

U.S.A.
Special Report

Revisiting U.S. Banks' Home Equity Portfolios: Have Losses Abated or Is More Pain in Store?

Ratings

Associated Banc-Corp	BB+
Bank of America Corporation	A+
Bank of Hawaii Corp	A-
BankAtlantic Bancorp	B-
Citizens Republic Bancorp	B-
Fifth Third Bancorp	A-
First Horizon National Corporation	BBB+
FirstMerit Corp	A-
Fulton Financial Corporation	A-
HuntingtonBancshares	BBB
JPMorgan Chase & Co.	AA
KeyCorp	A-
M&T Bank Corporation	A-
Peoples United Bank	A-
PNC Financial Services Group	A+
Regions Financial Corporation	BBB+
SunTrust Banks, Inc.	BBB+
TCF Financial	A-
Webster Financial Corp	BBB-
Wells Fargo & Co.	AA-

Rating Outlook

Associated Banc-Corp	Negative
Bank of America Corporation	Stable
Bank of Hawaii Corp	Stable
BankAtlantic Bancorp	Negative
Citizens Republic Bancorp	Negative
Fifth Third Bancorp	Stable
First Horizon National Corporation	Negative
FirstMerit Corp	Stable
Fulton Financial Corporation	Stable
HuntingtonBancshares	Stable
JPMorgan Chase & Co.	Stable
KeyCorp	Negative
M&T Bank Corporation	Negative
Peoples United Bank	Stable
PNC Financial Services Group	Stable
Regions Financial Corporation	Negative
SunTrust Banks, Inc.	Stable
TCF Financial	Negative
Webster Financial Corp	Negative
Wells Fargo & Co.	Stable

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Overview

Just over two years ago, Fitch Ratings highlighted increasing losses and asset quality pressures in a special report titled "U.S. Home Equity Woes: Banks Grapple with Higher Losses," dated March 14, 2008. Additionally, Fitch took negative rating actions on eight large U.S. banking companies based in part on their exposure to home equity and other consumer loans as well as Fitch's belief that losses would be much higher than previously anticipated. Furthermore, since then, Fitch, in its rating process, has applied various stresses to banks' loan portfolios, including home equity. Additionally, banks have worked to reduce open credit lines, curtailed originations from the most problematic channels, and generally shrunk their exposure to this asset class. Additionally, three of the top five institutions representing some of the most heavily concentrated lenders in this space (Countrywide, National City, and Washington Mutual) have been absorbed by other institutions. However, the tepid housing market recovery and elevated unemployment levels are expected to keep the mortgage sector pressured over the next year.

Further rating action for the banks likely will not be driven by home equity exposure alone, although it continues to be a concern for several issuers. Additional loan losses in this segment, as banks deal with losses in this as well as other lending segments, will keep provisioning elevated and be a drag on historical earning levels. Collectively, at YE09, FDIC-insured institutions held \$842.3bn of junior liens and home equity loans, averaging almost 12% of total gross loans. Without adjusting for the effects of purchase accounting, Fitch believes losses in these bank-held portfolios could range between \$30bn to \$65bn for 2010. This report highlights the 20 publicly traded banking institutions rated by Fitch that exceed the aforementioned average exposure to home equity and junior liens. While we are highlighting only 20 institutions, these account for the majority (over 60%) of the outstanding junior lien and home equity loans outstanding at YE09. In aggregate, Fitch estimates losses for this group of companies could range between \$20bn and \$40bn, or 4%–8% with the 8% considered a more severe stressed loss level. Losses for this group averaged 2.61% for 4Q09. However, individual bank performance has varied greatly and will continue to do so. The loss scenarios used in this report were derived from a combination of an assessment of historical loss rates of home equity and closed-end second lien loans, as well as Fitch's view of default rates and loss severities on prime first lien mortgages. Fitch's more severe stressed loss scenarios anticipate these loans will exhibit loss severities more similar to unsecured credit.

In this report, Fitch will discuss:

- Bank home equity exposure as a percentage of loans and equity.
- Relative credit metrics of banks with the largest exposures.
- Potential impact of higher credit losses on bank profitability and capital.

