

SR003_7: Failed Bank Report

Downey Savings and Loan Association, F.A.

3501 Jamboree Rd
Newport Beach, CA 92660

(10/16/1957 – 11/21/2008)

Report Objective

This report has **two** objectives, using the bank's **data***

1. To examine the bank finances in the quarters prior to its failure.
2. To analyze the bank finances using our Key Performance Indicator (KPI) scoring approach to determine if the bank's failure is something we could have predicted.

*Data source: FDIC and company filings.

Bank Background

FDIC Certificate #	30968
Bank Charter Class	Savings Association
Asset Concentration	Mortgage Lending Specialization
Product Specialty	Deposit Accounts, Education and Retirement Accounts, Bank Cards, Home Loans, Online Banking Services
Number of Branches	175 (as of September 30, 2008)
Number of Employees	2,199 (as of September 30, 2008)

Executives	
CEO	Charles R. Rinehart
CFO	Brian E. Cote
COO	Thomas E. Prince

What took place?

The banking operations of Downey Savings and Loan Association, F.A. - Newport Beach, CA was sold to U.S. Bank, National Association, Minneapolis, MN in a transaction facilitated by the Federal Depository Insurance Corporation (FDIC) and the Office of Thrift Supervision. The estimated cost to the FDIC Deposit Insurance Fund is \$1,400,000,000, compared to the average cost of \$389,206,944. U.S. Bancorp acquired all deposits and some assets.

Bank Financial Snapshot

Financial Data Overlay (thousands)			
	2007 Q3	2008 Q3	Percentage Change
Assets	\$ 14,417,050	\$ 12,779,371	↓ 11.4%
Liabilities	\$ 12,875,072	\$ 11,821,073	↓ 8.2%
Net Income	\$ 56,484	-\$ 537,335	↓ 1,051%

- The average net income change for all FDIC banks was -66.92% in the same period.
- The average net income change for all the mortgage lending specialization banks was -129% in the same period.
- Compared with the whole industry and other mortgage lending specialization banks, Downey Savings and Loan Association's decline from Net Income is relatively large (-1051%) during 2008.

Key Performance Indicators


KPI Summary for 2008 Q3	
Normalized Income Rating	Moderate
Delinquent Asset Rating	Moderate
Asset: Liabilities Rating	Poor
Real Estate Asset Rating*	Very Poor
Bankability Composite Score	31.60** (Poor)

Possible ratings: *Excellent, Good, Moderate, Poor, Very Poor.*

*This rating is relevant to the current “financial crisis” fueled by mortgage security backed loans.

**This is out of 100.

Normalized Income Analysis

	2007Q2	2007Q3	2007Q4	2008Q1 	2008Q2	2008Q3
Normalized Income	0.23%	-0.15%	-0.80%	-1.87%	-1.72%	-0.58%
SD's from Average*	0.175	-0.467	-1.51	-4.41	-4.64	-0.753
Ranking	Moderate	Moderate	Poor	Very Poor	Very Poor	Moderate

- Downey Savings and Loan had a normalized income of -0.58% in the third quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (mortgage lending specialization) had an average normalized income of -0.01%. The standard deviation of the normalized incomes was 0.76%, which means that Downey Savings and Loan was 0.753 SD's below the average.

*Average of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

Delinquent Asset Analysis

	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3
Delinquent Asset	0.4628%	0.9165%	1.5154%	2.2209%	2.6275%	3.4732%
SD's from Average*	-0.38	-0.20	0.01	0.45	0.61	0.96
Ranking	Good	Good	Moderate	Moderate	Moderate	Moderate

- Downey Savings and Loan Association had a delinquent assets out of total assets ratio 3.47% in the third quarter of 2008, the quarter before it failed.
- Banks of the same asset concentration hierarchy (mortgage lending specialization) had an average delinquent asset of 1.52%. The standard deviation of the delinquent assets was 2.02%, which means that Downey Savings and Loan Association was about 0.96 SD's above the average.
- Since the second quarter of 2007, Downey Savings and Loan Association's delinquent assets ratio has been better than the rest of mortgage lending specialization banks. Although the ratio became worse since 2008, it was still in a stable and good condition compared with other banks.

