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Current Issues in Bank Accounting & Reporting: Managing the Deluge

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April 18, 2014

Current Issues in Bank Accounting & Reporting

Agenda

- **Current Issues (the Deluge)**
- **The Impact of the Deluge on the Finance Status Quo**
- **Preparing Finance to Succeed**
- **Leading the Bank (CEO and Board) to Success**

Current Issues in Bank Accounting & Reporting

CFO’s face a deluge of accounting, reporting and process changes:

- Allowance for Loan & Lease Losses
- Financial Instruments: Classification & Measurement
- Revenue Recognition
- Leases
- TDR EITF
- Dodd Frank
- Volker Rule
- Basel III
- New COSO framework
- Even more Regulation

Rule	Key Issue(s)	Issuance / Implementation	Impact
ALLL (CECL)	- Credit losses recognized even when not incurred or meet a probability threshold - Credit losses recognized upfront & as the estimate is revised up or down	2H 2014	- New ALLL processes - Impact to capital & earnings
Financial Instruments: Measurement & Classification	- Separate models for loans, and securities retained - All equities at FV, all changes thru earnings. Not through OCI	2H 2014	- More complex processes - Earnings volatility - SEC & Regulatory Reporting changes

Rule	Key Issue(s)	Issuance / Implementation	Impact
Revenue Recognition	- New revenue model based on customer contracts - Leases, financial instr, excluded from the scope	- 2Q 2014 - Effective: 12/15/16 - No early adoption	Revenue patterns change
Leases	Most leases on-balance sheet	No target date	- Assets increase - No upfront recognition of profit if asset is not transferred to lessee
TDR Acctg. (ASU 2014-4)	Reclass of loans to foreclosed real estate (in substance repossession or foreclosure)	Issued January 2014	ASU provides guidance on when the reclass is to be made

Rule	Key Issue(s)	Issuance / Implementation	Impact
Dodd - Frank	Regulatory overload; Even rules not intended to be are applied to Community Banks.	Current Law, some regulations not yet issued	- Cost of compliance - More complex web of regulations (CFPB) - Potential violations
Volker Rule	Limited impact to Community Banks (theoretically)	Currently being implemented. Some rules being written.	De-facto application to Community Banks
BASEL III	Limited impact to Community Banks (theoretically)	Being phased in through 2019	- Higher market capital expectations - Capital planning critical

Rule	Key Issue(s)	Issuance / Implementation	Impact
New COSO framework	- More emphasis on risk assessment - Additional considerations related to IT	No formal transition guidance issued by the SEC	More formal structure for designing & evaluating effectiveness of internal control
OCC, FDIC, FED & State Regulations	Regulatory overload	Federal Register lists new Banking regulations daily, it seems	CFO & Staff allocate high percentage of resources dealing with Regulatory Comments

Recap :

- New, more complex processes
- Earnings volatility
- Balance sheet changes
- Reclassifications
- Tougher examinations with new standards
- Complex capital planning
- Improved control environment
- Even more regulation

Current Issues in Bank Accounting & Reporting: Managing the Deluge

The challenges are:

- **Integrate all these new requirements in a way that the CFO does not become MIA from the strategic decision making process**
- **Implement accurately, timely, with good documentation and transparency**
- **Explain the outcomes to our colleagues & the Board**

Broadly speaking, these CFO challenges fall into four buckets:

- **Staff training & capability**
- **Systems, data and IT issues**
- **The breadth and complexity of GAAP, regulatory, & SEC regulatory frameworks**
- **Cost constraints**

Industry wide, there is a great shortage of resources with appropriate talent and skills:

- Hiring the right resource is time consuming and expensive,
- Pressure on costs requires innovative solutions

Typical systems infrastructures are outdated and overly complex, creating:

- Data management and governance issues
- Suboptimal management decisions
- Inaccurate regulatory reports
- Cyber security threats

