StoneCastle

March 2016

THE NEW CASH MANAGEMENT REALITY

A Discussion on Short Term/Operating Cash Balances

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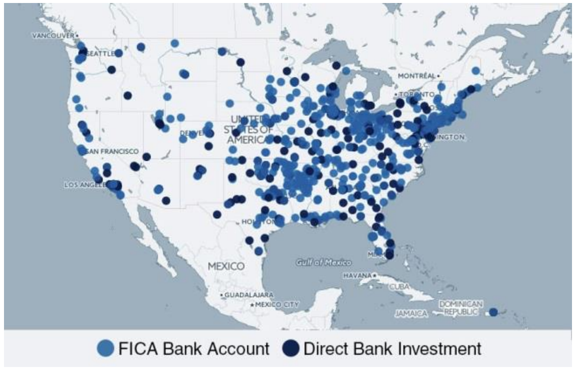
ABOUT STONECASTLE

ABOUT STONECASTLE

StoneCastle leverages its deep banking experience and extensive regulatory relationships to provide investment services to institutions and community banks. Our investment strategies and products make us one of the largest investors in U.S. community banks and a proven resource for institutional investors.

ACTIVE BANK



STONECASTLE SNAPSHOT

Current Initiatives

- Deliver highly efficient cash management solutions to leading treasury professionals
- Provide community banks with access to capital and funding that are often only available to larger competitors
- Create tailored, innovative investment strategies focused on community banks for institutional investors

AUM

- $11.17 billion in total assets
- $9.48 billion in managed cash; $1.69 billion in fixed income, preferred and equity investments
- Over 600 banks participate in StoneCastle’s funding network
- On October 15, 2015 StoneCastle facilitated $250 million in financing to 35 community banks in 24 states

Flagship Products

- FICA: Cash management product providing FDIC insurance, next day liquidity and a competitive yield
- ICA: Provides institutions access to highly rated banks via a single, convenient account
- BIDS: Adviser to third party administrators and non-depository custodians
- StoneCastle Financial Corp.: Publicly listed company investing in community banks (Nasdaq: **BANX**)

WHAT WE DO

STONECASTLE			
	ASSET MANAGEMENT	*Federally Insured Cash Account (FICA)*	FDIC-insured cash management solution for institutional investors
		Institutional Cash Account (ICA)	Grants access to a pool of money fund eligible, A1/P1 banks for institutional investors
		Bulk Insured Deposit Services (BIDS)	Advisor for non-depository custodians seeking pass through FDIC insurance for client investors
		Closed-End Investment Fund	Publicly listed investment company (Nasdaq: **BANX**) that invests primarily in yield producing securities issued by banks
		CDO Management	Investment advisor on six securitizations, primarily collateralized by trust preferred securities issued by community banks
	BANK SOLUTIONS	*Funding*	Provides banks with an efficient, reliable and way to manage their primary and contingency funding
		Capital	Direct investor in publicly traded and privately held community banks seeking capital for organic growth, acquisitions, share repurchases and other refinancing activities
		AMMA	Allocates a bank customer's large deposits across a proprietary bank network, offering expanded FDIC-insurance on their deposits
	BROKER DEALER	*Trading*	Trading of investment grade 144A private placement and physical securities

“StoneCastle Partners, LLC has emerged as one of the leading innovators in the cash management arena.”

InvestmentNews
“Cash Management That Could Crush Money Markets”
June 2011

CURRENT STATE OF THE CASH MANAGEMENT LANDSCAPE

MARKET ENVIRONMENT PRESENTS NEW CHALLENGES

Regulation and Central Bank Action Pose Threats

BANK REGULATORY REFORM	• New bank regulations are changing financing dynamics and potentially impact fixed income liquidity • Changes may continue to impact bank balance sheet availability
MONEY MARKET FUND REGULATORY REFORM	• Cash investors will have to re-evaluate options in light of new MMF requirements. • Changes throw the "default option" of cash into chaos at the same time as market disruption
MISMATCHED SUPPLY/ DEMAND DYNAMICS	• Stricter banking regulation has led to a significant decline in supply of money market instruments • Demand for liquid assets is at record levels which is having a material impact on money market yields.

“THE NEW REALITY”

Recent Headlines

Not Enough Urgency Ahead of MMF Reform?
iTreasurer-March 11, 2016

Low yields, counterparty risks worry treasurers
Bloomberg Brief- February 26, 2016

Low yields, counterparty risks worry treasurers
Bloomberg Brief-February 26, 2016

The biggest risk to your money market fund
CNBC-February 24, 2016

The $400 Billion Money-Fund Exodus With Banks in Its Crosshairs
Bloomberg-February 23, 2016

Fed official warns on rush to 'government-only' US money funds
CNBC-February 23, 2016

BANK REGULATORY REFORM: BASEL III

The purpose of Basel III is to enforce banks to provide a mattress of **short-term (LCR)** and **long-term (NSFR)** liquidity should a run occur during market stress.

Liquidity Coverage Ratio (LCR)

- The LCR is a relatively standard liquidity risk ratio in its construct and aims to ensure that the level of High Quality Liquid Assets (HQLA) at a bank is sufficient to cover significant cash outflows **over the next 30 days** in the event of a stressed market environment such as an economic downturn, massive deposits run-off or the minimum roll-over of credit facilities.
- LCR also governs the 1) **classification of operational and non-operational deposits** and the 2) **treatment of run-off prone deposits**

Net Stable Funding Ratio (NSFR)

- The Net Stable Funding Ratio is designed to make sure that the amount of available stable funding at a bank commensurate with the minimum stable funding as required based on the nature and maturity of its assets and off-balance sheet activities.
- The horizon of this indicator is longer than the LCR, **as it is a one year ratio.**

WHAT DOES THIS MEAN FOR YOU?