*Average of banks of the same asset concentration hierarchy

Real Estate Loan Asset Analysis

	2007Q2 	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3
Real Estate Loan Asset Ratio	83.56%	82.02%	85.19%	85.06%	89.23%	88.22%
SD's from Average*	1.11	1.00	1.16	1.24	1.42	1.31
Ranking	Poor	Poor	Poor	Very Poor	Very Poor	Very Poor

- Downey Saving and Loan Association had a 88.22% of R/A ratio in 08 Q3, the quarter before it failed.
- In 08 Q3, banks of the same asset concentration hierarchy (Mortgage lending specialization) had an average R/A ratio of 59.49%. The standard deviation of the R/A ratio was 21.99%, which means that Downey Saving and Loan Association was 1.31 SD's above the average.

*Average of banks of the same asset concentration hierarchy



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Asset: Liability Analysis

	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2 	2008Q3
Asset: Liability Ratio	111.78%	111.98%	112.00%	109.92%	108.68%	108.11%
Median A/L Ratio*	112.03%	112.12%	112.00%	112.04%	111.72%	111.55%
Ranking	Moderate	Moderate	Moderate	Moderate	Poor	Poor

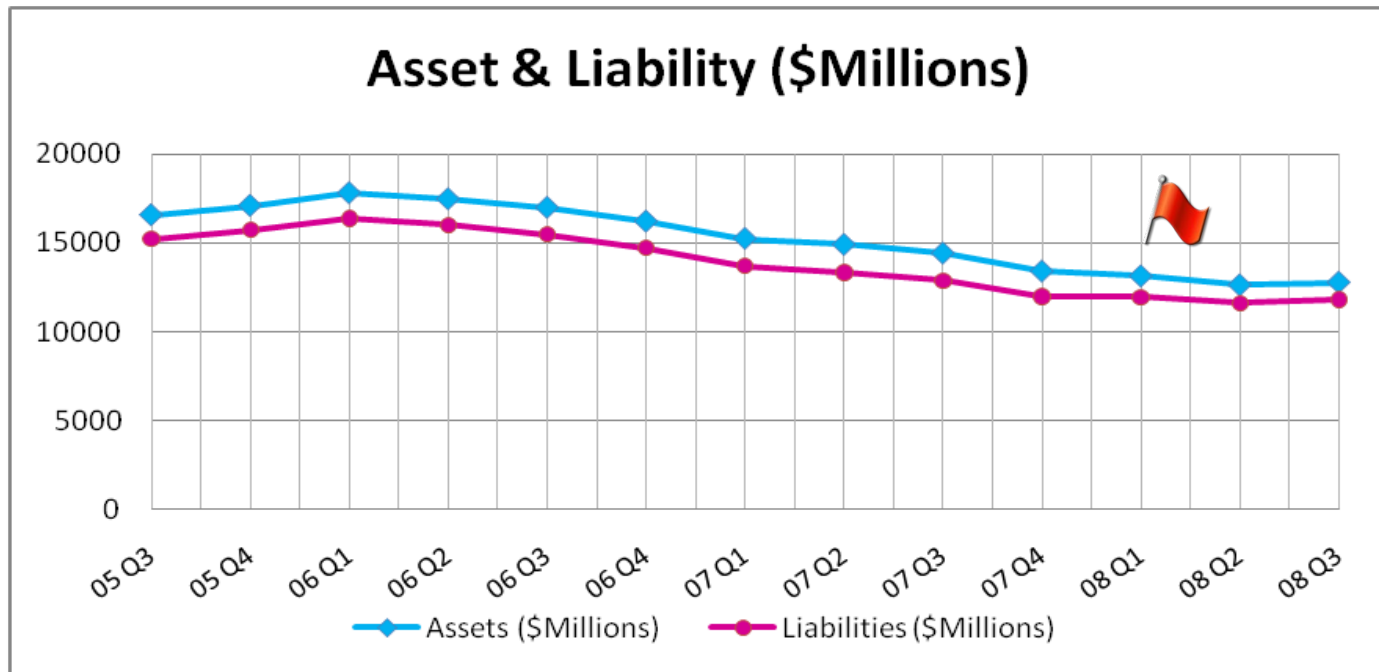
- Downey Saving and Loan Association's A/L ratio was decreasing since 08 Q1.
- The bank's A/L ratio was below average in all 6 quarters.

