

Turmoil Breeds Opportunity

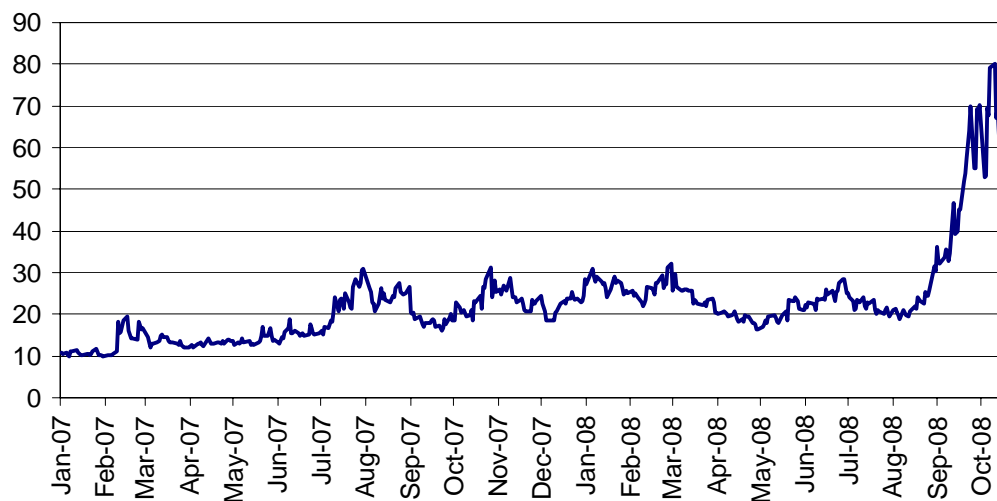
FinPro Inc.

November 6, 2008

Turmoil . . .

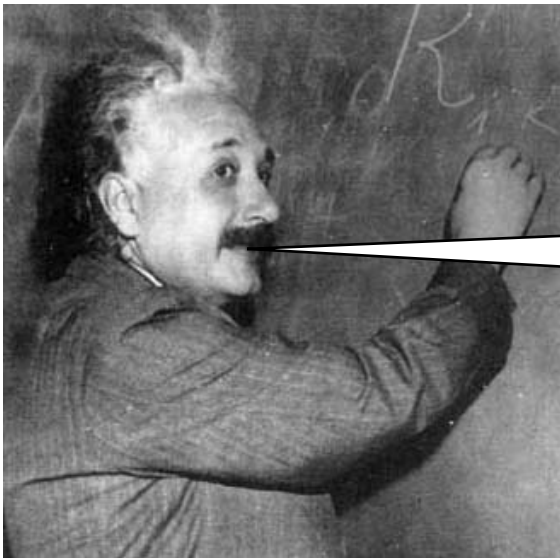
- Don spent time going over the turmoil in the market place
- There has been enough turmoil in the market place to fundamentally change the entire financial system.
- It is going to require everyone in the room to take a new perspective

Chicago Board Options Exchange (CBOE)
Volatility Index (VIX)



Turmoil creates opportunity for all of us in the room . . .

- Great individuals, companies, and ideas emerge in times of great crisis
- You already heard from Don Gibson and Drayton Alldritt on how they have been capitalizing on opportunity in two very different ways
- Some initiatives may take you out of your comfort zone but ostrich syndrome is not going to work



**“In the middle of difficulty
lies opportunity”**

Let's talk about the reality of what is happening today and what that means for institutions in the room . . .

