MOGO
CAPITAL CONSULTING, LLC
balancing the scale

"BOLI csv to Tier 1 Capital Program"

Information for Community Banks

Confidential for discussion purposes only

The Target Institutions

- Community Banks
  - Less than $1.5 billion in assets
  - More than $2.0 million in BOLI csv
  - Tier 1 Capital ratios of over 4.5% and typically under 9.0%
    - With limited exceptions
  - Trends of decreasing
    - NPAs
    - OREO
  - Trends of increasing
    - Operational profits

The Transactions

- Purchase BOLI policies from bank
  - For book value or CSV
    - Balance sheet neutral transaction for the bank and investor
  - Become owner and beneficiary on all policies
  - May be purchase in separate LLC should shared ownership be required
- Borrow on CSV from issuing insurance company
  - Typically 70% to 80% of CSV can be safely borrowed without incurring out of pocket cash for interest payments or mortality cost
- Using borrowed funds purchase Stock in target bank

Bank Owned Life Insurance (BOLI)

- Single Premium Whole or Universal Life policies
    - The bank is usually the owner and beneficiary
    - Key bank employees are the insured
- Key features:
    - Death benefit (DB)
    - Cash Surrender Value (CSV)
        - The CSV is the value used by the bank to carry the policies on its books
    - DB is typically 2.5 to 3 time the CSV
    - The Net Present Value of the DB using a rate equal to 80% of the 30 year treasury is significantly higher than the CSV
- The income on these policies is tax deferred to the bank if they designate it to be used to fund some type of employee benefit plan, these are modified endowment contracts (MECs) and held until maturity

The Stock used to make the investment

- We would typically recommend a Preferred Stock
    - Non-Voting
    - Non-Cumulative
    - Perpetual
    - With a coupon of 4.5% to 6.0% initially
        - We expect that most banks will not be able to make this payment for the first 24 months
        - The coupon will, in most cases have a variable feature
            - Fixed with a variable share of income
            - Variable based on some rate
        - We will restrict the payment of common dividends such that the Preferred coupon must have been paid currently each of the prior 4 quarters before common can be paid
    - Convertible to common with a 4.9% governor
        - This is to keep us out of being a bank holding company
        - Upon change of control this restriction would end
        - The conversion rate will be based as follows
            - Using a current "Adjusted Tangible Book Value" formula
            - Current book + reserves – 7% of 30+ past due – 23% of 90+ past due – 20% of Other Real Estate Owned (OREO) – 52% of Non-Performing Assets (NPAs) with a multiplier for Core Deposits
    - Over time and or with certain events the coupon rate will increase
        - This is to give the bank ample incentive to re-capitalize down the road when it is stronger and pay the fund out
- In limited circumstances (with healthier banks) we may use straight common or a Preferred with fewer advantages

Advantages for Investor / Fund

- Community Bank values are depressed
  - Most have market values at a significant discount to their book value
- During the 30 years ended in 2007 Community Bank market values averaged a 1.98 times premium to book value
- The Net Present Value of the Death Benefit gives assurance that the risk of principal loss is almost totally mitigated
- There are 3 cash income streams
  - Dividends
  - Death Benefits
  - Policy interest income should it exceed borrowing cost
- Several exit strategies
  - Investments could be acquired by larger banks
    - Bank merger and acquisition has all but ceased during the last 5 years
    - There is a pent up demand for larger banks to grow
  - The investment could be bought out by larger fund as banking industry comes back into vogue
  - Individual banks could recapitalize to grow or go public

Disadvantages for Investor / Fund

- Relatively small individual transaction size
- Long term nature of the hedge (death benefit)
- Illiquid nature of community bank stocks
  - This investment will most likely need to be tied up for 4 to 7 years
  - Our yield curves are calculated based on a maximum of 10 years
  - However in some specific cases where the hedge is required the payout could take 35 to 40 years

Advantages for Banks

- New Tier 1 Capital for up to 90% of BOLI csv amount
- Improved liquidity
- Cost of this type offering are relatively low
- Infusion of Tier 1 Capital should insure survival and growth
- Transaction may attract additional investors as needed
- Bank will not be taken over by FDIC

Disadvantages for Banks

- Preferred Stock dividend cost
- Dilution
- Need to re-work and fund employee benefit plans supported by BOLI
- MEC tax penalty
- Need NOL to offset potential ordinary income or capital gain on BOLI policy sale

“BOLI csv to Tier 1 Product”

- MOGO has a patent pending application based on this business process or activity
- MOGO has worked with over 132 banks and reviewed over 2300 policies
- MOGO has completed one transaction and has 2 currently pending closing

The Market

- In the United States
  - There are approximately 6790 total banks
    - There is a total of approximately $120 billion in CSV on banks books
  - Approximately 5300 are Community Banks
    - There is a total of approximately $23 billion in CSV on these banks books
  - We have identified 562 banks that meet our criteria
    - Maximum asset size $1.5 billion
    - There is a total of
      - $4.1 billion of CSV
        - $7.2 million average
      - $10.3 billion of Death Benefit
        - $18.4 million average
    - Capital rates between 4.5% and 9.0%
    - Minimum CSV $2.0 million