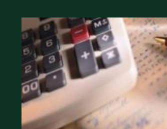
FEDERAL RESERVE BANK OF BOSTON™

November 8, 2011

THE KAFAFIAN GROUP INC.

...helping banks perform better℠



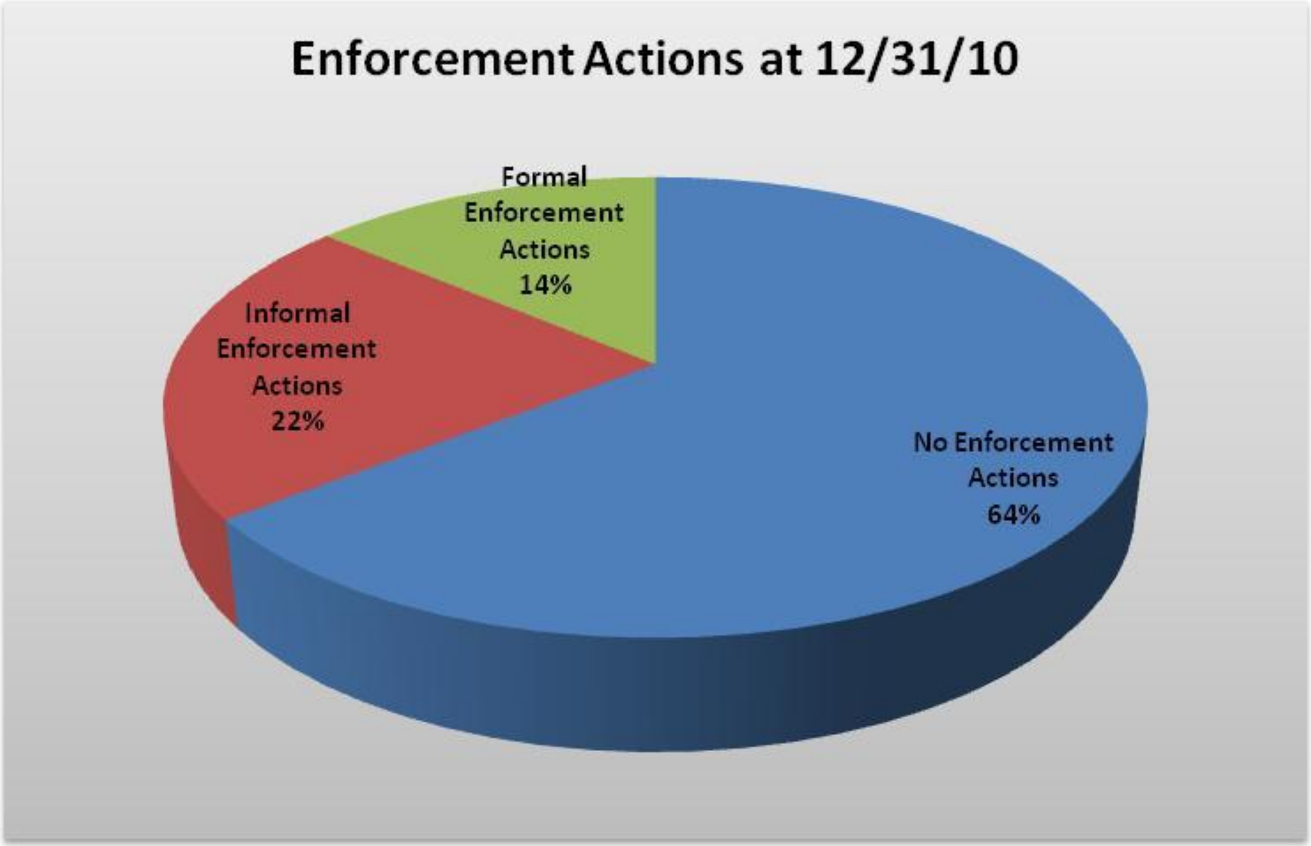
Community Bank Overview

Key & Emerging Themes

- Regulatory Burden
- Changing Capital Requirements & Availability
- Credit Quality
- Loan Demand and Net Interest Margins
- Demographic Trends
- Fee Income
- Customer Preferences
- Technology Utilization
- "Too Small to Succeed"?
- Financial Industry Mergers/Acquisitions
- What Drives Franchise Value

Regulatory Burden

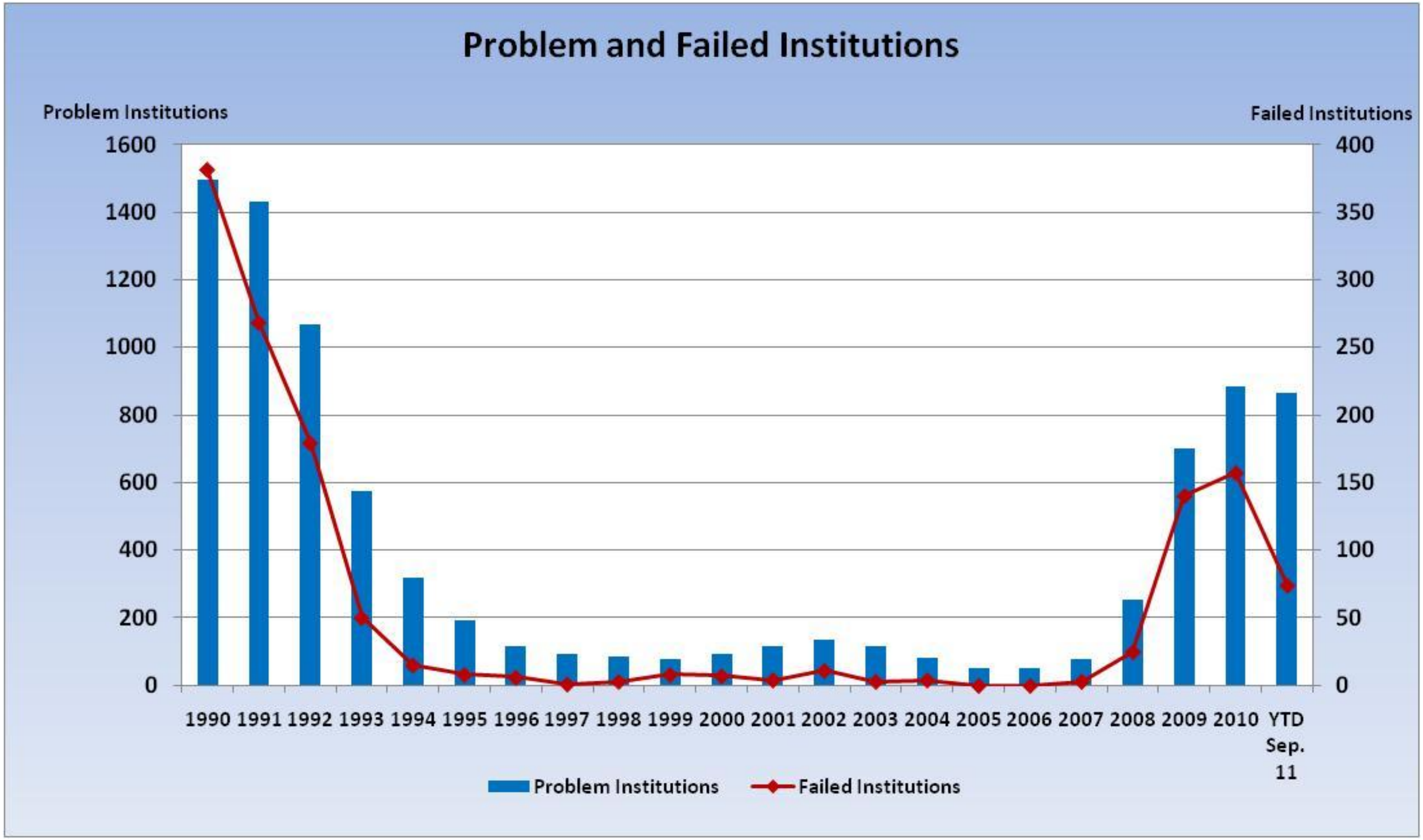
Enforcement Actions



Source: American Banker and SourceMedia, Inc., February 11, 2011

Regulatory Burden

Problem and Failed Institutions



Source: FDIC

Regulatory Burden

Dodd-Frank Act Impactful Provisions

- Collins Amendment: BHC capital requirements to be the same as bank capital requirements. Trups ineligible for Tier 1 treatment in banks > $15B. No new Trups for banks between $500MM and $15B.
- Executive Compensation: For listed companies; independent Compensation Committee; non-binding shareholder vote every 3 years on exec. comp.
- SOX 404(b) exemption for non-accelerated filers.
- Abolishes OTS but not thrift charter.

Regulatory Burden

Dodd-Frank Act Impactful Provisions

- **FDIC assessments based on average total assets minus average tangible equity.**
- **FDIC reserve ratio raised from 1.15% to 1.35%. Large banks (>$10B) to bridge the gap.**
- **FDIC deposit insurance permanent increase to $250,000.**
- Countercyclical capital requirements. Regulators permitted to require greater amounts of capital during good times.
- To receive regulatory approval for a merger, resulting institutions must be "well capitalized and well managed."