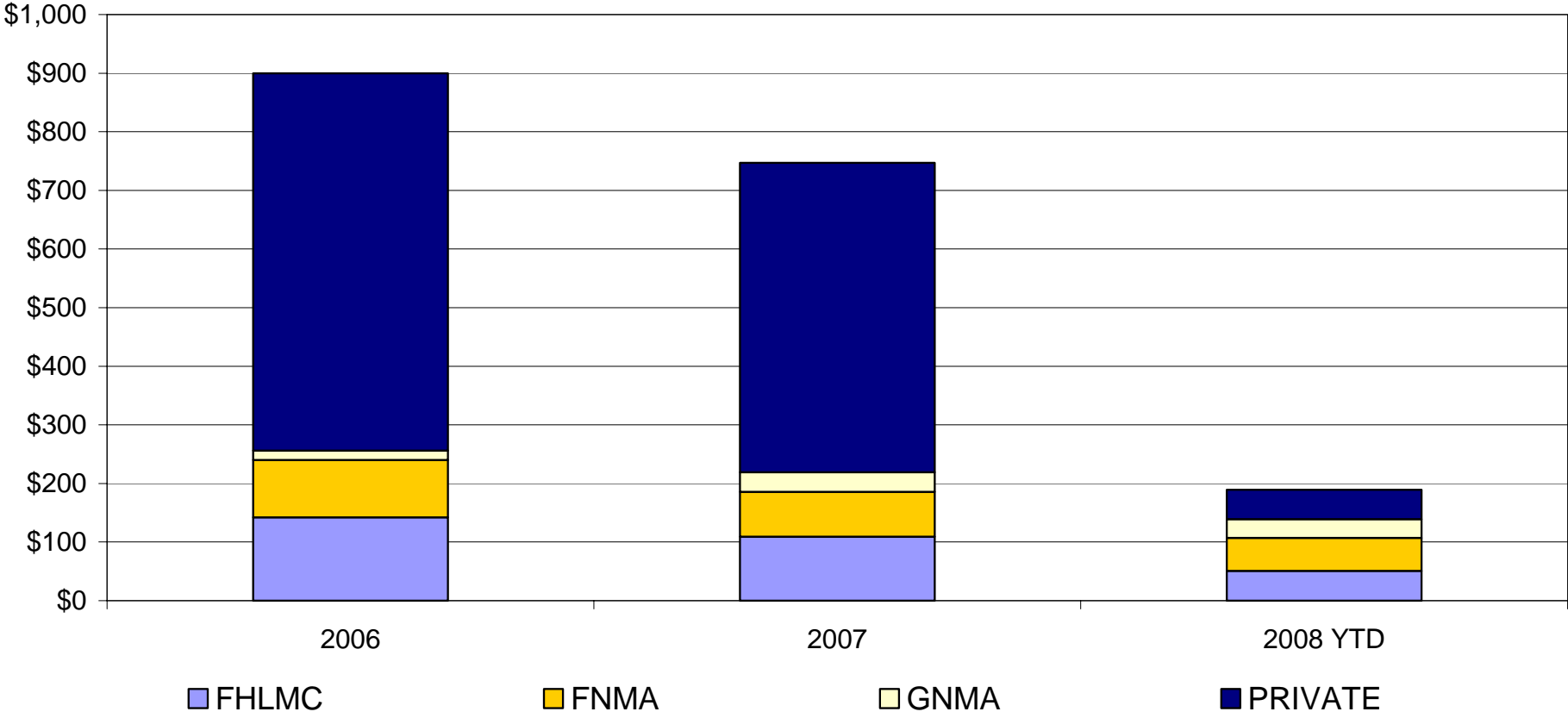
- Less Hybrids and Exotic Securities
 - More Plain Vanilla Investments – Held to Maturity
- Less Investments
 - More Loans - Residential
- Less Volatile Funding
 - More Core Deposits
- Less Branching
 - More Digital
- Less Transactional Staff
 - More Skilled People – Business Development Staff
- Less Traditional Fee Income
 - More Nontraditional Fee Income
- Less Control Over the Cost of Banking
 - More Expense Reduction
- Less Complaining
 - More Planning & Execution

Less hybrids and exotic securities . . .

- Categories formerly considered secure may become stressed:
 - CMOs and CDOs will face continued ratings downgrades and defaults on underlying collateral
 - Corporate debt is shaky as economy weakens
 - Municipalities face an uncertain fiscal environment
- Some purchased securities aren't fully understood by the bank
- Banks are buying based on the recommendation of their broker
- Ongoing review of your existing investment portfolios has become even more critical

CMO issuance, along with other hybrid securities, has significantly declined . . .

CMO Issuance by Year
(\$ in Billions)



More plain vanilla investments . . .

- Brokers often charge bigger mark-ups on hybrids or exotic securities versus plain vanilla investments
- If the brokers don't have the exotic security mark-ups to feed the trough, they may try and get through bigger mark-ups on plain vanilla investments
- Need to bid out securities to multiple brokers
- And you still need to analyze the securities

At first glance, the security shown below appears to be a “plain vanilla” adjustable rate agency MBS with a 5.6% coupon and 6.1% yield, and geographic diversity . . .

Htge **DES**

Security Description

Agency	FH	Issue Date	05/01/06	Originator	
Pool	1L1287	Mty Date	05/01/36	Wells Fargo Bank, N.A.	
CUSIP	3128Q3NC1	Idx+Hrqn	H15T1Y+2.25	1 Home Campus, Des Moines IA 5032800	
		Cap Structure	5/2/5		
Type	(1L) Annual/One Year Trsy Hybrid ARM 30 yea	Coupon		5.588	
Traits	HyB 10/1, 30/360	WA Months To Reset		91	

Information As Of Oct08

Coupon	5.588	Orig Coupon	5.600	Factor	0.73100586	Prepayments					
WAC*	6.088	Orig WAC	5.921	Orig Amt	92,616,252	1 Mon	CPR 3.8	PSA 64			
WARH	330	Orig WARH	358	Curr Amt	67,703,023	3 Mon	5.1	91			
WALA	29					6 Mon	11.5	216			
		WAGLT	359	AOLS	233,033	1 year	16.0	340			
		WAGLTV	73	WAGOLS	266,370	Life	11.1	362			
# Loans	307	WAGCS	743	MAX LS	510,000	Geographics (Top 3)					
		WAGCLTV	74			State	%UPB				
		WAGDTI	36	Curr TPO	8.51	FL	11				
Delay	74 (44)					CA	8				
1 Month CPR	<input type="checkbox"/> 21) More Historical Data				*Calculated value	WA	8				
Oct08	Sep08	Aug08	Jul08	Jun08	May08	Apr08	Mar08	Feb08	Jan08	Dec07	Nov07
3.8	7.4	4.2	23.8	10.3	17.6	29.8	37.8	23.2	10.8	11.7	3.3

