

## Reshaping the Banking Industry (Part I)

### Attempting to Define the Impact

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### The Actions of the Government Will Lower Earning Capacity

Bank stocks have had a good run in the past 14 to 15 months. Depending on the index used, they have grown twice as rapidly as the S&P 500 and 6 times faster than the price of gold. They have almost tripled in price.

Now the stocks are facing substantial headwinds:

- The financial regulation bill, and other actions by the regulators, has lowered the earnings capacity of the industry by an estimated 25%.
- The financial dilemmas in Europe are likely to cause earnings problems for a small number of companies.

These events may setback bank stocks by as much as 25%. Half of this retracement has already occurred. This is expected to be a very short-term trading pause, however. Even with lower earnings capacity, banking companies are likely to experience a sharp pretax earnings recovery over the next few years. The companies are likely to raise their dividends to 40% of their net earnings. Moreover, once the financial bill is passed there is likely to be a meaningful relief rally. The stocks appear to be undervalued once again creating a new buying opportunity.

The purpose of this comment is to assess the impact of all government activities on the industry and to develop a profile of where banking is headed. To do this the recent history of the industry will be viewed as well as the near-term future. In Part II, to be published later this week, the outlook for individual stocks will be assessed.

### The Opportunity

The banking industry had record pretax earnings in 2005 and 2006. In 2006, pretax profits actually reached a peak of \$210.6 billion.

A different concept, pretax, pre-provision earnings also reached a new record of \$240.2 billion in 2006. This was 119% higher than pretax, pre-provision earnings were ten years earlier in 1996. The 2006 record was surpassed in 2009, however. In that year pretax, pre-provision earnings reached \$270.3 billion. The problem, of course, is that the pretax portion of this number was only \$22.7 billion in the same year.

While pretax, pre-provision earnings reached a record in 2009, pretax earnings, alone, stumbled. The differential between these two earnings concepts is the basis for suggesting that bank earnings could soar despite the headwinds they are facing from financial legislation and Europe.

The size of this pretax earnings opportunity can be derived from these numbers. In 2006, pretax earnings were 87.7% of the total pretax, pre-provision profit. In 2009, pretax was 8.4% of the total. Assuming:

- The government's actions have reduced the potential for pretax, pre-provision earnings by 25% or to approximately \$200 billion, and that
- Pretax earnings grow back to 87.5% of that number or about \$175 billion, then
- The potential pretax earnings growth from 2009 to hypothetical 2015 is 771%.

As investors flee banking stock near-term fearing the worst, this set of metrics should be kept in mind. This is particularly true if one expects the United States economy to recover from the present to hypothetical 2015. The projected gains could be deterred if there is a new financial crisis caused by sovereign defaults in Europe but the inevitability of this improvement is not likely to be stopped.

**Note: The tables in this report were prepared by Rochdale securities from sources believed to be accurate. However, accuracy cannot be guaranteed.**

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### The Five Year Record and the Future

The commentary in this section is based on the industry's five year record as shown in the tables at the back of this report. The data is from the Federal Deposit Insurance Corporation (FDIC). Some adjustments had to be made to make the balance sheets, balance, and the income statements add up. However, this data source is the best available when looking at the overall industry.

#### Balance Sheet

There have been dramatic changes in the industry's balance sheet in the past 5 years. It has gone from one of high risk, high return to one of low risk, low returns:

#### *Equity*

Common equity was 10.2% of assets in 2005. Weak earnings resulted in this ratio dropping to 9.3% in 2008. However, aided by aggressive capital raises in 2009 this number was back at 11.2% by the end of that year. The last time it was this high was in 1938 following the cleansing of the industry's balance sheet in the bank holiday of 1933. The records on tangible common equity do not stretch that far back in history. However, tangible common equity to assets has gone from 7.07% to 7.72%, 2005 to 2009 (TCE/TA is up from 7.30% to 7.98%).

What these numbers show is that the industry is funding itself with more core capital. This is positive from a safety and soundness standpoint but it lowers the return on equity of the sector. The government wants these numbers higher, however. This means that the industry will be forced to deleverage further. If the industry must raise this ratio by 50 basis points, it would result in lost net interest revenues of \$2.3 billion.

The Federal Reserve uses different concepts to monitor capital rather than solely common equity. It looks at Tier 1 Common Equity; Tier 1 Capital; and Total Capital ratios. At present, the industry is in good standing on these ratios. The Tier 1 ratio is 11.68% and the Total Capital ratio is 14.34% (the Tier 1 Common ratio is not available). It is believed that the Fed wants these ratios at 8% - Tier 1 Common, 10% - Tier 1, and 12% - Total Capital.

The FDIC uses a different measure. It might be called the Tier 1 leverage ratio or the Core Capital Leverage ratio. It differs from the calculation of Tier 1 Capital ratios because the denominator in this calculation is average assets and not risk-weighted assets. The new banking bill suggests that this ratio be calculated by eliminating hybrid or trust preferred securities. Additionally, it is thought the FDIC wants this ratio to be at least 6.00% not the current 5.00% currently required. Again the industry should have no trouble with this measure since its Core Capital Leverage Ratio is 8.65%.

It should be noted, however, that the reason that the industry exceeds most of the regulators preferred ratios is because small banks are much better capitalized than large banks. Large banks failing to meet the required levels will be forced to raise capital and further lower returns.

#### *Liabilities*

There has been a significant shift in the banking industries liabilities in the past five years. In 2005, deposits provided 65.6% of the industry's funding. Another 7.3% came from borrowings with trading liabilities and subordinated debt providing an additional 3.4%. From a historical perspective, this is the lowest level of deposit funding in the industry's recorded history. There have been decades in which deposits funded over 90% of the industry's assets.

The low level of deposit funding meant that banks were relying on borrowings, trading liabilities, and subordinated debt for a relatively large portion of the monies they needed. In 2008, when the government suggested that banks could be nationalized, providers of funds to the industry panicked, and started pulling their money out. This precipitated the banking crisis which almost wrecked the economy.

During the crisis, the regulators took a number of actions to rebuild confidence in the industry. Two of interest here were:

- Increasing the amount of deposits that were backed by FDIC insurance; and
- Insuring the new debt being issued by large banks.

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Insured deposits in banks went from 63.0% of total domestic deposits at the end of 2005 to 70.0% at the end of 2009. It is believed that the FDIC is now insuring hundreds of billions of other bank liabilities, also.

The government is now discouraging banks from borrowing money in the wholesale markets. It wants deposits to grow meaningfully as a percent of the industry's funding. This is happening. Total deposits are now up to 70.4% of bank funding. In addition the FDIC now wants to charge an insurance fee on all of a bank's liabilities not just their insured deposits. If one applies a 13 basis point assessment to defined liabilities, the incremental cost to the industry could be \$2.9 billion.

### *Liquidity*

In 2005, banks had 4.0% of their assets in cash and 0.5% in Treasuries. The bulk of their securities were mortgage backed and it is estimated that 9.1% of all assets were government guaranteed mortgage backed securities (MBS). Thus, one might assume that 13.6% of the banking industry's assets were liquid and available to stop runs on the banks. In 2008, this proved to be inadequate so the government had to resort to the extreme measures now well known to avert the crisis of that year from deepening.

To address this problem in the future, the banking regulators demanded that banks increase their holdings of cash and truly liquid securities. By the end of 2009, banks had responded and 8.0% of their assets were in cash, 0.8% in Treasuries, and an estimated 9.5% in government backed MBS. Total liquidity was now 18.3% of assets. The differential was 4.7%.

This shift meant that the industry would be getting an estimated 100 basis less in yield on \$563 billion in assets. The cost in pretax earnings would be \$5.6 billion.

### *Loans*

In 2005, the industry's assets were allocated among the following loans:

- Construction and development (C&D) was 4.1% ultimately reaching 4.8% of total assets.
- Home equity (HELOCs) - 4.9%
- Residential mortgages - 18.8% (ARMs - 8.4%).
- Commercial real estate (CRE) – 7.6%.
- Commercial and Industrial (C&I) – 10.0%.
- Credit cards – 3.6%.
- All other consumer – 5.1%.
- All other loans – 6.4%.

This mix was higher in risk than historically due to C&D, ARM's and credit cards. Consequently, the yield on earning assets was a relatively high 6.30% in the first quarter of 2006 rising to 6.93% in the third quarter of 2007. The 63 basis point increase in yield occurred as the yield on Fed Funds rose by 4 basis points and the yield on the 10-yaer Treasury rose by 16 basis points, another reflection of higher than normal risk.

