Accelerating and Sustaining Commercial Loan Growth

Stonier Graduate School of Banking Capstone

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EXECUTIVE SUMMARY

Bank ("BANK") is a community bank that grew through acquisition to approximately $10B in assets in the late 20th century and embarked on a variety of relatively aggressive strategic initiatives which extended the bank beyond its community banking roots. BANK then experienced substantial credit problems in the early 2000s which precipitated a management change and a return to a basic community bank strategy. That strategy along with the credit quality restoration process has resulted in a very well-capitalized bank that has generated loss rates far less than the peer but has struggled to generate consistent earnings growth. Accordingly, the bank adopted a strategic plan in 2016 to accelerate its balance sheet and net income growth and enhance its efficiency.

The credit lessons learned from the turn-around have wrought a comparatively conservative credit discipline inside BANK including its hold limits. The bank's size and capital base have increased significantly in the last several years, but the exposure limits have not kept track. This paper recommends an approach to right-size those hold limits to better position the bank to fulfill its strategic plan the centerpiece of which is a 10.7% compound annual growth rate in commercial loan balances.

By moderately increasing hold limits to levels in line with historical averages vis-à-vis BANK's capital, the bank faces little downside risk and stands to enjoy enhanced earnings, client retention, competitive effectiveness, and talent attraction.

INTRODUCTION AND BACKGROUND

Bank History

Bank's ("BANK") home state didn't allow bank branching across county lines until July 1985. After statutory reform lifted that restriction, BANK pursued sustained expansion across the ensuing fifteen years with multiple bank acquisitions in its region. By the late 1990s, BANK was comprised of 21 separately-chartered community banks with the preponderance of the locations in smaller rural towns.

BANK consolidated its charters into one in 1999 and then expanded its strategic focus beyond traditional community banking with the pursuit of various initiatives:

- Metro strategy – BANK built high-end de novo banking centers using a personal banker staffing model in larger metropolitan areas.
- Signature Group ("SG") – SG was established in 2002 to manage the company's fee-based businesses including insurance, investments, trust, asset management, and financial planning. Under SG, the company made significant acquisitions outside its core markets and established its own proprietary investment funds.
- Mortgage Company – BANK segregated mortgage as a separate line of business outside the banking group and opened loan production offices.

In the early 2000s, BANK began to experience a more intense level of regulatory scrutiny following the consolidation of its charters. With approximately $10 billion of assets at the time, BANK's balance sheet was composed of loans which were underwritten from a community bank, local director loan committee approach. Underwriting documentation had been slight

and lending policies were more loosely enforced in favor of local decision-making. The increased regulatory scrutiny led to a discovery of more layers of credit risk than had been recognized.

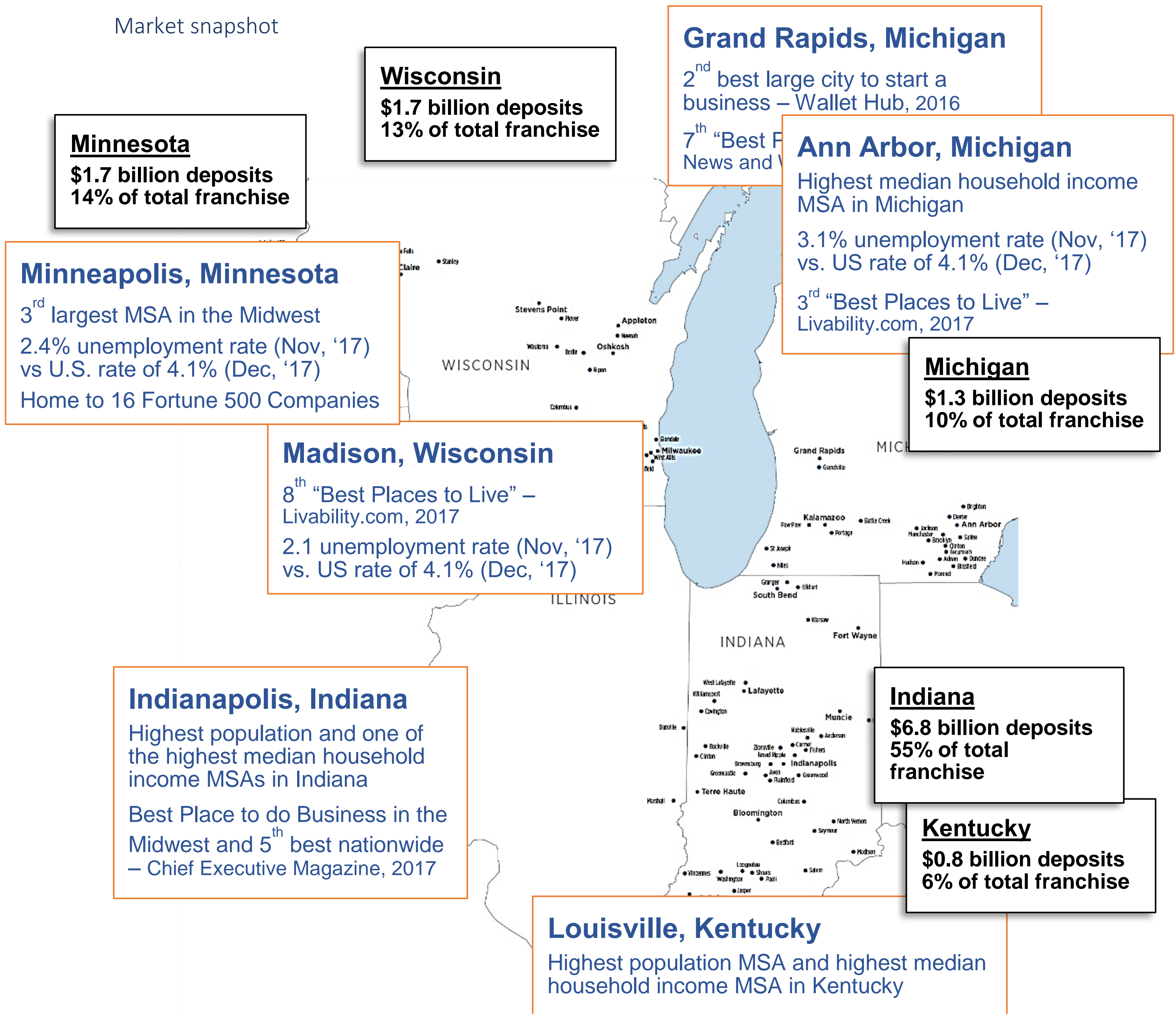
In 2003, BANK recorded a loan provision expense of $85 million as non-accrual balances peaked at approximately 2.6% of loans outstanding. In this same period, the anticipated synergies between the SG initiatives and mortgage loan production offices as drivers for core banking activities failed to materialize and the company's acquisitions from that period didn't demonstrate an integration of cultures. Dilution caused by acquisition (i.e., share issuances) and impaired profitability caused EPS to fall nearly 50% from $1.81 in 2002 to $0.93 in 2003.

The board triggered a management change and a new CEO was brought in during the fall of 2004. This leadership change ushered in a "back to basics" strategy where BANK focused on traditional community banking. Non-strategic assets including some of the SG acquisitions were divested. The management structure was flattened, and the credit underwriting function was restructured and made more independent in the bank's bid to strengthen its risk profile. In the ensuing years, several branch divestitures, consolidations, and bank acquisitions re-positioned the company into more attractively-growing markets as the company developed a more disciplined M&A strategy with more thoughtful and thorough cultural – not just system – integrations.

