Hello CFG clients . . . Brian here. In my first email to you folks on 06/08 I outlined information from the FDIC's Quarterly Banking Profile. In that email, I compiled a chart of relevant information from these quarterly reports going back to 03/30/01.

Last week the 06/30/09 report was released . . . and in my 10-years of reviewing these reports, this latest report is the most dire report I've read! Here is a portion of that chart with the latest data added:

REPORTING PERIOD	# OF FDIC INSURED BANKS REPORTING	# OF PROBLEM BANKS	INCREASE (DECREASE)	% OF PROBLEM BANKS	BANK FAILURES	
9/30/2006	8,743	**47**	(3)	0.54	0	
12/31/2006	8,681	**50**	3	0.58	0	
3/31/2007	8,650	**53**	3	0.61	1	
6/30/2007	8,615	**61**	8	0.71	0	
9/30/2007	8,560	**65**	4	0.76	1	(11)
12/31/2007	8,533	**76**	11	0.89	1	(12)
3/31/2008	8,494	**90**	14	1.06	2	(13)
6/30/2008	8,451	**117**	27	1.38	2	(14)
9/30/2008	8,384	**171**	54	2.04	9	(15)
12/31/2008	8,305	**252**	81	3.03	12	(16)
3/31/2009	8,246	**305**	53	3.70	21	(17)
6/30/2009	8,195	**416**	111	5.08	24	(18)

(11) Credit quality problems drag down earnings; real estate mortgage delinquencies skyrocket
(12) Non-current rate on mortgages reaches new high; net charge-offs reach 5-yr high
(13) Industry earnings decline 46% from a year earlier; troubled loans accumulate in RE portfolios
(14) Industry income falls to $5 billion; Quarterly loss provisions surpass $50 billion; asset quality indicators continue to deteriorate
(15) Highest quarterly failure since 1993 when 16 failed; asset quality problems continue to depress earnings
(16) Industry posts $32 billion loss (first quarterly loss since 1990); loan loss provisions/goodwill write downs/trading losses outstrip revenues; asset quality indicators show further deterioration
(17) Charge-offs of $37.8 billion only slightly less than 4th qtr charge-offs of $38.5 billion; charge-offs did not stem non-current loans which saw the largest quarterly increase ($59 billion) & at highest rate since 1991; largest number of failures since 1992;
(18) Charge-offs of $48.9 billion represent a record high; non-current loans increased $41.4 billion; average noncurrent rate on all loans and leases rose from 3.76% to 4.35%

Notice the 24 Bank Failures figure in the last column on the right; add that to the 21 in the first quarter and you have 45 Bank Failures in the first half of the year. Over the weekend, 3 more failures were announced bringing the total year-to-date figure to 84. Subtracting the 45 from the first and second quarter means that 39 have failed thus far in the third quarter . . . and we're a month away from the end of the 3rd quarter! Notice the trend . . . it's ACCELERATING!

The report has confirmed what I've outlined in some of my prior emails; (1) the state of the banking industry remains in serious trouble, (2) the bank failure rate is accelerating and (3) in order to survive, the industry will continue to reign in consumer and commercial lending which will dampen any efforts to grow the economy. Coupled with the fact that unemployment continues to rise and housing has yet to find a bottom, and you may wonder "Why does it seem the market continues to rise every day"?

Let's dissect this statement a bit; while it's true the market has risen substantially since its March 9 low, it has risen only 4.5% since the beginning of the year when the Dow was at 9,035. Furthermore, it is down 18.16% year over year when you consider the Dow closing value on 08/31/08 was at 11,543.

