

MIBIZ CRYSTAL BALL 2010 ROUNDTABLE DISCUSSION: BANKING

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Want to know what to expect from the banking industry? MiBiz asked the leaders of local institutions to share their predictions of the New Year. Participating are:

DAVID H. BLOSSEY – Grand River Bank
JOHN BULTEMA – Fifth Third Bank
JOE DAVIO – Comerica
GARTH DEUR – The Bank of Holland
LEONARD IAKIRI – Northpointe Bank
MICHAEL H. PRICE – Mercantile Bank of Michigan

What pending federal and/or state legislation could impact your ability to do business?

Price: Our ability to do business will not be impacted by any pending legislation. Some discussions surrounding issues such as a ubiquitous regulator, as well as proposals for certain regulatory changes could have future impact on the banking industry as a whole.

Davio: We continue to monitor developments as the federal level, however, it's premature to say if and how those developments might impact our business.

Deur: As long as challenges remain in the banks' loan portfolios, the industry will continue to receive heightened scrutiny by the FDIC and other regulators. New regulation comes with the territory. We suspect the new legislation in 2010 will be more focused on consumer protection. Since we are primarily a business bank, this type of regulation will not impact us much. It will have a negative impact on financial institutions that derive a significant portion of their profits from consumer account fees. We also believe that capital requirements for banks will be increased in the future. We have built this expectation into our future financial plans. Regardless of the type of bank regulations that come our way, we will comply with them and get on with business.

Bultema: Ongoing change and uncertainty in new federal regulations requires us to be flexible and able to adapt to change quickly. However, we don't see any impending legislation impacting our ability to service our customers.

Blossey: Without a doubt, Sen. Dodd's proposal in the Senate could have a significant impact on the community banking world. I am concerned about the "unintended consequences" that always seem to pop up when major changes like this bill are proposed. The bill is attempting to manage the largest financial institutions but unfortunately it ends up creating issues for all bankers to deal with. The last thing community bankers need is more regulation.

Iakiri: There are a variety of reform efforts focusing on mortgages, so we're watching that very closely. We still see great opportunity in this sector.

When will the banking industry turn the corner on loan losses? Does your institution expect to continue expensing capital at the current rate? What would help abate the losses?

Price: We are projecting that the industry will see the peak on loan losses sometime during 2010. However, this projection is entirely dependent on the stabilization of the economy, especially the real estate market. We have seen some recent signs that the market has stabilized, though at much lower values than were experienced in 2005-2007.

Davio: I can't speak for other banks, but here at Comerica we have been working hard to effectively manage credit, particularly in this economic environment. We believe that our strong capital position, or vigilance in managing credit and our focus on controlling expenses will position us well as the economy improves.

Deur: The value of real estate has an enormous impact on banks' loan loss provision. The industry will continue to see loan losses as borrowers struggle with carrying the costs of non-performing real estate. The real estate market will ultimately improve only when employment turns upward and population increases, neither of which we are experiencing right now. Therefore, we do not expect any significant improvement in the real estate market over the next 18 months. In the traditional C&I markets, we've already witnessed some upside in the later portion of 2009 as companies have reduced their operating budgets and restructured their businesses to be more in line with current revenues. We expect to see continued improvement in C&I businesses in 2010. We would expect to see continued stress in the banking industry at least through 2010. Since we have remained profitable through this difficult period, we have been able to manage our loan losses without any deterioration of existing capital.

Bultema: Although the credit environment remains challenging, we are seeing some stabilization in loan losses. Improvement in the overall economy will determine future trends. We have and will continue to extend capital to qualified business and consumer borrowers. In September alone, we extended over \$6 billion in new and renewed credit to consumers and businesses. This represented a 17-percent increase over our activity in August. We are also the largest mortgage lender in the area and continue to see strong refinance and first time

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homebuyer activity.

Blossey: Personally, I believe your first question has two parts (1) in the country as a whole, and (2) in Michigan. Most likely, loan losses will continue in the country as a whole into 2011 until residential housing stabilizes and the depth of the problem in commercial real estate is reached. Grand River Bank, as a new bank, is experiencing operating losses until we reach a stabilized situation and as such, our losses are not related to credit quality. Overall, to abate the losses, both in Michigan and on a national level, the key is reducing unemployment. The lack of viable, long-lasting employment options is the major contributor to the economic problems we are expecting. Once the unemployment problem improves, I think you will begin to see bank losses subside.

Iakiri: I believe that Michigan will take longer to recover than other parts of the nation. For commercial loans, I believe Michigan banks will struggle well into 2011 and perhaps 2012. Northpointe has been proactive with reaching out to borrowers offering loans programs that help, not hurt them. This has been a major focus for us in 2009. Michigan is our primary lending market, so seeing improvements in the economic and job climate would help us recover. For the past two years, Northpointe has focused on diversifying the markets we do business in by strategically working in markets that are in better economic shape.