Bank Today

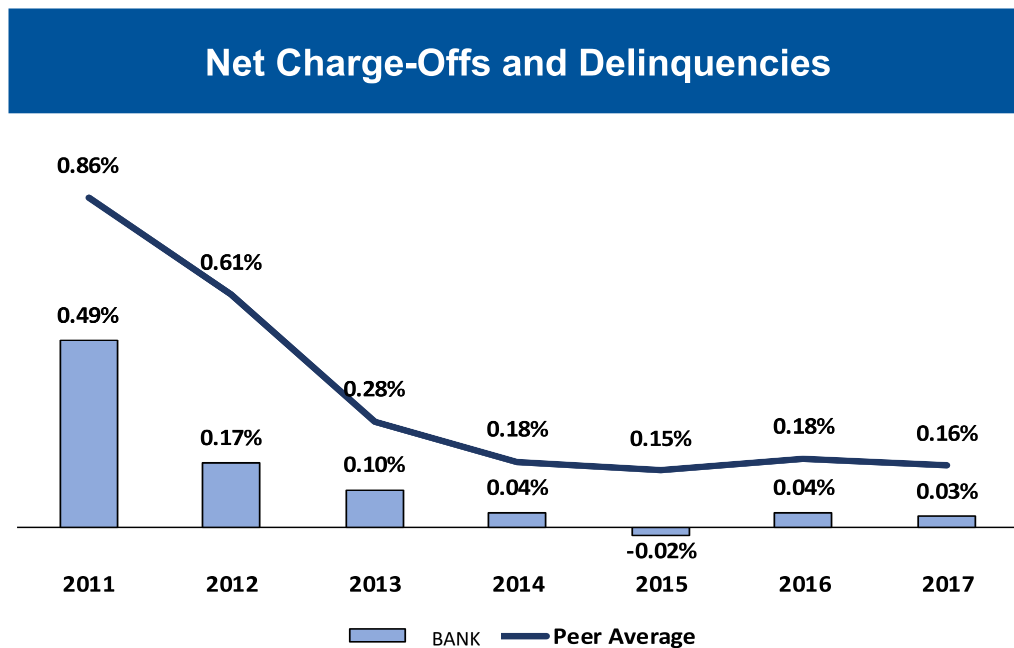
BANK is a $18B organization operating across Indiana, Kentucky, Michigan, Wisconsin and Minnesota offering commercial and retail banking, trust, brokerage, and capital markets services. BANK has repositioned its franchise and profiles as a dominant market participant in its mature markets with substantial upside in several growth markets.

Market snapshot

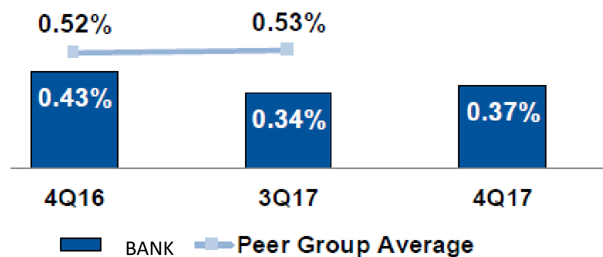


In reversing its decline in the early 2000s the company has pursued a consistent set of strategic imperatives: (1) strengthen the risk profile; (2) enhance management discipline; and (3) generate consistent, quality earnings. BANK has been exceptionally effective at the first strategic imperative to strengthen the risk profile as evidenced by its credit expenses, delinquency metrics, and capitalization.

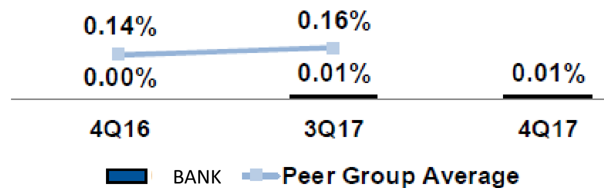
Net charge-offs and delinquency: BANK vs. peer group average



30-89 Days Delinquent Loans[1]

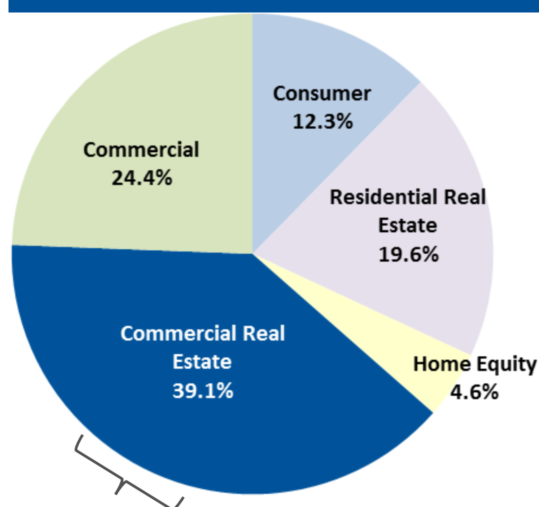


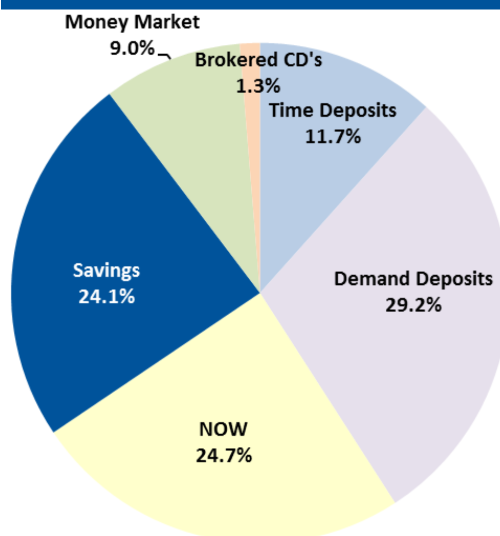
90+ Day Delinquent Loans[1]



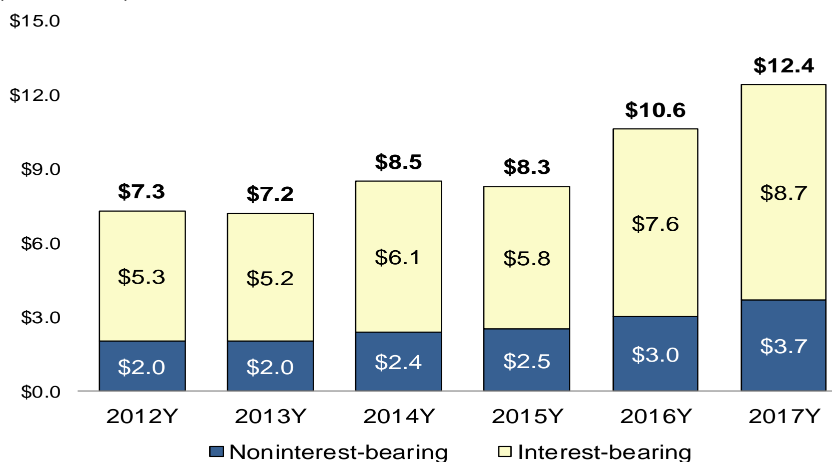
BANK's balance sheet summary

The bank's balance sheet is well-capitalized with a ratio of total capital to risk-weighted assets of 11.73% as of 12/31/17 and a strong Moody's rating of Aa3, the 2nd highest possible long-term rating. BANK is funded with a strong, low-cost core deposit franchise with a 5% deposit beta[1] and deploys that capital across a balanced portfolio of loan types.





CRE Breakout	
Construction	8.6%
Multifamily	22.3%
Owner Occupied	27.8%
Non-Owner Occupied	41.3%



[1] Deposit beta defined as increase in cost of interest bearing deposits divided by increase in fed funds rate from 3Q2015 through 4Q2017.

Efficiency ratio and EPS headwinds

BANK has seen less progress on the latter two strategic imperatives: enhance management discipline and consistent, quality earnings. BANK has faced a stubborn efficiency ratio ranging from a low of 65.8% (2016) to a high of 70.0% (2014) and stagnant core EPS from a low of $0.85 (2017) to a high of $1.09 (2013).[2] BANK's peer group demonstrated an average efficiency ratio of 56.1% as of the 3rd quarter of 2017.