1) Summary	2) Arm	3) Resets	4) Prepay	5) Geo/LOY	6) Loans
Australia 61 2 9777 8600	Brazil 5511 3048 4500	Europe 44 20 7330 7500	Germany 49 69 9204 1210	Hong Kong 852 2977 6000	
Japan 81 3 3201 8900	Singapore 65 6212 1000	U.S. 1 212 318 2000			

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But this “plain vanilla” agency contains vacation and investor properties . . .

Collateral Composition
FH 1L1287
 As of Oct 2008

	#Loans	%Bal	\$Balance		#Loans	%Bal	\$Balance
Loan Purpose				Occupancy			
Purchase	251	80.60	54,568,635	Owner Occ.	259	86.61	58,637,589
No Cash Refi	29	9.96	6,743,221	Vacation	33	10.10	6,838,006
Cashout Refi	27	9.45	6,397,936	Investor	15	3.29	2,227,429
Unspec Refi	-	-	-	Non-Reported	-	-	-
Non-Reported	-	-	-				
Mortgaged Properties				Borrowers			
Single Family	300	97.50	66,010,447	1 Borrower	113	37.36	25,293,849
2-4 Family	7	2.50	1,692,576	>1 Borrower	194	62.64	42,409,174
Non-Reported	-	-	-				
First Time Home Buyer				Mortgage Insurance			
First Time	71	23.23	15,727,412	Insured	45	14.44	9,776,317
Unknown	-	-	-	Unknown	-	-	-

And over 40% of the borrowers in the pool have a debt-to-income ratio above 40% . . .

Collateral Composition
FH 1L1287

DTI WAVG:	36.3
DTI SDEV:	11.3

Debt to Income Distribution as of Oct 2008

DTI (%)	# LHS	BAL \$NIL	% BAL
n/a	4	1.0	1.3
0- 9	4	.8	1.1
10- 19	23	4.9	6.9
20- 29	60	14.3	20.0
30- 39	99	20.9	29.3
40- 49	86	21.0	29.4
50- 59	35	7.6	10.6
60- 69	5	1.0	1.4
TOTAL	307	71.4	100.0

Almost 20% of the loans were “no-income” / “no-asset” verification loans . . .

Collateral Composition
FH 1L1287
 As of Oct 2008

	#Loans	%Bal	\$Balance
Asset Verification			
Verified/Waived	251	80.51	54,507,704
Asset Not Verified/Waived	56	19.49	13,195,319
Asset Unknown	-	-	-
Employment Verification			
Employment Verified/Waived	307	100.0	67,703,023
Employment Not Verified/Waived	-	-	-
Employment Unknown	-	-	-
Income Verification			
Income Verified/Waived	251	80.51	54,507,704
Income Not Verified/Waived	56	19.49	13,195,319
Income Unknown	-	-	-
Third Party Origination (TPO)			
Retail TPO	283	91.49	61,941,496
Broker TPO	-	-	-
Correspondent TPO	-	-	-
TPO Unknown	-	-	-

More Held to Maturity . . .

- Mark-to-market is part of the problem in the marketplace
- Banks need to keep more securities in HTM versus AFS
- Holding securities HTM will insulate banks from future declines in investment values and shore up equity
- Most banks don't actively buy and sell, so why hold securities AFS?
- Declining equity levels at banks is resulting in lack of confidence
 - Unrealized loss in AFS portfolio is helping to drive down book value

Holding securities AFS versus holding securities HTM . . .



		Market Price	
AFS Securities	\$ 15,000		
UnRealized G/L	\$ (1,000)	93%	
<u>Net Book Value</u>	<u>\$ 14,000</u>		

HTM Securities	\$ 15,000
UnRealized G/L	\$ -
<u>Net Book Value</u>	<u>\$ 15,000</u>

Gross Equity	\$ 10,000
UnRealized G/L	\$ (1,000)
<u>Net Equity Value</u>	<u>\$ 9,000</u>

Gross Equity	\$ 10,000
UnRealized G/L	\$ -
<u>Net Equity Value</u>	<u>\$ 10,000</u>

Shares Outstanding	1,000
Book Value Per Share	\$ 9.00



Shares Outstanding	1,000
Book Value Per Share	\$ 10.00

Reported book value increases 11% simply by holding HTM versus AFS

Less Investments . . .

