CBA/DFI Roundtable

November 3, 2010

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Department of Financial Institutions

Topics for Discussion

- Update on Condition of the Industry
- Observations on the Outlook for the Economy & Credit Conditions
- Where Do We Go from Here with Bank Regulation and Supervision?

Condition of the Industry

- Preliminary Q3 data show evidence of continuing improvement
  - Industry ROA up from Q2
  - % noncurrent loans/total loans down
  - Reserves/noncurrent loans up
- Anticipate that bank failures in 2010 will be < 2009
- Pace of capital raises continues -- 8 banks completed offerings in Q3

Equity Offerings by California State Chartered Banks Since 2009

- 34 state-chartered banks in California or their BHCs completed 69 equity offerings that raised $4.4 billion.
- Number of completed offerings by CAMELS rating at the time of the offering:

CAMELS	Rating at Offering Date
1	0
2	16
3	23
4	25
5	3
Unrated	2
Total	69

Transaction Report
Capital Purchase Program
all California Banks
for the period ending October 29, 2010

Type of Bank	#	Total Purchase Amount	Total Capital Repayment Amount	Total Treasury CPP Investment Amount
State Banks	53	1,948.8	489.0	1,459.8
National Banks*	15	686.7	402.6	284.1
Federal Savings Banks	4	46.5	4.9	41.6
Total	**72**	**$2,682.0**	**$896.5**	**$1,785.5**

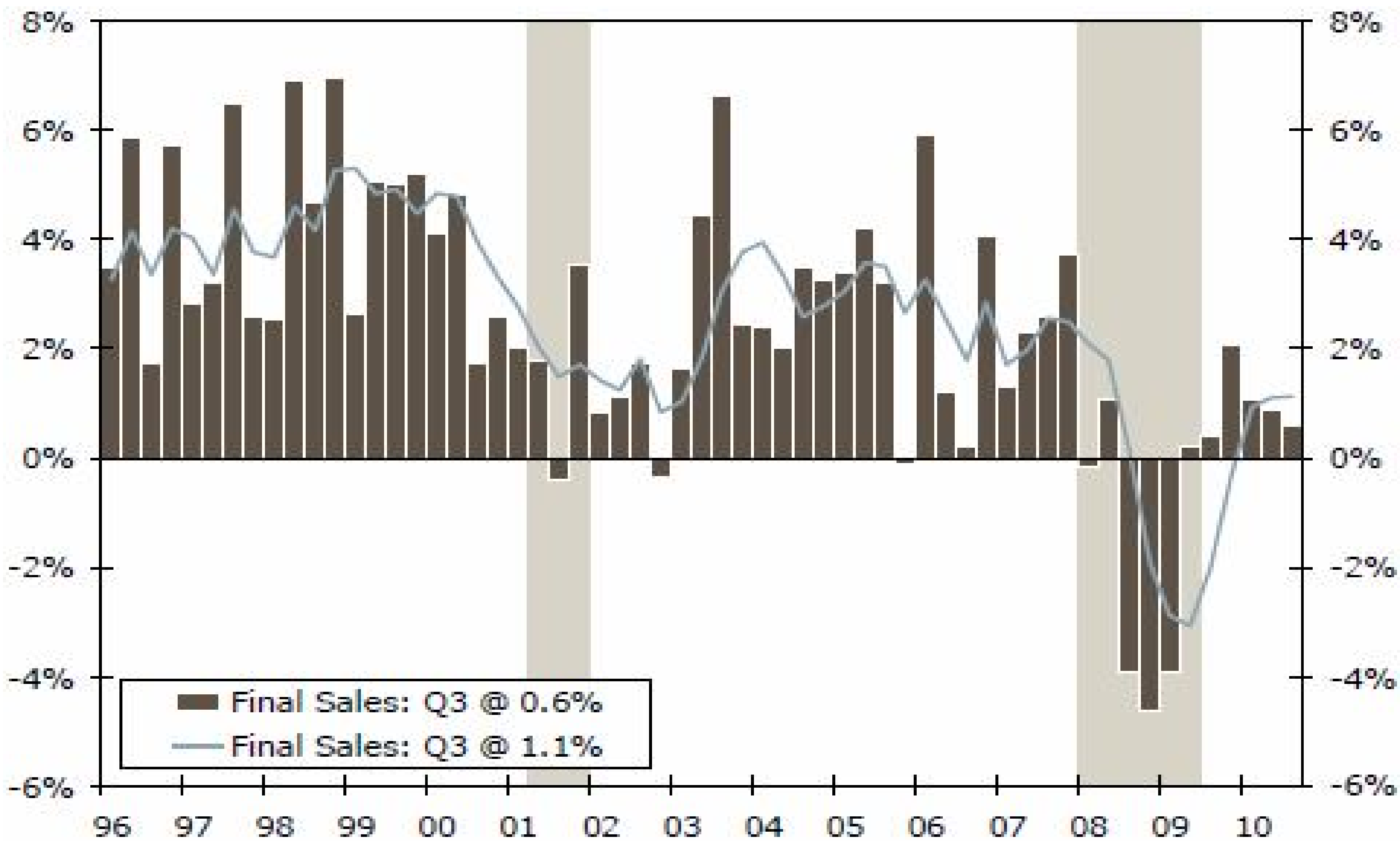
* Excludes $25 billion TARP investment in Wells Fargo & Company

