STRAATEGIC PLAN AND CAPITAL PLAN ALIGNMENT: 
A DEEPER DIVE!

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Strategic Plan and Capital Plan Alignment: “A Deeper Dive!”

4 Objectives

1. Stimulate your thinking!
2. Get you a bit out of your comfort zone.
3. Do some assessment and collaboration.
4. Head home with 1 or 2 important things to do as a result of spending this time together!
Part One

Capital as the foundation

- Capital Policy or Plan
- Capital Forecasting
- Alignment with strategic priorities

Refresher Questions

Why does capital get so much attention from regulators?
How do banks and holding companies increase or decrease capital?

Does your capital plan align with your strategic plan?
What is Capital?

*It depends on who you ask.*

To a *regulator*, capital means protection. More is better.

- Amount of capital should be commensurate with the bank’s risk level.
- It is the last line of defense against loss to the insurance fund.

What is Capital?

To *shareholders*, their investment represents an ownership position.

- They expect a stable rate of return with bank management optimizing their return.
- They would like to have a liquidity source if their circumstances change and they need liquidity.
What is Capital?

**Interpretation:**
- Capital planning balances the needs of shareholders and regulators.
- Management and the Board need to be able to document/articulate how the Bank determined the balance or the “right” amount to retain.

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Strategic Priorities

- List of strategic priorities from your plans
- Examples of your strategic goals

We will refer to these as we link capital to strategic priorities throughout the rest of this session.
What is Regulatory Capital?

Common Equity Tier 1 (CET1)

- CET1 was effective on January 1, 2015, for all banks and represents capital that does not have contractual cash payments
- Acquisition intangibles are a direct reduction of CET1
### Additional Tier 1 Capital

- Noncumulative Perpetual Preferred Stock, including surplus
- SBLF & TARP (Bank Issued)
- Qualifying Tier 1 Minority Interest

Less Certain Investments in Financial Institutions

= Additional Tier 1 Capital

* Only if original bank issuance qualified as Tier 1 Capital

Source: FDIC

### Tier 2 Capital

- Limited Allowance for Loan & Lease Losses
- Preferred Stock & Subordinated Debt
- Qualifying Tier 2 Minority Interest

Less Tier 2 Investments in Financial Institutions

= Tier 2 Capital

Eliminated Limits on:
- Subordinated debt
- Limited-life preferred stock
- Amount of Tier 2 Capital included in Total Capital

* Includes bank-issued SBLF and TARP instruments that originally qualified as Tier 2 Capital

Source: FDIC
Capital Ratio Calculations

\[
\text{CET1} \quad \frac{\text{Tier 1 Capital}}{\text{Total Risk Weighted Assets}} = \text{CET1 Risk-Based Capital}
\]

\[
\text{Tier 1 Capital} \quad \frac{\text{Average Assets}}{\text{Total Risk Weighted Assets}} = \text{Tier 1 Risk-Based Capital}
\]

\[
\text{Total Capital} \quad \frac{\text{Total Risk Weighted Assets}}{\text{Total Risk Weighted Assets}} = \text{Total Risk-Based Capital}
\]

Prompt Corrective Action (PCA)

<table>
<thead>
<tr>
<th>PCA Categories</th>
<th>Tier 1 Leverage (%)</th>
<th>Common Equity Tier 1 RBC (%)</th>
<th>Tier 1 RBC Current (%)</th>
<th>Tier 1 RBC Interim Final Rule (%)</th>
<th>Tier 1 RBC Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Well Capitalized</td>
<td>≥ 5.0</td>
<td>≥ 6.5</td>
<td>≥ 6.0</td>
<td>≥ 8.0</td>
<td>≥ 10.0</td>
</tr>
<tr>
<td>Adequately Capitalized</td>
<td>≥ 4.0</td>
<td>≥ 4.5</td>
<td>≥ 4.0</td>
<td>≥ 6.0</td>
<td>≥ 8.0</td>
</tr>
<tr>
<td>Undercapitalized</td>
<td>&lt; 4.0</td>
<td>&lt; 4.5</td>
<td>&lt; 4.0</td>
<td>&lt; 6.0</td>
<td>&lt; 8.0</td>
</tr>
<tr>
<td>Significantly Undercapitalized</td>
<td>&lt; 3.0</td>
<td>&lt; 3.0</td>
<td>&lt; 3.0</td>
<td>&lt; 4.0</td>
<td>&lt; 6.0</td>
</tr>
</tbody>
</table>

