

Prospects for California Banking and the New Regulatory Environment

**CBA Directors College
July, 2010**

**William S. Haraf, Commissioner
Department of Financial Institutions**

Discussion Topics for Today

1. Condition of California's Banks
2. The Economy and Credit Market Conditions
3. Regulatory Reform
4. Lessons Learned from the Crisis

State / National Bank Comparison

California Headquartered Institutions

(as of 12/31/09)

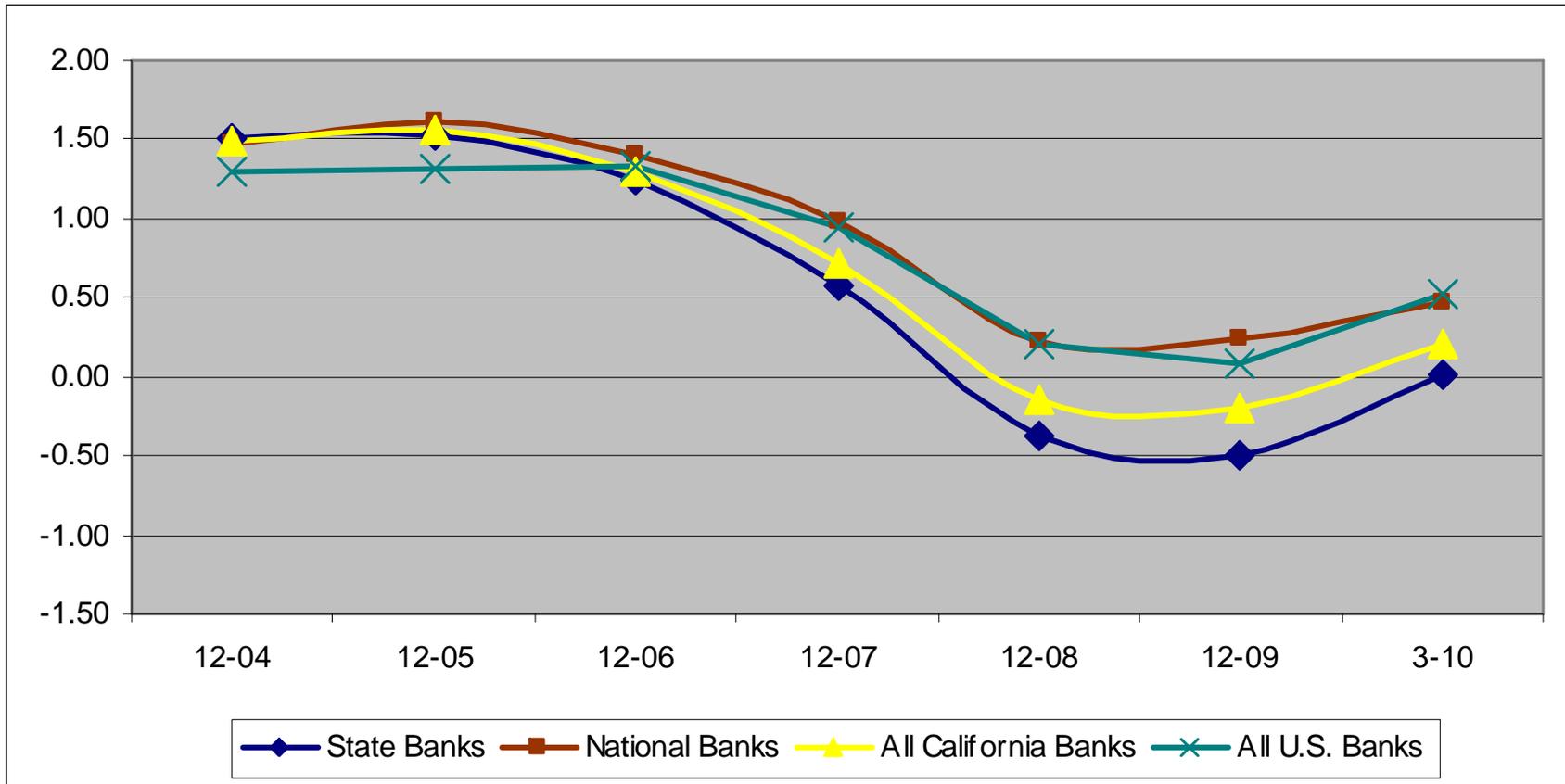
<u>Banks Over 3 Years of Operation by Asset Size</u>	<u># State</u>	<u>% of Total</u>	<u># Nat'l</u>	<u>% of Total</u>
< \$100MM	25	12%	7	13%
\$100MM to \$500MM	107	49%	32	59%
\$500MM to \$2B	40	18%	5	9%
<u>\$2B and ></u>	<u>19</u>	<u>9%</u>	<u>6</u>	<u>11%</u>
<u>Banks < 3 Years of Operations</u>	<u>26</u>	<u>12%</u>	<u>4</u>	<u>7%</u>
Total	217	100%	54	100%

State / National Bank Comparison

Total Asset Size
(as of 12/31/09)

<u>Banks Over 3 Years of Operation by Asset Size</u>	<u>State Banks</u>	<u>% of Total</u>	<u>Nat'l Banks</u>	<u>% of Total</u>
< \$100MM	\$1.8B	1%	\$446M	0%
\$100MM to \$500MM	\$24.8B	11%	\$6.9B	4%
\$500MM to \$2B	\$38.8B	16%	\$5.7B	3%
<u>\$2B and ></u>	<u>\$162.8B</u>	<u>69%</u>	<u>\$148.5B</u>	<u>87%</u>
<u>Banks < 3 Years of Operations</u>	<u>\$8.3B</u>	<u>3%</u>	<u>\$10.4B</u>	<u>6%</u>
Total	\$236.5B	100%	\$171.9B	100%

Return on Assets



Return on Assets by Quintile*

State Chartered Commercial and Industrial Banks

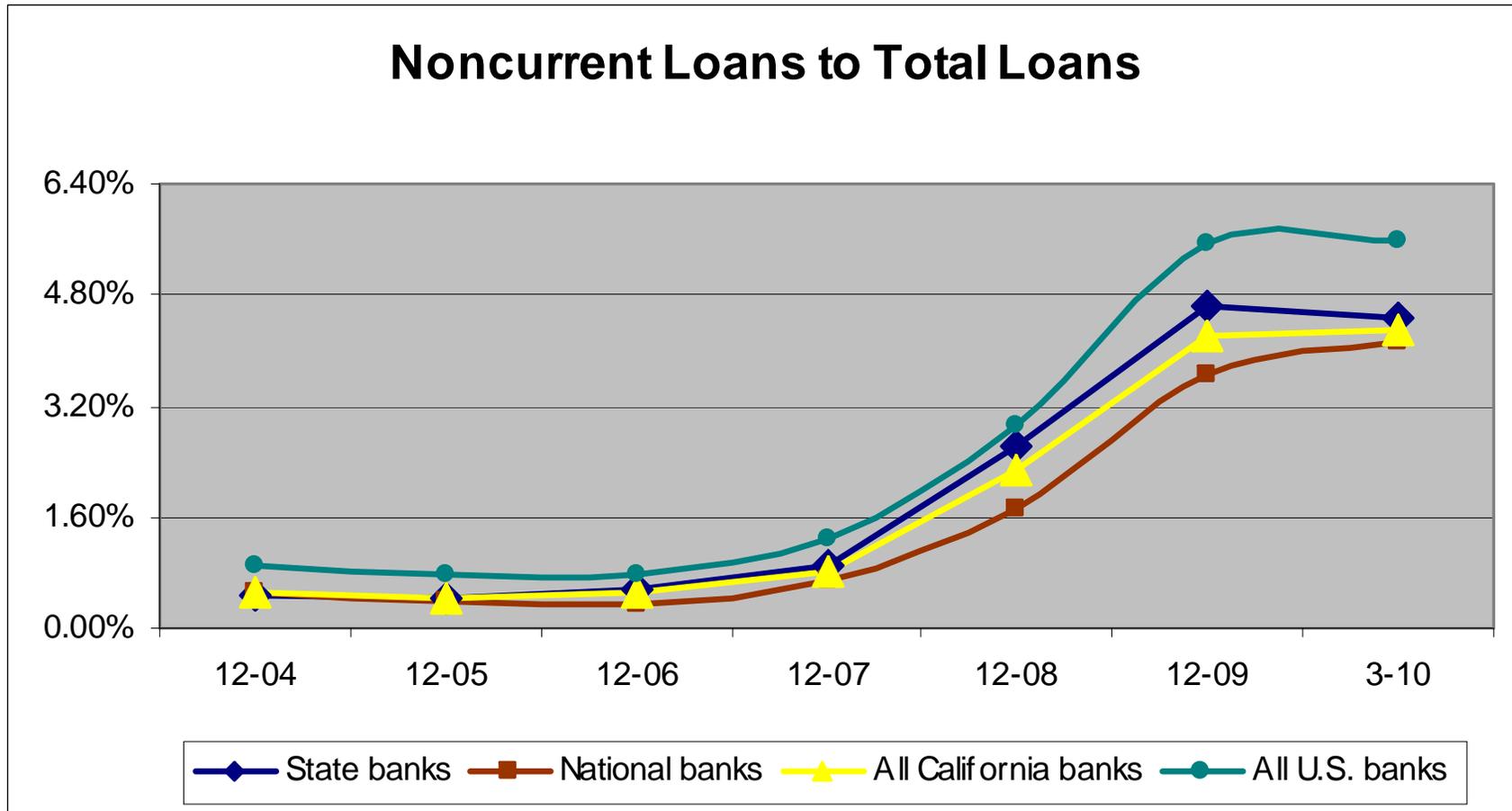
Annualized year-to-date through March 31, 2010

