



GEORGIA BANKERS ASSOCIATION
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Georgia Banking Update - May 2009

Facts, Figures and Issues important for Recovery

Updated May 29, 2009

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Executive Summary

Georgia's banking environment remained unusually challenging through the end of 2008 and in the first quarter of 2009. The broad economic recession, weakness in the residential real estate sector and growing concerns about commercial real estate are causing continued stress on many Georgia banks.

Even so, a vast majority of Georgia's banks remain well capitalized, and through the end of the first quarter 2009, more than 55 percent of the state's banks were profitable.

The banks encountering the most difficulty are those with significant concentrations of loans to residential builders and developers. Decreased demand from home buyers and rising foreclosures led to weak sales and high levels of building lot and housing inventories, putting pressure on these bank clients' ability to pay back loans. As a result, Georgia banks with heavy loan concentrations to the builder/developer industry have suffered significant losses and have had to set aside significant amounts of earnings and capital to cover anticipated losses.

Perhaps the most visible consequence of the economic downturn has been an increase in bank closures in Georgia. As of May 28, six Georgia banks have closed this year out of 334 banks on Jan. 1, 2009. Since 2008, 11 Georgia banks have closed out of 354 active banks at the beginning of 2008. However, to put that in perspective, California has experienced 10 bank closures out of 312 banks at the beginning of 2008. That's roughly the same percentage as Georgia. Other states such as Nevada and Oregon have experienced a higher percentage of their banks closing than Georgia. Nationally in 2008, 25 banks were closed out of more than 8,300 banks operating, and 36 banks have been closed to date in 2009. While that does indicate an extremely challenging banking environment, it pales in comparison to the more than 1,000 banks and savings institutions that were closed in 1989 and 1990, the height of the last period of significant stress on the financial services industry. See Appendix D on page 17 for more details.

There are several key economic and regulatory issues that continue to put pressure on the ongoing viability of many Georgia banks. They include:

- Real-estate: Regulatory interpretations of accounting guidelines, failed-bank asset disposition and the difficulty of obtaining reasonable and consistent property appraisals
- FDIC special assessment of 5 basis points on assets minus tier-1 capital
- Artificial disallowance of more than \$1.5 billion of capital in Georgia banks
- Limited investment in Georgia banks from the TARP/Capital Purchase Program
- Access to capital and sources of liquidity continue to be limited.

Likewise, continued uncertainty about the effectiveness of the variety of government programs designed to enhance stability in the financial services sector remains an ongoing concern for bankers, investors and consumers.

Regulatory flexibility, time and actions that lead to more market certainty and consumer confidence are the key factors to encourage economic recovery and a return to profit for many of our state's banks.

Despite ongoing uncertainty and the continuing challenges, there are tentative signs that improvement is nearing. Georgia's unique demographics and business climate set a solid underlying foundation for recovery. Georgia continues to be a leader in population growth, mortgage rates are extremely low, mortgage volume has increased, housing inventories have declined from peak levels and consumer confidence was up in April.

Based on those facts, and if we are able to work in good partnership with regulators and other policymakers, we are guardedly optimistic that we'll see more significant signs of improvement in the coming quarters.

Georgia's Banks, at a Glance

Through first quarter 2009.

- There are 372 FDIC-insured banks and savings institutions operating in Georgia¹.
- Of those, 326 are based in Georgia²
- Georgia-based banks employ 50,054 people²
- Conservatively, GBA estimates that all banks operating in Georgia employ more than 60,000 people
- There are 2,777 banking offices in Georgia
- 92 percent of Georgia's banks remain well capitalized based on the regulatory guideline for having a 10% or higher total risk-based capital ratio.²
- Deposits grew at Georgia's banks by \$7.6 billion since the beginning of 2009 and by \$12.1 billion during the past 12 months.
- 55 percent of Georgia's banks were profitable in the first quarter of the year, an improvement from the number of banks profitable at year end.
- Georgia's banks are lending to creditworthy borrowers. Gross loans and leases at Georgia's banks totaled \$214.1 billion at the end of first quarter 2009, relatively flat in a challenging environment.

Chart data as reported by FDIC

| Measurement (Year-to-date data) | Georgia March 31, 2009 | Georgia, Year-end 2008 | Georgia, March 31, 2008 | National, March 31, 2009 | National, March 31, 2008 |
|------------------------------------|---------------------------|---------------------------|----------------------------|-----------------------------|-----------------------------|
| Institutions | 328 | 334 | 357 | 8,246 | 8,494 |
| Employees | 50,054 | 50,848 | 54,255 | 2,114,527 | 2,212,533 |
| Assets | \$289.3 billion | \$300.3 billion | \$288.4 billion | \$13.5 trillion | 13.3 trillion |
| Deposits | \$216.9 billion | \$209.3 billion | \$204.7 billion | \$8.9 trillion | \$8.5 trillion |
| Gross loans and Leases | \$214.1 billion | \$215.5 billion | \$215.8 billion | \$7.7 trillion | \$7.9 trillion |
| % Profitable | 55.49 | 51.80 | 74.79 | 78.35 | 85.77 |
| Cost of Funding Earning Assets | 1.90% | 2.51% | 3.00% | 1.47% | 2.95% |
| Net Interest Margin | 2.96% | 3.18% | 3.30% | 3.39% | 3.33% |
| Net Income | -1.2 billion | \$125.2 million | \$466.8 million | \$7.6 billion | \$19.3 billion |
| Return on Assets | -1.63% | 0.04% | 0.65% | 0.22% | 0.58% |
| Return on Equity | -15.56% | 0.39% | 5.71% | 2.26% | 5.69% |
| Loss Allowance/Loans | 2.15% | 1.85% | 1.31% | 2.50% | 1.52% |
| Noncurrent Loans/Loans | 4.77% | 4.06% | 2.50% | 3.77% | 1.72% |
| Equity Capital to Assets | 10.49% | 10.48% | 11.41% | 10.15% | 10.18% |
| Total Risk-Based Capital Ratio | 11.87% | 11.75% | 11.77% | 13.46% | 12.81% |
| Other Real Estate Owned | \$2.5 billion | \$2.2 billion | \$1.2 billion | \$30.5 billion | \$16.6 billion |
| Net Charge-Offs | \$1.1 billion | \$2.8 billion | \$433 million | \$37.9 billion | \$19.6 billion |
| Net Charge Offs to Loans | 2.0% | 1.31% | 0.80% | 1.94% | 0.99% |

¹ FDIC Summary of Deposits, most recent available, through June 30, 2008, <http://www2.fdic.gov/sod/sodMarketRpt.asp?baritem=2>. The 11 banks closed since that time have been subtracted from the 383 listed in the market share report on the web site.

