

**Economic Solutions:
An Alternative Proposal**

Draft: As of 3/17/2009

What has been done so far . . .

- September 16, 2008: Insurance Bailout begins
- October 13, 2008: TARP
- November 21, 2008: TLGP & TAGP
- November 25, 2008: TALF
- December 6, 2008: Auto Bailout
- February 19, 2009: American Recovery and Reinvestment Act
- March 11, 2009: Latest spending bill to fund government (\$410 billion)

Can we tell if any of the measures are working . . .

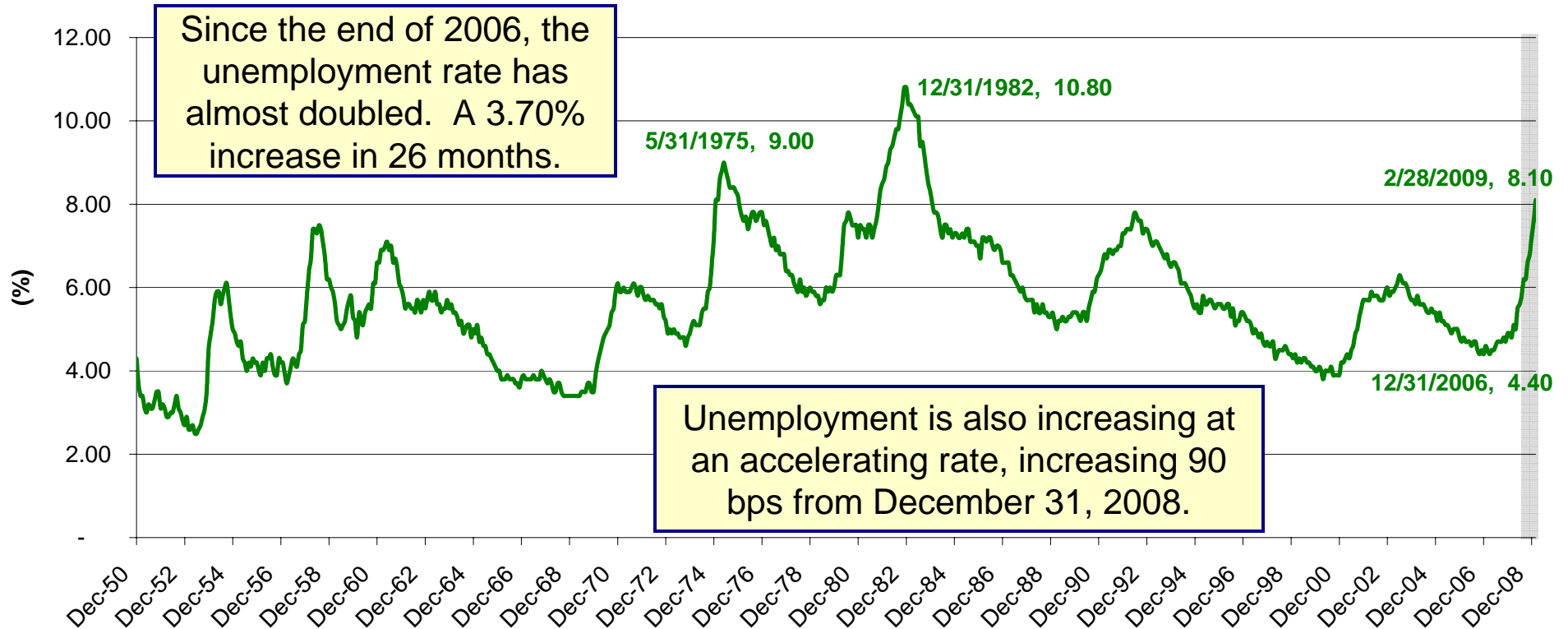
-
- Unemployment
 - DOW
 - State GDPs & Deficits
 - Foreclosures
 - Bankruptcies
 - AIG/Citigroup/GM
 - FDIC fund \$
 - Troubled Banks
 - Bank Failures
 - US Budget Deficit
 - Consumer Confidence
 - Inflation / Deflation
 - Personal Income
 - Performance of TARP Participants
 - Derivatives



So, Is Anything Working?

Unemployment is at the highest level in the past decade and climbing . . .

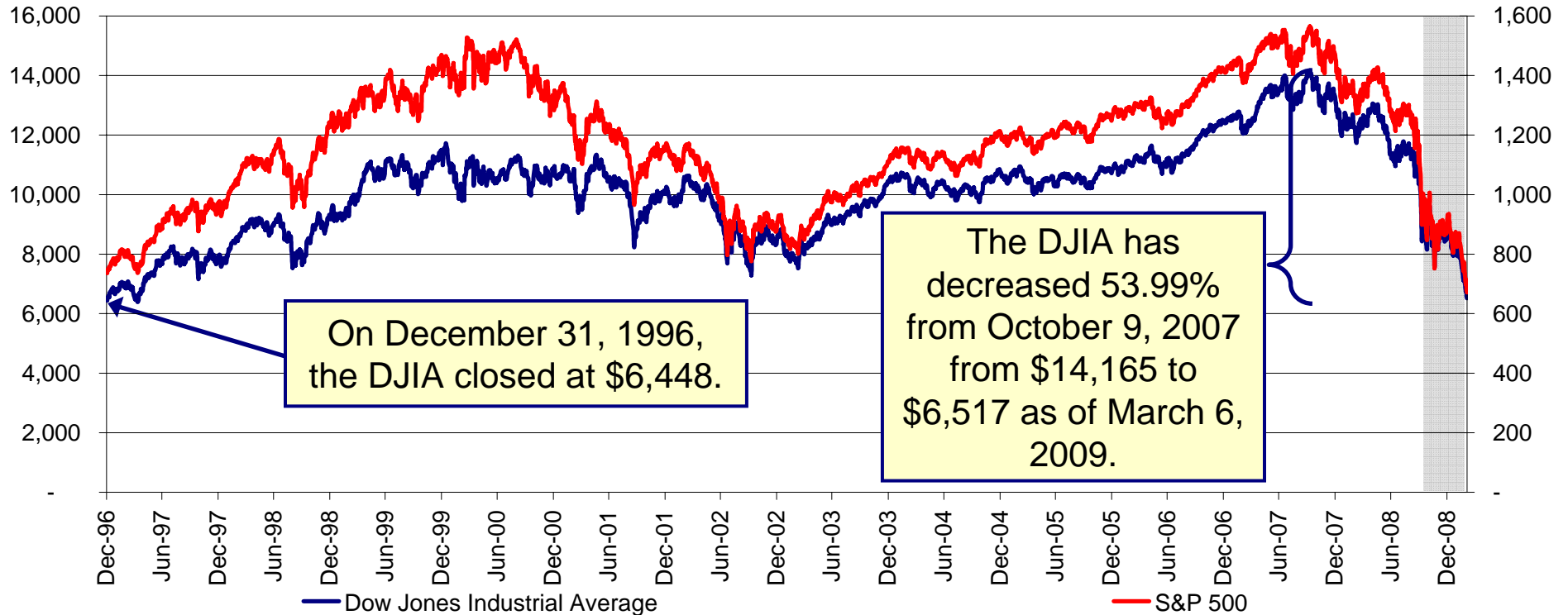
Unemployment



The DJIA and S&P500 are at the lowest point in over a decade . . .

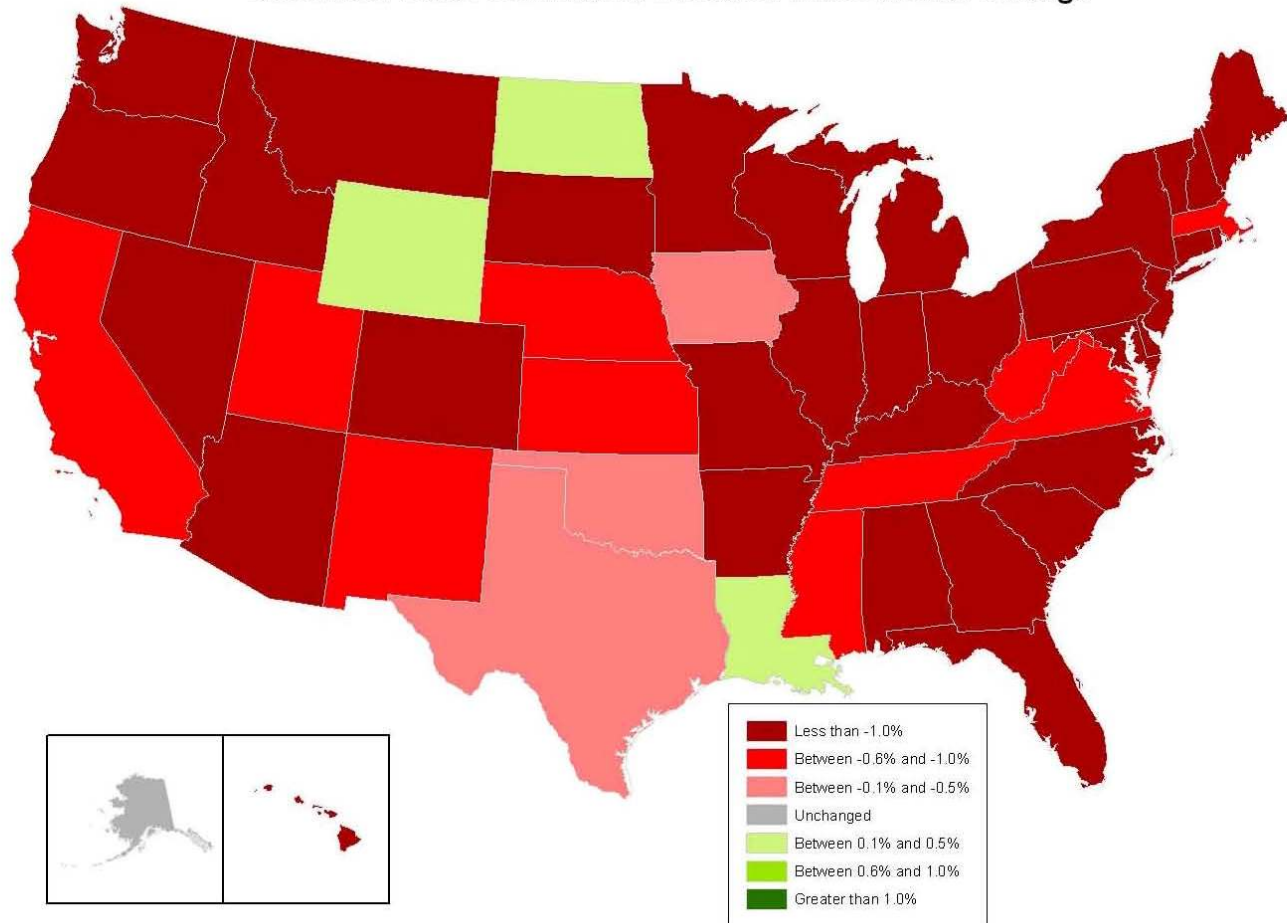


Performance of Dow and S&P 500



Only three states in the nation had positive GDP growth over the three month period ended December 31, 2008 . . .

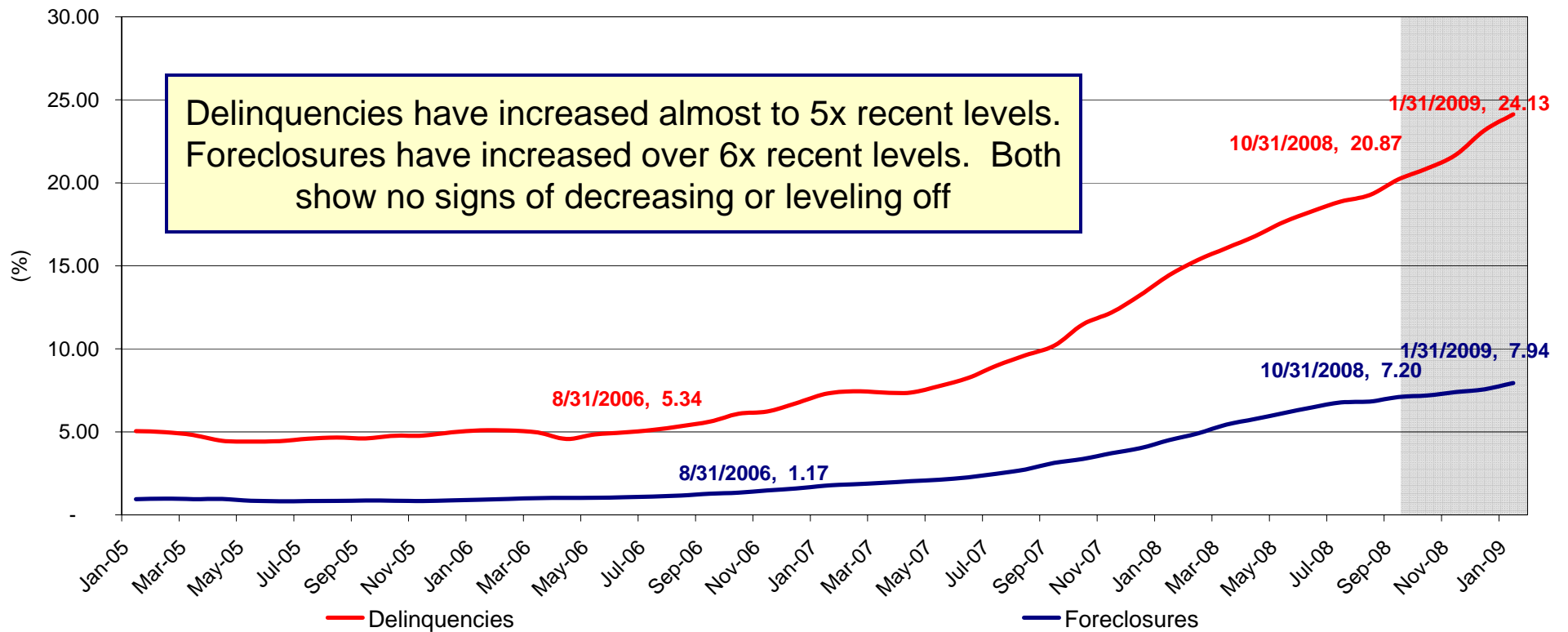
December State Coincident Indexes: Three-Month Change



Delinquency and foreclosure levels are increasing at an alarming rate . . .