*Median of banks of the same asset concentration hierarchy



Indicates sign of bank in financial distress

Asset & Liability History

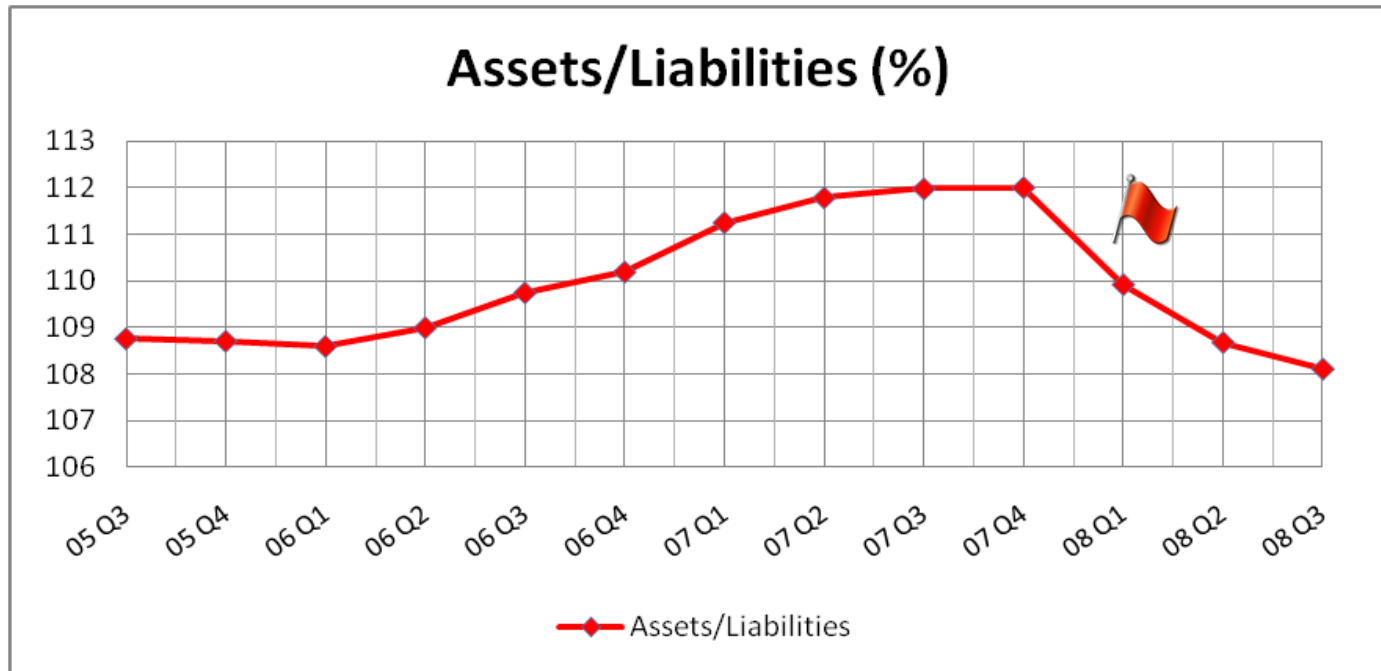


- The difference between asset and liability was getting closer in 08 Q1.



