



# SR003\_7: Failed Bank Report

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## Meridian Bank

308 Locust  
Eldred, IL 62027

(10/12/1910 – 10/10/2008)

# Report Objective

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This report has **two** objectives, using the bank's **data**\*

1. To examine the bank finances in the quarters prior to its failure.
2. To analyze the bank finances using our Key Performance Indicator (KPI) scoring approach to determine if the bank's failure is something we could have predicted.

\*Data source: FDIC and company filings.

# Bank Background

<b>FDIC Certificate #</b>	<b>13789</b>
<b>Bank Charter Class</b>	Federal Reserve Non-Member
<b>Asset Concentration</b>	Commercial Lending Specialization
<b>Product Specialty</b>	Commercial Banking Services, Personal Loans and Small Business Lending Services
<b>Number of Branches</b>	5 (as of September 30, 2008)
<b>Number of Employees</b>	31 (as of September 30, 2008)

<b>Executives</b>	
<b>CEO/President</b>	Brad S. Rench

# What took place?

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**M**eridian Bank, Eldred, Illinois was closed by the Department of Financial and Professional Regulation of the Illinois Division of Banking on October 10<sup>th</sup>, 2008. The Federal Deposit Insurance Corporation (FDIC) was named Receiver. The estimated cost to the FDIC Deposit Insurance Fund is \$14,500,000, compared to the average cost of \$389,206,944. National bank of Hillsboro, Illinois acquired all deposits and some assets.

# Bank Financial Snapshot

Financial Data Overlay (thousands)			
	2007 Q3	2008 Q3	Percentage Change
<b>Assets</b>	\$ 48,504	\$ 38,223	↓ 21.2%
<b>Liabilities</b>	\$ 44,141	\$ 36,345	↓ 17.7%
<b>Net Income</b>	-\$ 630	-\$ 2,219	↓ 252%

- The average net income change for all FDIC banks was -66.92% in the same period.
- The average net income change for all the commercial lending specialization banks was -73.88% in the same period.
- Compared with the whole industry and other commercial lending specialization banks, Meridian Bank's decline from Net Income is relatively large (-252%) during 2008.

# Key Performance Indicators


KPI Summary for 2008 Q3	
Normalized Income Rating	Very Poor
Delinquent Asset Rating	Poor
Asset: Liability Rating	Very Poor
Real Estate Asset Rating*	Moderate
Bankability Composite Score	-0.26** (Very Poor)

Possible ratings: *Excellent, Good, Moderate, Poor, Very Poor.*

\*This rating is relevant to the current “financial crisis” fueled by mortgage security backed loans.


\*\*This is out of 100.

# Normalized Income Analysis

	2007Q2	2007Q3	2007Q4	2008Q1 	2008Q2	2008Q3
Normalized Income	-0.33%	-0.38%	-0.50%	-1.49%	-0.31%	-3.60%
SD's from Average*	-1.32	-1.41	-0.821	-3.19	-0.523	-4.32
Ranking	Poor	Poor	Moderate	Very Poor	Moderate	Very Poor

- Meridian Bank had a normalized income of -3.60% in the third quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average normalized income of -0.06%. The standard deviation of the normalized incomes was 0.82%, which means that Meridian Bank was 4.32 SD's below the average.


\*Average of banks of the same asset concentration hierarchy

 Indicates sign of bank in financial distress

# Delinquent Asset Analysis

	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3 
Delinquent Asset	2.8647%	2.0250%	3.9020%	1.3210%	3.0934%	4.1640%
SD's from Average*	1.22	0.51	1.49	-0.11	0.91	1.39
Ranking	Poor	Moderate	Poor	Good	Poor	Poor

- Meridian Bank had a delinquent assets out of total assets ratio 4.16% in the third quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (commercial lending specialization) had an average delinquent asset of 1.4993%. The standard deviation of the delinquent assets was 1.9%, which means that Meridian Bank was about 1.4 SD's above the average.
- Since the second quarter of 2007, Meridian Bank's delinquent assets ratio has been unstable and fluctuating around the average. However, after the second quarter of 2008, delinquent asset ratio has been increasing into a poor condition.