BANK executive management has identified growing revenue as the primary means to address these performance weaknesses. The centerpiece of BANK's recently-adopted strategic plan is a 10.7% compound annual growth rate in commercial loan balances. The following tables show BANK's uneven loan growth in recent years. Because that growth rate outpaces the markets in which BANK operates, BANK will be required to acquire market share from competitors more effectively than it has in recent years. Considerable headwinds are in place. According to *The Wall Street Journal*, "The rate of 12-month loan growth at U.S. banks in the third quarter hit its lowest level since the end of 2013, according to data released last week by the Federal Deposit Insurance Corp. That marked the sixth consecutive quarter of decline for this measure of loan growth. … Notably, the growth rate for business lending, an important source of revenues for banks in recent years, plumbed its lowest level since the first quarter of 2011."[3]

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[2] Efficiency ratio is noninterest expense before foreclosed property expense, amortization of intangibles, and goodwill impairments as a percent of net interest income and noninterest revenues, excluding only gains from securities transactions and nonrecurring items. Core EPS is net income after taxes and before extraordinary items, less net income attributable to noncontrolling interest, gain on the sale of held to maturity and available for sale securities, amortization of intangibles, goodwill and nonrecurring items on a per share basis.

[3] Rexrode, Christina. "The Economy is Humming, but Businesses Aren't Borrowing." *The Wall Street Journal*. November 26, 2017. Accessed at https://www.wsj.com/articles/the-economy-is-humming-but-businesses-arent-borrowing-1511697600 on November 27, 2017.

Uneven commercial loan growth history

TOTAL LOANS

	Actual Loan balances (A)	Balances added via acquisition (B)	Adjusted Balances (A -B)	Growth Rate (annualized)
6/30/2017	$ 9,259,465			3.5%
12/31/2016	$ 9,101,194	$ 1,647,140	$ 7,454,054	7.1%
12/31/2015	$ 6,962,215	$ 343,041	$ 6,619,174	1.3%
12/31/2014	$ 6,531,691	$ 1,171,577	$ 5,360,114	5.3%
12/31/2013	$ 5,090,669	$ 5,426	$ 5,085,243	

COMMERCIAL LOANS

	Actual Loan balances (A)	Balances added via acquisition (B)	Adjusted Balances (A -B)	Growth Rate (annualized)
6/30/2017	$ 5,261,619	$ -	$ 5,261,619	8.5%
12/31/2016	$ 5,047,952	$ 975,044	$ 4,072,908	11.5%
12/31/2015	$ 3,652,436	$ 186,510	$ 3,465,926	3.7%
12/31/2014	$ 3,340,710	$ 871,950	$ 2,468,760	-2.6%
12/31/2013	$ 2,534,305	$ -	$ 2,534,305	

BANK has a strong risk culture and defines itself as having a conservative-moderate risk appetite. These attributes are frequently reinforced as non-negotiable by executive management and codified in the board's risk appetite statement. The outsized growth in 2016 is largely attributable to the Wisconsin acquisition, which closed on May 1, 2016. Of the total $420 million of growth in that year, $188 million (45%) came in Wisconsin in the last 8 months. Most of that period of time the Wisconsin franchise was practically operating under the target bank's credit approach. As the new market has become more fully integrated into the BANK system and culture, that rate of growth has slowed dramatically from an average of $23.5mm/month in 2016 to $9.5mm/month in 2017:

BANK Wisconsin Commercial Loan Growth	
Q3 2017	$6.8 mm
Q2 2017	$20.9 mm
Q1 2017	$57.5 mm

STRATEGY AND IMPLEMENTATION

Increased Hold Limits

The proposed strategy is to increase the hold limits and revise aggregation methodology employed in computing holds. BANK's conservative risk posture – informed and influenced by the credit losses of the early 2000s as discussed above – have resulted in low hold limits which are constraining the revenue growth potential of the franchise. The hold limit constraints are amplified by the following elements of BANK policy which render the practical hold limits lower than the advertised hold limits:

(1) **The hold limits are graduated by asset quality rating**. While the current maximum hold of $45 million seems proportional to the bank's size and capital base, that limit is reserved for investment grade loans to publicly traded companies which carry published debt ratings of either A3 or A- or better. 83% of BANK's commercial borrower relationships are limited to $30 million or less. The risk rating distribution of BANK's commercial loan assets as of 6/30/17 and the respective hold limits are as follows:

Asset Quality Rating	Description	Balance	Actual %	Hold Limit per Relationship
0-1	Investment Grade (0) Minimal Risk (1)	$506,973	10.1%	$45 mm (0) $40 mm (1)
2	Modest Risk	$340,501	6.8%	$35 mm
3	Average Risk	$1,466,853	29.4%	$30 mm
4	Strong Risk	$759,093	15.2%	$25 mm
5	Monitor	$1,215,688	24.3%	$17.5 mm
6	Watch	$424,591	8.5%	$7.5 mm
7	Special Mention	$92,030	1.8%	$5 mm
8	Substandard – accrual	$100,794	2.0%	$5 mm
9	Substandard – non-accrual (9) Doubtful (9-D)	$90,201	1.8%	$5 mm
Total		$4,996,723	100.0%	

(2) **BANK's credit exposure definition aggregates values beyond what is required by OCC regulation.** Other financial institutions will test the independence of the sources of repayment to disaggregate borrowing relationships vis-à-vis hold limits; BANK aggregates these based on common ownership or contingent liability at 20% or more. A common example of when this aggregation is triggered at BANK but not at other financial institutions would be individual, unrelated commercial real estate projects with different tenants (sources of repayment) but which share the same sponsor with 20% or more ownership in the separate projects. Furthermore, BANK includes not only direct commercial loan commitment amount but also swap exposure, foreign exchange exposure, and any unsecured consumer exposure extended through its private banking franchise.

(3) **Commercial real estate projects have a maximum based on BANK capital.** Exposure to any single commercial real estate project is limited to 2% of Tier I Capital + allowance for loan and less losses ("ALLL"). BANK's historical acquisitions result in a credit mark on a significant pool of loan assets which is not included in the ALLL calculation.