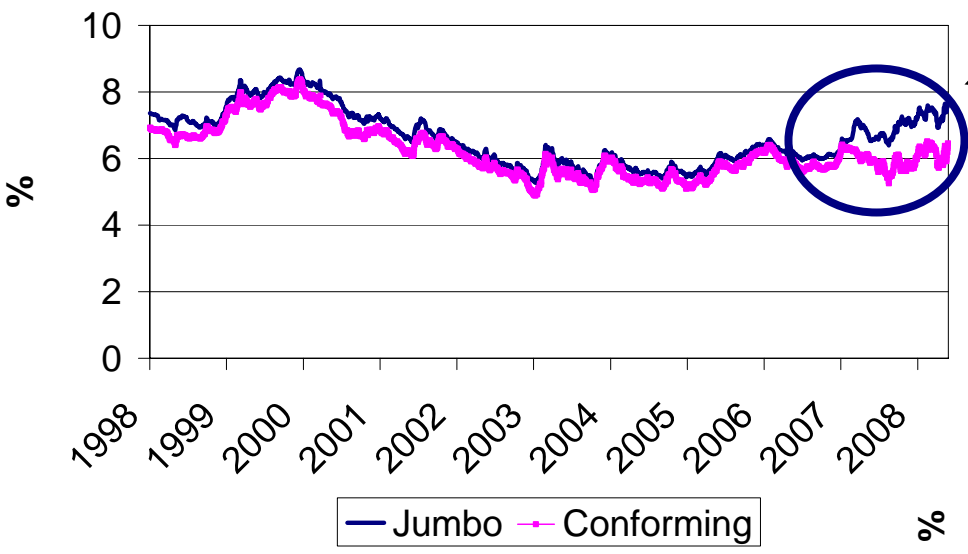
- Back to old days of banking on asset side of balance sheet
 - Mortgage bankers and brokers out of business
 - Secondary markets have collapsed
 - Less securitization, more held on balance sheet
 - Resulting in limited supply of securities
- Banks have direct control over their lending underwriting and know the customer, more difficult to “know” the investment they are purchasing

More loans . . .

- Banks in the room must become the lender of choice
- Focus on your local market
- Return to basic common sense credit and property underwriting and solid loan documentation
- Residential lending should not be taboo
- Set a tolerance level of fixed rate residential loans
 - Equal to a percentage of equity and noninterest bearing accounts
 - Manage growth to it

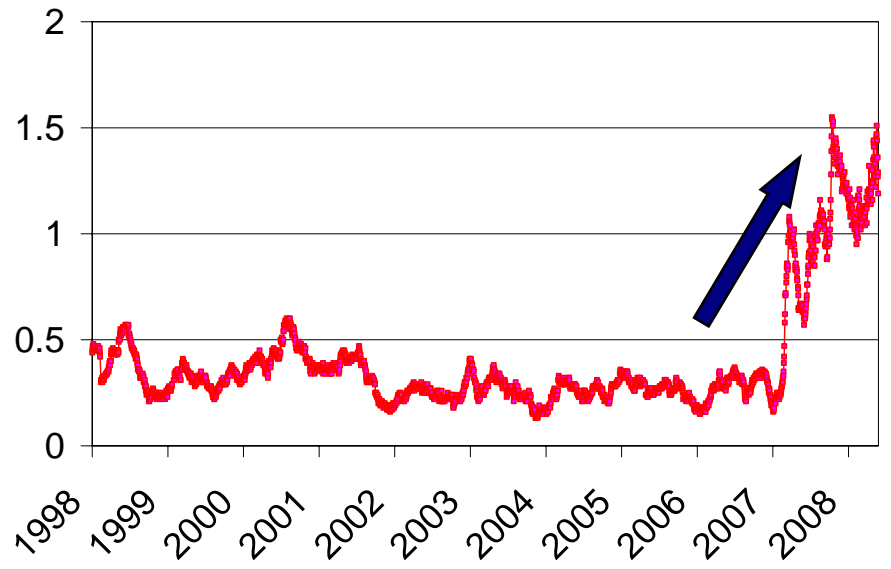
More residential . . .

Residential Mortgage Loans: Conforming vs. Jumbo Rates



Spread opportunity in
jumbo residential lending

Spread: Conforming vs. Jumbo Rates



Less volatile funding . . .

- Regulators are going to force less reliance on brokered deposits and borrowings
- Wholesale funding will be costly due to new proposed FDIC risk-based assessment deposit insurance

Total Base Assessment Rates

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	10 – 14	20	30	45
Unsecured debt adjustment	-2 – 0	-2 – 0	-2 – 0	-2 – 0
Secured liability adjustment	0 – 7	0 – 10	0 – 15	0 – 22.5
Brokered deposit adjustment		0 - 10	0 - 10	0 - 10
Total base assessment rate	8 – 21.0	18 – 40.0	28 – 55.0	43 – 77.5