Observations on the Outlook

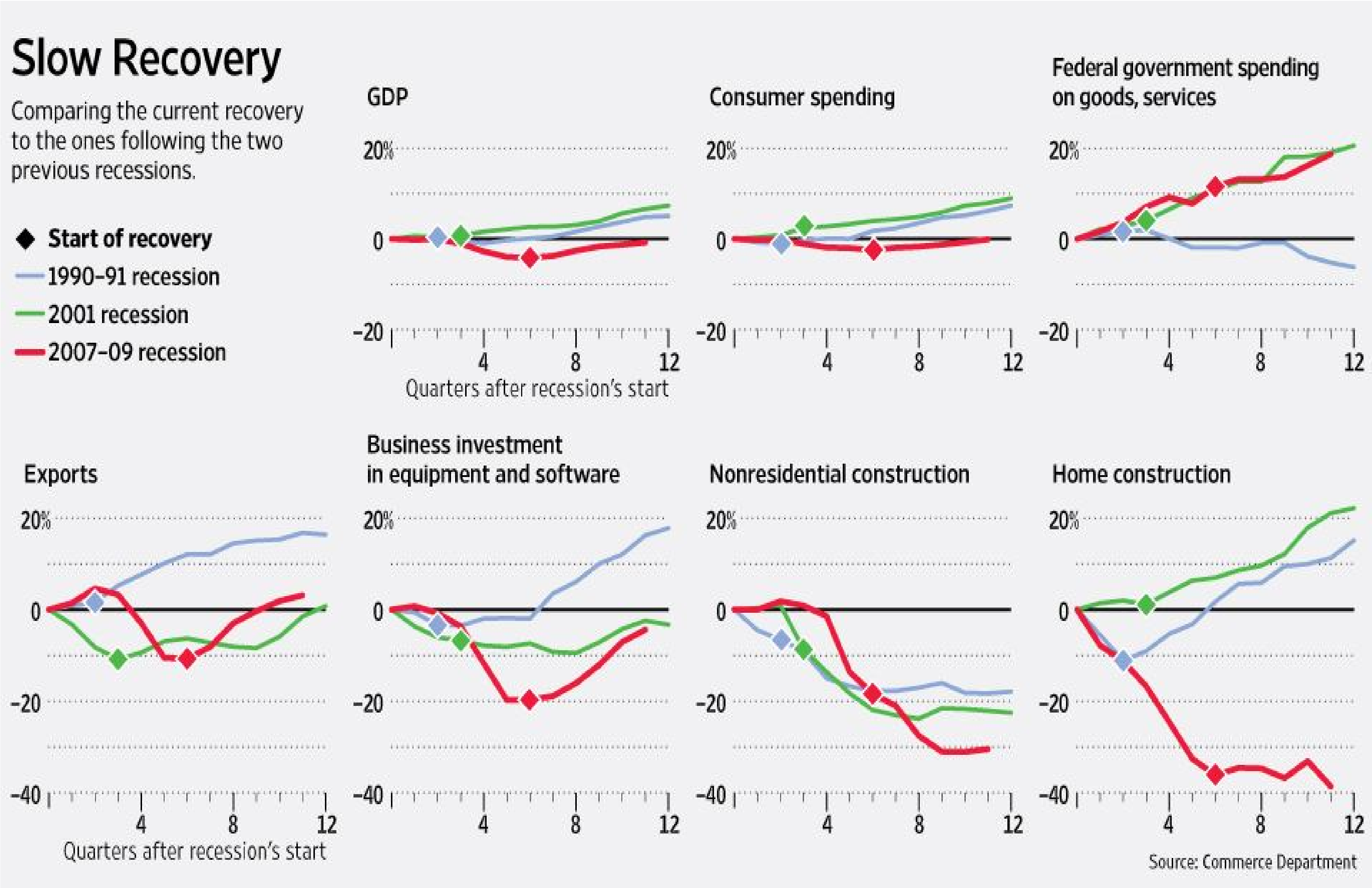
- Economic Conditions
- Credit Outlook
- Revenue Prospects