Unfortunately the banks were not being paid for the risks that they were taking because their non-performing assets rose from 48 basis points of assets in the first quarter of 2006 to 332 basis points in the fourth quarter of 2009. The result here was a dramatic reduction in the loans in the troubled categories: a) ARM's dropped to 5.2% of assets; C&D lending fell to 3.4% and credit cards came down to 3.2%. This caused yields to decline on banking assets. It took earning capacity out of the industry. However, this was not government driven so no loss estimate is being offered here due to government intervention.

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### Income Statement

One might argue that there has been \$11 billion in pretax earnings lost due to balance sheet shifts. The income statement potential losses are as follows:

- The Credit Card legislation, possibility of usury ceilings, possibility of price controls, and increased regulatory costs could take \$2.5 billion in profit out of the industry.
- The Interchange fee changes might cost \$3.0 billion of the industry's \$22 billion in revenues.
- Regulation E may cost \$4.2 billion in lost overdraft and insufficient fee charges or 10% of the total.
- The cost of the potential inability to use derivatives to stabilize funding costs is difficult to estimate since it impacts the banking industry's net interest margins. Rough approximation might be \$5.0 billion.
- The elimination of proprietary trading could reduce revenues by \$10.0 billion. The industry made \$14.5 billion from interest rate trading alone in 2009.
- There would be no venture capital profits costing an estimated \$1.0 billion.
- Securitization revenues have already dropped by \$17.0 billion. Assume that the industry will not recapture \$10.0 billion of this since it can no longer have as many, or as varied, conduits.
- The cost of the new regulations might increase operating costs by \$2.0 billion.
- For no definable reason, I am setting aside another \$20.0 billion in possible losses due to the unknown.

### **Earnings Outlook**

The total of the numbers listed above is shown in the table below:

#### **Lost Pretax Earnings**

| <u>Category</u>     | <u>Cost</u>             |
|---------------------|-------------------------|
| Deleverage          | \$2,294,154,000         |
| FDIC                | \$2,900,000,000         |
| Liquidity cost      | \$5,637,066,080         |
| Credit Card         | \$2,500,000,000         |
| Interchange         | \$3,000,000,000         |
| Regulation E        | \$4,167,600,000         |
| Derivatives         | \$5,000,000,000         |
| Proprietary trading | \$10,000,000,000        |
| Venture capital     | \$1,000,000,000         |
| Securitization      | \$10,000,000,000        |
| Regulatory expenses | \$2,000,000,000         |
| Unknown             | \$20,000,000,000        |
| <b>Total</b>        | <b>\$68,498,820,080</b> |

If this number is deducted from the \$270.4 billion in pretax, pre-provision earnings posted in 2009, then the total earning capacity of the industry by this measure is \$201.9 billion. This assessment may be too draconian or, in fact, not harsh enough. However, it is a base on which to begin the valuation of the industry.

If the assumption is made that the industry's earnings capacity by this measure is \$200 billion and that this capacity will not increase over time, then the key to the pretax growth will be reducing loan losses and shifting the loan loss provision to pretax earnings. This seems highly likely for a series of reasons:

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- The gross loans and leases in the industry in 2009 were \$7.3 trillion. This is approximately the same as it was in 2006 (\$7.2 trillion) and 7.8% below what it was in 2007 (\$7.9 trillion).
- The nature of the portfolio has shifted meaningfully eliminating many higher risk loans.
- Further reducing high risk loans, in the past five years the industry has written off \$390 billion in bad loans.
- Moreover, the size of the loan allowance is now \$227 billion or three times higher than it was in 2005 cushioning against further write-offs.
- Perhaps, most importantly, early stage delinquencies fell by 11.9% in 2009.
- Plus, and perhaps surprisingly, 94.6% of the loans in the banks are current in terms of principal and interest payments. A total of 97.1% of the loans are making some kind of payment.

The loan loss provision was \$247.7 billion in 2009. This was up 8 fold from where it was in both 2005 and 2006. As is well known the provision is composed of two parts: a) actual losses and b) amounts set aside to build reserves. The reserve build in 2009 was \$60.9 billion. If the banks stop building reserves they can increase pretax earnings by 3.5 fold. If the economy continues to improve, the likelihood is that loan losses will revert to where they were in 2005 and 2006 or 12.5% of the pretax, pre-provision number.

The mathematics are clear. At 87.5% of estimated pretax, pre-provision earnings of \$200 billion, pretax income would be \$175 billion. This would be almost 8 times current industry pretax earnings of \$22 billion. Thus, while the impact of the new legislation will be quite severe it will not stop a meaningful recovery in bank earnings.

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### Europe

It is my belief that the situation in Europe is similar to that of Latin America in 1985. The debt to GDP ratios of many of these countries, not just Greece, is so high that they will never be able to repay what they owe.

| External Debt 2009 as a % of GDP |                   |                  |                   |              |              |               |
|----------------------------------|-------------------|------------------|-------------------|--------------|--------------|---------------|
| <u>Country</u>                   | <u>Short-term</u> | <u>Long-term</u> | <u>Government</u> | <u>Banks</u> | <u>Other</u> | <u>Total</u>  |
| Luxembourg                       | 2,218.1%          | 1,528.7%         | 2.8%              | 1,284.0%     | 2,459.9%     | 3,746.8%      |
| Ireland                          | 353.9%            | 513.7%           | 40.5%             | 355.9%       | 471.2%       | 867.6%        |
| United Kingdom                   | 240.0%            | 102.3%           | 15.0%             | 215.3%       | 112.0%       | 342.3%        |
| Hong Kong                        | 234.3%            | 78.2%            | 0.7%              | 231.3%       | 80.6%        | 312.5%        |
| Netherlands                      | 111.7%            | 171.4%           | 41.6%             | 157.2%       | 84.3%        | 283.2%        |
| Belgium                          | 157.7%            | 90.8%            | 56.4%             | 133.3%       | 58.7%        | 248.4%        |
| Switzerland                      | 158.4%            | 87.9%            | 4.0%              | 141.5%       | 100.8%       | 246.3%        |
| Portugal                         | 81.6%             | 143.7%           | 57.8%             | 110.4%       | 57.1%        | 225.2%        |
| Austria                          | 55.1%             | 145.1%           | 53.4%             | 100.6%       | 46.3%        | 200.2%        |
| Sweden                           | 61.0%             | 123.1%           | 14.4%             | 103.1%       | 66.5%        | 184.0%        |
| France                           | 73.8%             | 109.4%           | 46.4%             | 84.2%        | 52.7%        | 183.2%        |
| Denmark                          | 75.9%             | 102.9%           | 15.1%             | 118.7%       | 45.1%        | 178.8%        |
| <b>Greece</b>                    | <b>58.3%</b>      | <b>105.2%</b>    | <b>86.9%</b>      | <b>45.7%</b> | <b>30.9%</b> | <b>163.5%</b> |
| Spain                            | 46.6%             | 112.1%           | 26.8%             | 70.1%        | 61.8%        | 158.7%        |
| Finland                          | 55.7%             | 91.8%            | 34.3%             | 71.6%        | 41.6%        | 147.5%        |
| Hungary                          | 18.5%             | 127.4%           | 40.6%             | 35.4%        | 69.9%        | 145.8%        |
| Germany                          | 45.4%             | 95.2%            | 35.5%             | 67.0%        | 38.0%        | 140.6%        |
| Latvia                           | 30.5%             | 93.6%            | 20.1%             | 65.9%        | 38.1%        | 124.1%        |
| Norway                           | 50.4%             | 72.1%            | 17.3%             | 50.4%        | 54.8%        | 122.5%        |
| Italy                            | 30.5%             | 82.2%            | 49.4%             | 37.7%        | 25.6%        | 112.7%        |
| Bulgaria                         | 37.2%             | 73.5%            | 8.1%              | 24.2%        | 78.5%        | 110.8%        |
| Estonia                          | 38.7%             | 68.4%            | 5.1%              | 57.8%        | 44.2%        | 107.1%        |
| Slovenia                         | 24.2%             | 81.6%            | 17.3%             | 43.3%        | 45.2%        | 105.8%        |
| Australia                        | 30.3%             | 72.9%            | 7.1%              | 58.8%        | 37.2%        | 103.1%        |
| <b>United States</b>             | <b>35.7%</b>      | <b>62.0%</b>     | <b>26.3%</b>      | <b>20.1%</b> | <b>51.3%</b> | <b>97.7%</b>  |

This will lead to defaults. The defaults will then result in loan renegotiations that will cause:

- Banks to forgive some loans;
- Extend the repayment schedules on others,
- Re structure the amount of the repayments on still others.