\*Average of banks of the same asset concentration hierarchy  
 Indicates sign of bank in financial distress

# Real Estate Loan Asset Analysis

	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3
Real Estate Loan Asset Ratio	35.63%	35.32%	33.73%	42.14%	44.42%	50.00%
SD's from Average*	-1.28	-1.31	-1.43	-0.89	-0.79	-0.45
Ranking	Excellent	Excellent	Excellent	Good	Good	Moderate

- Meridian Bank had a 50.00% of R/A ratio in 08 Q3, the quarter before it failed.
- In 08 Q3, banks of the same asset concentration hierarchy (commercial lending specialization) had an average R/A ratio of 56.74%. The standard deviation of the R/A ratio was 14.82%, which means that Meridian Bank was 0.45 SD's below the average.


\*Average of banks of the same asset concentration hierarchy

# Asset: Liability Analysis

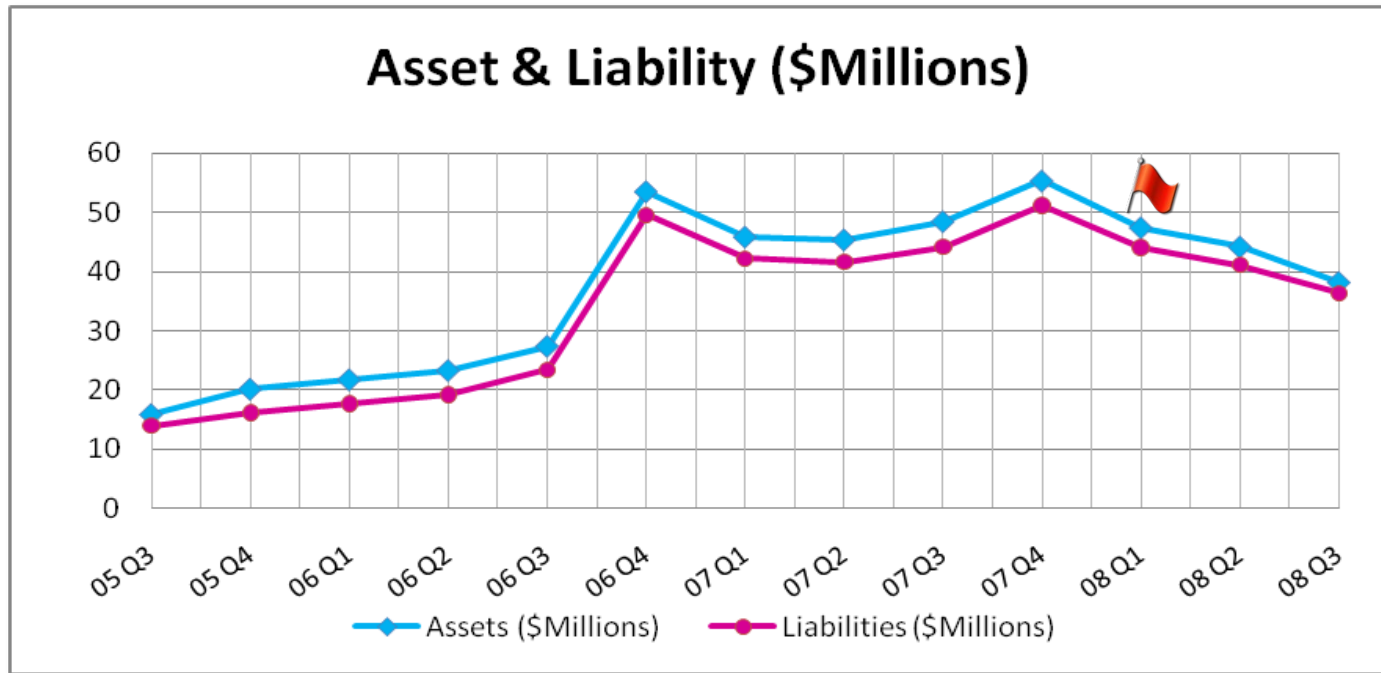
	2007Q2	2007Q3	2007Q4	2008Q1 	2008Q2	2008Q3
Asset: Liability Ratio	109.16%	109.88%	108.13%	107.78%	107.58%	105.17%
Median A/L Ratio*	110.74%	110.97%	110.95%	110.93%	110.69%	110.65%
Ranking	Poor	Moderate	Poor	Poor	Poor	Very Poor