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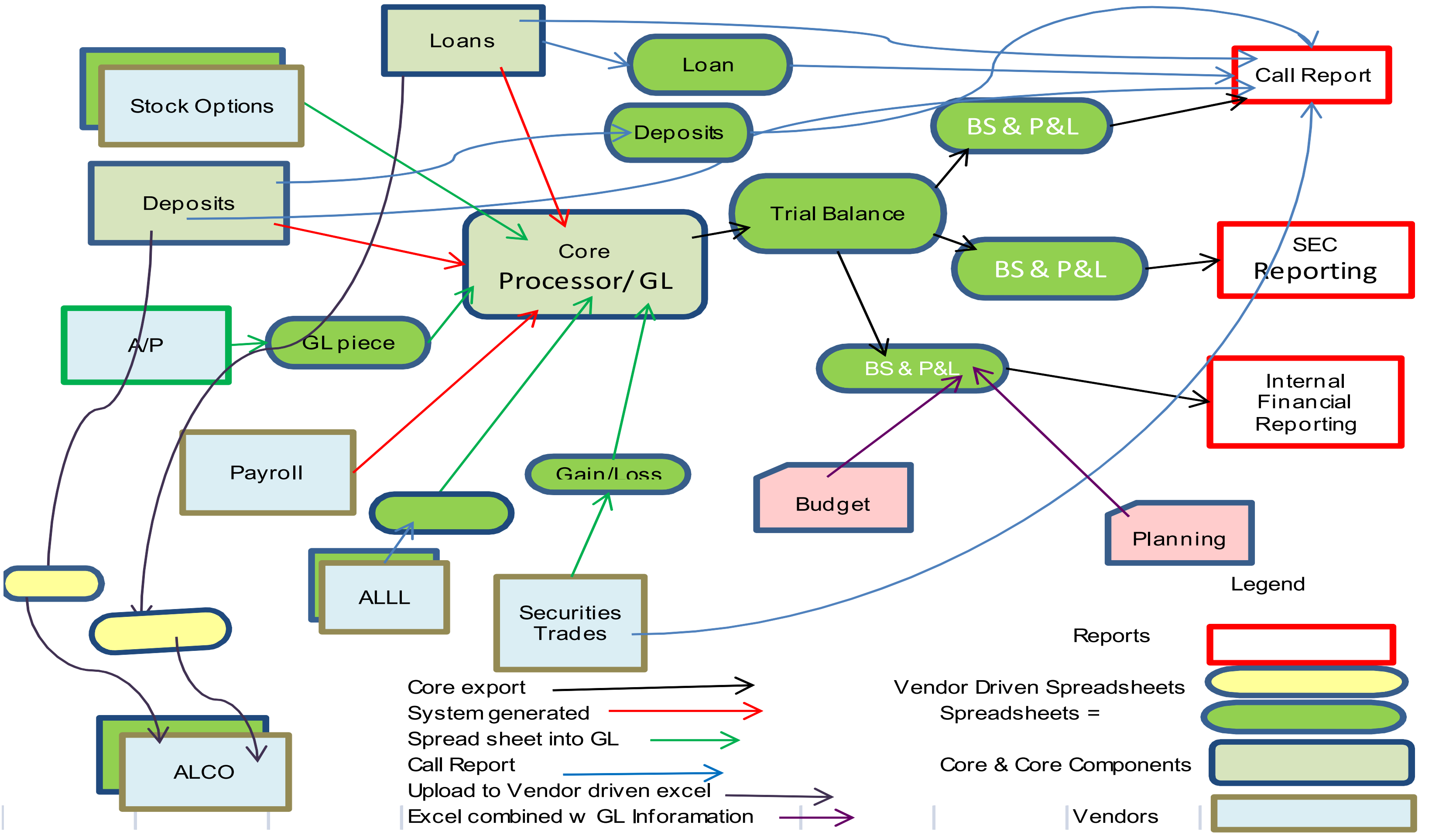
A Representative Community Bank System Schematic



GAAP, regulatory, & SEC regulatory frameworks continue to expand & become more complex:

- **In-house technical GAAP and regulatory & SEC knowledge often falls short of the need**
- **New processes and procedures require training staff, designing appropriate controls, creating documentation and manuals**

Cost of compliance can drive very significant decisions. Last week the WSJ reported the following:

Executives from at least a half-dozen small banks that have agreed to be acquired in recent months said the increasing regulatory burden was a factor in their decisions."