How will bank failures compare from 2009 to 2010 and how do you ensure your bank isn't one of them? With the FDIC going broke to cover insured deposits at failed banks, how will the standing institutions be affected?

Price: We suspect that bank failures will remain elevated in 2010. Banks like Mercantile Bank that have well-capitalized equity positions are poised to better weather the economic storm. The FDIC has increased its premiums for the remaining institutions, which adds to operating costs. However, FDIC insurance is a very valuable part of the confidence in the U.S. banking system and, even at its elevated cost, is an integral expense.

Davio: As I mentioned earlier, I believe we're positioned well for an economic recovery. I prefer not to speculate on what the effect of any actions by the FDIC may be.

Deur: We expect the number of bank failures to increase in 2010 over 2009 but the magnitude of the losses will be lower since the failing institutions will be

smaller. The FDIC dealt with the largest bank failures first. As far as The Bank of Holland is concerned, we will continue to manage our business appropriately in light of current conditions and expect to remain profitable despite the market turbulence. We are approaching 2010 and beyond as a growth opportunity for us.

Increased FDIC premiums will be necessary as the banking industry funds the losses of the FDIC. Since many banks are challenged to be profitable, they may also struggle to pay their premiums.

Bultema: Fifth Third Bank has been in business for more than 150 years because we've managed through many deteriorating credit cycles, recessions and even the Great Depression. We are dedicated and determined to emerge from this period in our country's history smarter and stronger than before, and better able to serve our customers. Our stability is reflected in our strong capital ratios, which continue to be higher than target ranges set by the U.S. Treasury.

Many banks are still struggling with very high non-performing asset levels that are not sustainable in the long term without sufficient capital. The improvement in the economy will certainly determine the impact on how many more bank failures there will be. We do anticipate increased consolidation particularly among smaller players as they work to navigate through this tough credit cycle and seek to become more efficient.

Blossey: It would appear that 2010 will most likely be somewhat of a mirror-image of 2009 in reference to bank failures. Unfortunately, the "Problem List" as noted by the FDIC continues to grow and is the highest it's been in 16 years. It is important to understand, however, by any measure, the actual number of annual failures in no way compares to the number of banks closed during the late '80s and early '90s. Also, on a percentage basis, the number of banks closed is very small. At Grand River Bank, we remain extremely well capitalized and we are in a position of strength in the market. While it is true the FDIC fund has been depleted, that issue was recently addressed and all member banks (Grand River Bank included) are pre-funding their annual assessments for the next three years on Dec. 31, 2009. From a financial statement standpoint, the assessment will be "accrued" and subsequently expensed each quarter, so the only effect on the individual bank is the opportunity cost of not having that liquidity available for other purposes. Additionally, the FDIC has a \$100 billion line of credit with the Treasury that can be used for additional support if necessary although political pressure makes the use unlikely.

Iakiri: Unfortunately, I believe that 2010 will see the

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same or higher levels of bank failures across the nation. Although the economy may start to move up, banks will still have difficulties raising capital. Northpointe is focused on continuing to identify new business opportunities and introducing new products and services for our customers. Our work has paid off as our mortgage teams are seeing growth. We will continue to offer a full banking experience in the markets we serve in 2010. As a result of the bank failures and FDIC struggles, I would assume we'll see bank premiums for FDIC insurance increase.

What are your bank's goals to grow its market share in the business-to-business market in 2010?

Price: As a bank that has always been very involved with business lending and services, we expect that 2010 will continue to provide numerous opportunities to expand our market share in this area as well. Mercantile has been a market leader in the use of technology and innovation, and we plan to continue this strategy in 2010 and beyond.

Davio: At Comerica, we have been meeting the financial needs of businesses, business owners, employees, friends and neighbors for over 160 years. With our strong capital position, it is our intent to grow our market the same way we always have. The growth will come from our products delivered by experienced colleagues. The key is our relationship managers take the time to understand their clients, not only assisting them with financial services but also serving as trusted advisors.

Deur: As a private company, we don't divulge our specific growth goals. But, we can say that we see the future as an opportunity for steady and responsible growth. We'll continue to focus on our sweet spot with small to mid-sized businesses in Grand Rapids and Holland. There are many, many opportunities in this environment. Business people are looking for advisors who understand both the current challenges in their respective businesses but also believe in the long term opportunities this kind of market represents.

Bultema: The best way to grow share is by relentlessly meeting the total financial needs of our customers, and delivering outstanding service. In these tough economic times, customers want to work with a bank that listens and understands their needs, and provides the right products and solutions to achieve their goals.

One way to achieve this is by having specialization in different segments of the business, such as healthcare, education and energy, to name a few. We are focusing our teams to really understand these segments so we can

understand and better anticipate the needs of our clients. When we do that, we add value to our relationships and become trusted advisors to our clients.