- Meridian Bank experienced decreasing A/L ratio since 07 Q4.
- The bank fell into the worst ranking in 08 Q3.
- Of the banks failed in 08 Q4, 83.33% of them had an A/L ratio under 107%.

\*Average of banks of the same asset concentration hierarchy

 Indicates sign of bank in financial distress

# Asset & Liability History

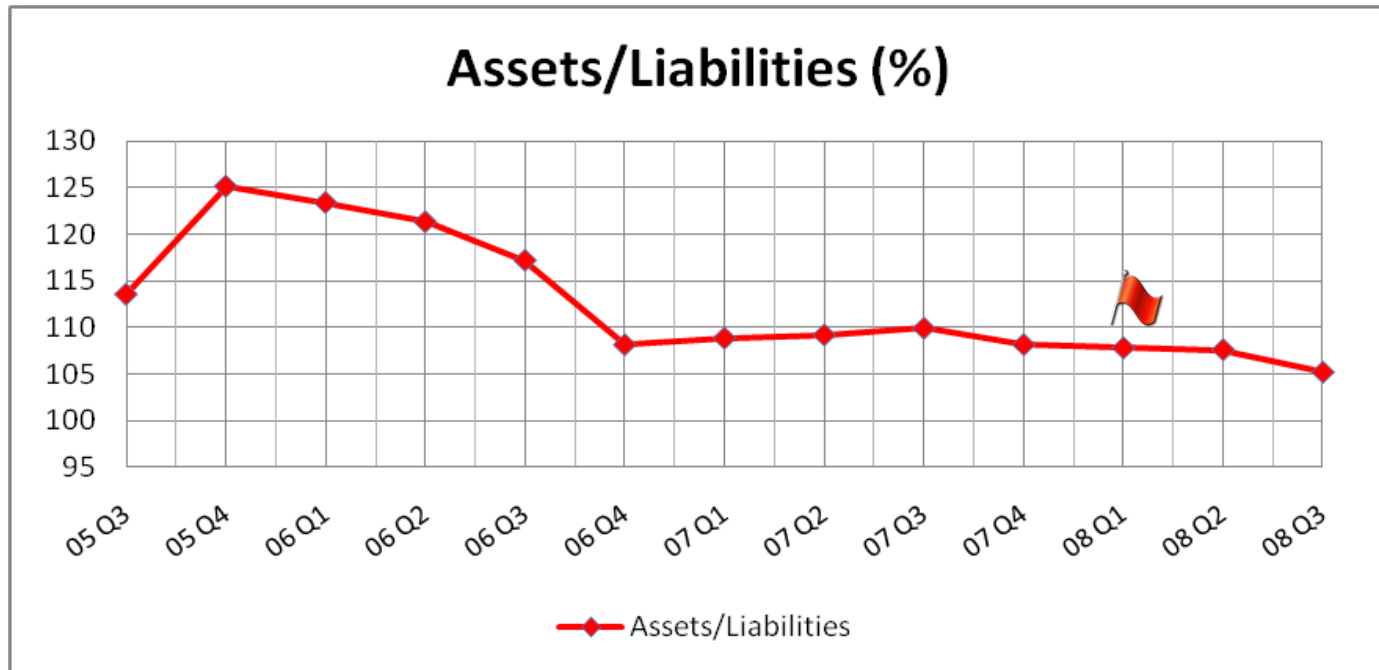


- The difference between asset and liability was getting closer in 08 Q3.