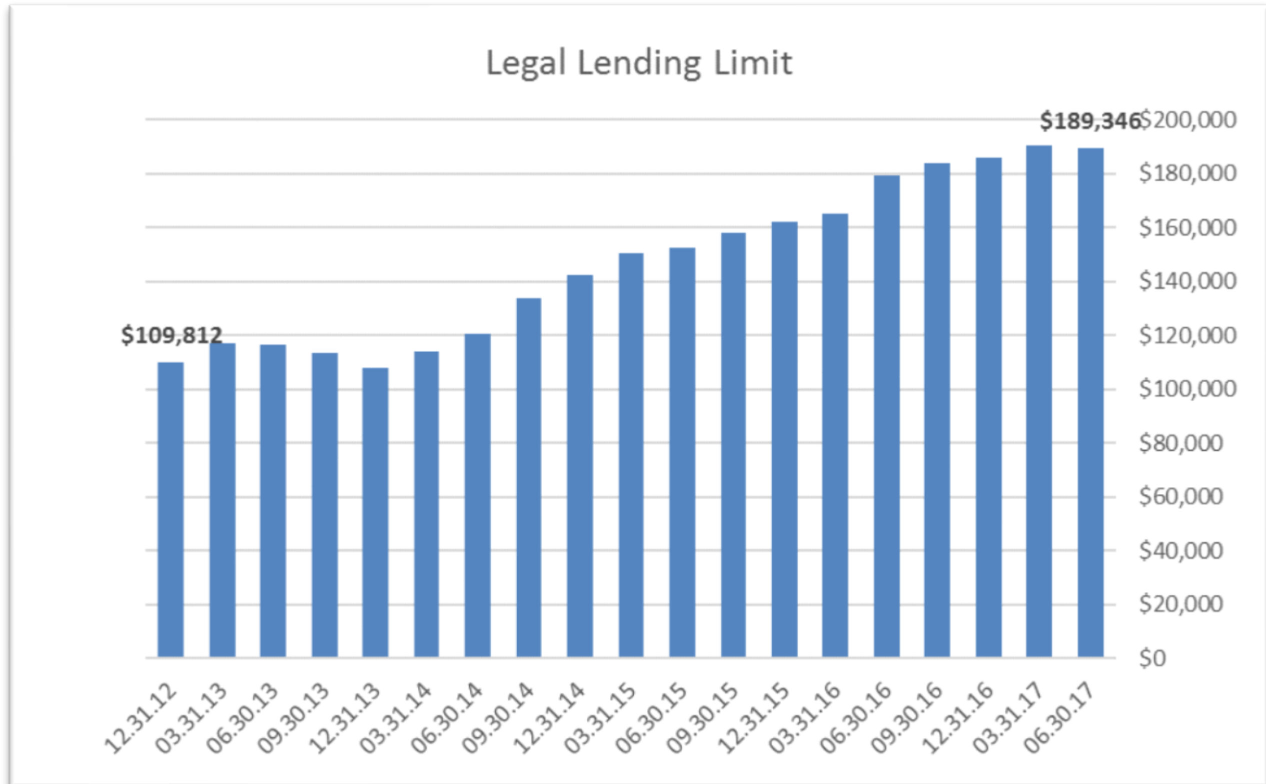
Rationale for Hold Limit Increase

The magnitude of the hold limits relative to the bank's asset size and capital base has shrunk over time, further putting pressure on the bank's return on assets and return on equity results. In the last five years, hold limits have been increased twice but the increases have not kept pace with the bank's growth. The following two charts demonstrate the relationship between the hold limits and BANK's size. Since 12/31/12, BANK's weighted average hold as a percentage of total assets has declined 12.5% and its weighted average hold as a percentage of capital has declined 17.3%. In the same period, BANK's legal lending limit has increased 94% while its weighted average hold has increased only 61%.

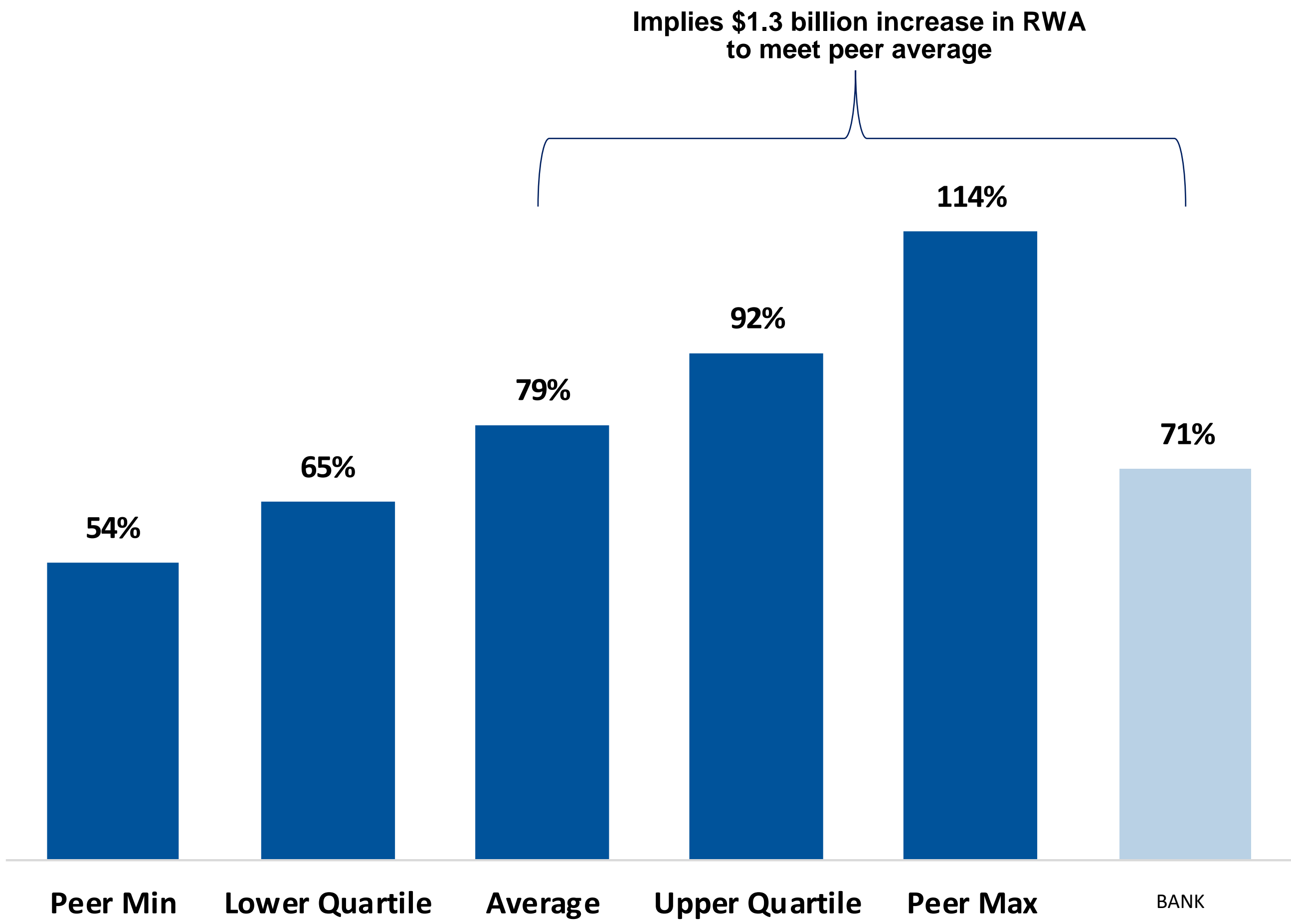
Hold limits over time relative to total assets and capital

Borrower Asset Quality Rating	Hold Limit (7/31/17)	Asset Distribution	Hold Limit (6/30/16)	Asset Distribution	Hold Limit (12/31/12)	Asset Distribution
0	$ 45.0	2.5%	$ 30.0	3.0%	$ 30.0	2.9%
1	$ 40.0	7.5%	$ 25.0	9.0%	$ 25.0	8.8%
2	$ 35.0	6.9%	$ 25.0	8.3%	$ 25.0	10.5%
3	$ 30.0	29.4%	$ 22.5	29.5%	$ 20.0	20.6%
4	$ 25.0	15.6%	$ 17.5	15.1%	$ 15.0	13.9%
5	$ 17.5	24.2%	$ 12.5	19.0%	$ 10.0	19.2%
6	$ 7.5	8.4%	$ 7.5	8.8%	$ 7.5	7.1%
7	$ 5.0	1.8%	$ 5.0	2.4%	$ 5.0	4.4%
8	$ 5.0	2.0%	$ 5.0	2.1%	$ 5.0	3.7%
9	$ 5.0	1.6%	$ 5.0	2.8%	$ 5.0	8.8%
Weighted Avg Hold ("WAH")	$ 24.4		$ 17.9		$ 15.2	
Assets**	$ 17,000		$ 14,420		$ 9,544	
WAH/Assets	0.0014		0.0012		0.0016	
Capital**	$ 1,418		$ 1,196		$ 732	
WAH/Capital	0.0172		0.0150		0.0208	

Legal lending limit over time



Risk-weighted assets relative to total assets: BANK vs. peer group average



Right-sizing the commercial hold limits commensurate with the bank's capital provides a balanced approach to protect against loss and optimizes BANK's ability to drive shareholder return. The following revised hold limits are recommended:

Recommended Holds

Borrower Asset Quality Rating	Current Hold Limit	Recommended Hold Limit	Asset Distribution
0	$ 45.0	$ 50.0	2.5%
1	$ 40.0	$ 45.0	7.5%
2	$ 35.0	$ 40.0	6.9%
3	$ 30.0	$ 40.0	29.4%
4	$ 25.0	$ 30.0	15.6%
5	$ 17.5	$ 20.0	24.2%
6	$ 7.5	$ 7.5	8.4%
7	$ 5.0	$ 5.0	1.8%
8	$ 5.0	$ 5.0	2.0%
9	$ 5.0	$ 5.0	1.6%
Weighted Avg Hold ("WAH")	$ 24.4	$ 29.6	
Assets[1]	$ 17,000	$ 17,000	
WAH/Assets	0.0014	0.0017	
Capital[1]	$ 1,418	$ 1,418	
WAH/Capital	0.0172	0.0209	

[1]These asset and capital figures are estimated using the process described on page 10.

