

HARRIS COMMERCIAL BANK

How Major Trends Including the Dodd-Frank Act Impact the Optimization of Working Capital

Presented At Windy City Summit

May 18th, 2011

3:50-4:40 p.m.

By Mike Lipinski & Dave Robertson



Intro

- Dodd-Frank Impacts Recap:
 - FDIC; Mandatory coverage & asset based assessment
 - Reg Q Repeal; Interest-bearing Commercial Accounts vs ECR
 - Interchange Fees capped
 - Money Fund Reform
 - Derivatives; OTC swaps traded on exchanges, guaranteed by clearinghouses
- Other Non Dodd-Frank Working Capital Impacts
 - Tax Changes
 - Credit Availability & Bank Liquidity Requirements – Increased bank scrutiny
 - Stimulus & GDP
 - Unemployment
- Closing remarks



FDIC Changes

- Under proposed change banks will be charged insurance premiums based on net assets (total assets less tangible equity)
- FDIC has option to adjust rate as much as 15 basis points not to exceed 35 basis points, based on its own judgment of a bank's risk
- Temporary Unlimited Deposit Insurance non-interest bearing transaction accounts 2011-2012

Source: Initial and Total Base Assessment Rates FDIC 12 CFR part 327

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV	Large and Highly Complex Institutions
Initial Base Assessment rate	5-9	14	23	35	5-35
Unsecured debt adjustment	(4.5)-0	(5)-0	(5)-0	(5)-0	(5)-0
Brokered deposit adjustment	0-10	0-10	0-10	0-10
Total Base Assessment Rate	2.5-9	9-24	18-33	30-45	2.5-45



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Reg Q Repeal – ECR vs Interest Rate

- Banks will provide choice post July 2011
- Interest-bearing commercial accounts will trigger 1099INT for interest income earned throughout the year
- Interest-bearing commercial accounts for 2011-2012 will have limited FDIC coverage at \$250k

	DDA/non-interest bearing transaction account	MMDA	Corporate NOW	Money Market Mutual Fund Sweep	Eurodollar Sweep	Repo/MMDA Sweep	Interest-bearing transaction account	Fixed Income Investment	Separate Managed Portfolio
Cash Type	Operating	Reserve	Operating	Operating	Operating	Operating	Operating	Reserve, Restricted, Strategic	Reserve, Restricted, Strategic
Liquidity/Duration	daily	weekly	daily	daily to 90days	daily	daily	daily	daily to > 90 days +	90 days > 360 days +
FDIC Coverage	Unlimited	\$250,000 limit	\$250,000 limit	Unlimited on DDA portion- None on invested	Unlimited on DDA portion- None on invested	Unlimited on DDA portion- \$250k limit on interest portion	\$250,000 limit	None	None
Yield Type	ECR	Interest	Interest	Dividends	Interest	Interest	ECR/Interest	Interest/Cap gains/Divs	Interest/Cap gains/Divs
IRS	None	1099INT	1099INT	1099DIV	1099INT	1099INT	1099INT	1099DIV/INT & other	1099DIV/INT & other
Restrict	None	Limited to 6 disbursements /month	Limited to non-profit; sole proprietorships	Limits dictated by portfolio selected	Base amount required prior to sweep	Base amount required prior to sweep	None	Client Investment Policy/risk tolerance	Client Investment Policy/risk tolerance



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Interchange Fees



- VISA and MasterCard settlement with US Justice Department.
 - Merchants can offer discounts for preferred payment methods.
- Durbin amendment requirements must be implemented by April.
 - Fed draft proposal could reduce interchange by up to 70%.
 - Potential for reduced income from \$48B interchange revenue, leading to repositioning of card / debit rewards and products.



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Money Market Reform

- SEC 2a-7 reform requires funds to:
 - Take on less credit risk
 - Shorten maturities
 - Hold a higher percentage of fund assets in highly liquid instruments
- All of these factors lower yield.
- The President's Working Group is exploring further changes.
 - Funds could find it difficult to compete with bank deposits.



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Rising Commodity Prices

How sweet it isn't

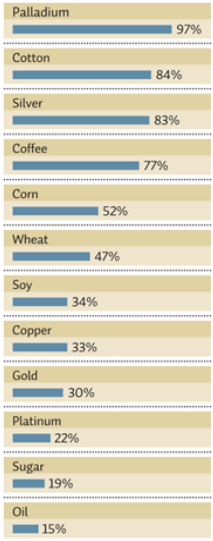
Corn, sugar prices soar



Source: Fortune.com 2/16/11

Price Shocks

Commodity price increases in 2010, by percentage.