This will be associated with a general slowdown in the European economy. Banks will take writedowns on some of these loans. They will also suffer from fewer business opportunities in the impacted areas.

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Fortunately, only five American banks will be meaningfully impacted if these events deteriorate as expected. They are shown in the table below:

| <u>Categories</u>   | <b>Cross Border Exposure (mil)</b> |                  |                    |                         |                  |                    |
|---------------------|------------------------------------|------------------|--------------------|-------------------------|------------------|--------------------|
|                     | <b>Universal Banks</b>             |                  |                    | <b>Investment Banks</b> |                  | <b>Totals</b>      |
|                     | <u>BAC</u>                         | <u>C</u>         | <u>JPM</u>         | <u>GS</u>               | <u>MS</u>        |                    |
| <u>Europe</u>       |                                    |                  |                    |                         |                  |                    |
| Benelux             |                                    |                  |                    |                         |                  |                    |
| Denmark             |                                    |                  |                    |                         | \$7,144          | \$7,144            |
| Eastern Europe      |                                    |                  |                    |                         |                  |                    |
| France              |                                    | \$101,200        | \$207,488          | \$19,355                | \$26,560         | \$354,603          |
| Germany             |                                    | \$81,600         | \$210,036          | \$18,254                | \$24,227         | \$334,117          |
| Ireland             |                                    |                  |                    | \$7,468                 | \$8,442          | \$15,910           |
| Italy               |                                    | \$42,900         | \$105,538          |                         | \$5,551          | \$153,989          |
| Luxembourg          |                                    |                  |                    |                         | \$12,590         | \$12,590           |
| Netherlands         |                                    | \$86,000         | \$107,286          |                         | \$14,527         | \$207,813          |
| Norway              |                                    |                  | \$12,258           |                         |                  | \$12,258           |
| Russia              |                                    |                  |                    |                         |                  |                    |
| Poland              |                                    |                  |                    |                         |                  |                    |
| Spain               |                                    |                  | \$69,865           |                         | \$6,187          | \$76,052           |
| Switzerland         |                                    |                  |                    |                         | \$11,061         | \$11,061           |
| Turkey              | \$591                              |                  |                    |                         |                  | \$591              |
| United Kingdom      |                                    | \$156,700        | \$652,488          | \$60,461                | \$22,826         | \$892,475          |
| Other               | <u>\$1,720</u>                     |                  |                    |                         |                  | <u>\$1,720</u>     |
| <b>Total Europe</b> | <b>\$2,311</b>                     | <b>\$468,400</b> | <b>\$1,364,959</b> | <b>\$105,538</b>        | <b>\$139,115</b> | <b>\$2,080,323</b> |

While their earnings will be impacted, it should be recalled that three of these banks had the following loan loss provisions in 2009; the other two do not report this number:

| <b>Company Name</b>         |     | <b><u>2009Q1</u></b> | <b><u>2009Q2</u></b> | <b><u>2009Q3</u></b> | <b><u>2009Q4</u></b> |
|-----------------------------|-----|----------------------|----------------------|----------------------|----------------------|
| Bank of America Corporation | BAC | \$13,352,000         | \$13,375,000         | \$11,705,000         | \$10,110,000         |
| Citigroup Inc.              | C   | \$9,915,000          | \$12,233,000         | \$8,771,000          | \$7,841,000          |
| JPMorgan Chase & Co.        | JPM | \$8,596,000          | \$8,031,000          | \$8,104,000          | \$7,284,000          |

The point here is that it will take a sizable of writedowns in Europe to cause these companies to increase their loan losses if domestic loan problems are contracting as is also expected in a growing domestic economy. At best European losses will slow earnings growth; they are not expected to cause deficits.

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### A More Bullish Point of View

To this point in this commentary, a negative point of view has been expressed concerning both the potential impact of the financial bill now in Congress and the European plight. It has been suggested that the only potential source of earnings growth will be a reduction in loan losses. This is not totally realistic. This is because the banks will be able to counter some of the negative developments being thrust upon them. They are expected to do the following:

- Cut costs by closing branches, cutting back hours of operations,, and swapping full-time employees for part time employees.
- Eliminate all free products and forgiveness of fees.
- Establish new charges for all banking products. A monthly maintenance fee is highly likely for all accounts.
- Introduce new products, like pay day loans, that carry imputed interest costs of 20% for two weeks.
- Establish capital market businesses outside the United States that are not controlled by U.S. law.

Moreover at some point the build-up of excess capital and liquidity will end. At this point, banks will start to use the power they have created in their balance sheets to generate new earnings. These companies are not helpless and they provide services that the national economy must have. A new era in banking will begin along the lines suggested above -- i.e., higher prices for reduced services.

### Refining the Investment Approach

Investors may also try to benefit by refining their approach to investing in the industry. For example, consumer finance is to be highly regulated. Commercial finance is not only avoiding this regulation but the government is introducing programs to stimulate activity in this sector. Thus, it would make sense to seek out companies in commercial finance and avoid those in consumer finance.

Also consider that all of the regulation in the world is not going to stop money supply from growing. This money will not remain as cash. It will be converted into financial instruments; these will be traded; their transference recorded; and ultimately they must be held by someone.

- Therefore, capital market companies who are not regulated should be considered.
- Companies like trust banks that do the record keeping and benefit from increased regulation might be more attractive than the traditional banks.
- Foreign banks, which are larger than U.S. banks and operate in countries with low regulation, seem to be naturals.

### Conclusion

Bank stocks have rallied sharply in the past 14-15 months. They are now facing challenges from new legislation and problems in Europe. These problems can be quantified. When this is done it becomes apparent that banking companies are still looking at sharp upturns in earnings. They may fall another 10% to 12% reflecting market fears but they are still very attractive investments. Longer term, I still expect that these stocks will grow in multiples not percentages.