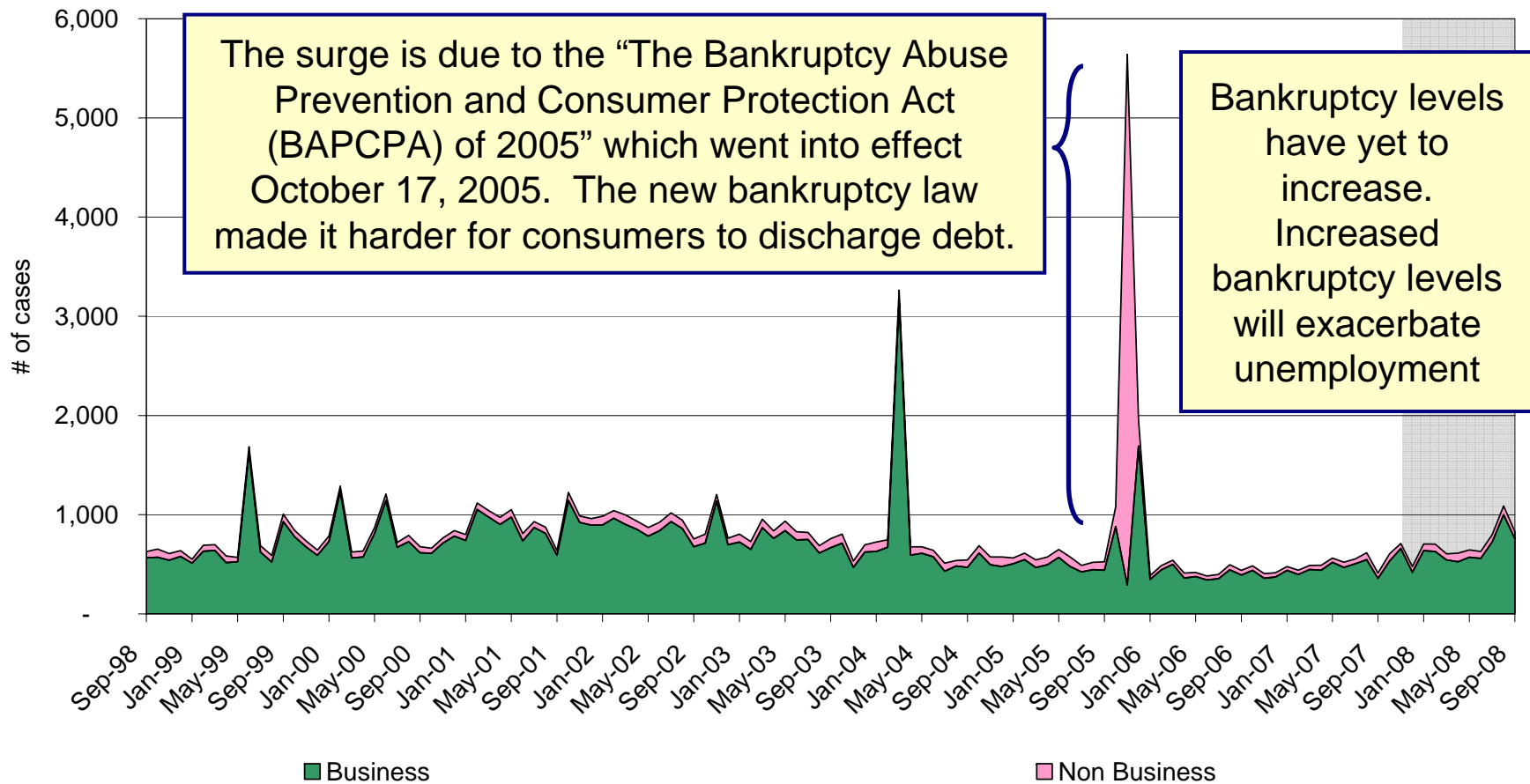


Delinquency and Foreclosure Rates

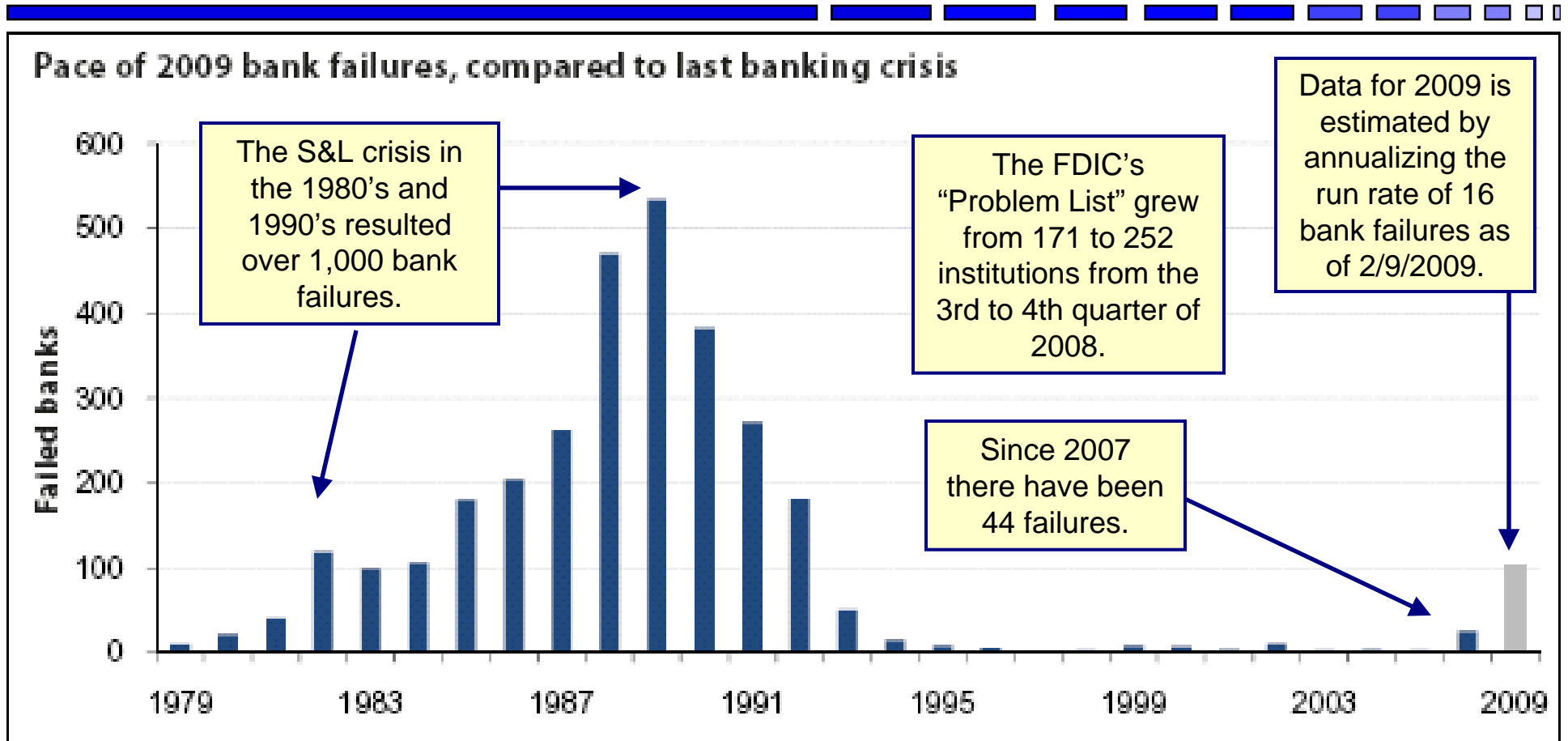


The total number of Chapter 11 cases filed in the US Courts . . .

Total Chapter 11 Filings



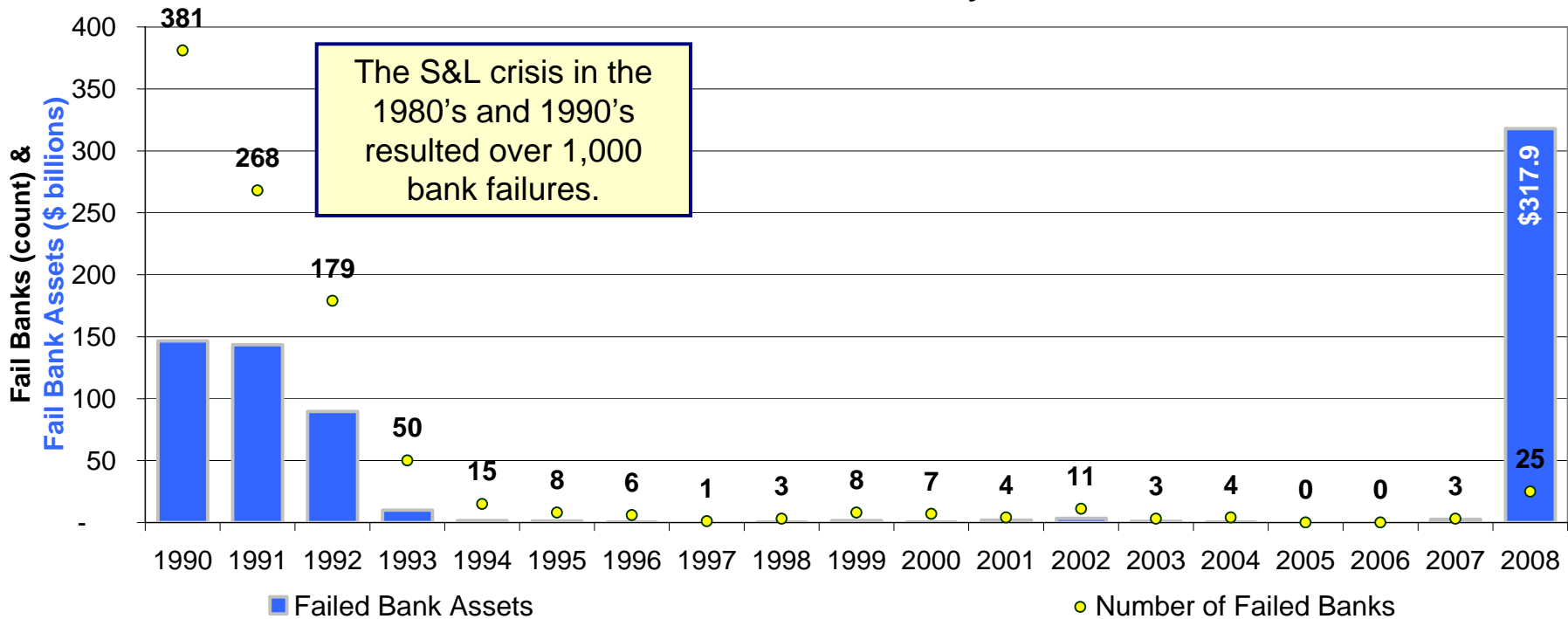
A summary of the failed banks in the U.S. from 1979 to 2009 . . .



A look at the failed banks in the United States since 1990 is shown below. While the number of bank failures is low, the volume of failed bank assets is extremely large . . .



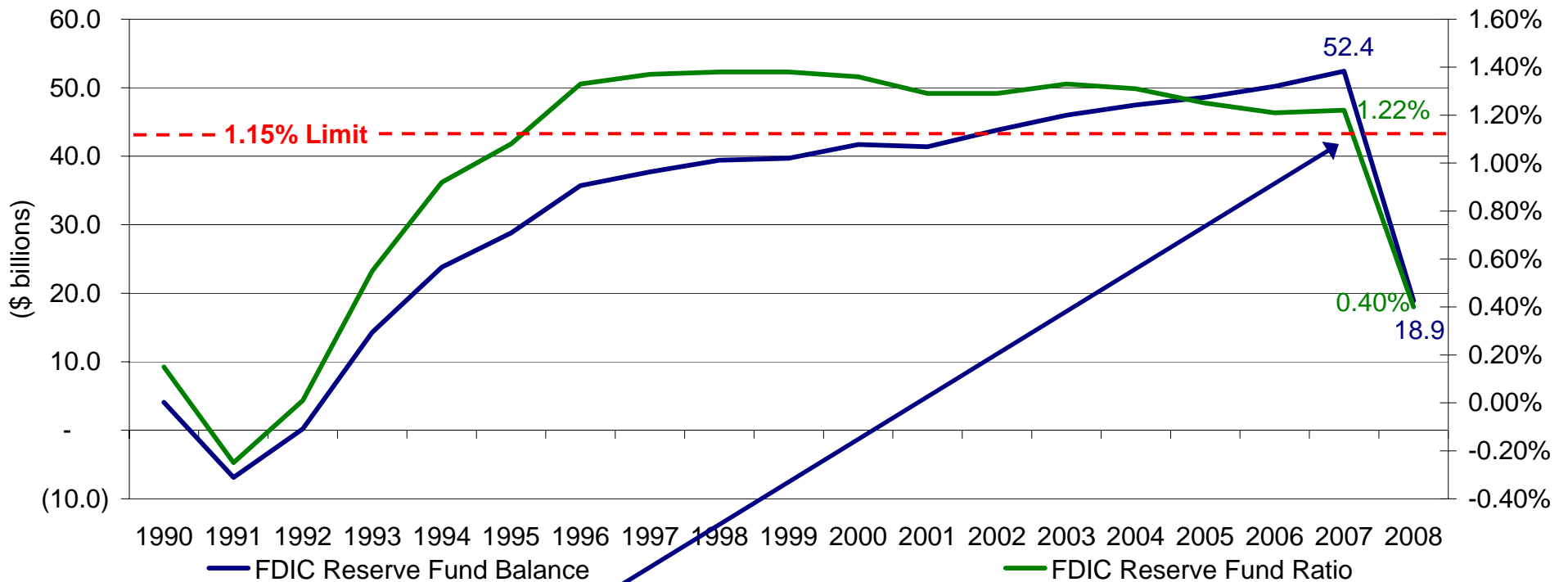
FDIC Failed Bank Analysis



Annualizing the bank failures so far in 2009, the total failures may reach 96 at the end of 2009.

As a result of the size and magnitude of the recent failures, the FDIC Reserve Ratio fell below the mandated percentage in 2008 . . .

FDIC Reserve Fund Balance & Ratio



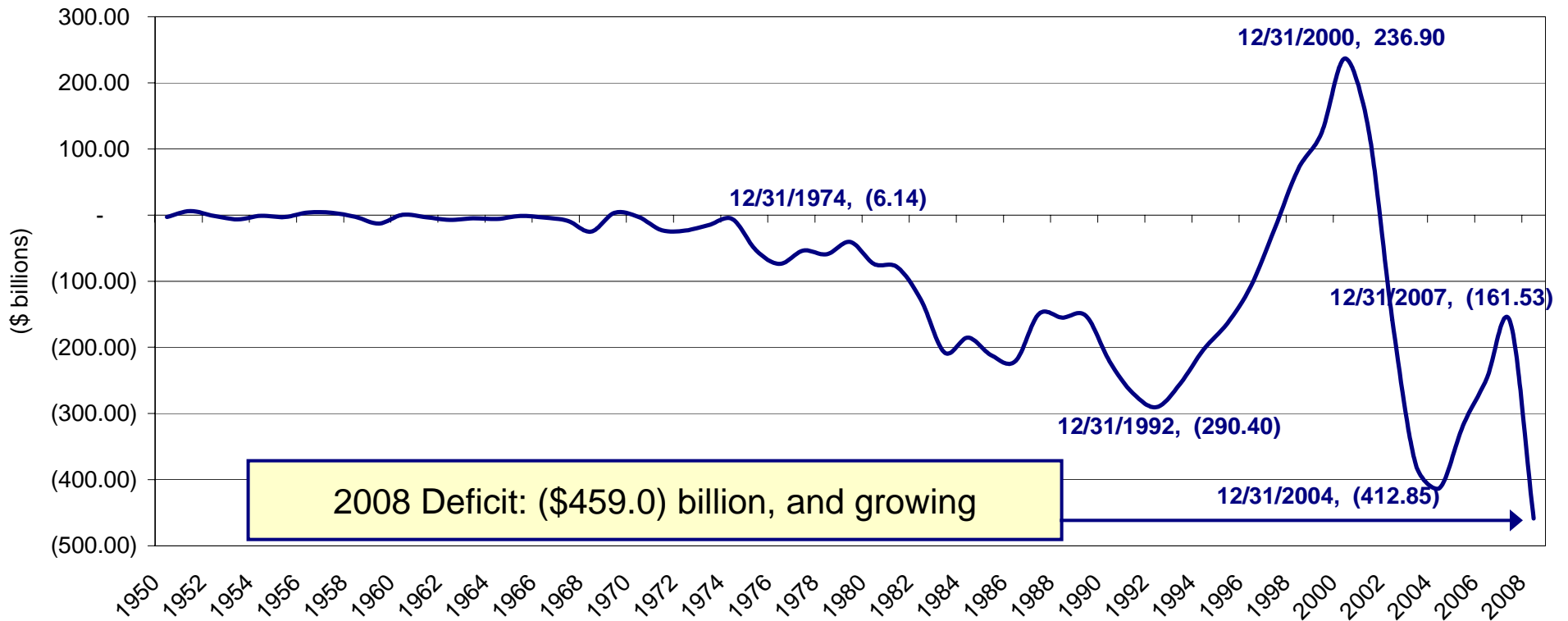
The FDIC is required by law to replenish the fund when the reserve ratio, falls below 1.15 percent.

The FDIC is proposing a combination of increasing insurance premiums and access to a LOC from the U.S. Treasury to replenish the fund over a period of 5-7 years.

The government's decision to spend record amounts of money will run record deficits and create the most intrusive government in history . . .



