

ACT I – HERE AND NOW

8:30	Welcome to the Big Top: Opening Comments from the Ringmaster
9:00	Walking a Legal Tightrope: Avoiding Problems with Workforce Reduction
9:30	Taming the Lions: Dealing with Distressed Assets
10:15	Intermission
10:30	Leaping Through Rings of Fire: Operating Under a Regulatory Action
11:15	On with the Show: What to Do with Underwater ESOPs
11:45	Panel Discussion: Stay S Corp or Convert Back to C Corp?
12:15	Meal Time at the Midway: Lunch

ACT II – THE FUTURE

1:15	Send in the Clowns: Tax Law Changes and Tax Implications of Operating Issues
2:00	Juggling Your Financials: Estate Planning with Depressed Assets
2:30	Intermission
2:45	Dealing with the Elephant in the Room: New Business, Capital and Human Capital Models
3:30	The New Strong Man: Consumers and Retailers
4:00	Grand Finale
4:30	Beer and Banter

Panelists

Bryan Cave Powell Goldstein	Porter Keadle Moore, LLP	Consultants
Kim Civins, Associate Tax Advice & Controversy Group	Tim Keadle, Partner Audit Department	David Jones Consultant
Frank Crisafi, Partner Tax Advice & Controversy Group	Janet Sammons, Director Tax Department	Nathan Gittner Consultant
Walt Moeling, Partner Financial Institutions Group	Pat Tuley, Partner Tax Department	
Steve Schaffer, Partner Employee Benefits & Executive Compensation Group		
Lyn Schroeder, Counsel Financial Institutions Group		
Kalee Vargo, Partner Labor & Employment Group		


**Welcome to the Big Top:
Opening Comments
from the Ringmaster**

Walt Moeling


**Walking a Legal Tightrope:
Avoiding Problems with
Workforce Reduction**

Kalee Vargo

- ## Legal Risk Arising from RIFs
- Individual disparate treatment claims
 - Federal/state discrimination laws
 - Other protected classes: veteran's status, citizenship, employees who have reported illegal behavior
 - Statutory leaves of absence
 - Retaliation
 - Use of leave/request for leave
 - Discrimination/harassment complaint
 - Report of illegal conduct
 - Disparate impact claims
 - Class claims
 - OFCCP audits
 - EEOC systemic discrimination initiative

RIF Legal Minefields

- Selection Process
- Document Preservation
- Adverse Impact
- Severance/Releases
- Attorney-Client Privilege
- 401(k) and Pension Plans



RIF Legal Minefields: Selection Process

- Selections must be made using a consistent process to avoid an argument that leaders engaged in subjective “cherry-picking” of their favorite candidates
- A formula or process or set of criteria should apply to everyone in an objectively-defined group
 - Defining the group cannot be arbitrary
 - No exceptions
 - Support with examples and specifics, especially where subjective criteria is used
- While most leaders are well-versed not to overtly consider protected traits, sometimes legal risk arises from language that can be perceived as “proxies” for discrimination



RIF Legal Minefields: Documentation

- A RIF should be documented in a way that will tell the entire story of the RIF, should those involved leave or their memories fade
- Because of the likelihood of a legal challenge arising from RIFs, leaders should consider all documents or records they create to be potential relevant evidence at some point in the future. Accordingly, they should not draft any language that they would not be comfortable defending in detail, with substantiation, in front of a lawyer, senior leader, or the media
- Moreover, to keep the universe of relevant evidence primed for later preservation and collection in the case of a legal challenge, leaders should resist the temptation to make their own extraneous lists, notes, slates, rankings, or comparisons outside of the employee selection process
- During the RIF process, drafts and notes should be maintained as leaders would normally keep them in the ordinary course of business; If, however, a reason to anticipate litigation arises, all documents, including drafts and notes and versions, must be maintained after that time



RIF Legal Minefields: Adverse Impact

- Adverse impact is a theory of unlawful discrimination that refers to neutral criteria that, when applied, has a significantly more negative impact on protected groups than on unprotected groups
- A statistical analysis is the first step in exploring whether adverse impact exists
 - Impact ratio analysis (less than 80%)
 - Standard deviation (greater than 2.0)
- A valid defense exists if legitimate business reasons explain the disparity