Basel III's capital ratios have made certain client deposits too expensive to hold on their balance sheet.

Basel III was designed in a way that favors local and central government debt.

BANK REGULATORY REFORM: LIQUIDITY COVERAGE RATIO

LCR: Classifying Deposits

- The final U.S. rules laid out specific qualitative and quantitative criteria U.S. banks must satisfy to meet the definition of operational

QUALITATIVE

- Services subject to 30-day termination or significant switching costs
- Held in account designated as operational account
- Primary purpose of deposit is operational
- Must not be provided in connection with prime brokerage or by a non-regulated fund
- Must not be for arrangements where a bank (correspondent) holds deposits owned by another depository institution (respondent) and respondent temporarily places excess funds in an overnight deposit with the bank

QUANTITATIVE

- Empirically linked to the operational services with methodology for identifying any excess amount, taking into account volatility of average balance
- No economic incentive for the customer to maintain excess funds through increased revenue, fee reduction or other incentives

OPERATIONAL

- Held at the bank to fund critical operational activity
- High switching costs
- Balance fluctuates day-to-day

NON-OPERATIONAL

- Fundable across multiple products/providers
- Cash is sensitive to and may move to alternatives for yields
- Balances are highly stable or large and short-term

IMPLICATIONS

Non-operational balances have a greater runoff factor than balances tied to day-to-day operational activity and therefore require banks to hold more HQLA against non-operational balances.

BANK REGULATORY REFORM: LIQUIDITY COVERAGE RATIO

LCR: Runoff Prone Deposits

- With LCR, banks need to cover 30 days of outflows with HQLA – however not all outflows are treated equal
- The determining factors are the nature of the deposit and who the depositor is – the more risk prone categories and types of depositor govern the highest outflow factor
- So cash taken from say, a hedge fund, with a 100% outflow factor, needs to be 100% covered by HQLA either owned outright or repo'ed in for more than 30 days
- It is no surprise that cash from these kinds of institutions are becoming too expensive for banks to hold

CATEGORY	BALANCES IN QUESTION	LCR OUTFLOW FACTOR	POTENTIAL IMPACT
Small Business (retail vs. wholesale)	~$1.0 T	10% vs. 40%	~$300 BN
Stable vs. Other (retail deposits)	~$9.0 T	3% vs. 10%	~$600 BN
Financial vs. Non- Financial Deposits	~$1.5 T	40% vs. 100%	~$900 BN
Operational vs. Non-operational deposits	~$1.0 T	25% vs. 40%	~$150 BN

In 2018 the Net Stable Funding Ratio (NSFR) is only expected to tighten the governance of these deposits

BANK REGULATORY REFORM: NET STABLE FUNDING RATIO

- The NSFR is seen as a **long term** complement to its previously finalized Liquidity Coverage Ratio (LCR), which is intended to promote **short term** resilience of a firm's liquidity risk profile.
- The Net Stable Funding Ratio ("NSFR") compares the amount of a firm's available stable funding (ASF) to its required stable funding (ASF) to measure how the firm's asset base is funded.
- Funding from non-financials will be more valuable than cash from financials.
    - The Available Stable Funding (ASF) factor applied to cash from a non-financial is 50% for trades 1 year or less.
    - To get that same 50% factor for funding from a financial institution, the maturity has to be ***at least*** 6 months.
    - **Funding from a financial shorter than 6 months has a 0% ASF factor.**
- Implementation of NSFR is not scheduled until January 1, 2018

SEC MONEY FUND REFORM

- Floating NAV for institutional prime and municipal funds
  - Potential for small losses
  - Some administrative burdens

- Liquidity fees and redemption gates for prime and municipal funds
  - Potentially limited access to liquidity during stress (up to 10 business days in a 90 day period)
  - Fees of up to 2% for investors who require cash in times of stress
  - Operational complexity for fund managers and intermediaries

- Government funds exempt from floating NAV and fees/gates
  - Expected inflows could bump against limited supply

- Enhanced diversification, stress testing, and reporting requirements

- Important Dates:
  - **April 14, 2016: forms N-IA, PF, N-MFP**
  - July 14, 2016: form N-CR website disclosure
  - October 14, 2016: floating NAV, liquidity fees and gates, advertisement and prospectus disclosure

DAYS TO REFORM

212

MONEY FUND INDUSTRY RESPONDS

- Restructuring of existing 2a-7 prime money funds
  - "Short-maturity" funds: investing inside of 60 days or 7 days to limit applicability of floating NAV and/or fees and gates

- Launching or expanding alternative liquidity products to meet clients' needs
  - Private/unregistered prime money funds
  - Short-term bond funds
  - Separately managed accounts

- Converting retail prime money funds to government funds
  - $116 billion Fidelity Cash Reserves and the $25 billion Franklin Templeton Money Market Portfolio

- Smaller fund managers exiting the industry or merging funds to reduce costs
  - This reflects the higher cost of reform implementation for prime funds compared to government funds, which is particularly onerous for fund managers that lack scale to absorb the outlays

MOODY'S MAINTAINS NEGATIVE OUTLOOK ON MMF INDUSTRY

- Despite cautious investment approaches, MMFs struggle to maintain the highest credit and stability profiles
- The number of Aaa-mf funds is likely to decrease
  - Challenging market conditions drive higher rates of rating withdrawals
- Shortage of short-dated high quality investments significant challenge for MMFs
  - Supply conditions remain tight and expected to be tighter by year-end
- Divergence in global monetary policies drives changes in MMF investor behavior
- New MMF reforms in the US and proposed MMF regulations in Europe will make MMFs less attractive to institutional investors globally
  - Investors continue to kick tires on alternatives but "new" options not yet introduced

HOW MUCH WILL INVESTORS MOVE OUT OF PRIME AND INTO GOVERNMENT FUNDS, OR OTHER VEHICLES, IN 2016?