Blossey: Again, Grand River Bank is a de novo bank started in April of 2009, so our plans are consistent with our original business plan, to become the bank of choice for the small business owner in the greater Grand Rapids marketplace. We have the capital to expand, and we are aggressively looking to allocate that capital in partnership with businesses who want to work with a community bank.

Many people are saying that the entrepreneurs will help lead Michigan and the country out of its current situation. How does your institution plan to support these potentially risky entrepreneurial ventures in a risk-adverse climate? How do loan programs, like those guaranteed loans offered by the SBA, play into those plans?

Price: We have always felt that entrepreneurs are a very important part of the economy. Business lending is a core competency of Mercantile Bank and we plan to remain a very strong competitor in this arena. As an industry, banks became very aggressive during the low rate, high liquidity environment of the early part of this decade. What was normally considered owners equity or mezzanine capital was frequently financed through normal bank lending during this period. Going forward, a return to more traditional and conservative lending is in order. The SBA loan guaranty program, as well as other guaranty programs, plays an important role in lending to entrepreneurs. Mercantile has always been one of the leading SBA lenders in our market and we would expect this to continue well into the future.

Davio: I agree that entrepreneurs will help Michigan and our country out of the current economic downturn. Your follow-up question regarding how Comerica will support these risky ventures is an interesting one. In my 35 years in the financial services industry, with most of it in the business lending segment, I have found that a key to helping all business owners is to help minimize and mitigate the risk. Entrepreneurs start with an idea or a dream. It is up to them to determine whether or not there is a market for their product or service. Once a market is established, a solid detailed business plan needs to be produced to obtain the capital (equity) to start production.

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This equity normally comes from personal savings, family members and friends. This is sometimes referred to as "friendly debt." Our lenders will use their experience to help entrepreneurs through this process. The next step is providing the liquidity to fund operations normally through working capital (lines of credit) and equipment financing. Comerica actively uses the 504 Program and the 7A program through Small Business Administration. We may recommend an SBA product or standard product to provide the funding. Whatever we recommend, it is our goal to partner with our clients as a trusted advisor not just a provider of liquidity.

Deur: We have great empathy for entrepreneurs, since we are an entrepreneurial organization ourselves. We understand the great challenge to not only birth a business but to manage it for growth. Entrepreneurs deserve to have partners who are honest with them about their opportunities and their challenges. It's important to not only be mindful of the risks but to not use that as an excuse to stay on the sidelines. We may choose to directly participate or utilize our strong relationships in the business community to match people or businesses with equity to these new business ventures. At the same time, not all entrepreneurial opportunities are undercapitalized and/or risky. There are many opportunities for well established existing businesses to start up new lines of business or acquire other businesses to build share. In five to ten years, we'll look back at this time and know that the initiatives we started when the times were the darkest, have created the success we enjoy that day.

We agree that SBA and other government loan programs will be an important source of funding for quality small businesses that are reasonably good credit risks but, for various reasons, may not qualify for conventional financing. The government guarantee allows us to provide businesses with highly competitive and customized alternatives to conventional loan products. We have recently invested in this line of business and added resources to our Business Resource Lending group in order to increase the experience and expertise to approve and service these loans in-house.

Bultema: Fifth Third Bank is an industry leader in offering SBA Loans as an option for those entrepreneurs looking to start or purchase a business in today's economic environment. These SBA loan programs are SBA 504, 7A, and the SBA Express products. Today over 25 percent of our new loan activity servicing the small business owner utilizes an SBA product. These programs can offer extended amortizations and can provide more flexible down payment options than your typical bank products.

We also have a variety of other loan products that entrepreneurs can use until their business has the ability to support a business loan. The most important element is that they have a plan and have a way to fund that plan assuming things go exactly the way it is written out. There are great resources that we work with at the SBTDC, SCORE and others that can help entrepreneurs build the right plan so they can work with the bank and hopefully find a way to fund that dream.

Western Michigan is especially blessed to have benefited from the generosity of many entrepreneurs. I am confident that this strength will be one of the factors that lead this region out of our current slump.

Blossey: This is always a difficult situation for a bank. Please remember we are lending our depositor's money, so if we lend those dollars we must have the expectation that the funds will be repaid in a timely manner. All banks attempt to minimize the risk of losses by adding collateral or utilizing guaranteed loans such as the Small Business Administration, but ultimately a bank doesn't want to rely on those support mechanisms. For example, real estate is collateral for many bank loans, and we all know the current market condition for real estate; it offers little in the way of comfort right now. So, unfortunately, if you have a high-risk venture, it is most likely not a bank loan, it is a venture capital situation. Only through venture capital can an investor price for risk, that is, get an adequate return on money invested.

Iakiri: Northpointe continues to assess the viability of offering lending programs that cater to entrepreneurial, start-up business ventures. Expanding our business services is a key strategic component of our planning efforts for the next 10 years. We want to help these new ventures and start-up companies succeed in our markets, so offering programs that work for them, and are sound for us, are indeed worth exploring.