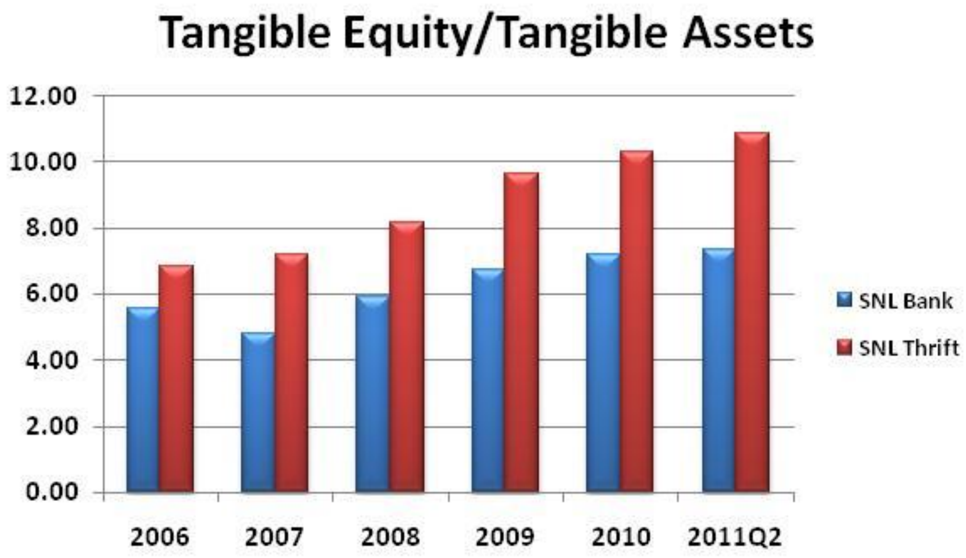
Regulatory Burden

Dodd-Frank Act Impactful Provisions

- Hotel California provision: Can't switch charters if under an enforcement action.
- Interstate branching restrictions lifted to put state and national banks on par with thrifts.
- Eliminates federal prohibitions on paying interest on business checking accounts.
- Established Consumer Financial Protection Bureau.
- Durbin Amendment: Interchange fees must be "reasonable and proportionate." (<$10B are exempt)

Changing Capital Requirements & Availability

Tangible Equity



- Dodd-Frank Limitations on Tier 1 Capital
- Regulatory preference for common equity
- Increased regulatory issuance of individual minimum capital ratios (IMCRs)

Source: SNL Financial, LC

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Changing Capital Requirements & Availability

Basel III

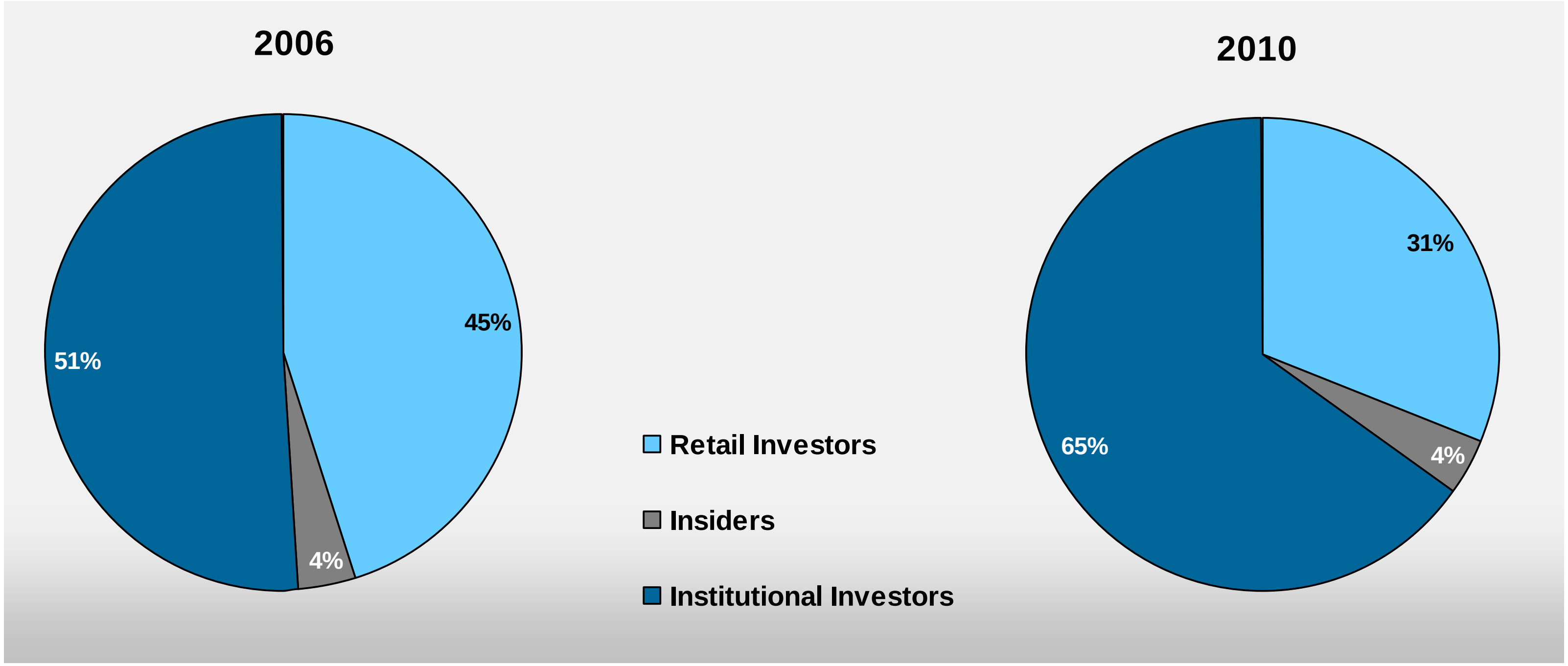
BASEL III Capital and Liquidity Requirements

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Leverage Ratio (3.0%)	Supervisory Monitoring		Parallel Run Phase (Public Disclosure as of January 2015)					Effective January 2018	
Minimum Common Equity Capital Ratio	2.0%	2.0%	3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital Conservation Buffer	-	-	-	-	-	0.625%	1.25%	1.875%	2.5%
Minimum Common Equity plus Capital Conservation Buffer	2.0%	2.0%	3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of Deductions (including for FI Investments, MSRs and DTAs)	-	-	-	20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital	4.0%	4.0%	4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum Total Capital plus Capital Conservation Buffer	8.0%	8.0%	8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%
Capital Instruments Not Qualified for Tier 1 or Tier 2 Capital Treatment			Phased-Out (2013-2023)						
Liquidity Coverage Ratio	Observation Period				LCR applies as minimum standard				
Net Stable Funding Ratio	Observation Period							NSFR applies as minimum standard	

Source: Mayer Brown – Legal Update January 7, 2011

Changing Capital Requirements & Availability

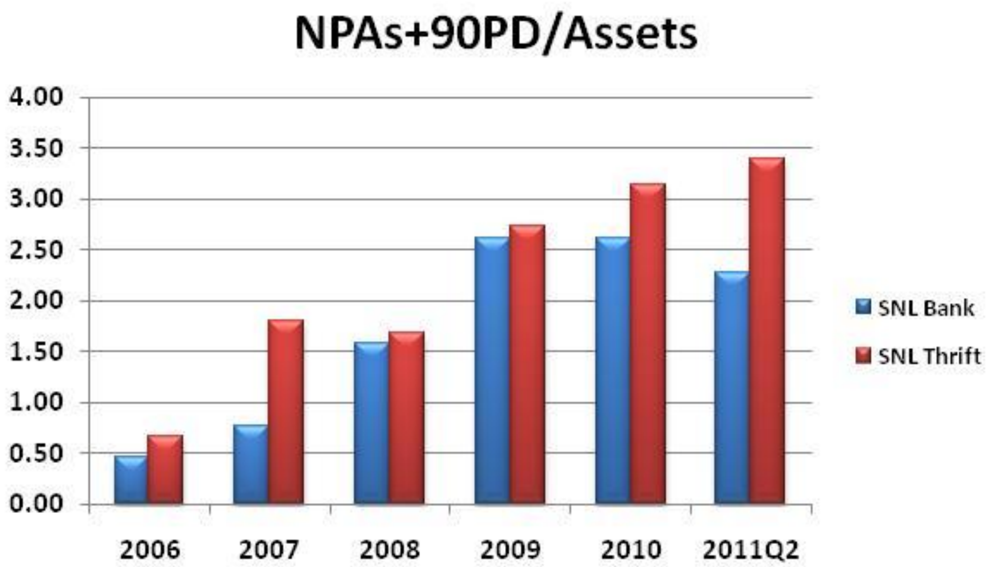
Ownership



Source: Sandler O'Neill & Partners

Credit Quality

NPAs

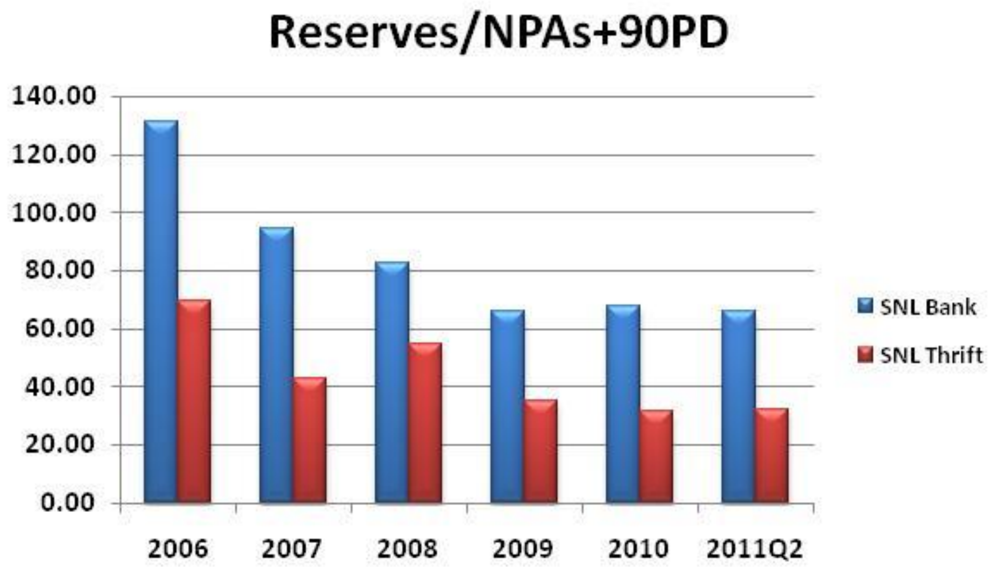


- Asset quality remains a concern. Negative trend continued.
- Median home sale price 4Q05: $226k, 4Q10: $172k