The hold limit revisions recommended above provide additional lending capacity to 86% of BANK's current outstandings. Keeping the lower limits in place in the higher risk categories and reserving the larger increases for the lower risk categories is in alignment with BANK's conservative-moderate risk appetite posture.

In addition to these hold limit modifications, the 2% of capital project limit overlay should be removed and the hold limit matrix by asset quality rating should be the exclusive risk calibration for all projects, including commercial real estate.

Finally, the aggregation policy should be amended to provide for disaggregation of related loan commitments when the sources of repayment are sufficiently independent. An example of this would be aggregating based on contingent liability of guarantors, but not on common ownership when recourse is limited or not required. Moreover, when the tenants of individual real estate projects evidence a lack of correlation in probabilities of default, those projects should be viewed as disaggregated. Different real estate segments (e.g., multi-family versus office), different geographic markets, different price points (property classes), and commercial and industrial tenants in unrelated or counter-cyclical industries are all examples of considerations relevant in establishing the independence of the sources of repayment for aggregation purposes.

Alignment of Hold Limit Increase with Overall Corporate Strategy

The increase in hold limits better positions BANK to deliver on its stated strategic objective of 10.7% compound annual growth rate of commercial loan balances. Moreover, the increased revenue should provide needed downward pressure on the efficiency ratio (in line with the strategic imperative of enhanced management discipline) and upward pressure on the earnings per share (in line with the strategic imperative of consistent, quality earnings). Because loan origination expenses do not vary materially for manually-underwritten commercial loans, the additional revenue from increased hold limits should be accretive. In other words, it generally takes the same amount of work to originate a $20mm loan that it does to originate a $40mm loan.

This strategy initiative will require the project manager to present to executive management, the Board’s Enterprise Risk Committee, and ultimately the Board of Directors. The project manager will need to present the data analysis contained in this plan as well as address objections raised and confront how the bank can monitor and manage and mitigate the risks associated with increased hold limits.

Task Plan for Implementing Increased Hold Limit Policy

The following draft project plan identifies proposed actions to implement this strategy:

WHO	WHEN	WHAT
Project Mgr	Mar / Apr	Prepare presentation for c-suite. Refine presentation for enterprise risk committee and then board of directors to obtain approval of new hold limits.
Chief Credit Officer	Apr	Revise loan policy and communicate to sales and production associates
Loan operations	May	Compile listing of all sold loans and provide to commercial management to evaluate any buy-back opportunities in light of new hold limits.
Credit analysts	May / June / July	Perform reviews of existing aggregations and identify prospect for disaggregation based on revised policy considering independence of repayment sources.
Relationship Managers	May and ongoing	Communicate with borrowers, prospects, and centers of influence enhanced lending capacity, refine prospecting efforts to leverage new lending capacity, and solicit loan requests in line with new lending capacity.
Chief Credit Officer	Jan 2019 and each February thereafter	Review and recommend revised lending limits based on updated capital base; present recommendation to CEO, enterprise risk committee, and board of directors for ratification.

FINANCIAL IMPACT

Inititial Investment

Because it is a policy change and not a system change, this strategy initiative will not require any material capital investment. There will be some labor investment (and associated opportunity costs of those efforts) to analyze the existing portfolio and identify and prioritize opportunities for newly created lending capacity with existing borrowing relationships. Another indirect cost will be increased provision expense; however, this expense will only move in concert with expanded loan commitments and therefore the associated revenue with that lending funds the provision expense over time.

Pro forma Financials

The following assumptions were employed in building pro forma financial analysis for the proposed hold limits:

- Increased revenue for loans currently sold down to remain within prior hold limits. The increased revenue would be in net interest income. Given BANK's loan-to-deposit ratio of less than 88%, the increased revenue is calculated based on 173 basis points times the additional loan balances. While the actual yield on those assets would be higher than that, 173 basis points was used as an average differential between commercial loan yields and investment asset yields based on BANK's 2017 10-K as summarized in this table:

	2017 Avg Bal	2017 Avg Yield
Commercial	$ 2,083,779	4.11%
CRE	$ 3,426,757	5.00%
TOTAL (weighted avg)	$ 5,510,536	4.66%
Investments	$ 3,669,976	2.93%
Difference		**1.73%**

- A sampling of commercial loans sold for the Wisconsin super region of BANK was analyzed. The subject sample was selected as it represents 23% of BANK's commercial portfolio and is deemed to be representative of BANK, including the strategic initiative centered around commercial loan growth. The Wisconsin balance sheet reveals $203mm of gross loan balances for 17 unique loans which were sold down. At origination, these loans represented $252mm of loan commitments. At the time of this analysis, those loans were sold down to $110mm in net balances. This $110mm net balance reflects approximately 8.7% of all Wisconsin commercial balances. The analysis reviewed each participated loan and identified how much of the sold amount could have been retained using the proposed hold limits and the asset quality rating of each loan. Of the 17 participated loans, 14 could have been fully funded by BANK under the proposed hold limits. The remaining three loans would still require some – though much smaller – participation to maintain holds within the proposed limits. It's important to note that this analysis was completed based on the loan face amount, not the current balance. The net result reflects the capacity to hold an additional $78.5mm of loan balances. These additional balances represent a 6.2% increase from the comparable period balances for BANK Wisconsin. The best case scenario assumes those additional outstandings are held by BANK; the worst case scenario asssumes none of those are held by BANK; and the likley case assume 50% of those balances are able to be re-purchased while the remainder are left with the participant due to a desire to maintain lending availability for future loan requests from that borrower and/or to manage the risk exposure to that borrower, project, or asset class.

- The vintage of the participated loans were as follows:

Year of origination	# of Loans	$ of Loans (original face amt)
2013	1	$17.206mm
2014	2	$24.060mm
2015	4	$87.4mm
2016	5	$75.718mm
2017	5	$48.024mm

Many of the 2017 loans are still in the draw-up / construction funding phase with only $18.9mm outstanding of the $48.0mm face amount. The prior loans are effectively fully funded and in the amortizing period where balances are being reduced each month based on principal payments by the borrower. Therefore, there are three dynamics that affect the calculation of pro forma interest income:

a) Timing of loan origination in the analyzed year – Loans originating earlier in 2017 would generate more income relative to similarly-sized loans originated later in 2017.

b) Timing and amount of construction loan advances – These advances increase loan outstandings and therefore increase interest income.

c) Rate of amortization of existing, seasoned loans – The monthly payments of principal reduce those balances and therefore reduce interest income.

This analysis assumes the loan advances (which approximate just less than $30mm of funding availability not yet accessed at the time of this report) would increase in a way that would offset both the timing differences of originations later into 2017 as well as the reduction of principal balances from amortization. Note that a basic test of average amortization supports this given the $204mm face amount at origination. While commercial and industrial ("C&I") term loans

would tend to amortize in five years, commercial real estate ("CRE") loans would tend to amortize in twenty or more years. Applying a simply ten year amortization average to the $204mm in original balances yields an approximate amortization baseline of $20mm, which is more than offset by the $30mm of funding availability. Moreover, note that by using the annual average balances (instead of period end balances), the analysis introduces a factor to compensate for the changes over time.