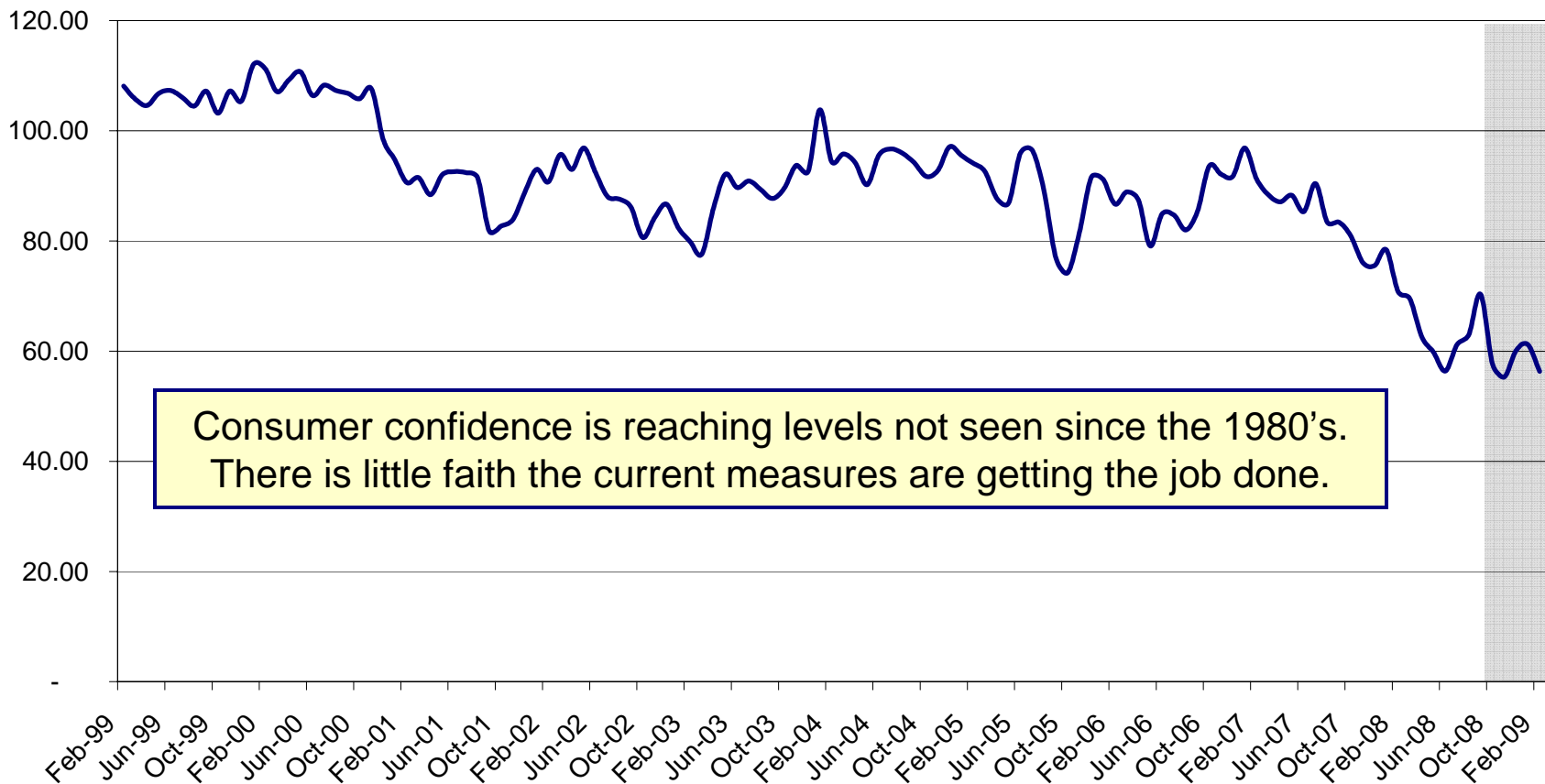
National Budget Surplus (Deficit)



Consumer confidence has been on a freefall since the beginning of 2007 . . .

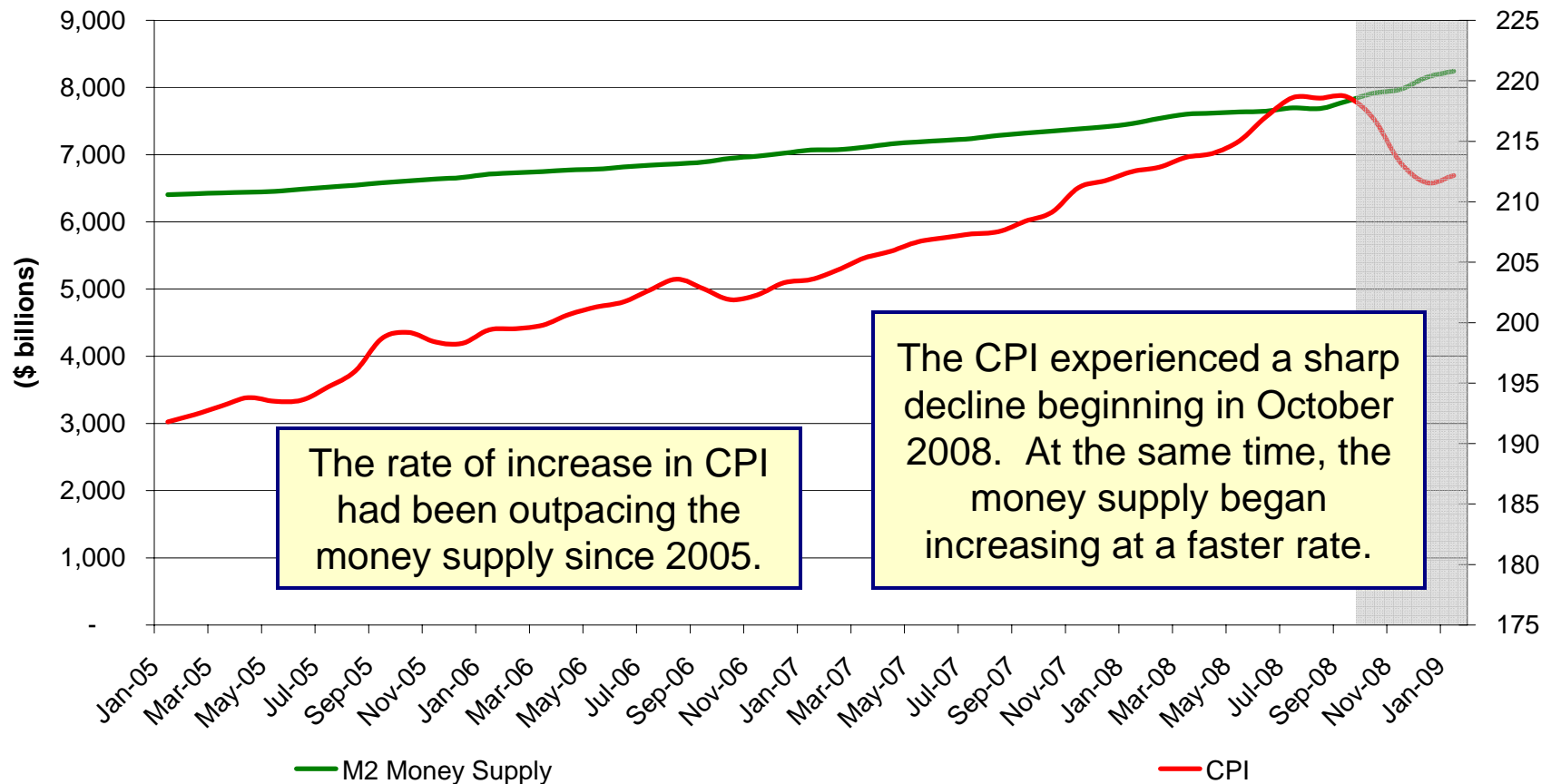


Consumer Confidence Survey



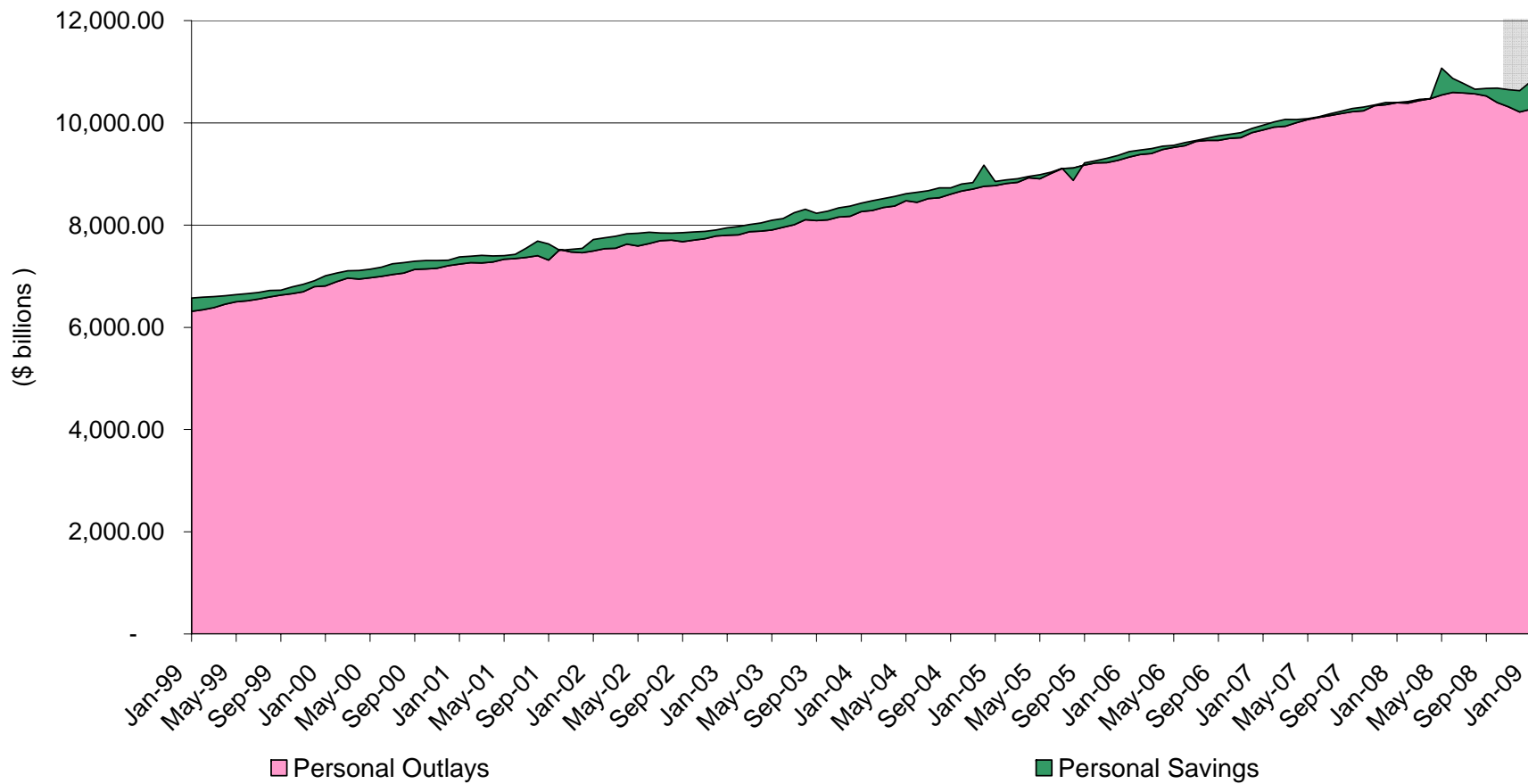
Pricing levels have decreased for the first time in over a decade as the money supply has increased at the fastest rate in years . . .

Consumer Price Index vs. The M2 Money Supply



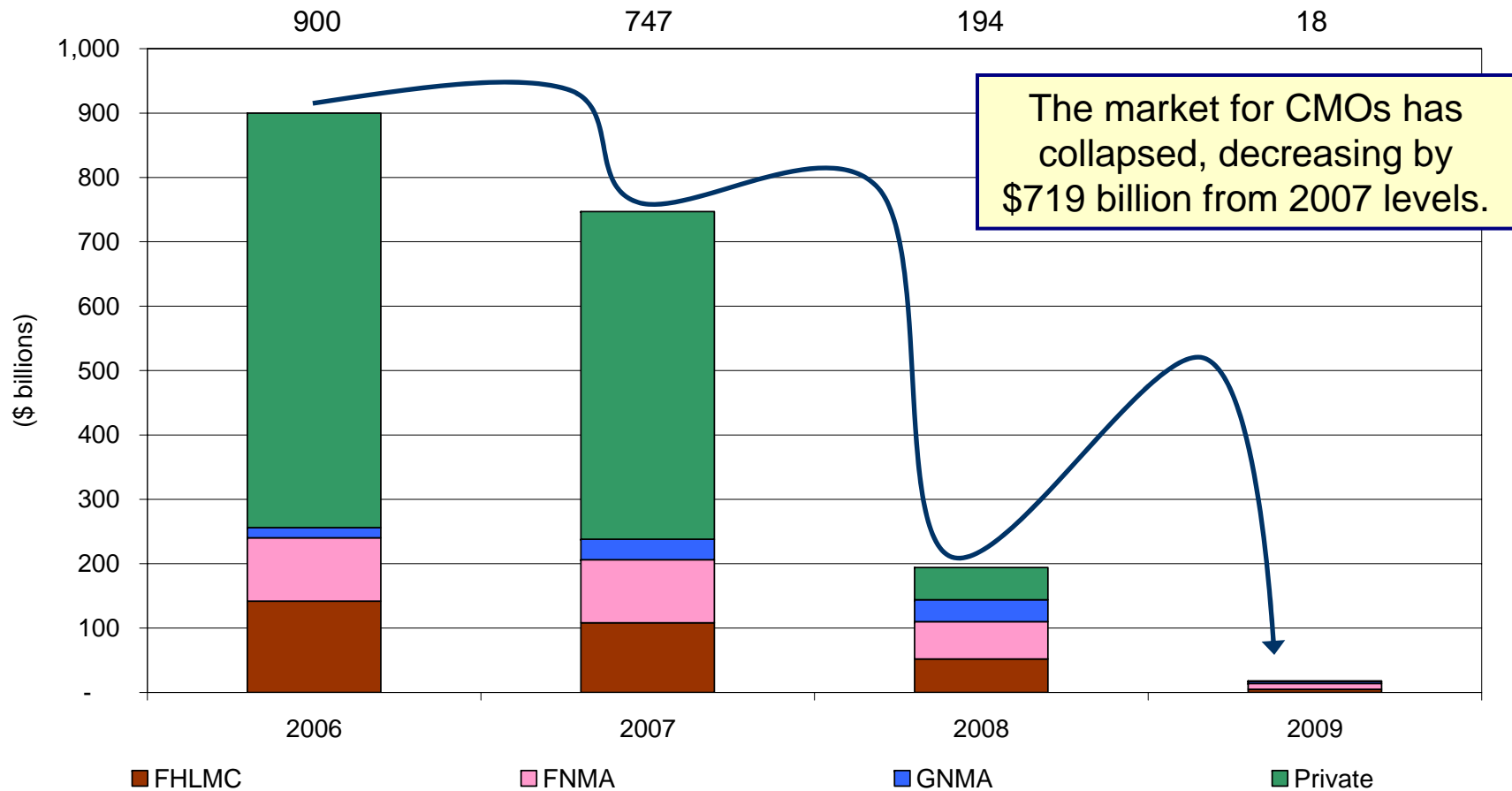
Personal outlays have decreased as total disposable income remained relatively flat through most of 2008 . . .