Source: SNL Financial, LC

Credit Quality

Reserves

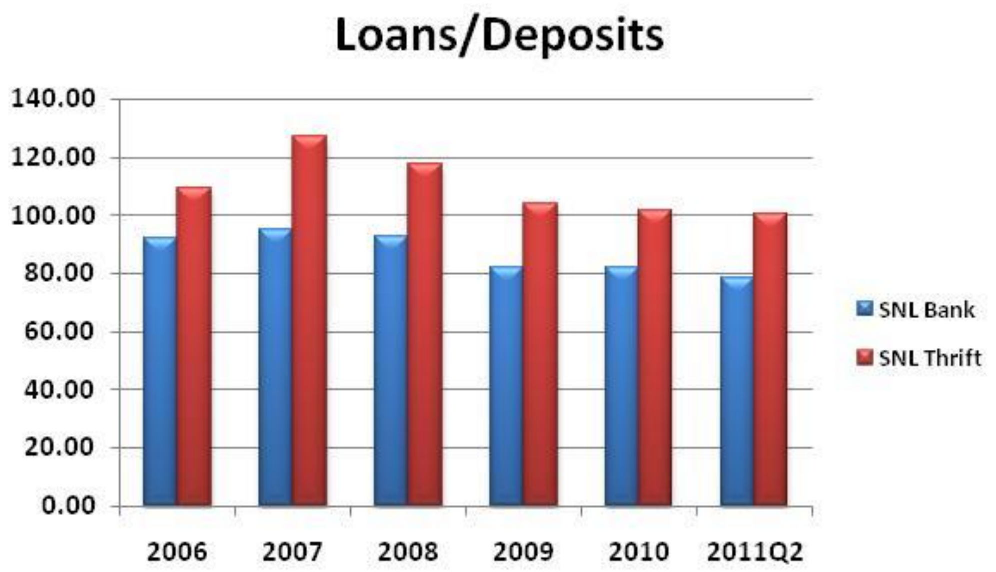


- Reserve ratios are historically low. Combined with lower collateral values, regulators are concerned.
- Regulators reduced the five “c’s” (character, capacity, capital, collateral, conditions) of credit to one: cash flow. If it doesn’t cash flow, it gets written down.

Source: SNL Financial, LC

Loan Demand

Loan/Deposit Ratio

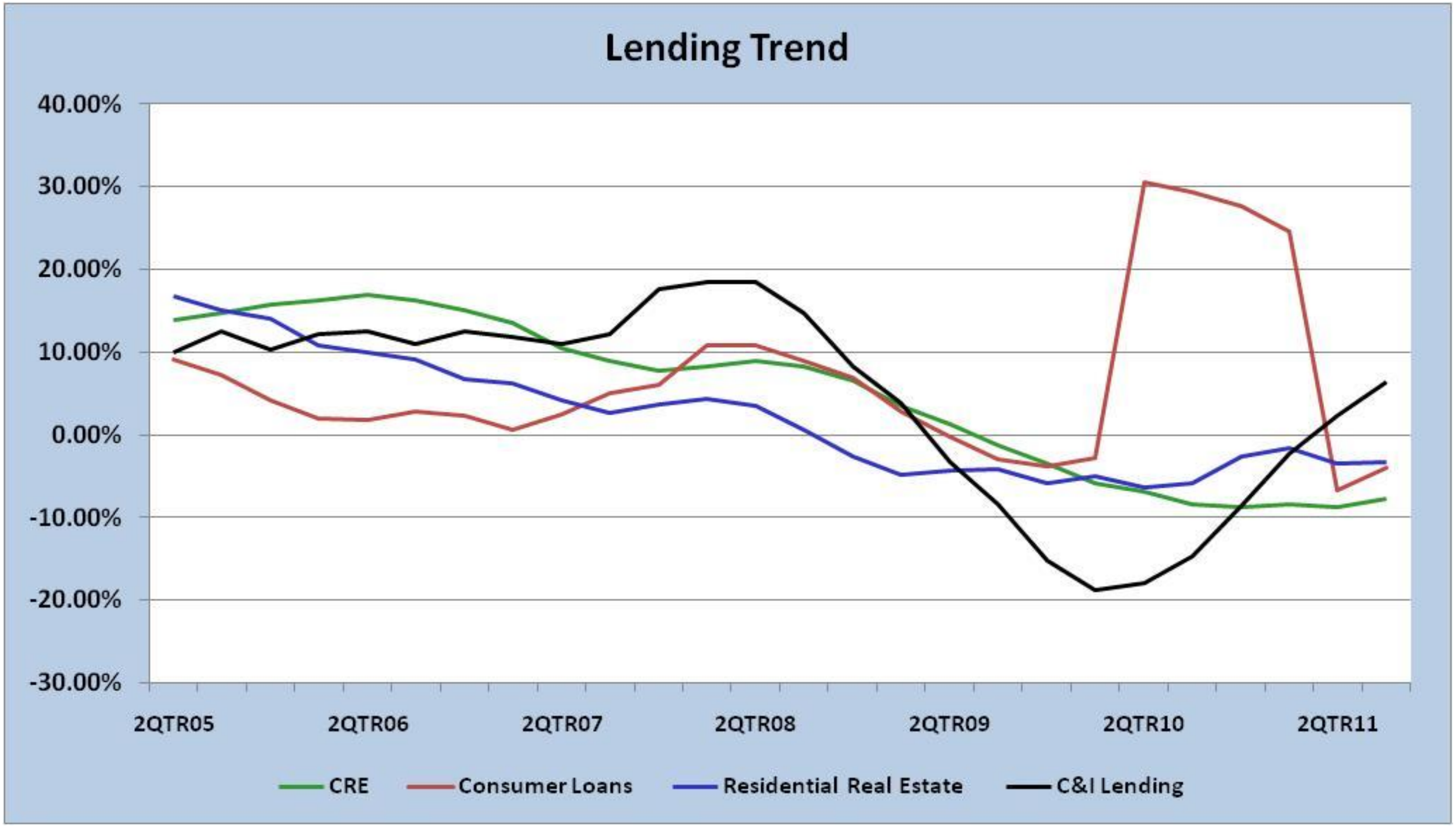


- Declining loan demand is muting the positive impact of increased core deposits and downward liability repricing.
- 4Q09-4Q10 NIMs increased 15 bps for banks / 8 bps for thrifts. Minimal gains concern bankers that margin decline may be on horizon.
- Floors implemented during the financial crisis will contribute to margin contraction as rates begin to rise.

Source: SNL Financial, LC

Loan Demand

Trends



- Low to no growth in 3 of the 4 loan categories may put downward pressure on NIM