I'd like to share a story with you; a lifeguard was overlooking his area of the beach when all of the sudden he saw a shark approaching a swimmer. He raced down his ladder, grabbed his life ring and dove through the crashing waves to rescue the swimmer. Without hesitation, he grabbed the swimmer and began pulling him back to the safety of the shore. When they arrived safely on the shore, the lifeguard told the swimmer about the approaching shark and, sure enough when they looked back out in the water they saw the dorsal fin of the shark still lingering about. The swimmer thanked the lifeguard for the excellent job he did in foreseeing the danger and getting him back to shore safely. Five minutes later, the swimmer began walking away toward another section of beach patrolled by another lifeguard. The first lifeguard yelled "hey, where are you going?" The swimmer said "I'm going down to that section of the beach where the other lifeguard is stationed". The lifeguard said "but why, I just saved your life from imminent danger" to which the swimmer said "that's true, but what have you done for me lately?". The lifeguard watched as the swimmer walked on down the beach, worried because the last time a swimmer needed the help of the lifeguard stationed there, a sign was hung reading "out to lunch".

I told Val that I would never comment on the stock market since that's not my area of expertise . . . so now I've learned "never say never". But the point I'd like to make is this; many of you have been pulled from the danger in the waters. And this was because Val was paying attention to the waters . . . she was not "out to lunch". Yes, the market has increased 4.5% this year, and it may feel like the shark has moved away. However let me also point to the picture that the Quarterly Banking Profile report and many other reports and articles are painting; the shark is still definitely in the water . . . and he moves with lightening speed! While it's hot outside (i.e. the market) and we'd sure like to get into the water, I believe if any of us were standing on the shore looking out at that fin, we'd all think twice about going swimming just yet. Val has allowed us to get our toes wet . . . some of us less conservative swimmers have even been allowed to wade out to our knees . . . but believe me she is keeping her eye focused on that fin while scouring the horizon for other dangers that many of us don't yet see. Believe me, I'm grateful she's in that chair . . .

Below is the summary of the 06/30/09 Quarterly Banking Profile report. If you don't have time to read the whole thing, make sure you read the highlighted areas. Already, we can expect the 09/30/09 report (which will be released around Thanksgiving) will paint an even worse picture than this report.

Quarterly Banking Profile

Federal Deposit Insurance Corporation All FDIC-Insured Institutions

INSURED INSTITUTION PERFORMANCE

• Higher Loss Provisions Lead to a $3.7 Billion Net Loss

• More Than One in Four Institutions Are Unprofitable

• Charge-Offs and Noncurrent Loans Continue to Rise

• Net Interest Margins Show Modest Improvement

• Industry Assets Decline by $238 Billion

The Industry Posts a Net Loss for the Quarter

Burdened by costs associated with rising levels of troubled loans and falling asset values, FDIC-insured commercial banks and savings institutions reported an aggregate net loss of $3.7 billion in the second quarter of 2009. Increased expenses for bad loans were chiefly responsible for the industry's loss. Insured institutions added $66.9 billion in loan-loss provisions to their reserves during the quarter, an increase of $16.5 billion (32.8 percent) compared to the second quarter of 2008. Quarterly earnings were also adversely affected by writedowns of asset-backed commercial paper, and by higher assessments for deposit insurance. Almost two out of every three institutions (64.4 percent) reported lower quarterly earnings than a year ago, and more than one in four (28.3 percent) reported a net loss for the quarter. A year ago, the industry reported a quarterly profit of $4.7 billion, and fewer than one in five institutions (18 percent) were unprofitable. The average return on assets (ROA) was -0.11 percent, compared to 0.14 percent in the second quarter of 2008.

Noninterest Income Grows 10.6 Percent Year-Over-Year

In addition to the $16.5-billion increase in loss provisions, the industry reported a $3.3 billion increase in extraordinary losses and a $1.7 billion (1.7 percent) year-over-year increase in noninterest expenses. The extraordinary losses stemmed from asset-backed commercial paper writedowns, while the increased noninterest expenses primarily reflected higher deposit insurance assessments. These negative factors were partially offset by higher noninterest income (up $6.5 billion, or 10.6 percent), increased net interest income (up $3.4 billion, or 3.5 percent), and a $1.5-billion reduction in realized losses on securities and other assets. Gains on asset sales (up $4.5 billion), increased trading revenue (up $4.5 billion), and higher servicing fees (up $3.6 billion) were the largest contributors to the year-over-year improvement in noninterest income.