² FDIC Statistics on Depository Institutions, Georgia-based institutions only, most recent available, through March 31, 2009, <http://www2.fdic.gov/SDI/main.asp>. Two closed banks in April subtracted from number of active Georgia-based banks.

Key Regulatory Issues Facing Georgia's Banks

- Severe regulatory application of accounting guidelines dealing with real estate loans
- FDIC's disposal process of managing failed bank assets is devaluing real estate for both bank customers and banks, causing increased losses
- Decision making related to loan participations from failed banks needs improvement
- Appraisals: Difficulty in obtaining reasonable, consistent valuations
- FDIC special assessment: could cost Georgia banks almost \$405 million
- Artificial disallowance of more than \$1.5 billion of capital in Georgia banks
- Mandatory reduced reliance on brokered deposits has unintended consequences
- Limited investment in Georgia banks from TARP/Capital Purchase Program
- Access to capital and sources of liquidity continue to be limited by the market and regulatory issues
- Open bank assistance rules should be reviewed by FDIC
- Overdraft accommodation programs should not be unduly restricted for consumers
- New regulatory oversight being considered: systemic risk regulator and a financial products regulator

Real-Estate Related Mark to Market/Fair Value Accounting (see Appendix A on page 12)

Certain accounting standards, primarily FAS 157, create unnecessary write downs of a bank's securities portfolio in a troubled market. We are appreciative of the helpful adjustments recently adopted related to how banks are allowed to value these securities. However, the actions taken to date do not address fair value treatment of real estate, which is the critical issue for most Georgia banks. The accounting guidelines, primarily FAS 114 and FAS 5, need to be reviewed. However, bank regulators seem to be taking more aggressive positions than the guidelines require. For example, banks are being pressured to sell foreclosed real estate faster than five years; the "look back" period for estimating losses has shrunk to months instead of years; the absorption rates for developed lots has been extended to as much as 15 years by some examiners; and banks are being forced to take write downs of specific loans and then replenish their loan loss reserve for that exact amount even though guidelines seem to suggest otherwise. These and many other recent changes in regulatory policy are having a serious and detrimental effect on bank capital. In essence, bankers are being required to use real capital to account for theoretical losses.

FDIC Disposal of Failed Bank Assets; Loan Participations with Failed Banks (see Appendix B on page 14)

Listings and sales indicate that FDIC is willing to take steep losses on assets that are acquired through bank failures. We have recently seen FDIC sales of assets, both real estate and loans, at 25% to 50% below current appraisals, costing the FDIC fund millions of dollars. This overly aggressive discounting also hurts surviving banks in markets where the closed bank had loans as the real estate supporting loans at these banks or foreclosed real estate is being appraised at these new, lower – and artificial – fire-sale values. This overly aggressive discounting hurts borrowers when the value of their real estate pledged collateral is artificially devalued, resulting in their struggling to meet either loan covenants requiring specific levels of collateral or selling properties at these lower values to repay or pay down loans. Banks are also being required to write down their real estate portfolios to these new values, which is an unnecessary hit to capital. With a government entity intentionally resetting prices downward this steeply and this quickly, our fear is that there is not enough capital in the marketplace to sustain many banks located in the most troubled geographic areas. These decisions are burning through capital at an alarming rate at a time when the private capital markets remain constrained. One of the more significant problems involving closed banks are loans

that have been participated out to other institutions and how the FDIC is protecting its position in these loans, now as either the lead participant or as a minority participant. Other bank participants in these loans have reported lengthy times for responses to offers to buy out FDIC's position. Other bankers are reporting the sale of loans with participations has gone too quickly to the online auction companies, often while bankers are waiting for answers on proposals to FDIC. Also, FDIC had been pooling loans for sale at auction, which effectively prevented participant banks from bidding as they had no interest in buying other loans that were outside their markets. FDIC has recently announced a change in policy on participation loans so that loans will be sold individually rather than in pools, which is a positive move. However, more work needs to be done on communicating with participants and responding to live offers.

Appraisals: Difficulty in Obtaining Reasonable, Consistent Valuations

Obtaining good appraisals in the current market environment is extremely difficult. Because the real estate market is so weak, appraisal assumptions sometimes do not realistically reflect absorption periods that take into account the naturally increasing demand for vacant lots that will occur once today's excess inventory of homes and lots is absorbed. This result is appraised values that seem unreasonably low when considering more realistic sales and absorption periods. Our recommendation is that all appraisers should consider the environment for improved sales in the future when determining market values. Otherwise, they are appraising the value of the collateral at the lowest point of the business cycle with little regard for the realistic expectation that the supply and demand equation calls for improvement in the not too distant future.

Furthermore, bankers have told us that field examiners are applying their own appraisal methodology in evaluating the validity of independent appraisals. Or, in the absence of a newly revised appraisal in the loan file, they are making their own determination of value based upon their own methodology. We fully acknowledge that field examiners must review appraisals with a critical eye. However, we suggest further discussion about whether it is within the scope of the regulators' work to override independent appraisals using their own methodology. This is of greater concern when regulatory determinations are based upon extremely conservative assumptions based on today's slow pace of absorption instead of more reasonable historical absorption estimates as indicated above. We encourage our regulators to continue to support rational methodologies for valuations.