Related Research

- *Global Economic Outlook, April 6, 2010*
- *U.S. Financial Institutions Financial Reform: Five Issues to Watch, March 26, 2010*
- *U.S. Banking Quarterly 1Q10 — Finding Stability, June 2, 2010*
- *Purchased Impaired Loans, April 22, 2010*
- *Troubled Debt Restructuring, April 22, 2010*
- *U.S. Structured Finance: 2010 Outlook, Dec. 8, 2009*

Background

During the housing boom, against a backdrop of robust housing appreciation and easily available credit, U.S. consumers were able for a number of years to readily tap home equity, and this product became a growing part of many banks' loan portfolios. Despite low interest rates, the reduced availability of mortgage-related product and declining home values has impacted consumers' ability to tap home equity. The weak housing market, high unemployment, and significant value declines, especially in some specific real estate markets, have reduced equity levels in homes, in many cases, below zero. Continued home price depreciation, high consumer debt levels, and elevated unemployment have all combined to yield accelerating losses in many bank home equity portfolios and credit losses are expected to remain elevated in 2010.

The banks highlighted in this report have seen increasing levels of net charge-offs in these portfolios. That said, the performance by institution varies greatly. For instance, annualized net charge-offs ranged from 0.24%–5.68% in 4Q09. Performance differences are attributed primarily to differences in underwriting. For instance, loans sourced through brokers or third parties, a channel that most banks have previously exited, have performed considerably worse than similar loans originated through the bank's branch network. Geography and vintage are also key credit factors, as markets with greater home price depreciation and/or higher current loan-to-value (LTV) ratios have exhibited higher loss rates especially for loans made at the height of the market. Additionally, those institutions with a higher percentage of home equity loans in a first lien position generally have better credit metrics given their priority claim on the liquidation value of the property and the attractiveness of this product for a less levered consumer.

Rated Bank Exposures

Regulatory Data: Home Equity Exposure Defined as Second Lien Closed-End Loans and Revolving 1–4 Family Loans at YE09

(%)

	Institution	% of Gross Loans	% of Assets	% of Total RBC	% Growth 2008–2009	% Growth 2004–2007
1	First Horizon National Corporation	31.30	22.31	123.97	(10.12)	(5.60)
2	Webster Financial Corp	24.35	15.16	144.16	(6.19)	49.46
3	PNC Financial Services Group	20.36	12.08	93.67	(5.11)	23.14
4	JPMorgan Chase & Co.	18.12	5.80	66.59	(10.29)	64.23
5	TCF Financial	17.92	14.58	172.59	(3.63)	38.64
6	SunTrust Banks, Inc.	17.90	12.16	92.53	(7.37)	55.28
7	BankAtlantic	17.31	14.27	158.97	(7.76)	82.39
8	HuntingtonBancshares	16.77	12.11	100.19	0.39	54.31
9	Regions Financial Corporation	15.40	9.98	87.16	(2.45)	146.07
10	Bank of Hawaii Corp	15.38	7.16	98.35	(10.63)	23.04
11	KeyCorp	15.36	10.39	66.66	0.25	(15.30)
12	Bank of America Corporation	15.29	6.60	64.94	(0.76)	103.01
13	Wells Fargo & Co.	15.07	10.03	92.82	(3.95)	24.80
14	Fifth Third Bancorp	14.74	10.25	65.88	(3.92)	12.09
15	FirstMerit Corp	14.64	9.64	94.79	1.51	19.90
16	Peoples United Bank	13.92	9.59	94.08	1.71	15.51
17	Associated Banc-Corp	12.83	7.98	83.68	(11.90)	21.75
18	Fulton Financial Corporation	12.60	9.13	80.00	2.89	58.83
19	M&T Bank Corporation	12.20	9.20	80.31	22.03	3.95
20	Citizens Republic Bancorp	11.64	7.78	78.37	(11.62)	47.42