Asset Size	Over 3 years of operation				< 3 yrs ops.	Total
	Less than \$100MM	\$100 to \$500MM	\$500MM to \$2 Billion	\$2 Billion and More**	All asset sizes	
Number of Banks	22	108	40	17	22	209
First Quintile	1.2	1.0	1.3	1.0	0.3	1.1
Second Quintile	0.5	0.5	0.8	0.5	-0.1	0.6
Third Quintile	0.0	0.3	0.4	0.3	-1.4	0.3
Fourth Quintile	-1.0	-0.3	0.1	-3.0	-1.9	-0.4
Fifth Quintile	-2.4	-2.3	-1.2		-4.2	-2.7
Total	-0.4	0.0	0.3	0.1	-2.2	0.0

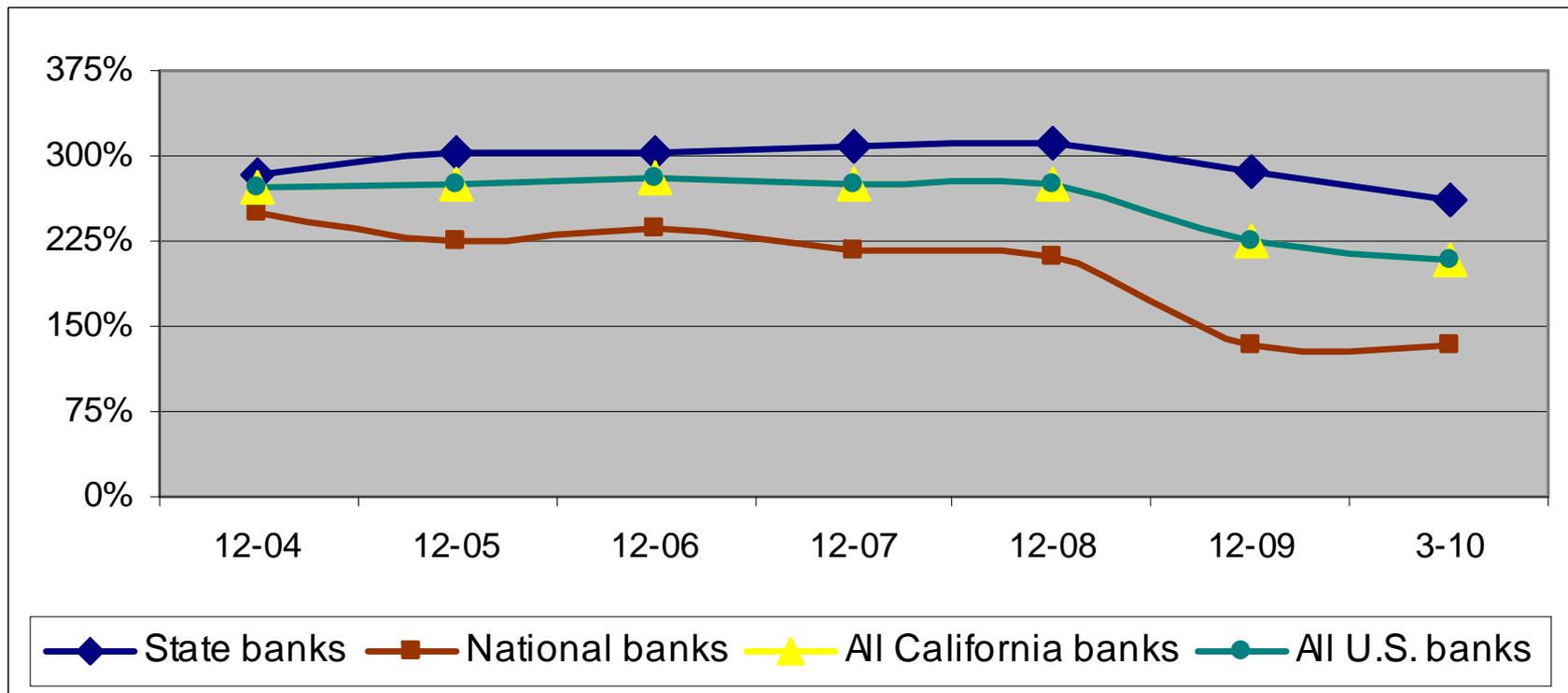
* Quintiles of equal sizes are created by dropping off first the highest then the lowest ratio in each group until the number of institutions is divisible by 5.

** Due to the small population in this category, it was divided into four equal sized groups.

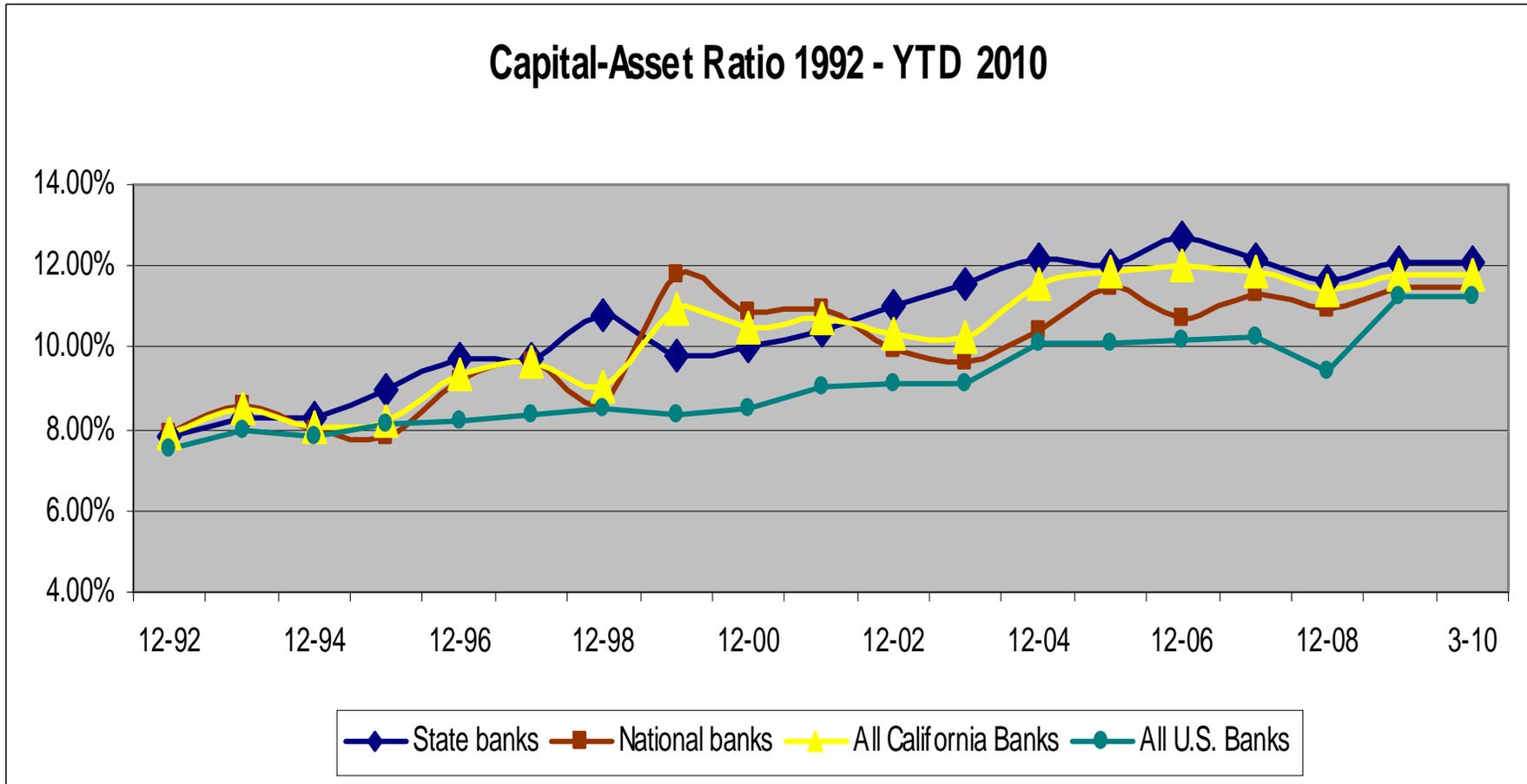
Noncurrent Loans and Leases to Total Loans and Leases



