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Specialists in Financial Services

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Politics and the Financial Markets

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Please refer to important disclosures and analyst certification information on pages 24-26 of this report.

New Regulatory Era – Historical Overview

- Three regulatory cycles beginning with the Great Depression
- Great Depression/WWII era
 - ❑ New regulatory framework following the Crash of 1929
 - ❑ Wartime centrally planned economy
 - ❑ Lasts into early 1970s
- 1970s Begins Deregulation
 - ❑ Transportation (trucking and airlines)
 - ❑ Interest on demand deposits
 - ❑ Brokerage commissions
 - ❑ Lasts into early 2000s
- New Era
 - ❑ Starts with Sarbanes-Oxley



Current Political Environment

- Banking industry entered 2009 playing defense especially on the Hill
- Populism run amok
- Regulation by coercion; economy by extortion?
 - ❑ BAC/MER
 - ❑ TARP: Pay it back; no, wait, don't
 - ❑ Chrysler: "Secured" creditor doesn't mean what it says



Who's Running the Show

➤ Tough start for Geithner

- Summers

- Bernanke

➤ Capitol Hill

- House Financial Services Committee Chairman Barney Frank

- Senate Banking Committee Chairman Christopher Dodd

 - Sen. Richard Shelby



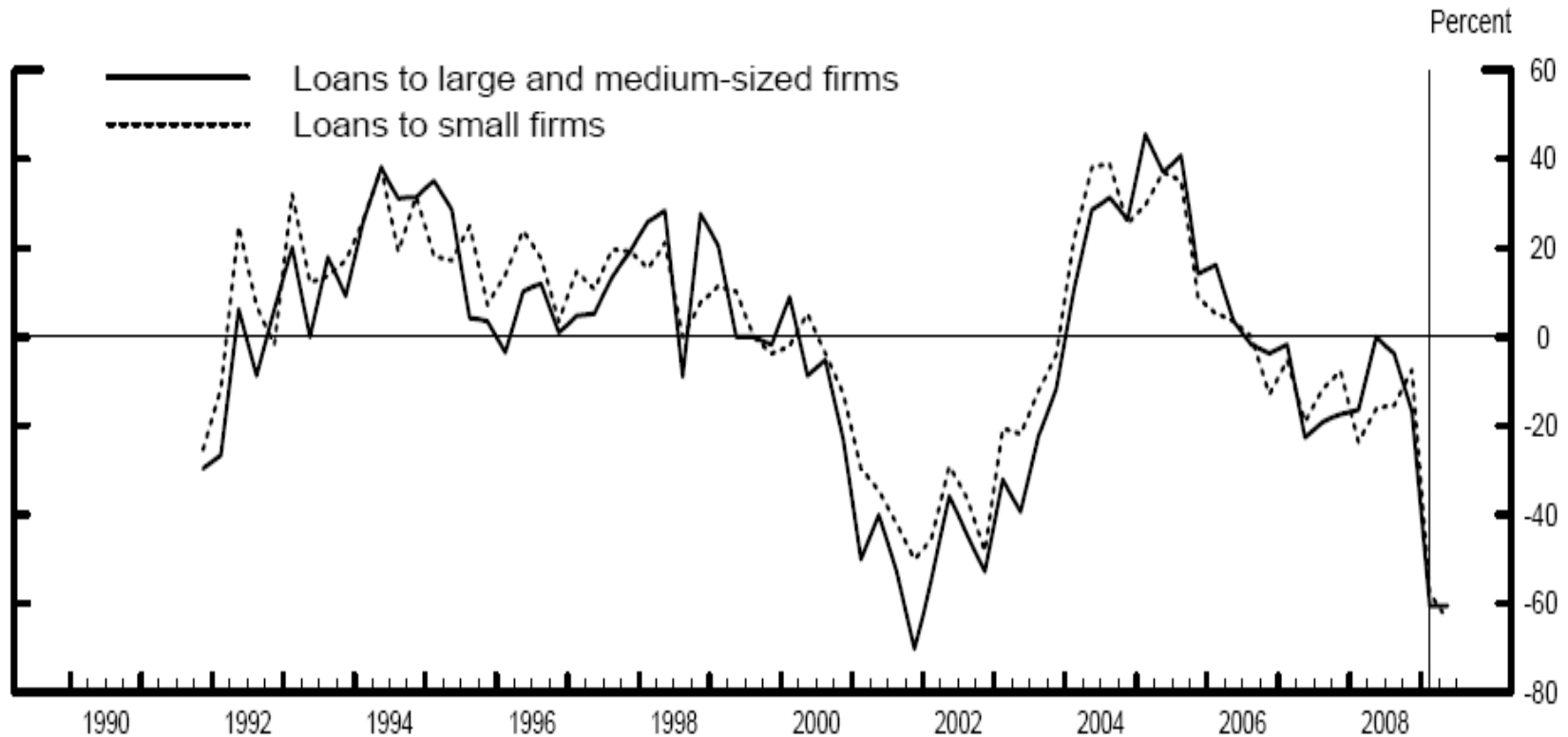
Green Shoots – It's Not Just the Economy