“Total **Government money fund assets are almost equal to Prime MMF assets -- $1.267 trillion is in Prime vs. $1.241 trillion in Government**. Among Prime assets, $797.8 billion is Institutional and $469.6 billion is Retail. , the range of outflows is anywhere from zero to $1.3 trillion.”

– *Money Market Fund Assets, Investment Company Institute's,*

”Expect an **additional $400 billion to leave Prime funds via investor outflows with a portion potentially finding its way into government MMFs.”**

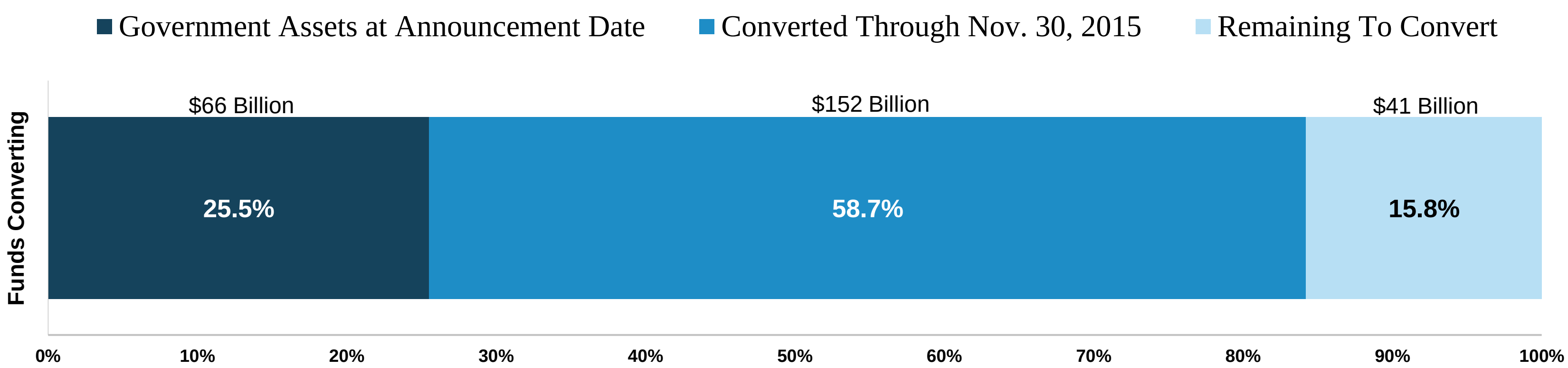
– *Short-Term Market Outlook and Strategy, J.P. Morgan Securities, February 1, 2016*

“**We expect that the switch to a floating NAV and the imposition of fees and gates will result in a large migration of assets out of Prime funds**. The global money market industry is roughly $3.3tn in size, $2.7tn of which is in the US. Prime funds account for just over half the US total, about $1.4tn. **We estimate as much as 70% of the $1.4tn [$980 billion] in Prime funds will migrate elsewhere.”**

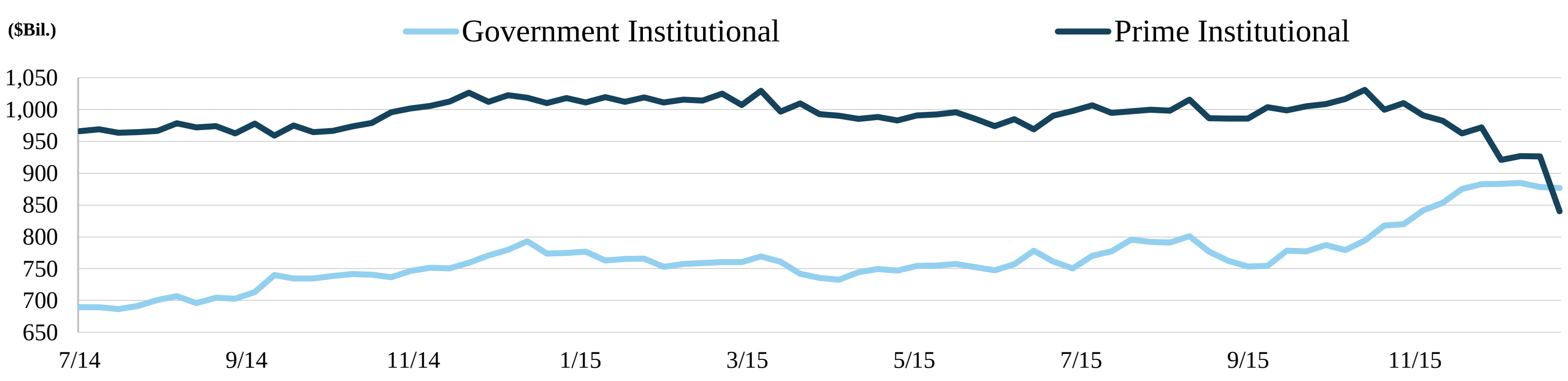
–*Sees Almost $1 Trillion Leaving Prime Money Market Funds, Goldman Sachs AM, October 9, 2015*

The movement of such large positions is set to impact the short-term markets, benefiting government securities while reducing demand for bank and corporate debt.