RIF Legal Minefields: Severance/Releases

- Banks in Troubled Condition must get approval from the regulators before offering severance to employees
 - Rank and file employees
 - Employees with Employment Contracts
- While releases give some certainty that an employee will not later file a legal challenge, releases can be challenged themselves
- Review all release agreements to ensure they do not contain any language that might be interpreted to be a ban against filing an EEOC charge
- Releases signed by employees over 40 must also comply with the OWBPA
- Moreover, train managers to avoid any discussions that could be perceived as coercion or duress



RIF Legal Minefields: Attorney-Client Privilege

- While application of the attorney-client privilege is not always clear cut, in general, documents covered by the attorney-client privilege include:
 - Memos, e-mails, or summaries prepared by an attorney or paralegal (either in-house or outside counsel)
 - Any correspondence to and from an attorney or paralegal that is related to legal advice
 - Notes from meetings that involve an attorney or paralegal
 - Investigations, spreadsheets, memos, notes, tests, analyses, and drafts prepared at the direction of an attorney or paralegal
 - Drafts of documents circulated for Legal's advice
 - Documents prepared in connection with a lawsuit, charge, or employee legal demand
- Simply marking a document “Attorney-Client Privileged” will not protect it from disclosure in a lawsuit or investigation; The document must have been created as part of the process of requesting, giving, or receiving legal advice



RIF Legal Minefields: 401(k) Plan Partial Terminations

- After a RIF, be aware of benefits issues, particularly with your 401(k) or Pension Plan.
- If **20% or more** of the “eligible participants” of the Plan leave the company due to **involuntary** terminations, it could require a “partial plan termination.”
- With a Partial Plan termination:
 - Fully vest everyone that was involuntarily terminated during the year.
 - Look at both 2008 and 2009 numbers if you had RIFs both years, to determine if you must aggregate the two percentages together in calculating the 20%.
- Partial Plan Terminations do not count voluntary separations.
- Talk to your benefits counsel if you have had significant RIFs or other involuntary terminations.

Takeaways: RIF Guiding Principles

- All messages about selection and displacement must be consistent to avoid a pretext argument
- Communications should not create the perception of making promises the company cannot keep
- Selections must be made using a consistent process to avoid an argument that leaders engaged in subjective “cherry-picking” of their favorite candidates; A formula or process or set of criteria should apply to everyone in an objectively-defined group
- Treat employees with dignity and respect
- Develop an action plan for your remaining employees to bridge morale concerns

Questions?

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Taming the Lions: Dealing with Distressed Assets

Tim Keadle

Leaping Through Rings of Fire: Operating Under a Regulatory Action

Lyn Schroeder

Operating with a Regulatory Action

- Regulatory landscape and the sea change
- Positioning yourself to best negotiate a regulatory action
- Navigating capital requirements and dividend, debt and other restrictions
- Other issues

Regulatory Landscape and the Sea Change

- The regulatory bar has been raised
- Office of the Inspector General Reports
- Risk to the regulator for giving the benefit of the doubt
- 2009 jump in enforcement actions
- Perspective – “problem banks” vs. banks with problems



Negotiating a Regulatory Action

- Overview of types of actions – numbers driven
- Preparation and documentation
- Address issues early
- Make a strong case when the facts support it
- To consent or not to consent and the implications



Capital is KING!

- Standard capital requirements
- S-corp capital options
 - Common Stock
 - Non-voting common
 - Sub-debt
 - Trust Preferred
 - Warrants
- Realistic pricing/dilution
- Potential termination of S-election
- Have a Plan B



Dividend, Debt and Other Restrictions

- No dividend payments
 - New provision under GA Banking Code
 - Book and Tax income may be different
 - Creates debt service issues
- Debt restrictions
- Management changes



Other Issues

- D&O insurance
- Personal Liability
 - LTOB issues with decreasing capital
- Document, document, document
- Managing publicity