Source: FDIC

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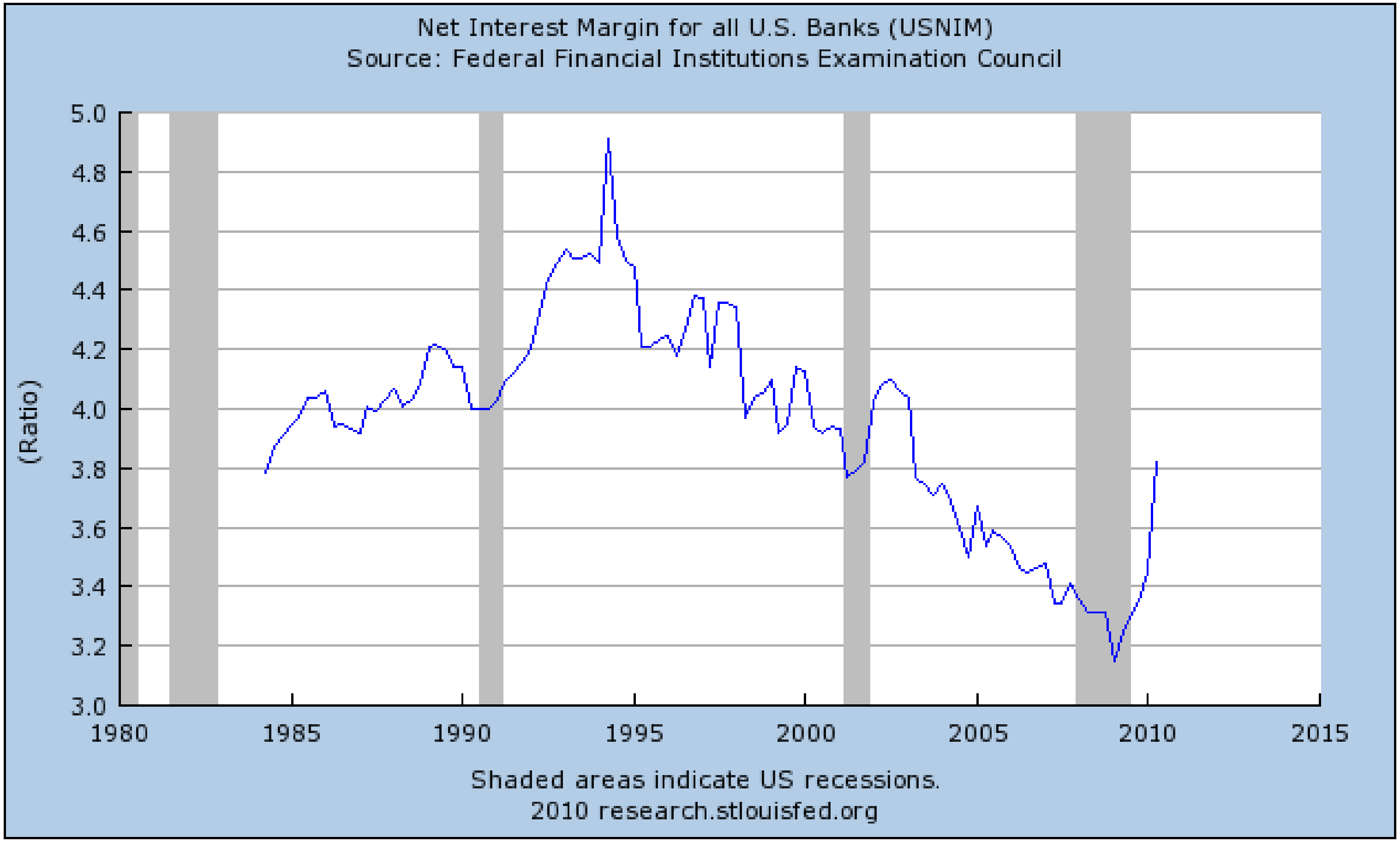
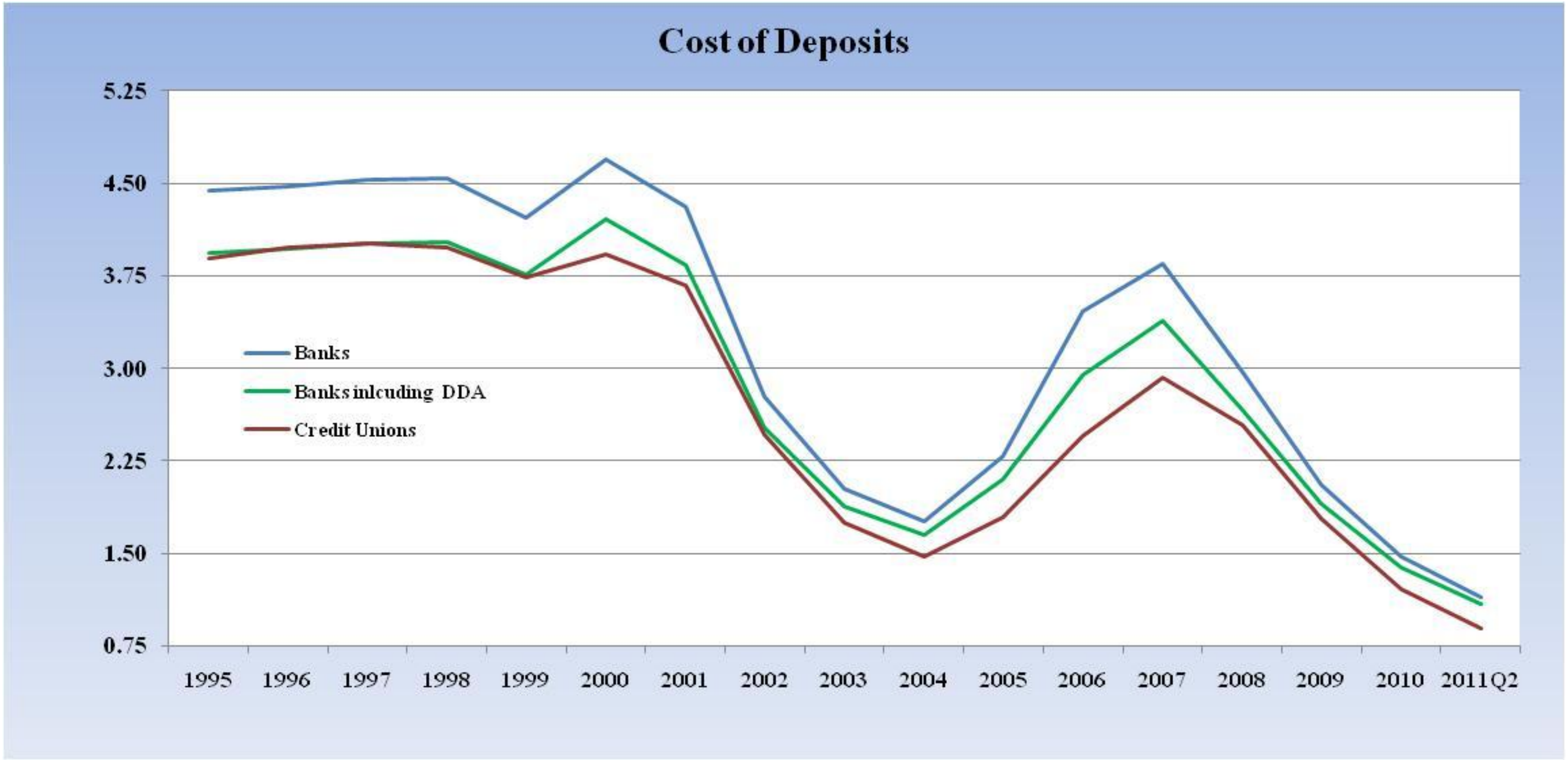
Net Interest Margin

Trend



Net Interest Margin

Cost of Deposits

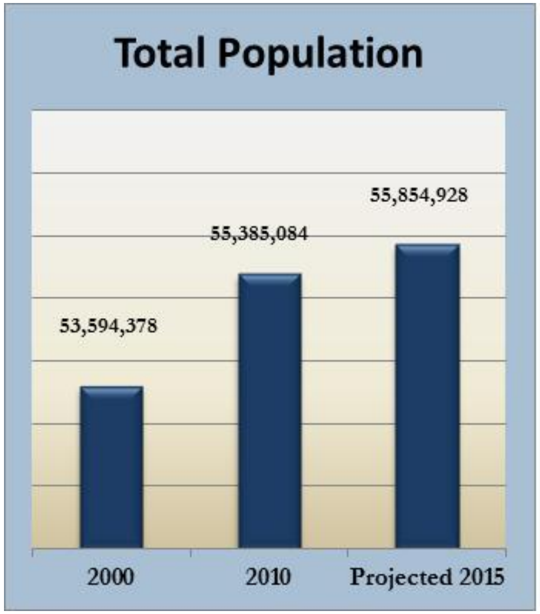


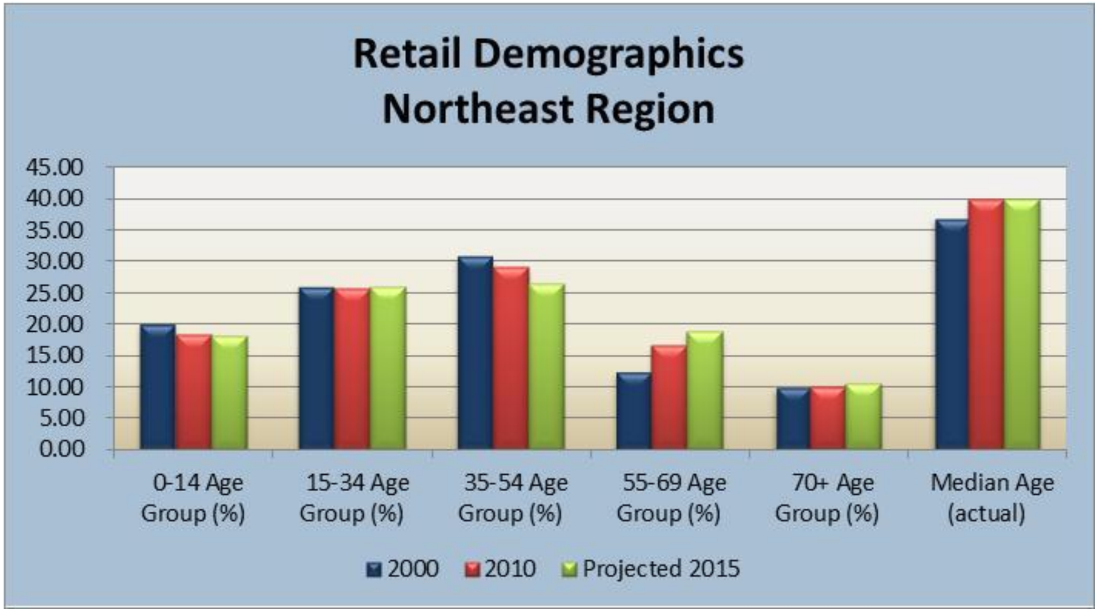
Source: SNL Financial, LC

Institutions with total assets between $100 million and $40 billion. Trend reflects annual averages