FDIC Deposit Insurance Assessments

The FDIC has levied a special assessment on banks of 5 basis points based on total assets minus tier-1 capital. A cap was set of no more than 10 basis points times the institution's deposit assessment base for the second quarter 2009 risk-based assessment. The assessment will be collected Sept. 30, 2009. The board may impose additional special assessments of up to 5 basis points on all insured depository institutions based on each institution's assets minus tier-1 capital for the third and fourth quarters of 2009, if the FDIC estimates that the Deposit Insurance Fund reserve ratio will fall to a level that the Board believes would adversely affect public confidence or to a level that will be close to or below zero. Additional assessments will be capped at 10 basis points times the institution's deposit assessment base for the corresponding quarter's risk-based assessment.

This was preferable to the initial proposed 20 basis points on deposits, but we had hoped for a solution that would have negated the need for any assessment during a time which keeping capital in our banks is so critical. The banking industry fully supports the industry paying to maintain the fund. We had suggested the following alternatives as options available besides the one-time assessment such as: 1) banks should be allowed to expense the cost over time, 2) FDIC should tap its line of credit with Treasury, 3) bonds similar to the FICO bonds used to pay off FSLIC

deposits should be issued, 4) develop a type of convertible borrowing authority from the banks allowing the money to be drawn down as needed rather than prepaid in a lump sum, 5) allow FDIC to use the new Temporary Liquidity Guarantee Program fees to be counted as part of the Deposit Insurance Fund (which has been done), or 6) allow banks to make an equity investment into FDIC. (See page 10 for further discussion about legislation passed related to FDIC's borrowing authority.)

Capital-Loan Loss Reserves

The current regulatory threshold, which states loan loss reserves above 1.25 percent of risk-weighted assets cannot be included in calculations for meeting regulatory capital guidelines, should be reviewed. Banks have prudently reserved above this level in the current climate in order to protect against possible losses. This is real capital that banks have on hand and is available. By removing the cap, banks will have stronger capital ratios without affecting the safety of the system. Current calculation rules on Total Risk-Based Capital as of March 31, 2009, artificially disallow \$1.56 billion of valid capital in Georgia Banks. John Dugan, Comptroller of the Currency, the principal federal regulator for national banks, has suggested removing this arbitrary cap and allowing 100% of the bank's allowance for loan losses to count towards regulatory capital. As Dugan says, "If any counts, why not all?" We fully support this change.

Brokered Deposits

Banks that fall below regulatory requirements for being well capitalized are legislatively prohibited from renewing maturing brokered deposits or raising additional liquidity in the brokered deposit market. These banks then have to raise local deposits increasing prices for all institutions and further compressing margins in a tight market. Brokered deposits have played a necessary and critical role as a safe and reliable source of funding for many Georgia banks. When a bank has to reduce its level of brokered deposits or cannot renew current brokered deposits, it must acquire local deposits by paying higher rates to take deposit clients away from other local banks. Other local banks, then, are faced with the dilemma of matching these artificially high rates just to retain their own deposits. This unduly increases costs, reduces profits and damages the stability of the entire local bank market. One possible helpful easing of the regulation would allow "adequately capitalized" banks to renew maturing brokered deposits but continue to prohibit them from acquiring new brokered deposits. If the statute cannot be changed regarding brokered deposits, banks having to shed those deposits should be allowed to reduce their reliance over a longer period of time than simply upon renewal. If the FDIC could require an orderly reduction of brokered deposits of perhaps 10% per quarter or some other reasonable number, the impact would less.

TARP/PPP Investments and Sources of Private Capital

The TARP/PPP process has been frustrating for most Georgia banks that have chosen to apply to participate. As of this writing, only 22 Georgia banks have been funded for TARP/PPP investment (see Appendix C page 16). Private capital has essentially dried up for most banks because of uncertainly and mixed messages on federal capital investments. Private investors are waiting to see if companies qualify for TARP/PPP, and anecdotally we are hearing daily from banks that have been told to withdraw their applications as the rules have changed. The guidelines for how Treasury decides whether to invest in TARP/PPP have never been published and the process is totally opaque. Private investors tell bankers they feel that the regulators know more about the bank's balance sheet than do the bankers; and if Treasury is not willing to invest, then they need not risk their capital. The markets have to know Treasury's intentions with certainty. Also of note related to the PPP, Treasury Secretary Geithner announced recently that community banks with under \$500 million in assets will have an additional six months to apply for participation regardless of whether they are public, private, Subchapter S corporations or mutual institutions. They also can request the capital equivalent of up to 5 percent of their risk-weighted assets, instead of the program's original 3

percent. Current CPP participants with less than \$500 million in assets can reapply to get the higher amount, with an expedited approval process, Geithner said. Further details have yet to be released, and at this point, unless the approval criteria are improved and there is more transparency and certainty with this program, it's anyone's guess how appealing to or helpful this announcement will be for Georgia's banks.

We also understand that certain regulatory hurdles, such as percentage of ownership restrictions, are turning investors with significant capital away from the market. The Bank Holding Company Act, which restricts control ownership of a bank on a percentage basis, should be revisited, and new methods of controlling ownership risk should be considered.

Open Bank Assistance for Troubled Institutions

One possible helpful approach that would encourage more private capital and reduce the cost of failed banks to the deposit insurance fund is for the FDIC to make use of open bank assistance arrangements for failing institutions rather than insisting on closing the banks and placing them into receivership. With the current closure and receivership philosophy, investors who may normally be interested in acquiring a bank and its assets are sitting on the sidelines waiting on closures so they can bid on and buy assets from the FDIC for pennies on the dollar. There are investors or other financial institutions who would buy such banks and all of their assets without a bank having to be closed provided there was an appropriate loss-sharing arrangement with the FDIC. This approach would also reduce the negative stigma that a closed bank has on the local community and the employees of such a bank. Part of this approach would also need to include a change in the rule that requires bidders of a failed bank to have an existing bank charter. Some recent bank closures have had no bidders for the failed banks' deposits, due to the FDIC limiting bidders only to holders of existing bank charters. One example of positive regulatory response to address this issue is a shelf charter that was approved by the Comptroller of the Currency last fall for an investor group which expanded the pool of bidders for troubled institutions.