- Political worst-case scenario seems to be off the table
- Mortgage bankruptcy cramdown
- Card-check legislation
- Even credit card legislation is a slight positive
- GDP numbers contained some hopeful signs
- Fed Senior Loan Officer Survey



Fed's Loan Officer Survey – C&I Demand

Net Percentage of Domestic Respondents Reporting Stronger Demand for Commercial and Industrial Loans

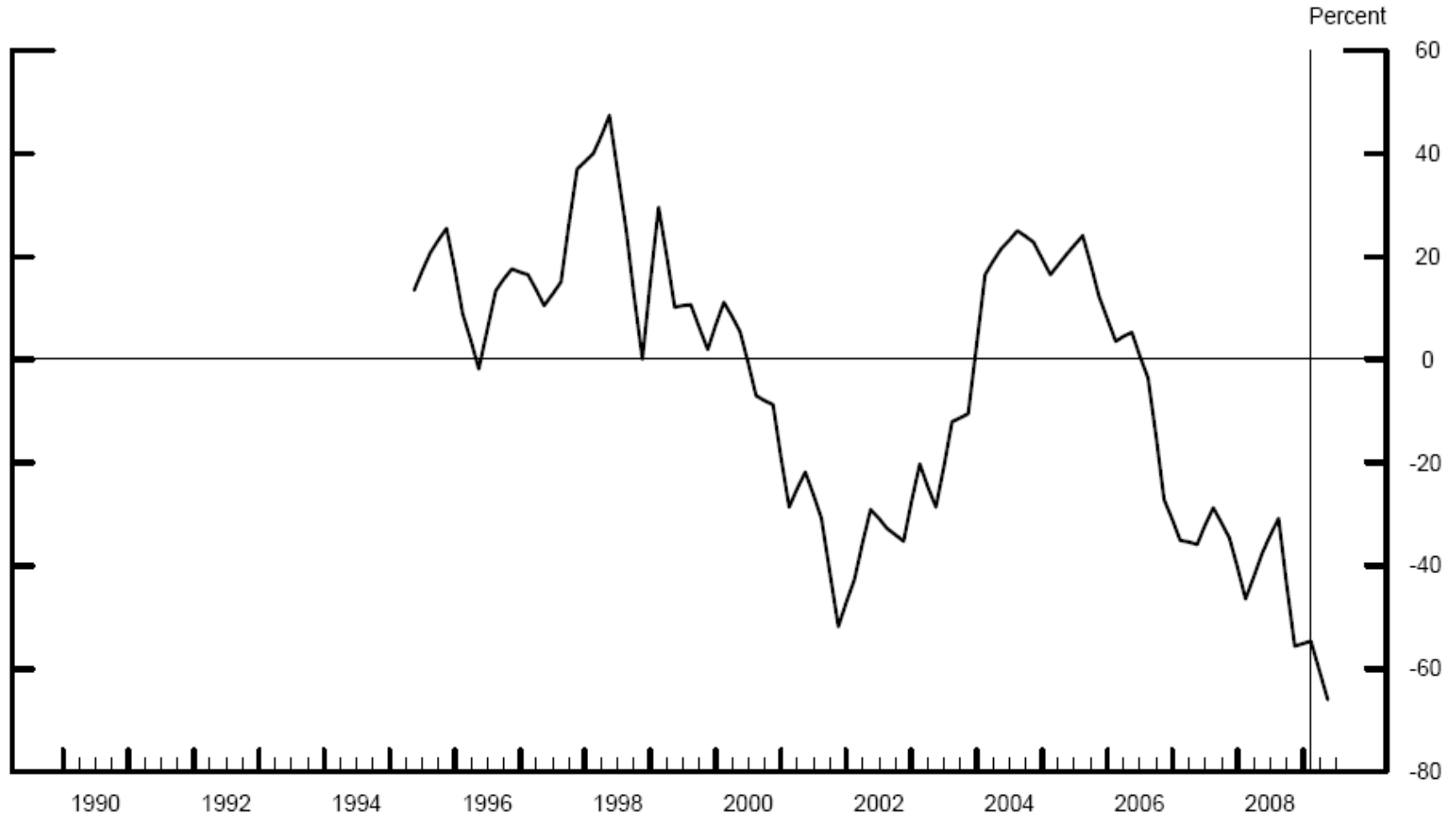


Source: Federal Reserve Board.



Fed's Loan Officer Survey – CRE Demand

Net Percentage of Domestic Respondents Reporting Stronger Demand for Commercial Real Estate Loans