Source: Oliver Wyman



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Rising Commodity Prices

Economy faces new threats

OIL'S ECONOMIC BITE



PHOTOS: THINKSTOCK. SOURCE: DEUTSCHE BANK

Source: CNN Money.com 2/24/11 By Chris Isidore, senior writer February 24, 2011: 4:02 PM ET



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Rising Commodity Prices

- Margins & Capital requirements on non-financial firms may spark a mass exodus of clients from U.S. banks based abroad, i.e., regulatory arbitrage
- By July 2011 the CFTC and SEC will have completed most new derivatives rules
- New derivatives rules could punish firms that pose no systemic risk
- SEC looking at end-user exemptions – utilities, manufacturing and agriculture - at how to trade derivatives to hedge risk without being subject to margin and capital demands imposed by Dodd-Frank
- The bipartisan debt commission recommendation to cut \$4T is to raise the gas tax by 15 cents/gallon



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Tax Changes Impacting Working Capital

- **Illinois**
 - Corporate rate raised from 7.3% to 9.5%... **30% increase**
 - Individual rate raised from 3% to 5% ... **67% increase**
 - Online sales tax collection impacts not only individuals but eCommerce as well, taxing affiliates of web-based entities domiciled in the state
- **Section 179**
 - Write-off full amount of purchases of qualifying equipment or computer software made in 2010 or 2011 up to \$500,000 per business per year (buildings are excluded)
- **General Business Credits**
 - 2010 general business credits are allowable under AMT
- **Repeal 1099 Reporting All Supply Purchases > \$600 / Vendor**
 - Section 9006 of Health Care Reform Act requiring businesses to report all purchases at this low level; Intent was to raise \$19B to pay for healthcare reform
- **Extension of Bush Tax cuts**



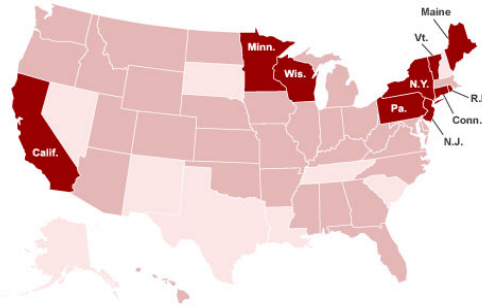
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Tax Changes Impacting Working Capital

Tax burden falls for first time in decade

STATES WITH THE WORST TAX BURDENS



New Jersey	12.2%	California	10.6%
New York	12.1	Minnesota	10.3
Connecticut	12.0	Vermont	10.2
Wisconsin	11.0	Maine	10.1
Rhode Island	10.7	Pennsylvania	10.1

SOURCE: TAX FOUNDATION STUDY BASED ON 2009 DATA

Source: CNN Money.com 2/24/11



State & Local Tax Burdens

Source: Tax Foundation calculations based on data from the Bureau of Economic Analysis, the Census Bureau, the Council on State Taxation, the Travel Industry Association, Department of Energy, and others.

State-Local Tax Burdens, All States 2009

State	Rate	Rank (1 is highest)	Total State and Local Per Capita	Per Capita Income
United States	9.80%	-	\$4,160	\$42,539
Alabama	8.50%	40	\$2,967	\$34,911
Alaska	6.30%	50	\$2,973	\$46,841
Arizona	8.70%	38	\$3,140	\$36,228
Arkansas	9.90%	14	\$3,281	\$33,238
California	10.60%	6	\$4,910	\$46,366
Colorado	8.60%	39	\$4,011	\$46,716
Connecticut	12.00%	3	\$7,256	\$60,310
Delaware	9.60%	23	\$4,091	\$42,688
Florida	9.20%	31	\$3,897	\$42,146
Georgia	9.10%	32	\$3,350	\$36,738
Hawaii	9.60%	22	\$4,399	\$45,725
Idaho	9.40%	28	\$3,276	\$34,973
Illinois	10.00%	13	\$4,596	\$46,079
Indiana	9.50%	25	\$3,396	\$35,767
Iowa	9.50%	24	\$3,688	\$38,688
Kansas	9.70%	19	\$3,911	\$40,302
Kentucky	9.30%	30	\$3,059	\$32,959
Louisiana	8.20%	42	\$3,037	\$37,109
Maine	10.10%	9	\$3,832	\$37,835
Maryland	10.00%	12	\$5,218	\$52,130
Massachusetts	10.00%	11	\$5,316	\$53,029
Michigan	9.70%	21	\$3,565	\$36,880
Minnesota	10.30%	7	\$4,651	\$45,220
Mississippi	8.70%	36	\$2,878	\$30,689
Missouri	9.00%	34	\$3,425	\$37,853
Montana	8.70%	35	\$3,216	\$36,784