Commercial Real Estate Loans to Total Equity Capital



Capital Adequacy



Equity Capital / Assets by Quintile*

State Chartered Commercial and Industrial Banks

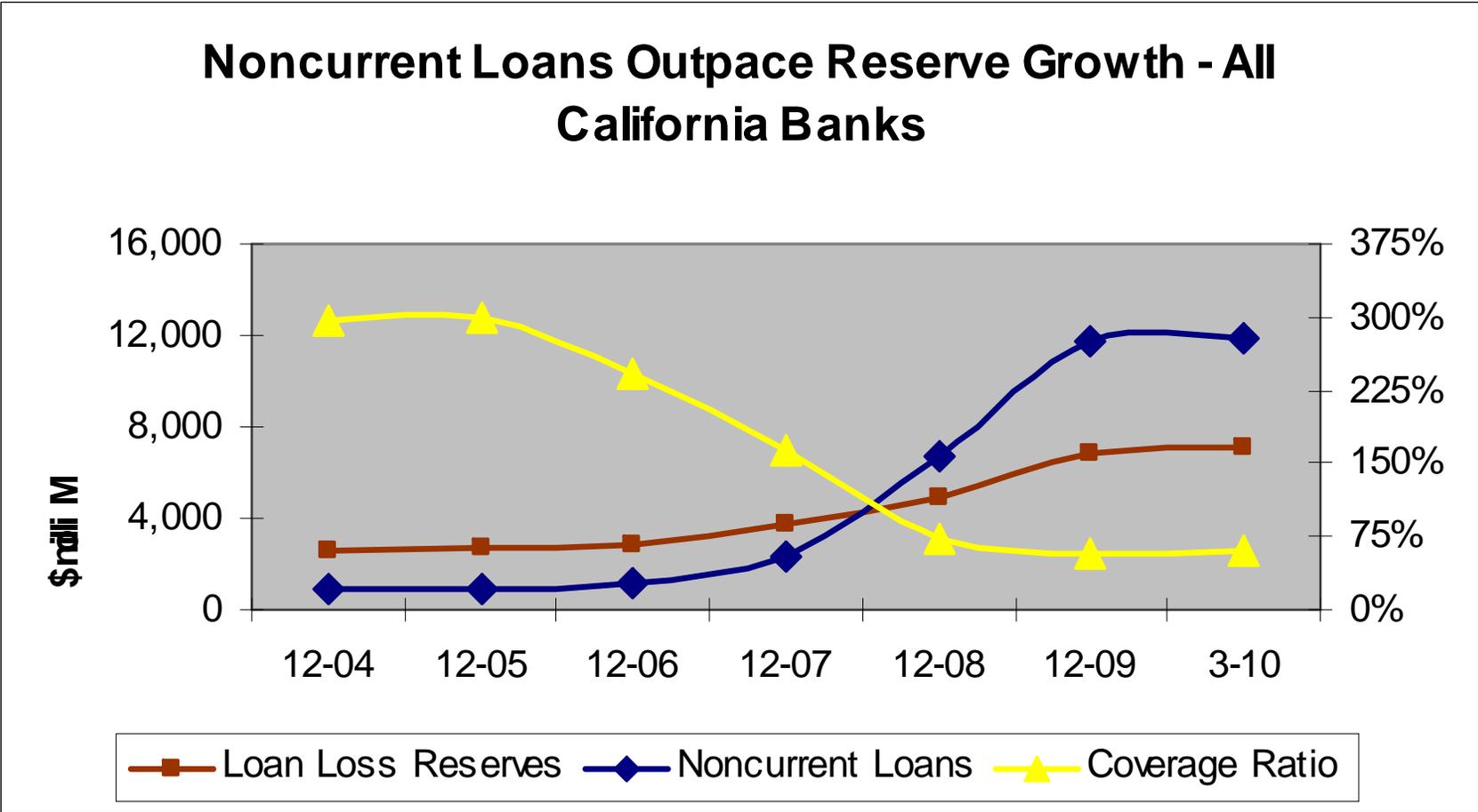
As of March 31, 2010

Asset Size	Over 3 years of operation				< 3 yrs ops.	Total
	Less than \$100MM	\$100 to \$500MM	\$500MM to \$2 Billion	\$2 Billion and More**	All asset sizes	
Number of Banks	22	108	40	17	22	209
First Quintile	29.9	15.7	17.7	13.1	23.7	19.7
Second Quintile	13.9	12.3	12.7	11.4	18.7	13.0
Third Quintile	11.8	10.7	10.5	10.4	15.7	11.1
Fourth Quintile	10.0	9.7	9.7	7.7	13.5	9.9
Fifth Quintile	6.9	7.7	7.4		11.6	7.6
Total	14.7	11.9	11.7	13.1	15.2	12.8

* Quintiles of equal sizes are created by dropping off first the highest then the lowest ratio in each group until the number of institutions is divisible by 5.

** Due to the small population in this category, it was divided into four equal sized groups.

Loan Loss Reserves vs. Noncurrent Loans and Leases



Crystal Ratio by Quintile*
[(Past Due Loans + Other Real Estate Owned)/(Capital + ALLL)]
State Chartered Commercial and Industrial Banks

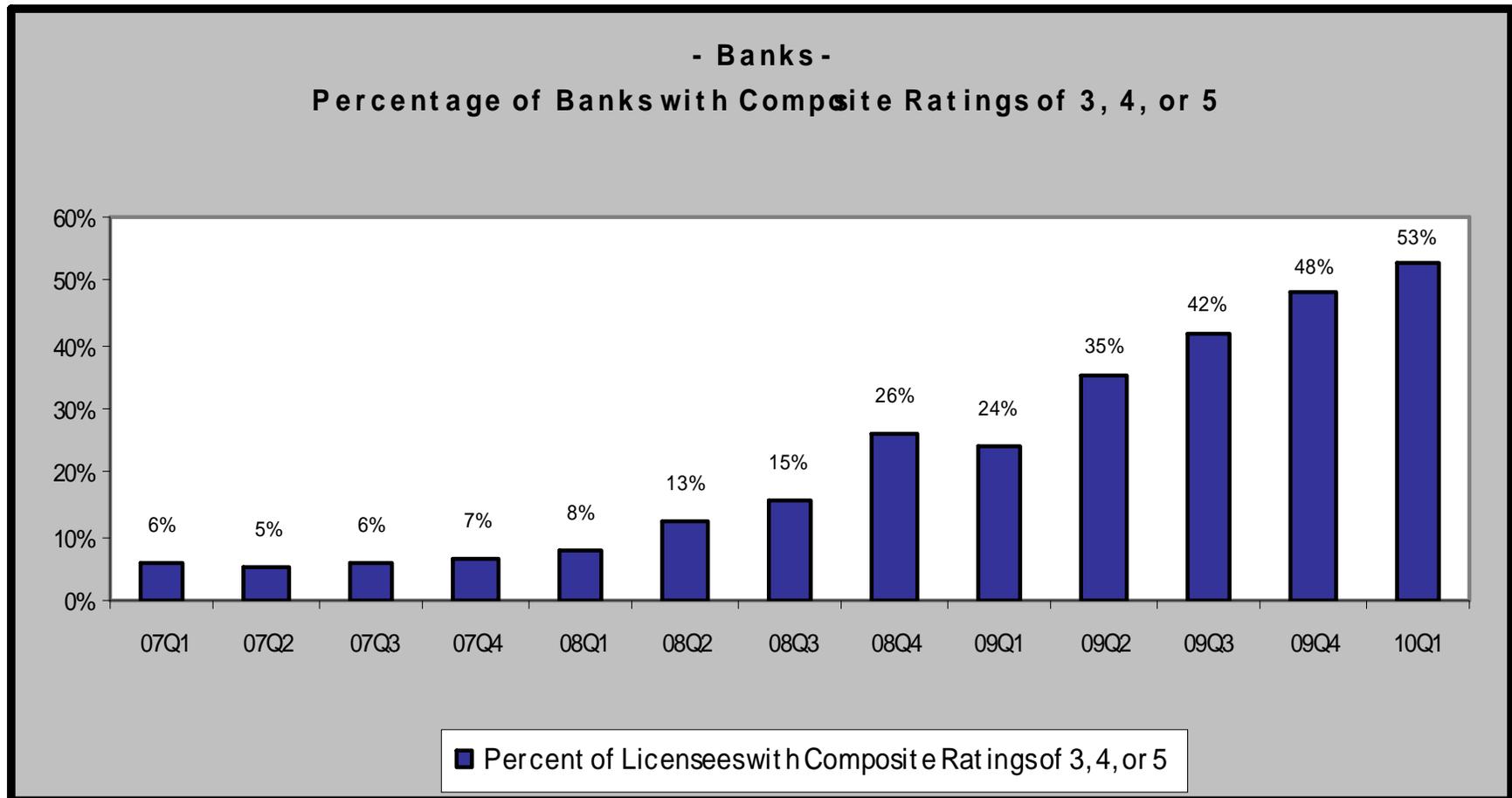
As of March 31, 2010

Asset Size	Over 3 years of operation				< 3 yrs ops.	Total
	Less than \$100MM	\$100 to \$500MM	\$500MM to \$2 Billion	\$2 Billion and More**	All asset sizes	
Number of Banks	22	108	40	17	22	209
First Quintile	109.1	81.2	102.8	44.2	19.6	86.6
Second Quintile	26.2	42.7	50.4	33.6	8.0	40.1
Third Quintile	13.7	31.0	32.6	26.8	2.4	27.2
Fourth Quintile	4.9	18.5	23.2	15.5	0.0	14.9
Fifth Quintile	2.3	5.9	10.7		0.0	3.0
Total	23.2	33.4	36.0	28.5	22.9	29.9