Real Final Sales to Domestic Purchasers

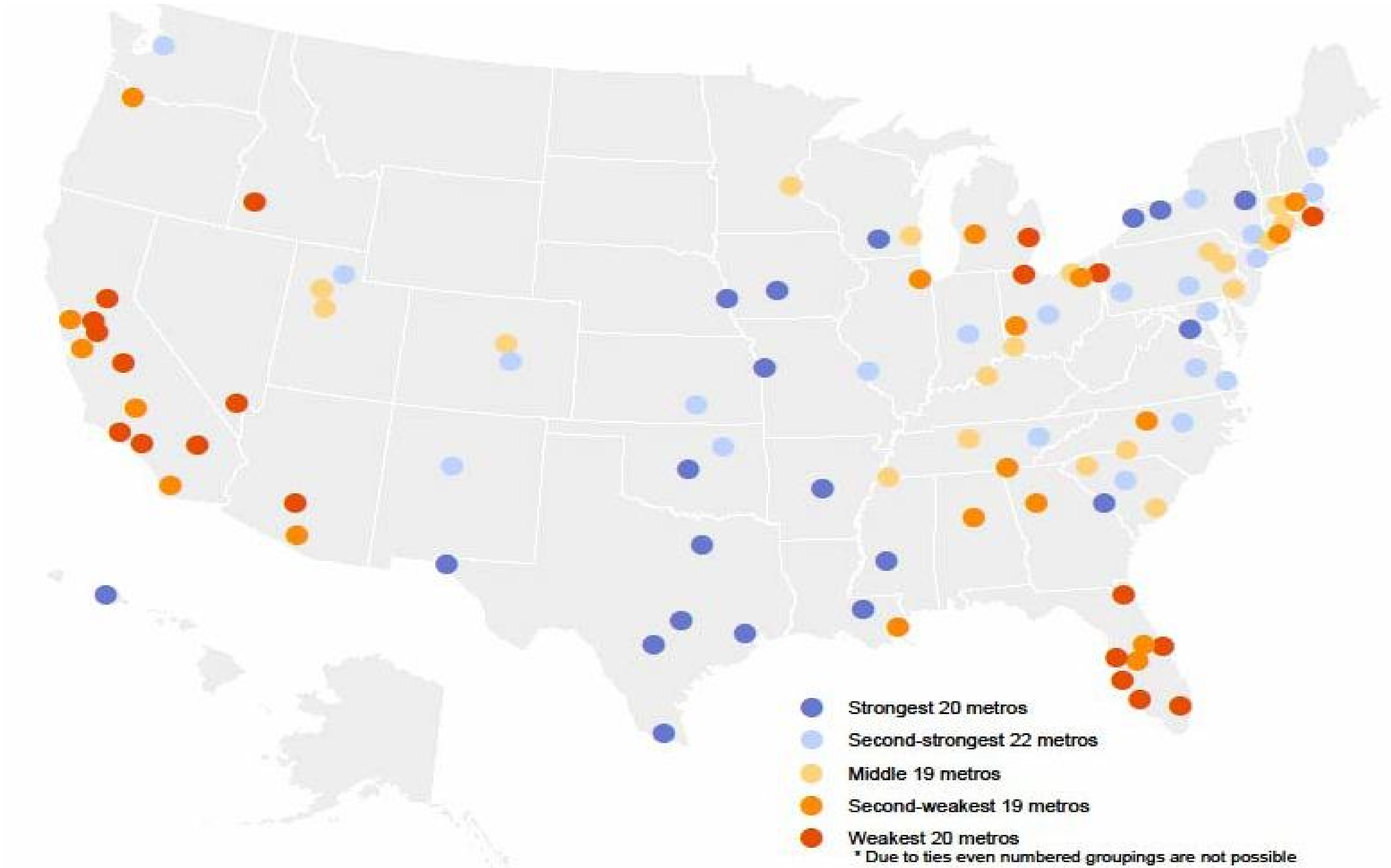
Bars = Q/Q % change annualized, Line = Y/Y % change