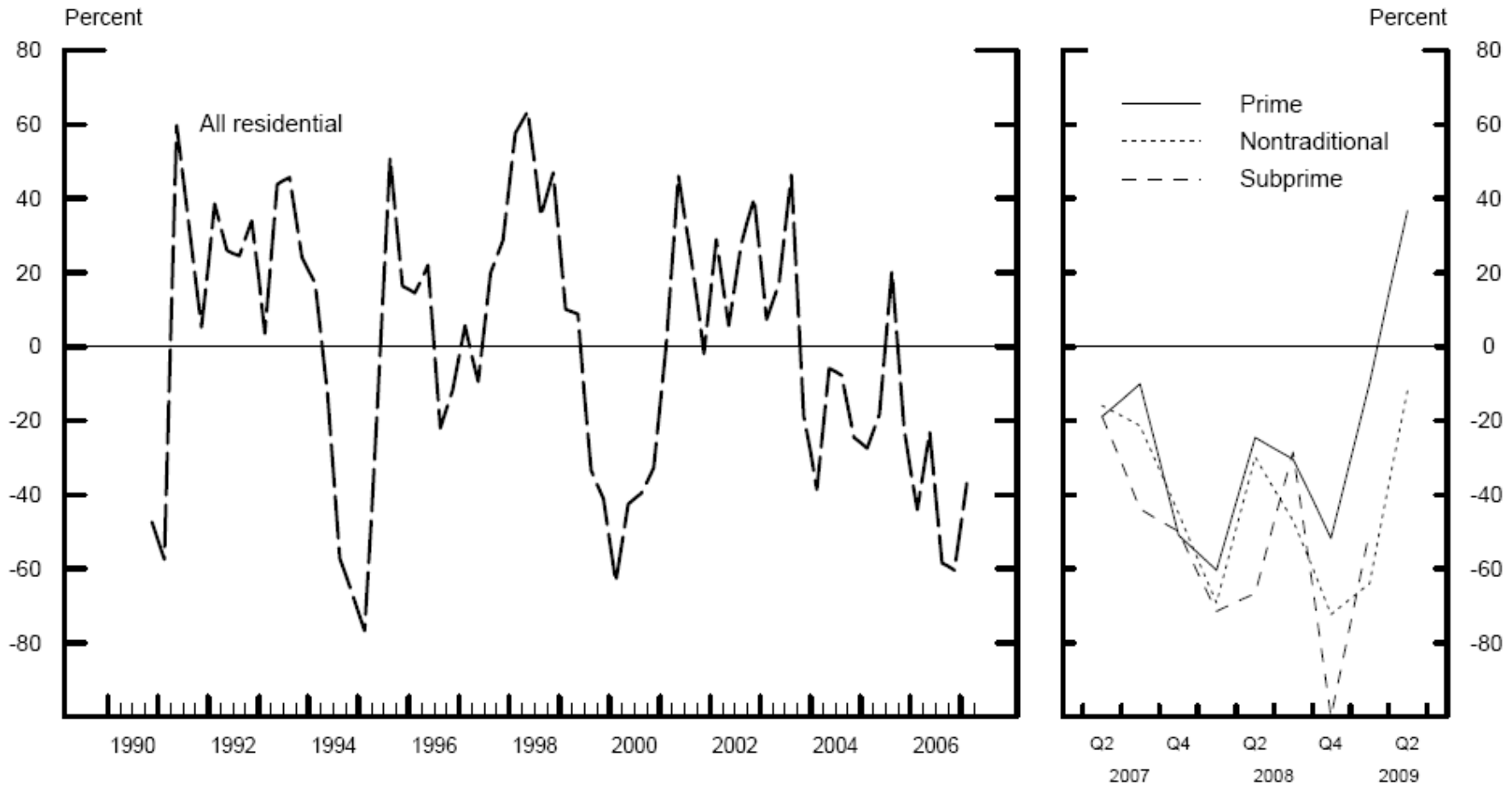


Source: Federal Reserve Board.



Fed's Loan Officer Survey – Mortgage Demand

Net Percentage of Domestic Respondents Reporting Stronger Demand for Residential Mortgage Loans