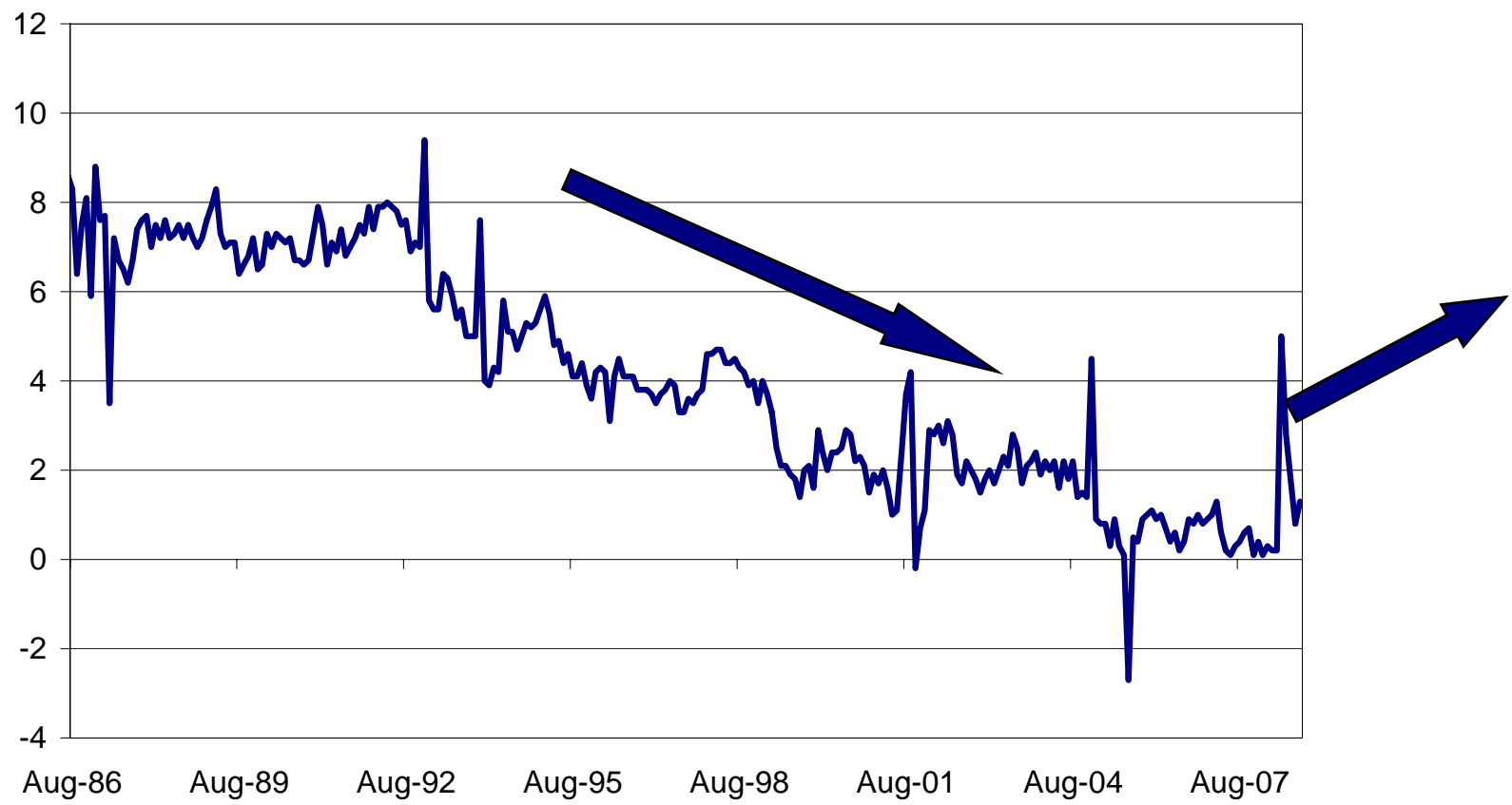
More core deposits . . .

- Capitalize on the flight to safety coming in to the banking industry due to turmoil in the markets
- Unlimited insurance on noninterest bearing deposits levels playing field for community banks
- Stability and safety are important to customers, core deposit growth is possible