GDP Components in Current vs. Prior Recoveries



Economic Performance by SMA

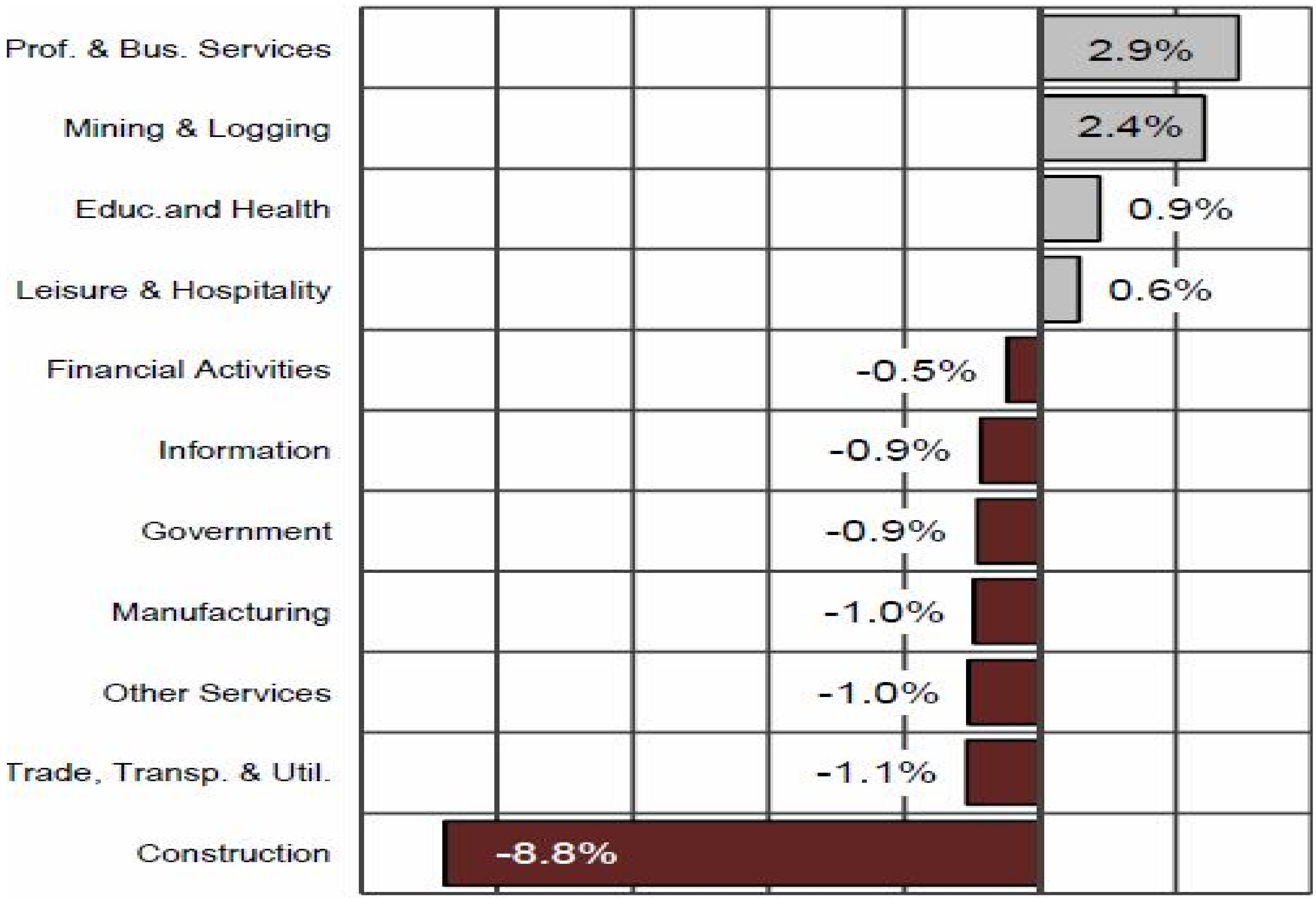


Best/Worst Metro Areas

The 20 strongest-performing metro areas		The 20 weakest-performing metro areas	
Albany, NY	Jackson, MS	Boise City, ID	Oxnard, CA
Augusta, GA-SC	Kansas City, MO-KS	Cape Coral, FL	Palm Bay, FL
Austin, TX	Little Rock, AR	Detroit, MI	Phoenix, AZ
Baton Rouge, LA	Madison, WI	Fresno, CA	Providence, RI-MA
Buffalo, NY	McAllen, TX	Jacksonville, FL	Riverside, CA
Dallas, TX	Oklahoma City, OK	Las Vegas, NV	Sacramento, CA
Des Moines, IA	Omaha, NE-IA	Los Angeles, CA	Stockton, CA
El Paso, TX	Rochester, NY	Miami, FL	Tampa, FL
Honolulu, HI	San Antonio, TX	Modesto, CA	Toledo, OH
Houston, TX	Washington, DC-VA-MD-WV	North Port, FL	Youngstown, OH-PA