TOTAL ANNOUNCED AUM FUNDS CONVERTING: $259B



Source: Fitch, Crane Data, Fund Documents, SEC



Source: iMoneyNew, Fitch

UNDER PRESSURE: HQLA

Supply & Demand Constraints of HQLA

- Basel III liquidity coverage ratio and leverage ratio requirements are putting pressure on the availability of short-term bank debt, deposits and repo
- With large flows expected into US government funds, the Fed's RRP will absorb a large portion of that cash since the supply of Treasury and Agency securities is limited and yields on these securities will continue to be pressured

Treasury Bills

- JPMorgan Chase & Co. expects an extra $900 billion of demand for government securities, putting pressure on a sizable chunk of the $1.4 trillion bill market
- The mismatch between supply and demand has been so acute that four-week bill rates fell to minus 0.0304 percent on April 29 2015, the lowest on a closing basis since December 2008
- The average maturity of U.S. debt outstanding has lengthened to 69 months, the longest since 2001, as the amount of bills has decreased to about 11 percent of the Treasuries

Commercial Paper

- The number of collateralized commercial paper (CCP) programs peaked in February 2014 and had thus fallen by 43% in August 2015.
- Commercial Paper holdings in Prime funds amounted to 24.7% and down to $355.8 billion in latest report (Feb 2016)

Source: Bloomberg, Fitch Ratings, CraneData

UNDER PRESSURE: HQLA

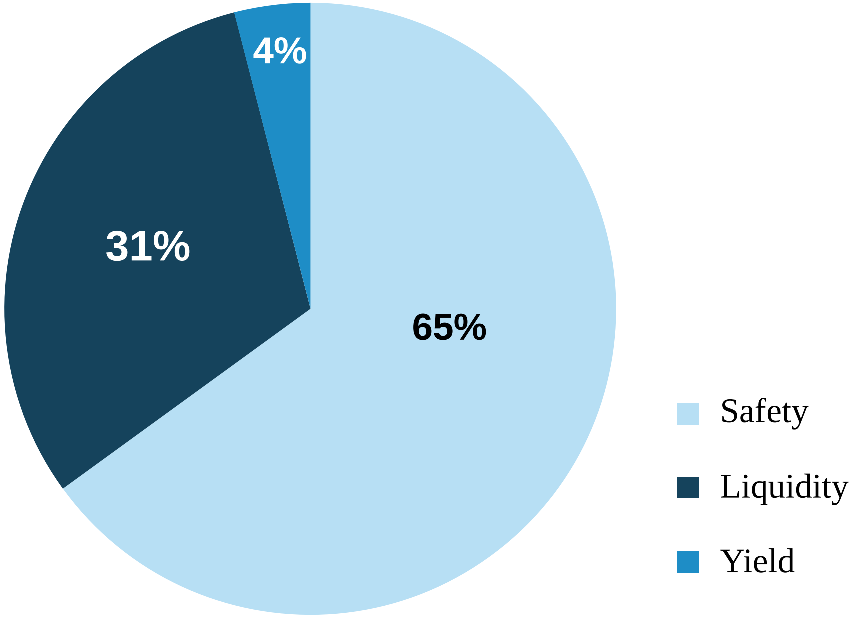
Reverse Repo Facility

- Introduced in 2013, the Fed's RRP program was introduced to help guide market rates higher in times of normalizing monetary policy
- Participation has increased significantly – especially around key reporting dates – hitting the $300B cap at the end of Q3 2014 and remain the largest MMF portfolio segment followed by Treasuries and Agencies
- The Fed expects to expand the capacity of the RRP from $300B to $2T
- Members of the Federal Open Market Committee (FOMC) remain concerned that there is a relatively large reliance on RRP and continuing to raise the capacity may represent a potentially destabilizing run risk
- The RRP was framed as **a temporary facility to be eventually be phased out completely**, at that point, interest of excess reserves (IOER) is expected to be the main tool used to influence money market rates