Critically Undercapitalized

- Revised PCA ratios were effective on January 1, 2015, for all banks
- Successive limitations placed on a Bank based on deterioration to next capital classification

Source: FDIC
Capital Buffer

- The 2.5% buffer is applied only to ADEQUATELY capitalized ratios [not WELL capitalized]
- Will fully phased January 1, 2019

### Regulatory Capital Ratio Minimums

<table>
<thead>
<tr>
<th>Reg Ratio</th>
<th>Tier 1 Leverage</th>
<th>CET 1 Risk-Based Capital</th>
<th>Tier 1 Risk-Based Capital</th>
<th>Total Risk-Based Capital</th>
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<tr>
<td>Well Capitalized</td>
<td>5.00%</td>
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<td>10.00%</td>
</tr>
<tr>
<td>Adequately Capitalized + 2.5% Conservation Buffer</td>
<td>4.00% (Buffer NA)</td>
<td>4.50% +2.50% 7.00%</td>
<td>6.00% +2.50% 8.50%</td>
<td>8.00% +2.50% 10.50%</td>
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</tbody>
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Source: FDIC

Capital Buffer

- Can limit cash leaving the bank, such as:
  - Dividends
  - Share buy-backs
  - Discretionary bonus payments

### Maximum Payout Ratio

- **Size of Buffer (% of RWA)**
  - Greater than 2.5
  - 1.875 to 2.500
  - 1.250 to 1.875
  - 0.625 to 1.250
  - ≤ 0.625

Source: FDIC
Capital - Resources

<table>
<thead>
<tr>
<th>Regulator</th>
<th>Helpful web site</th>
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</thead>
<tbody>
<tr>
<td>Federal Reserve</td>
<td><a href="http://www.federalreserve.gov/bankinforeg/topics/capital.htm">http://www.federalreserve.gov/bankinforeg/topics/capital.htm</a></td>
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Capital Plan – A Major Focus

- Regulations set minimums
- Expected to have capital over minimums to cover risk in your balance sheet – interest rate, credit, liquidity, capital, operations, and to provide a “cushion”.
- Regulators provide some guidance for troubled institutions with required capital levels.
Your capital plan helps document your required capital today and how you will access in the future.

Your capital plan can estimate and create cushion for one-time uses/sources of capital, the timing and amounts of which can be difficult to predict precisely.

Bottom line: **Must build a capital plan that includes an assessment of your minimum required levels.**

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Your Bank ?? ?? ?? ??
Reality of How Much Capital?

• Question is how much above well capitalized levels does your Bank target

• Guidance for your ratio comes from:
  ➢ Regulatory agreements such as a consent order or MOU with a capital component
  ➢ Regulatory releases such as:
    • “Guidance for Evaluating Capital Planning and Adequacy” published by the OCC June 7, 2012
    • “SR 09-4 Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies” published by the FRB February 24, 2009 -- Revised December 21, 2015

Guidance for Evaluating Capital Plan and Adequacy

A capital plan assists the bank’s board of directors and senior management to:

1. Identify and evaluate all material risks, including credit, operational, interest rate, liquidity, price, and compliance risks

2. Determine the bank’s capital needs, over time, in relation to material risks and strategic direction;

Source: OCC
Guidance for Evaluating Capital Plan and Adequacy

3. Have a strategy to maintain capital adequacy to support growth and build capital if needed

4. Ensure the integrity, objectivity, and consistency of the process through adequate governance.

Source: OCC

Capital Forecasting

• I would encourage your bank to utilize a capital forecast, which is your roadmap on how you will use capital.

• For most banks, the primary source of capital is net income.

• Capital forecasting helps to show if your strategic plan can be supported by forecasted results.
Capital Forecasting

- Uses would include:
  - Shareholders’ needs:
    - Dividends – Required rate of return.
    - Dividends – Coverage of shareholder taxes for those who are an S Corp.
  - Fund profitable growth.
  - Holding company needs.
  - One-time uses from capital plan.