California Job Growth By Industry

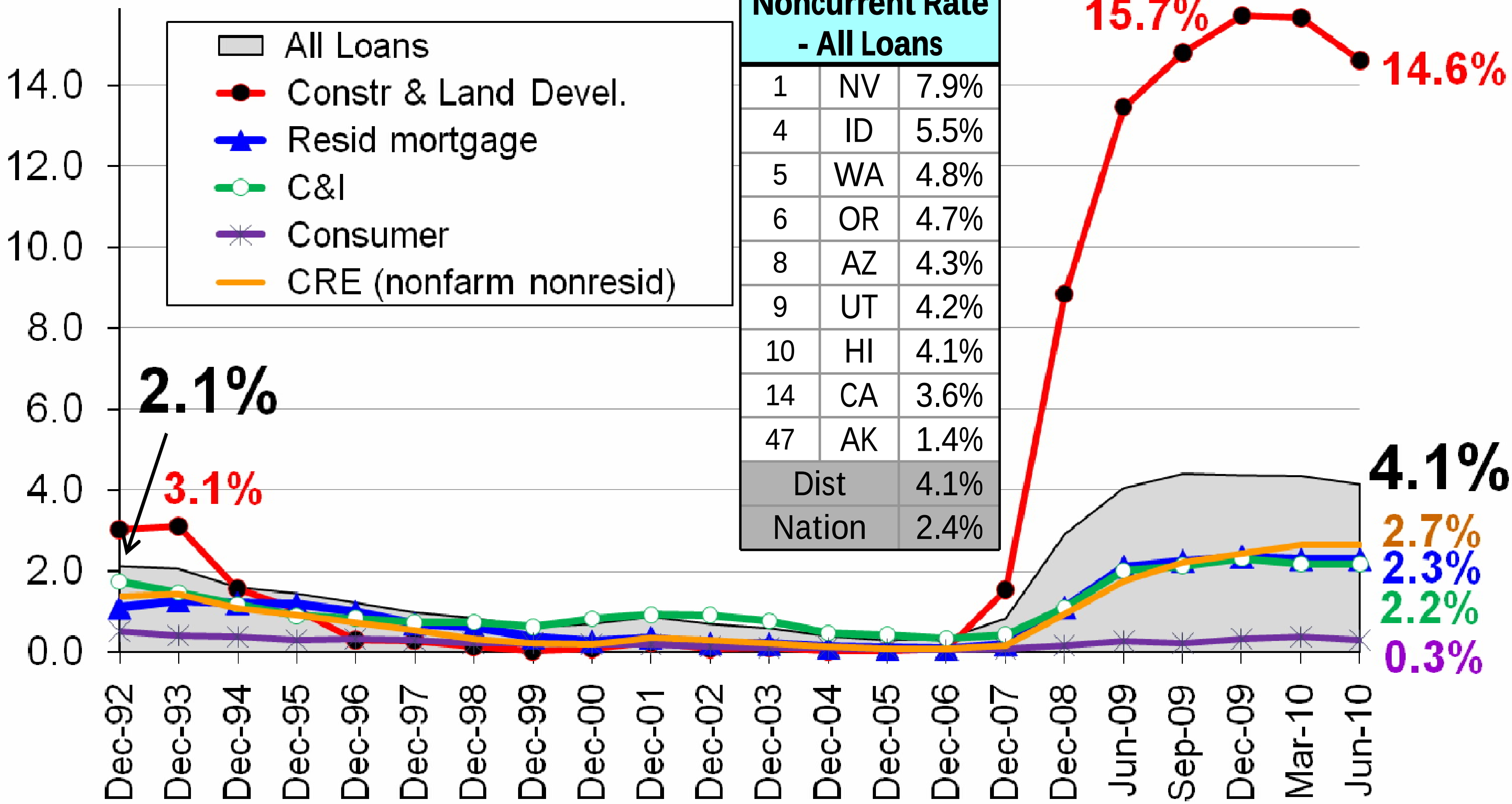
% Change from a Year Earlier



Noncurrent Loan Rates Edged Downward, Due Largely to C&LD Loan Charge-offs

CRE Income Property Noncurrent Rates Continue to Rise in 1H10

12th District Bank Noncurrent Loan Rates (Pct 90+ days past due or on nonaccrual -%)