WHAT TREASURERS ARE SEEKING TODAY:
A PRACTIONER’S PERSPECTIVE

THE MOST IMPORTANT OBJECTIVE OF ORGANIZATIONS' CASH INVESTMENT POLICY

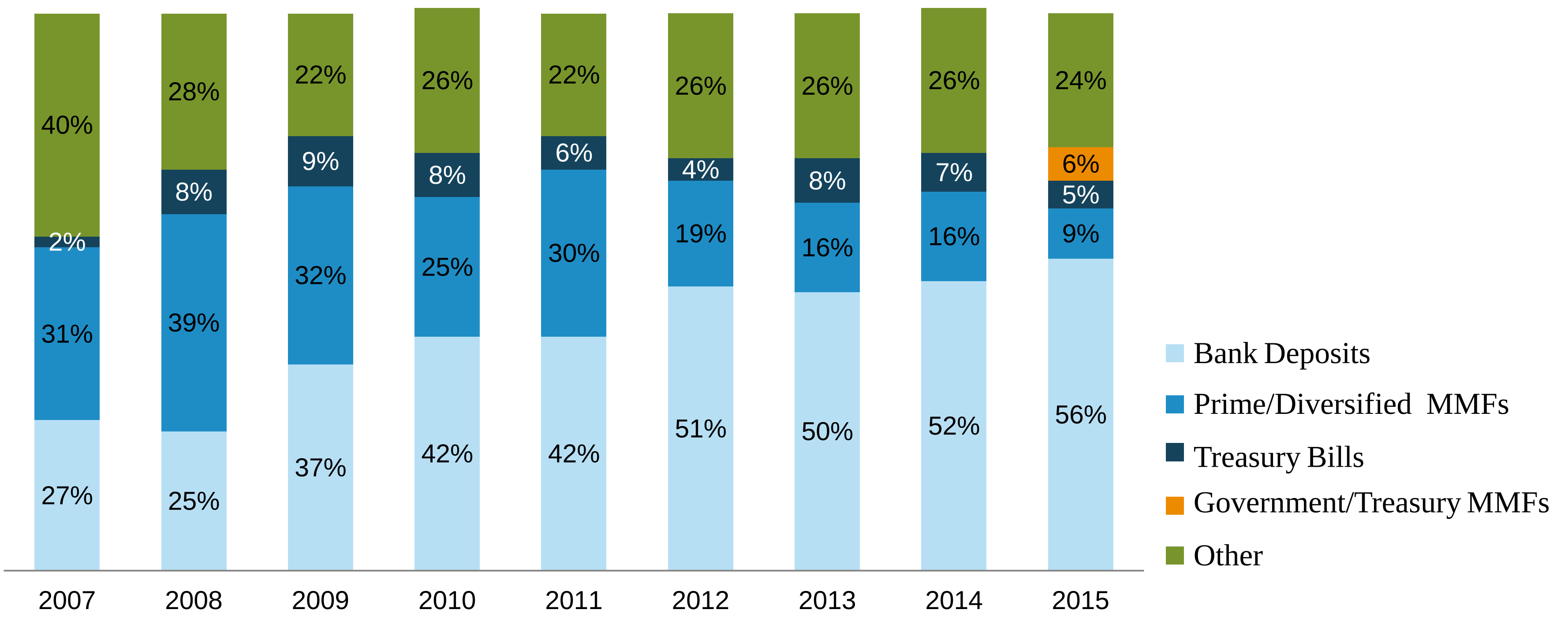
(Percentage Distribution)



Source: 2015 AFP Liquidity Survey

ALLOCATION OF SHORT-TERM INVESTMENTS, 2007-2015

(Mean Percentage Distribution)



Source: 2015 AFP Liquidity Survey

LIQUIDITY MANAGEMENT: WHAT ARE THE OPTIONS?

PRODUCT	VALUATION	REDEMPTION RESTRICTIONS	REGULATED	RESTRICTED ACCESSIBILITY
Bank demand deposit	Stable	No	Yes	No
Time/certificates of deposit	Stable	Yes	Yes	No
Private money funds	Stable (generally)	By contract	No	Yes (large clients)
Ultra-short bond funds	Floating NAV	Some	Yes	No
Short-duration ETFs	Floating NAV	No	Yes	No
Separately managed accounts	Market value	No, but investor bears losses on sale	No	Yes (large clients)
Direct investments in money market instruments	Market value	No, but investor bears losses on sale	No	Some
Retail prime MMFs	Stable NAV	Yes, fees & gates	Yes	Yes (retail only)
Inst. prime MMFs	Floating NAV	Yes, fees & gates	Yes	No
“Short maturity” prime MMFs	Potentially stable	Yes, but potentially less likely	Yes	No
Government MMFs	Stable NAV	No	Yes	No
Structured bank deposits (FICA)	**Stable NAV**	**Yes**	**No**	**Yes (large clients)**

Source: SEC, Fitch Ratings

THERE IS HOPE AND OPPORTUNITIES

"Regular opportunities exist to purchase full faith and credit instruments of the U.S. government at spreads of 40 to 50 basis points above otherwise comparable but more liquid treasury issues."

–David Swensen, CIO, Yale University

CASH MANAGEMENT BEYOND THE BIG THREE

ONE OPTION: STRUCTURED BANK DEPOSIT VEHICLES

Structured Bank Deposit Vehicles have gained recognition as alternatives to other cash vehicles and according to the most recent AFP Liquidity Survey, now represent 24% of institutional bank deposits.

Instruments Used When Investing in Bank Deposits

(Percent of Organizations that Maintain Cash and Short-Term Investment Holdings in Banks)

	All Responses	Annual Revenues Under $1B	Annual Revenues At Least $1B	Net Borrower	Net Investor	Investment Grade	Non- Investment Grade	Publicly Owned	Privately Held	2014 Survey All Respondents
Time Deposits (e.g., CDs)	54%	47%	62%	52%	56%	57%	51%	61%	51%	55%
Non-interest bearing deposit accounts	40	40	38	41	38	40	38	35	45	51
Structured Bank Deposit Products (e.g., FICA)	24	26	24	21	29	27	21	27	24	26
Structured certificates of deposit (e,g,, CDARS)	15	15	14	11	17	15	13	12	12	13

Source: 2015 AFP Liquidity Survey

WHAT ARE STRUCTURED FDIC INSURED BANK DEPOSIT PRODUCTS?

- Primarily a series of electronically-linked bank deposit accounts at one or more banks available within a single account
- Programs can offer extended FDIC insurance as a result of having multiple banks or savings institutions, each providing up to $250,000 of insurance.
- FDIC opinion allows for agency pass-through of deposit insurance
  - Look for letter from FDIC confirming offering meets FDIC requirements
- Two type of programs - Term (utilizes CDs) and Liquid (utilizes MMDA)
- Programs can offer from $500,000 to $50 million plus of FDIC insurance via a single account, <u>per tax ID</u>
- An estimated $600 billion is in FDIC- insured deposit vehicles (CraneData)

WHY ARE STRUCTURED FDIC INSURED BANK DEPOSIT PRODUCTS ATTRACTIVE FOR SHORT TERM CASH?