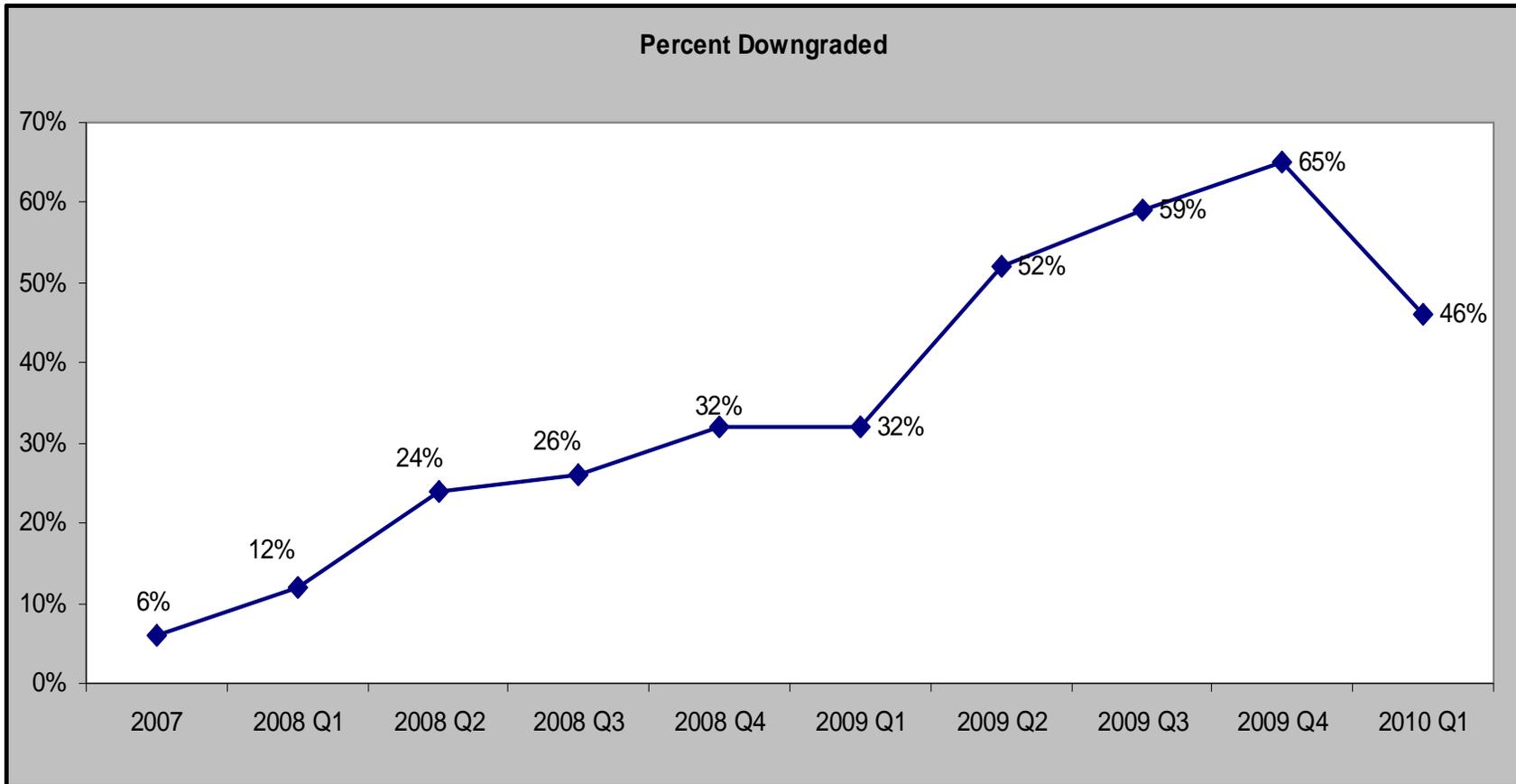
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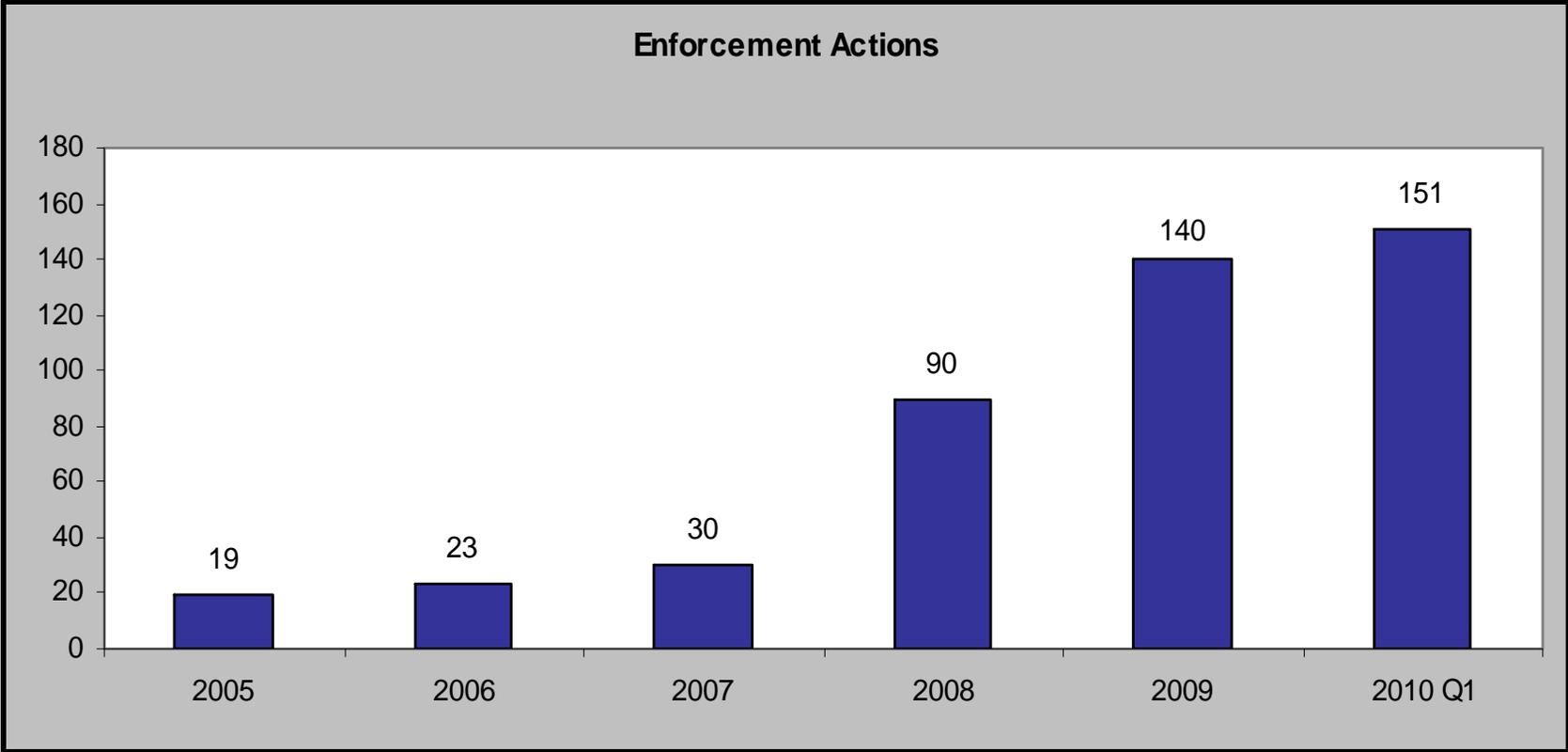
Increase in Problem Banks



Downgrades Decelerated in Q1 (...Finally!)



Enforcement Actions are UP



California Bank and Thrift Failures

September 2008 – Present

<u>Name</u>	<u>Type</u>	<u>City</u>	<u>Total Assets (000)</u>	<u>Date Closed</u>
Security Pacific Bank	State	Los Angeles	527,959	11/7/08
Downey Savings and Loan Association	FSB	Newport Beach	12,779,371	11/21/08
PFF Bank & Trust	FSB	Pomona	3,715,433	11/21/08
1st Centennial Bank	State	Redlands	797,959	1/23/09
Alliance Bank	State	Culver City	1,113,361	2/6/09
County Bank	State	Merced	1,711,552	2/6/09
IndyMac Federal Bank, F.S.B.	FSB	Pasadena	23,477,908	3/19/09
First Bank of Beverly Hills	State	Calabasas	1,260,354	4/24/09
MetroPacific Bank	State	Irvine	75,316	6/26/09
Mirae Bank	State	Los Angeles	480,619	6/26/09
Temecula Valley Bank	State	Temecula	1,396,622	7/17/09
Vineyard Bank, National Association	National	Rancho Cucamonga	1,638,378	7/17/09
Affinity Bank	State	Ventura	1,211,431	8/28/09

* Total assets are as of quarter-end prior to failure.