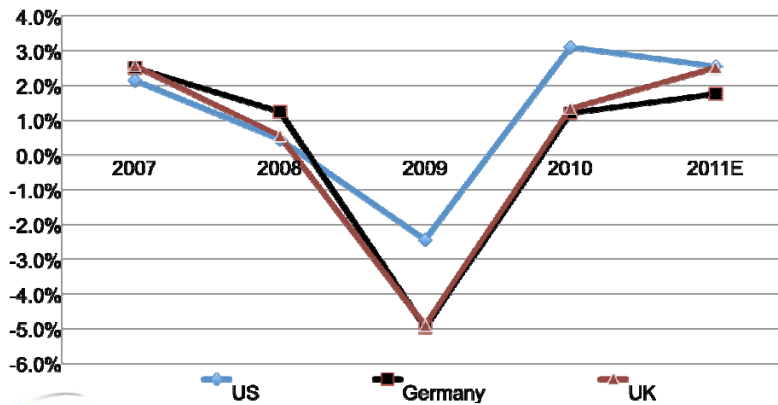
State-Local Tax Burdens, All States 2009

State	Rate	Rank (1 is highest)	Total State and Local Per Capita	Per Capita Income
Nebraska	9.80%	15	\$3,960	\$40,349
Nevada	7.50%	49	\$3,311	\$44,241
New Hampshire	8.00%	44	\$3,765	\$46,828
New Jersey	12.20%	1	\$6,751	\$55,303
New Mexico	8.40%	41	\$2,997	\$35,780
New York	12.10%	2	\$6,157	\$51,055
North Carolina	9.80%	16	\$3,583	\$36,650
North Dakota	9.50%	26	\$3,892	\$41,088
Ohio	9.70%	18	\$3,652	\$37,600
Oklahoma	8.70%	37	\$3,259	\$37,464
Oregon	9.80%	17	\$3,761	\$38,527
Pennsylvania	10.10%	10	\$4,190	\$41,672
Rhode Island	10.70%	5	\$4,647	\$43,372
South Carolina	8.10%	43	\$2,742	\$33,954
South Dakota	7.60%	48	\$3,042	\$40,082
Tennessee	7.60%	47	\$2,752	\$36,157
Texas	7.90%	45	\$3,197	\$40,498
Utah	9.70%	20	\$3,349	\$34,596
Vermont	10.20%	8	\$4,181	\$41,061
Virginia	9.10%	33	\$4,392	\$48,210
Washington	9.30%	29	\$4,408	\$47,361
West Virginia	9.40%	27	\$3,034	\$32,560
Wisconsin	11.00%	4	\$4,427	\$40,321
Wyoming	7.80%	46	\$4,205	\$53,931
District of Columbia	9.60%		\$6,076	\$63,492



Stimulus

- GDP growth has recovered due to the stimulus, but uncertainty remains around the magnitude and sustainability of the recovery.



Treasury Strategies
The Power of Experience™

Source: IMF

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Stimulus – Where do we go from here?

- Higher interest rates
- Increased loan demand to fund working capital / capital expenditures
- Access to credit key buying behavior for business
- Decline in business cash leads to greater bank competition for deposits
- Continued low rates
- Low loan demand due to modest working capital and limited investment in growth
- Weak competition for deposits
- Access to credit key to those firms that need it; relationship and fees critical to remainder



Treasury Strategies
The Power of Experience™

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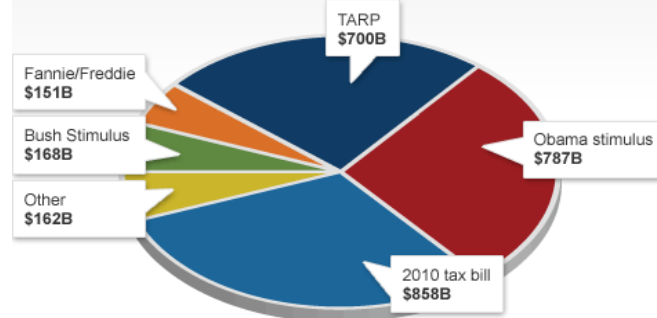
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Tax Changes Impacting Working Capital

[America's Debt Crisis](#)

Stimulus price tag: \$2.8 trillion

A TRILLION HERE, A TRILLION THERE



Source: CNN Money.com 12/20/10 By Chris Isidore, senior writer December 20, 2010: 1:34 PM ET