Overdraft Programs

The Federal Reserve Board issued a proposal under Regulation E this year that GBA submitted a comment letter about in late March. The proposal would require that an institution provide its consumers the right to opt out of the institution's payment of ATM withdrawals and one-time debit card transactions pursuant to the institution's overdraft service. The Board is also proposing an alternative approach that would require an institution to obtain a consumer's affirmative consent (opt-in) before the institution could pay overdrafts for ATM withdrawals and one-time debit card transactions and assess a fee. In addition, the Board has proposed restricting the circumstances under which banks can assess fees for overdrafts that would not occur but for a debit-card hold that exceeds the amount of the underlying transaction. GBA urged the Board to adopt a rule based on a customer's right to opt-out of overdraft accommodation programs and for banks to satisfy that option by offering alternative accounts that are reasonable or customary. We believe that those who choose to opt-out are in the minority and should not disadvantage the majority through a program to the contrary. We favor permitting either an all-in account level choice or a partial election limited to debit card transactions that properly recognizes how they are used and processed given operational limitations. We also encouraged the Board to recognize the evolving nature of electronic payments and the need to continue to place the responsibility for account management on the accountholder.

New Regulatory Oversight Being Considered

Congress and the Administration are moving forward with discussions to overhaul the entire financial regulatory structure. Talks include appointing a single systemic-risk regulator with authority to take broad responsibility for a variety of "too-big-to-fail" financial-services institutions. A single bank regulator would merge the Office of Thrift

Supervision, Office of the Comptroller of the Currency, and the regulatory functions of the FDIC and the Federal Reserve Board. It would, in effect, put an end to the effective dual banking system of federally and state regulated institutions. GBA does support a mechanism to address the failures of systemically important institutions. But the association is concerned about proposals to make the FDIC the systemic resolution authority because it could dilute the agency's key mission of protecting depositors. Also being considered is a new consumer products regulator. We're concerned this could produce duplicate regulation on many products and services already covered by existing banking rules and laws, as well as increase cost, reduce availability of credit and increase bureaucracy. However, assigning regulatory authority over non-regulated institutions and non-regulated financial products capable of doing significant harm to the economy, consumers, and businesses (including hedge funds, credit default swaps and other derivatives, and mortgage brokers), is important.

Federal Legislative Issues

FDIC Insurance Coverage Limits and Increased FDIC Borrowing Authority

In October 2008, the Emergency Economic Stabilization Act increased the level of deposit insurance coverage from \$100,000 per depositor per bank to \$250,000 on a temporary basis until the end of 2009. This has been extended through 2013. In addition, the same legislation provided for increased borrowing authority from the U.S Treasury, which allowed the FDIC to significantly reduce the special assessment rate discussed earlier in this document. GBA strongly supported both measures.

Bankruptcy Cram-down

Legislation is pending in the House and Senate that would allow bankruptcy judges to arbitrarily rewrite the terms of a mortgage contract, including reducing (cram-down) the amount owed on a mortgage, changing the interest rate or stretching out the term of the mortgage. The House version, H.R. 1106, also includes a provision that provides that even minor violations of the Truth in Lending Act could result in a home-equity loan or even a mortgage being disallowed in bankruptcy. GBA feels these provisions will increase the cost and availability of credit, thereby undermining other efforts to stabilize the housing market. An unsuccessful attempt was made to add bankruptcy cram-down authority to the FDIC legislation mentioned above. Should the issue arise again, we encourage the Georgia Congressional Delegation to oppose the idea.

Loss Carry Back

The economic stimulus bill Congress passed in February expanded the net operating loss carry back period from two to five years, but the provision applied only to companies with gross receipts of up to \$15 million. There is also language in the President's proposed budget calling for an expanded carry back. In addition, Senator Max Baucus (D-Montana) and Senator Olympia Snowe (R-Maine) introduced S. 823 that would expand the net operating loss carry back period from two to five years for 2008 and 2009. Unfortunately, the legislation includes a provision that would prevent TARP/PPP recipients from using the extended period. GBA supports the expanded loss carry back period to five years and believes that all of its members, including those participating in the TARP/PPP, should be eligible to take advantage of the extended loss carry back period.

Interchange Fees

Interchange is the fee retailers pay to access the credit and debit card payment system, usually a penny or two on each dollar for the ability to accept electronic payments. In return, retailers are provided safe and guaranteed payments and bear no risk associated with fraud, failure to pay or data breaches. Retailers have asked Congress to pass the so-called Credit Card Fair Fee Act, which will arbitrarily determine rates and terms for interchange fees. GBA feels the proposed legislation is unnecessary as interchange fees are a cost of doing business for merchants, similar to employee salaries and other expenses. Many banks use the income provided by interchange fees to subsidize and provide consumer services such as fee-free checking accounts. The availability of that type of fee-free product could be limited if artificial price caps are imposed and interchange income drops significantly. About 80% of Georgia banks responding to a recent GBA survey said interchange income is an important part of their non-interest income stream, and 85% had not received complaints about interchange fees from their business or retail banking customers.

Mortgage Reform/Predatory Lending

The Mortgage Reform and Anti-Predatory Lending Act of 2009, H.R. 1728, has passed the House of Representatives. The legislation is purportedly aimed at curbing abusive mortgages by: reducing the triggers on high-cost loans; requiring lenders to determine that borrowers have a reasonable ability to repay; prohibiting lenders and brokers from steering borrowers to more expensive loans; and allowing borrowers to file a cause of action against assignees, including securitizers, for violating minimum underwriting standards. Although the bill was amended in committee in a positive fashion, we still have concerns in the areas of risk retention requirements and the narrow safe harbor excluding “garden variety” adjustable rate mortgages. The Senate has not taken any action on this bill.

Appendix A – Negative Effects on Bank Capital Caused by Regulatory Interpretation of Accounting Guidelines

Recent FASB rulings provided some relief to some banks related to fair-value and mark to market accounting as they relate to accounting for the value of securities-related assets (SFAS 157). However, this relief is **not related** directly to guidance on actual real-estate loans. The guidelines are clear that if a loan is a confirmed loss, then it should be charged off. The major ongoing concerns, and frustration banks are having with regulators, are related to how regulators are interpreting the rules that apply to how much capital banks should reserve for losses or potential losses on those assets. These interpretations are causing banks to use real capital for theoretical real estate losses, putting further stress on bank capital levels. Following is a summary of the accounting rules and examples of how this is playing out in Georgia.