Putting all the pieces together …
Sources of Capital

1. ± Bank equity via net income or net loss

2. Sell common stock to current and new shareholders: 
   *May dilute existing shareholders and needs to balance size with offering costs*

3. Preferred Stock: 
   *Only allowable for a C Corporation; dividend is not tax deductible. Liquidity considerations for preferred shareholder and cash required by Bank Holding Company (BHC)*

4. Borrowing senior debt at Holding Company: 
   *Generally requires pledging of Bank stock as collateral and does not qualify as regulatory capital at BHC*

5. Convertible debt and subordinated debt: 
   *Typically more expensive than senior debt*

6. C Corps with disallowed deferred tax assets which may become allowable in computing capital ratios: 
   *Solely dependent on generating sufficient earnings to make this work*
Compelling Story

If your organization is planning on increasing capital through anything other than net income . . .

The organization will need a compelling story to passionately describe its vision and strategic plan in order to excite and entice potential investors and/or lenders.

Summary Question

Does your Capital plan support the Strategic Plan...and is it the “foundation” for the strategic priorities?

Yes!
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Part Two

Why are you here?
Part Two

Do you have the “right” Strategic Priorities?

i.e. What are the 4-5 biggest, most critical “things” that need to happen at your institution over the next 3 years?

Strategic Thinking in “Not so ordinary times!”

- Maintain it?
- Re-Vamp it?
- Re-Prioritize it?
- Start doing it?
- Do it even better?
Meaningful Strategic Thinking

Enhance your bank’s strategic planning . . . or “jump-start”!

. . . And link critical strategies to bottom-line profit

Level Set

1 Do you have a Plan?
Level Set

Do you have the 7 Components?

Refresh Memory!
7 Parts of a Plan

1. SWOT
2. Vision
3. Mission
4. Strategic Priorities
5. Goals/Strategies
6. Action Plan
7. Financial Measures
Level Set

3 Does the process **work**?

Level Set

4 Do the “tough topics” get thoroughly discussed to **resolution / conclusion**?
Level Set

Do you have a Culture of Accountability that tenaciously tracks / measures execution and implementation?

The Creative Imperative

“A greater emphasis on human imagination, innovation and creativity must be the key differentiators for business.”

World Economic Forum
Davos, Switzerland (WSJ 1/28-29/2006)
Challenges Are Plenty

Role of Brick/Mortar

Or Are They Opportunities?
The Ultimate Challenge

From where will tomorrow’s profitable growth come?

- What MARKETS . . .
- Which NICHEs within those markets . . .
- HABITS of consumers . . .
- The role of TECHNOLOGY and Digital Strategy

Refresh Memory!
7 Parts of a Plan

1. SWOT
2. Vision
3. Mission
4. Strategic Priorities
5. Goals/Strategies
6. Action Plan
7. Financial Measures
Setting Strategic Priorities

Six Keys

Evaluating Priorities

1. Margin and non-interest expense pressures are placing a renewed sense of urgency on operating expense and non-interest income.

*How dependent on margin is your bank?*
Evaluating Priorities

2. Delivery Channels: 3!
   - Branch
   - Mobile
   - Digital

   *Where are you on digital delivery?*

3. Non-interest expense and efficiency ratios have remained relatively flat . . .
   - *How will non-interest income be augmented?*
   - *How can you position against emerging larger bank product strategies?*
4. Non-interest income growth is murky, at best . . .

What percent of total operating revenue is comprised of non interest income?

5. Customers live in a 24/7 world

- Amazon’s purchase of Whole Foods 6/2017
- Shuttering of retail stores
- Other examples?

Do we still think we are “different?”
Evaluating Priorities

6. Winning the Talent War!

Most Strategic Priority

• Examples
• Contemplation
• Discussion
Refresh Memory!
7 Parts of a Plan

1. SWOT
2. Vision
3. Mission
4. Strategic Priorities
5. **Goals/Strategies**
6. Action Plan
7. Financial Measures
Reality Check

• Strategy success measured by the numbers

• Do we have the “right” strategies?