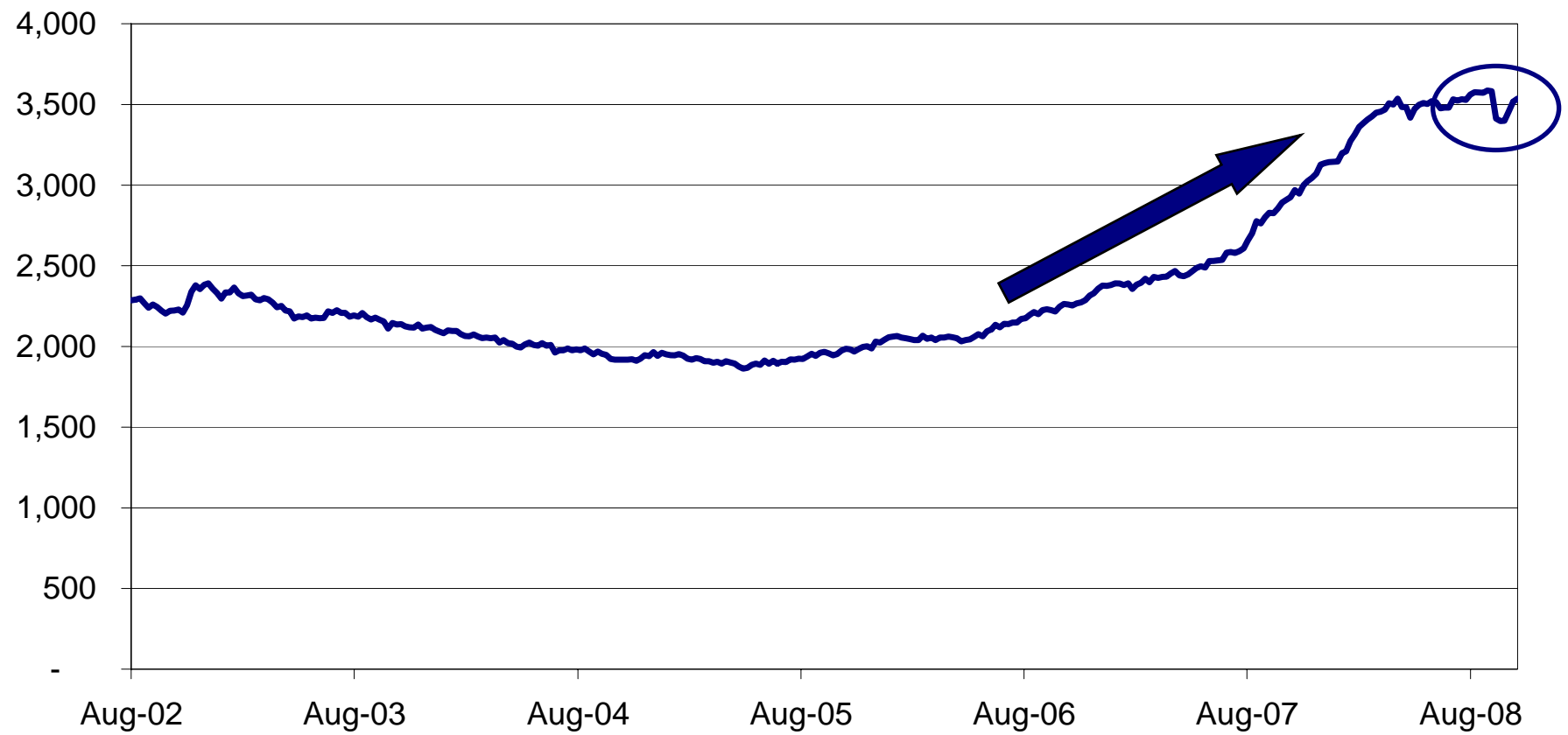
The American consumer will need to save again . . .

Personal Savings as a Percent of Disposable Income



Growth can be taken back from money market mutual funds that had seen explosive growth prior to 2008 but have leveled off and actually began to decline before the government stepped in as a backstop . . .