Total Disposable Income

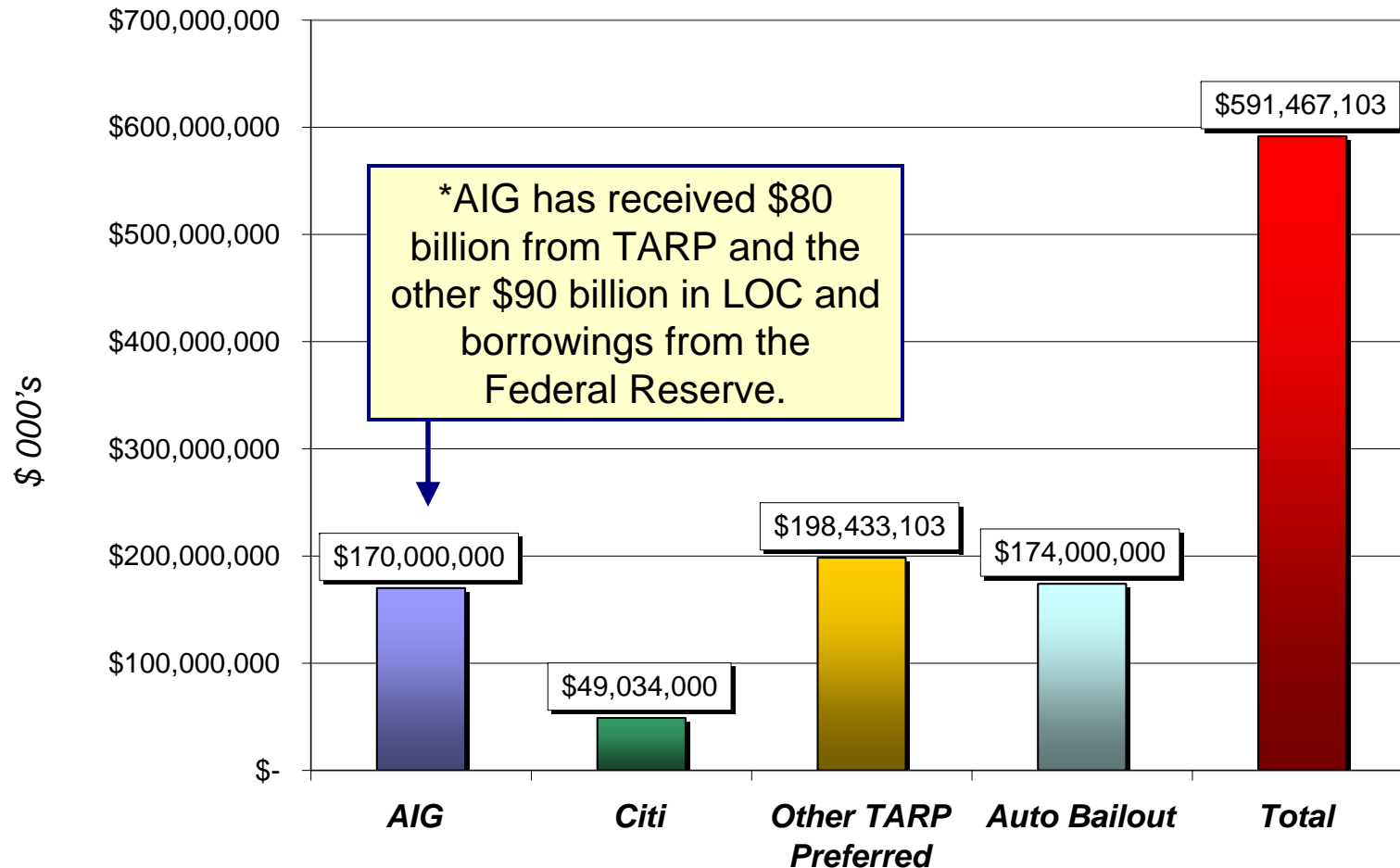


The CMO issuance has dried up to 2.00% of 2006 levels. The appetite for convoluted investment instruments has all but vanished from banking institutions . . .

CMO Issuance

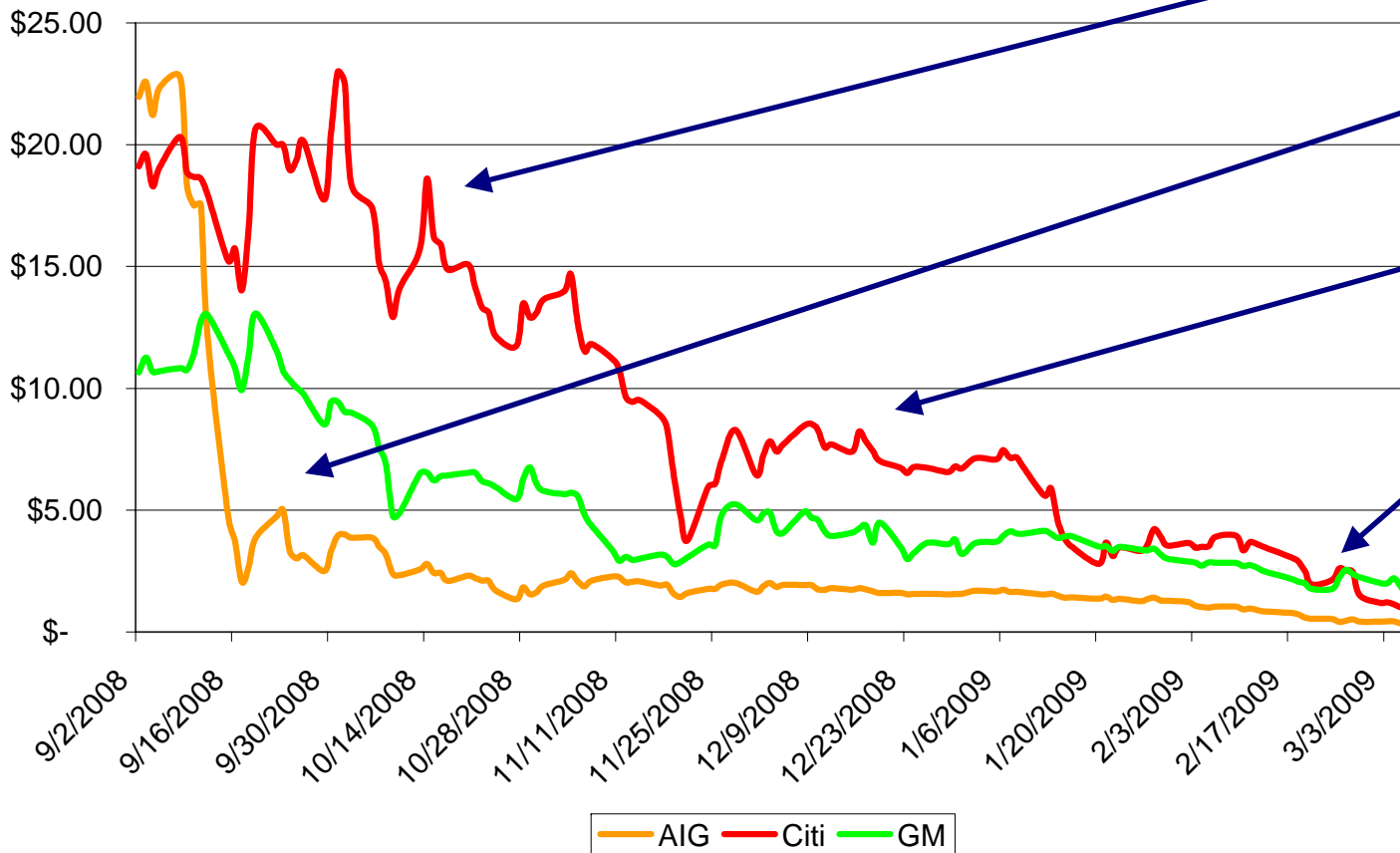


The total estimated committed bailout funds – TARP plus additional bailouts – by the U.S. Government as of March 2009 . . .



The three largest beneficiaries of government bailout funds have not re-gained the confidence of equity investors . . .

Stock Prices of AIG, GM and Citi



- The TARP Program is announced.
- AIG's initial LOC and investment from the Federal Reserve.
- The Auto bailout is announced.
- AIG announces the largest quarterly loss in history and plans for more government funds.
- Citi will convert over \$30 billion of TARP preferred into common equity. The stock closes at \$1.02 on 3/5/09.

The government has authorized \$350 billion and has actually utilized \$327 billion since mid October 2008, when the program was announced . . .

- General Terms

- The U.S. Government receives a 5+% dividend on 3 year preferred shares injected into financial institutions. The program also allows the government to exercise warrants at anytime during the investment period.

- Reasons for TARP

- To bolster the capital ratios of financial institutions and create stability in the equity and credit markets.
- Encouraged by regulators for the “good of the United States economy”
- Provide the U.S. Government (and taxpayers) with income in exchange for its injection of capital

<i>Data as of 3/6/2008</i>		
Summary	Institutions	Preferred Outstanding Amount (\$000)
Applied	57	0
Approved	61	0
Participating	495	327,467,103
Total	613	327,467,103

First and foremost, the TARP program has created net interest income for the U.S. Government . . .

- The first tranche of the TARP program issued \$327 billion of preferred shares with dividend yields on 5+% depending on the company. The government can expect the following annual net interest income from its TARP investments:

	\$ 000's	%
Interest Income	\$ 18,523,655	5.66%
Cost of Funding	\$ 6,894,671	2.11%
Net Interest Income	\$ 11,628,984	3.55%

- If all of the government's shares of Citigroup are converted from preferred to common shares and A.I.G. defers or does not pay its TARP preferred, net interest income falls drastically but still is positive:

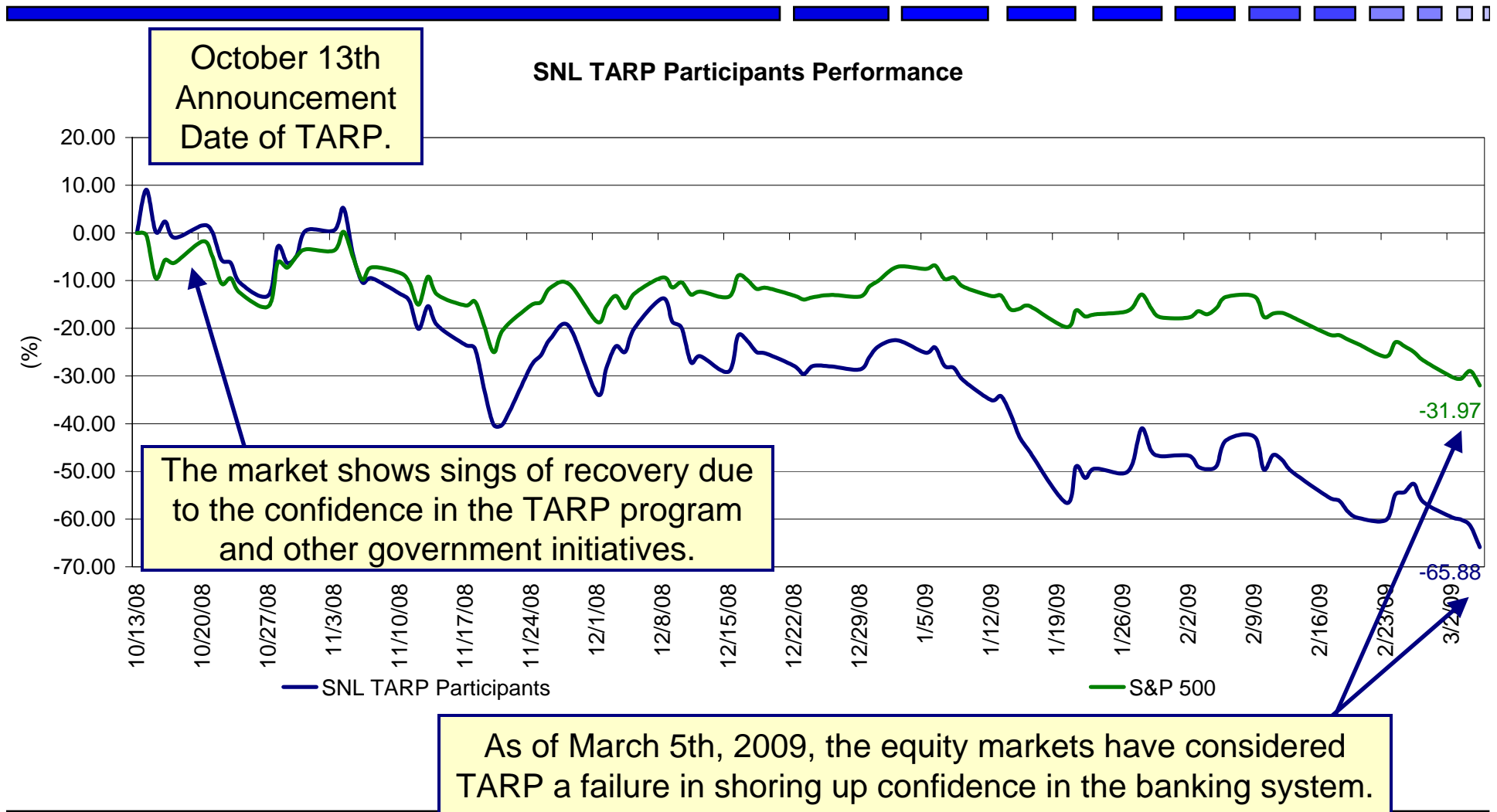
	\$ 000's	%
Interest Income	\$ 10,071,955	5.08%
Cost of Funding	\$ 6,894,671	2.11%
Net Interest Income	\$ 3,177,284	2.97%

Note: Cost of funds was calculated by spreading expense equally across the Treasury Curve for the week ending 10/17/2008.

Continued, results of the TARP program . . .

- Many institutions who accepted TARP funds have or are planning to pay the government back.
 - Some of the major institutions that have announced they plan to give back the TARP funds include TCF Financial Corp, PNC Financial Services Group Inc., U.S. Bancorp, Northern Trust Corp., JP Morgan Chase & Co., and IBERIABANK Corp.
 - One of these reasons is due to the negative publicity.
- Some institutions are cutting their dividend on existing common and/or preferred stock in order to preserve the capital. Some institutions are preserving capital in order to pay back the government bank TARP funds.
- TARP has failed to create stability in the equity markets.

The stocks in the SNL TARP Index have plunged 65.88% since the October 13th, 2008 announcement of the program, while the S&P Index has declined 31.97% over the same period . . .



The derivatives industry has come under fire primarily due to the fallout of A.I.G. The primary issue in the derivative markets is counterparty risk . . .

- A.I.G. was one of the largest writers of protection from default, also known as credit default swaps (C.D.S.).
 - For example, Goldman Sachs holds a corporate bond on its book, and it purchases insurance from A.I.G. to offset its risk of default. In this example, Goldman Sachs is the counterparty to A.I.G. in the CDS transaction.
- As the value of securities held by A.I.G.'s counterparties have fallen rapidly and A.I.G.'s own credit ratings have fallen, A.I.G. has been forced to post more collateral to its counterparties.
- The problem was A.I.G. did not have the capital nor liquidity to post further collateral to its counterparties. As such, A.I.G. faced the risk of default and its counterparties would take losses due to the contracts being essentially worthless.
- The massive government injection (approximately \$170 billion) was aimed to boost capital and liquidity and allow A.I.G. to meet its collateral requirements to its counterparties in connection with its C.D.S. transactions.



What Can Be Done: Economic Stimulus Going Forward

The economic solutions put forth today do not appear to be working. It is time to re-examine the core issues . . .