On With the Show: What to Do with Underwater ESOPs

Steve Schaffer

ROYAL BANK
FIDELITY INVESTMENT

**Stay S Corp or
Convert Back to C Corp?**

Panel Discussion

**Send in the Clowns:
Tax Law Changes and
Tax Implications of Operating Issues**

Frank Crisafi
Janet Sammons
Pat Tuley

**Juggling Your Financials:
Wealth Planning with
Depressed Assets**

Kim Civins

Current State of the Estate Tax

	<u>Estate Tax Exemption</u>	<u>Lifetime Gift Exemption</u>	<u>Rate</u>
2009	\$3,500,000	\$1,000,000	45%
2010	Unlimited	\$1,000,000 (step-up in basis eliminated)	35%-45%
2011-	\$1,000,000	\$1,000,000	41%-55%

Federal Estate Tax Law (Proposed)

Estate Tax Exemptions	\$3.5 million (Jan./Mar.II legislation) \$3.75 - \$5 million (Mar.I legislation) \$5 million (Apr.I legislation) \$2 million (Apr.II legislation)
Estate Tax Rate Ceiling	Inflation Indexing (Mar.I/Mar.II/Apr.I/Apr.II leg.) 45% (under Jan./Mar.II legislation) Capital gains rate (under Mar.I legislation) for estates up to \$25 million and 2x capital gains rate for estates over \$25 million 35% (Apr.I legislation) 45%-55% (Apr.II legislation)
Portability of Exemptions	Yes (Mar.I/Mar.II/Apr.I/Apr.II legislation)
Reunification of Exemptions	Yes (Mar.I/Mar.II/Apr.I/Apr.II legislation)
Step-up in Basis	Maintained (ALL)
Valuation Discounts	Possibly eliminated for entities with "nonbusiness" assets (Jan. legislation)



Traditional Approach



"No, he didn't suffer. That's my only regret."

Trust Approach

Traditional Approach (2009 deaths)

Spouse 1 dies w/ \$4 million → Spouse 2 dies w/ \$8 million → Kids \$6 million (\$2 million tax)

\$4 million (no estate tax/marital exemption) → \$8 million (approx. \$2 Million estate tax - \$3.5 million exemption)

Trust Approach (2009 deaths)

Spouse 1 dies w/ \$4 million → Spouse 2 dies w/ \$4.5 million → Kids \$7.5 million (\$500k tax)

\$4 million (no estate tax/marital exemption) → \$4.5 million (approx. \$500k estate tax - \$3.5 million exemption)

\$3,500,000 (no estate tax/\$3.5 million exemption) → Trust for family - \$3.5 million → \$3,500,000 (no estate tax/\$3.5 million prior exemption)

Concept of Portability

Traditional Approach (2009 deaths)

Spouse 1 dies w/ \$4 million → Spouse 2 dies w/ \$8 million → Kids \$6 million (\$2 million tax)

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Portability Approach (2009 deaths)

Spouse 1 dies w/ \$4 million → Spouse 2 dies w/ \$8 million → Kids \$7.5 million (\$500k tax)

\$4 million (no estate tax/marital exemption) PLUS \$4,000,000 → \$8 million (approx. \$500k estate tax - \$3.5 million x 2 exemptions)



"Sure, I play hard, but I also inherit hard."

Grantor Retained Annuity Trust (GRAT)

Parents

Contribute Assets \$6,000,000

←

GRAT

→

Annuity Payments Over 10 years \$6,820,000 (\$682,000/year)

Beneficiaries = Children

Step 1: -Contribute Assets to GRAT

Step 2: -Parents receive annuity payments over 10 years

Step 3: - GRAT payments terminate in year 10
- Assets/GRAT value of \$3,073,546 passes to children

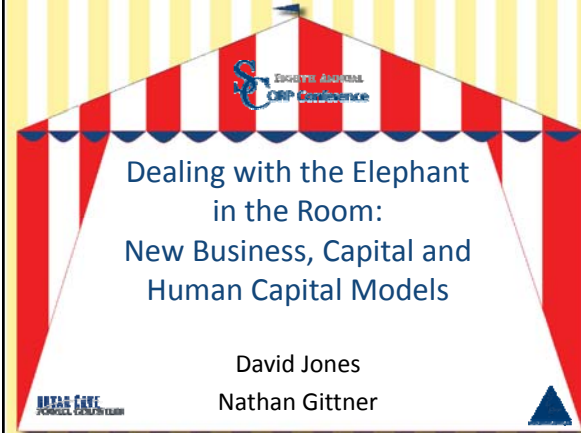
2.4% May 2009 hurdle rate
11.36% annual payout (zeroed-out GRAT)
8.0% actual return