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| Industry Balance Sheet   |               |               |               |               |               |                         |               |               |               |               |               |
|--------------------------|---------------|---------------|---------------|---------------|---------------|-------------------------|---------------|---------------|---------------|---------------|---------------|
|                          | Assets (mil)  |               |               |               |               | Liabilities (mil)       |               |               |               |               |               |
| <b>Assets</b>            | <b>Dec 05</b> | <b>Dec 06</b> | <b>Dec 07</b> | <b>Dec 08</b> | <b>Dec 09</b> | <b>Liabilities</b>      | <b>Dec 05</b> | <b>Dec 06</b> | <b>Dec 07</b> | <b>Dec 08</b> | <b>Dec 09</b> |
| Cash & due               | \$435,357     | \$469,913     | \$524,166     | \$1,104,808   | \$1,048,958   | <b>Deposits</b>         |               |               |               |               |               |
| <b>Securities</b>        |               |               |               |               |               | <b>Domestic</b>         |               |               |               |               |               |
| Treasury                 | \$59,031      | \$48,407      | \$31,396      | \$33,090      | \$102,494     | Interest bearing        | \$5,003,398   | \$5,414,082   | \$5,718,346   | \$6,073,164   | \$6,143,921   |
| Mortgage backed          | \$1,139,752   | \$1,207,118   | \$1,236,006   | \$1,299,759   | \$1,395,282   | Non-Interest bearing    | \$1,216,689   | \$1,217,102   | \$1,194,455   | \$1,423,254   | \$1,552,891   |
| Other                    | \$494,512     | \$547,379     | \$509,853     | \$472,436     | \$768,135     | Other                   | \$586         |               |               |               |               |
| Total available for sale | \$1,693,295   | \$1,802,904   | \$1,777,255   | \$1,805,285   | \$2,265,911   | Total domestic deposits | \$6,220,673   | \$6,631,184   | \$6,912,801   | \$7,496,418   | \$7,696,812   |
| Held to Maturity         | \$199,883     | \$178,046     | \$176,894     | \$229,987     | \$234,471     | Deposits in foreign off | \$920,648     | \$1,194,035   | \$1,502,575   | \$1,539,300   | \$1,529,974   |
| Total securities         | \$1,893,178   | \$1,980,950   | \$1,954,149   | \$2,035,272   | \$2,500,382   | Total deposits          | \$7,141,321   | \$7,825,219   | \$8,415,376   | \$9,035,718   | \$9,226,786   |
| Fed Funds & Repos        | \$463,794     | \$560,636     | \$691,705     | \$722,828     | \$414,082     | Fed Funds & Repos       | \$760,957     | \$800,540     | \$834,853     | \$881,586     | \$604,652     |
| <b>Loans</b>             |               |               |               |               |               | <b>Borrowings</b>       |               |               |               |               |               |
| Construction & develop   | \$449,670     | \$565,282     | \$629,496     | \$590,920     | \$451,511     | Due in a year           | \$420,215     | \$451,441     | \$611,069     | \$790,453     | \$478,174     |
| Secured by farmland      | \$48,006      | \$52,668      | \$57,410      | \$63,698      | \$66,675      | Due in over 1 year      | \$372,506     | \$456,676     | \$544,474     | \$530,886     | \$491,453     |
| Home equity LOC          | \$534,257     | \$559,307     | \$611,389     | \$668,286     | \$661,445     | Total borrowings        | \$792,721     | \$908,117     | \$1,155,543   | \$1,321,339   | \$969,627     |
| 1-4 Family homes (Fixed) | \$1,126,297   | \$1,200,747   | \$1,296,214   | \$1,167,205   | \$1,236,597   | Subordinated debt       | \$131,428     | \$160,547     | \$185,393     | \$185,464     | \$156,989     |
| 1-4 Family homes (ARMs)  | \$916,146     | \$975,043     | \$945,258     | \$877,989     | \$680,117     | Trading liabilities     | \$251,751     | \$266,383     | \$342,725     | \$470,095     | \$253,458     |
| Multifamily              | \$188,138     | \$193,058     | \$202,817     | \$206,523     | \$211,421     | All other liabilities   | \$681,293     | \$652,826     | \$752,720     | \$655,881     | \$429,993     |
| Non-residential          | \$825,699     | \$904,368     | \$968,695     | \$1,066,230   | \$1,091,386   | Total liabilities       | \$9,759,471   | \$10,613,632  | \$11,686,610  | \$12,550,083  | \$11,641,505  |
| Foreign RE               | \$52,478      | \$57,298      | \$70,531      | \$64,410      | \$63,543      |                         |               |               |               |               |               |
| Total RE                 | \$4,140,691   | \$4,507,771   | \$4,781,810   | \$4,705,261   | \$4,462,695   | <b>Equity (mil)</b>     |               |               |               |               |               |
| Commercial & industrial  | \$1,085,613   | \$1,214,754   | \$1,439,129   | \$1,493,975   | \$1,220,793   | Perpetual preferred     | \$5,716       | \$5,814       | \$8,005       | \$9,736       | \$8,259       |
| Agricultural             | \$51,669      | \$54,257      | \$56,786      | \$59,801      | \$59,584      | Common stock            | \$33,278      | \$34,769      | \$36,967      | \$46,546      | \$47,484      |
| Loans to depositories    | \$160,309     | \$128,682     | \$136,337     | \$111,871     | \$111,888     | Surplus                 | \$657,659     | \$765,852     | \$894,982     | \$958,840     | \$1,085,578   |
| Credit cards             | \$396,062     | \$384,980     | \$421,818     | \$444,692     | \$422,095     | Undivided profits       | \$442,638     | \$461,243     | \$425,996     | \$355,783     | \$331,275     |
| All other consumer       | \$552,642     | \$570,283     | \$636,640     | \$644,197     | \$638,232     | Other comprehensive inc | (\$19,530)    | (\$18,714)    | (\$17,989)    | (\$78,763)    | (\$24,143)    |
| Total consumer           | \$948,704     | \$955,263     | \$1,058,458   | \$1,088,889   | \$1,060,327   | Common equity           | \$1,114,045   | \$1,243,150   | \$1,339,956   | \$1,282,406   | \$1,440,194   |
| Sovereign loans          | \$3,272       | \$5,018       | \$1,673       | \$2,423       | \$3,146       | Minority interests      | (\$971)       | (\$1,078)     | (\$575)       | (\$1,051)     | \$19,498      |
| State & Municipal        | \$32,450      | \$38,685      | \$45,204      | \$55,888      | \$62,050      | Total equity            | \$1,118,790   | \$1,247,886   | \$1,347,386   | \$1,291,091   | \$1,467,951   |
| All other loans          | \$159,038     | \$192,678     | \$258,616     | \$237,465     | \$200,136     |                         |               |               |               |               |               |
| Leases                   | \$138,524     | \$139,040     | \$130,797     | \$120,816     | \$109,320     |                         |               |               |               |               |               |
| Loans & leases           | \$6,720,270   | \$7,236,148   | \$7,908,810   | \$7,876,389   | \$7,289,939   |                         |               |               |               |               |               |
| Unearned income          | \$3,156       | \$2,401       | \$2,309       | \$2,878       | \$3,770       |                         |               |               |               |               |               |
| Allowance                | \$77,363      | \$77,521      | \$102,692     | \$173,878     | \$227,480     |                         |               |               |               |               |               |
| Net Loans                | \$6,639,751   | \$7,156,226   | \$7,803,809   | \$7,699,633   | \$7,058,689   |                         |               |               |               |               |               |
| Premises & equipment     | \$106,484     | \$111,919     | \$120,084     | \$122,028     | \$121,141     |                         |               |               |               |               |               |
| Other RE Owned           | \$4,082       | \$6,057       | \$12,127      | \$26,672      | \$41,357      |                         |               |               |               |               |               |
| Trading accounts         | \$512,618     | \$625,244     | \$876,065     | \$946,729     | \$711,917     |                         |               |               |               |               |               |
| Acceptances              | \$5,229       |               |               |               |               |                         |               |               |               |               |               |
| Intangible assets        | \$344,597     | \$413,434     | \$461,744     | \$421,607     | \$428,428     |                         |               |               |               |               |               |
| All other assets         | \$473,171     | \$537,139     | \$590,147     | \$761,597     | \$784,502     |                         |               |               |               |               |               |
| Total assets             | \$10,878,261  | \$11,861,518  | \$13,033,996  | \$13,841,174  | \$13,109,456  | Total funding           | \$10,878,261  | \$11,861,518  | \$13,033,996  | \$13,841,174  | \$13,109,456  |
| <b>Note:</b>             |               |               |               |               |               |                         |               |               |               |               |               |
| Loans 30-89 days past    | \$58,548      | \$71,507      | \$107,999     | \$159,340     | \$140,430     | Tangible common equity  | \$769,448     | \$829,716     | \$878,212     | \$860,799     | \$1,011,766   |
| Loans 90 days past due   | \$21,047      | \$22,275      | \$31,513      | \$74,836      | \$125,791     |                         |               |               |               |               |               |
| Nonaccrual loans         | \$28,875      | \$35,169      | \$80,490      | \$158,806     | \$265,518     |                         |               |               |               |               |               |
| Restructured loans       | \$3,341       | \$2,606       | \$6,934       | \$11,064      | \$21,056      |                         |               |               |               |               |               |