Indicates sign of bank in financial distress

# Asset/Liability History

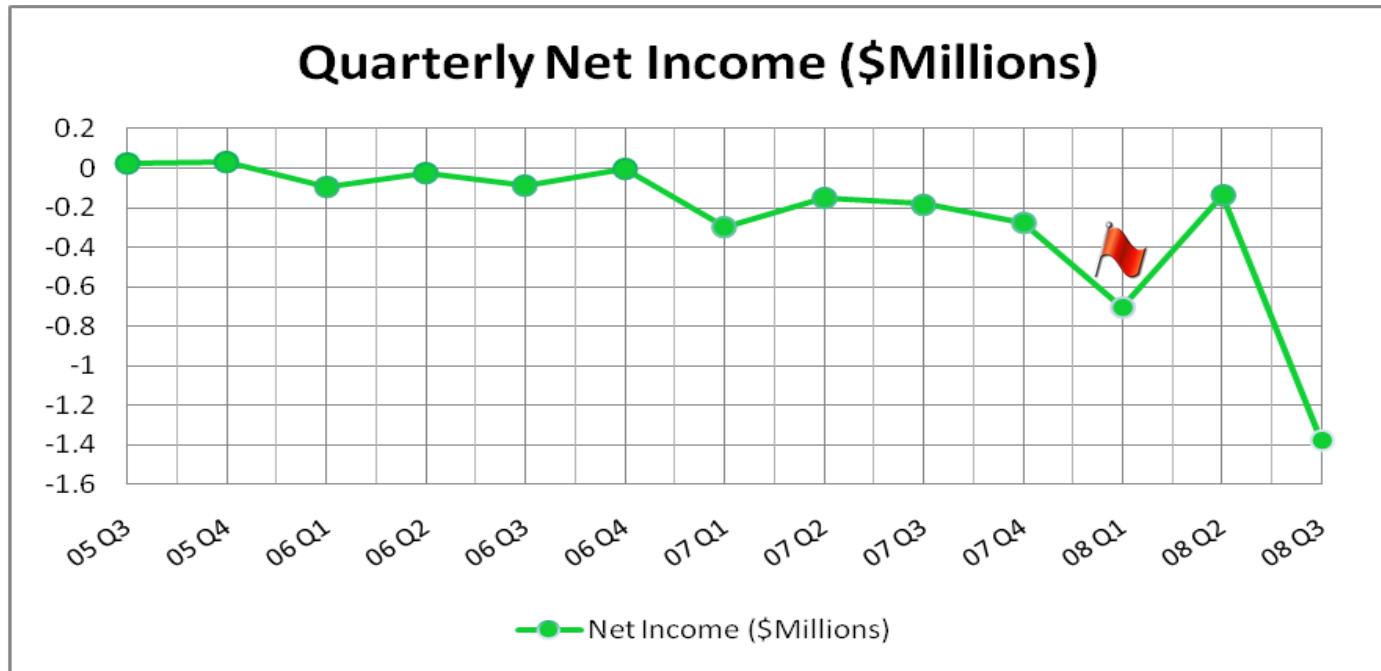


- From 05 Q4 to 06 Q4, Meridian Bank's A/L ratio dropped nearly 20%.