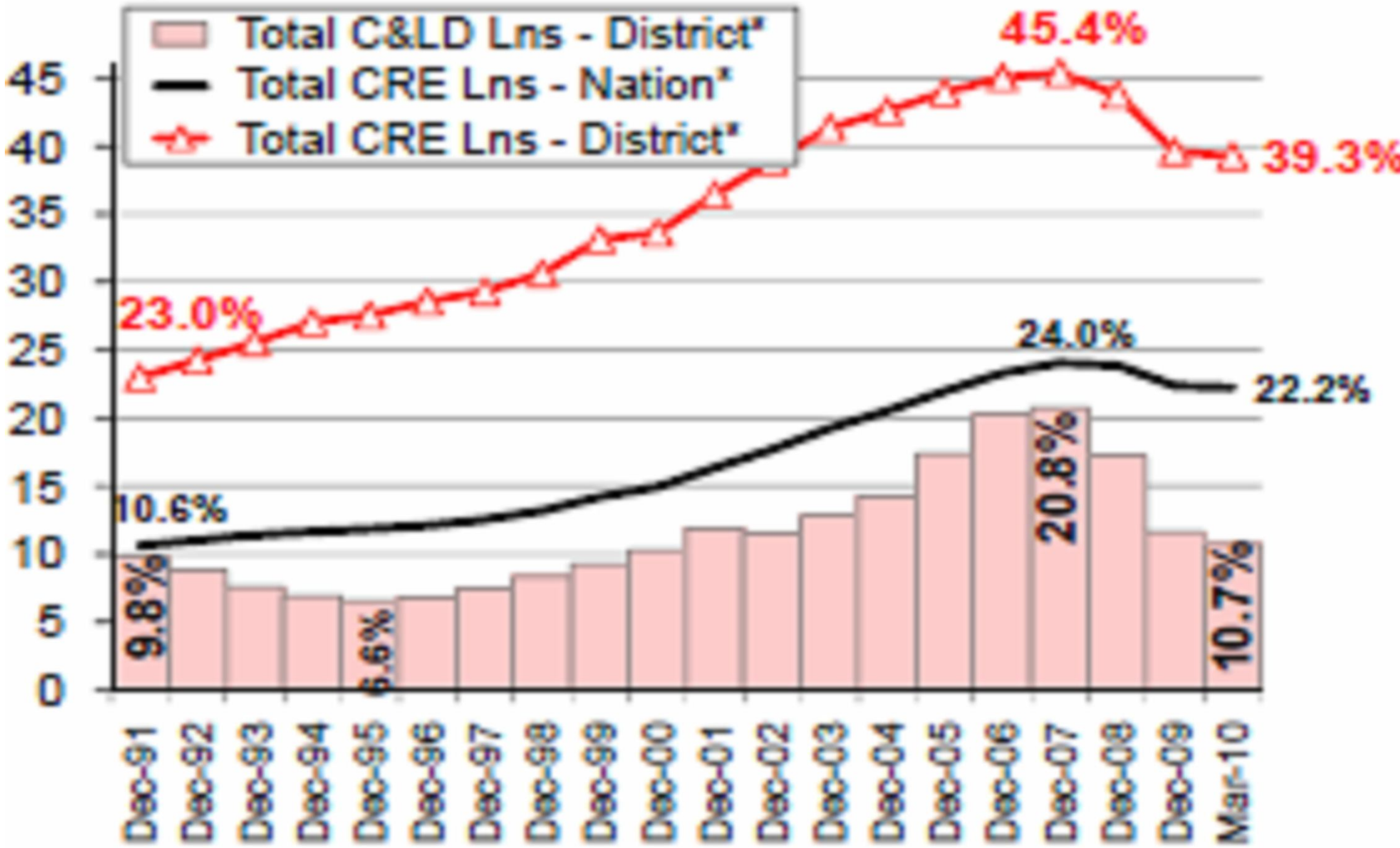


Noncurrent Rate - All Loans		
1	NV	7.9%
4	ID	5.5%
5	WA	4.8%
6	OR	4.7%
8	AZ	4.3%
9	UT	4.2%
10	HI	4.1%
14	CA	3.6%
47	AK	1.4%
Dist		4.1%
Nation		2.4%

Source: Regulatory Call & Income Reports; all commercial & industrial banks excluding De Novos; trimmed means, preliminary 1H10 data

District Avg. Total CRE Loan Concentrations Have Declined But are Still Well Above the Nation

Average Loan Concentrations as a Pct of Total Loans – %



CRE Lns / Tot. Lns excl. owner occupied NFNR		
U.S. Rank	State	State Avg
1	NV	46%
2	CA	42%
5	AZ	38%
6	WA	38%
7	OR	37%
10	HI	34%
11	UT	34%
16	AK	31%
17	ID	30%
12th District		39%
Nation		22%

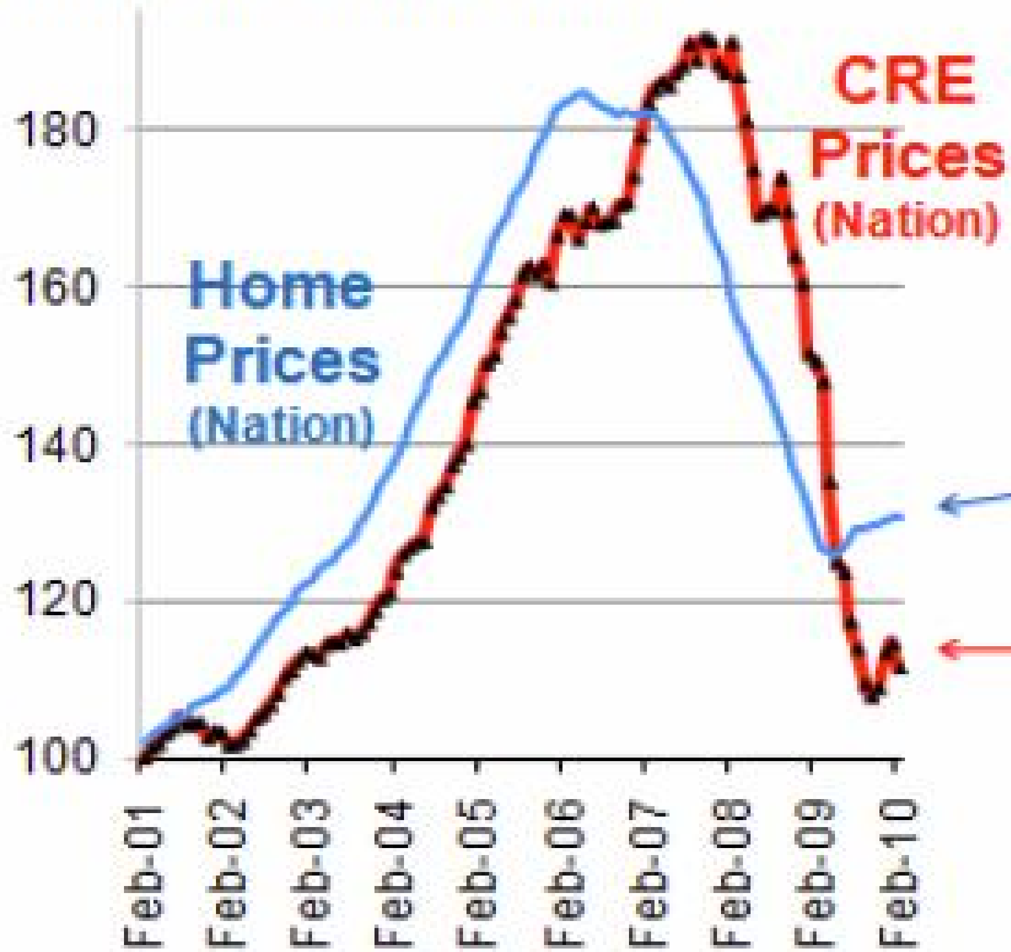
FRB-SF

Commercial banks only (excludes industrials); trimmed means; * Total CRE loans include C&LD loans, and exclude owner-occupied nonfarm nonresidential secured loans, as estimated prior to 2008, preliminary 3/2010 data