Demographic Trends

Population – Northeast Region



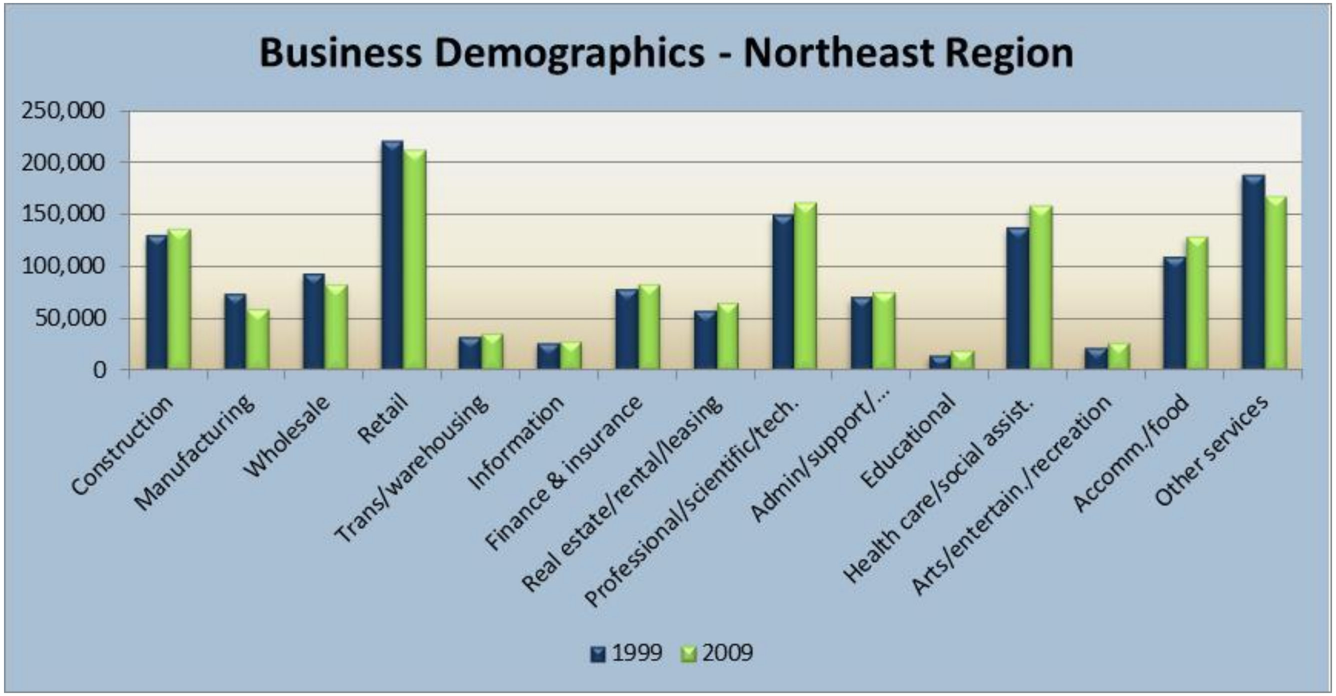


- Projected population growth is led by the boomers, who are increasingly comfortable using technology.

Source: SNL Financial, LC

Demographic Trends

Industry Groups – Northeast Region



- Growing industry groups include construction, finance/ insurance, real estate/rental/leasing, professional/ scientific, admin/support, education, health care, arts, and food services.
- In determining strategy, FIs must determine if these industries have real estate to lend against.

Source: SNL Financial, LC

Fee Income

Profit Contribution

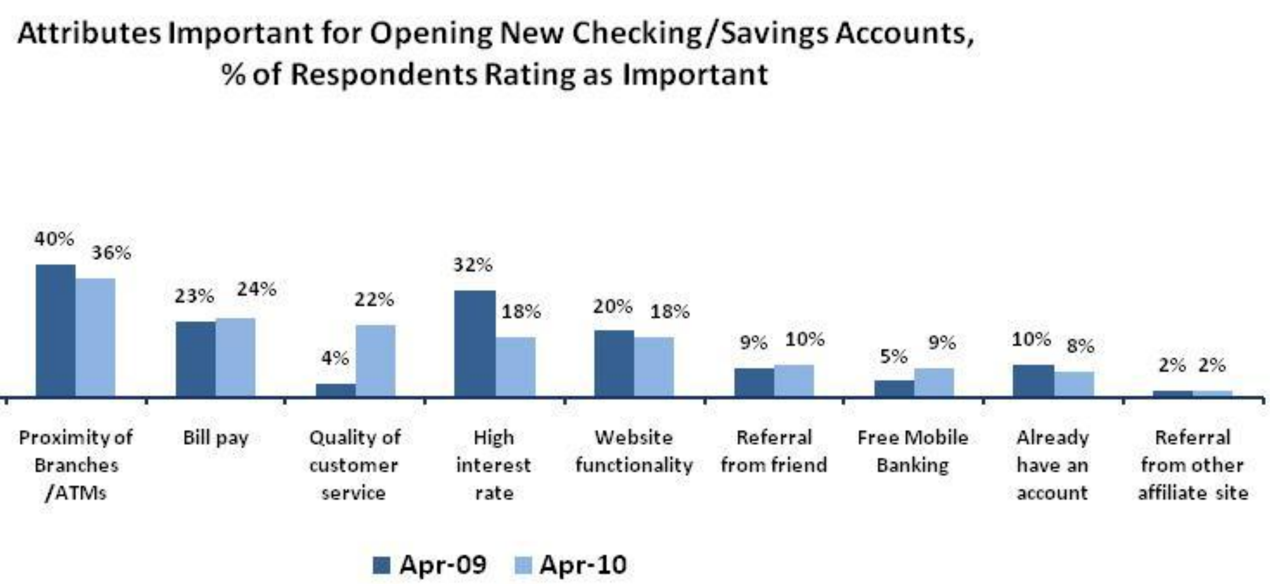
Bank & Thrift Profit Contribution in Fee-Based Products/Services

	2002	2010
Fund Using Products	67%	109%
Fund Providing Products	40%	7%
Fee-Based Products	-7%	-16%
	100%	100%

Source: The Kafafian Group, Inc.

Customer Preferences

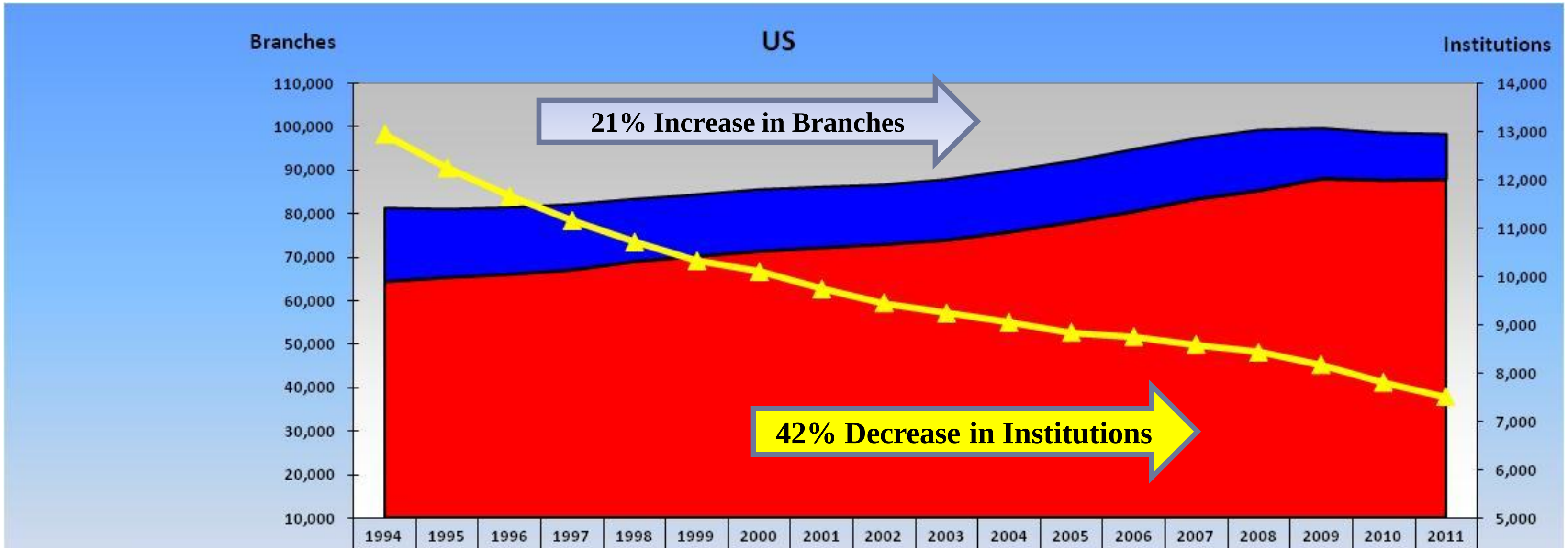
Important Attributes



- While the importance of the proximity of branches is declining as a factor in choosing a bank, it remains a significant factor.
- Increasing in importance is Bill Pay, the quality of service, and mobile banking.