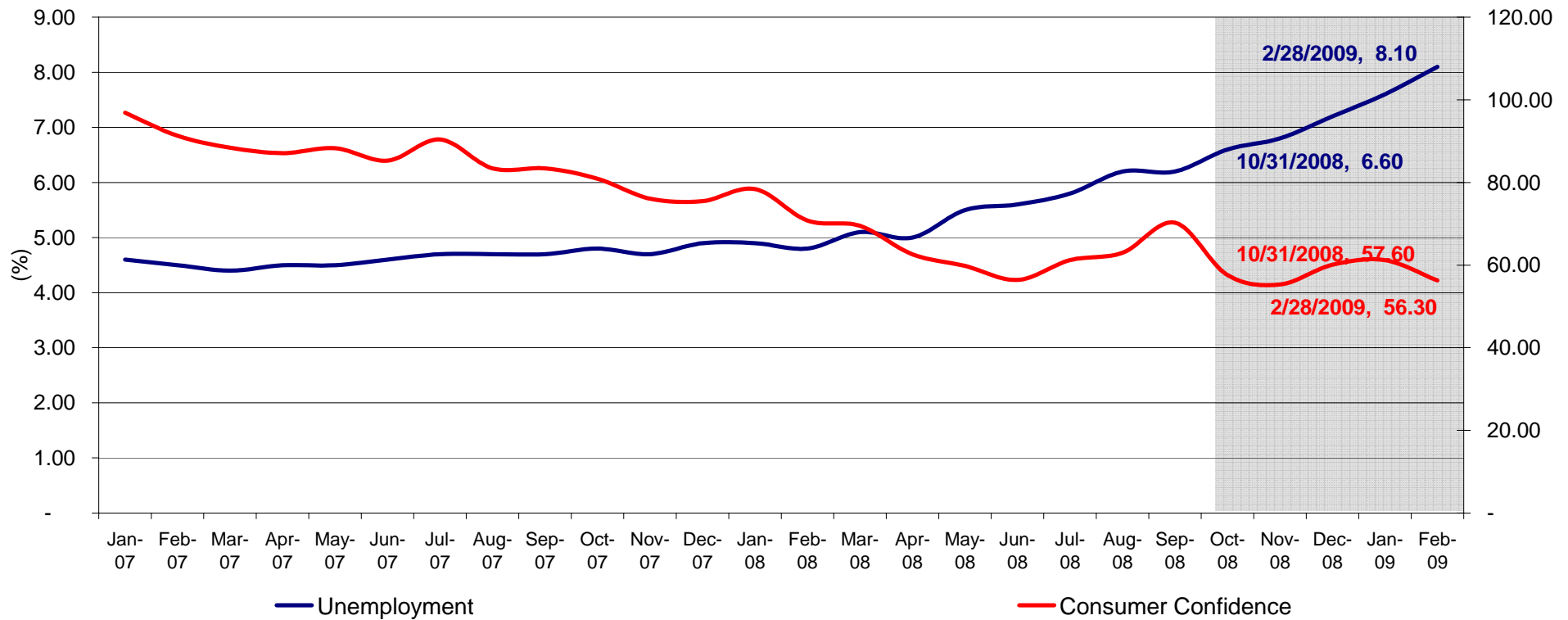
- Economic Stimulus

1. Restore consumer and business confidence
2. Stabilize real estate values
3. Lower taxes on business
4. Permanently reinstate uptick rule
5. Eliminate mark-to-market accounting
6. Regulation of derivatives
7. Put stimulus towards creating jobs/building infrastructure only
8. Fiscal Management - Budget reduction – Eliminate Pork & Earmarks
9. Fund the government with long term treasuries
10. Decrease the influence of lobbyists and special interest groups
11. Eliminate government contradictions (jobs vs. environment)
12. Get the right people on the bus – restore confidence in our leadership –
Term limits

To restore consumer and business confidence, stabilizing the job market must be one of the first priorities . . .

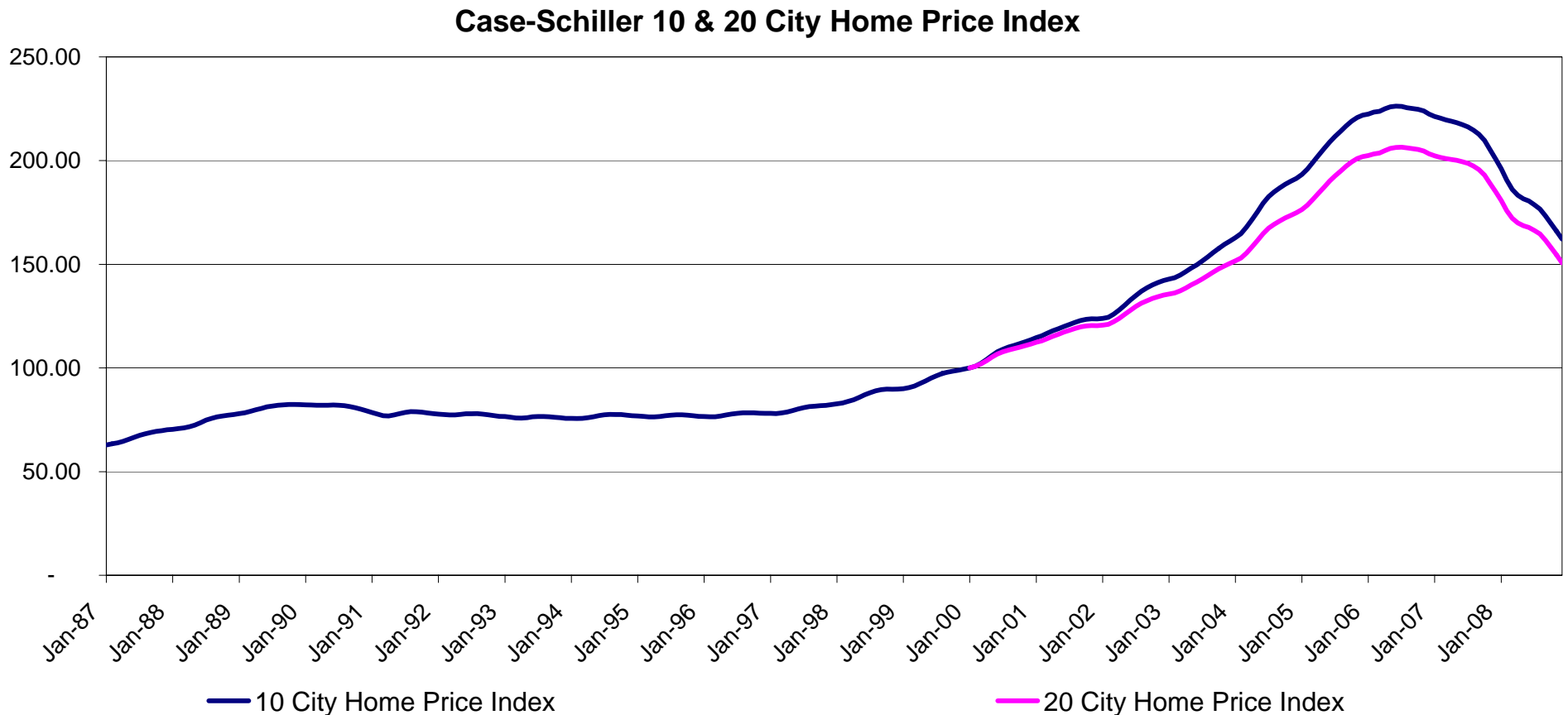
- Stabilizing the real estate market, stock market and bond markets would also help greatly.

Unemployment and Consumer Confidence



To stabilize the real estate market, the government sponsored agencies need to continue purchasing mortgages in an effort to support lending and housing market . . .

- Returning the housing market to affordable levels will provide the stability.



Affordability is based off income. How much of a mortgage payment can an individual afford to pay based off monthly income . . .

AFFORDABILITY ANALYSIS	The United States	California	New Jersey	Florida	New York	Mass.	Hawaii	District of Columbia
2007 Estimated Median Owner-Occupied Housing Unit Value	\$172,914	\$466,668	\$329,990	\$194,467	\$263,870	\$346,842	\$466,595	\$377,048
<i>Assumed Median LTV</i>	80%							
Estimated Median Mortgage	\$138,331	\$373,334	\$263,992	\$155,574	\$211,096	\$277,474	\$373,276	\$301,638
<i>Assumed Term (months)</i>	360							
<i>Assumed Rate</i>	6.00%							
Req'd Monthly Payment on Median Mortgage	\$829	\$2,238	\$1,583	\$933	\$1,266	\$1,664	\$2,238	\$1,808
Interest Only Monthly Payment on Median Mortgage	\$692	\$1,867	\$1,320	\$778	\$1,055	\$1,387	\$1,866	\$1,508
Principle	\$138							
2007 Estimated Median Household Income	\$49,314	\$56,379	\$65,216	\$45,757	\$50,322	\$60,331	\$59,106	\$49,549
<i>Assumed Tax Rate</i>	20%							
<i>Assumed Underwriting Qualifying Level</i>	30%							
Median Qualifying Monthly Payment	986	1,128	\$1,630	915	1,006	1,207	1,182	991
Difference: Ability to Pay vs. Market req'd Pmt	157	(1,111)	48	(18)	(259)	(457)	(1,056)	(817)
Difference: Ability to Pay vs. IO Pmt	295	(739)	310	137	(49)	(181)	(684)	(517)
Home Price that Set Ability to Pay = Market req'd Pmt		\$235,176		\$190,797	\$209,832	\$251,568	\$246,460	\$206,609
Change Needed		(231,492)		(3,670)	(54,038)	(95,274)	(220,135)	(170,439)

Using the assumptions above (in blue), the median owner occupied housing unit is barely affordable.

However, many states are not affordable. States such as California are prime examples of states where housing prices need to fall into line with the state's income levels.

As credit tightens for most businesses, taxes only further sap the resources of companies struggling to survive the recession . . .

For every increase in the tax rate, companies lose economic value . . .

	20% Tax Rate	40% Tax Rate	Difference
Net Income Pre Tax	4,000,000	4,000,000	
Taxes	800,000	1,600,000	800,000
Net Income Post Tax	3,200,000	2,400,000	(800,000)

To compensate, jobs and other resources are lost . . .

Salary Cuts	-	740,000
R&D Cuts	-	355,000
Occupancy Cuts	-	240,000
Total Cuts		1,335,000

In the end, an increase in tax revenue comes at the cost of employment . . .

Net Income after cuts	-	5,335,000
Taxes After Cuts	-	2,134,000
Net Income Post Tax & Cuts		3,201,000

All cuts are in order to return to the same post tax net income levels.

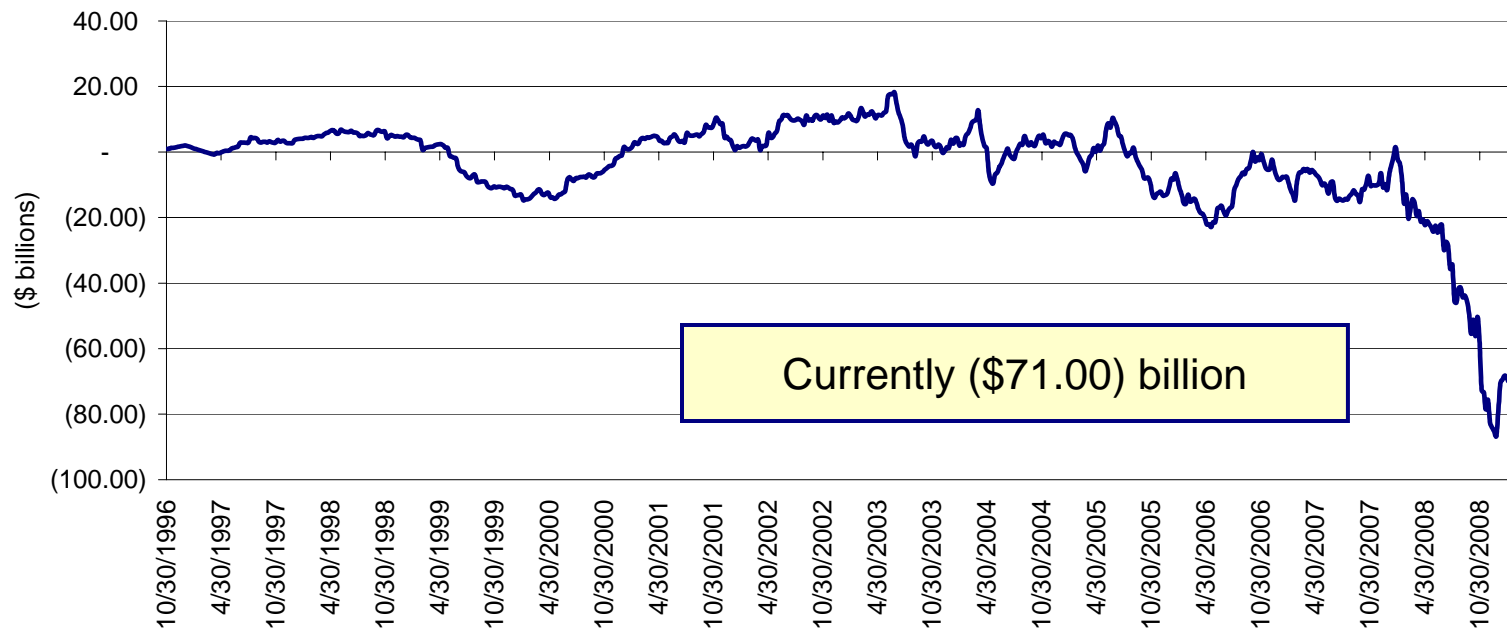
The SEC eliminated the “uptick rule” in 2007, the moment it would have served the most use . . .

- Many have been critical of the SEC since repealing the uptick rule.
 - Using a 6 month study on select securities starting in May of 2005, the SEC studied the effectiveness of the uptick rule.
 - Critical parties point to the fact that the study was not thorough, indicating that the uptick rule had not been tested during recessionary periods.
- In the 12 months following Sept. 30, 2007, the number of NYSE-listed stocks with price drops of over 40% in one day doubled as compared to a prior period with similar market declines and high volatility -- the 12 months following March 31, 2000.

Mark-to-market accounting forces institutions to take unrealistic hits against the market value of illiquid but performing securities carried on their balance sheet . . .


- As real estate value has deteriorated and credit has dried up, the value of performing securities have been severely depressed.
- Mark-to-market accounting creates artificial swings in valuations of companies as they take losses on otherwise performing securities.

Net Unrealized Gain(Loss) on AFS Securities at Commercial Banks



Holding an investment “Available For Sale” is a mistake for an institution that does not actively trade the investment portfolio . . .

- Using the projected cash flow to determine the price of an investment product is more accurate than the market’s demand.
 - Using the market’s demand to determine a price relies on the assumption of efficient, liquid, rational markets. The advantage of using a cash flow to determine a price is that when the markets are inefficient, irrational or illiquid and the security is still performing the result is a price that reflects performance.

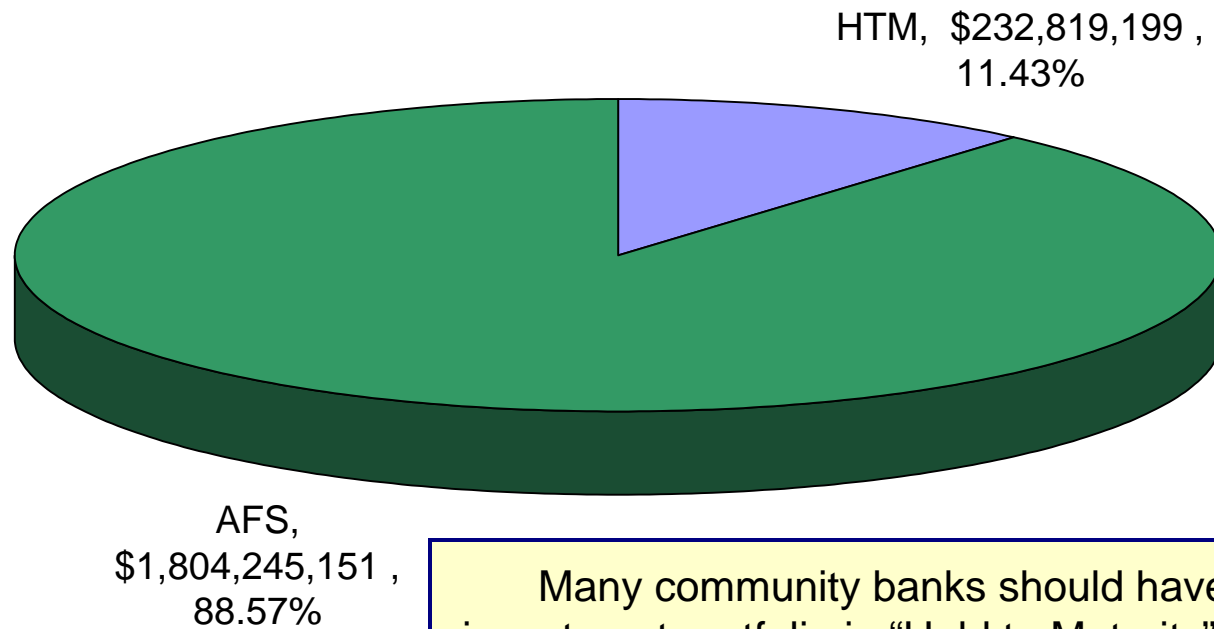
Example Bond		At issue:		Price decreases 20:
Security Value:	\$	1,000,000	\$	800,000
Coupon:		5.00%		6.25%
Price:		100.00		80.00
Monthly Cashflow:	\$	4,167	\$	4,167
Hit to Capital:		-		200,000
Asset Growth Capacity Deminished by:			\$	2,500,000
<i>based on 12.5x leverage*hit to capital</i>				

There is a yield adjustment, but if this security is still performing and is projected to repay all principal, why write down the value and take a hit to capital?