The Accounting Guidelines

Banks are required to reserve, or set aside, capital to cover losses on actual loans. This reserve is technically known as Allowance for Loan and Lease Losses (ALLL). Two specific accounting standards determine how much capital banks must reserve, SFAS 5 and SFAS 114 (these are sometimes simply called FAS 5 and FAS 114).

SFAS 5: This standard determines a bank's general reserve for loan losses. Banks determine how much capital to reserve to protect against losses by grouping loans into similar categories that have common risk characteristics then assigning a risk factor to each pool. Examples of categories would be acquisition, construction and development (AC&D) loans or commercial real estate loans. A variety of information is used to determine the risk factor and how much should be set aside. Information includes historical losses on similar loans as well as historical and current trends in past-due percentages, the number of loan renewals, general economic conditions and other internal bank factors such as staffing changes, new products, geographic expansion and others.

SFAS 114: This standard determines how much capital a bank must reserve for a specific loan for which the bank does not believe it will collect the full interest and principal in accordance with the original terms of the loan. These types of loans are called impaired loans. There are three ways to determine how much capital to reserve for an impaired loan: 1) Reserve amount based on an observable secondary market price for the loan (securitization); 2) Present value of expected cash flows to the bank from the loan; or 3) Fair value of the collateral if the loan is considered collateral dependent, meaning the loan can only be repaid by selling the collateral. This last option is the most-common method used by community banks, and the one associated with most concern about regulatory interpretation.

Examples of Regulatory Interpretations that We Believe Go Further than Accounting Guidelines

Example 1: Loans have been evaluated under SFAS 114 and deemed that no reserve is necessary, meaning the collateral value backing the loan provides enough buffer in case of a loss. This is a good outcome. However, we understand that some regulators in this case are then requiring the bank to place the loan back into the pool of loans to be evaluated under SFAS 5, which could unnecessarily affect the risk factors and increase the resulting reserve set aside for that pool of loans.

Example 2: In some instances, regulators have required banks to use extremely short timeframes to set historical loss ratios used to evaluate loans and determine appropriate reserves under SFAS 5. Historically, banks have used average three-year or five-year ratios. More recently, regulators have been requiring banks to use loss ratios from only the past three months in some cases. These loss ratios, of course, have been much higher and are at levels banks have never experienced. Along with the additional risk factors taken into account related to the current economic environment, this practice is causing banks to have to set aside unreasonably high reserves.

Example 3: Some regulatory teams have forced banks to evaluate some real estate loans as impaired and collateral dependent under SFAS 114 even though loan customers were paying and were not past due. This causes artificial reserves and loss of capital based on unusually low values of property that there's no intent or need to sell in a depressed market.

Example 4: In some cases, regulators are taking an overly aggressive stance on defining loans as confirmed losses when there is still uncertainty as to whether the loan can be repaid. Some have taken the position that any real estate loan that a bank determines is a collateral-dependent loan evaluated under method 3 of SFAS 114 is already a confirmed loss even when payments continue to be made. Their thinking is that because the bank is taking the position that the only source of future payment is the sale of collateral, the bank should charge it off based on the collateral value of the real estate. This stance fails to recognize that the amount of uncertainty in the appraisal process alone means it is difficult to accurately value this type theoretical confirmed loss. And, if the loan's collateral value improves in the next few months or years while the loan continues to be paid, the improvement cannot be recognized by taking capital out of the loss reserve because the loan has been technically charged off at the lower value. The recovery of capital will not be recognized until the entire loan is paid back. So, even if the bank has the ability and intent to hold the loan until it could be paid, it could not recognize an improvement in the collateral values or capital levels until the entire loan was collected. This treatment can significantly lower the bank's capital ratios.

Example 5: Another problem has been with the inclusion of expected future declines in economic conditions. In 2008, one regulatory team told a bank that it needed to add an additional risk factor to their SFAS 5 evaluation of loans for the continued decline expected in 2009. Estimating and adding risk for expected declines in the next calendar year is not necessary because those risks should be properly evaluated during that particular calendar year: 2008 conditions affect 2008 evaluations; 2009 conditions affect 2009 evaluations.

Appendix B – FDIC Management of Failed Bank Loans and Loan Participations

We are concerned that the FDIC's current procedures for dealing with loans and assets from failed banks, and how some of its teams are managing loan participations of failed banks, are further depressing real estate values and causing unnecessary capital losses for surviving banks.

We have recently seen FDIC sales of assets, both real estate and loans, at 25% to 50% below current appraisals, costing the FDIC fund millions of dollars. This overly aggressive discounting also hurts surviving banks in markets where the closed bank had loans as the real estate supporting loans at these banks or foreclosed real estate is being appraised at these new, lower – and artificial – fire-sale values.

This overly aggressive discounting hurts borrowers when the value of their real estate pledged collateral is artificially devalued, resulting in their struggling to meet either loan covenants requiring specific levels of collateral or selling properties at these lower values to repay or pay down loans. Banks are also being required to write down their real estate portfolios to these new values, which is an unnecessary hit to capital.

With a government entity intentionally resetting prices downward this steeply and this quickly, our fear is that there is not enough capital in the marketplace to sustain many banks located in the most troubled geographic areas. These decisions are burning through capital at an alarming rate at a time when the private capital markets remain virtually frozen.

One of the more significant problems involving closed banks are loans that have been participated out to other institutions and how the FDIC is protecting its position in these loans, now as either the lead participant or as a minority participant. Other bank participants in these loans have reported lengthy times for responses to offers to buy out FDIC's position. Other bankers are reporting the sale of loans with participations has gone too quickly to the online auction companies, and often while bankers are waiting for answers on proposals to FDIC. Also, FDIC had been pooling loans for sale at auction, which effectively prevented participant banks from bidding as they had no interest in buying other loans that were outside their markets. FDIC has recently announced a change in policy on participation loans so that loans will be sold individually rather than in pools, which is a positive move. However, more work needs to be done on communicating with participants and responding to live offers.