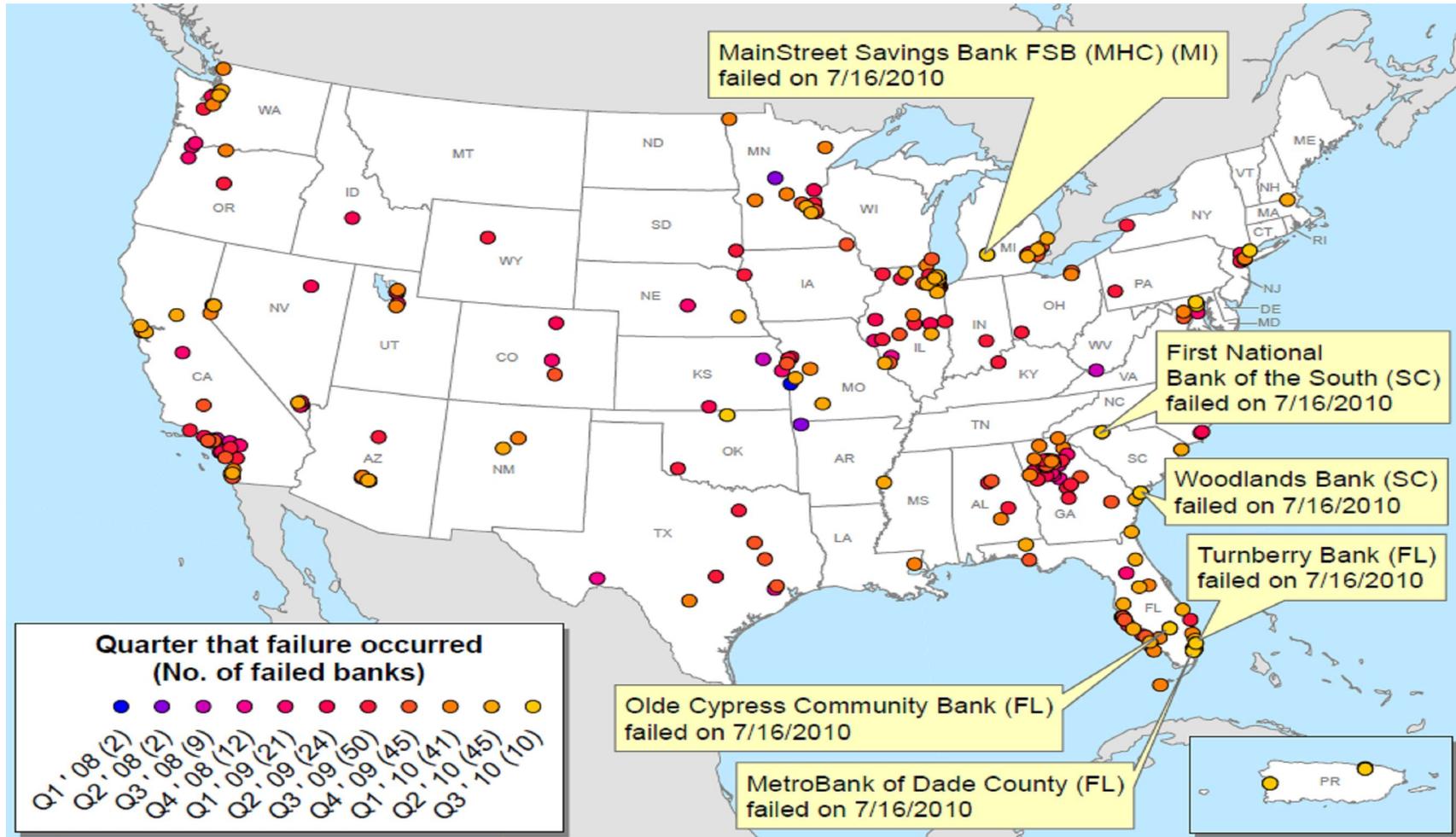
California Bank and Thrift Failures

September 2008 – Present (Continued)

<u>Name</u>	<u>Type</u>	<u>City</u>	<u>Total Assets (000)</u>	<u>Date Closed</u>
San Joaquin Bank	State	Bakersfield	766,359	10/16/09
California National Bank	National	Los Angeles	7,781,100	10/30/09
Pacific National Bank	National	San Francisco	2,319,263	10/30/09
San Diego National Bank	National	San Diego	3,594,544	10/30/09
United Commercial Bank	State	San Francisco	10,895,336	11/6/09
Pacific Coast National Bank	National	San Clemente	131,418	11/13/09
First Federal Bank of California	FSB	Santa Monica	6,143,903	12/18/09
Imperial Capital Bank	State	La Jolla	4,046,888	12/18/09
First Regional Bank	State	Los Angeles	2,082,684	1/29/10
La Jolla Bank, FSB	FSB	La Jolla	3,646,071	2/19/10
Innovative Bank	State	Oakland	266,816	4/16/10
Tamalpais Bank	State	San Rafael	611,504	4/16/10
1st Pacific Bank of California	State	San Diego	335,798	5/7/10

* Total assets are as of quarter-end prior to failure.

Bank and Thrift Failures Since 2008



As of: July 16, 2010
Source: SNL Financial

California Chartered Institutions

Completed Capital Offerings

September 2008 – Present

<u>Name</u>	<u>Location</u>	<u>Date</u>	<u>Funding Type</u>	<u>Offering Amount (\$000)</u>
New Resource Bank	San Francisco	9/17/08	Common Stock	13,900
Seacoast Commerce Bank	Chula Vista	10/31/08	Common Stock	4,000
Mission Community Bancorp	San Luis Obispo	12/2/08	Common Stock	3,848
Pacific Valley Bank	Salinas	12/22/08	Common Stock	2,495
UCBH Holdings, Inc.	San Francisco	12/23/08	Common Stock	30,070
PacWest Bancorp	San Diego	1/14/09	Common Stock	100,000
Preferred Bank	Los Angeles	2/11/09	Senior Debt	26,000
Pacific Valley Bank	Salinas	2/19/09	Common Stock	1,502
Bank of the West	San Francisco	3/23/09	Senior Debt	1,000,000
East West Bancorp, Inc.	Pasadena	7/14/09	Common Stock	27,500
East West Bancorp, Inc.	Pasadena	7/20/09	Common Stock	69,850
CVB Financial Corp.	Ontario	7/21/09	Common Stock	115,245

California Chartered Institutions

Completed Capital Offerings

September 2008 – Present (Continued)

<u>Name</u>	<u>Location</u>	<u>Date</u>	<u>Funding Type</u>	<u>Offering Amount (\$000)</u>
PacWest Bancorp	San Diego	8/25/09	Common Stock	50,000
Sierra Bancorp	Porterville	8/28/09	Common Stock	21,285
Hanmi Financial Corporation	Los Angeles	9/4/09	Common Stock	6,946
Preferred Bank	Los Angeles	9/9/09	Common Stock	17,029
Cathay General Bancorp	El Monte	9/30/09	Common Stock	32,379
Pacific Valley Bank	Salinas	9/30/09	Common Stock	1,900
Cathay General Bancorp	El Monte	10/13/09	Common Stock	70,435
Nara Bancorp, Inc.	Los Angeles	10/21/09	Common Stock	75,000
Pacific Premier Bancorp, Inc.	Costa Mesa	11/4/09	Common Stock	15,000
East West Bancorp, Inc.	Pasadena	11/6/09	Preferred Stock	335,047
East West Bancorp, Inc.	Pasadena	11/6/09	Common Stock	164,953
SVB Financial Group	Santa Clara	11/18/09	Common Stock	300,300

California Chartered Institutions

Completed Capital Offerings

September 2008 – Present (Continued)

<u>Name</u>	<u>Location</u>	<u>Date</u>	<u>Funding Type</u>	<u>Offering Amount (\$000)</u>
Center Financial Corporation	Los Angeles	11/30/09	Common Stock	1,510
Center Financial Corporation	Los Angeles	11/30/09	Common Stock	11,271
Pacific Mercantile Bancorp	Costa Mesa	12/3/09	Preferred Stock	1,650
American River Bankshares	Rancho Cordova	12/7/09	Common Stock	22,000
Pacific Mercantile Bancorp	Costa Mesa	12/9/09	Preferred Stock	5,250
Pacific Mercantile Bancorp	Costa Mesa	12/18/09	Preferred Stock	950
Pacific Mercantile Bancorp	Costa Mesa	12/21/09	Preferred Stock	200
Central Valley Community Bancorp	Fresno	12/23/09	Preferred Stock	1,359
Central Valley Community Bancorp	Fresno	12/23/09	Common Stock	6,641
Cathay General Bancorp	El Monte	12/24/09	Common Stock	12,550
Sierra Vista Bank	Folsom	12/30/09	Common Stock	1,232
Center Financial Corporation	Los Angeles	12/31/09	Preferred Stock	73,500
Mission Valley Bancorp	Sun Valley	12/31/09	Preferred Stock	4,580
Pacific Valley Bank	Salinas	12/31/09	Common Stock	500

California Chartered Institutions

Completed Capital Offerings

September 2008 – Present (Continued)