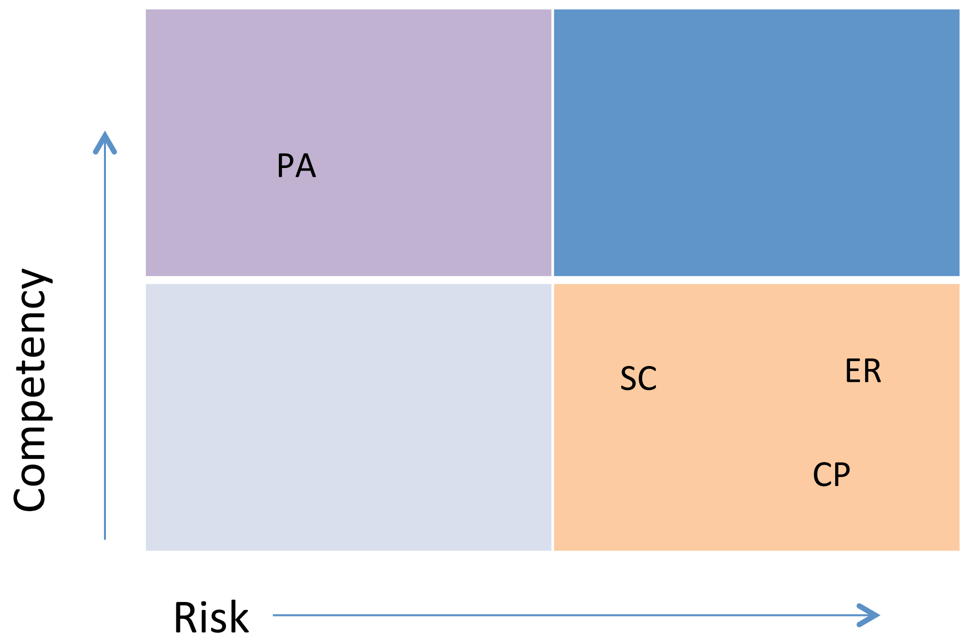
The CFO needs to objectively evaluate:

- **Staff capabilities and challenges**
- **Systems, data and IT situation**
- **The breadth and complexity of new GAAP, regulatory, & SEC regulatory frameworks**
- **Cost constraints**

These components will be inputs into the CFO's assessment of the READINESS of the Bank & the Finance group to implement new requirements.

This as a framework with which the CFO can evaluate the readiness level of the Finance organization

A grid that ranks each reviewed area by Competency and Risk, Cost to Remediate & Benefit may look like the following:



Area	Bank's Cost to Remediate	Benefit
PA	$5K	Improve decision making
SC	$15K	Improve effectiveness & efficiency
ER	$60K	Free up resource
CP	$30K	Accuracy, Improve decision making

CP – Closing Process; **SC** – Staff Competency; **PA** – Planning & Analysis;
ER – External Reporting

Once readiness levels and gaps are understood then how can the CFO set up the Finance team to succeed?

Innovative and cost effective solutions exist to close these readiness gaps:

- **Next generation IT management**
- **Project management**
- **Information subject matter expertise and data governance discipline**
- **Strategic outsourcing of CFO functions**
- **Strategic Partnerships**

The payoff from getting in front of these issues is huge for the organization:

- **The Bank gets the CFO back from "process Siberia"**
- **Decisions are supported with thoughtful financial and economic analysis**
- **Costs for audit and legal SEC work may drop**
- **CEO and CFO attestations and certifications can be completed with more confidence**

Eric Segal, Managing Director, CFO Consulting Partners

Eric Segal, a partner of the firm, heads the firm's Banking and Financial Institutions practice. His work with CFO Consulting Partners has included serving as the Interim CFO for a $1 billion public community bank, providing clients with regulatory guidance, conducting M&A sell-side due diligence, managing SEC reporting (including 10-Q restatements), developing business plans, developing mortgage bank accounting policies, securitization analysis, and other services.

Eric has more than twenty-five years experience in senior financial management positions with companies ranging from the Fortune 500 to community banks. He was Senior Vice President and Chief Financial Officer of Spencer Savings Bank, a $2 billion community bank in New Jersey, and is a 17 year veteran of American Express and Ameriprise Financial. He was Vice President and CFO of Ameriprise Bank, FSB, and he was the head of finance for the American Express consumer banking business before Ameriprise was spun off from American Express. Eric also had six years at American Express Bank, Ltd., as CFO of the Financial Institutions, Corporate Banking, and Global Investment Products divisions. Also at American Express, Eric served as Vice President & CFO during the incubation and start-up phases of the company's on-line brokerage business, and as Director of Risk Management within that firm's Treasury function. Eric joined American Express in 1989 from Moody's Investors Service, where he was trained in credit analysis and worked as an Analyst in the financial institutions group.

Eric holds a BA degree from Carnegie-Mellon University and an MBA in Finance from Pace University.