Examples of these issues collected from bankers include:

- Sales at prices as low as 20 and 30 cents on the dollar. In one example a borrower bought his own foreclosed collateral from a closed-bank liquidation for 30 cents on the dollar.
- Sales are being offered through online auctions at discounts from other offers. In one instance, the online auction price was substantially lower than an offer made before the auction by a bank, plus the loan pool being auctioned included loans in non-local markets making the pool unworkable to the local participant bank. In another example, the FDIC turned down a cash-in-hand resolution offer by the borrowers on a loan, liquidated the loan through an auction service receiving only half the amount of the original cash offer. The original offer was for less than the full amount of the loan, but it would have limited the actual loss realized from the auction sale.

- The FDIC sold a pool of loans at a steep discount through their online auction vendor. The purchaser of that pool, because of possible technical default by the borrower caused by the steep discount of collateral, could also cause the borrower to default on a different loan held by a surviving bank.
- Conversely, we've heard examples of regulators not accepting reasonable appraised values of properties other banks were attempting to assume as part of resolving a loan participation from a failed bank. This means banks are being told they need to reserve capital using extremely low valuations on properties they continue to hold, but not to use such extremely low valuations for properties they are attempting to purchase from the FDIC. There seems to be a lack of consistency in how the regulatory teams apply appraisal standards, which appears to work against surviving banks regardless of the situation.
- The regulator's contractor handling a failed bank's participation loan has failed to move quickly to approve simple requests such as signing off on a Quitclaim Deed that would allow another participating bank to move ahead with quality construction loans to the borrower. This unnecessarily inhibits the surviving banks' ability to strengthen its business and the marketplace.
- Regulatory teams have blocked reasonable attempts by other banks participating in failed banks' loans to resolve and assume the loans at no loss to the FDIC.

Comment : It appears that at times two of the FDIC's primary missions may be at odds in the current environment. On one hand, the Division of Supervision and Consumer Protection (DSCP) is responsible for examining and supervising banks to ensure ongoing safety and soundness. On the other hand, the key role of the Division of Resolution and Receiverships (DRR) is to act as receiver for banks that have to be closed and deal with the assets of closed banks. In our view, the DRR's bias toward rapid, deeply discounted sales of assets actually puts additional and destabilizing pressure on capital levels at surviving banks in the market the DSCP is responsible for examining and supervising.

Recommendation: We recommend the FDIC's approach be more focused on procedures that sustain real estate values in the marketplace instead of an emphasis on rapid resolution at extremely low prices. This type of approach would ensure the stabilization of the local market, protection of capital at surviving banks, potentially reduce the number of bank closures in Georgia and ultimately limit losses to the deposit insurance fund. It is also problematic that all decisions have to be routed to the Dallas FDIC office for approval. Of note is that the FDIC has decided to open a regional resolution office this fall in Jacksonville, Florida to be staffed with 500 people.

Recommendation: We recommend more thorough coordination between the (DRR) and (DSCP) to ensure that the actions of one arm of the FDIC don't inadvertently trigger the necessity for supervisory or regulatory action against other banks in the marketplace.

Appendix C – Georgia Banks Receiving Capital Purchase Program Investments

| Bank | Total Assets | City | Investment Amount | Approval Status | Date Funds Received |
|--------------------------------------|--------------|--------------|-------------------|-----------------|--------------------------|
| 1. SunTrust Banks, Inc. | \$185 b | Atlanta | \$4.84 b | Money received | 11/14/2008 12/31/2008 |
| 2. Ameris Bancorp | \$2.4 b | Moultrie | \$52 m | Money received | 11/21/2008 |
| 3. United Community Banks Inc. | \$8.6 b | Blairsville | \$180 m | Money received | 12/5/2008 |
| 4. Fidelity Southern Corp. | \$1.8 b | Atlanta | \$48 m | Money received | 12/12/2008 |
| 5. Synovus Financial Corp. | \$36.2 b | Columbus | \$973 m | Money received | 12/19/2008 |
| 6. Colony Bancorp, Inc. | \$1.3 b | Fitzgerald | \$28 m | Money received | 1/9/2009 |
| 7. The Queensborough Company | \$ 861 m | Louisville | \$12 m | Money received | 1/9/2009 |
| 8. Metro City Bank | \$289 m | Doraville | \$7.7 m | Money received | 1/30/2009 |
| 9. Georgia Commerce Bancshares, Inc. | \$296 m | Atlanta | \$8.7 m | Money received | 2/6/2009 |
| 10. Hamilton State Bancshares | \$288 m | Hoschton | \$7 m | Money received | 2/20/2009 |
| 11. CBB Bancorp | \$114 m | Cartersville | \$2.6 m | Money received | 2/20/2009 |
| 12. Liberty Shares, Inc | \$769 m | Hinesville | \$17.3 m | Money received | 2/20/2009 |
| 13. Midtown Bank and Trust | \$213 m | Atlanta | \$5.2 m | Money received | 2/27/2009 |
| 14. PeoplesSouth Bancshares, Inc. | \$515 m | Colquitt | \$12.325 m | Money received | 3/6/2009 |
| 15. Citizens Bancshares Corp. | \$348 m | Atlanta | \$7.462 m | Money received | 3/6/2009 |
| 16. First Intercontinental Bank | \$250 m | Doraville | \$6.398 m | Money received | 3/13/2009 |
| 17. CSRA Bank Corp | \$101 m | Wrens | \$2.5 m | Money received | 3/27/2009 |
| 18. Tifton Banking Co. | \$153 m | Tifton | \$3.8 m | Money received | 4/17/2009 |
| 19. Georgia Primary Bank | \$180 m | Atlanta | \$4.5 m | Money received | 5/1/2009 |
| 20. One Georgia Bank | \$248 m | Atlanta | \$5.5 m | Money received | 5/8/2009 |
| 21. Gateway Bancshares | \$218 m | Ringgold | \$6 m | Money received | 5/8/2009 |
| 22. United Bank Corporation | \$689m | Barnesville | 14.4m | Money received | 5/22/2009 |