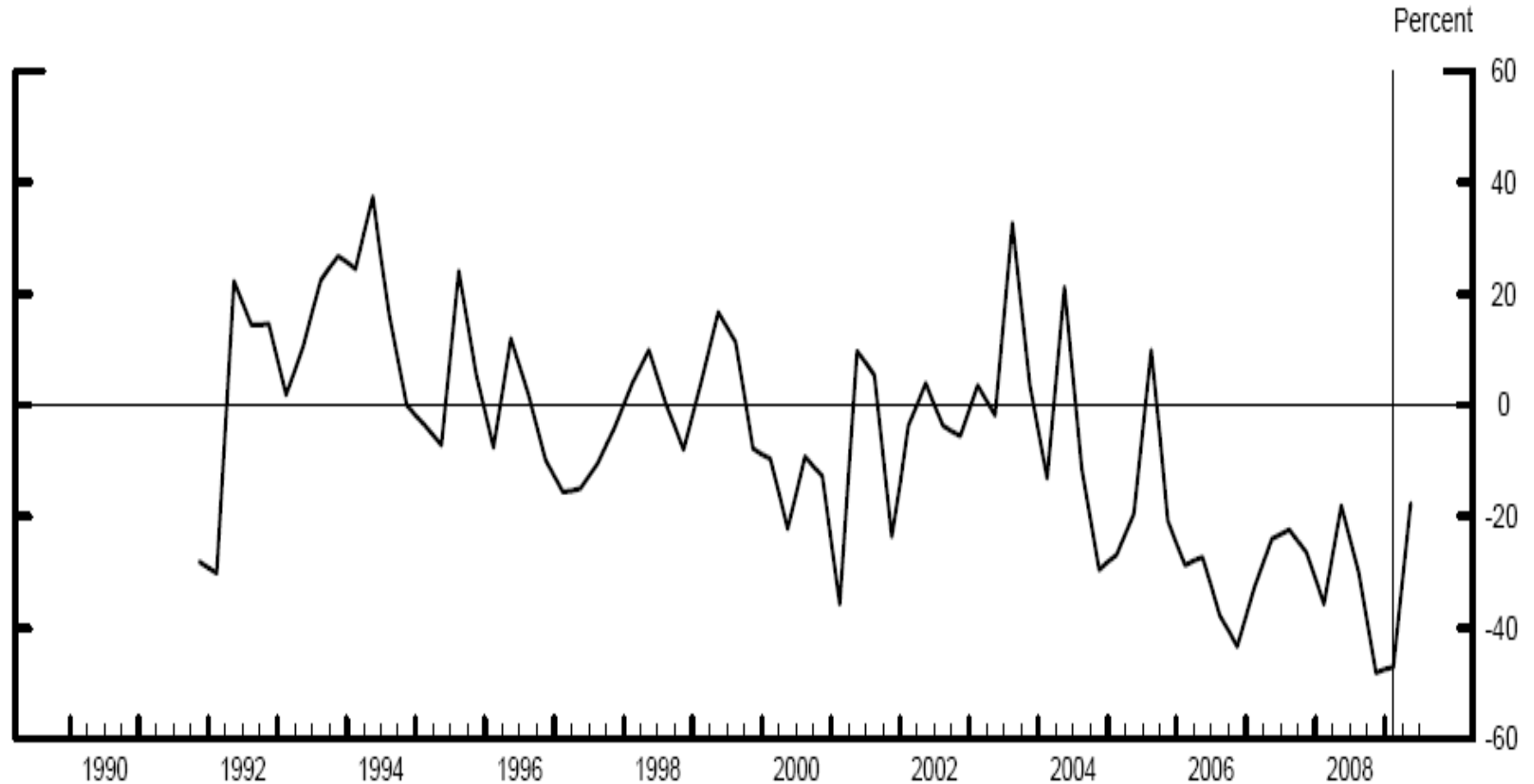
Note: For data starting in 2007:Q2, changes in demand for prime, nontraditional, and subprime mortgage loans are reported separately.