Indicates sign of bank in financial distress

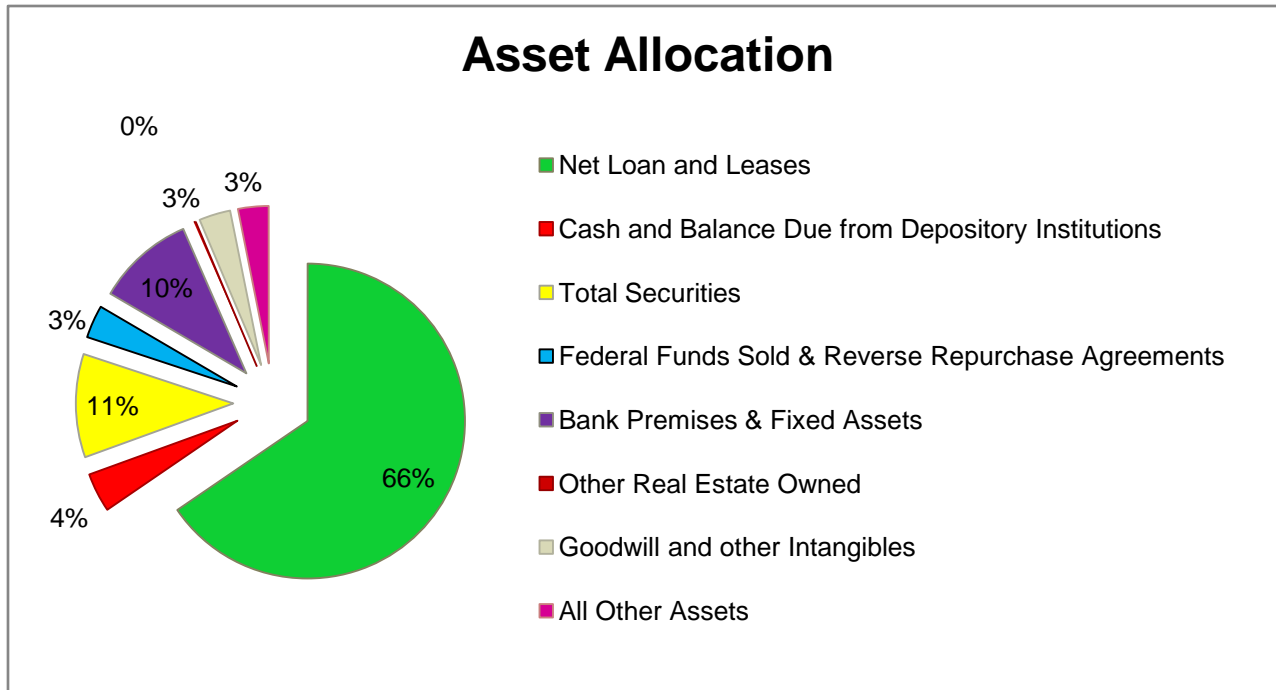
# Net Income History



- The bank recorded a big loss in the last quarter prior to failure.
- The bank reported losses since 07 Q1.

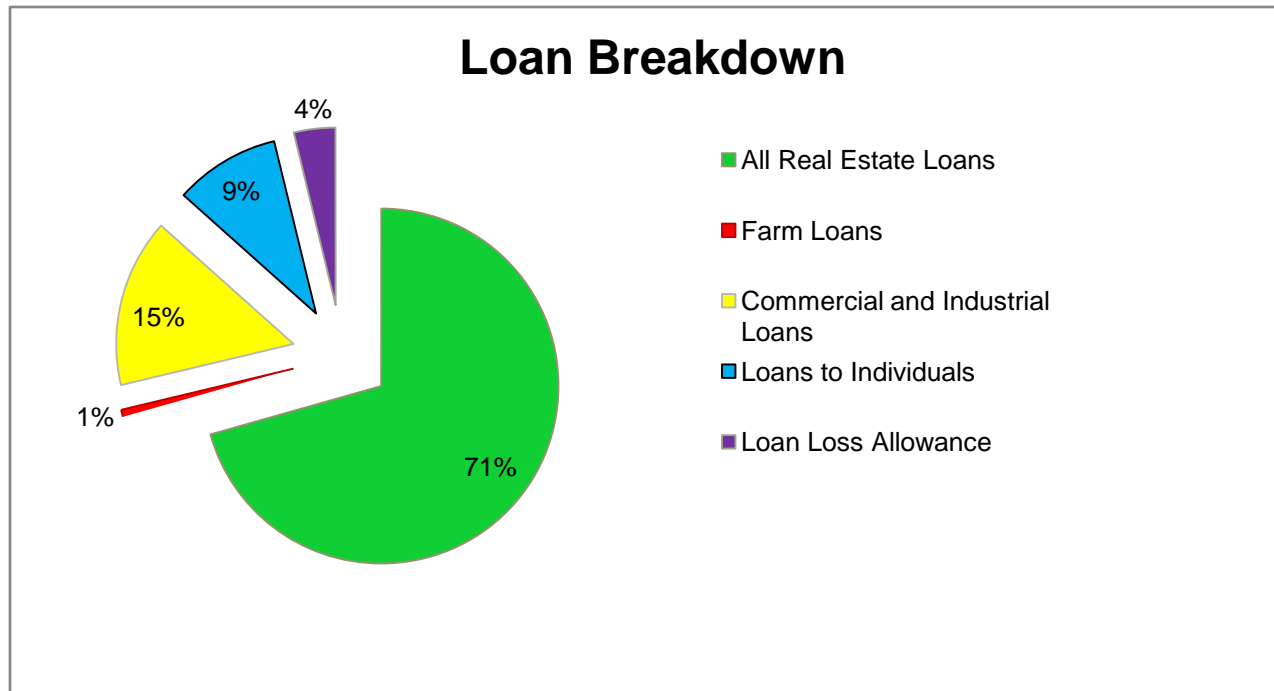
 Indicates sign of bank in financial distress