- In addition to fewer sold participations, the higher hold limits would likely allow BANK to obtain new clients who previously were out of reach with lower lending limits. By growing the universe of potential prospects – and possibly increasing BANK's attractiveness to the prospect universe with more robust loan limits – the potential exists for additional client acquisition. The analysis assumes no new client acquisition in the worst case scenario and one additional $40mm (asset quality rated 3) relationship acquired in each of the seven super regions of BANK in the best case scenario. The likely case scenario assumes 25% of that rate of client acquisition. These new client acquisitions would also most likely include additional depository business and potentially other services. This analysis doesn't contemplate any of that potential revenue but instead uses the additional loan interest income as a proxy for the total relationship income.
- In those cases when an interest rate swap is employed, the fee income from that instrument would also be fully retained instead of shared with a participant. For purposes of this analysis, the various scenarios use derivative income changes from zero up to 25 basis points of 25% of additional loan outstandings (i.e., assume a derivative was employed on 25% of the transaction balances and those derivatives generated a fee of 25 bps of the loan commitment).

- On the expense lines of the pro forma income statement, loan loss provision would be increased with the additional loan outstandings. It's important to note that the increased exposures to individual projects or Borrowers present the possibility of increased losses as the portfolio could become less granular (i.e., loss events could be from larger loans therefore incurring higher credit costs). This possibility is accounted for, however, in the loan loss provision which factors in anticipated losses based on the risk and size of loans. The analysis uses the following loan loss provision calculations based on BANK's 4th quarter 2017 allocation. BANK's weighted average AQR is 3.89. Therefore, the pro forma analysis uses 0.33% loan loss provision for the additional loan balances projected from the higher hold limits.

Asset Quality Rating	C&I reserve %	CRE reserve %	Weighted Avg based on ONB portfolio mix**
0	0.01%	0.00%	**0.00%**
1	0.04%	0.00%	**0.02%**
2	0.13%	0.07%	**0.09%**
3	0.48%	0.18%	**0.29%**
4	0.59%	0.19%	**0.34%**
5	1.74%	0.36%	**0.88%**
6	4.09%	1.07%	**2.21%**
7	5.56%	5.82%	**5.72%**
8	10.12%	9.09%	**9.48%**

**2017 Avg C&I balance was 2,083,779m (38%) and Avg CRE balance was 3,426,757m (62%)

- Increased loan production would potentially increase the incentive income for relationship managers. However, fewer loan participations would create less demand for operational support required to administer participant relationships (reconciling postings, sharing borrower communication and financial reporting, confirming agreement to fund draws, etc.). For purposes of this analysis, these potential impacts to personnel expense offset one another and are therefore deemed immaterial. Accordingly, no adjustments to personnel expense have been factored in.

The calculations based on the assumptions outlined above are as follows:

		2017
C&I	$	2,083,779
CRE	$	3,426,757
TOTAL COMMERCIAL AVG BALANCES	**$**	**5,510,536**
Interest Income		
Best (+ 6.2% of existing commercial outstandings)	$	341,653
Int Income @ 1.73% incremental interest income	$	5,911
Best (7 new $40mm relationships)	$	280,000
Int Income @ 1.73% incremental interest income	$	4,844
TOTAL INTEREST INCOME - BEST CASE	**$**	**10,755**
Likely (+3.1% of existing commercial outstandings)	$	170,827
Int Income @ 1.73% incremental interest income	$	2,955
Likely (2-3 new relationships totalling $70mm)	$	70,000
Int Income @ 1.73% incremental interest income	$	1,211
TOTAL INT INCOME - LIKELY CASE	**$**	**4,166**
Capital Markets Income		
Best (25% of new origination @ 25 bps fee)		
$280mm new origination from new clients		175
$342mm sold origination face amt retained		214
TOTAL CAPITAL MARKETS INCOME - BEST CASE		**389**
Likely (25% of originaton @ 25 bps, with less origination)		
$70mm new origination from new clients		44
$171mm sold origination face amt retained		107
TOTAL CAPITAL MARKETS INCOME - LIKELY CASE		**151**
Provision for Loan Losses		
Best (33 bps based on $622mm origination volume)		**2,053**
Likely (33 bps based on $241mm origination volume)		**795**

Applying the adjustments calculated to BANK's 2017 income statement generates the following impact:

		BEST CASE ADJUSTMENT	WORST CASE ADJUSTMENT	LIKELY CASE ADJUSTMENT
	12/31/2017			
Interest income	495,336	10,755		4,166
Less: interest expense	58,168			
Net interest income	437,168			
Provision for loan losses	3,050	2,053		795
Net interest income after provision for loan losses	434,118	8,702		3,371
OTHER noninterest income	176,838			
Capital markets income	6,544	389		151
Total noninterest income	183,382	389		151
Total noninterest expense	448,836			
Income before income taxes	168,664	9,091		3,522
*Income tax expense****	72,939	3,182		1,233
Net income (loss)	**95,725**	5,909		2,289
ADJUSTED Net income (loss)		**101,634**		**98,014**
ADJUSTED Net income Chg %		***6.2%***		***2.4%***
***Income tax expense adjustments apply straight 35% federal tax rate				

Possible Risks Associated with Deviation from Assumptions

The primary risk with the increased hold limits would be the possibility of catastrophic loss associated with a single, large loan. Such a possibility is not directly contemplated in the worst case scenario above because such an event would likely occur in a subsequent period from the year of loan origination. This risk would be mitigated by the following factors:

1. Prudent underwriting – The moderate hold increases contemplated in this recommendation would not and should not be correlated with any change of underwriting philosophy or posture. The same underwriting discipline that has generated a net charge off ratio ranging from a recovery of 2 bps to a high net charge off of 4 bps across the last four years for BANK is expected to safeguard the bank from such a catastrophic event.

2. Increased underwriting and portfolio administration capacity – By originating larger loans, the possibility exists that fewer origination events are required to deliver the same or better results. The net effect of this more efficient model would be to increase capacity for the risk monitoring and management practices that safeguard the bank from catastrophic losses. By originating fewer, but larger loans, BANK staff would have the opportunity spend more time in due diligence and analysis to make better-informed credit decisions.

Financial Justification of Increased Hold Limits

The increased hold limits reveal no meaningful downside pressure on net income as shown in the worst case scenario above. The only downside would be additional losses in subsequent periods, but the continuation of BANK's disciplined underwriting as well as the potential for increased credit administration capacity from fewer, larger loans should adequately safeguard BANK from that risk. Moreover, the increased provision – which is reflected in the pro forma analysis – provides a validated methodology to set aside adequate reserves to fund any potential increase in losses.

The increased hold limits reflect substantial upside potential on both profitability and balance sheet optics. Profitability is anticipated to increase between 2% and 6% before factoring in some of the indirect lift outlined in the non-financial impacts discussed later. Moreover, the additional outstandings should create between 4% and 11% additional commercial loan balances, which is in direct alignment with BANK's strategy to generate a 10.7% compound annual growth rate in commercial balances.

NON-FINANCIAL IMPACT

Stock Price

The primary objection to the increased lending limit is that a larger loss event enabled by the lending limit increase would have a negative impact on shareholder value. Analysis of the BANK peer group of banks in the $10B - $50B asset size reveals, however, that loss events are not a strong indicator of price. In fact, the 2nd quartile banks (trading on average at 218% of tangible book value per share) showed average net charge-offs (as a percentage of average loans outstanding) over three times that of the 3rd quartile banks[4]. In fact, even the 1st quartile banks (trading on average at 262% of tangible book value per share) showed average net charge-offs at a rate almost 150% of the 3rd quartile banks. This suggests that (1) credit losses aren't as strong a predictor of shareholder value as often assumed; and (2) the share price benefits to be gained by driving increased earnings likely offset the perceived risks of taking on more credit risk.