Safety

- Deposits are FDIC insured and backed by the full faith and credit of the U.S. Government
  - *"No insured depositor has ever lost a penny of FDIC insured deposits— and none ever will." – Sheila Bair, Former Chairman of the Federal Deposit Insurance (November 17, 2009)*

Liquidity

- No term commitments
- No penalties or withdrawal fees

Yield

- May offer a premium yield over money funds, treasuries and short term CDs

FEDERALLY INSURED CASH ACCOUNT (FICA®)

- FICA is a proprietary “alternative” cash management vehicle that offers a high level of FDIC insurance, next day liquidity and an attractive yield.
- Provides over 1,000 institutional depositors with access to our network of 600+ carefully screened banks via a single, convenient account.
- Uses proprietary algorithms to allocate customers' large deposits to ensure full FDIC insurance and attractive yields versus money funds, treasuries and other cash products.

SAFETY	LIQUIDITY	PERFORMANCE
• Fully FDIC-insured • Deposits are backed by the full faith and credit of the U.S. government • Highly diversified—no single bank holds more than $250,000 per depositor • No market or credit risk	• No term commitment • Next day liquidity with same day purchase credit • Unlike a money fund liquidity is not adversely affected by other investors	• Superior yield when compared to money market funds, U.S. Treasuries, commercial paper, CDs, time deposits and all other money market instruments

FICA AT-A-GLANCE

Product Category: FDIC-Insured Liquid Structured Bank Deposit Vehicle

Current Yield (3/1/16): .35%[1]

Minimum Initial Deposit: $1,000,000

Account Transparency: Daily

Purchases: Daily[2]

Redemptions: Daily[2]

Custodial Bank: U.S. Bank, N.A.

ADDITIONAL BENEFITS

Transparency: Ability to view location of all deposits

Direct ownership: Provides direct ownership of underlying deposit, which is not impacted by the actions of other investors, unlike a money fund or investment pool

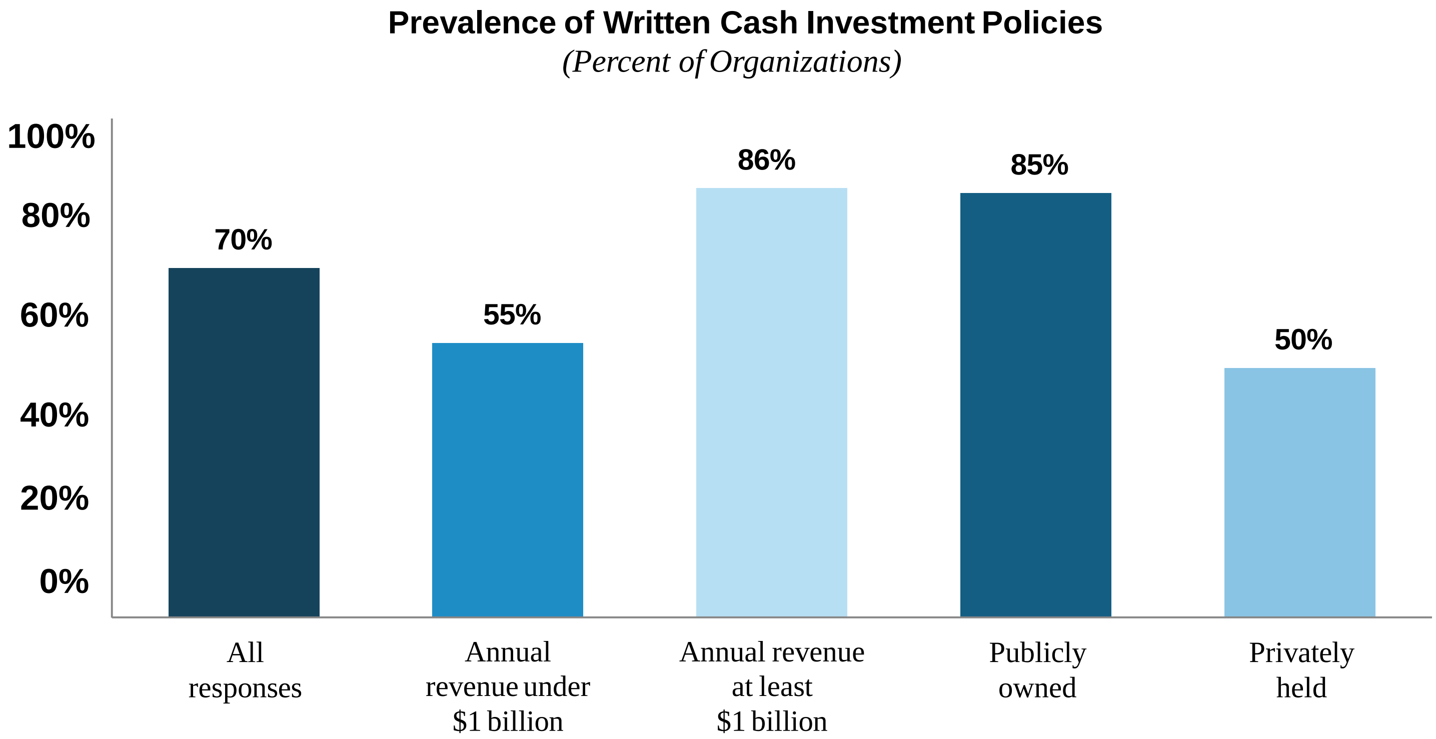
Control: Ability to opt out of specific banks

Diversification: No single bank holds more than $250,000 of any individual client deposit