Total Money Market Mutual Funds Outstanding

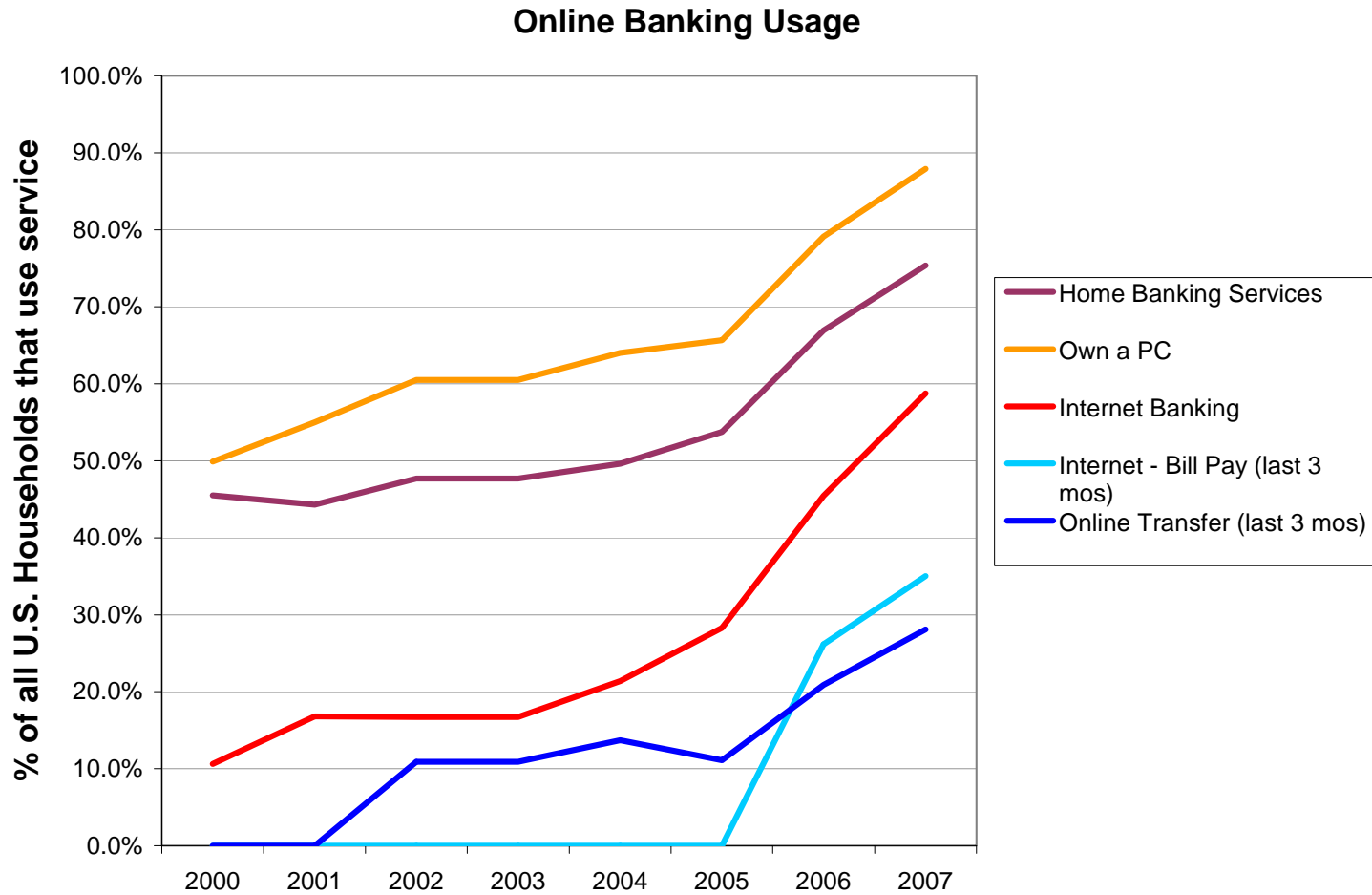


Less branching . . .

- Difficult to find top locations
- Roadblocks like government interference and building restrictions
- Large retail franchise have already experienced the decline in brick and mortar locations: Blockbuster and Starbucks
- Digital transactions recently surpassed physical check transactions
- Smaller stand alone branches, strip mall branches, and new generation ATMs are all effective ways to penetrate the market.

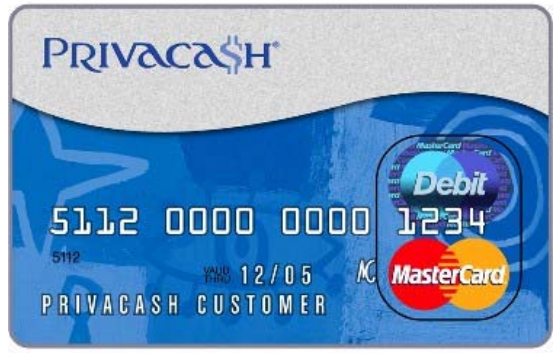


Electronic transactions are increasing. Number of paper checks processed declined from 50 billion to 19 billion over the same time period shown below . . .



More digital . . .

- Will need technology to compete
- Remote deposit capture
- Mobile Banking
- Internet Banking
- Prepaid debit cards for underserved



Besides digital, banks need to be more cognizant of differentiated pricing strategies . . .

- Utilize differentiated pricing strategies throughout your network
- Don't view network as homogeneous for pricing
 - Portions of a branch network that are geographically distant
 - Markets where a recent acquisition has taken place
 - Branches void of balances in a specific deposit or loan product
 - Branches with differentiated customer focus
- “Doing business as” branches
- Other industries do it, why not banking