Data as of May 29, 2009

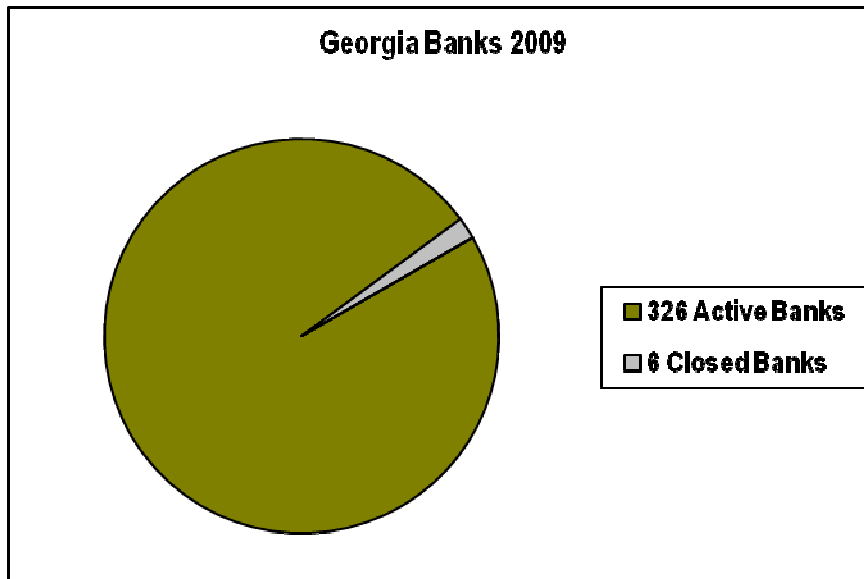
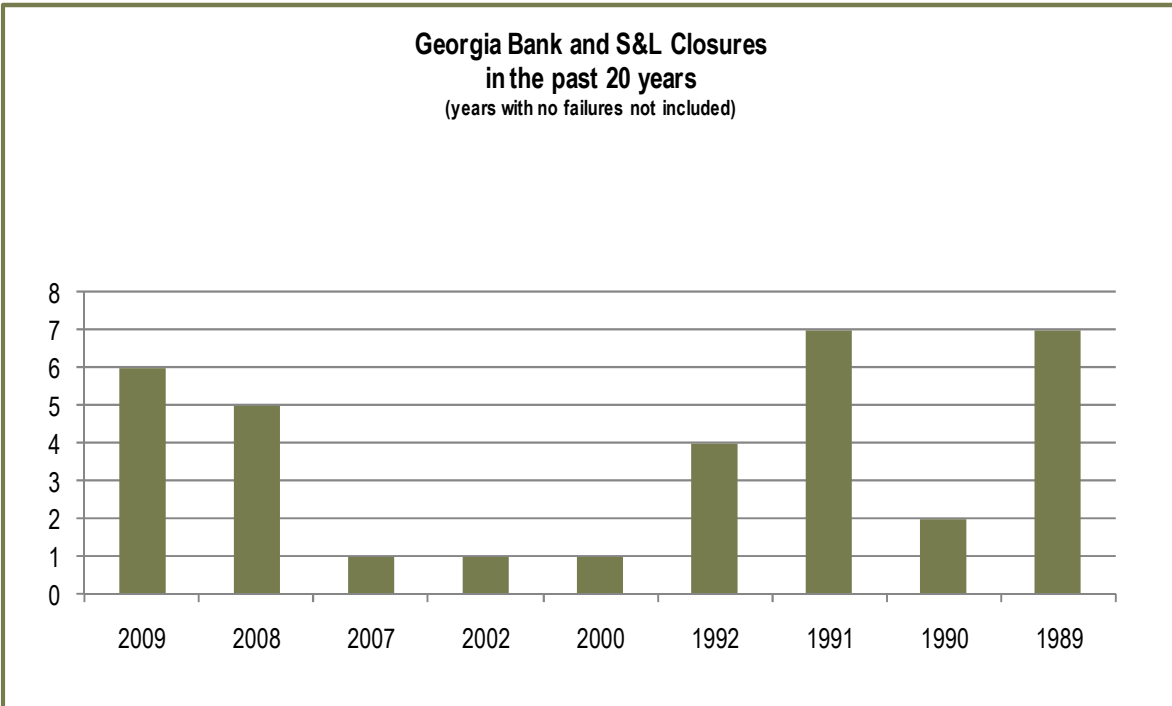
Appendix D – Georgia Financial Institution Closures 2008-2009

As of May 29, six Georgia banks have closed this year out of 334 banks on Jan. 1, 2009. In perspective, this is how Georgia stands compared to other states since the beginning of 2008.

- GA: 11 closures of 354 at beginning of 2008
- CA: 10 of 312 – about same percentage
- Nevada: 6 closures out of 44 banks
- Illinois: 6 out of 671
- Florida : 6 out of 317
- Nationally – 25 banks last year and 36 this year out of about 8,300; compared to about 1,000 in 89/90.