Name	Location	Date	Funding Type	Offering Amount (\$000)
Pacific Mercantile Bancorp	Costa Mesa	5/7/10	Preferred Stock	805
Ventura County Business Bank	Oxnard	5/19/10	Common Stock	9,359
Heritage Oaks Bancorp	Paso Robles	6/8/10	Preferred Stock	4,072
Mission Community Bancorp	San Luis Obispo	6/15/10	Common Stock	15,000
First Republic Bank	San Francisco	6/18/10	Common Stock	1,862,004
Heritage Commerce Corp	San Jose	6/21/10	Preferred Stock	53,996
Heritage Commerce Corp	San Jose	6/21/10	Preferred Stock	21,004
Preferred Bank	Los Angeles	6/21/10	Preferred Stock	77,000
Community Bank of the Bay	Oakland	7/19/10	Common Stock	7,700
Hanmi Financial Corporation	Los Angeles	7/21/10	Common Stock	TBD
Total				\$ 5,038,971

Capital Purchase Program - All California Banks

Period Ending 6/30/2010 (in million \$s)

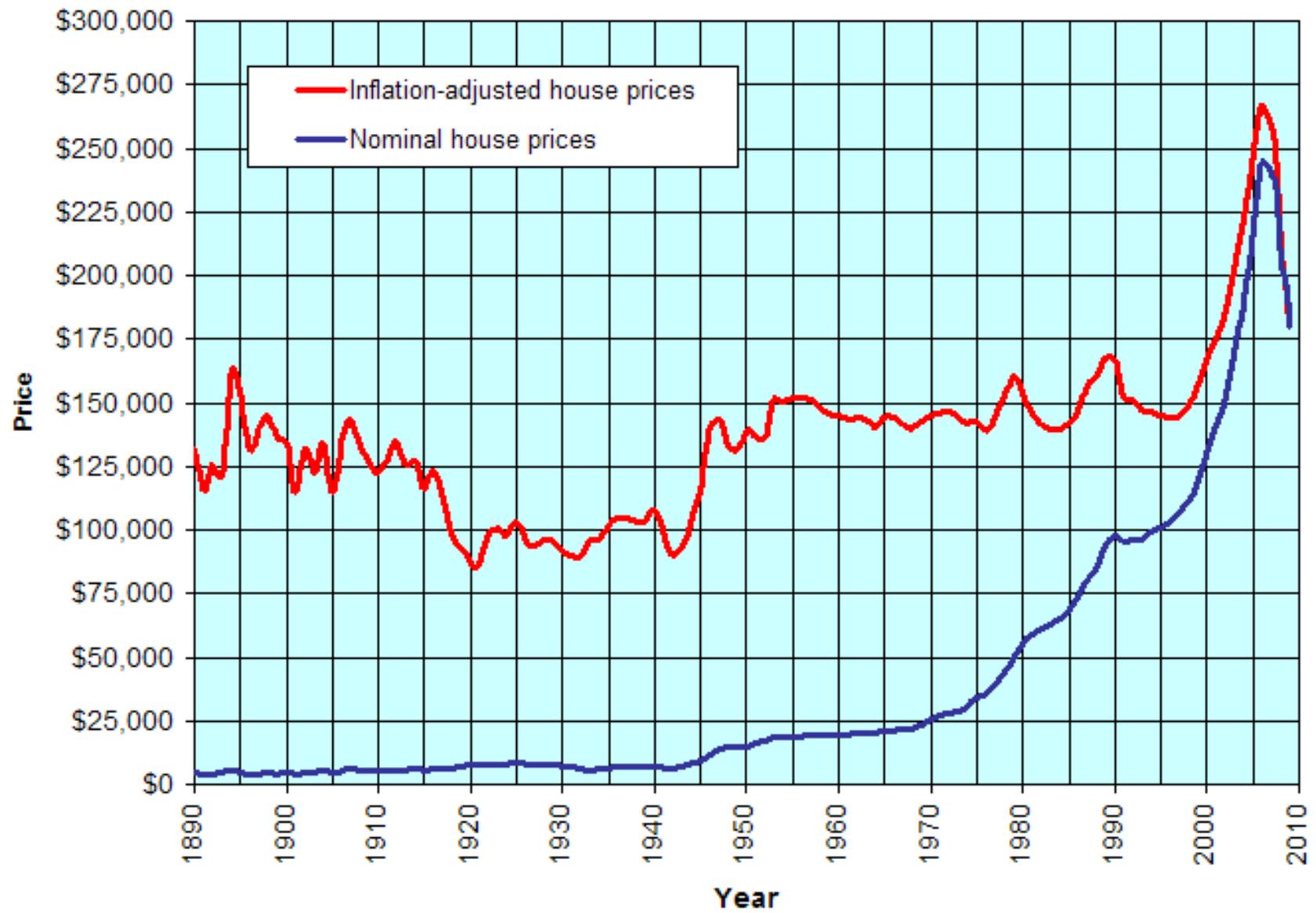
<u>Type of Bank</u>	<u>#</u>	<u>Total Purchase Amount</u>	<u>Total Capital Repayment Amount</u>	<u>Total Treasury CPP Investment Amount</u>
State Banks	53	\$1,948.8	\$476.7	\$1,472.1
National Banks	14	672.3	402.6	269.7
Federal Savings Banks	4	46.5	4.9	41.6
Total	71	\$2,667.6	\$884.2	\$1,783.4

The Economy and Credit Conditions

Characteristics of Post-crisis Economies

- These are not normal cyclical events. Postwar U.S. experience with recessions and recoveries is not a good guide.
- Balance sheet damage from a collapse in valuations produces a slow, protracted recovery.
- Process of balance sheet repair takes time.
- Normal tools of monetary and fiscal policy less effective or unavailable.
- “Sovereign” risk and crises are part of the landscape.
- =>Prepare for a Slow, Potentially Bumpy Recovery

