	
Assets	**Equity: $225**
Sub 1 Stock	

Subsidiary (the bank)	
Assets	**Liabilities**
Cash: $100	Deposits: $200
Loans: $400	Sub. Debt: $75
	Equity: $225

Consolidated view	
Assets	**Liabilities**
Cash: $100	Deposits: $200
Loans: $400	Debt: $75
	Equity: $225

The equity in the bank is the primary asset of the BHC. Dividends are distributed from the bank to the BHC, which then distributes the dividends to its own shareholders.

The consolidated view shows the assets, liabilities, and equity on a consolidated basis.

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	Opening	A cash loan amounting to $100 is made; a $5 loan loss reserve is established	Borrower misses payment; value of loan declines to $98	Borrower misses another payment; value of loan declines to $91
	12/31/10	12/31/11	3/31/11	6/30/11
BALANCE SHEET				
Cash	500	430	450	470
Gross loans	0	100	98	91
Less: Allowance for loan losses (reserves)	0	5	3	0
Net loans	0	95	95	91
Total Assets	**500**	**525**	**545**	**561**
Liabilities	410	410	410	410
Equity	90	115	135	151
Total Liabilities & Equity	**500**	**525**	**545**	**561**
Balance check	0	0	0	0
INCOME STATEMENT				
Net interest income		30	20	20
- Recoveries		0	0	0
+ Provision for credit losses		5	0	0
+ Unprovisioned charge offs		0	0	4
Less: Total provision for credit losses expense (income)		5	0	4
Equals: Pretax income		25	20	16
CASH FLOW STATEMENT				
Cash inflows/outflows from operations		30	20	20
Cash inflows/outflows from financing		-100	0	0
Net cash flows during period		-70	20	20
Allowance for loan losses (reserves) - BOP		0	5	3
- Loans charged off	0	0	-2	-7
+ Charged off loans that have been recovered	0	0	0	0
Net charge-offs	*0*	*0*	*-2*	*-7*
+ Provision for credit losses	0	5	0	4
Allowance for loan losses - EOP	**0**	**5**	**3**	**0**

Gross loans are reduced by cumulative NCOs

Net loans are reduced by cumulative provisions

Credit loss expense on the income statement is a non-cash expense item and must be backed out of the cash flow statement