Margins Improve at a Majority of Institutions

Average net interest margins (NIMs) improved slightly from first quarter levels, as average funding costs fell more rapidly than average asset yields. The average margin increased to 3.48 percent from 3.39 percent in the first quarter and 3.37 percent in the second quarter of 2008. The consecutive-quarter improvement was relatively broad-based: more than half (56.5 percent) of all institutions reported higher NIMs than in the first quarter. However, the year-over-year improvement was concentrated among larger institutions. Only 45.3 percent of insured institutions reported year-over-year NIM improvement. Despite the widening in margins, net interest income growth has been limited by recent shrinkage in earning asset portfolios. Interest-earning assets declined by $149.6 billion during the second quarter, following a $163.7 billion decline in the first quarter. In the 12 months ended June 30, the industry's earning assets increased by only $18.3 billion (0.2 percent).

Net Charge-Off Rate Sets a Quarterly Record

Net charge-offs continued to rise, propelling the quarterly net charge-off rate to a record high. Insured institutions charged-off $48.9 billion in the second quarter, compared to $26.4 billion a year earlier. The annualized net charge-off rate in the second quarter was 2.55 percent, eclipsing the previous quarterly record of 1.95 percent reached in the fourth quarter of 2008. **The $22.5 billion (85.3**

percent) year-over-year increase in net charge-offs was led by loans to commercial and industrial (C&I) borrowers, which increased by $5.3 billion (165.0 percent). Net charge-offs of credit card loans were $4.6 billion (84.5 percent) higher than a year earlier, and the annualized net charge-off rate on credit card loans reached a record 9.95 percent in the second quarter. Net charge-offs of real estate construction and development loans were up by $4.2 billion (117.0 percent), and charge-offs of loans secured by 1-4 family residential properties were $4.0 billion (41.1 percent) higher than a year ago.

Noncurrent Loan Rate Rises to Record Level

The amount of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) increased for a 13th consecutive quarter, and the percentage of total loans and leases that were noncurrent reached a new record. Noncurrent loans and leases increased by $41.4 billion (14.3 percent) during the second quarter, led by 1-4 family residential mortgages (up $15.4 billion, or 12.7 percent), real estate construction and development loans (up $10.2 billion, or 16.6 percent), and loans secured by nonfarm nonresidential real estate properties (up $7.1 billion, or 29.2 percent). Noncurrent home equity loans and junior lien mortgages fell for the first time in three years, declining by $1.7 billion and $1.5 billion, respectively. Noncurrent levels rose in all other major loan categories. Although the increase in total noncurrent loans was almost one-third smaller than the $59.7 billion increase in the first quarter, the average noncurrent rate on all loans and leases rose from 3.76 percent to 4.35 percent. This is the highest level for the noncurrent rate in the 26 years that insured institutions have reported noncurrent loan data. On a more positive note, loans that were 30-89 days past due declined by $16.7 billion (10.6 percent). This is the largest quarterly decline in dollar terms in the 26 years that these data have been reported, and the largest percentage decline since the first quarter of 2004, when 30-89 day past due loans were one-third the current level. The decline in past due loans occurred across all major loan categories, but real estate loans accounted for 83.5 percent ($13.9 billion) of the total improvement. Restructured loans and leases that were in compliance with their modified terms increased by $13.7 billion (41.6 percent) at commercial and savings banks that file Call reports, as restructured 1-4 family residential real estate loans rose by $10.2 billion (55.4 percent).