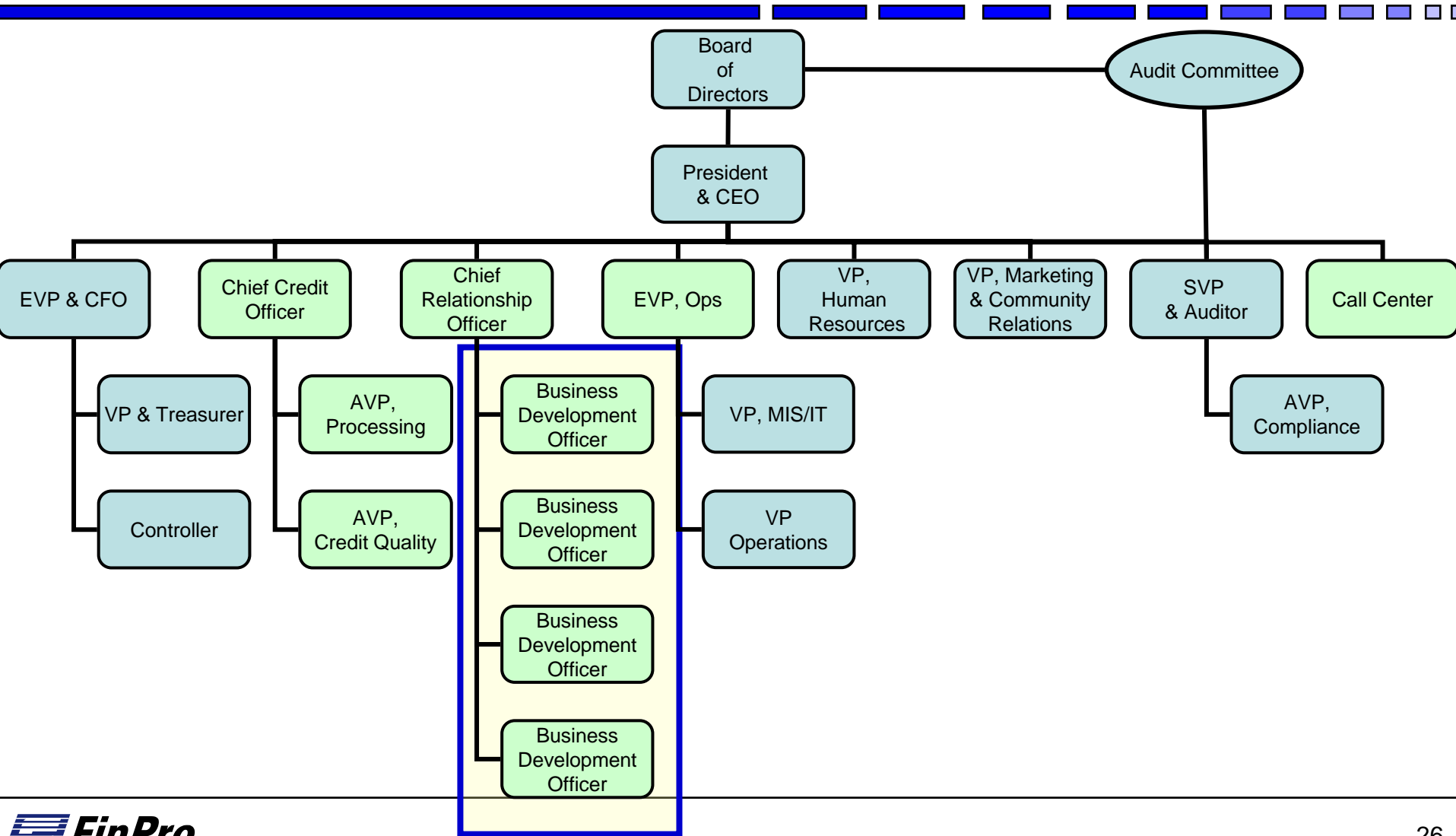
Less transactional staff . . .

- Teller transactions and checks have been declining and there has been an increase in electronic transactions
- Many branches are staffed more than they need to be
- Number of transactions being handled in branches is declining

More skilled people . . .

- The shift of the organizational structure is towards a business development and credit administration structure versus the separation of lending divisions
- Business developers not lenders and branch managers
- Incremental balance sheet and income statements for individual BDOs
- Credit specialists for underwriting and processing
- Individuals will be focused on advisory and service, not transactions
- Steal from larger banks and currently unemployed people in the market
- More internal training for individuals with potential
- Educate and train personnel to enable them to perform

No product silos, business development staff should be competent enough to sell or cross-sell all of the bank's services . . .



Less traditional fee income . . .

- Customers are becoming more and more aware of fees
 - Banks have to give everything away free in order to attract new customers
 - Traditional banking fees are becoming more and more difficult
- Sheila Bair is a consumer advocate
- Once FDIC and other regulators have a chance to breath they will again hone in on assisting the consumer
 - More regulation of overdraft protection
 - More regulation of banking fees

More nontraditional fee income . . .

- Insurance Brokerage
 - Commercial and Personal Lines
 - Life Insurance
 - Employee Benefits
- Asset Management
 - Advisory
 - Securities Brokerage
 - Trust
 - Financial Planning
- Foreign remittances and wire transfers
- Prepaid cards for the unbanked or new immigrants

Less control over the cost of banking . . .

- FDIC insurance assessments are doubling or tripling
- Regulatory burden resulting in higher expenses
- Increasing compliance costs
- Provision expense is rising as loan delinquencies increase
- Increasing health care costs
- Increasing taxes

More Expense Reduction . . .

- Expense savings will need to be realized in other areas of the organization
- Need to conduct line items reviews of general ledgers to find areas where we can realize expense reduction
- Review unnecessary service costs
- Examine health care plan
- Move to incentive based compensation
- Bid out insurance coverage
- Push customers to electronic statements
- Review accounting and audit fees
- Use technology to create efficiencies
- Analyze occupancy costs for reductions

Less Complaining . . .

- Reality is that times are difficult and complaining about it isn't going to help your company
- Everyone wants some silver bullet but it doesn't exist
- Get your employees invigorated to work for the future and beat your competitors
- Times like these is when there will be companies that win, and companies that lose

More planning and execution . . .

- Protect your capital, stay with plain vanilla investments, transfer securities into and/or hold more HTM going forward
- More lending, particularly residential, fewer investment securities
- Grab market share of core deposits flowing in to the banking industry
- Smarter branching decisions, leverage technology
- Better skilled staff focused on advisory and service
- Expand services to generate more nontraditional fee income
- Find expense savings since uncontrollable expenses are increasing

Talk is Cheap
Stop Talking and Start Executing
Create and Seize the Opportunities