Rolling GRAT Analysis

Year	Initial Funding of new Year GRAT	Payout from previous GRATs use to fund this year's GRAT	Payout to beneficiaries
Year 1	\$6,000,000		
Year 2	\$3,100,000	\$3,100,000 (year 1's GRAT)	
Year 3	\$4,700,000	\$1,400,000 (year 1's GRAT)	\$932,000 (year 1's GRAT)
Year 4	\$4,900,000	\$1,800,000 (year 2's GRAT)	\$276,000 (year 2's GRAT)
Year 5	\$4,400,000	\$2,400,000 (year 2's GRAT)	\$417,000 (year 2's GRAT)
Year 6	\$4,300,000	\$2,800,000 (year 3's GRAT)	\$395,000 (year 3's GRAT)
Year 7	\$4,500,000	\$2,300,000 (year 3's GRAT)	\$390,000 (year 3's GRAT)
Year 8	\$4,900,000	\$2,300,000 (year 4's GRAT)	\$392,000 (year 4's GRAT)
Year 9	\$4,600,000	\$2,300,000 (year 4's GRAT)	\$400,000 (year 4's GRAT)
Year 10	\$4,700,000	\$2,300,000 (year 5's GRAT)	\$400,000 (year 5's GRAT)
Year 11		\$2,400,000 (year 5's GRAT)	\$406,000 (year 5's GRAT)
Year 12		\$2,400,000 (year 6's GRAT)	\$417,000 (year 6's GRAT)
	Grantor Total	\$7,300,000	Total Payout \$3,976,000


Questions

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Dealing with the Elephant in the Room: New Business, Capital and Human Capital Models

David Jones
Nathan Gittner




Dealing with the Elephant

- Overview – David Jones
 - A look back at community banking results
- Under the New Big Top – Nathan Gittner
 - New business model for future success
 - New capital model to meet future needs
- It's Not Much of a Circus without Great Performers – David Jones
 - Only elephants perform for peanuts.




What History Teaches

- “Those who cannot remember the past are condemned to repeat it.”
 - George Santayana
- “History doesn’t repeat itself – at best it sometimes rhymes.”
 - Mark Twain



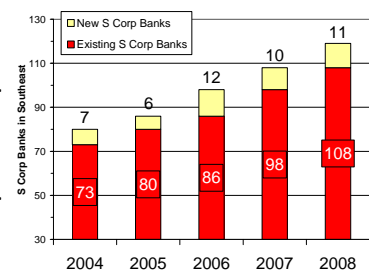
Community Banking: 2004 - 2008

- 500 banks in the southeastern U.S.
- \$150 to \$750 million in 2008 assets
- Established before 1/1/2005
- S-Corp conversions
- Contrasting C and S-Corp results




S-Corp Conversions

- 10% converted to S-Corp in past 5 years.
- 2003 – 85/15 split.
- 2008 – 75/25 split.



Year	Existing S Corp Banks	New S Corp Banks
2004	73	7
2005	80	6
2006	86	12
2007	98	10
2008	108	11



Initial Comparisons

- Similarities
 - Asset Size
 - Loan to Asset Ratio
 - Loan to Deposit Ratio
 - Credit Quality (or lack thereof)
- Some C-Corp Advantages
 - Faster asset growth
 - Higher capital asset ratio
 - More assets per employee

Asset Growth

- C-Corp lead disappeared, re-emerged.

Year	C Corp (%)	S Corp (%)
2004	9.2	7.5
2005	12.0	9.5
2006	10.0	9.2
2007	7.5	7.8
2008	6.0	5.0

Equity to Asset Ratio

- C-corp banks had up to .5% higher ratio.

Year	C Corp (%)	S Corp (%)
2004	9.85	9.50
2005	10.05	9.75
2006	10.10	9.80
2007	10.05	9.55
2008	9.65	9.20

Assets per Employee

- C-Corps maintained the advantage.