Customer Preferences

Branch Trends - National



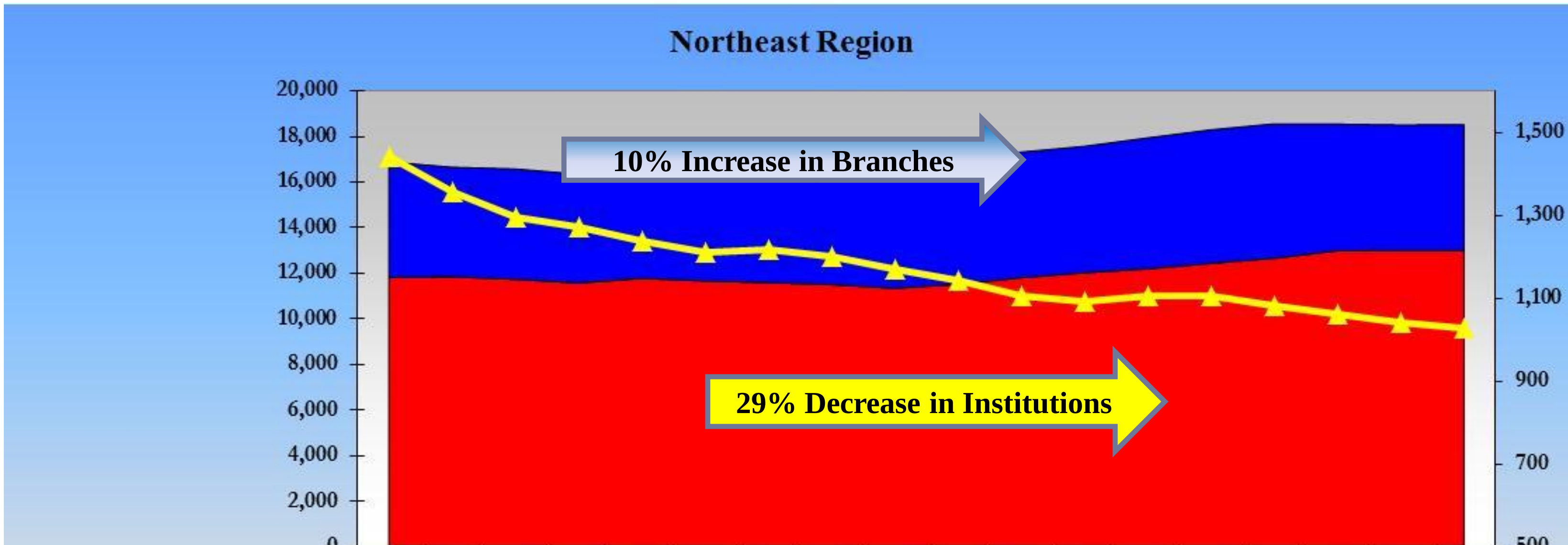
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total Branches	81,245	80,958	81,342	82,079	83,287	84,290	85,473	86,051	86,560	87,775	89,772	92,030	94,740	97,263	99,153	99,540	98,507	98,192
Savings Institutions	16,878	15,637	15,302	15,059	14,313	14,085	14,136	13,887	13,620	13,882	14,000	14,003	14,267	13,903	13,867	11,479	10,784	10,319
Commercial Banks	64,367	65,321	66,040	67,020	68,974	70,205	71,337	72,164	72,940	73,893	75,772	78,027	80,473	83,360	85,286	88,061	87,723	87,873
Total Institutions	12,950	12,248	11,661	11,159	10,711	10,324	10,100	9,739	9,456	9,241	9,053	8,843	8,755	8,594	8,430	8,175	7,811	7,513

- Branch decline over past several years is predominantly driven by acquisitions and subsequent branch footprint consolidations of large financial institutions.
- Future branch consolidations may result from demographic trends and technology utilization.

Source: FDIC

Customer Preferences

Branch Trends - Northeast



	1994*	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total Branches	16,889	16,658	16,579	16,349	16,491	16,608	16,650	16,667	16,752	17,036	17,320	17,574	17,942	18,297	18,561	18,549	18,509	18,524
Savings Institutions	5,063	4,807	4,840	4,766	4,710	4,943	5,055	5,160	5,404	5,516	5,511	5,545	5,743	5,857	5,896	5,554	5,508	5,509
Commercial Banks	11,826	11,851	11,739	11,583	11,781	11,665	11,595	11,507	11,348	11,520	11,809	12,029	12,199	12,440	12,665	12,995	13,001	13,015
Total Institutions	1,442	1,356	1,297	1,273	1,237	1,212	1,217	1,200	1,169	1,143	1,106	1,093	1,106	1,106	1,081	1,060	1,042	1,027

Source: FDIC

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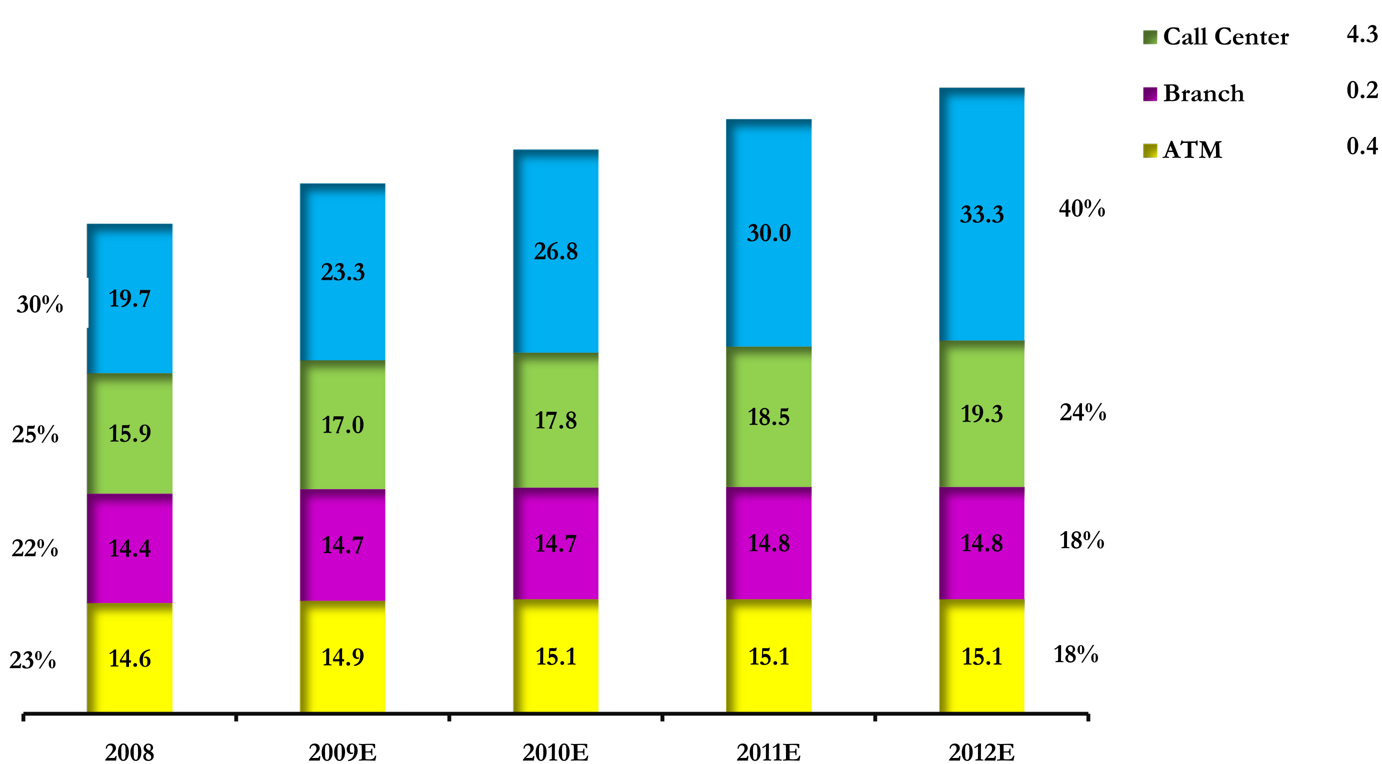
Customer Preferences

Delivery Channels

CAGR (08-12)
Percent

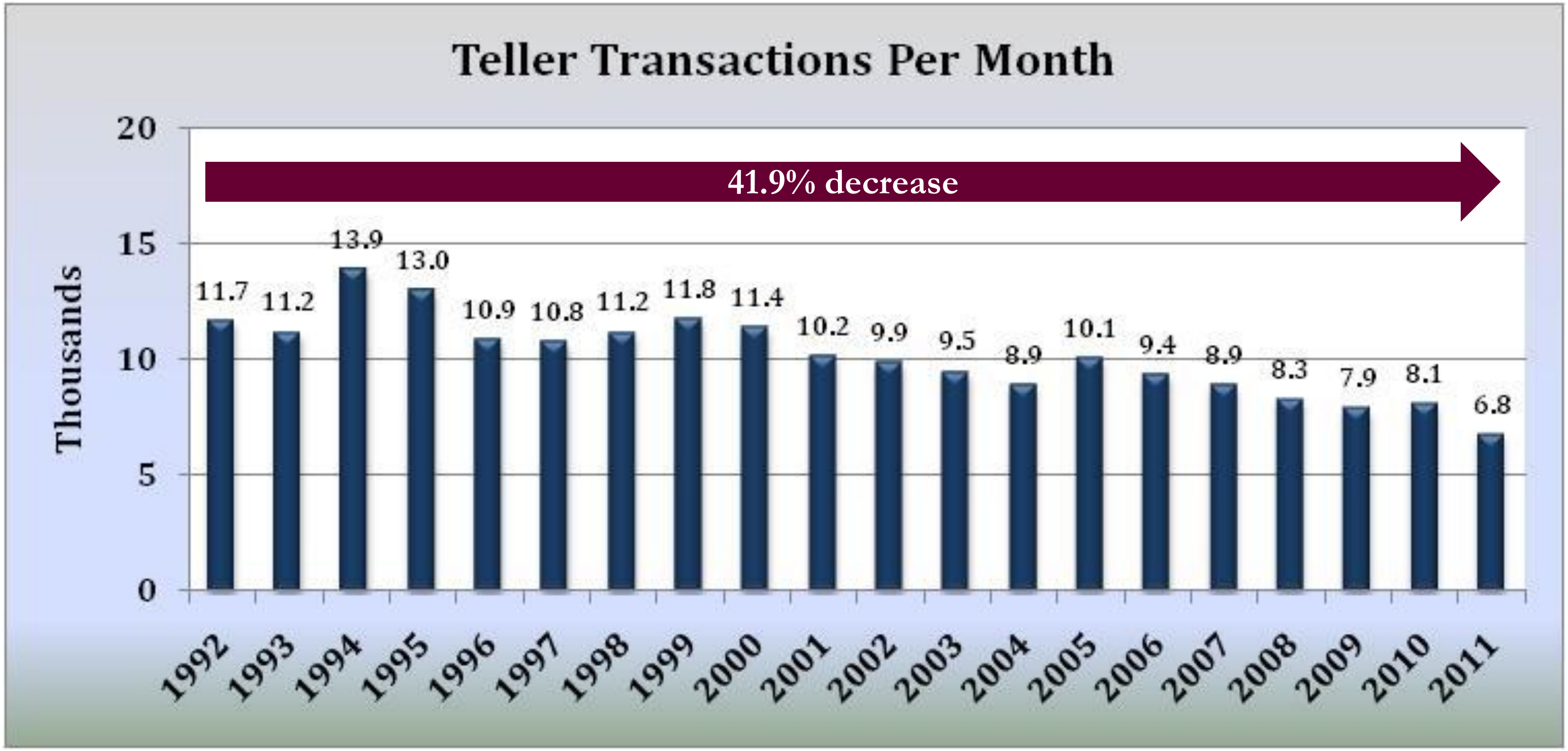
Banking Channels
Transactions (Billions)