SOURCE: CBO



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Credit Availability & Bank Liquidity

- Regulators are requiring banks to hold greater capital and to manage liquidity risk more aggressively.
 - Businesses may face higher fees for credit commitments
 - Banks may restructure deposits to increase stability of deposits - caps, fixed maturities
 - Cost of collateralizing deposits will likely rise



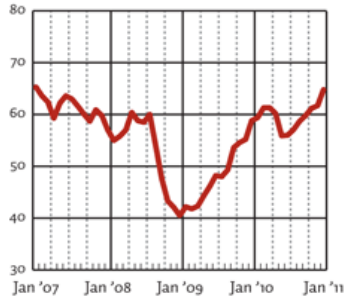
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Credit Availability...Easier Credit Extended by Suppliers

EASIER ACCESS

The amount of credit extended by suppliers to their trade customers has reached its highest level since January 2007.



Source: National Association of Credit Management's Credit Managers' Index



Source: CFO.com 2/7/11

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- Large companies that have access to the capital markets are issuing debt at incredibly low rates and doing their own balance sheet cleaning
 - These players are now sitting on more than \$1 trillion in cash
- Small businesses do not have easy access to the capital markets to issue debt
 - These players are getting access to loans that they need from the banks
 - Materially impact the economy, i.e. account for >60% of employment in the U.S.
- Focusing on Small Business & Middle Markets
 - Bank of America announced hiring 1,000 small business bankers to be added in Dallas, Los Angeles, Baltimore and Washington DC, hitting the Chicago market in 4th Qtr 2011
- Focusing on Mid-Market companies
 - Mid-market companies needing capital may not have to look much farther than a large regional bank, banks such as Wells Fargo, U.S. Bankcorp and PNC Financial Services according to CreditSights.



Economic Review & Jobs

Fed predicts weak recovery for several years

FED'S ECONOMIC OUTLOOK

	2010	2011	2012	2013
GDP	2.4 to 2.5	3.0 to 3.6	3.6 to 4.5	3.5 to 4.6
Unemployment	9.5 to 9.7	8.9 to 9.1	7.7 to 8.2	6.9 to 7.4
Inflation	1.2 to 1.4	1.1 to 1.7	1.1 to 1.8	1.2 to 2.0

SOURCE: FEDERAL RESERVE

Source: CNN Money.com 11/23/10 By Chris Isidore, senior writer November 23, 2010: 4:13 PM ET



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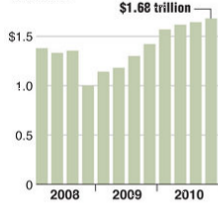
Unemployment Forecast

What gives?

U.S. corporations are rebounding nicely from the 2008 financial crisis, but the overall picture for workers is not pretty.

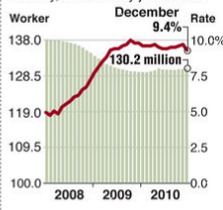
Corporate profits have been rising steadily ...

Profits quarterly since 2008, in trillions



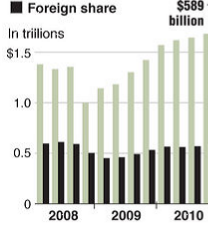
While unemployment remains high

Number of workers, in millions, monthly, and monthly jobless rate



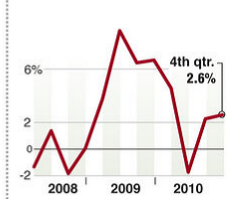
But a growing share of profits comes from foreign subsidiaries ...

In trillions



... and state-side companies are doing more with fewer workers

Quarterly percent change in output per hour (productivity), at an annual rate



Source: By Kevin G. Hall | McClatchy Newspapers
http://www.mcclatchydc.com/2011/03/27/

Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics
Graphic: Pat Carr © 2011 MCT



Unemployment Forecast



President Ronald Reagan and Vice President George H. Bush in January 1983, when the unemployment rate fell to 10.4 percent from 10.8 percent, the first decline that large in five years.