Source: Federal Reserve Board.



Fed's Loan Officer Survey – Consumer Loan Demand

Net Percentage of Domestic Respondents Reporting Stronger Demand for Consumer Loans



Source: Federal Reserve Board.



Political Risk Is Diminished, Not Gone

- No such thing as “dead” in Washington
- Mortgage cramdown can come back
- Looking at bank lending. Turning up the heat on the industry.
- Washington is reactive, not proactive – the economy will drive the political environment.



Big Items – Game Changers

- Future of the mortgage industry
- What do Fannie and Freddie look like?
- What does the securitization market look like?
- Regulatory restructuring – Limiting systemic risk and ending too big to fail
- Future of bank capital standards



Game Changers -- Systemic Risk Legislation

- Addressing Too Big Too Fail
- More capital and regulation for systemically significant institutions
- Banks as well as nonbanks
- Defining “systemically significant” and “systemic risk”
- Who is the systemic regulator?
- Separation – The return of Glass-Steagall?
- Basel II



Game Changers -- Regulatory Restructuring – Step II

- Making sense of the regulatory framework
- Later in 2009 into 2010
- Consolidating the regulators
- Eliminating regulatory arbitrage
- Regulating the mortgage industry
- Credit rating agencies



Game Changers – Bank Capital

- Revisiting Basel II
- Higher capital – Revising risk weightings
- New measures – TCE



Immediate Agenda – Next 6 Months

- TARP – How to repay it
- Buying back TARP warrants
- Deposit insurance
 - Special assessment
 - Restoration plan
- Mortgage reform/anti-predatory lending
- Credit cards



Grading the Government's Response to the Financial Crisis

- Mixed grades
- Liquidity program (TLGP and TALF vs. TARP)
- Solvency solutions
- Letting some banks fail



TARP 2.0 – The Capital Assistance Program

- Stress test results last Thursday for the Big 19
- Who else gets CAP? Who else wants it?
- Converting preferred shares into common
- Advantages – Quality of capital
- Disadvantages
 - ❑ Government as your senior partner
 - ❑ Section 5.3



TARP 2.0 – PPIP

- Moving target
- FDIC seems to be ready to change the legacy loan program
- Treasury/Fed still need time to roll out the legacy securities program
- Who uses/needs it?



Housing Rescue Plan

- Loan modifications and refis
- Second lien program
- Eligibility questions remain and get tied into CPP/CAP
- Principal writedowns