## Reshaping the Banking Industry (Part I)

| Industry Balance Sheet   |                   |          |         |         |         |                         |                        |          |         |         |            |
|--------------------------|-------------------|----------|---------|---------|---------|-------------------------|------------------------|----------|---------|---------|------------|
|                          | Assets (% Change) |          |         |         |         |                         | Liabilities (% Change) |          |         |         |            |
|                          | Dec 05            | Dec 06   | Dec 07  | Dec 08  | Dec 09  |                         | Dec 05                 | Dec 06   | Dec 07  | Dec 08  | Dec 09     |
| <b>Assets</b>            |                   |          |         |         |         | <b>Liabilities</b>      |                        |          |         |         |            |
| Cash & due               |                   | 7.9%     | 11.5%   | 110.8%  | (5.1%)  | Deposits                |                        |          |         |         |            |
| <b>Securities</b>        |                   |          |         |         |         | Domestic                |                        |          |         |         |            |
| Treasury                 |                   | (18.0%)  | (35.1%) | 5.4%    | 209.7%  | Interest bearuig        |                        | 8.2%     | 5.6%    | 6.2%    | 1.2%       |
| Mortgage backed          |                   | 5.9%     | 2.4%    | 5.2%    | 7.3%    | Non-Interest Bearing    |                        | 0.0%     | (1.9%)  | 19.2%   | 9.1%       |
| Other                    |                   | 10.7%    | (6.9%)  | (7.3%)  | 62.6%   | Other                   |                        | (100.0%) | 0.0%    | 0.0%    | 0.0%       |
| Total available for sale |                   | 6.5%     | (1.4%)  | 1.6%    | 25.5%   | Total domestic deposits |                        | 6.6%     | 4.2%    | 8.4%    | 2.7%       |
| Held to Maturity         |                   | (10.9%)  | (0.6%)  | 30.0%   | 1.9%    | Deposits in foreign off |                        | 29.7%    | 25.8%   | 2.4%    | (0.6%)     |
| Total securities         |                   | 4.6%     | (1.4%)  | 4.2%    | 22.9%   | Total deposits          |                        | 9.6%     | 7.5%    | 7.4%    | 2.1%       |
| Fed Funds & Repos        |                   | 20.9%    | 23.4%   | 4.5%    | (42.7%) | Fed Funds & Repos       |                        | 5.2%     | 4.3%    | 5.6%    | (31.4%)    |
| <b>Loans</b>             |                   |          |         |         |         | <b>Borrowings</b>       |                        |          |         |         |            |
| Construction & develop   |                   | 25.7%    | 11.4%   | (6.1%)  | (23.6%) | Due in a year           |                        | 7.4%     | 35.4%   | 29.4%   | (39.5%)    |
| Secured by farmland      |                   | 9.7%     | 9.0%    | 11.0%   | 4.7%    | Due in over 1 year      |                        | 22.6%    | 19.2%   | (2.5%)  | (7.4%)     |
| Home equity LOC          |                   | 4.7%     | 9.3%    | 9.3%    | (1.0%)  | Total borrowings        |                        | 14.6%    | 27.2%   | 14.3%   | (26.6%)    |
| 1-4 Family homes         |                   | 6.6%     | 8.0%    | (10.0%) | 5.9%    | Subordinated debt       |                        | 22.2%    | 15.5%   | 0.0%    | (15.4%)    |
| ARMs                     |                   | 6.4%     | (3.1%)  | (7.1%)  | (22.5%) | Trading liabilities     |                        | 5.8%     | 28.7%   | 37.2%   | (46.1%)    |
| Multifamily              |                   | 2.6%     | 5.1%    | 1.8%    | 2.4%    | All other liabilities   |                        | (4.2%)   | 15.3%   | (12.9%) | (34.4%)    |
| Non-residential          |                   | 9.5%     | 7.1%    | 10.1%   | 2.4%    | Total liabilities       |                        | 8.8%     | 10.1%   | 7.4%    | (7.2%)     |
| Foreign RE               |                   | 9.2%     | 23.1%   | (8.7%)  | (1.3%)  | Perpetual preferred     |                        | 1.7%     | 37.7%   | 21.6%   | (15.2%)    |
| Total RE                 |                   | 8.9%     | 6.1%    | (1.6%)  | (5.2%)  | Common stock            |                        | 4.5%     | 6.3%    | 25.9%   | 2.0%       |
| Comercial & industrial   |                   | 11.9%    | 18.5%   | 3.8%    | (18.3%) | Surplus                 |                        | 16.5%    | 16.9%   | 7.1%    | 13.2%      |
| Agricultural             |                   | 5.0%     | 4.7%    | 5.3%    | (0.4%)  | Undivided profits       |                        | 4.2%     | (7.6%)  | (16.5%) | (6.9%)     |
| Loans to depositories    |                   | (19.7%)  | 5.9%    | (17.9%) | 0.0%    | Other comprehensive inc |                        | (4.2%)   | (3.9%)  | 337.8%  | (69.3%)    |
| Credit cards             |                   | (2.8%)   | 9.6%    | 5.4%    | (5.1%)  | Common equity           |                        | 11.6%    | 7.8%    | (4.3%)  | 12.3%      |
| All other consumer       |                   | 3.2%     | 11.6%   | 1.2%    | (0.9%)  | Minority interests      |                        | 11.0%    | (46.7%) | 82.8%   | (1,955.2%) |
| Total consumer           |                   | 0.7%     | 10.8%   | 2.9%    | (2.6%)  | Total equity            |                        | 11.5%    | 8.0%    | (4.2%)  | 13.7%      |
| Sovereign loans          |                   | 53.4%    | (66.7%) | 44.8%   | 29.8%   | Total funding           |                        | 9.0%     | 9.9%    | 6.2%    | (5.3%)     |
| State & Municipal        |                   | 19.2%    | 16.9%   | 23.6%   | 11.0%   | Tangible common equity  |                        | 7.8%     | 5.8%    | (2.0%)  | 17.5%      |
| All other loans          |                   | 21.2%    | 34.2%   | (8.2%)  | (15.7%) |                         |                        |          |         |         |            |
| Leases                   |                   | 0.4%     | (5.9%)  | (7.6%)  | (9.5%)  |                         |                        |          |         |         |            |
| Loans & leases           |                   | 7.7%     | 9.3%    | (0.4%)  | (7.4%)  |                         |                        |          |         |         |            |
| Unearned income          |                   | (23.9%)  | (3.8%)  | 24.6%   | 31.0%   |                         |                        |          |         |         |            |
| Allowance                |                   | 0.2%     | 32.5%   | 69.3%   | 30.8%   |                         |                        |          |         |         |            |
| Net Loans                |                   | 7.8%     | 9.0%    | (1.3%)  | (8.3%)  |                         |                        |          |         |         |            |
| Premises & equipment     |                   | 5.1%     | 7.3%    | 1.6%    | (0.7%)  |                         |                        |          |         |         |            |
| Other RE Owned           |                   | 48.4%    | 100.2%  | 119.9%  | 55.1%   |                         |                        |          |         |         |            |
| Trading accounts         |                   | 22.0%    | 40.1%   | 8.1%    | (24.8%) |                         |                        |          |         |         |            |
| Acceptances              |                   | (100.0%) | 0.0%    | 0.0%    | 0.0%    |                         |                        |          |         |         |            |
| Intangible assets        |                   | 20.0%    | 11.7%   | (8.7%)  | 1.6%    |                         |                        |          |         |         |            |
| All other assets         |                   | 13.5%    | 9.9%    | 29.1%   | 3.0%    |                         |                        |          |         |         |            |
| Total assets             |                   | 9.0%     | 9.9%    | 6.2%    | (5.3%)  |                         |                        |          |         |         |            |
| <b>Note:</b>             |                   |          |         |         |         |                         |                        |          |         |         |            |
| Loans 30-89 days past    |                   | 22.1%    | 51.0%   | 47.5%   | (11.9%) |                         |                        |          |         |         |            |
| Loans 90 days past due   |                   | 5.8%     | 41.5%   | 137.5%  | 68.1%   |                         |                        |          |         |         |            |
| Nonaccrual loans         |                   | 21.8%    | 128.9%  | 97.3%   | 67.2%   |                         |                        |          |         |         |            |
| Restructured loans       |                   | (22.0%)  | 166.1%  | 59.6%   | 90.3%   |                         |                        |          |         |         |            |