Quartile (ranked by share price / TBV)	Average price / TBV	Average NCOs / Loans
1	262	0.13
2	218	0.27
3	179	0.08
4	115	0.47

Market Reputation Impacting Client Acquisition, Retention, and Talent Attraction

By increasing hold limits, BANK will be a more attractive provider of financing to larger, stronger commercial borrowers who value lending capacity to support their operations and growth. Moreover, existing client relationships can be strengthened and better defended from other financial institutions. By increasing borrowing limits, BANK is making a statement about the value of the individual borrowers to the bank and reinforcing BANK's ability and willingness to grow with them and support their business objectives. Increased hold limits also strengthen BANK's ability to attract talent as many of the highest producing commercial bankers evaluate lending capacity in determining their best match with potential

[4] See appendix for methodology of this analysis.

employers. The larger lending capacity translates into more complex – and often more interesting – transactions with higher profiles. In this way, higher lending limits can position a move to BANK as a career booster for commercial talent.

Measuring Non-Financial Impact

The key success indicators of the non-financial impacts can be measured in the following ways:

1. Share price over time and relative to peer group
2. Share price adjustments relative to net charge off ratio
3. Client retention statistics – Number of client relationships lost and the associated revenue, including identification of those which left due to lending capacity restraints
4. Client acquistion statistics – Number of client relationships acquired and the associated revenue, including identification of those which would not have fit under prior hold limits
5. Talent attration statistics – Length of time key relationship manager or credit underwriter positions remain open and the number of new associates in those areas added who are identified as high potential in the annual talent review process

Relationship Between Non-Financial Metrics and Long-Term Profitability

The non-financial metrics present an inter-related web of impacts which ultimately support the bank's profitability.

1. Share price – Strengthening share price drives shareholder return which in turn attracts more investment capital which can be deployed to grow the bank with its own capital and less reliance on borrowed funds. Moreover, the additional capital strengthens the bank's debt ratings which lowers the cost of accessing the debt markets. Both relying on more investment capital over borrowed funds and lowering the cost of borrowing funds enhances the bank's net interest margin, which ultimately

should drive increases in net income. Finally, stronger stock performance can serve as a more valuable currency for an acquisitive institution like BANK. This ability be an attractive acquirer is particularly important in light of the expectation of continuing consolidation in the financial services industry.

2. Share price relative to net charge off – This statistic can boost the risk-taking acumen and confidence for BANK associates. By taking on incremental risk which is measured and monitored and managed appropriately, BANK has the ability to accelerate its growth without violating its adherenece to its risk appetite statement. In doing so, its net charge off ratio and the ratio of risk-weighted assets to total assets should normalize with peer averages, which would present more attractive growth potential to the equity markets (further enhancing stock price with the related effects as outlined above) and adding incremental additional income from the additional transactions.
3. Client retention statistics – By retaining more of the existing book of business (assuming acceptable risk characteristics), BANK's new production will further accelerate loan growth, driving more net interest income and therefore net income.
4. Client acquisition statistics – By attracting new client relationships to the bank at a faster rate and a higher level with expanded lending capacity, BANK's net interest income will grow from increased loan outstandings and BANK's non-interest income will grow driven by additional service charge and other income from the related products and services purchased by these new clients to the bank.
5. Talent attraction statistics – No qualitative factor has a greater influence on the stability, growth and prospects of an organization than the caliber of the personnel serving clients and operating the business. Particularly in banking – where there is a

relative low level of variation in distinctiveness among competitor product and service offerings – relationships are the substantial determiner of success. By raising the level of the talent inside the organization, BANK accelerates its revenue generation as more talented individuals generate more opportunities for new business and adjudicate those opportunities with more acumen to maintain an appropriate risk and return relationship. Moreover, the enhanced talent strengthens BANK's management succession plan to ensure long term performance and future growth.

CONCLUSION

The increased hold limits require virtually no up-front capital investment and present minimal downside risk of reduced income. Moreover, the increased hold limits provide compelling upside opportunity to increase the bank's efficiency and position BANK up market to grow the bank's profile and profitability. The proposed hold limit modifications are not substantial relative to the capital base of the bank and are in line with the bank's historical hold limit exposures. These modifications do not represent any dramatic shift of bank strategy but are instead a natural evolution of BANK's growth in line with BANK's risk appetite statement. Therefore – based on the financial upside of a likely 2% increase in net income and an additional 4% of commercial loan balance growth – it is recommended to adopt the increased hold limits as described herein.

APPENDIX

BANK Peer Group

BANK defines its peer group as follows: Like-size, publicly-traded financial services companies, generally in the midwest, serving comparable demographics with comparable services as BANK.

Associated Banc-Corporation	ASB	IberiaBank Corporation	IBKC
BancorpSouth, Inc.	BXS	International Bancshares Corp	IBOC
Bank of Hawaii Corporation	BOH	MB Financial Inc.	MBFI
Bank of the Ozarks	OZRK	Prosperity Bancshares Inc.	PB
Chemical Financial Corporation	CHFC	TCF Financial Corporation	TCF
Commerce Bancshares, Inc.	CBSH	Trustmark Corporation	TRMK
Cullen/Frost Bankers, Inc.	CFR	UMB Financial Corporation	UMBF
F.N.B. Corporation	FNB	United Bankshares Inc.	UBSI
First Midwest Bancorp Inc.	FMBI	Valley National Bancorp	VLY
Fulton Financial Corporation	FULT	Western Alliance Bancorporation	WAL
Great Western Bancorp, Inc.	GWB	Wintrust Financial Corporation	WTFC
Hancock Holding Company	HBHC		

Sold Participation Analysis

Customer	Asset Quality Rating	Year of Origination	Original Face	Current Balance	Amt Sold	% Sold	Amt Held	Pro Forma Hold	Increase	Income
Client 1	3	2013	$ 17,205,980	$ 16,588,582	$ 12,380,134	45%	$ 4,208,448	$ 16,588,582	$ 12,380,134	$ 371,404
Client 2	3	2014	$ 5,560,000	$ 5,418,477	$ 2,347,788	43%	$ 3,070,689	$ 5,418,477	$ 2,347,788	$ 70,434
Client 3	3	2014	$ 18,500,000	$ 16,587,440	$ 7,621,249	22%	$ 8,966,191	$ 16,587,440	$ 7,621,249	$ 228,637
Client 4	3	2015	$ 1,500,000	$ 1,462,765	$ 672,080	22%	$ 790,684	$ 1,462,765	$ 672,080	$ 20,162
Client 5	5	2015	$ 31,315,000	$ 28,673,440	$ 13,734,578	48%	$ 14,938,862	$ 18,312,911	$ 3,374,049	$ 101,221
Client 6	4	2015	$ 33,025,000	$ 32,882,092	$ 11,972,965	36%	$ 20,909,127	$ 29,870,182	$ 8,961,055	$ 268,832
Client 7	5	2015	$ 21,560,000	$ 19,878,872	$ 3,909,379	20%	$ 15,969,493	$ 18,440,512	$ 2,471,019	$ 74,131
Client 8	5	2016	$ 8,078,400	$ 8,071,875	$ 2,497,981	31%	$ 5,573,894	$ 8,071,875	$ 2,497,981	$ 74,939
Client 9	4	2016	$ 26,350,000	$ 21,381,198	$ 10,548,599	49%	$ 10,832,600	$ 21,381,198	$ 10,548,599	$ 316,458
Client 10	4	2016	$ 21,465,000	$ 14,862,912	$ 11,051,729	50%	$ 3,811,183	$ 14,862,912	$ 11,051,729	$ 331,552
Client 11	3	2016	$ 7,025,000	$ 6,812,243	$ 3,337,999	49%	$ 3,474,244	$ 6,812,243	$ 3,337,999	$ 100,140
Client 12	4	2016	$ 12,800,000	$ 11,467,246	$ 5,618,951	49%	$ 5,848,296	$ 11,467,246	$ 5,618,951	$ 168,569
Client 13	3	2017	$ 5,792,500	$ 5,646,828	$ 2,766,946	49%	$ 2,879,882	$ 5,646,828	$ 2,766,946	$ 83,008
Client 14	4	2017	$ 3,400,000	$ 3,355,321	$ 1,677,660	50%	$ 1,677,660	$ 3,355,321	$ 1,677,660	$ 50,330
Client 15	5	2017	$ 4,512,000	$ 4,463,813	$ 2,231,907	50%	$ 2,231,907	$ 4,463,813	$ 2,231,907	$ 66,957
Client 16	4	2017	$ 8,325,000	$ 1,973,218	$ 183,930	9%	$ 1,789,288	$ 1,973,218	$ 183,930	$ 5,518
Client 17	4	2017	$ 25,994,738	$ 3,457,010	$ 797,268	23%	$ 2,659,742	$ 3,457,010	$ 797,268	$ 23,918
			$ 252,408,618	$ 202,983,333	$ 93,351,141	46%	$ 109,632,192	$ 188,172,533	$ 78,540,342	$ 2,356,210
							8.7%		106.2%	