9 Regulatory Realities Ensuring Alignment of Strategy
Reality #1

Is the Capital Plan the foundation to strategy?

• How well developed is the Capital Plan?
• What’s the Capital Policy?
• Reactions/Aha’s from yesterday?

Reality #3

Margin Compression

• Interest rate risk in a rising rate environment
• “We must grow loans”
• Core deposits

(Real-life scenarios)
Reality #4

Diversification of Revenue

• What % of Total Revenue is derived from NII?
• What are your strategies to increase this ratio?

Hint: Discloses old school / new school

Reality #5

The “wave of consolidation” is upon us!

How will you compete successfully?

What does that portend for strategy?
Your Bank’s Reality?

Buy? . . .
Sell? . . .
Hold? . . .
Who Knows?

*What does that portend for strategy?*

Reality #6

Regulatory Reform has changed the game!

Compliance, compliance, compliance!
Real Life:

Holding Company CEO:

“My secret to success?”

World Class Compliance!

Our Regulatory system:

“Strengthened but not Simplified” – Jamie Dimon, JPMorgan Chase

Financial Regulatory Oversight Council

Identify risks to the financial stability of the US, from officials of large, interconnected financial companies. Authority to gather information from financial institutions. Make recommendations to the Fed and other primary financial regulatory agencies.

Office of the Comptroller of the Currency

Focus on safety and soundness. Primary regulator of national banks, thrifts, foreign banks, federal savings banks, federal thrifts, federal savings associations. Supervises non-bank federal savings associations. Regulates bank holding companies, parent companies, directors, officers, employees, managers, and directors.

Federal Reserve

Focuses on price stability and maximum employment. Independent, non-partisan, federal regulatory system. LFASRA. Federal Reserve supervises and sets risk management standards for bank holding companies.

Office of Financial Research

Monitors the health of financial markets and the financial system. Provides policymakers and the public with comprehensive, high-quality, independent analysis.

FDIC

Focus on protecting deposits through supervision, risk management, and consumer protection.

SEC

Regulates issuers, investment advisors, investment companies, transfer agents, brokers, and dealers. Examination authorities, rule making, and enforcement authorities. Authority over national securities exchanges, options markets, and self-regulatory organizations.

CFTC

Regulates futures and options exchanges, market participants, and related entities. Authority over futures, commodity options, and swaps.

FINRA

Regulates brokers, dealers, and investment advisers. Authority over securities exchanges, quote systems, market participants, and exchanges.

Examinations

Examinations of securities and derivative markets, investment companies, and other financial firms. Authority over broker-dealers, advisory firms, and investment companies.

Compliance

Compliance with laws and regulations, and regulatory oversight, are fundamental to maintaining the integrity of financial markets and protecting investors.

Investment Management

Focus on the integrity of financial markets and the protection of investors. Authority over investment companies, investment advisers, and other financial institutions.

Banking

Focus on national banks, savings associations, and federal thrifts. Authority over national banks, savings associations, and federal thrifts.

Commodities

Regulate futures and options exchanges, market participants, and related entities. Authority over futures, commodity options, and swaps.

Banking

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Regulation

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Reality #7

At the end of the day, it’s still about MANAGING RISK

Risk Management Strategies

- Separation or risk oversight from risk taking
- Chief Risk Officer
- ERM
- Risk assessment of compensation
- Concentrations of the loan portfolio
- Too dependent on Mortgage?
Reality #8

Board Governance

• Never been more important . . .
• Never been more challenging to find competent, qualified directors.

NOW is the time!

. . . For shareholders to mandate the best Board governance they can find/retain to oversee their investment.

How good is yours?
Suggested Reading

- **Execution: The Discipline of Getting Things Done**
  - Larry Bossidy and Ram Charan
- **Boards That Deliver**
  - Ram Charan

Reality #9

Risk Assessment of Compensation aligned with strategy

- Executive Comp
- Incentive Comp
Regulatory Concerns

In deconstructing the events leading to the financial crisis in the financial institution industry, the agencies determined that a significant contributing factor was poorly designed compensation arrangements.