## Reshaping the Banking Industry (Part I)

| Industry Balance Sheet   |                      |        |        |        |        |                         |                           |        |        |        |        |
|--------------------------|----------------------|--------|--------|--------|--------|-------------------------|---------------------------|--------|--------|--------|--------|
| Assets                   | Assets (% of Assets) |        |        |        |        | Liabilities             | Liabilities (% of Assets) |        |        |        |        |
|                          | Dec 05               | Dec 06 | Dec 07 | Dec 08 | Dec 09 |                         | Dec 05                    | Dec 06 | Dec 07 | Dec 08 | Dec 09 |
| Cash & due               | 4.0%                 | 4.0%   | 4.0%   | 8.0%   | 8.0%   | Deposits                |                           |        |        |        |        |
| Securities               |                      |        |        |        |        | Domestic                |                           |        |        |        |        |
| Treasury                 | 0.5%                 | 0.4%   | 0.2%   | 0.2%   | 0.8%   | Interest bearuig        | 46.0%                     | 45.6%  | 43.9%  | 43.9%  | 46.9%  |
| Mortgage backed          | 10.5%                | 10.2%  | 9.5%   | 9.4%   | 10.6%  | Non-Interest Bearing    | 11.2%                     | 10.3%  | 9.2%   | 10.3%  | 11.8%  |
| Other                    | 4.5%                 | 4.6%   | 3.9%   | 3.4%   | 5.9%   | Other                   | 0.0%                      | 0.0%   | 0.0%   | 0.0%   | 0.0%   |
| Total available for sale | 15.6%                | 15.2%  | 13.6%  | 13.0%  | 17.3%  | Total domestic deposits | 57.2%                     | 55.9%  | 53.0%  | 54.2%  | 58.7%  |
| Held to Maturity         | 1.8%                 | 1.5%   | 1.4%   | 1.7%   | 1.8%   | Deposits in foreign off | 8.5%                      | 10.1%  | 11.5%  | 11.1%  | 11.7%  |
| Total securities         | 17.4%                | 16.7%  | 15.0%  | 14.7%  | 19.1%  | Total deposits          | 65.6%                     | 66.0%  | 64.6%  | 65.3%  | 70.4%  |
| Fed Funds & Repos        | 4.3%                 | 4.7%   | 5.3%   | 5.2%   | 3.2%   |                         |                           |        |        |        |        |
| Loans                    |                      |        |        |        | 0.0%   | Fed Funds & Repos       | 7.0%                      | 6.7%   | 6.4%   | 6.4%   | 4.6%   |
| Construction & develop   | 4.1%                 | 4.8%   | 4.8%   | 4.3%   | 3.4%   |                         |                           |        |        |        |        |
| Secured by farmland      | 0.4%                 | 0.4%   | 0.4%   | 0.5%   | 0.5%   | Borrowings              |                           |        |        |        |        |
| Home equity LOC          | 4.9%                 | 4.7%   | 4.7%   | 4.8%   | 5.0%   | Due in a year           | 3.9%                      | 3.8%   | 4.7%   | 5.7%   | 3.6%   |
| 1-4 Family homes         | 10.4%                | 10.1%  | 9.9%   | 8.4%   | 9.4%   | Due in over 1 year      | 3.4%                      | 3.9%   | 4.2%   | 3.8%   | 3.7%   |
| ARMs                     | 8.4%                 | 8.2%   | 7.3%   | 6.3%   | 5.2%   | Total borrowings        | 7.3%                      | 7.7%   | 8.9%   | 9.5%   | 7.4%   |
| Multifamily              | 1.7%                 | 1.6%   | 1.6%   | 1.5%   | 1.6%   |                         |                           |        |        |        |        |
| Non-residential          | 7.6%                 | 7.6%   | 7.4%   | 7.7%   | 8.3%   | Subordinated debt       | 1.2%                      | 1.4%   | 1.4%   | 1.3%   | 1.2%   |
| Foreign RE               | 0.5%                 | 0.5%   | 0.5%   | 0.5%   | 0.5%   | Trading liabilities     | 2.3%                      | 2.2%   | 2.6%   | 3.4%   | 1.9%   |
| Total RE                 | 38.1%                | 38.0%  | 36.7%  | 34.0%  | 34.0%  | All other liabilities   | 6.3%                      | 5.5%   | 5.8%   | 4.7%   | 3.3%   |
| Comercial & industrial   | 10.0%                | 10.2%  | 11.0%  | 10.8%  | 9.3%   |                         |                           |        |        |        |        |
| Agricultural             | 0.5%                 | 0.5%   | 0.4%   | 0.4%   | 0.5%   | Total liabilities       | 89.7%                     | 89.5%  | 89.7%  | 90.7%  | 88.8%  |
| Loans to depositories    | 1.5%                 | 1.1%   | 1.0%   | 0.8%   | 0.9%   |                         |                           |        |        |        |        |
| Credit cards             | 3.6%                 | 3.2%   | 3.2%   | 3.2%   | 3.2%   |                         |                           |        |        |        |        |
| All other consumer       | 5.1%                 | 4.8%   | 4.9%   | 4.7%   | 4.9%   |                         |                           |        |        |        |        |
| Total consumer           | 8.7%                 | 8.1%   | 8.1%   | 7.9%   | 8.1%   | Perpetual preferred     | 0.1%                      | 0.0%   | 0.1%   | 0.1%   | 0.1%   |
| Sovereign loans          | 0.0%                 | 0.0%   | 0.0%   | 0.0%   | 0.0%   |                         |                           |        |        |        |        |
| State & Municipal        | 0.3%                 | 0.3%   | 0.3%   | 0.4%   | 0.5%   | Common stock            | 0.3%                      | 0.3%   | 0.3%   | 0.3%   | 0.4%   |
| All other loans          | 1.5%                 | 1.6%   | 2.0%   | 1.7%   | 1.5%   | Surplus                 | 6.0%                      | 6.5%   | 6.9%   | 6.9%   | 8.3%   |
| Leases                   | 1.3%                 | 1.2%   | 1.0%   | 0.9%   | 0.8%   | Undivided profits       | 4.1%                      | 3.9%   | 3.3%   | 2.6%   | 2.5%   |
| Loans & leases           | 61.8%                | 61.0%  | 60.7%  | 56.9%  | 55.6%  | Other comprehensive inc | (0.2%)                    | (0.2%) | (0.1%) | (0.6%) | (0.2%) |
| Unearned income          | 0.03%                | 0.0%   | 0.0%   | 0.0%   | 0.0%   | Common equity           | 10.2%                     | 10.5%  | 10.3%  | 9.3%   | 11.0%  |
| Allowance                | 0.7%                 | 0.7%   | 0.8%   | 1.3%   | 1.7%   |                         |                           |        |        |        |        |
| Net Loans                | 61.0%                | 60.3%  | 59.9%  | 55.6%  | 53.8%  | Minority interests      | (0.0%)                    | (0.0%) | (0.0%) | (0.0%) | 0.1%   |
| Premises & equipment     | 1.0%                 | 0.9%   | 0.9%   | 0.9%   | 0.9%   | Total equity            | 10.3%                     | 10.5%  | 10.3%  | 9.3%   | 11.2%  |
| Other RE Owned           | 0.0%                 | 0.1%   | 0.1%   | 0.2%   | 0.3%   |                         |                           |        |        |        |        |
| Trading accounts         | 4.7%                 | 5.3%   | 6.7%   | 6.8%   | 5.4%   |                         |                           |        |        |        |        |
| Acceptances              | 0.0%                 |        |        |        |        |                         |                           |        |        |        |        |
| Intangible assets        | 3.2%                 | 3.5%   | 3.5%   | 3.0%   | 3.3%   |                         |                           |        |        |        |        |
| All other assets         | 4.3%                 | 4.5%   | 4.5%   | 5.5%   | 6.0%   |                         |                           |        |        |        |        |
| Total assets             | 100.0%               | 100.0% | 100.0% | 100.0% | 100.0% | Total funding           | 100.0%                    | 100.0% | 100.0% | 100.0% | 100.0% |
|                          |                      |        |        |        |        |                         |                           |        |        |        |        |
|                          |                      |        |        |        |        | Tangible common equity  | 7.07%                     | 7.00%  | 6.74%  | 6.22%  | 7.72%  |
|                          |                      |        |        |        |        | TCE/TA                  | 7.30%                     | 7.25%  | 6.99%  | 6.41%  | 7.98%  |