Indicates sign of bank in financial distress

Asset/Liability History

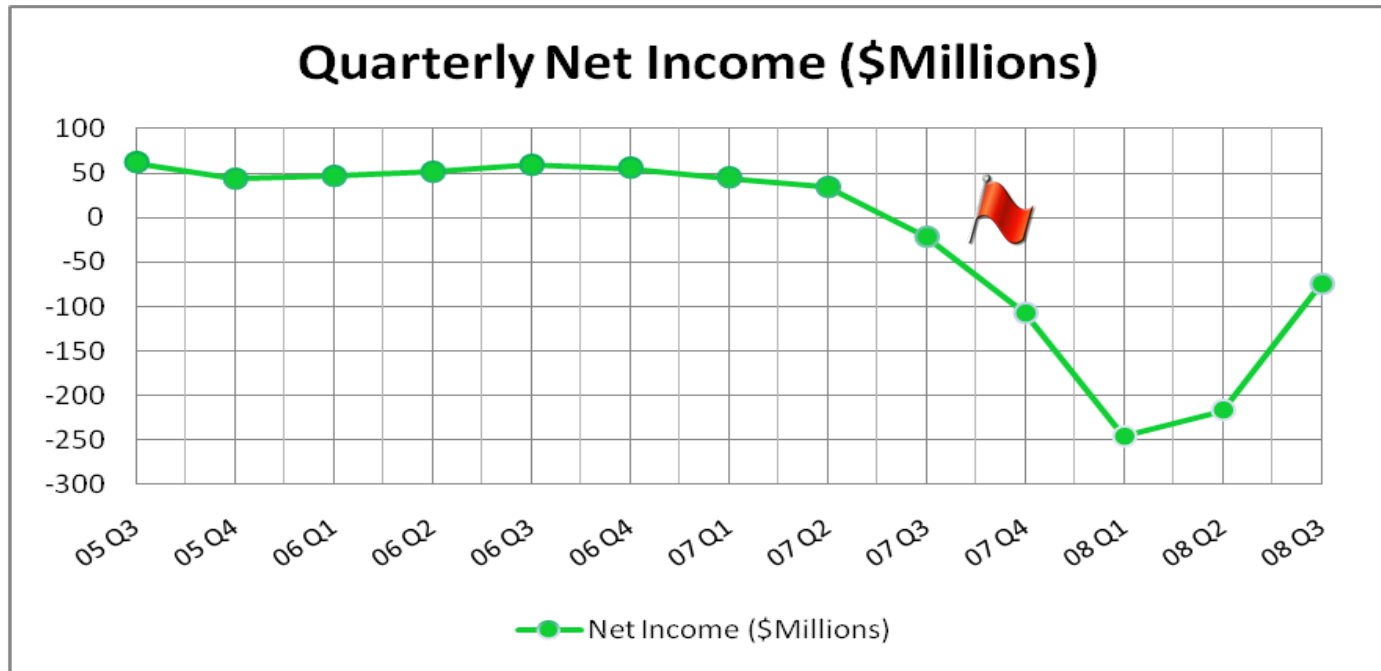


- The A/L ratio was decreasing since 07 Q4.