Year	C Corp (000)	S Corp (000)
2004	3,080	2,850
2005	3,250	2,950
2006	3,450	3,150
2007	3,550	3,300
2008	3,830	3,360

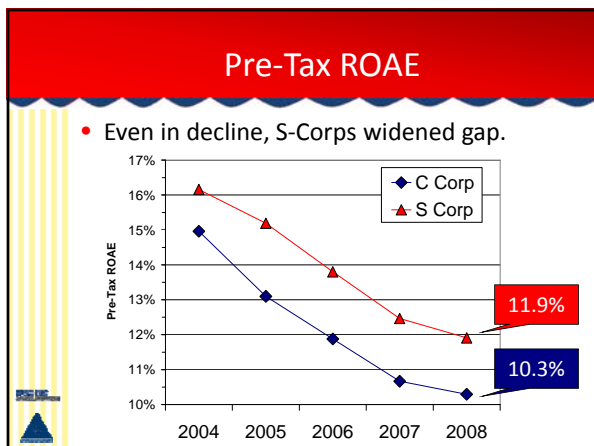
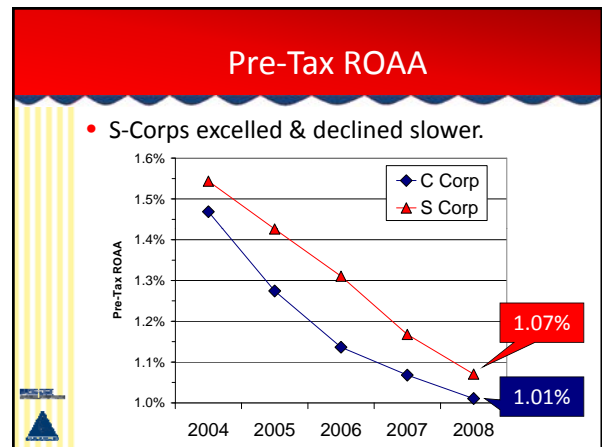
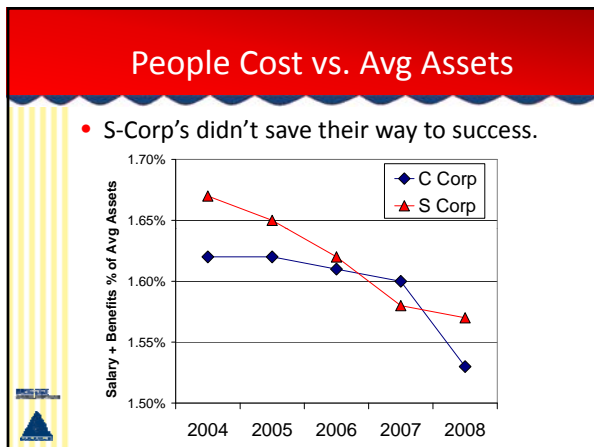
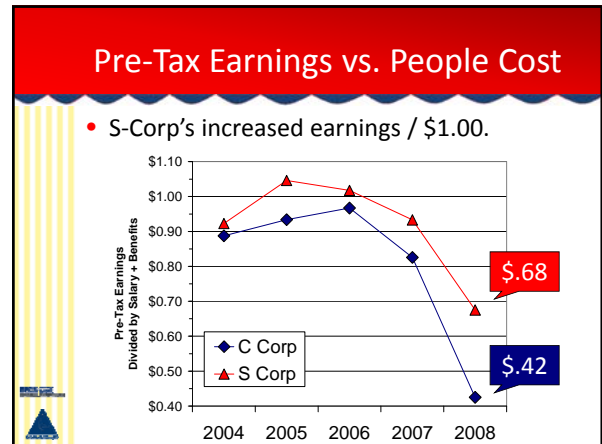
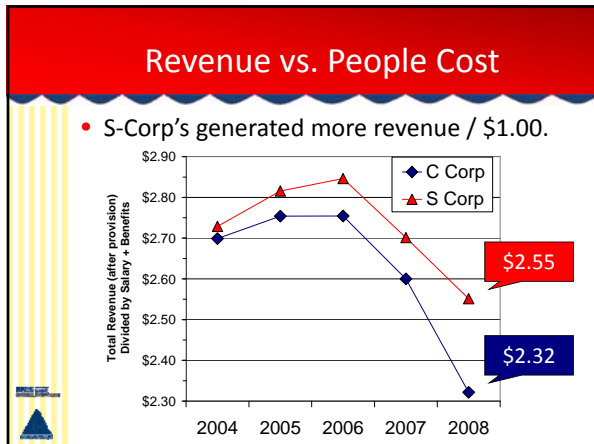
S-Corp Advantages