## Reshaping the Banking Industry (Part I)

| Industry Income Statement |              |           |           |           |           |                       |        |         |         |                              |        |        |        |        |
|---------------------------|--------------|-----------|-----------|-----------|-----------|-----------------------|--------|---------|---------|------------------------------|--------|--------|--------|--------|
| Millions                  | Income (mil) |           |           |           |           | Annual Percent Change |        |         |         | Percent of Operating Revenue |        |        |        |        |
|                           | Dec 05       | Dec 06    | Dec 07    | Dec 08    | Dec 09    | Dec 06                | Dec 07 | Dec 08  | Dec 09  | Dec 05                       | Dec 06 | Dec 07 | Dec 08 | Dec 09 |
| <b>Interest Income</b>    |              |           |           |           |           |                       |        |         |         |                              |        |        |        |        |
| <b>Domestic</b>           |              |           |           |           |           |                       |        |         |         |                              |        |        |        |        |
| C&I loans                 | \$61,738     | \$78,441  | \$87,716  | \$69,342  | \$57,724  | 27.1%                 | 11.8%  | (20.9%) | (16.8%) | 11.4%                        | 13.7%  | 15.0%  | 12.3%  | 8.8%   |
| RE loans                  | \$228,738    | \$280,898 | \$312,538 | \$244,528 | \$229,748 | 22.8%                 | 11.3%  | (21.8%) | (6.0%)  | 72.2%                        | 85.1%  | 88.6%  | 68.4%  | 58.0%  |
| CC loans                  | \$36,488     | \$36,499  | \$38,076  | \$37,692  | \$39,068  | 0.0%                  | 4.3%   | (1.0%)  | 3.7%    | 8.0%                         | 7.6%   | 7.4%   | 7.4%   | 7.0%   |
| Other Consumer            | \$27,861     | \$34,307  | \$40,695  | \$38,579  | \$37,415  | 23.1%                 | 18.6%  | (5.2%)  | (3.0%)  | 7.8%                         | 9.2%   | 10.3%  | 9.6%   | 8.5%   |
| Other Loans               | \$20,392     | \$28,325  | \$26,544  | \$22,223  | \$19,409  | 38.9%                 | (6.3%) | (16.3%) | (12.7%) | 4.5%                         | 6.0%   | 5.1%   | 4.2%   | 3.4%   |
| Domestic Loans            | \$375,217    | \$458,470 | \$505,569 | \$412,364 | \$383,364 | 22.2%                 | 10.3%  | (18.4%) | (7.0%)  | 59.1%                        | 69.2%  | 70.2%  | 56.8%  | 49.1%  |
| Foreign loans             | \$23,930     | \$29,896  | \$39,646  | \$38,886  | \$26,368  | 24.9%                 | 32.6%  | (1.9%)  | (32.2%) | 7.5%                         | 9.1%   | 11.2%  | 10.9%  | 6.7%   |
| Leases                    | \$7,409      | \$7,391   | \$6,852   | \$4,536   | \$6,554   | (0.2%)                | (7.3%) | (33.8%) | 44.5%   | 2.3%                         | 2.2%   | 2.0%   | 1.3%   | 1.7%   |
| Deposit Institutions      | \$5,221      | \$7,807   | \$9,977   | \$10,417  | \$5,225   | 49.5%                 | 27.8%  | 4.4%    | (49.8%) | 1.0%                         | 1.4%   | 2.0%   | 2.9%   | 1.2%   |
| Securities                | \$81,854     | \$96,495  | \$102,256 | \$91,365  | \$97,420  | 17.9%                 | 6.0%   | (10.7%) | 6.6%    | 21.5%                        | 24.2%  | 25.6%  | 25.1%  | 24.3%  |
| Fed Funds & Repos         | \$11,186     | \$21,409  | \$28,823  | \$16,461  | \$3,517   | 91.4%                 | 34.6%  | (42.9%) | (78.6%) | 2.5%                         | 4.5%   | 6.3%   | 4.6%   | 0.9%   |
| Other                     | \$17,225     | \$22,009  | \$31,717  | \$29,272  | \$18,732  | 27.8%                 | 44.1%  | (7.7%)  | (36.0%) | 5.4%                         | 6.7%   | 9.0%   | 8.2%   | 4.7%   |
| Gross interest income     | \$522,042    | \$643,477 | \$724,840 | \$603,301 | \$541,180 | 23.3%                 | 12.6%  | (16.8%) | (10.3%) | 164.7%                       | 194.9% | 205.5% | 168.6% | 136.7% |
| <b>Interest Expense</b>   |              |           |           |           |           |                       |        |         |         |                              |        |        |        |        |
| <b>Domestic deposits</b>  |              |           |           |           |           |                       |        |         |         |                              |        |        |        |        |
| Domestic deposits         | \$104,608    | \$164,341 | \$197,789 | \$131,623 | \$88,959  | 57.1%                 | 20.4%  | (33.5%) | (32.4%) | 33.2%                        | 49.4%  | 52.3%  | 30.4%  | 19.5%  |
| Foreign deposits          | \$23,780     | \$40,280  | \$53,961  | \$34,636  | \$9,911   | 69.4%                 | 34.0%  | (35.8%) | (71.4%) | 7.5%                         | 12.2%  | 15.3%  | 9.7%   | 2.5%   |
| Fed Funds & Repos         | \$20,769     | \$35,111  | \$38,613  | \$20,041  | \$5,596   | 69.1%                 | 10.0%  | (48.1%) | (72.1%) | 5.3%                         | 8.3%   | 8.3%   | 4.9%   | 1.3%   |
| Borrowings                | \$48,771     | \$64,554  | \$71,679  | \$52,168  | \$35,120  | 32.4%                 | 11.0%  | (27.2%) | (32.7%) | 15.4%                        | 19.6%  | 20.3%  | 14.6%  | 8.9%   |
| Sub debt                  | \$7,107      | \$9,067   | \$10,102  | \$7,108   | \$5,786   | 27.6%                 | 11.4%  | (29.6%) | (18.6%) | 2.2%                         | 2.7%   | 2.9%   | 2.0%   | 1.5%   |
| Gross interest expens     | \$205,035    | \$313,353 | \$372,144 | \$245,576 | \$145,372 | 52.8%                 | 18.8%  | (34.0%) | (40.8%) | 64.7%                        | 94.9%  | 105.5% | 68.6%  | 36.7%  |
| <b>Credit Income</b>      |              |           |           |           |           |                       |        |         |         |                              |        |        |        |        |
| Net interest income       | \$317,007    | \$330,124 | \$352,696 | \$357,725 | \$395,808 | 4.1%                  | 6.8%   | 1.4%    | 10.6%   | 100.0%                       | 100.0% | 100.0% | 100.0% | 100.0% |
| Loss provision            | \$29,797     | \$29,574  | \$69,251  | \$176,196 | \$247,683 | (0.7%)                | 134.2% | 154.4%  | 40.6%   | 9.4%                         | 9.0%   | 19.6%  | 49.3%  | 62.6%  |
| Credit income             | \$287,210    | \$300,550 | \$283,445 | \$181,529 | \$148,125 | 4.6%                  | (5.7%) | (36.0%) | (18.4%) | 90.6%                        | 91.0%  | 80.4%  | 50.7%  | 37.4%  |
| <b>Noninterest income</b> |              |           |           |           |           |                       |        |         |         |                              |        |        |        |        |
| <b>Recurring revenues</b> |              |           |           |           |           |                       |        |         |         |                              |        |        |        |        |
| Fiduciary                 | \$24,009     | \$25,325  | \$28,226  | \$28,586  | \$24,548  | 5.5%                  | 11.5%  | 1.3%    | (14.1%) | 7.6%                         | 7.7%   | 8.0%   | 8.0%   | 6.2%   |
| Deposit charges           | \$34,450     | \$36,300  | \$39,214  | \$39,525  | \$41,676  | 5.4%                  | 8.0%   | 0.8%    | 5.4%    | 10.9%                        | 11.0%  | 11.1%  | 11.0%  | 10.5%  |
| Servicing fees            | \$16,845     | \$14,478  | \$15,263  | \$13,566  | \$30,813  | (14.1%)               | 5.4%   | (11.1%) | 127.1%  | 5.3%                         | 4.4%   | 4.3%   | 3.8%   | 7.8%   |
| Insurance fees            | \$4,584      | \$4,438   | \$4,460   | \$3,974   | \$3,882   | (3.2%)                | 0.5%   | (10.9%) | (2.3%)  | 1.4%                         | 1.3%   | 1.3%   | 1.1%   | 1.0%   |
| Total recurring rev       | \$79,888     | \$80,541  | \$87,163  | \$85,651  | \$100,919 | 0.8%                  | 8.2%   | (1.7%)  | 17.8%   | 25.2%                        | 24.4%  | 24.7%  | 23.9%  | 25.5%  |