Indicates sign of bank in financial distress

Net Income History

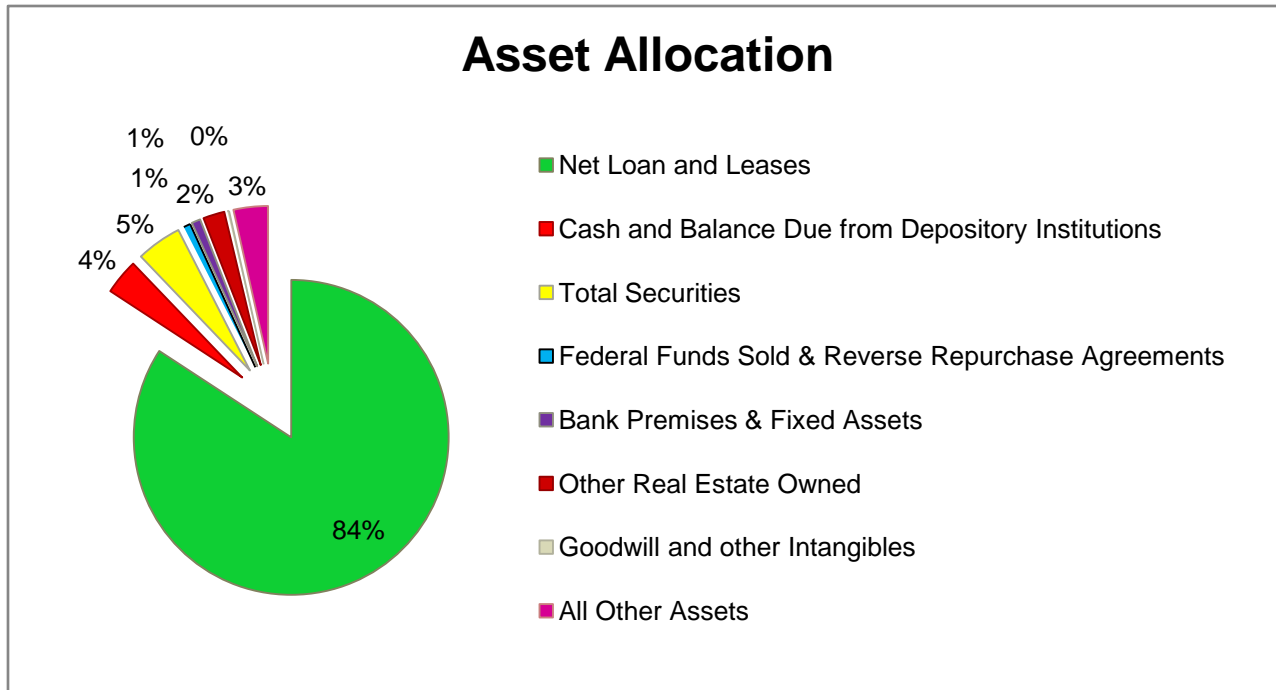


- The bank recorded big losses in 08 Q1 and Q2.
- The bank started reporting losses since 07 Q3.



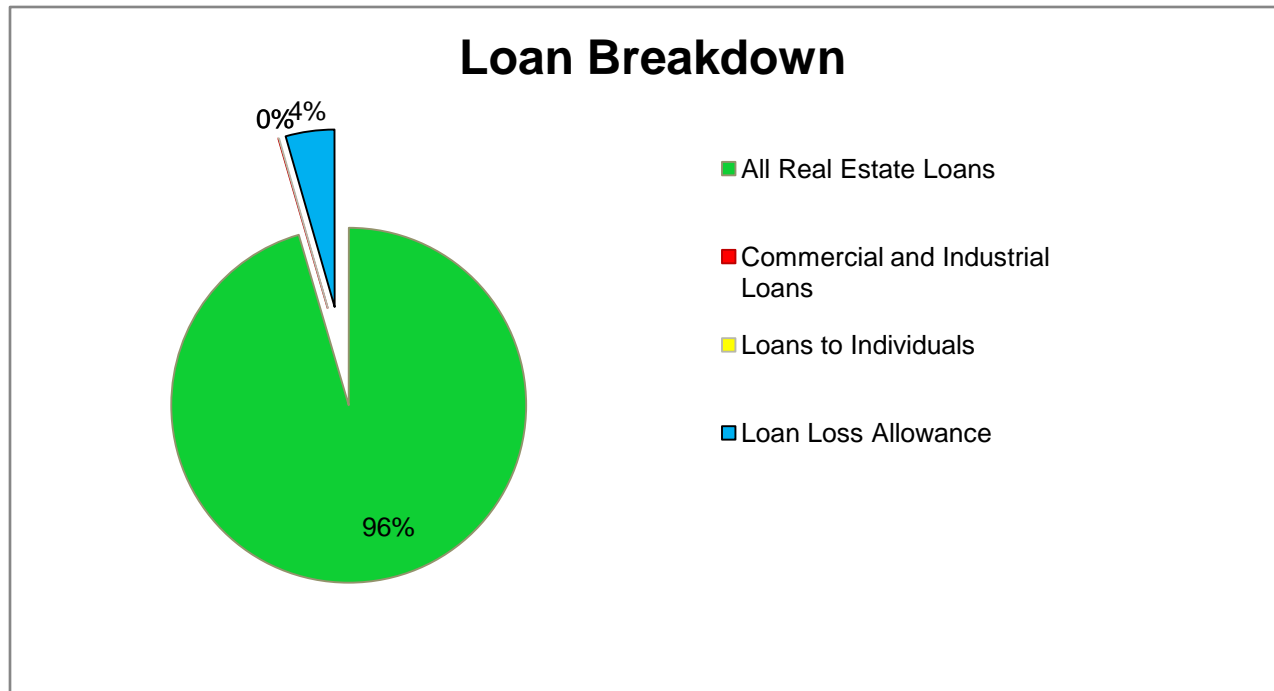
Indicates sign of bank in financial distress