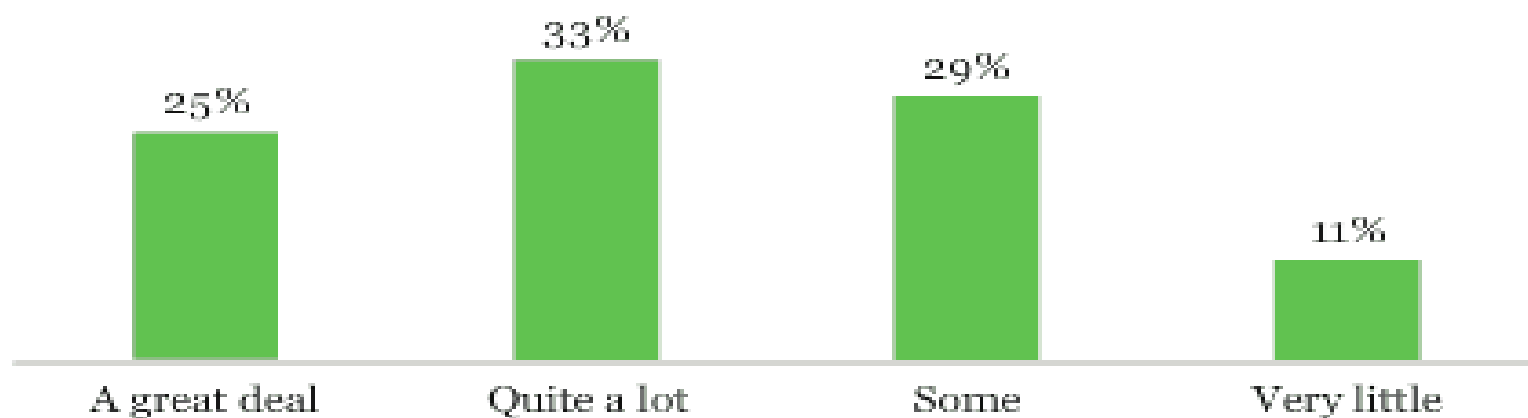
Budget and Taxes

- Prospects for the Obama Budget
- The looming compromise on income tax rates
 - ❑ 2010 – How a tax increase is a tax cut
- Dividends and capital gains
- Mortgage interest and charitable donation deductions



What This Means for Community Banks

Confidence in Your Primary/Main Bank, 2009



Gallup Poll Daily tracking, April 6-19, 2009

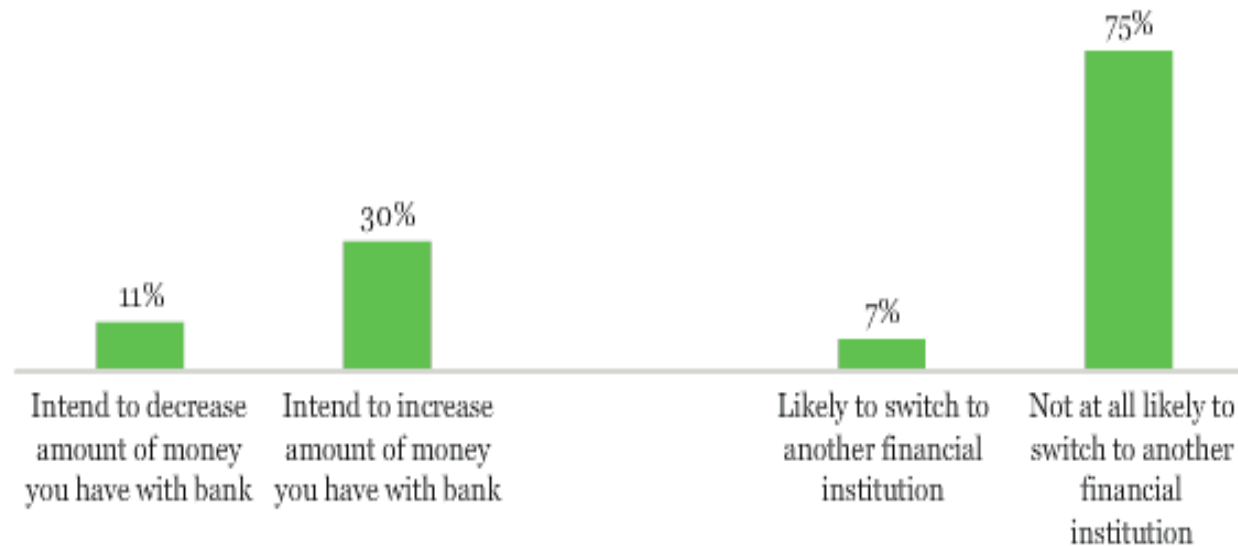
GALLUP POLL

Source: Gallup Poll



What This Means for Community Banks

Americans' Intentions Toward Their Primary Bank in the Next Three Months, April 2009



Gallup Poll Daily tracking

GALLUP POLL

Source: Gallup Poll



What This Means for Community Banks

- Political advantages for community banks
- Money vs. Muscle
- Votes trump donations
- American DNA – Bigger isn't always better



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Restricted [RES]	0	0.00	0	0.00
Suspended [SP]	12	2.27	4	33.33

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