- Net Interest Margin
- Workforce Productivity
- Returns

Net Interest Margin

- S-Corp held the advantage, despite decline.

Year	C Corp (%)	S Corp (%)
2004	4.20	4.30
2005	4.35	4.45
2006	4.35	4.45
2007	4.05	4.15
2008	3.74	3.99



DEALING WITH THE ELEPHANT

New Business Model

New Capital Model

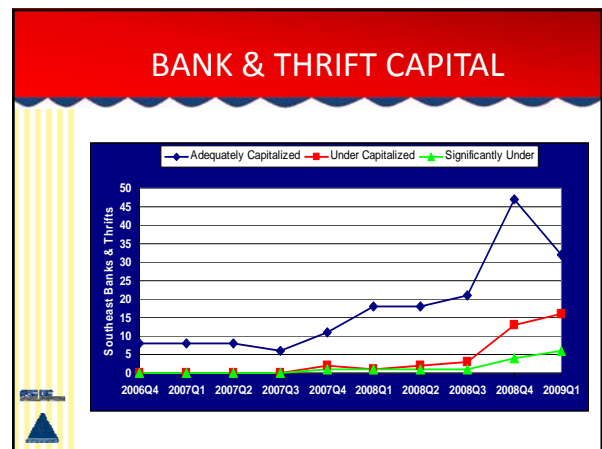
New Human Capital Model



- ### FEE INCOME
- Net interest margins have declined steadily for the past 16 years
 - Fee income as a percentage of gross revenue for banks has increased in the same time
 - 36.2% of gross revenue in 1992
 - 44.5% of gross revenue in 2006
 - High-performing banks win with consistent, above-average streams of fee income
 - High-performers in fee income typically specialize in one particular area or niche

- ### BUSINESS BANKING
- Unbelievable explosion of AD&C in the past 10 years
 - Risk was severely underpriced because competitors refused to “blink”
 - Reliance on AD&C alone will diminish after this credit cycle
 - Community banks will have to reintroduce themselves to a forgotten customer – local businesses and their owners
 - US economy is shifting from manufacturing based to service/technology based
 - C&I lending will require a new understanding of this shift
 - Again, niche and specialty focused players will be ahead of the game

- ### EFFECTIVE AND SELECTIVE USE OF TECHNOLOGY
- Understand the shift in payment trends and the effects on the institution’s customer base
 - Leverage efficiencies on basic commodity services to fund growth and innovation in new areas
 - Use technology to better understand and target all customer segments
 - Which customers are profitable?
 - What are they using?
 - Which segments do I want to expand and what do they need?
 - Technology will be the price to play



FDIC RISK-BASED INSURANCE ASSESSMENT RATES

CAPITAL GROUP	SUPERVISORY GROUP		
	A (CAMELS of 1 or 2)	B (CAMELS of 3)	C (CAMELS of 4 or 5)
Well Capitalized	Risk Category I: 8 to 21 bps (previously 5-7 bps)	Risk Category II: 18 to 40 bps (previously 10 bps)	Risk Category III: 28 to 55 bps (previously 28 bps)
Adequately Capitalized			
Undercapitalized	Risk Category III: 28 to 55 bps (previously 28 bps)		Risk Category IV: 43 to 77.5 bps (previously 43 bps)

The assessment cost for an institution with a deposit portfolio of \$250 million can range from 8 bps or \$200,000 pre-tax (Risk Category I) to 77.5 bps or \$1.94 million pre-tax (Risk Category IV)