# Asset Allocation



- The average percentage of Net Loans for banks of the same Asset Concentration Hierarchy in the third quarter of 2008 was 72.85%.
- The average Net Loan percentage of all banks in the third quarter of 2008 was 66.63%.

# Loan Breakdown



- The average percentage of Real Estate Loans for banks of the same Asset Concentration Hierarchy in the third quarter of 2008 was 76.31%.
- The average percentage for all banks in the third quarter of 2008 was 70.99%.

# Events Timeline

- Mar. 4, 08** - SEC voted to disclose information for the secondary market ETF investors in Form N-1A.
- Mar. 7, 08** - The Fed will initiate a series of term repurchase transactions that are expected to cumulate to \$100 billion.
- Mar. 19, 08** - Fannie Mae and Freddie Mac is expected to provide support to the U.S. mortgage market, up to \$200 billion immediate liquidity.
- May 23, 08** - Meridian Bank lost \$14.1 million in the 1Q, a 207% drop from net income of \$13.1 million for the same period last year.
- May 23, 08** - Meridian Bank reported 9.9% of its total loans were more than 90 days overdue at the end of 2007.
- May 23, 08** - Meridian boosted its loan-loss reserves by nearly \$4.5 million.
- May 29, 08** - U.S.-Canada mutual recognition arrangement: U.S. Securities markets and certain U.S. financial service firms could gain greater freedom to operate in Canada under SEC.
- June 10, 08** - FDIC releases a supervisory letter to all banks on interest reserves that examines the risks that this underwriting practice presents.
- June 11, 08** - SEC voted on a comprehensive series of credit rating agency reforms to bring increased transparency to credit rating process.
- June 17, 08** - New HOPE NOW guidelines to deal with issues surrounding second mortgages and short sales.
- June. 26, 08** - FDIC adopts Basel II-Based Standardized Approach as an alternative risk-based capital framework available to all banks except the largest and most complex banks

# Events Timeline

- June. 26, 08** - FRS, FDIC, and OCC issued the host state loan-to-deposit ratios, which help indicate branches outside of the home state that were established or acquired for the purpose of deposit production.
- Jul. 13, 08** - Paulson Announces a three-part plan for GSEs: a temporary increase in the line of credit, a temporary authority for Treasury to purchase equity, and an advisory role is given to the Fed.
- Jul. 18, 08** - Scottsdale's Meridian Bank gets \$50 million in capital and has moved \$100 million in underperforming assets off its books.
- Jul. 21, 08** - Scottsdale's Meridian Bank reports that it lost \$42.8 million in 2Q.
- Aug. 20, 08** - FDIC's implementation in Loan Modification Program will help to modify troubled IndyMac mortgages loans.
- Sept. 17, 08** - SEC clarified that bank support of money market mutual funds generally are not required to present the fund on-balance sheet, but disclosure of the nature of the support provided is expected.
- Sept. 18, 08** - SEC requires that certain institutional money managers report their new short sales of certain publicly traded securities.
- Sept. 19, 08** - SEC prohibited short selling in 779 financial institutions.
- Sept. 20, 08** - Treasury Secretary Hank Paulson releases \$700 billion proposal to purchase troubled mortgage-related assets.
- Oct. 7, 08** - Emergency Economic Stabilization Act of 2008 Temporarily Increases Basic FDIC Insurance Coverage from \$100,000 to \$250,000 per Depositor.