Institutions Continue to Add to Reserves

The industry's reserves for loan losses increased by $16.8 billion (8.6 percent) during the second quarter, as loss provisions of $66.9 billion exceeded net charge-offs of $48.9 billion. The ratio of reserves to total loans and leases set another new record, rising from 2.51 percent to 2.77 percent. However, the pace of reserve building fell short of the rise in noncurrent loans, and the industry's ratio of reserves to noncurrent loans fell from 66.8 percent to 63.5 percent, the lowest level since the third quarter of 1991.

Overall Capital Levels Register Improvement

Equity capital increased by $32.5 billion (2.4 percent), raising the industry's equity-to-assets ratio from 10.13 percent to 10.56 percent, the highest level since March 31, 2007. Average regulatory capital ratios increased as well. The leverage capital ratio increased from 8.02 percent to 8.25 percent, while the total risk-based capital ratio rose from 13.42 percent to 13.76 percent. However, fewer than half of all institutions reported increases in their regulatory capital ratios. Only 43.2 percent reported increased leverage capital ratios, and 47.0 percent had increased total risk-based capital ratios. Insured institutions paid $6.2 billion in dividends in the quarter, about two-thirds less than the $17.7 billion in dividends paid in the second quarter of 2008.

Industry Assets Decline for a Second Consecutive Quarter

Total assets declined by $238.1 billion (1.8 percent), following a $303.2-billion decline in the first quarter. Loans and leases accounted for more than half of the decline ($125.5 billion, or 52.7 percent of the total), while the industry's balances at Federal Reserve banks fell by $99.4 billion (a 20.4 percent decline). As was the case in the first quarter, much of the decline in industry assets was concentrated at a few large institutions. More than 57 percent of institutions increased their assets during the second quarter, and a similar majority increased their loan balances. Among the loan categories registering the largest declines during the quarter were C&I loans (down $67.7 billion, or 4.7 percent), 1-4 family residential mortgage loans (down $33.2 billion, or 1.6 percent), and real estate construction and development loans (down $31.0 billion, or 5.5 percent). Assets in trading accounts declined by $65.5 billion (7.9 percent). The industry's total securities holdings increased by $130.6 billion (5.9 percent).

Small Business Loan Balances Declined Over the Past 12 Months

Annual data on loans to small businesses and farms indicate that the industry's balances of these loans experienced shrinkage during the twelve months ended June 30 while loans to larger borrowers had a slight increase. Small C&I, agricultural, and nonresidential real estate loans1 declined by $14.8 billion (1.9 percent) between June 30, 2008 and June 30, 2009, compared to an increase of $2.2 billion (0.1 percent) in larger business and farm loans.

Institutions Reduce Their Reliance on Nondeposit Funding Sources

In contrast to the decline in industry assets, total deposits of insured institutions increased by $66.7 billion (0.7 percent). Deposits in foreign offices accounted for more than three quarters ($51.0 billion, or 76.5 percent) of the increase in deposits. Domestic office deposits increased by only $15.7 billion (0.2 percent), as deposits in large denomination (> $250,000) noninterest-bearing transaction accounts increased by $42.0 billion (4.9 percent), and deposits in interest-bearing accounts fell by $16.9 billion. Nondeposit liabilities declined by $337.3 billion (10.6 percent), as trading liabilities fell by $85.0 billion (23.7 percent), and FHLB advances dropped by $62.2 billion (8.9 percent). At the end of June, deposits funded 67.8 percent of the industry's assets, the highest proportion since March 1998.

"Problem List" Expands to 15-Year High

The number of insured commercial banks and savings institutions reporting financial results fell to 8,195 in the quarter, down from 8,247 reporters in the first quarter. Thirty-nine institutions were merged into other institutions during the quarter, twenty-four institutions failed, and there were twelve new charters added. During the quarter, the number of institutions on the FDIC's "Problem List" increased from 305 to 416, and the combined assets of "problem" institutions rose from $220.0 billion to $299.8 billion. This is the largest number of "problem" institutions since June 30, 1994, and the largest amount of assets on the list since December 31, 1993.

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