THE FINANCIAL CRISIS: ITS

As some larger regional banks pull back on their lending levels, more clients are seeking loans from smaller financial services firms.

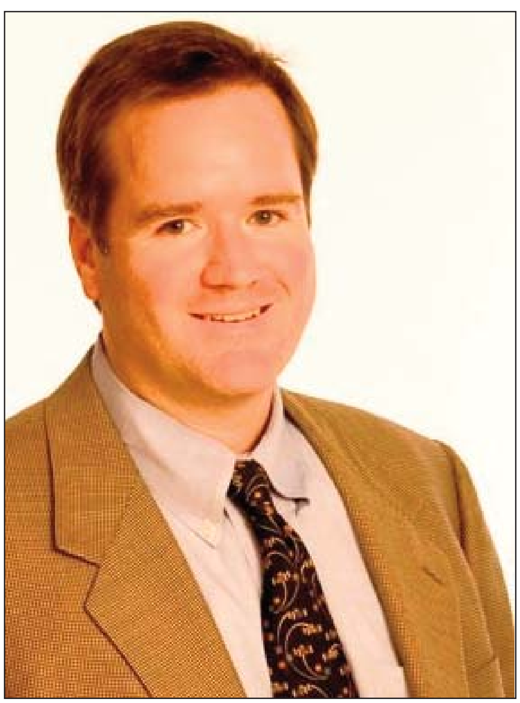
by Mac Johnston

The financial sector faced one of its most turbulent years ever in 2008, with monumental changes taking place daily. To fully understand how trouble on Wall Street has affected Main Street banks in Tennessee, we need to look back at the origin of the problem.

Basically, the investment banks on Wall Street took mortgages, packaged them together in mortgage-backed securities, split them up a hundred ways, sold and traded them, and made a lot of money doing it. The investment banks selling these mortgages lowered their lending standards when the supply of traditionally qualified borrowers diminished.

When the bottom fell out, the assets of the financial firms that acquired these high-risk mortgages declined significantly, which depleted their capital. Consumer confidence tanked, taking stock prices with it. That dealt a significant blow to the entire financial sector.

Institutional investors began a flight to quality away from risky mortgage-backed corporate and municipal bonds, which had the effect of eliminating credit availability to consumers and corporations.



Mac Johnston, chief investment strategist, Pinnacle Financial Partners.

The credit crunch has affected banks by limiting the amount of liquidity in the system as well as increasing credit risk and losses related to falling home prices, falling property values, and rising unemployment.

Impact on area banks

Overall, Tennessee fared better than other states. The worst of the crisis has been on the coasts, with California and Florida bearing the brunt of the consequences of unrealistic home pricing and overbuilding.

Locally, Davidson and Williamson counties have managed better than the surrounding counties. However, a number of banks that operate in middle Tennessee have been weakened by increasing foreclosures and additional credit losses resulting from the crisis.

In response, a few larger regional banks pulled back on their lending levels. More clients are seeking loans from smaller financial services firms such as Pinnacle Financial Partners.

Like all other financial services firms, Pinnacle faces challenging times until the national situation turns around. However, we are better positioned than most other banks to get through it. Pinnacle continues to experience strong performance and earnings, which is a tribute to the strategy we have stuck to since our inception eight years ago. Pinnacle has no direct exposure to bad loans in the subprime arena because we have a conservative approach to underwriting and have disciplined credit practices.

We've always said that our performance is a tribute to the skill and long-term experience of our associates. Our approach of hiring only highly experienced bankers pays off in more difficult economic environments because it enables us to continue growing at a rapid rate while maintaining excellent credit quality.

Impact of the federal economic rescue plan

The reaction of the U.S. Treasury and Congress to the credit crisis was to roll out one stimulus

IMPACT ON AREA BANKS

package for consumers and start to assemble another stimulus plan for banks. The goal is to stimulate lending and investment in communities.

Pinnacle applied for and received preliminary approval for the sale of $95 million of preferred stock and related warrants to the U.S. Treasury under the Capital Purchase Program (CPP) of the Emergency Economic Stabilization Act of 2008. Receipt of the funding is subject to execution of definitive agreements and satisfaction of closing conditions.

The CPP should help stabilize the difficult economic challenges facing our country. While some banks desperately need the capital to survive, others lack the momentum to be able to effectively deploy any additional capital for the benefit of their community.

At Pinnacle, we are pleased that we have avoided the traps that are currently plaguing many banks and that we are well positioned to seize the many strategic opportunities that result for those who are prepared.

On September 30, 2008, Pinnacle's capital levels were well above "well-capitalized" regulatory benchmarks. The additional capital resulting from participation in the Treasury program will immediately increase Pinnacle's capital ratios.

Since inception, Pinnacle's strong capital position has allowed us to meet the lending needs of our growing client base. Although participating in the CPP will strengthen our capital position, we do not believe that participation in the CPP is necessary for us to maintain our well-capitalized status. For us, the additional capital will not only strengthen our lending capacity so that we can do even more to encourage growth and investment for the communities in which we do business but also provide us the opportunity to seize other potential strategic options.

Other effects

Another provision of the federal bailout package raises the basic FDIC insurance limit from $100,000 to $250,000 per person for the combined total of their savings, checking, and other deposit accounts. The temporary limit increase expires December 31, 2009.

Greater FDIC insurance coverage should provide greater confidence in commercial banks, avoiding any potential "run on the banks" that would lead to frozen credit markets, contracting businesses, and massive job cuts. The safest place for money is still in an FDIC-insured institution like Pinnacle.

Pinnacle offers an additional opportunity to increase FDIC insurance coverage with a program called CDARS. The client's relationship stays with Pinnacle, but we place certificates of deposit in amounts below the insurance cap across multiple institutions to maximize the coverage. We establish the account, work with clients on rates, provide them with one monthly statement, and let them know when their CD matures.

Looking at 2009

While credit has tightened, people with a good credit history will continue to have access to mortgage, credit card, and other types of loans. With lending standards tightening, it's more important than ever to monitor credit reports and keep scores in the "good" to "excellent" range.

Hundreds of bank failures are projected in 2009. We should also expect an increase in merger and acquisition activity as regulators will force some banks to find partners and others will choose to find partners because of the stress on their company in this environment.

Those factors work to our advantage. Pinnacle was formed in 2000 to capitalize on turmoil in large regional banks. That volatility will provide us an even better opportunity to attract desirable new clients than what we have enjoyed in our first eight years of existence. ■

Mac Johnston is chief investment strategist for Pinnacle Financial Partners.

Another provision of the federal bailout package raises the basic FDIC insurance limit from $100,000 to $250,000 per person for the combined total of their savings, checking, and other deposit accounts. The temporary limit increase expires December 31, 2009.