## Reshaping the Banking Industry (Part I)

| Industry Income Statement   |              |           |            |            |           |                       |          |          |          |                              |        |        |        |        |
|-----------------------------|--------------|-----------|------------|------------|-----------|-----------------------|----------|----------|----------|------------------------------|--------|--------|--------|--------|
| Millions                    | Income (mil) |           |            |            |           | Annual Percent Change |          |          |          | Percent of Operating Revenue |        |        |        |        |
|                             | Dec 05       | Dec 06    | Dec 07     | Dec 08     | Dec 09    | Dec 06                | Dec 07   | Dec 08   | Dec 09   | Dec 05                       | Dec 06 | Dec 07 | Dec 08 | Dec 09 |
| <b>Volatile income</b>      |              |           |            |            |           |                       |          |          |          |                              |        |        |        |        |
| Trading                     |              |           |            |            |           |                       |          |          |          |                              |        |        |        |        |
| Interest rate               | \$4,462      | \$4,642   | \$4,330    | (\$1,108)  | \$14,508  | 4.0%                  | (6.7%)   | (125.6%) | #####    | 1.4%                         | 1.4%   | 1.2%   | (0.3%) | 3.7%   |
| FX                          | \$6,202      | \$7,948   | \$6,897    | \$10,701   | \$5,596   | 28.2%                 | (13.2%)  | 55.2%    | (47.7%)  | 2.0%                         | 2.4%   | 2.0%   | 3.0%   | 1.4%   |
| Equities                    | \$3,112      | \$4,956   | \$2,895    | \$28       | \$1,071   | 59.3%                 | (41.6%)  | (99.0%)  | #####    | 1.0%                         | 1.5%   | 0.8%   | 0.0%   | 0.3%   |
| Commodity                   | \$593        | \$1,264   | \$294      | \$1,474    | \$1,461   | 113.2%                | (76.7%)  | 401.4%   | (0.9%)   | 0.2%                         | 0.4%   | 0.1%   | 0.4%   | 0.4%   |
| Other exposure              | (\$432)      | \$226     | (\$10,347) | (\$12,879) | \$2,210   | (152.3%)              | #####    | 24.5%    | (117.2%) | (0.1%)                       | 0.1%   | (2.9%) | (3.6%) | 0.6%   |
| Total trading               | \$13,937     | \$19,036  | \$4,069    | (\$1,784)  | \$24,846  | 36.6%                 | (78.6%)  | (143.8%) | #####    | 4.4%                         | 5.8%   | 1.2%   | (0.5%) | 6.3%   |
| Investment banking          | \$9,978      | \$11,999  | \$14,191   | \$12,638   | \$11,999  | 20.3%                 | 18.3%    | (10.9%)  | (5.1%)   | 3.1%                         | 3.6%   | 4.0%   | 3.5%   | 3.0%   |
| Securitization              | \$22,252     | \$22,169  | \$21,119   | \$15,342   | \$4,758   | (0.4%)                | (4.7%)   | (27.4%)  | (69.0%)  | 7.0%                         | 6.7%   | 6.0%   | 4.3%   | 1.2%   |
| <b>Gains &amp; Losses</b>   |              |           |            |            |           |                       |          |          |          |                              |        |        |        |        |
| Venture capital             | \$730        | \$262     | \$172      | \$88       | (\$140)   | (64.1%)               | (34.4%)  | (48.8%)  | (259.1%) | 0.2%                         | 0.1%   | 0.0%   | 0.0%   | (0.0%) |
| Loan sales                  | \$6,815      | \$7,493   | \$2,385    | (\$714)    | \$9,313   | 9.9%                  | (68.2%)  | (129.9%) | #####    | 2.1%                         | 2.3%   | 0.7%   | (0.2%) | 2.4%   |
| OREO sales                  | \$160        | \$115     | (\$409)    | (\$1,801)  | (\$4,079) | (28.1%)               | (455.7%) | 340.3%   | 126.5%   | 0.1%                         | 0.0%   | (0.1%) | (0.5%) | (1.0%) |
| Other asset sales           | \$1,892      | \$2,967   | \$4,653    | \$2,434    | \$4,576   | 56.8%                 | 56.8%    | (47.7%)  | 88.0%    | 0.6%                         | 0.9%   | 1.3%   | 0.7%   | 1.2%   |
| Securities                  | \$4,929      | \$1,969   | (\$1,369)  | (\$15,438) | (\$1,443) | (60.1%)               | (169.5%) | #####    | (90.7%)  | 1.6%                         | 0.6%   | (0.4%) | (4.3%) | (0.4%) |
| Total gains & losses        | \$14,526     | \$12,806  | \$5,432    | (\$15,431) | \$8,227   | (11.8%)               | (57.6%)  | (384.1%) | (153.3%) | 4.6%                         | 3.9%   | 1.5%   | (4.3%) | 2.1%   |
| Total volatile income       | \$60,693     | \$66,010  | \$44,811   | \$10,765   | \$49,830  | 8.8%                  | (32.1%)  | (76.0%)  | 362.9%   | 19.1%                        | 20.0%  | 12.7%  | 3.0%   | 12.6%  |
| Other                       | \$72,574     | \$80,094  | \$83,957   | \$83,732   | \$97,352  | 10.4%                 | 4.8%     | (0.3%)   | 16.3%    | 22.9%                        | 24.3%  | 23.8%  | 23.4%  | 24.6%  |
| Unaccounted                 | \$10,234     | \$13,786  | \$17,167   | \$27,561   | \$12,431  | 34.7%                 | 24.5%    | 60.5%    | (54.9%)  | 3.2%                         | 4.2%   | 4.9%   | 7.7%   | 3.1%   |
| Noninterest income          | \$223,389    | \$240,431 | \$233,098  | \$207,709  | \$260,532 | 7.6%                  | (3.0%)   | (10.9%)  | 25.4%    | 70.5%                        | 72.8%  | 66.1%  | 58.1%  | 65.8%  |
| <b>Non-interest expense</b> |              |           |            |            |           |                       |          |          |          |                              |        |        |        |        |
| Personnel                   | \$140,923    | \$150,725 | \$159,869  | \$151,915  | \$163,297 | 7.0%                  | 6.1%     | (5.0%)   | 7.5%     | 44.5%                        | 45.7%  | 45.3%  | 42.5%  | 41.3%  |
| Occupancy & equipm          | \$40,929     | \$41,853  | \$44,158   | \$43,351   | \$45,647  | 2.3%                  | 5.5%     | (1.8%)   | 5.3%     | 12.9%                        | 12.7%  | 12.5%  | 12.1%  | 11.5%  |
| All other expense           | \$135,527    | \$139,731 | \$163,017  | \$173,044  | \$175,619 | 3.1%                  | 16.7%    | 6.2%     | 1.5%     | 42.8%                        | 42.3%  | 46.2%  | 48.4%  | 44.4%  |
| Total expenses              | \$317,379    | \$332,309 | \$367,044  | \$368,310  | \$384,563 | 4.7%                  | 10.5%    | 0.3%     | 4.4%     | 100.1%                       | 100.7% | 104.1% | 103.0% | 97.2%  |
| <b>Profits</b>              |              |           |            |            |           |                       |          |          |          |                              |        |        |        |        |
| Adjustment                  | \$4,929      | \$1,970   | (\$1,370)  | (\$15,438) | (\$1,442) | (60.0%)               | (169.5%) | #####    | (90.7%)  | 1.6%                         | 0.6%   | (0.4%) | (4.3%) | (0.4%) |
| Pretax income               | \$198,149    | \$210,642 | \$148,129  | \$5,490    | \$22,652  | 6.3%                  | (29.7%)  | (96.3%)  | 312.6%   | 62.5%                        | 63.8%  | 42.0%  | 1.5%   | 5.7%   |
| Tax/tax rate                | \$64,576     | \$68,084  | \$46,422   | \$6,299    | \$5,521   | 5.4%                  | (31.8%)  | (86.4%)  | (12.4%)  | 32.6%                        | 32.3%  | 31.3%  | 114.7% | 24.4%  |
| Net income                  | \$133,573    | \$142,558 | \$101,707  | (\$809)    | \$17,131  | 6.7%                  | (28.7%)  | (100.8%) | #####    | 42.1%                        | 43.2%  | 28.8%  | (0.2%) | 4.3%   |
| <b>Note:</b>                |              |           |            |            |           |                       |          |          |          |                              |        |        |        |        |
| Net charge-offs             | \$31,591     | \$27,016  | \$44,113   | \$100,357  | \$186,821 | (14.5%)               | 63.3%    | 127.5%   | 86.2%    |                              |        |        |        |        |
| Allowance build             | (\$1,794)    | \$2,558   | \$25,138   | \$75,839   | \$60,862  | (242.6%)              | 882.7%   | 201.7%   | (19.7%)  |                              |        |        |        |        |
| Pretax,pre-provision        | \$227,946    | \$240,216 | \$217,380  | \$181,686  | \$270,335 |                       |          |          |          | 71.9%                        | 72.8%  | 61.6%  | 50.8%  | 68.3%  |
| Pretax/PP earnings          | 86.9%        | 87.7%     | 68.1%      | 3.0%       | 8.4%      |                       |          |          |          |                              |        |        |        |        |
| Dividends                   | \$73,174     | \$93,497  | \$110,348  | \$51,088   | \$47,162  | 27.8%                 | 18.0%    | (53.7%)  | (7.7%)   |                              |        |        |        |        |
| Payout ratio                | 54.8%        | 65.6%     | 108.5%     | (6,315.0%) | 275.3%    |                       |          |          |          |                              |        |        |        |        |

## Reshaping the Banking Industry (Part I)

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## Reshaping the Banking Industry (Part I)

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**Sell** Company's cost of capital exceeds its return on capital; and the company has no intrinsic value or is trading at a significant premium to its intrinsic value. Expect stock to under-perform the market over next twelve months.

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-- Richard X. Bove