# Events Timeline

- Oct. 10, 08** - Meridian Bank was closed by the Illinois Department of Financial Professional Regulation-Division of Banking. National Bank acquires all the deposits.
- Oct. 14, 08** - FDIC creates new program to guarantee bank debts and fully insure non-interest bearing deposit transaction accounts.
- Oct. 14, 08** - The Treasury Department will invest up to \$250 billion in the nation's banks via the Capital Purchase Program.
- Nov. 20, 08** - FDIC announces the availability of IndyMac Loan Modification Model.
- Nov. 25, 08** - Created the Term Asset-Backed Securities Loan Facility to support the issuance of asset-backed securities collateralized by loans.
- Dec. 3, 08** - SEC approved measures to strengthen oversight of credit rating agencies.
- Dec. 16, 08** - Troubled banks have to provide certain position level and counterparty level data and QFC counterparty and portfolio identifiers to FDIC in a timely manner.
- Dec. 23, 08** - Treasury provides TARP funds to focal Banks by purchasing \$2.8 billion investment from 49 banks.
- Dec. 30, 08** - The Fed announced that it will purchase mortgage-backed securities.
- Jan. 15, 09** - The Senate voted to allow access to the remaining bailout funds of \$350 billion.
- Jan. 27, 09** - As part of the Capital Purchase Program, Treasury announced investments of \$386 million in 23 healthy banks.
- Feb. 10, 09** - Geithner rolls out the Financial Stability Plan, promises to perform "stress tests" on big banks, and commit \$100 billion to boost the TALF.

# Events Timeline

- Feb. 10, 09** - A Capital Assistance Program to help ensure banks hold sufficient capital, produce a more consistent and forward-looking assessment of risks on banks' balance and their potential capital needs.
- Feb. 10, 09** - A Public-Private Investment Fund will combine public and private capital with government financing to help free up capital to support new lending.
- Feb. 10, 09** - Treasury and Fed expended the Term Asset-Backed Securities Lending facility up to \$1 trillion.
- Feb. 18, 09** - President Obama signs the American Recovery and Reinvestment Act of 2009, which limits bonuses of the highest earning executives.
- Mar. 4, 09** - Treasury announced loan modification guidelines under the Administration's Homeowner Affordability and Stability Plan.
- Mar. 23, 09** - Using TARP capital and capital from private investors, the Public-Private Investment Program will generate \$500 billion in purchasing power to buy legacy assets.
- May 29, 09** - FDIC tightens the deposit interest rates paid by banks that are less than well capitalized. Generally, such banks will be permitted to offer to "national rate" plus 75 basis points.
- June 9, 09** - 10 Of the largest U.S financial institutions are expected to make CPP repayments to Treasury.
- Jul. 2, 09** - FDIC proposed guidelines require private equity firms to hold bank purchases for 3yrs and maintain capital levels.

# Report Summary – *Surprise?*

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Based on the methods with which we analyzed Meridian Bank, its failure was ***not a surprise.***

Here are the indications that Meridian Bank should fail:

- 1) **Meridian Bank's normalized income was more than 4 SD's below average the quarter before it failed.**
- 2) **More than 4% of its assets were delinquent the quarter before it failed.**
- 3) **Meridian Bank's asset to liability ratio declined each quarter since 2007 Q2.**
- 4) **Meridian Bank's bankability composite score was -0.26 the quarter before it failed and 31.28 the quarter before. Both these scores indicate the bank's poor overall financial health.**

# References

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