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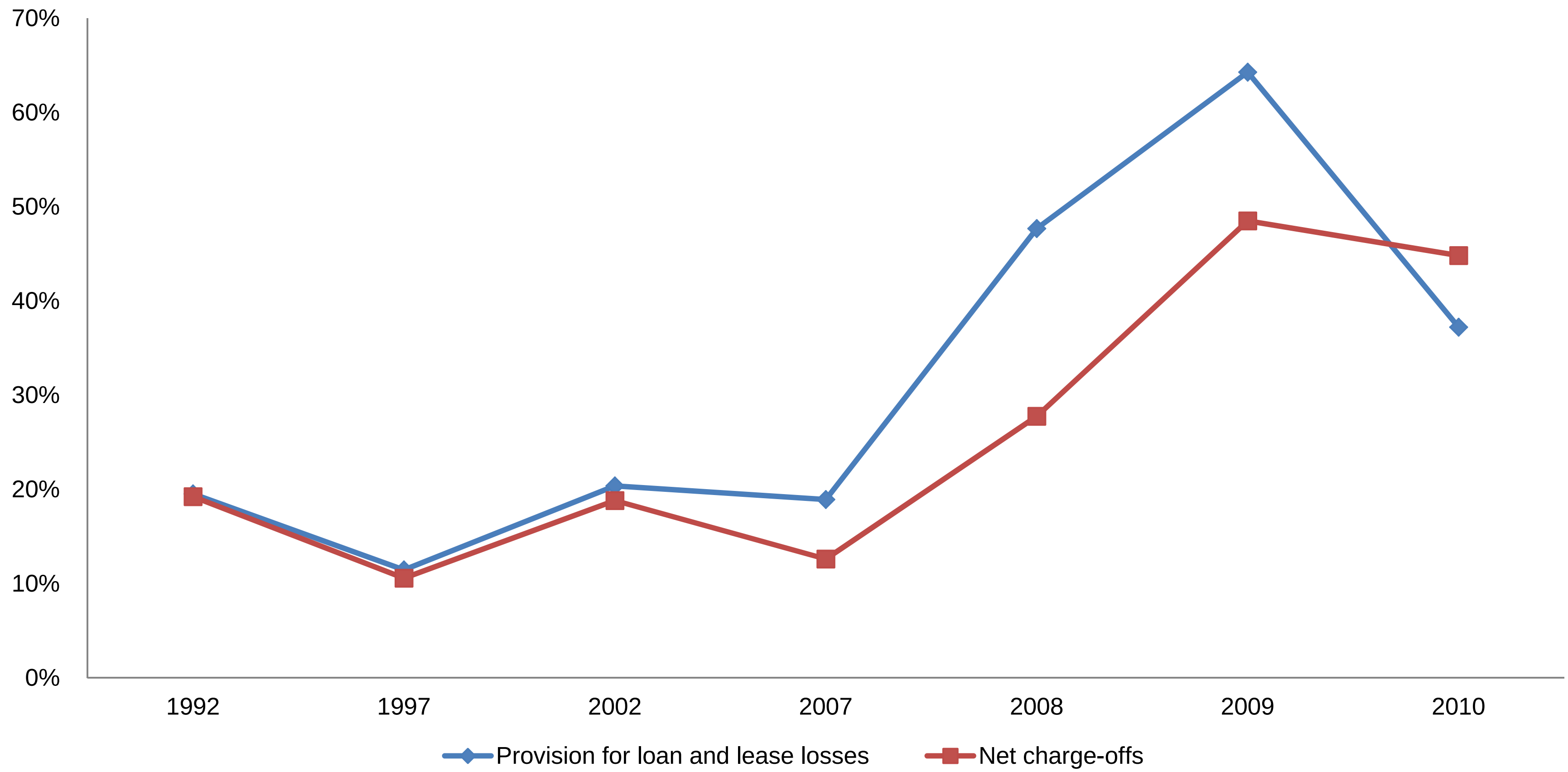
	Opening	A cash loan amounting to $100 is made; a $5 loan loss reserve is established	Borrower misses payment; value of loan declines to $98	Borrower misses another payment; value of loan declines to $91	immediately ahead of sale; loans are re-valued at $93	loan is sold for $93
	12/31/10	12/31/11	3/31/11	6/30/11	9/30/11	9/30/11
BALANCE SHEET						
Cash	500	430	450	470	470	563
Gross loans	0	100	98	91	93	0
Less: Allowance for loan losses (reserves)	0	5	3	0	0	0
Net loans	0	95	95	91	93	0
Total Assets	**500**	**525**	**545**	**561**	**563**	**563**
Liabilities	410	410	410	410	410	410
Equity	90	115	135	151	153	153
Total Liabilities & Equity	**500**	**525**	**545**	**561**	**563**	**563**
Balance check	0	0	0	0	0	0
INCOME STATEMENT						
Net interest income		30	20	20	0	0
- Recoveries		0	0	0	-2	0
+ Provision for credit losses		5	0	0	0	0
+ Unprovisioned charge offs		0	0	4	0	0
Less: Total provision for credit losses expense (income)		5	0	4	-2	0
Equals: Pretax income		25	20	16	2	0
CASH FLOW STATEMENT						
Cash inflows/outflows from operations		30	20	20	0	0
Cash inflows/outflows from financing		-100	0	0	0	93
Net cash flows during period		-70	20	20	0	93
Allowance for loan losses (reserves) - BOP		0	5	3	0	0
- Loans charged off	0	0	-2	-7	0	0
+ Charged off loans that have been recovered	0	0	0	0	2	0
Net charge-offs	*0*	*0*	*-2*	*-7*	*2*	*0*
+ Provision for credit losses	0	5	0	4	0	0
Elimination of reserve	0	0	0	0	-2	0
Allowance for loan losses - EOP	**0**	**5**	**3**	**0**	**0**	**0**

Provisions and charge-offs, as % of NII
All US Commercial Banks



Source: FDIC

Basel III

- Basel II is being replaced by Basel III, whose final framework was released in December 2010. Implementation will begin in 2013 and be fully phased in by 2019
- Will require banks to maintain substantially more capital, with a greater emphasis on common equity.
- Since national regulators issue their own guidelines, the precise effect on banks in the United States and other nations has not yet been fully determined
- The US regulators are expected to implement new regulations by mid-2012, while Wall Street reform legislation in the United States (Dodd-Frank) includes potentially more stringent capital requirements for systemically important financial institutions.
- Accordingly, the regulations US banks face may be substantially different from the Basel III framework described.

Basel III

- Introduces a new measure of Tier 1 capital: Common Equity Tier 1 (CET1), which will include various adjustments including the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 if any one category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Basel III framework when fully implemented	
CET1 / RWA	> 7%
Tier 1 / RWA	> 8.5%
Total (T1 & T2) / RWA	> 10.5%
Tier 1 / BS & Off-BS exposure	> 3%
Countercyclical capital buffer added to CET1 (an incremental requirement to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk)	2.5%