Source: Tower Group: McKinsey analysis

Customer Preferences

Teller Transactions

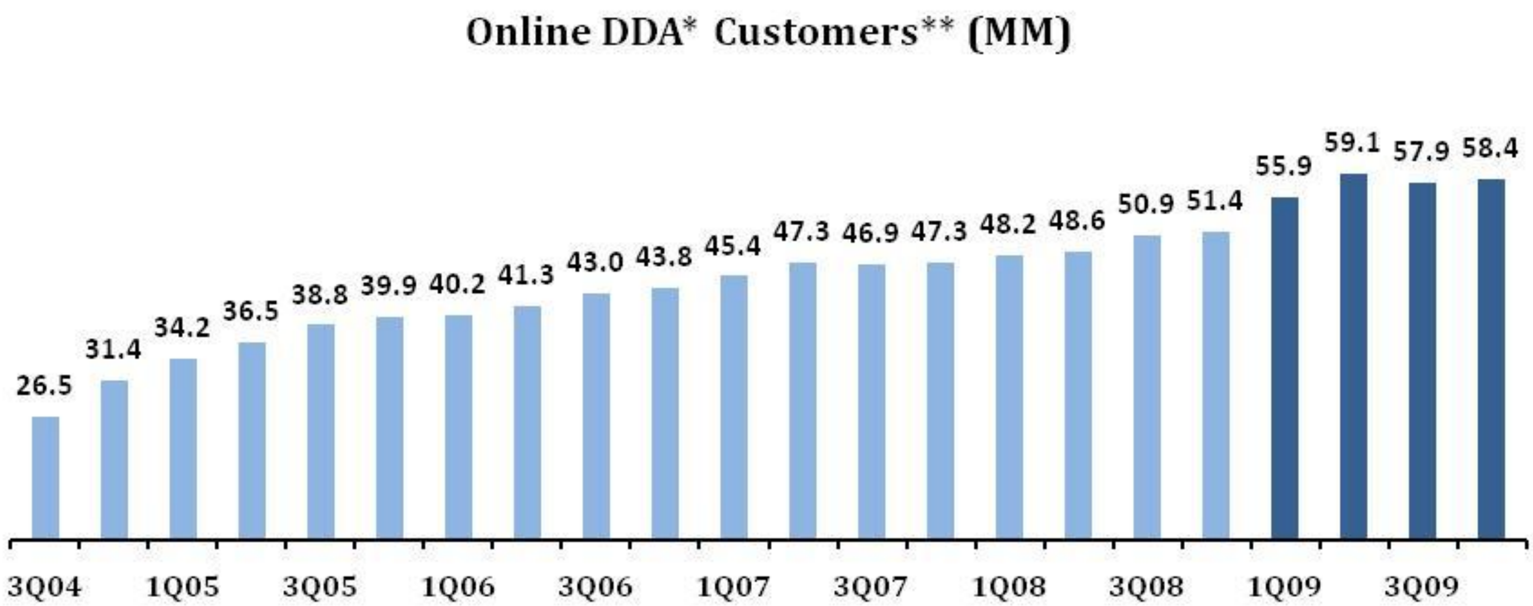


- Transaction volumes in branches are declining.
- Branching decisions will evolve around location, size, and staffing to maximize profit potential.

Source: Financial Management Solutions, Inc.

Technology Utilization

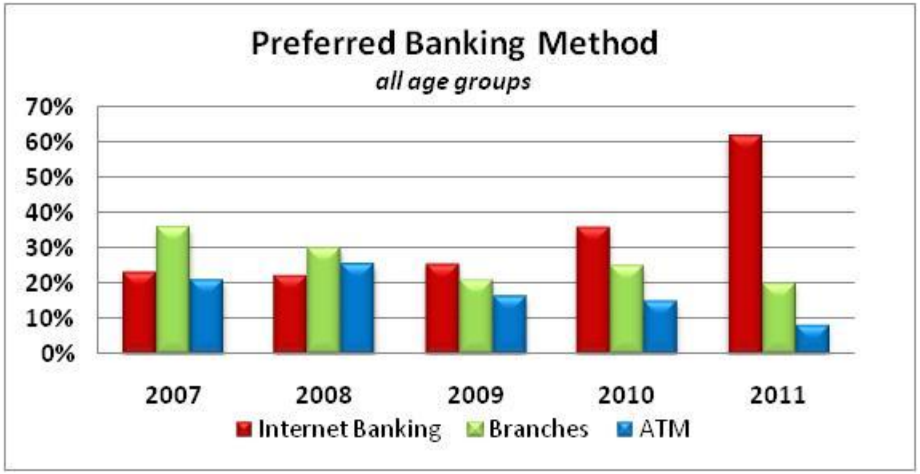
Online DDA Usage



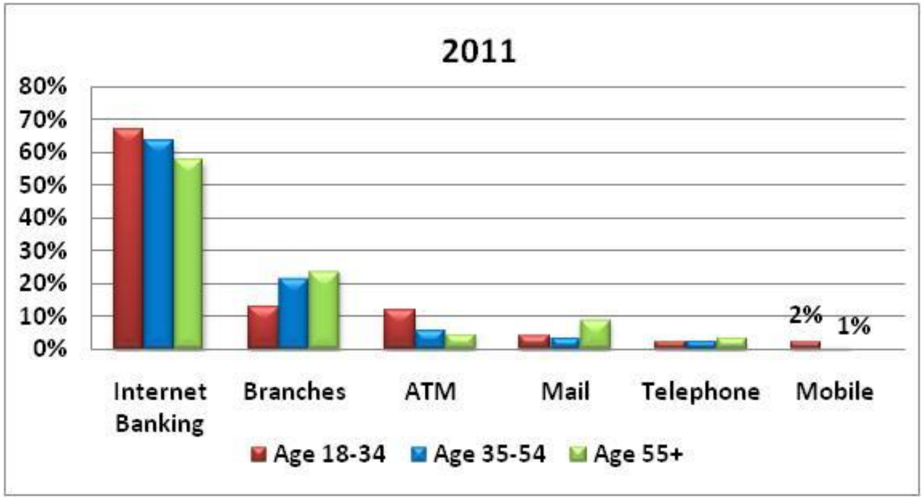
- Although online banking use has flattened, it doubled over a 5-year period.

Technology Utilization

Preferences



Among all consumers, the preference for online banking was followed by visiting branches and using ATMs.



Survey results showed that the popularity of online banking was not exclusive to the youngest consumers, it was the preferred banking method for all bank customers.

Source: ABA 2011 Banking Survey

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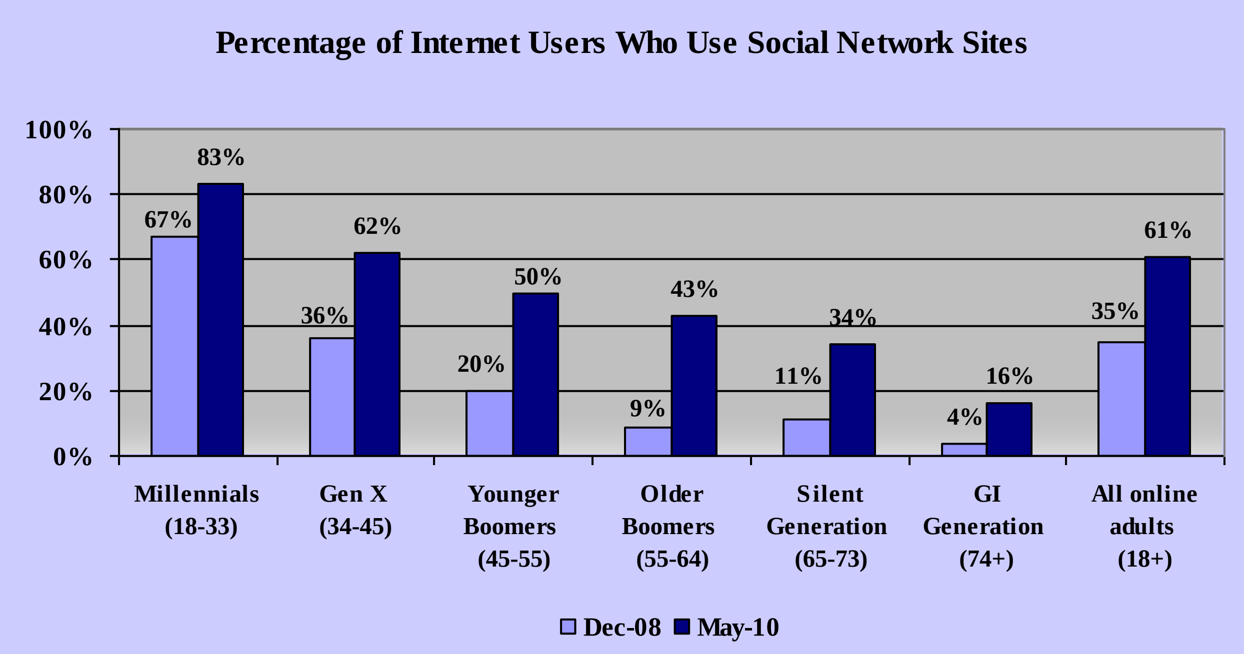
Technology Utilization

Online/Social Media

% of U.S. Adults Who Go Online						
Millennials (18-33)	Gen X (34-45)	Younger Boomers (45-55)	Older Boomers (55-64)	Silent Generation (65-73)	GI Generation (74+)	All online adults (18+)
95	86	81	76	58	30	79



Source: Pew Research Center's Internet & American Life Project

Too Small to Succeed?