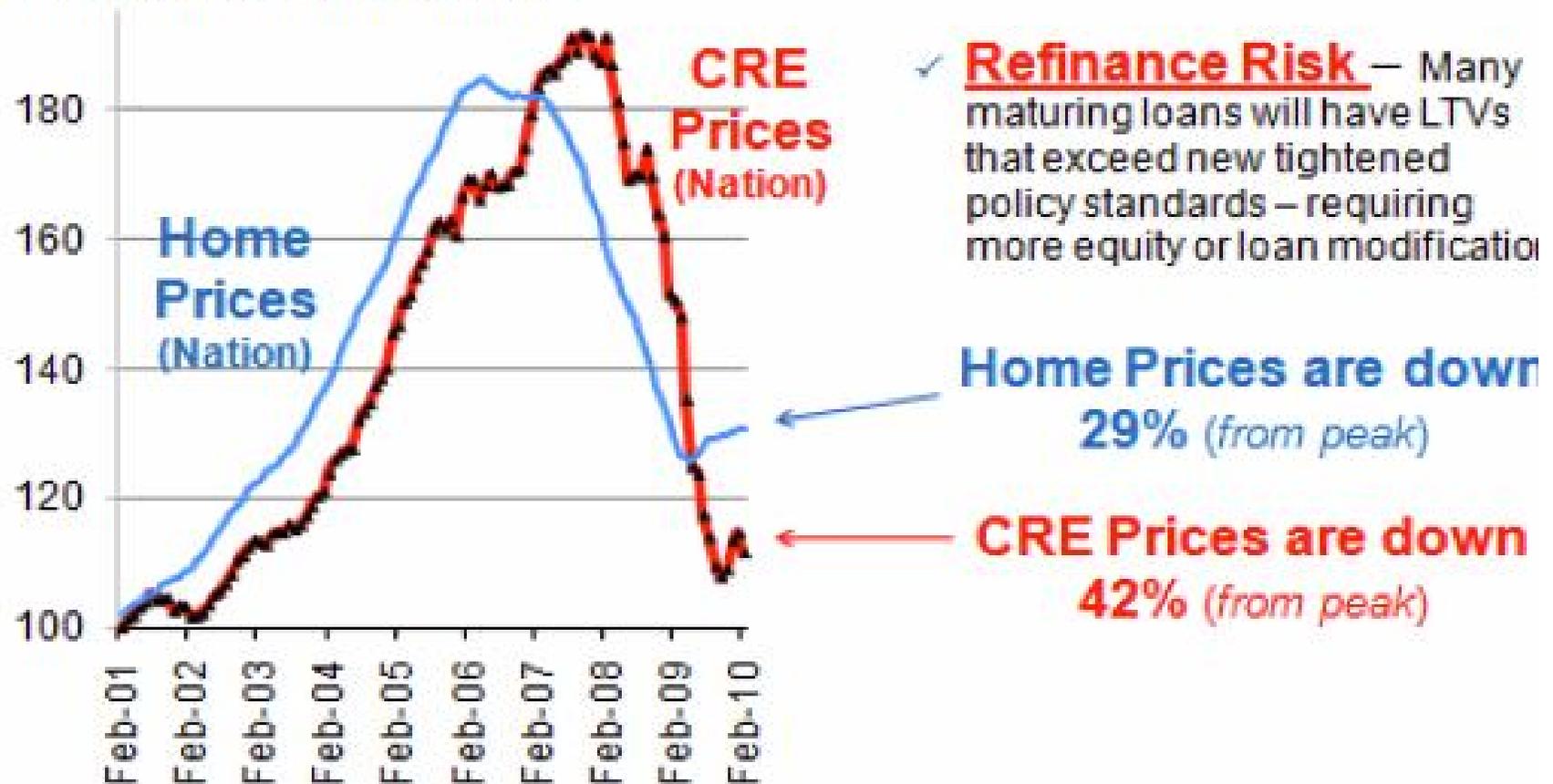
U.S. House Prices, 1890-2008



5) CRE Property Values Down Even More Than Housing

Maturing CRE Loans Increasingly to Require Extensions & Restructuring

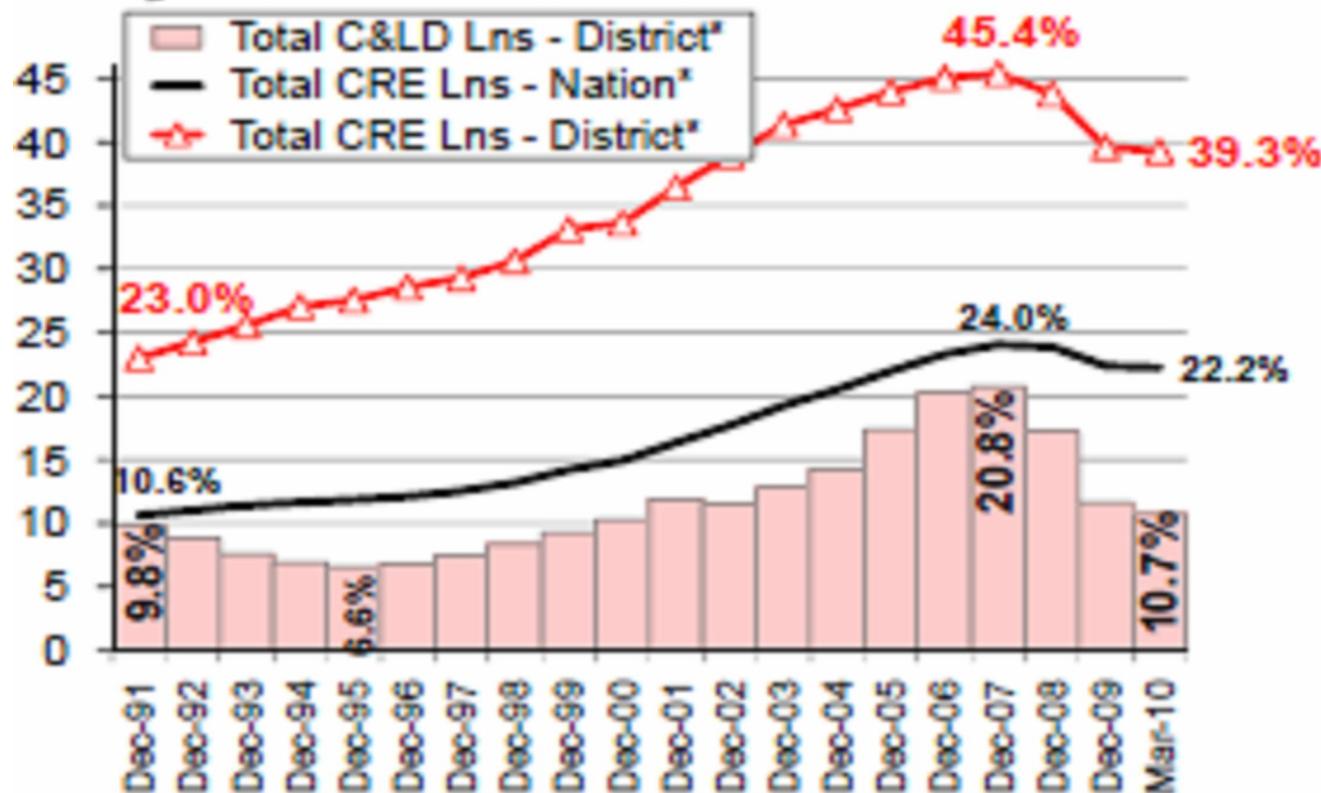
Home and CRE Price Indices



Sources: Moody's/REAL Commercial Property Index; S&P Case-Shiller Home Price Composite 20 Index, SA; Haver Analytics; re-indexed to 100 at Dec 2000. Note: the CRE index is based on very few transactions -- the value decline may be overstated

District Avg. Total CRE Loan Concentrations Have Declined But are Still Well Above the Nation

Average Loan Concentrations as a Pct of Total Loans – %



CRE Lns / Tot. Lns excl. owner occupied NFNR		
U.S. Rank	State	State Avg
1	NV	46%
2	CA	42%
5	AZ	38%
6	WA	38%
7	OR	37%
10	HI	34%
11	UT	34%
16	AK	31%
17	ID	30%
12 th District		38%
Nation		22%

FRB-SF

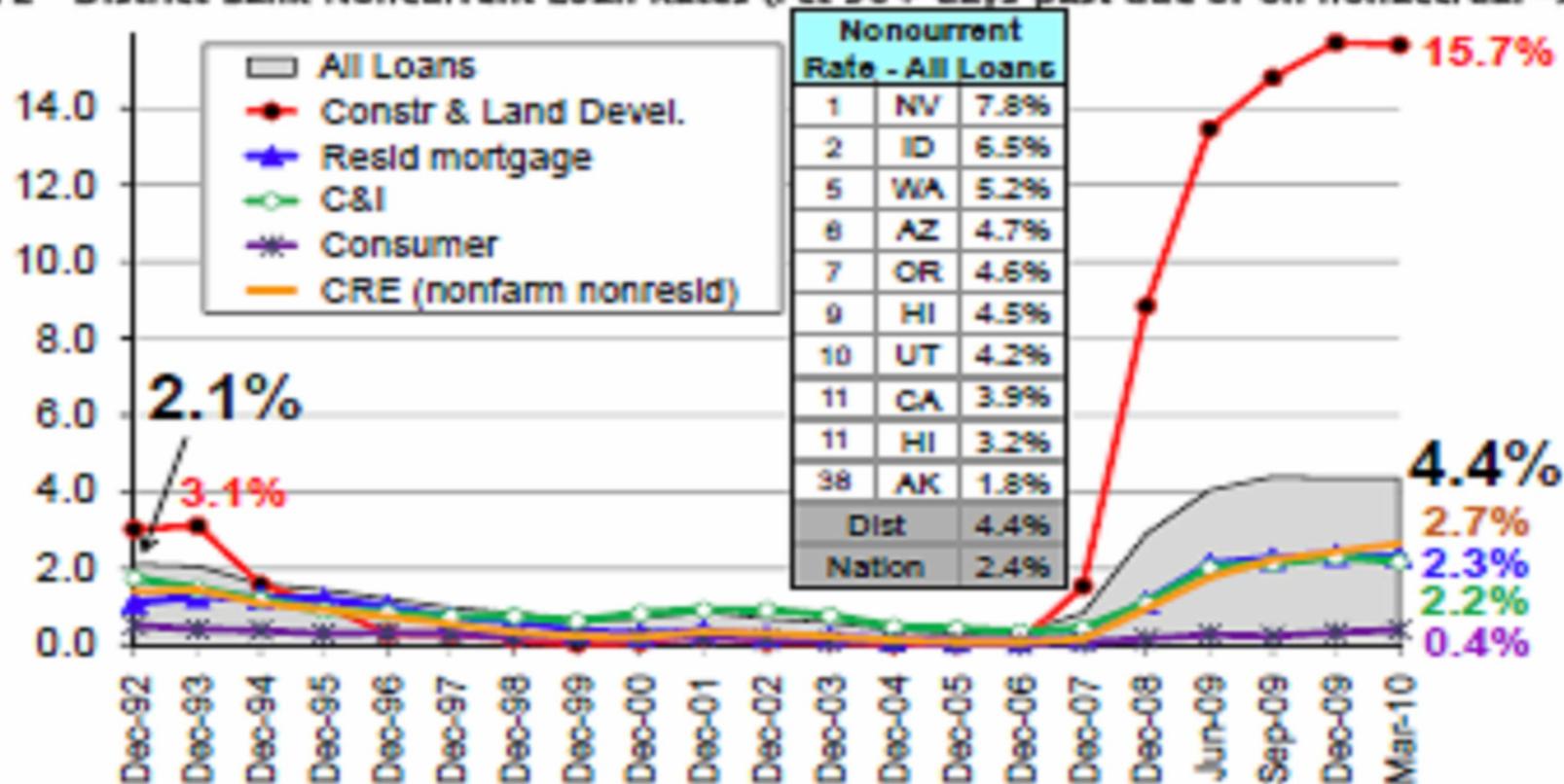
First Glance 12L - May 2010

Commercial banks only (excludes industrials); trimmed means; * Total CRE loans include C&LD loans, and exclude owner-occupied nonfarm nonresidential secured loans, as estimated prior to 2008, preliminary 2/2010 data.