Too much of the industry holds their portfolio in “Available for Sale” . . .



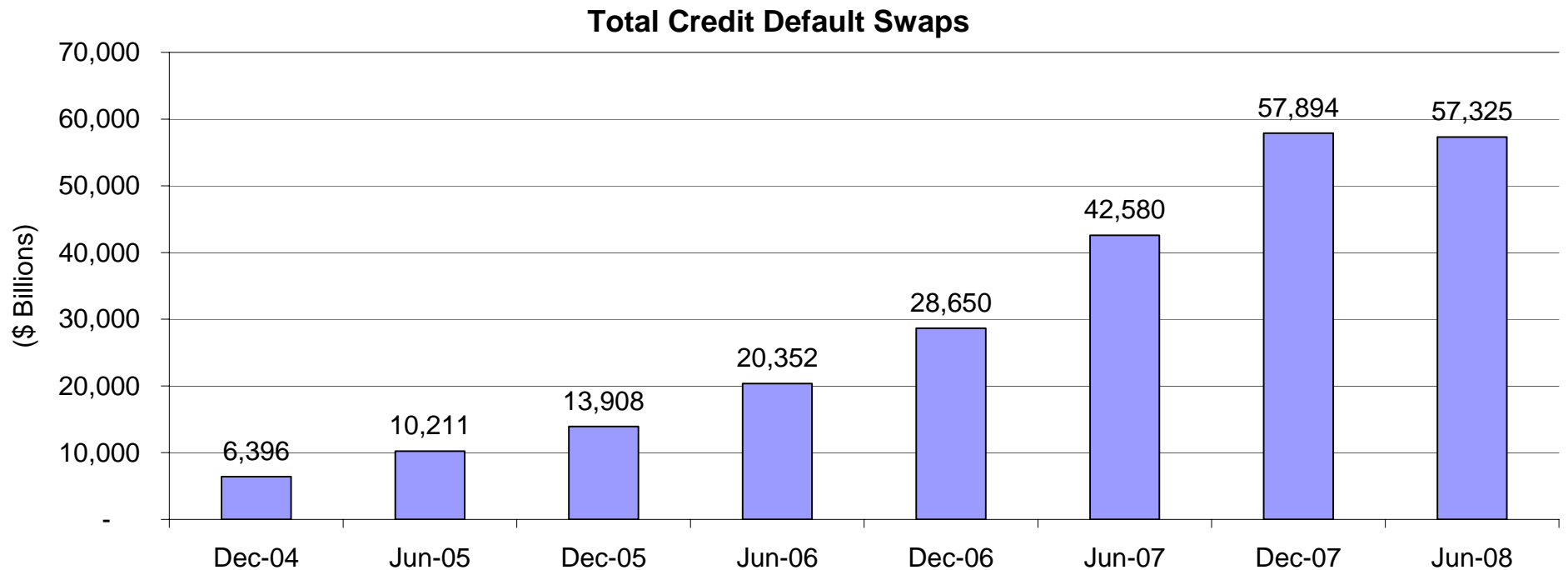
Total Held-to-Maturity vs. Available-for-Sale Investment Holdings



Many community banks should have all of their investment portfolio in “Held to Maturity” to avoid FASB 157 adjustments due to swings in market valuations.

The issuance of derivatives has exploded in the recent years . . .

- The credit default swaps (“CDS”) market contracted for the first time in the first half of 2008, from \$57.9 trillion to \$57.3 trillion. Prior to that, the market had grown at least 30% - usually over 40% - every six months since 2004.
- The total derivatives markets totaled \$683.7 trillion as of June 30, 2008.



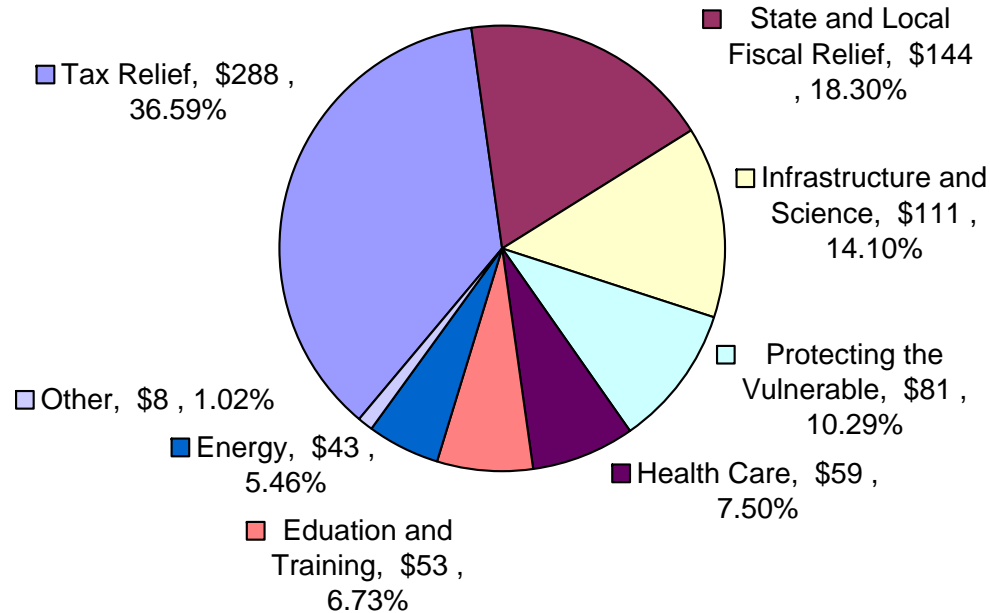
Many of the major exposure problems in the derivatives market, especially those of A.I.G. and Lehman Bros. are due to liquidity problems. Specifically, not having the collateral on hand to meet margin calls due to mark-to-market downgrades . . .

- The solutions needed to fix the derivatives market are as follows:
 - A central clearinghouse needs to be used to match buyers and sellers and mitigate counterparty risk. The government has approved ICE (Intercontinental Exchange) to do the preliminary clearing. This is a step in the right direction.
 - Regulated entities like banks, thrifts, insurance companies and broker-dealers must have guidelines and limitations to exposure on **both** sides of a derivative contract.
 - Much like traditional banks have capital adequacy guidelines, buyers and sellers of derivative contracts should have guidelines defining the amount of leverage that can be used when entering into a derivative transaction.
 - Companies that want to speculate in the derivative markets should **not** be part of a traditional insurance company or bank/thrift.
 - Regulated financial institutions should be allowed to buy and sell derivatives to hedge their positions, not to speculate.

The stimulus should be used for infrastructure and job creation **only** . . .

- The stimulus package has \$144.0 billion earmarked for “State and local fiscal relief” for governments that cannot balance a budget. A total of \$81.0 billion is tagged for “Protection of the Vulnerable”. “Other” totals \$8.0 billion without additional clarification.

The \$787 Billion Stimulus Bill



Only \$111.0 billion has been directly allocated towards investment in job creation.

The stimulus package is loaded with spending items that will fail to create jobs or revitalize the economy, meanwhile the economy has now lost 4.4 million jobs since January 2008, 2.6 million jobs in the past four months alone.

And on top of the \$787 billion stimulus package, another \$410 billion worth of spending was passed in March. That is over \$1.2 trillion worth of spending in 20 days . . .

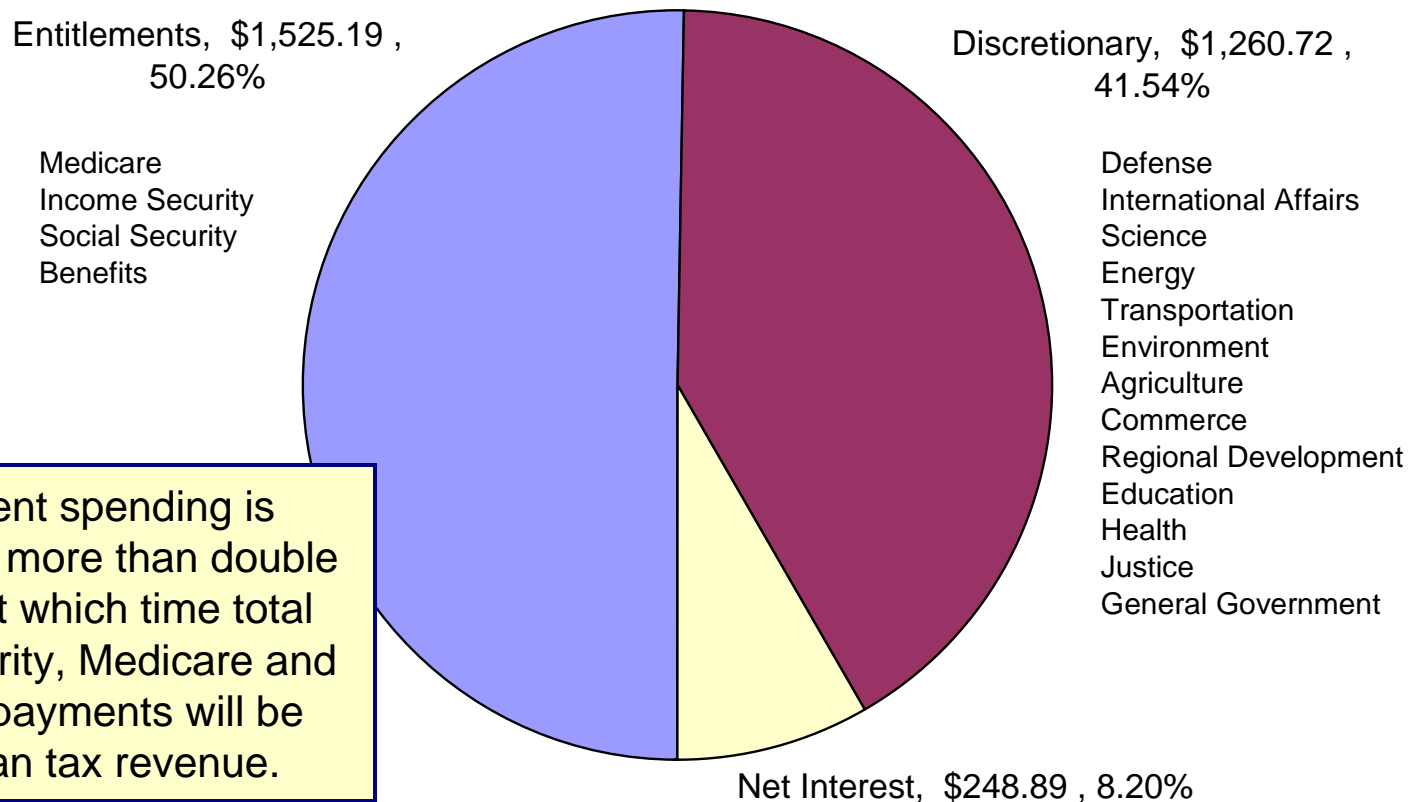
- The latest spending bill had 9,000 earmarks, including absurdities such as:
 - \$200,000 for the Tattoo Removal Violence Prevention Outreach Program
 - \$473,000 for the National Council of La Raza
 - \$750,000 for “Illinois Height Modernization” for the Illinois State Geological Survey.
 - \$5,800,000 for the Ted Kennedy Institute for the Senate.

Not only is the amount of spending irresponsible, but what the government is spending the money on is absolutely ridiculous.

Looking at the deficit, entitlement spending is out of control . . .



2008 Budget Outlays, Entitlements vs. Discretionary
(\$ in billions)



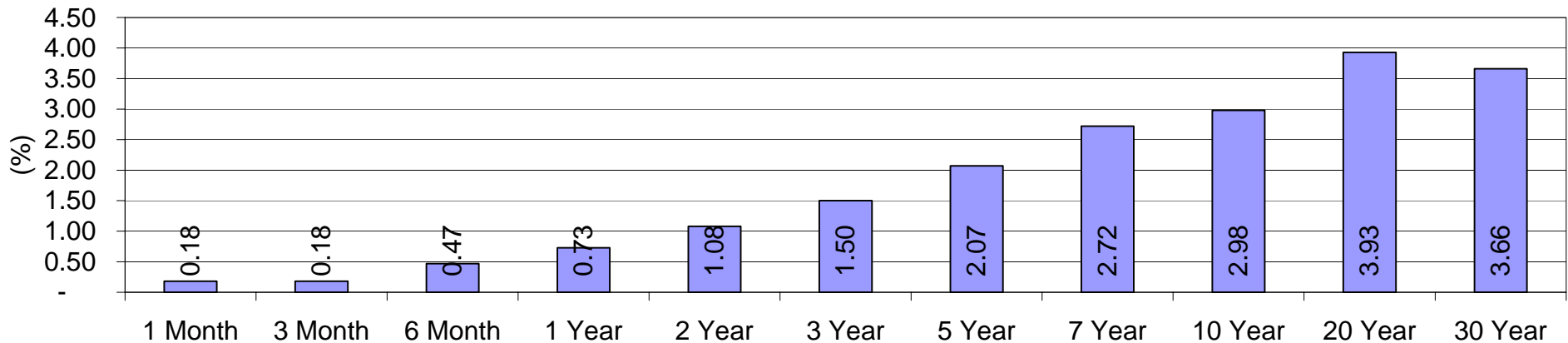
Entitlement spending is projected to more than double by 2052, at which time total Social Security, Medicare and Medicaid payments will be larger than tax revenue.

The government needs to fund itself with long term treasuries, not short term notes. The entire Treasury Curve is below the current cost of the US debt . . .

- As rates have come down, the government is in the perfect position to start funding itself based off of longer term bonds, eliminating funding by shorter term notes.