5) CRE Property Values Down Even More Than Housing

Maturing CRE Loans Increasingly to Require Extensions & Restructuring

Home and CRE Price Indices



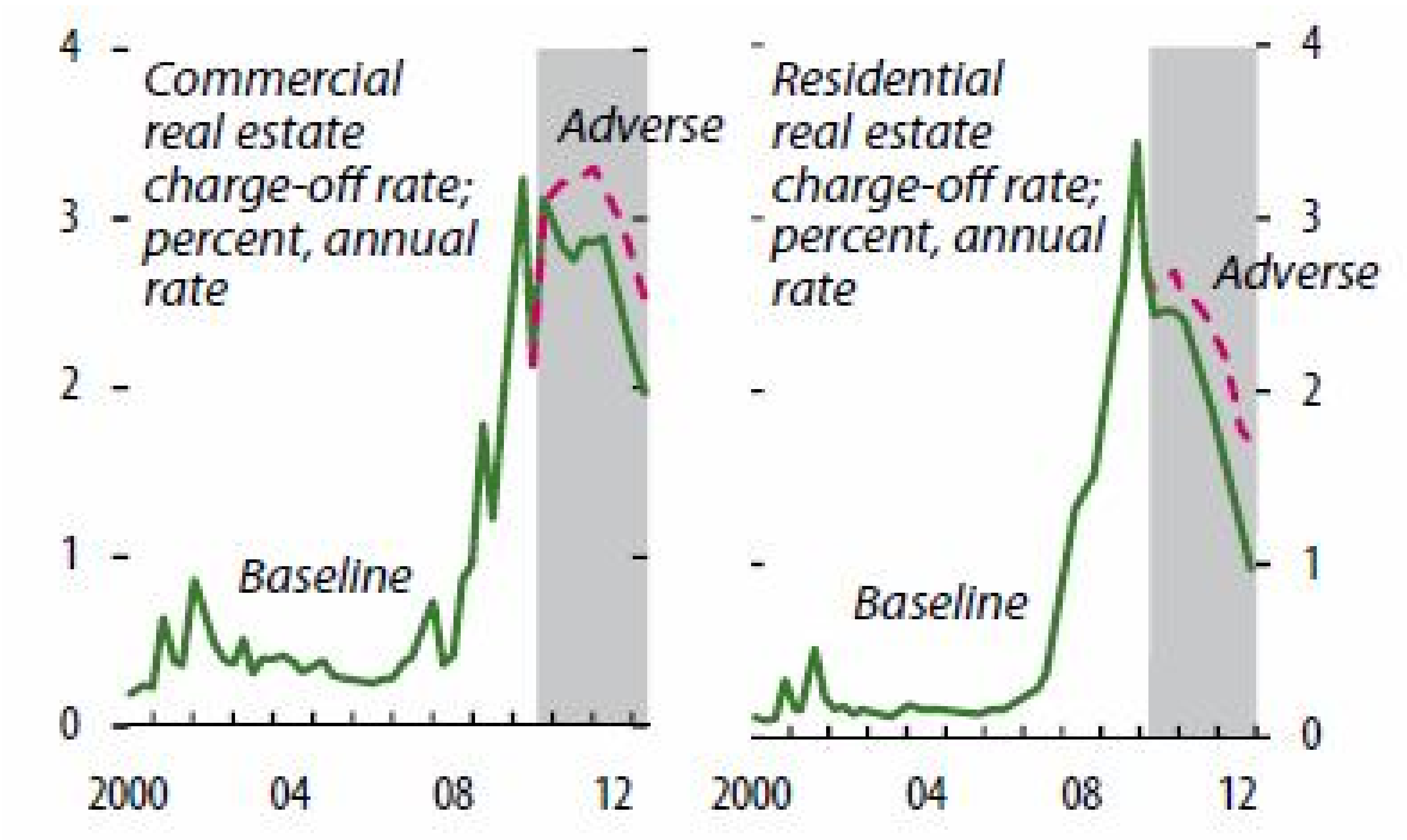
- ✓ **Refinance Risk** – Many maturing loans will have LTVs that exceed new tightened policy standards – requiring more equity or loan modificatio

Home Prices are down 29% *(from peak)*

CRE Prices are down 42% *(from peak)*

Sources: Moody's/REAL Commercial Property Index; S&P Case-Shiller Home Price Composite 20 Index, SA; Haver Analytics; re-indexed to 100 at Dec 2000. Note: the CRE index is based on very few transactions -- the value decline may be overstated

IMF Forecast: U.S. Real Estate Loan Charge-Offs



Superintendent Friend William Richardson, 1934

- *the combined statements submitted herewith give a factual demonstration of the urgent problem faced uniformly by all banks--earning assets in the form of good loans are not available in sufficient amounts to take up the increase in deposits. The only outlet is government bonds at extremely low rates--in fact lower than the prevailing rates on time deposits... Even the acquisition of government bonds on a low yield basis may cause future embarrassment should prevailing rates increase due either to declining public confidence in government issues or to the flotation of more attractive private issues.*

Where Do We Go from Here with Bank Regulation and Supervision?

Impact of Dodd-Frank + Heighted Regulatory Expectations

- Dodd-Frank will touch every corner of the financial system, but its biggest impact will be on largest financial institutions.
- Direct and indirect impacts on community and regional banks are difficult to assess at this time.
  - Key provisions: increase in deposit insurance coverage now permanent, interest payable on DDA, Fed to regulate interchange fees
- CFPB creates major new uncertainties.
- Roll-back of OCC's preemption authority invites new state-level consumer financial legislation.
- Basle III initiative could be at least as significant as Dodd-Frank and should be watched closely.