Noncurrent Loan Rates Plateaued, Due Largely to Charge-offs

Only CRE Income Property Noncurrent Rates Rose Materially in 1Q10

12th District Bank Noncurrent Loan Rates (Pct 90+ days past due or on nonaccrual -%)



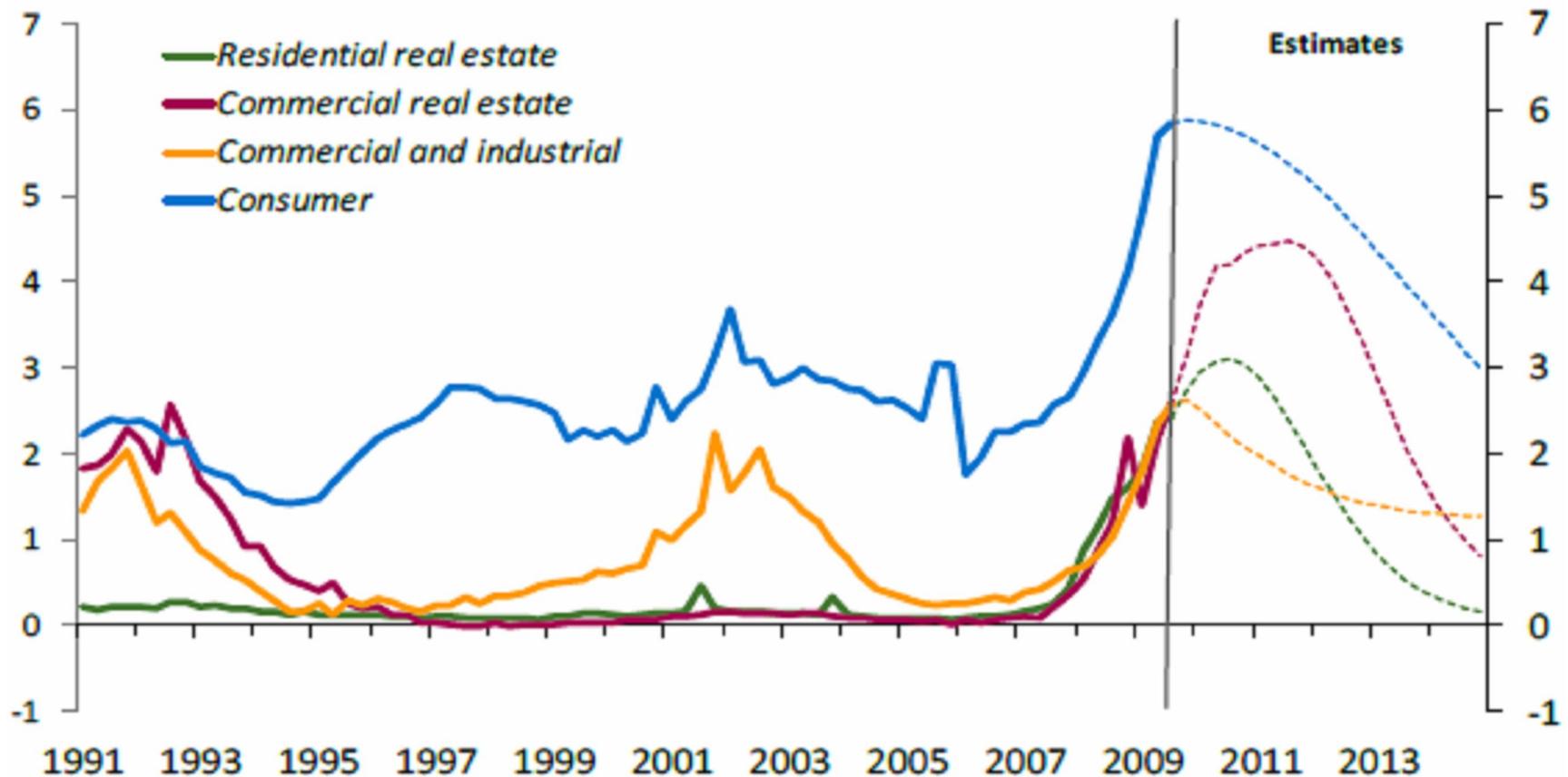
FRB-SF

First Glance 12L - May 2010

Source: Regulatory Call & Income Reports; all commercial & industrial banks excluding De Novos; trimmed means, preliminary 1Q10 data.

U.S. Loan Charge-Off Rates (Including IMF Forecasts)

(In percent of total loans)



Sources: Federal Reserve; and IMF staff estimates.

Back to the Future?

California Banking in the 1930s

**Excerpts from the reports of
California State Bank Superintendants**

Superintendent Will C. Wood, 1930

- *The people of California have reason to be proud of the fine way in which our banking institutions have handled financial problems growing out of the rather drastic deflation of the stock markets last fall. Not one bank failure can be attributed directly or indirectly to the market crisis of 1929...*

Superintendent Edward M. Rainey, 1932

- *In view of the unprecedented demands made upon banks everywhere during the past three years, the current statement of the California State banks are indeed reassuring.*
- *While failures are at all times to be regretted, it would be unfair not to mention the very enviable record maintained by banks in California during this depression period... Generally speaking, California is a distinctly bright spot on the National map of bank failures.*

Superintendent Friend William Richardson, 1934

- *the combined statements submitted herewith give a factual demonstration of the urgent problem faced uniformly by all banks--earning assets in the form of good loans are not available in sufficient amounts to take up the increase in deposits. The only outlet is government bonds at extremely low rates--in fact lower than the prevailing rates on time deposits... Even the acquisition of government bonds on a low yield basis may cause future embarrassment should prevailing rates increase due either to declining public confidence in government issues or to the flotation of more attractive private issues.*

Impact of Regulatory Reform

- Dodd-Frank
- Basle Committee Process (Basle III)
- Supervisory Changes

Dodd-Frank

- Dodd-Frank will touch every corner of the financial system, but its biggest impact will be on largest financial institutions.
- Direct and indirect impacts on community and regional banks are difficult to assess at this time.
 - Key provisions: increase in deposit insurance coverage now permanent, interest payable on DDA, Fed to regulate interchange fees
- CFPB creates major new uncertainties.
- Roll-back of OCC's preemption authority invites new state-level consumer financial legislation.
- Basle III initiative could be at least as significant as Dodd-Frank and should be watched closely.

A Lesson Learned from the Crisis

Taking the “M” in CAMELS Seriously
The Management Component Rating

The “M” in CAMELS

- *The capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of an institution’s activities and to ensure a financial institution’s safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in this rating.*

Uniform Financial Institutions Ratings System Revised
1996

The Traditional Emphasis

- *A bank's performance with respect to asset quality and diversification, capital adequacy, earnings performance and trends, liquidity and funds management, and sensitivity to fluctuations in market interest rates is, to a very significant extent, a result of decisions made by the bank's directors and officers. Consequently, findings and conclusions in regard to the other five elements of the CAMELS rating system are often major determinants of the management rating.*

Uniform Financial Institutions Ratings System
Revised 1996

A Better Emphasis

1. Does the bank have effective board oversight and corporate governance practices, policies and procedures?
2. Does the bank have an effective framework for risk management consistent with its size, complexity, structure and risk profile?
3. How well do the board, management and control functions execute against this framework?

1. Evaluate Corporate Governance

- Corporate governance involves the manner in which the business and affairs of a bank are governed by its board and management:
 - Setting strategy and objectives
 - Determining risk tolerances
 - Protecting the interests of depositors, other recognized stakeholders while meeting shareholder obligations
 - Operating the bank in a safe and sound manner, with integrity and in compliance with applicable laws and regulations.

Board Responsibilities

- *The board has overall responsibility for the bank, including overseeing the implementation of the bank's strategic objectives, risk strategy, corporate governance and corporate values. The board is also responsible for providing oversight of senior management.*

“Principles for Enhancing Corporate Governance”
Basle Committee on Banking Supervision
March 2010

Key Elements of Effective Governance

- Board members and management have the expertise and integrity to fulfill their roles.
- Information presented to the board is complete, accurate and presented in an understandable manner.
- Board has established processes to properly oversee and evaluate management and control functions and assess its own effectiveness.
- Internal audit function conducts independent, risk-based and effective audits.
- Board has knowledge of and controls over all potential conflicts of interest at board and management levels.

2. Evaluate Risk Management Framework

- How effectively does the bank:
 - Identifying key risks
 - Measure exposures to these risks
 - Monitor risk exposures on an ongoing basis and determine corresponding capital and liquidity needs
 - Control or mitigate risk exposures through effective processes that work as intended; and
 - Report to senior management and the board on these items.

Key Elements of Effective Risk Management

- Independent risk management function with adequate stature, authority, board access and resources.
- MIS and analytical capabilities to perform stress tests/scenario analyses for all key exposures.
- Risk mitigation strategies and contingency plans that are informed by such analyses.
- Capability to understand and effectively adapt to changes in the economic, financial and competitive environment.
- Compensation systems that are effectively aligned with prudent risk taking.

3. Assess Execution Against Risk Framework

- Are all risk factors appropriately identified, assessed and controlled?
- Are credit concentrations properly identified and mitigated?
- Are underwriting principles sound and sensitive to market conditions?
- Is there a realistic liquidity plan for dealing with a range of potential disruptions to normal liquidity sources?
- Has the board provided proper oversight of management?
- Are internal audit, compliance and control functions effective?