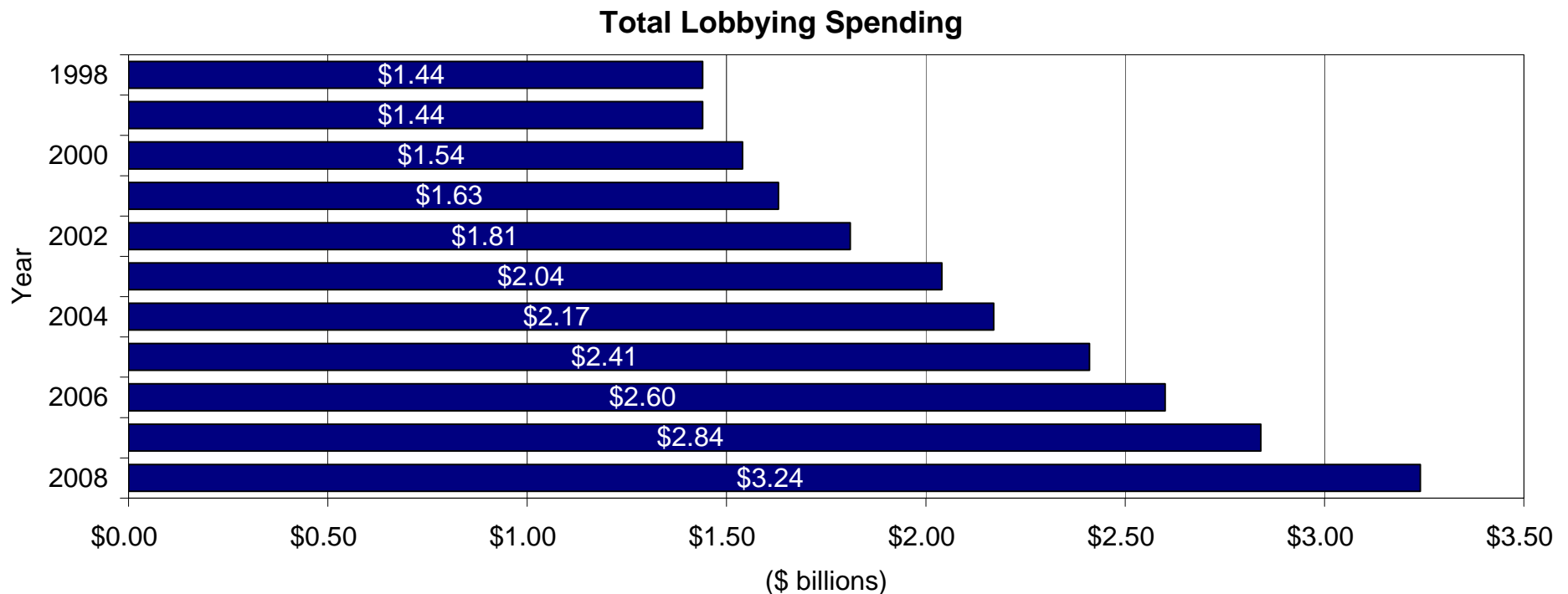
	(Billions)	
A. U.S. Debt	10,700	10,700
B. U.S. Budget	2,902	2,902
C. Interest expense on debt	451	319
(C / B) How much budget used for debt	15.55%	10.99%
(C / A) Cost of debt?	4.22%	2.98%

US Treasury Curve as of 26-Feb-09



Lobbyist spending has grown out of control and needs to be curtailed . . .

- Total lobbyist spending in 2008 topped \$3.24 billion, up over 50% from 2000 levels.



Lobbyist and special interest groups have too much power in Washington.

Government contradictions continue to provide enough red tape to discourage any innovation and job creation in many “green” job fields . . .

- The government would create jobs, but also decrease dependence on non-sustainable energy sources (oil, coal, etc.) by using stimulus money to invest in solar and wind energy systems for residential and commercial properties.

Total Government Investment:	\$	250,000,000,000	A
Cost of implementing solar/wind system:	\$	25,000	B
Total number of systems:		10,000,000	A / B = C

Estimate of systems installed per year:		2,500,000	D
Duration of Program (years):		4.00	C / D = E

Labor Costs

Cost of implementing solar/wind system:	\$	25,000	B
Percent of each system implemented:		30.00%	F
Labor costs of each system:	\$	7,500	B * F = G
Estimate of systems installed per year:		2,500,000	D
Total Payroll of Program (per year):	\$	18,750,000,000	D * G = H

Average employee salary:	\$	70,000	I
Total Jobs Created:		267,857	(H / I) = J

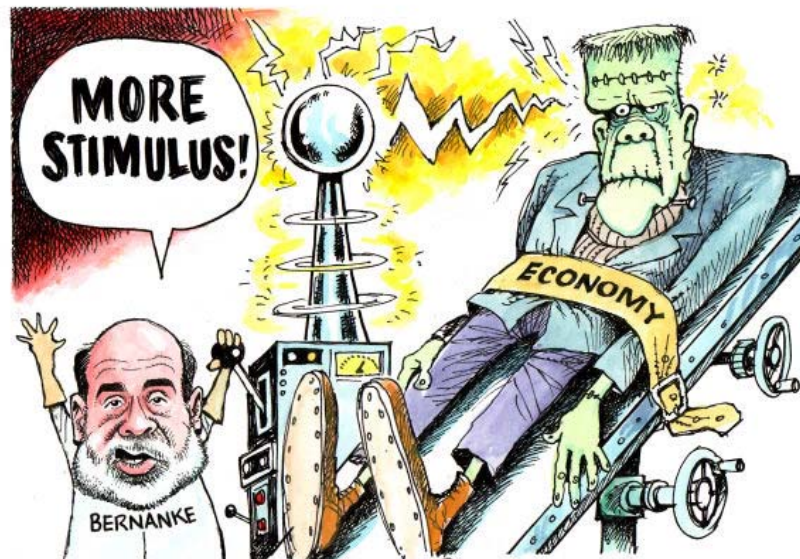
Cost of each job to the investment:	\$	233,333	(A / J) / E = K
Employee Salary:	\$	70,000	I
Paid to manufacturer:	\$	163,333	K - I = L

The initial investment will install 1,000,000 solar/wind systems over a 4 year period and will immediately create thousands of jobs.

Money will also flow to the manufacturer, who will face increased demand for the product, which will create more jobs, increasing total payrolls further.

Get the “right people on the bus” to solve the problem . . .

- The politician’s lack of real world experience leaves them completely unqualified to solve the current problems facing the nation.
- This problem was created by bankers and financial “experts” who made risky bets with highly leveraged balance sheets as well as consumers who failed to live within their means. The best chance to solve this problem is bankers and **actual** financial experts who live and work in the industry.





What Can Be Done: Financial Regulatory Reform

In addition to fixing the economy, regulatory reform is necessary . . .

- Financial Regulatory Reform

1. Eliminate “too big to fail doctrine”
2. Re-instate a reasonable ALLL calculation.
3. Financial Institution Regulatory reform
4. Temporarily decrease capital requirements for CAMELS 1 and 2 institutions
5. Make permanent insurance of all noninterest bearing deposits
6. Roles of FHLB and Federal Reserve
7. Eliminate liquidity contradictions
8. Cramdowns

1.

The big banks have become too large to function efficiently and are a systemic risk to the nation, however nationalizing these institutions is not the solution . . .

- The “too big to fail” have become the “too big to succeed” as losses continue to mount at these “financial supermarkets.”
- An organized break-up of the institutions will contribute to a safer banking system.

	Total Assets	Loans/ Assets	NPLs/Tot Lns	Risk Based Capital Ratio	Tier 1 Risk Based Ratio	Leverage Ratio
150 mil - 5 bil	331,521	73.97%	1.32%	12.94%	11.78%	9.00%
5 bil - 25 bil	8,962,225	70.23%	1.62%	13.15%	11.42%	8.79%
25 bil <	78,356,709	66.70%	1.70%	13.82%	10.66%	8.42%

Smaller institutions tend to have higher loan levels and better asset quality while maintaining higher capital ratios

2.

Regulators should have a consistent, long term view of ALLL. Institutions can no longer use their reserves as shock absorbers against losses . . .

- An institution with a \$1.0 billion loan portfolio and 1.0% reserves ratio that takes a charge off has to immediately return the reserves ratio to 1.0%.

Loans, Gross:	1,000,000,000
Reserve Level:	1.00%
Total Reserves:	10,000,000

\$2.0 million charge-off . . .

Loans, Gross:	998,000,000
Reserve Level:	0.80%
Total Reserves:	8,000,000

Immediately replace reserves . . .

Loans, Gross:	998,000,000
Reserve Level:	1.00%
Total Reserves:	9,980,000

Hit to income 1,980,000

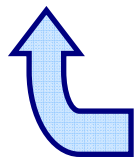
- Forcing charge-offs to immediately flow through to the income statement negates the purpose of reserves.
 - There is no purposes of keeping reserves if institutions are forced to replace them immediately.

3.

The consolidation of regulatory bodies would be able to provide continued clear, concise guidance on the status of the regulators . . .

- The Fed has taken the lead when the regulators have worked closely with the government on important industry issues during the current economic crisis. Important policy statements during this recession have either been handled by the FDIC or the Fed.
- The Federal Reserve is becoming the top watchdog, however the FDIC continues to play an important roll.

Systemic Regulator	Insurance	Primary Bank Examiners
Federal Reserve	FDIC	OCC OTS State



Watch for the role of the OTS, OCC and State regulators to decrease as the Federal Reserve continues to increase its role.



4.

Contrary to the actions of the government in recent months, there are ways to loosen up the credit markets without spending tax payer dollars . . .

-
- Loosening capital standards on “1” and “2” rated institutions will allow successful, well run institutions to further leverage their current capital base.
 - As a proxy for determining “1” and “2” rated institutions, institutions with four consecutive quarters of positive net income **and** four consecutive quarters of less than 75 bps of non performing assets as a percent of total assets where used.
 - The total universe of top tier consolidated institutions including bank holding companies, commercial banks, savings banks and savings institutions consists of 7545 institutions.
 - 4254 have four consecutive quarters of positive net income
 - 2820 have four consecutive quarters of less than 75 bps non performing assets as a percent of total assets.
 - Combining these criteria, **only 2016 institutions** have four consecutive quarters of positive net income and less than 75 bps non performing assets – 27.05% of all institutions.

4.

Assets for these institutions totaled \$1.8 trillion on total equity capital of \$159.0 billion . . .

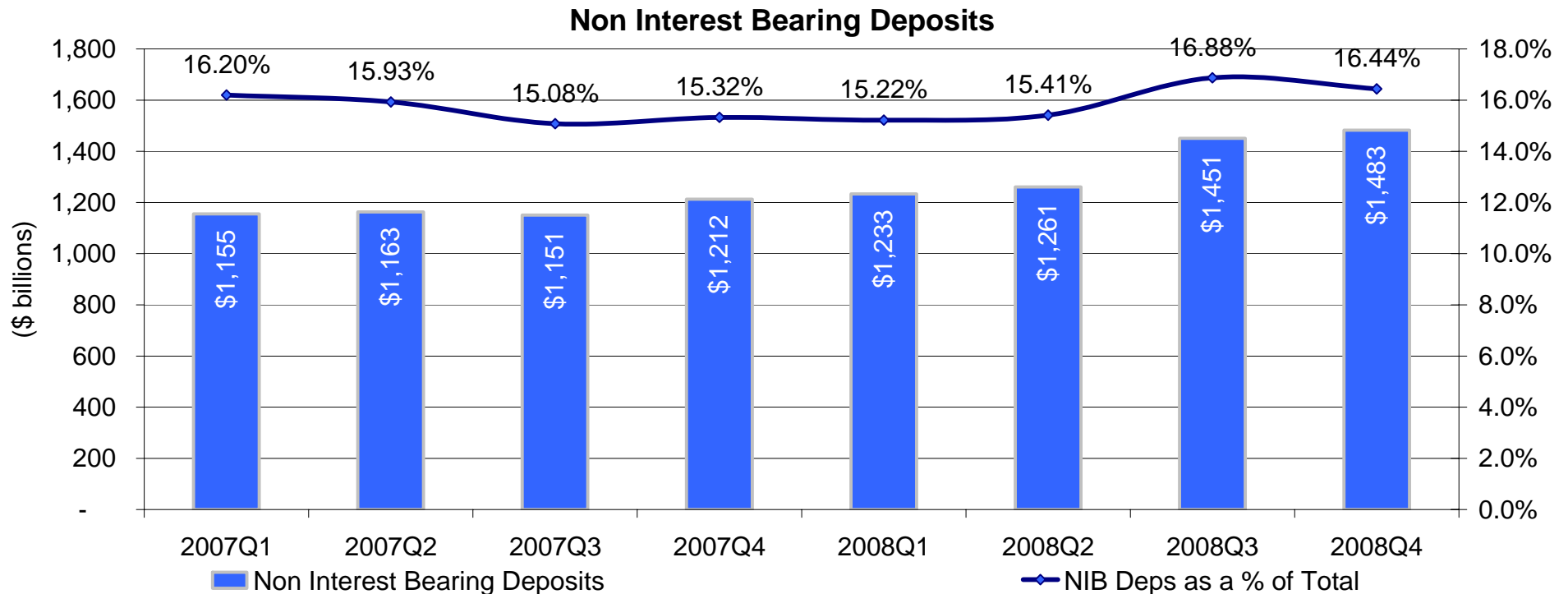


	Data As of 2008Q4	@ 8.00% Equity Capital	@ 7.00% Equity Capital	@ 6.00% Equity Capital
Number of Institutions:	2016			
Total Assets (\$000s):	1,769,959,369	1,987,094,363	2,270,964,986	2,649,459,150
Total Equity Capital (\$000s):	158,967,549	158,967,549	158,967,549	158,967,549
Equity to Assets Ratio:	8.98%	8.00%	7.00%	6.00%
Potential Growth:		217,134,994	501,005,617	879,499,781

With zero cost to the taxpayer, these **2016 institutions** would be able to increase their balance sheet by \$879.5 billion by lowering capital levels to 6.00%. Lowering the capital requirements for “1” and “2” rated institutions would allow for significant growth by safe and sound institutions.

5.

The FDIC should continue to insure all non interest bearing deposits. Non interest bearing levels significantly increased in the third quarter of 2008 . . .



Despite decreasing as a percent of total deposits, non interest bearing balance increased in the fourth quarter of 2008. The Transaction Account Guarantee Program began on October 17, 2008.

5.

By continuing to insure all non interest bearing deposits, the FDIC will drive deposits to the cost-free accounts - which in case of receivership it can sell for a larger premium . . .

Premium by Deposit Mix and Facility Strength Method

Product	Balance (in thousands)	% of Total	Cost of Funds	Price Premium	Price Dollars
Non interest bearing demand	\$20,000	20.00%		10.00%	\$2,000.0
Interest bearing demand	\$20,000	20.00%	0.25%	8.00%	\$1,600.0
Total Transaction Accounts	\$40,000	40.00%	0.13%	9.00%	\$3,600.0
Savings	\$20,000	20.00%	0.50%	6.00%	\$1,200.0
Money Market	\$20,000	20.00%	1.00%	4.00%	\$800.0
Certificates of Deposit	\$20,000	20.00%	2.00%	2.00%	\$400.0
Total Deposits	\$100,000	100.00%	0.75%	6.00%	\$6,000.0

Looking at an institution that has equal concentrations of all deposits types: non interest bearing deposits clearly will garner the largest premium for the FDIC on the open market.

6.

The Federal Reserve issuing its own debt . . .