The "M" in CAMELS

- *The capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of an institution's activities and to ensure a financial institution's safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in this rating.*

Uniform Financial Institutions Ratings System

1996

The Traditional Emphasis

- *A bank's performance with respect to asset quality and diversification, capital adequacy, earnings performance and trends, liquidity and funds management, and sensitivity to fluctuations in market interest rates is, to a very significant extent, a result of decisions made by the bank's directors and officers. <u>Consequently, findings and conclusions in regard to the other five elements of the CAMELS rating system are often major determinants of the management rating</u>.*

Uniform Financial Institutions Ratings System

Revised 1996

A Better Emphasis

1. Does the bank have effective board oversight and corporate governance practices, policies and procedures?

2. Does the bank have an effective framework for risk management consistent with its size, complexity, structure and risk profile?

3. How well do the board, management and control functions execute against this framework?

Common Governance Weaknesses

- Board lacks experienced, capable financial professionals with knowledge of regulations/guidance.
- Board is dysfunction (e.g., factional, distrustful, dominated by an individual or small group, unengaged, unprepared, etc.)
- Board is too trusting of the CEO & management. Dominant CEO controls the bank.
- Lack of formalized processes for management evaluations – both management structures and executive competencies. Board relies excessively on regulatory assessments of management.
- Lack of independence of the risk management functions.
- Weak or inactive risk committee structures at board and management levels.

Common Weakness in the Risk Framework

- Emphasis is on ROE without adequate consideration of risk factors. Board does not articulate risk appetite or set risk limits in a meaningful/measurable way.
- Comp plans that incent growth or short-run returns.
- Risk management function lacks leadership or support from the Board/CEO and/or lacks independence from revenue generating officers and units.
- Inadequate resources. Poor MIS. Inadequate analytical capabilities for stress testing/scenario analysis.
- Failure to recognize and control interrelated risks.
- Audit functions not independent of management.

Common Weaknesses in Risk Management Execution

- Failure to stay within prescribed policy limits. Exceptions to risk limits granted to meet competition.
- Inadequate communication flows.
- Ineffective oversight and controls.
- Inadequate credit underwriting standards/credit administration function.
- Excessive reliance on third parties' risk assessments (e.g., credit rating agencies, lead bank for loan participations).
- Failure to implement audit recommendations.
- Lack of accountability.

Financial Stability Oversight Council Membership

Voting

- Secretary of the Treasury
- Chair of FRB
- Comptroller
- Director of CFPB
- Chair of SEC
- Chair of FDIC
- Chair of CFTC
- Director of FHFA
- Chair of NCUA
- Insurance representative appointed by President

Nonvoting

- Director of office of financial research
- Director of federal insurance office
- State insurance commissioner
- State banking commissioner
- State securities commissioner

Financial Stability Oversight Council -- Purposes

- To identify risks to financial stability that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected BHCs or nonbanks.

- To promote market discipline by eliminating expectations on the part of shareholders, creditors and counterparties…that the government will shield them from losses in the event of failure.

- To respond to emerging threats to financial stability

Financial Stability Oversight Council -- Duties

- Information gathering and sharing
- Recommending supervisory priorities/prudential standards
- Identifying gaps in regulation
- Identify nonbank FIs that may pose risks to the financial system for supervision by FRB
- Identify systemically important financial utilities and payment, clearing and settlement activities
- Reporting to Congress & testimony by Chair annually
- Statements by voting members

10 Largest US BHCs 1960 vs. 2010

1960

Institution	Total assets (USD billions)	Assets as a percentage of GDP (percent)	Assets as a percentage of total banking sector assets[(b)(c)] (percent)
Bank of America	11.2	2.1	4.4
Chase Manhattan Bank	8.4	1.6	3.3
First National City Bank of New York	8.2	1.6	3.2
Manufacturer's Hanover Trust Company[(e)]	5.9	1.1	2.3
Morgan Guaranty Trust Company	4.1	0.8	1.6
Chemical Bank New York Trust Company	4.1	0.8	1.6
Security First National Bank	3.4	0.7	1.3
Bankers Trust Company	3.1	0.6	1.2
First National Bank of Chicago	3.0	0.6	1.2
Bank of California	0.7	0.1	0.3
Total	**52.1**	**9.9**	**20.3**

2010

Institution	Total assets (USD billions)	Assets as a percentage of GDP[(d)]	Assets as a percentage of total banking sector assets[(b)(c)] (percent)
Bank of America	2,363.9	16.7	19.7
JP Morgan	2,014.0	14.3	16.8
Citigroup	1,937.7	13.7	16.2
Wells Fargo	1,225.9	8.7	10.2
US Bancorp	283.2	2.0	2.4
PNC Financial Services.	261.8	1.9	2.2
Bank of New York Mellon	235.9	1.7	2.0
Suntrust banks	170.7	1.2	1.4
BB&T corporation	155.1	1.1	1.3
State Street	160.7	1.1	1.3
Total	**8,809**	**62.4**	**73.6**