Relationship Between Charge Off and Stock Price

This table compared price / tangible book value with the average of the prior 4 quarters net charge off. See following page for summary.

Ticker	Institution Name	Price/ Tangible Book (%)	AVG OF PRIOR 4 QTRs	NCOs/ Avg Loans (%)	NCOs/ Avg Loans (%)	NCOs/ Avg Loans (%)	NCOs/ Avg Loans (%)
131166	131160	139528		131995	131995	131995	131995
	Refresh Active Cells						
		MRQ		2017Q2	2017Q1	2016Q4	2016Q3
	$10-$50 Billion Banks	Current/Restated		Current/Restated	Current/Restated	Current/Restated	Current/Restated
BOH	Bank of Hawaii Corp.	299.36	0.13	0.13	0.16	0.14	0.11
WAL	Western Alliance Bancorp	295.22	0.00	-0.03	0.04	-0.03	0.04
FHB	First Hawaiian Inc.	274.41	0.12	0.11	0.14	0.12	0.12
STL	Sterling Bancorp	268.91	0.06	0.05	0.05	0.06	0.09
EWBC	East West Bancorp Inc.	266.46	0.14	-0.04	0.08	0.13	0.37
WBS	Webster Financial Corp.	251.35	0.15	0.16	0.13	0.15	0.16
MBFI	MB Financial Inc.	250.58	0.04	0.00	-0.03	0.10	0.08
	PrivateBancorp Inc.	250.03	0.04		-0.01	0.02	0.12
CFR	Cullen/Frost Bankers Inc.	249.38	0.25	0.39	0.26	0.19	0.17
PB	Prosperity Bancshares Inc.	248.94	0.10	0.13	0.16	0.09	0.01
CBSH	Commerce Bancshares Inc.	247.56	0.27	0.32	0.27	0.27	0.20
GWB	Great Western Bancorp	243.67	0.26	0.20	0.38	0.23	0.22
UBSI	United Bankshares Inc.	242.17	0.24	0.25	0.22	0.22	0.26
PACW	PacWest Bancorp	240.76	0.37	0.54	0.48	0.35	0.12
	Bank of the Ozarks Inc.	238.24	0.00				
SIVB	SVB Financial Group	237.50	0.40	0.44	0.24	0.44	0.48
FNB	F.N.B. Corp.	236.06	0.27	0.23	0.20	0.31	0.33
FMBI	First Midwest Bancorp Inc.	220.84	0.18	0.16	0.11	0.22	0.24
HBHC	Hancock Holding Co.	210.56	0.39	0.13	0.70	0.50	0.24
SBNY	Signature Bank	209.30	1.20	3.02	0.12	0.19	1.45
BXS	BancorpSouth Inc.	202.47	0.08	0.17	-0.02	0.12	0.04
PBCT	People's United Financial Inc.	200.47	0.05	0.09	0.03	0.06	0.03
FULT	Fulton Financial Corp.	200.18	0.07	0.11	0.09	-0.03	0.11
CATY	Cathay General Bancorp	198.86	0.04	-0.01	0.03	-0.04	0.19
TCBI	Texas Capital Bancshares Inc.	198.76	0.26	0.27	0.14	0.46	0.17
VLY	Valley National Bancorp	195.05	0.04	0.06	0.03	0.00	0.08
ONB	ONB (Holding Company)	194.85	0.02	0.01	0.01	0.00	0.07
WTFC	Wintrust Financial Corp.	194.00	0.08	0.10	0.03	0.06	0.12
SNV	Synovus Financial Corp.	192.02	0.16	0.26	0.11	0.14	0.12

Additional lines included in original; this table shown for illustration of methodology.

				2017 Q2	2017 Q1	2016 Q4	2016 Q3
Bank	**Price quartile**	**Price / Tangible Book Value**	**AVG NCO**	**NCOs / Avg Loans**	**NCOs / Avg Loans**	**NCOs / Avg Loans**	**NCOs / Avg Loans**
Bank of Hawaii Corp.	1	299.4	0.13	0.13	0.16	0.14	0.11
Western Alliance Bancorp	1	295.2	0.00	-0.03	0.04	-0.03	0.04
First Hawaiian Inc.	1	274.4	0.12	0.11	0.14	0.12	0.12
Sterling Bancorp	1	268.9	0.06	0.05	0.05	0.06	0.09
East West Bancorp Inc.	1	266.5	0.14	-0.04	0.08	0.13	0.37
Webster Financial Corp.	1	251.3	0.15	0.16	0.13	0.15	0.16
MB Financial Inc.	1	250.6	0.04	0.00	-0.03	0.10	0.08
PrivateBancorp Inc.	1	250.0	0.04		-0.01	0.02	0.12
Cullen/Frost Bankers Inc.	1	249.4	0.25	0.39	0.26	0.19	0.17
Prosperity Bancshares Inc.	1	248.9	0.10	0.13	0.16	0.09	0.01
Commerce Bancshares Inc.	1	247.6	0.27	0.32	0.27	0.27	0.20
Great Western Bancorp	1	243.7	0.26	0.20	0.38	0.23	0.22
United Bankshares Inc.	2	242.2	0.24	0.25	0.22	0.22	0.26
PacWest Bancorp	2	240.8	0.37	0.54	0.48	0.35	0.12
Bank of the Ozarks Inc.	2	238.2	0.00				
SVB Financial Group	2	237.5	0.40	0.44	0.24	0.44	0.48
F.N.B. Corp.	2	236.1	0.27	0.23	0.20	0.31	0.33
First Midwest Bancorp Inc.	2	220.8	0.18	0.16	0.11	0.22	0.24
Hancock Holding Co.	2	210.6	0.39	0.13	0.70	0.50	0.24
Signature Bank	2	209.3	1.20	3.02	0.12	0.19	1.45
BancorpSouth Inc.	2	202.5	0.08	0.17	-0.02	0.12	0.04
People's United Financial Inc.	2	200.5	0.05	0.09	0.03	0.06	0.03
Fulton Financial Corp.	2	200.2	0.07	0.11	0.09	-0.03	0.11
Cathay General Bancorp	2	198.9	0.04	-0.01	0.03	-0.04	0.19
Texas Capital Bancshares Inc.	2	198.8	0.26	0.27	0.14	0.46	0.17
Valley National Bancorp	3	195.1	0.04	0.06	0.03	0.00	0.08
BANK Holding Company)	3	194.9	0.02	0.01	0.01	0.00	0.07
Wintrust Financial Corp.	3	194.0	0.08	0.10	0.03	0.06	0.12

Additional lines included in original; this table shown for illustration of methodology.

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