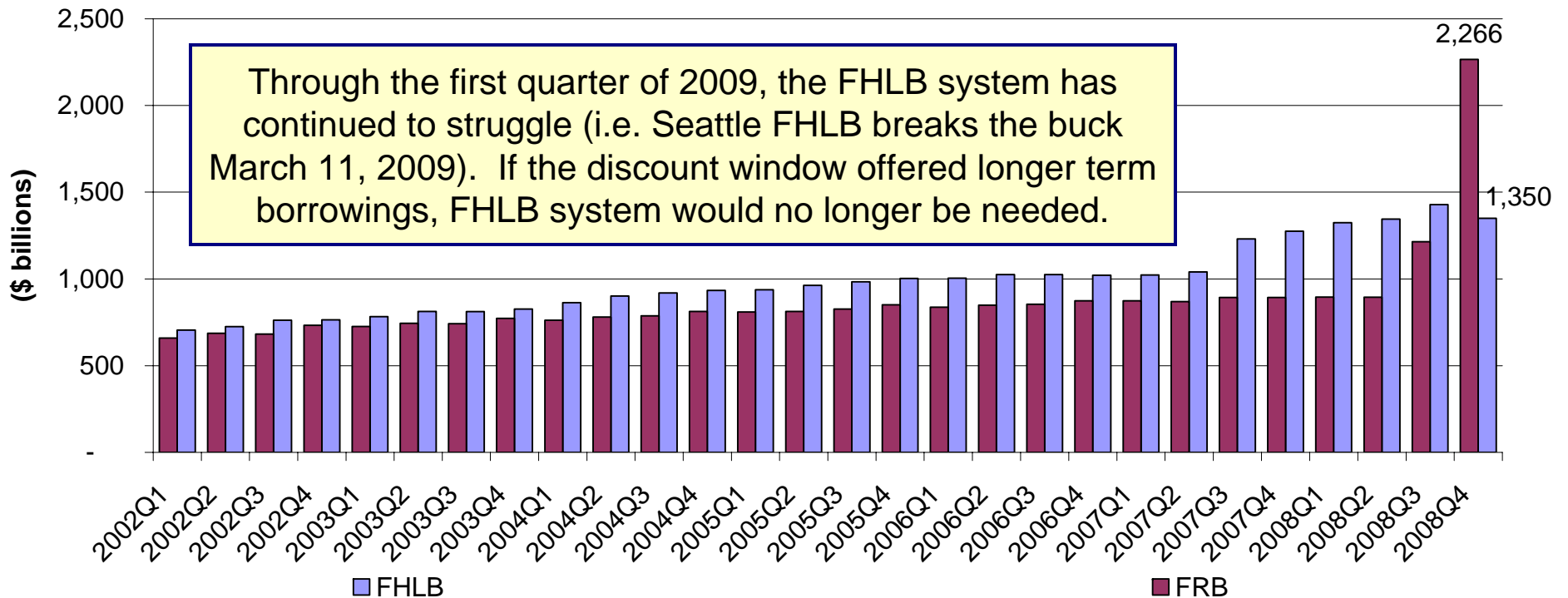
- The new head of the New York Federal Reserve Bank recently got behind the issue of the Fed issuing its own debt.
 - This would create a more independent role, allowing the Fed to distance itself from the Treasury.
 - It would also allow the Fed to provide liquidity without pumping excessive amounts of money into the system.

6.

The Federal Reserve's balance sheet has eclipsed the FHLB system in total assets in the fourth quarter of 2008 . . .



Total Assets of the Federal Reserve and the FHLB System

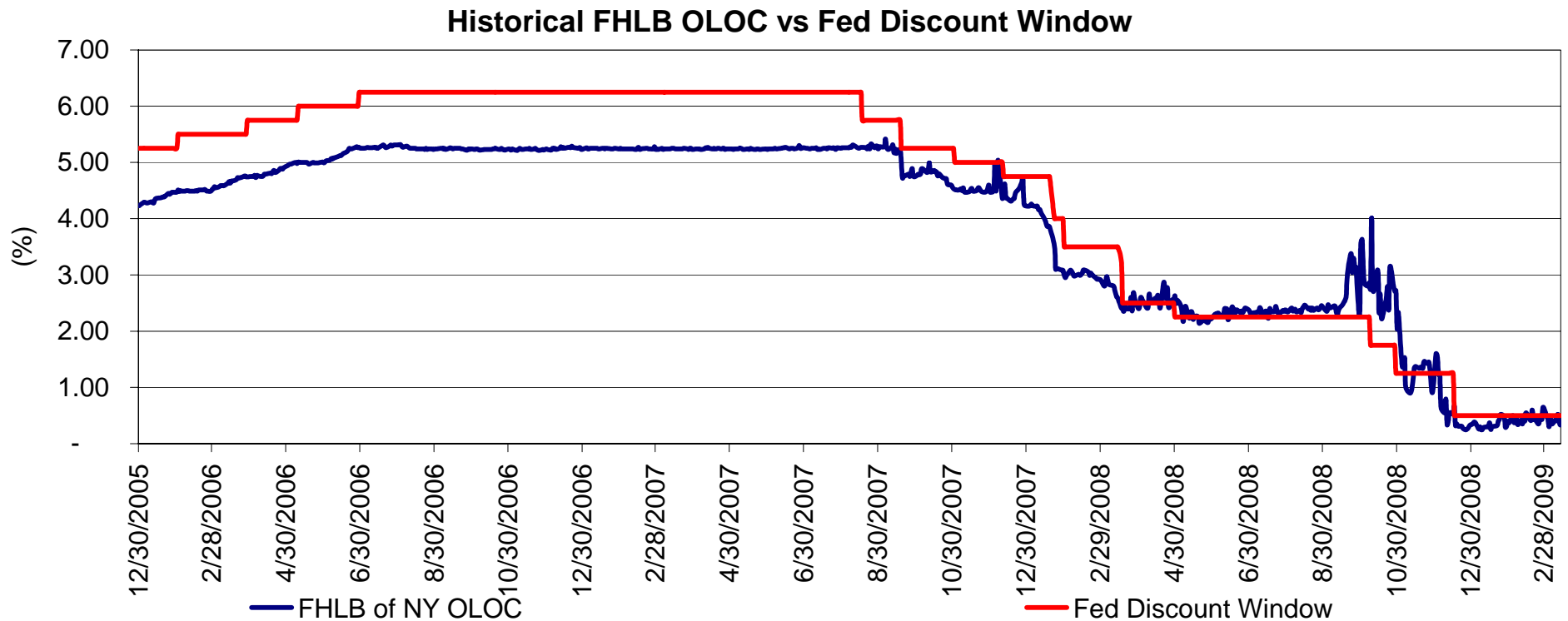


Through the first quarter of 2009, the FHLB system has continued to struggle (i.e. Seattle FHLB breaks the buck March 11, 2009). If the discount window offered longer term borrowings, FHLB system would no longer be needed.

The Federal Reserve more than doubled the size of its balance sheet in the last six months of 2008.

6.

And the spread between the discount window and the FHLB overnight line of credit has closed, occasionally inverting over the past year as the Fed took a more active role in supplying liquidity to the market . . .

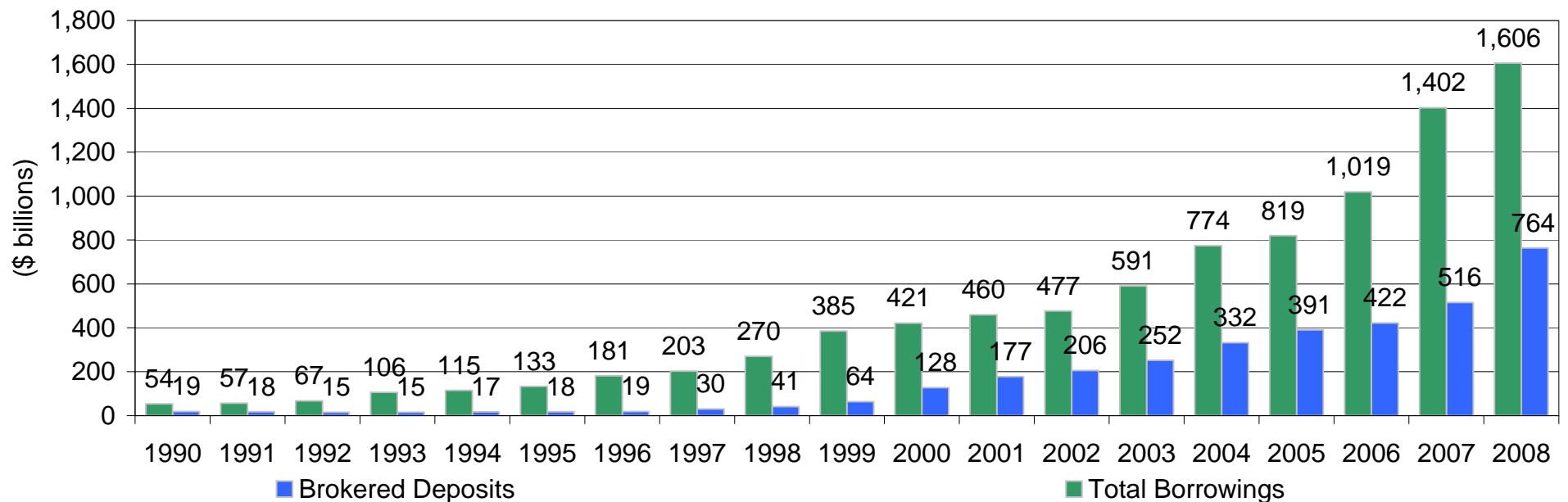


7.

While the FDIC does not like borrowing and brokered deposit levels to exceed 20.0% of total assets, institutions are seeing an increasing need for the alternative funding sources . . .

- Collateralized assets cannot be sold should an institution be brought into receivership and borrowings will face a prepayment penalty if they are paid back early. Both issues make life harder for the FDIC if they are forced to step in and take over an institution.

Total Borrowing and Brokered Deposit Levels



8.

Mortgage “cram downs” will force banks to restructure principle and interest on loans for borrowers who cannot afford their homes . . .

-
- Representative John Conyers (D-Mi.) introduced the “Helping Families Save Their Homes Act of 2009” (H.R. 1106) which will allow the courts to force restructured loan terms on owners (investors or banks) of the loans.
 - The bill passed the House of Representative on March 5, 2009 (234 to 191).
 - Modifying guaranteed loans requires the agencies to buy the loan back, stripping it out of the securitized pool.
 - The charges associated with modifying mortgages could cost Freddie Mac an estimated \$30 billion, if the agency is forced to purchase the loan.

8.

The “cram downs” will alter the cash flow for any securities where loans must be pulled out or restructured . . .

- Looking at a generic Fannie Mae 15 year mortgage backed security with a 6.00% coupon that was originated 2 years ago:

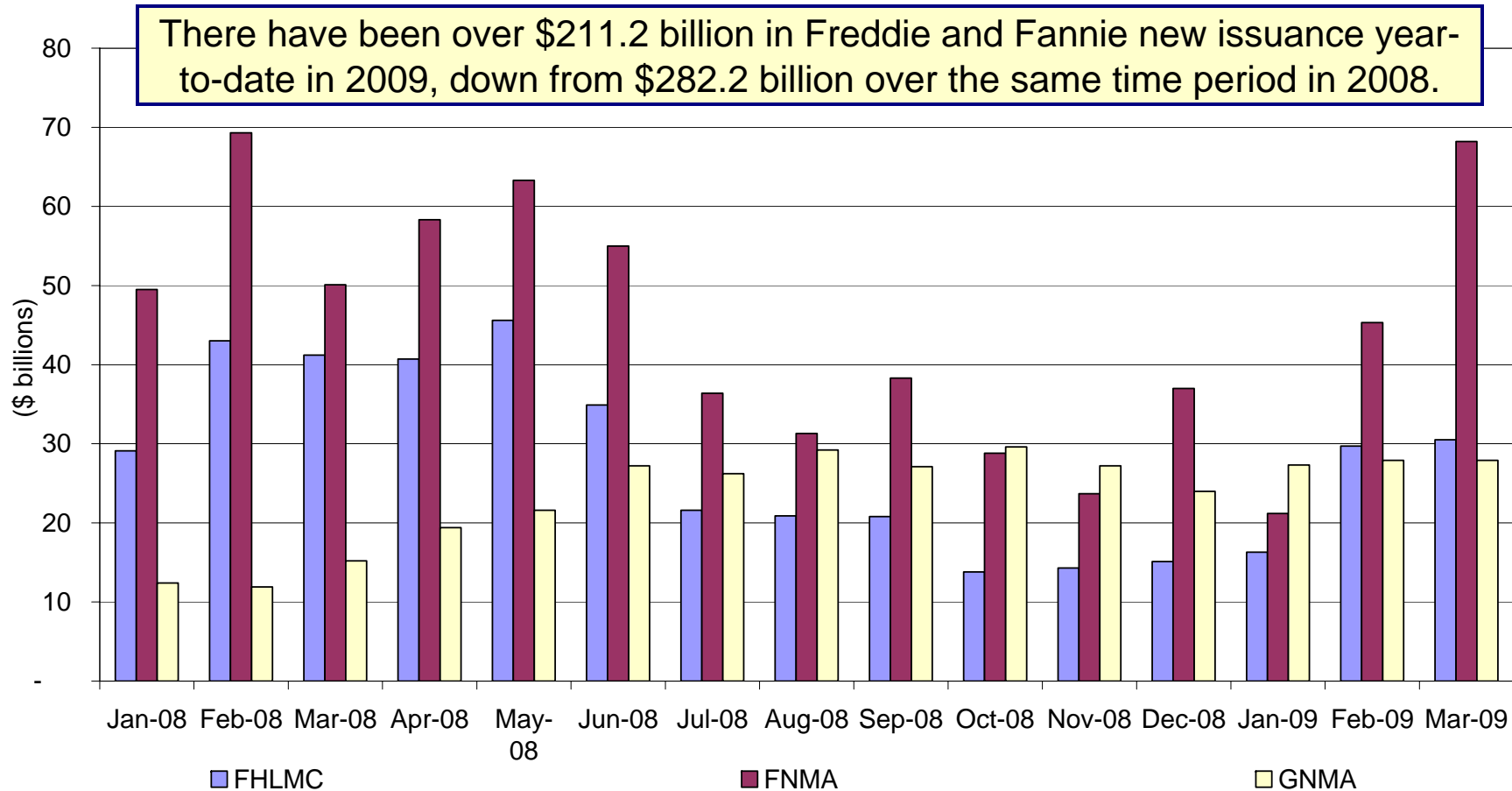
Sample 15 Yr Fixed Rate Agency Mortgage Backed Security			Cramdown: Loans have the same rate		Cramdown: Loans have several rates		Cramdown: Purchased @ premium of 105.0		
Purchased Amount:	\$ 1,000,000	6.00%	\$ 1,000,000	6.00%	\$ 1,000,000	6.00%	\$ 1,050,000	5.25%	
Remaining Balance After 2 Years & Cram down:	\$ 912,551	6.00%	\$ 730,041	6.00%	\$ 730,041	5.92%	\$ 770,365	5.06%	
By Component Loan:	\$ 182,510	6.00%	\$ 182,510	6.00%	\$ 182,510	5.50%	\$ 192,591	5.06%	
	182,510	6.00%	182,510	6.00%	182,510	6.33%	192,591	5.06%	
	182,510	6.00%	182,510	6.00%	182,510	5.50%	192,591	5.06%	
	182,510	6.00%	182,510	6.00%	182,510	6.33%	192,591	5.06%	
	182,510	6.00%	182,510	6.00%	182,510	6.33%	192,591	5.06%	
			182,510	6.00%	182,510	6.33%	182,510	6.00%	
			Removed from security						
Cashflow									
Original Monthly P & I:	8,439		8,439		8,439		8,439		
Principal Removed:	-		182,510		182,510		182,510		
Monthly P & I After Cram down:	8,439		6,751		6,718		6,751		
Difference in P & I:	(0)		1,688		1,720		1,688		
Yield Reduction From Cram down:	0.00%		0.00%		0.08%		0.18%		

Security pools with loans that have various yields will be subject to possible yield adjustments after a “cram down”. Securities purchased at a premium will face downward yield adjustments as well.

8.

Issuance of agency mortgage backed securities are on the rise, but still below 2008 levels. The restructuring of loans within the securities is going to force the agencies to take hits as they buy back loans from the security pools . . .

MBS Issuance by Agency





So, What IS Being Done?

From the FinPro October 1, 2008 Speech entitled “Fixing the Economic Doldrums”, the following issues were laid out in the table of contents. FinPro stands by these measures. Looking at what has taken place since then . . .

- Immediate Measures
 - Eliminate mark-to-market accounting: **working on it . . .**
 - Update FDIC Insurance: **Done.**
 - Eliminate conflict of interests with broker/dealers: **working on it . . .**
 - Regulate Private Equity, Hedge Funds and Mortgage Companies: **working on it . . .**
 - Change regulatory perspective
 - Eliminate CRE Thresholds: **no progress yet . . .**
 - Revisit BASEL II: **no progress yet . . .**
 - Allowance for loan and lease losses: **no progress yet . . .**
 - Permanently reinstate the “uptick” rule: **working on it . . .**
- Follow up Measures
 - Fix the Real Estate Market: **working on it . . .**
 - Modernize the Regulatory Framework: **working on it . . .**
 - Revisit SOX and GLB: **no progress yet . . .**
 - All digital transactions must go through the Federal Reserve: **no progress yet . . .**