In particular, incentive compensation plans.

Covered Employees

• Senior executives and others with bankwide (or material business line) oversight

• Individuals whose activities may expose the bank to material amounts of risk

• Groups of employees who may expose the organization to material amounts of risk
Components of a Risk Assessment

1. Participant Communications
2. Compensation Philosophy
3. Performance Measures
4. Calculation and Verification of Performance and Rewards
5. Stress Testing
6. Goal Setting
7. Corporate Governance

Compensation Philosophy

- Guides compensation decision making
- Specifies the purpose of each component of the employee’s total compensation mix
- Articulates the mix of base salary, short-term incentives, long-term incentives, and benefits
Performance Measures

• Measurable and quantifiable
• Tied to strategic plan
• Use absolute and/or relative goals
• Use “gates”/qualifiers to manage risk
• Balance bank, team, and individual
• Keep it simple and understandable

Homework Thinking

Your 4 - 5

Strategic Priorities

2017 to 2020
Part Three

*Putting It All Together!*

- Alignment of Strategy
- Execution & Implementation

Charting Strategic Direction
Pause and Ponder

Your 4 - 5 Strategic Priorities 2017 to 2020

Updated Priorities

... require updated Strategies.

Updated Strategies ... require updated Action Plans!

Updated Action Plans ... require updated measurement and timetables.
Strategic Priorities

Goal:
Profitably grow the Bank to $340MM in assets by year-end 2020, achieving upper 1/3 of peer ROE.

Goal:
Execute the “X” acquisition, growing “X” to $150MM in assets by year-end 2020.
Strategic Priorities

Goal:
Fully implement a Sales and Marketing culture, with emphasis on retention of the top 20% of customers in each niche.

ABC Bank
Strategic Plan: 2018-2020

Profitability and Growth

Goal #1:
Profitably grow the Bank to $340MM in assets by year-end 2020, achieving upper 1/3 of peer ROE.

- Strategy 1: Achieve targeted growth of core market niches.
- Strategy 2: Utilize electronic banking to achieve 50MM in deposit growth beyond physical boundaries.
- Strategy 3: Grow core deposit base net 45MM annually.
- Strategy 4: Enhance depth of Bank’s most profitable customers to minimum of 5.0 prod/services.
- Strategy 5: Increase non interest income by 20% annually.
ABC Bank

Strategic Plan: 2018-2020

Profitability and Growth

Goal #2:
Execute the “X” acquisition, growing “X” to $150MM in assets by year-end 2020.

Strategy 1: Retain/enhance relationship of profitable customers.

Strategy 2: Grow loan portfolio 20% annually.

Strategy 3: Downsize staff by 10% with efficiency of centralized operations.

Strategy 4: Develop a comprehensive training plan for retained employees.

Strategy 5: Fully integrate ABC bank/personnel in acquired community.

Strategy 6: Fully automate the Bank with up to date technology.

Goal #3:
Fully implement a Sales and Marketing culture, with emphasis on retention of the top 20% of customers in each niche.

Strategy 1: Develop an annual marketing plan by product line and location with budget.

Strategy 2: Identify/assign top 20% of loan customers and top 20% of deposit customers. Develop goals to maintain/enhance relationship.

Strategy 3: Implement CRM and/or MCIF w/relationship profitability.

Strategy 4: Develop continuous sales and service training for all staff, with measurable accountabilities by position.
Working Groups

You are the CEO of your Bank

What are the 3 most important Strategic Priorities for the next 3 years?

To what extent are they similar or different from your peers?

To what extent are the best strategies developed and being executed?

(Priority) ____________________

Goal #1:

Strategy 1:

Strategy 2:

Strategy 3:

Strategy 4:

Strategy 5:
PART IV
Management Tools
✓ Building Accountability
✓ Execution and Implementation

Developing Action Plans

The key to implementation!
Part 6: Action Plan

● A page for each Strategy
● What specifically needs to be done:
  ● …by WHOM
  ● …by WHEN
  ● …and in WHAT order!

Part 7: Financial Measures

● **Key:**
  ● The numbers are not the plan!…
  ● …but they ARE a key measuring stick!
QUESTIONS?

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