Asset Allocation



- The average percentage of Net Loans for banks of the same Asset Concentration Hierarchy in third quarter of 2008 was 63.78%.
- The average Net Loan percentage of all banks in the third quarter of 2008 was 66.63%.

Loan Breakdown



- The average percentage of Real Estate Loans for banks of the same Asset Concentration Hierarchy in the third quarter of 2008 was 90.73%.
- The average percentage for all banks in the third quarter of 2008 was 70.99%.

Events Timeline

Oct. 10, 07 - Downey posts loss about \$23 million, or 84 cents a share.

Oct. 10, 07 - The stock fell \$6.25 or 11%.

Mar. 4, 08 - SEC voted to disclose information for the secondary market ETF investors in Form N-1A.

Mar. 7, 08 - The Fed will initiate a series of term repurchase transactions that are expected to cumulate to \$100 billion.

Mar. 19, 08 - Fannie Mae and Freddie Mac is expected to provide support to the U.S. mortgage market, up to \$200 billion immediate liquidity.

May 29, 08 - U.S.-Canada mutual recognition arrangement: U.S. Securities markets and certain U.S. financial service firms could gain greater freedom to operate in Canada under SEC.

June 10, 08 - FDIC releases a supervisory letter to all banks on interest reserves that examines the risks that this underwriting practice presents.

June 11, 08 - SEC voted on a comprehensive series of credit rating agency reforms to bring increased transparency to credit rating process.

June 17, 08 - New HOPE NOW guidelines to deal with issues surrounding second mortgages and short sales.

June 26, 08 - FDIC adopts Basel II-Based Standardized Approach as an alternative risk-based capital framework available to all banks except the largest and most complex banks

June 26, 08 - FRS, FDIC, and OCC issued the host state loan-to-deposit ratios, which help indicate branches outside of the home state that were established or acquired for the purpose of deposit production.

Events Timeline

- Jul. 13, 08** - Paulson Announces a three-part plan for GSEs: a temporary increase in the line of credit, a temporary authority for Treasury to purchase equity, and an advisory role is given to the Fed.
- Aug. 20, 08** - FDIC's implementation in Loan Modification Program will help to modify troubled IndyMac mortgages loans.
- Sept. 5, 08** - Downey Savings and Loan Association reaches agreement with the OTS on Regulatory Consent Orders.
- Sept. 5, 08** - Sale of certain non-core real estate assets to a third party for \$110 million.
- Sept. 17, 08** - SEC clarified that bank support of money market mutual funds generally are not required to present the fund on-balance sheet, but disclosure of the nature of the support provided is expected.
- Sept. 18, 08** - SEC requires that certain institutional money managers report their new short sales of certain publicly traded securities.
- Sept. 19, 08** - SEC prohibited short selling in 779 financial institutions.
- Sept. 20, 08** - Treasury Secretary Hank Paulson releases \$700 billion proposal to purchase troubled mortgage-related assets.
- Oct. 7, 08** - Emergency Economic Stabilization Act of 2008 Temporarily Increases Basic FDIC Insurance Coverage from \$100,000 to \$250,000 per Depositor.
- Oct. 14, 08** - FDIC creates new program to guarantee bank debts and fully insure non-interest bearing deposit transaction accounts.
- Oct. 14, 08** - The Treasury Department will invest up to \$250 billion in the nation's banks via the Capital Purchase Program.