NEXT STEPS: THE INVESTMENT POLICY

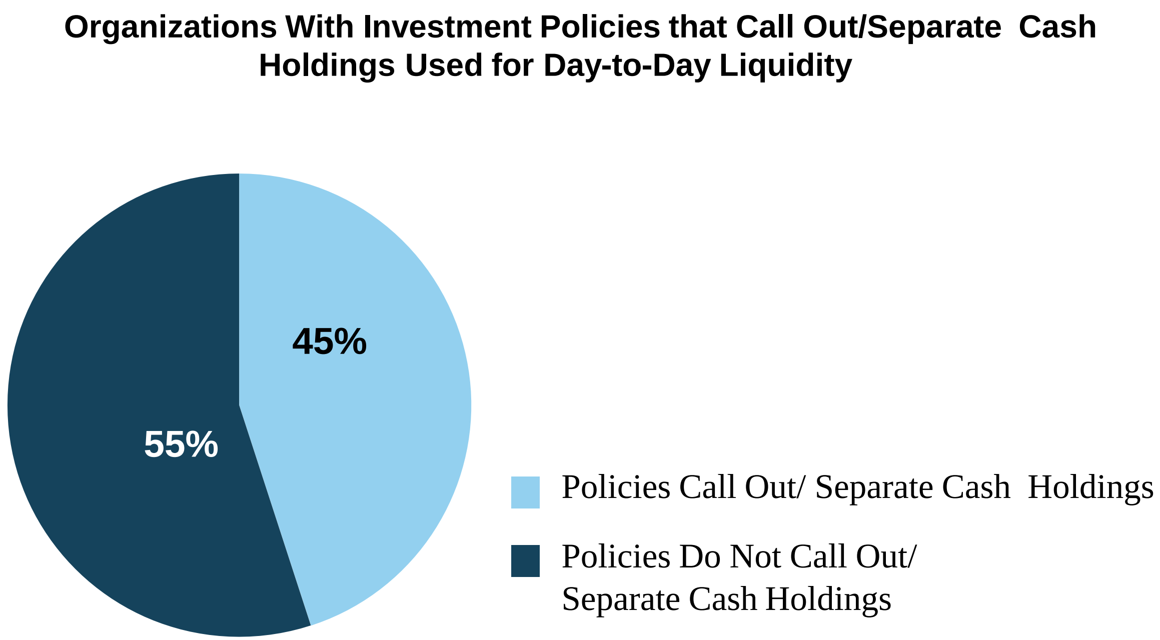
WRITTEN INVESTMENT POLICIES

As the market evolves, so should your investment guideline



Source: 2015 AFP Liquidity Survey

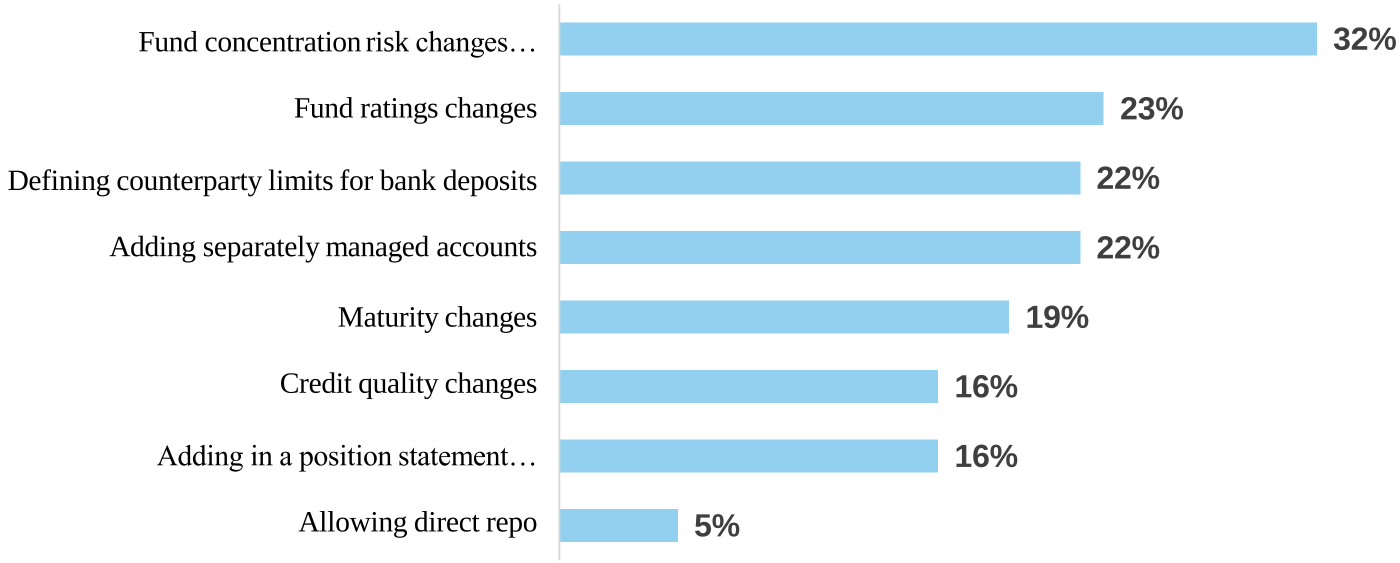
CASH SEPARATED IN INVESTMENT POLICY



Source: 2015 AFP Liquidity Survey

INVESTMENT POLICY CHANGES

Anticipated Changes in Organization's Investment Policy in Response to SEC's Changes in Money Fund Rules
(Percent of Organizations)



Source: Bank of America

INVESTMENT POLICY CONSIDERATIONS FOR EXTENDED FDIC INSURED VEHICLES

- Savings or deposit accounts in financial institutions provided that all of the following conditions are met:
  - Funds are deposited only with Well Capitalized financial institutions
  - The full amount of each deposit and the interest that may accrue on each deposit shall at all times be insured by the Federal Deposit Insurance Corporation