- ### CAPITAL OPTIONS FOR BANKS
- Equity-based capital
 - Common stock
 - Preferred stock (cumulative/non-cumulative, convertible/perpetual)
 - TARP
 - Retained earnings
 - Debt-based capital
 - Trust preferred securities
 - Holding company borrowings
 - Subordinated debt

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- ### CAPITAL TRENDS/FORECAST
- Can't be too rich or too thin
 - 12 is the new 10
 - LIBOR + 170 bps is now LIBOR + 700 bps (when available)
 - More regulatory focus on debt-based capital reliance
 - Alternate capital strategies
 - Manage balance sheet size
 - Manage risk weighted assets
 - Realize gains on assets
 - Minority interest in subsidiaries
 - Investor will be impacted
- ➔ Be creative



Recent Trends

- Base Salary
 - Two ends of the spectrum
 - Typical 3 – 4% vs.
 - Reduced or no increases (starting at the top)
- Annual Incentives
 - Lower payouts
 - Struggling with setting performance targets



Recent Trends

- Retirement Benefits
 - Defined benefit plans
 - Increasing number of underfunded plans
 - Uncertainty/volatility of future earnings
 - 401k and other defined contribution plans
 - Halting bank contributions
 - Profit-sharing plans shifting to true % of profit rather than % of payroll



Recent Trends

- Long-Term Incentives
 - Stock options underwater
 - But some real opportunities for leverage
 - Increased use of restricted stock
 - Time-vested for retention
 - Performance-vested for strategic results
- Change of Control / Severance Pay
 - Reduction in amounts
 - Targeted use vs. following the market



Some Serious Suggestions

- Base Salary
 - Still the largest single element in pay mix
 - To recognize promotions
 - To close gap with market level for specific employees
 - To manage employee commitment and effort
 - Employee perception
 - What's the real financial impact of raises?



Some Serious Suggestions

- Annual Incentives
 - Be cautious of eliminating the plan
 - Adjust to keep total payouts in line with actual profitability
 - Adjust target incentives accordingly
 - Give credit for performance vs. peers
 - But avoid being the tallest dwarf in the room.



Shareholder Return Plan

- Still a sound idea.
- Guaranteed pre-tax ROE to shareholders
 - Risk free rate adjusted to pre-tax
- Management gets share of return above threshold
- Incentives accumulated year to year
 - Annual distribution of 1/3rd of accumulated incentives at start of 4th year
 - Remainder rolls over and forfeited if participant resigns



Some Serious Suggestions

- Retirement Benefits
 - Defined benefit plans
 - Freeze rather than terminate
 - Give plan time to recover from underfunding
 - Consider adding "money purchase" plan
 - 401k and defined contribution plans
 - Be cautious of potential compliance problems
 - May not a very cost-effective item
 - Misses opportunity to participate in market recovery

Some Serious Suggestions

- Long-Term Incentives
 - Consider the Shareholder Value Plan
 - Reconsider use of real stock
 - Enough ownership "slots"?
 - Grant based on bank performance
 - Can be issued with restrictions
 - e.g., three-year cliff vesting
 - Expense fixed at grant date price
 - Require sale back to bank when employment terminates

The New Strong Man: Consumers and Retailers

Nathan Gittner
Walt Moeling



THE NEXT GENERATION BRANCH

- The one-size-fits-all approach will not work
- Different markets will require different approaches
- Overall branch expansion will slow from explosion in recent years
- Hybrid branches will continue to emerge
- Staffing models and branch layouts will need to evolve to maximize efficiency
- The branch design and functionality should revolve around the customer experience

EVOLVING CUSTOMER

- Generational change
- Products and services must:
 - Be relevant
 - Deliver financial value
 - Enhance the customer experience
- Share of wallet will trump share of market
- Many banks will stumble with new products and services
- Multiple delivery channels
- Technology will be the price to play



EDGEWELL ASSOCIATES
ERP CONFERENCE

The New Strong Man:
Consumers and Retailers

Nathan Gittner
Walt Moeling

ROYAL GOLF
PERFORMANCE CLUB



EDGEWELL ASSOCIATES
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Grand Finale

Panel Discussion

ROYAL GOLF
PERFORMANCE CLUB