LARGEST ONE-MONTH DECLINES IN U.S. UNEMPLOYMENT RATE, 1965-2010

MONTH	PERCENTAGE POINT CHANGE	CHANGE OVER NEXT 12 MONTHS	LEVEL
Mar. 1965	-0.4	-0.9	4.7%
Dec. 1977	-0.4	-0.4	6.4
Jan. 1983	-0.4	-2.4	10.4
Jul. 1983	-0.7	-1.9	9.4
Oct. 1983	-0.4	-1.4	8.8
Aug. 1996	-0.4	-0.3	5.1
Apr. 1998	-0.4	0.0	4.3
Dec. 2010	-0.4		9.4

Source: Bureau of Labor Statistics, via Haver Analytics

Source: The New York Times 2/3/11

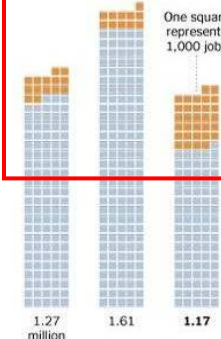


Keeping It Temporary

The portion of temporary workers hired by private-sector employers in the past year has been higher than in previous economic recoveries.

Share of temporary workers added during three economic recoveries

Period	Share (%)
Feb. '92-Jan. '93	11%
Jul. '03-Jun. '04	7%
Dec. '09-Nov. '10	26%



Source: Bureau of Labor Statistics



Closing

- **Key takeaways**
 - **FDIC shifting risk to banks with the largest assets**
 - **Banks will provide choice of interest-bearing commercial operation accounts**
 - **Interchange Fees**
 - **Derivatives use could get costly with the mandate of exchange traded deals guaranteed by clearinghouses**
 - **Federal, State & Local Tax impact**
 - **Increased Bank Scrutiny impacts credit availability**
 - **Stimulus & GDP**
 - **Temp Employment strategy**



Appendix / Research Sources For Further Reading

- **CNN Money and Fortune.com**
 - *How Sweet it Isn't, Corn, sugar prices soar*, 2/16/11 Source:
 - *Oil tops \$106 a barrel*, 3/7/2011
 - *Economy faces new threats, Oil's Economic Bite*, Photos: Thinkstock; Source: Deutsche Bank
 - *Gas prices high-and might get higher*, 1/2/11, Source: EIA
 - *The Big Divide in Global Inflation*, 2/14/11, By James C. Cooper, Source: The Fiscal Times
 - *States with the Worst Tax Burdens*, 2/24/11, Tax burden falls for the first time in decade, Source: Tax Foundation Study Based on 2009 Data
 - *State & Local Tax Burdens, All States, 2009*, 2/24/11, Source: Tax Foundation calculations based on data from the Bureau of Economic Analysis, The Census Bureau, The Council on State Taxation, the Travel Industry Association, the Department of Energy and others
 - *Tax cut deal and surprise stimulus-the cost*, 12/8/10
 - *America's Debt Crisis, Stimulus price tag \$2.8 trillion*, 12/21/10, Source: CBO
 - *Fed predicts weak recovery for several years, Fed's Economic Outlook*, 11/23/10, Source: Federal Reserve
 - *Growth to improve, Housing? Jobs? Not so much*, 12/22/10, Source: CNNMoney.com Survey of Economists
 - *Unemployment Rate*, 1/6/11; Source
 - *Small businesses ramp up jobs*, 3/7/11, Source: ADP
 - *January jobs report disappoints*, 2/4/11, Source: Seasonally Adjusted, Labor Department
- **CFO.com**
 - *Easier Access, The amount of credit extended by suppliers to their trade customers has reached its highest level since January 2007*, 2/7/11, Source: National Association of Credit Management's Credit Managers' Index.
- **FDIC.gov**
 - *Initial and Total Base Assessment Rates FDIC 12 CFR part 327*
- **Los Angeles Times**
 - *Jobless Claims Down, First-time claims for unemployment benefits seasonally adjusted*, Mark Hafer, Los Angeles Times, 3/3/11, Source: U.S. Department of Labor
- **Oliver Wyman**
 - *Price Shocks: Commodity price increases in 2010, by percentage*
- **The Atlantic**
 - *Quarterly Gross Domestic Product Growth*, 2/28/11, Source: Bureau of Economic Analysis
- **The New York Times**
 - *Most Regions Experience Modest Growth*, 3/3/11, Source: Fed's Beige Book info collected before 2/18/11
 - *Largest One-Month Declines in U.S. Unemployment Rate 1985-2010*, 2/3/11, Source: Bureau of Labor Statistics via Haver Analytics
 - *Keeping It Temporary, Net Private Sector Jobs Added*, Source: Bureau of Labor Statistics
- **TrendMacro.com/fed/**
 - *Fed Watch - Factors Affecting Reserve Balances from report H.4.1*, 2/22/11
 - *CBO's Fed Funds Futures, CME Eurodollar Futures Changes in LIBOR*, 2/22/11
- **Wall Street Journal**
 - *A Striking Pie, Money fund assets*, 1/1/11, Source: iMoneyNet