Dodd-Frank Estimated Impact

	$1B Bank	$250MM Bank
Compliance Officer & Compliance Asst (est. sal + ben)	$138,000	$138,000
Software maintenance	25,000	25,000
Depreciation of software ($100,000 purchase over 3 years)	33,333	33,333
Increased legal work	15,000	15,000
Increased outsourced compliance	10,000	10,000
Estimated Operating Expense Increases	$221,333	$221,333
Decrease in net interest income*	$20,155	$9,804
Decrease in non-interest income***	$334,850	$101,700

*Pay 1% on 1/2 of business DDA, assumed to be 67% of all DDA**

**Per TKG 2Q10 peer group reports for commercial banks.

***Assumes deposit fee income as % of deposits falls from 40 bps of deposits** to 35 bps due to Durbin Amendment.

Too Small to Succeed?

Dodd-Frank Estimated Impact - $1B Bank

(dollars in thousands, except per share data)

	Balance Sheet:	**$1B Bank**	**Adjustments**	**Proforma**
1	Total Assets	964,757		964,757
	Income Statement:			
2	Net Income Available to Common	7,290	($375)	6,915
3	Net Interest Income	24,839	(20)	24,819
4	Non-interest Income	9,669	(335)	9,334
5	Operating Expense	24,627	221	24,848
6	Return on Average Assets (%)	0.76		0.72
7	Efficiency Ratio (%)	71.48		72.76
	Market Pricing:			
8	Diluted Earnings Per Share	1.22		1.15
9	Assumed P/E multiple (x)	14.00		14.00
10	Estimated Market Price	17.08		16.16
11	Estimated Stock Price Decline (%)			5.38
12	Cost savings for no dilution (% of Op. Exp.)			2.32

Too Small to Succeed?

Dodd-Frank Estimated Impact - $250MM Bank

(dollars in thousands, except per share data)

		$250MM Bank	Adjustments	Proforma
	Balance Sheet:			
1	Total Assets	236,072		236,072
	Income Statement:			
2	Net Income Available to Common	1,055	($216)	839
3	Net Interest Income	6,913	(10)	6,903
4	Non-interest Income	938	(102)	836
5	Operating Expense	6,277	221	6,498
6	Return on Average Assets (%)	0.49		0.38
7	Efficiency Ratio (%)	79.95		83.96
	Market Pricing:			
8	Diluted Earnings Per Share	0.37		0.30
9	Assumed P/E multiple (x)	14.00		14.00
10	Estimated Market Price	5.18		4.13
11	Estimated Stock Price Decline (%)			20.17
12	Cost savings for no dilution (% of Op. Exp.)			5.12

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Too Small to Succeed?

100 Most Profitable Bank

	For the Quarter Ended June 30, 2010							
	Total Assets ($000)	ROAA (%)	ROAE (%)	Net Interest Margin (%)	Non-int. Expense / AA (%)	Tang. Equity / Tang. Assets (%)	NPAs / Assets (%)	Reserves / NPAs (%)
(medians. All Fis by total assets)								
> $1 billion total assets (6)	5,113,938	2.72	24.26	4.57	2.67	9.43	1.87	67.02
$100 million - $1 billion (55)	235,638	2.40	21.94	4.61	2.60	10.42	0.59	119.92
< $100 million (39)	59,736	2.49	20.31	4.74	2.31	12.44	0.46	114.57

- Tested for all banks/thrifts with ROA's > 1.8% for previous four quarters (eliminated one-time gainers)
- Significant representation of small community banks in the elite performers.

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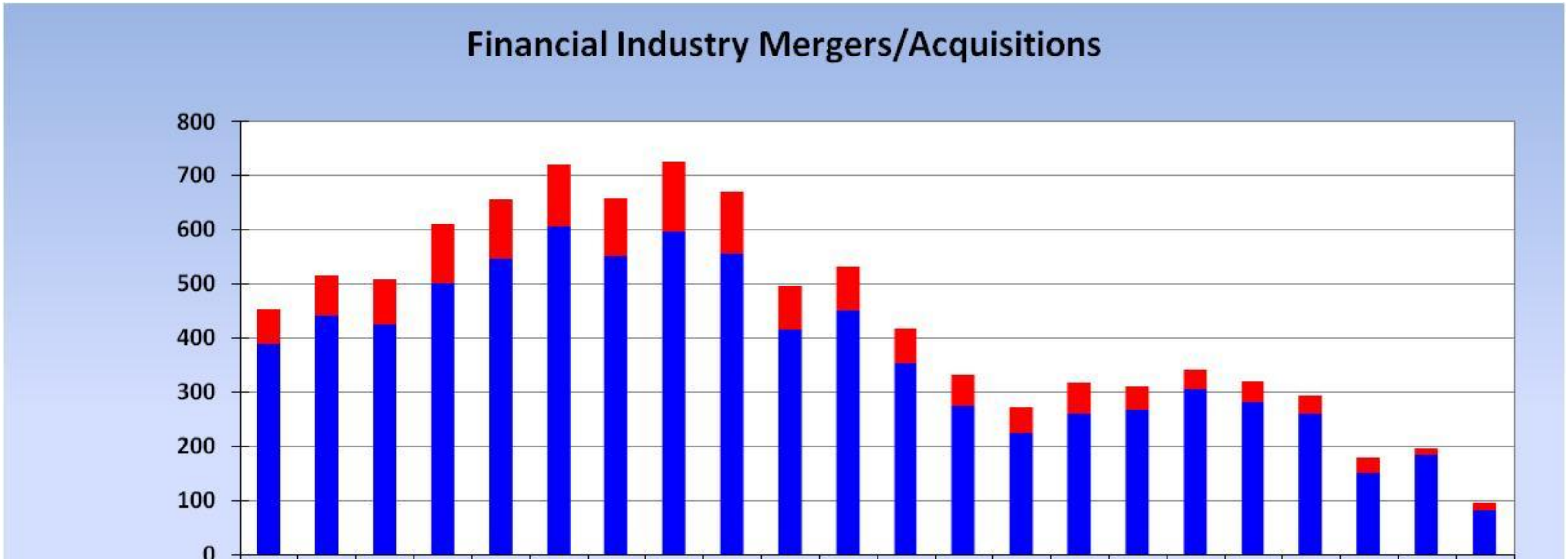
Financial Industry Mergers/Acquisitions

Trends



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	YTD Jun 11
Total Institutions	453	515	509	612	657	722	660	725	671	496	533	417	332	273	319	310	342	321	293	179	197	95
Savings Institutions	64	72	84	111	109	116	108	127	114	80	81	63	56	49	58	41	37	39	32	27	13	13
Commercial Banks	389	443	425	501	548	606	552	598	557	416	452	354	276	224	261	269	305	282	261	152	184	82

Source: FDIC

What Drives Franchise Value

Key Factors Affecting Stock Performance

- Financial condition and performance, both absolute and relative to peers, with a focus on Return on Equity (ROE)
- Perceived growth potential for earnings per share (EPS) and dividend
- Demographics of market area
- The market for bank stocks, especially peer institutions
- General stock market conditions

What Drives Franchise Value

What Drives "Franchise Value"

1. **Core Deposits**
2. **Sustained Financial Performance**
3. **Reputation and Brand Awareness**
4. **Geography and Geographic Coverage**
5. **Employees and Customer Relationships**
6. **Loan Quality and Diversity**
7. **Operating Efficiency**
8. **Effective and Efficient Use of Capital**
9. **Fee Based Lines of Business**
10. **Utilization of Technology**
11. **Other Specific Areas of Expertise**

What Drives Franchise Value

What Can You Control

1. **Sustained Financial Performance**
2. **The Other Drivers of Franchise Value**
3. **Preparation and Presentation of Investor Materials**
4. **Consistent Communication with Key Shareholders and Potential Shareholders**

What Drives Franchise Value

What Can't be Controlled

1. **The Local and National Economic Environment**
2. **Overall Stock Market Volatility**
3. **Banking Industry Volatility**
4. **Additional and Changing Regulatory Requirements**

Keys to Community Bank Success

1. **Need to be *relevant* to customers, communities and market area served**
2. **Need to maintain *credit quality* and credit standards for both the loan and investment portfolios**
3. **Need to develop an *enterprise-wide risk* management program**
4. **Need to *attract, develop and retain* the "right" employees, and properly plan for *succession***
5. **Need to provide customer *service* and *sales***
6. **Need to *manage* cost and operating efficiency**
7. **Need to understand *where* you do and don't make money**
8. **Need to focus on *safety and soundness* and *preserving capital***
9. **Need to define and develop a *Strategy/Strategic Direction* and start to *plan* for the opportunities that will become apparent and available as the markets begin to *recover***
10. **Need to *work* everyday**

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