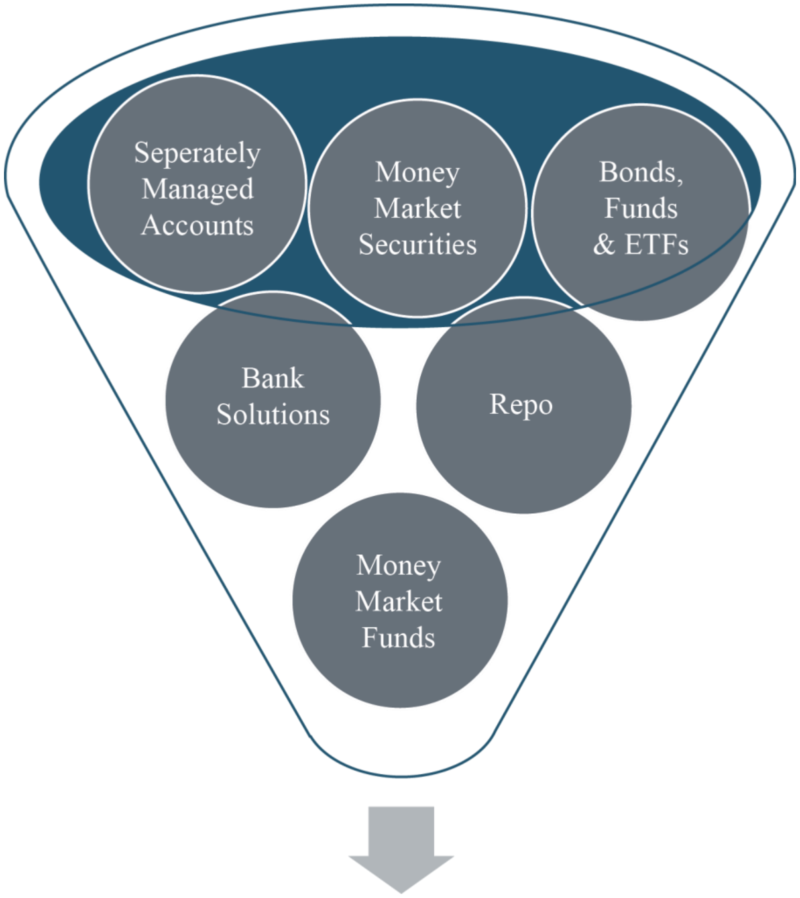
DO YOUR RESEARCH—NOT ALL PROGRAMS ARE EQUAL

Below are some criteria to consider when reviewing extended FDIC insured offerings:

- Due Diligence (research and inquire)
- Organizational stability – (company reputation, financial stability, quality, and thought leadership of senior management)
- Commitment to space – (infrastructure in support of offerings, how many persons in operations, support and resources dedicated to bank review and analysis)
- Referrals and references
- Industry visibility
- FDIC Insurance Pass Through Notice

CLIENTS NEED TO ASSESS THEIR READINESS AND PREPARE FOR THE NEW ENVIRONMENT

- Short term funding is being deemphasized with the adoption of Basel III bank regulation. This potentially has implications for bank balance sheet capacity.
- The availability of investment products traditionally used by liquidity investors will change and investors need to prepare for change.
- Products that provide optimal liquidity characteristics will play an important role in investment portfolios.



The optimal asset allocation considers, principal protection, liquidity and yield enhancement, counterparty risk, and diversification

Source: GSAM FOR ILLUSTRATIVE PURPOSES ONLY.

CONCLUSION

The changing regulatory environment is leading to a comprehensive review of investment policies and a reevaluation of strategies for managing corporate liquidity.

Source: GSAM

THANK YOU

STONECASTLE

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Managing Director
StoneCastle Cash Management

NOTES AND DISCLOSURES

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The Crane 100 Money Fund Index is an unmanaged index that tracks the yields of money market funds. Investments cannot be made in an index .

FICA®

1 FICA® return is the net yield to a new client with a maximum deposit of $50,000,000. Performance quoted represents past performance, which is no guarantee of future results. Current yield and maximum FDIC insurance coverage is indicative for FICA® and may change without notice due to changes in market or business conditions. FICA® return is the net yield to clients based on APYE for the period indicated as reported by StoneCastle.

2 Liquidity is available on a next business day basis. Same day purchase credit and next day liquidity redemptions are subject to a 11:00am EST cut-off. Please read the FICA Program Terms and Conditions for more complete information and the governing terms of the account (including liquidity, fees, terms, etc.). This can be found at www.ficaaccount.com.

3 Standard and Poor's has not issued a rating on FICA®

FICA® satisfies the FDIC's requirements for agency pass-though deposit insurance coverage .

FICA® is not a member of the strives to meet the needs Federal Deposit Insurance Corporation ("FDIC"), but the banks in StoneCastle's network are FDIC members. The maximum FDIC insurance per Tax ID at each institution is $250,000. The FDIC is an independent agency of the U.S. government that protects the funds depositors place in FDIC insured institutions. FDIC deposit insurance is backed by the full faith and credit of the U.S. government. Investors having cash at a depository institution that is in the FICA network does not necessarily guarantee full FDIC insurance on those deposits at those institutions if multiple accounts exist under the same Tax ID.

Funds may be submitted for deposit only after a depositor enters into a FICA® agreement. The Agreement contains important information and conditions regarding the depositing of funds.

FICA® is a service marks of StoneCastle.