Evaluation of Municipal Securities

I. Overview & Industry Trends
Overview of Presentation

Overview & Industry Trends

Investment Policies & Procedures

Basic Analysis

Expanded Analysis

Review & Additional Resources

FEDERAL DEPOSIT INSURANCE CORPORATION
Recent Regulatory Changes

The Dodd-Frank Act required regulators to remove references to ratings provided by rating agencies from regulations.

In 2012, the OCC & FDIC issued Final Rules and Guidance addressing alternatives to the use of external credit ratings.

Banks cannot rely solely on credit ratings to determine creditworthiness.
Supervisory Expectations

Risk Level

Lower

Higher

Lower Expectations

Exposure Level

Higher Expectations

FEDERAL DEPOSIT INSURANCE CORPORATION
Market Characteristics

- Size of market: $3.7 Trillion
- Average annual issuance: $381.2 Billion
- Majority of new issuances are under $10 Million
- Number of bonds outstanding: > 1 Million
- Number of issuers: > 89 Thousand

As of December 31, 2012

Source – Federal Reserve, EMMA, SEC, 2012 Census of Governments
Challenges in Assessing Credit Risk

- Untimely financial information
- Different accounting standards (GASB vs. FASB)
- Unfunded pension and other postemployment benefit obligations
- Legal uncertainty
- State-specific bankruptcy laws
Bank Median Exposures to Municipalities

Municipal Exposures to Capital

<table>
<thead>
<tr>
<th>Source – Call Report Data</th>
<th>Community Bank (Assets &lt; $1 Billion)</th>
<th>Large Bank</th>
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<tbody>
<tr>
<td>Median Percent</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2Q '03</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>2Q '04</td>
<td>20</td>
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<tr>
<td>2Q '05</td>
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<td>2Q '06</td>
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<td>2Q '07</td>
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<td>2Q '08</td>
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<td>2Q '09</td>
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<td>2Q '10</td>
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<td>2Q '11</td>
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<td>2Q '12</td>
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<tr>
<td>2Q '13</td>
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</tbody>
</table>
Vintage Analysis

Municipal Bonds Disclosing Impairment by Year Issued

Number of Bonds

Year Issued


Source – Municipal MarketAdvisors

FEDERAL DEPOSIT INSURANCE CORPORATION
Municipal Bond Historical Defaults

Defaults (1958-2011)

- Industrial Development Bonds
- Housing
- Nursing Homes
- Health Care
- Special Assessments
- Retirement
- Other

Source – Federal Reserve Bank of New York
Credit Risk by Type of Municipal Issuance

Higher Risk
- Other Municipal Issuances
- Non-Essential Purpose Revenue Obligation Bonds
- Essential Purpose Revenue Obligation Bonds

Lower Risk
- General Obligation Bonds
Summary

- Banks should have a process to determine whether investments satisfy creditworthiness standards

- Banks cannot rely exclusively on external credit ratings to determine creditworthiness

- Supervisory expectations are based on the exposure level and risk profile of the portfolio