Events Timeline

- Oct. 16, 08** - Downey Savings and Loan Association will cut about 200 jobs by closing its Wholesale Loan Department and the loan processing centers supporting that Department.
- Nov. 20, 08** - FDIC announces the availability of IndyMac Loan Modification Model.
- Nov. 21, 08** - U.S. Bank acquires all the deposits of Downey Savings and Loan Association.
- Nov. 25, 08** - Created the Term Asset-Backed Securities Loan Facility to support the issuance of asset-backed securities collateralized by loans.
- Dec. 3, 08** - SEC approved measures to strengthen oversight of credit rating agencies.
- Dec. 16, 08** - Troubled banks have to provide certain position level and counterparty level data and QFC counterparty and portfolio identifiers to FDIC in a timely manner.
- Dec. 23, 08** - Treasury provides TARP funds to focal Banks by purchasing \$2.8 billion investment from 49 banks.
- Dec. 30, 08** - The Fed announced that it will purchase mortgage-backed securities.
- Jan. 15, 09** - The Senate voted to allow access to the remaining bailout funds of \$350 billion.
- Jan. 27, 09** - As part of the Capital Purchase Program, Treasury announced investments of \$386 million in 23 healthy banks.
- Feb. 10, 09** - Geithner rolls out the Financial Stability Plan, promises to perform “stress tests” on big banks, and commit \$100 billion to boost the TALF.
- Feb. 10, 09** - A Capital Assistance Program to help ensure banks hold sufficient capital, produce a more consistent and forward-looking assessment of risks on banks' balance and their potential capital needs.

Events Timeline

- Feb. 10, 09** - A Public-Private Investment Fund will combine public and private capital with government financing to help free up capital to support new lending.
- Feb. 10, 09** - Treasury and Fed expanded the Term Asset-Backed Securities Lending facility up to \$1 trillion.
- Feb. 18, 09** - President Obama signs the American Recovery and Reinvestment Act of 2009, which limits bonuses of the highest earning executives.
- Mar. 4, 09** - Treasury announced loan modification guidelines under the Administration's Homeowner Affordability and Stability Plan.
- Mar. 23, 09** - Using TARP capital and capital from private investors, the Public-Private Investment Program will generate \$500 billion in purchasing power to buy legacy assets.
- May 29, 09** - FDIC tightens the deposit interest rates paid by banks that are less than well capitalized. Generally, such banks will be permitted to offer to "national rate" plus 75 basis points.
- June 9, 09** - 10 Of the largest U.S financial institutions are expected to make CPP repayments to Treasury.
- Jul. 2, 09** - FDIC proposed guidelines require private equity firms to hold bank purchases for 3yrs and maintain capital levels.

Report Summary – *Surprise?*

Based on the methods with which we analyzed, Downey Savings and Loan Association, its failure was **not a surprise**.

Although Downey Savings and Loan Association's normalized income and delinquent asset analysis was relatively typical of banks with the same asset concentration hierarchy, there are other indications that Downey Savings and Loan Association should fail:

- 1) **Since 2007 Q2, Downey Savings and Loan Association's real estate loan asset ratio has always been poor (>80%).**
- 2) **Downey Savings and Loan Association's asset: liability ratio rapidly decreased since 2008 Q1.**
- 3) **Its Bankability Composite Score was 31.60 before its failure, which was considered to be poor.**

The combination of these three measures being poor shows that the bank had a great chance of failing anytime.

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