Summary of 2008-2009 Georgia Bank Closures

| Bank | Date | Acquired by | Deposits Acquired | Estimated Cost to FDIC Fund |
|---------------------------------------|----------------|--|---|-----------------------------|
| Silverton Bank, Atlanta | May 1, 2009 | No Acquirer; Bridge Bank created | No acquirer necessary with bridge bank. All deposits insured. | \$1.3 billion |
| American Southern Bank | April 24, 2009 | Bank of North Georgia, Alpharetta | All deposits, except brokered | \$41.9 million |
| Omni National Bank, Atlanta | March 27, 2009 | No acquirer; SunTrust Bank, Atlanta paying agent | Insured (paying agent) | \$290 million |
| First City Bank, Stockbridge | March 20, 2009 | No acquirer | None – Insured deposits paid directly to depositors | \$100 million |
| Freedom Bank of Georgia | March 6, 2009 | Northeast Georgia Bank, Lavonia, GA | All Deposits | \$36.2 million |
| First Bank Financial Services | Feb. 6, 2009 | Regions Bank, AL | All Deposits | \$111 million |
| Haven Trust Bank, Duluth | Dec. 12, 2008 | BB&T, Winston Salem, NC | All Deposits | \$200 million |
| First Georgia Community Bank, Jackson | Dec. 5, 2008 | United Bank, Zebulon, GA | All Deposits | \$72.2 million |
| The Community Bank, Loganville | Nov. 21, 2008 | Essex Bank, VA | All Deposits | \$200-\$240 million |
| Alpha Bank and Trust, Alpharetta | Oct. 24, 2008 | Stearns Bank, MN | Insured Deposits | \$158.1 million |
| Integrity Bank, Alpharetta | Aug. 29, 2008 | Regions Bank, AL | All Deposits | \$250-\$350 million |



Appendix E:

Summary of Key Federal Stability Programs to Georgia Banks

Beginning in the fall of 2008, the U.S. Government began authorizing a series of significant programs to stabilize the financial markets, financial institutions and the general health of the economy. Here is a brief summary of the key programs that are affecting Georgia's banks. The information below is excerpted from the U.S Treasury web site, www.financialstability.gov, and the FDIC web site, www.fdic.gov.

Emergency Economic Stabilization Act

The Emergency Economic Stabilization Act of 2008 (EESA) was signed into law on October 3, 2008, during a time of tremendous financial upheaval and economic uncertainty. The Troubled Assets Relief Program (TARP) was established under the EESA with the specific goal of stabilizing the United States financial system and preventing a systemic collapse. Treasury has established several programs under the TARP to stabilize the financial system and has now created the Financial Stability Program to further stabilize the financial system, restore the flow of credit to consumers and businesses and tackle the foreclosure crisis to keep millions of Americans in their homes.

Capital Purchase Program (CPP)

Part of TARP, the Capital Purchase Program (CPP) is a voluntary program in which the U.S. Government, through the Department of Treasury, invests in preferred equity securities issued by qualified financial institutions. Participation is reserved for viable institutions that are recommended by their federal banking regulator. Treasury's intent is to provide immediate capital to stabilize the financial and banking system, and to support the economy. As discussed earlier, participation for Georgia banks has been limited to date. This is often referred to as the bank bailout, but we consider it a "buy-in" because it is an investment with rates of return guaranteed to the government.

Capital Assistance Program (CAP)

On February 25, 2009 the U.S. Department of the Treasury announced the terms and conditions for the Capital Assistance Program (CAP). The CAP was announced as a core element of the Administration's Financial Stability Plan. The purpose of the CAP is to restore confidence throughout the financial system that the nation's largest banking institutions have a sufficient capital cushion against larger than expected future losses, should they occur due to a more severe economic environment, and to support lending to creditworthy borrowers.

Under CAP, federal banking supervisors conducted forward-looking "stress test" assessments to evaluate the capital needs of the major U.S. banking institutions under a more challenging economic environment. Only one Georgia Bank, SunTrust, was included in these assessments. Eligible U.S. banking institutions with assets in excess of \$100 billion on a consolidated basis are required to participate in the coordinated supervisory assessments, and may access the CAP immediately as a means to establish any necessary additional buffer. Eligible U.S. banking institutions with consolidated assets below \$100 billion may also obtain capital from the CAP although we are unaware of any Georgia banks receiving such investment.

Public-Private Investment Program (PPIP)

To address the challenge of legacy assets, Treasury – in conjunction with the Federal Deposit Insurance Corporation and the Federal Reserve – has announced the Public-Private Investment Program as part of its efforts to repair balance sheets throughout our financial system and ensure that credit is available to the households and businesses, large and small, that is intended to help drive us toward recovery. Using \$75 to \$100 billion in TARP capital and capital from private investors, the Public-Private Investment Program could generate \$500 billion in purchasing power to buy legacy assets – with the potential to expand to \$1 trillion over time. The Public-Private Investment Program has two parts, addressing both the legacy loans and legacy securities clogging the balance sheets of financial firms. We are unaware of any Georgia banks participating in either program; however, if they do decide to participate, we believe they will primarily be interested in participating in the legacy loans component. Both components are summarized as:

- **Legacy Loans:** The overhang of troubled legacy loans stuck on bank balance sheets has made it difficult for banks to access private markets for new capital and limited their ability to lend.
- **Legacy Securities:** Secondary markets have become highly illiquid, and are trading at prices below where they would be in normally functioning markets. These securities are held by banks as well as insurance companies, pension funds, mutual funds, and funds held in individual retirement accounts.

Temporary Liquidity Guarantee Program (TLGP)

The FDIC has created this program to strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of banks, thrifts, and certain holding companies, and by providing full coverage of certain non-interest or low-interest bearing deposit transaction accounts, regardless of dollar amount. See the FDIC web site for full details.

Term Asset-Backed Securities Loan Facility (TALF) The Federal Reserve Board created the Term Asset-Backed Securities Loan Facility (TALF), a facility that will help market participants meet the credit needs of households and small businesses by supporting the issuance of asset-backed securities (ABS) collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration (SBA). Under the TALF, the Federal Reserve Bank of New York (FRBNY) will lend up to \$200 billion on a non-recourse basis to holders of certain AAA-rated ABS backed by newly and recently originated consumer and small business loans. The FRBNY will lend an amount equal to the market value of the ABS less a haircut and will be secured at all times by the ABS. The U.S. Treasury Department--under the Troubled Assets Relief Program (TARP) of the Emergency Economic Stabilization Act of 2008--will provide \$20 billion of credit protection to the FRBNY in connection with the TALF. The Bank began offering these loans in March.

Other Programs

There are several other programs of note related to non-depository institutions, consumer lending, housing and mortgage lending. See the U.S Treasury web site, www.financialstability.gov for complete details. These include, but are not limited to:

- Making Home Affordable Program – Helping Families Stay in Their Homes
- Automotive Industry Financing Program