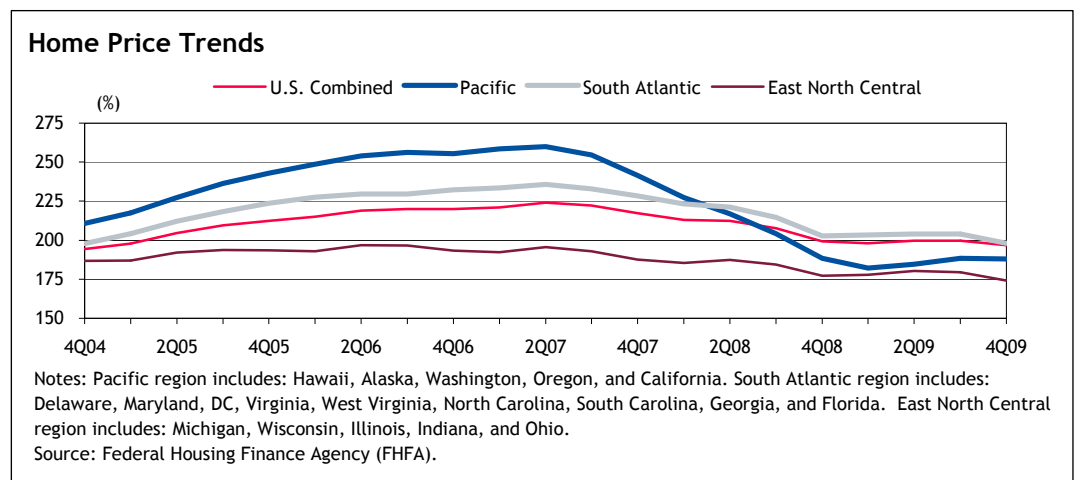
Source: Highline Financial.

Fitch conducted an analysis of its rated, publicly traded U.S. banks to assess their respective exposures to home equity loans as a percentage of gross loans, total assets,

- There is a great variance of performance by issuers.
- Generally speaking, the national lenders have had weaker credit performance than some regional banks.

and equity. For uniformity, issuer data was based on regulatory filings, and home equity loans were defined as the combination of closed-end loans secured by 1–4 family residential property secured by junior liens and revolving open-end loans secured by 1–4 family residential properties and extended under lines of credit. Data for Peoples' United was assembled from bank-level call report filings.

Home equity loans account for more than the national average of 11.5% of gross loans at 20 rated banks. First Horizon Financial, Webster Financial, and PNC Financial have the largest exposures, with home equity accounting for over 20% of gross loans. However, PNC is not among the five institutions in which home equity exposure exceeds 100% of total risk-based capital. While First Horizon and Webster have exposures that exceed 100% of total risk-based capital at 124% and 144%, respectively, TCF Financial has the highest exposure in terms of total capital at 172%. TCF Financial is followed by BankAtlantic at 159%. Huntington Bancshares rounds out the top five with a home equity exposure about equal to 100%. Growth rates in home equity have declined precipitously since 2007–2008. Most institutions reported negative or low single digit growth rates in home equity during 2009. This is due to companies scaling back on originations, closing open lines, and tightening up underwriting standards. The only institution to report a double digit growth rate in 2009 was M&T Bank Corporation, and that was primarily related to its acquisition of Provident Bank shares in early 2009. The seemingly excessive growth rates demonstrated by Bank of America and Regions, during the three-year period ending 2007 (encompassing the boom years), are also largely attributable to their respective acquisitions of Countrywide and AmSouth. The median growth of the banks with the top 20 exposures was approximately 32% for the three-year period 2004–2007, while the median decline was 4% for the 2008–2009 timeframe.



Fitch Stress Scenario

The home equity loss assumptions used in this analysis were considered in conjunction with other real estate loan categories, particularly prime first lien mortgage loans. In its analysis, Fitch considered unemployment forecasts for 2010 and 2011, which it currently estimates at 9.8% and 9.4%, respectively; home price indices; and an assessment of combined loan-to-value (CLTV) of home equity loans and junior lien loans. Fitch believes that persistent high unemployment, or for that matter underemployment, combined with further home price declines will continue to pressure these portfolios. Unemployment is expected to remain structurally high for a number of years, considering that it took nearly four years to recoup the jobs lost in the 2001 recession, which was not as long or severe as this most recent recession and the job losses were

only a fraction of those lost in this past recession. Home prices will continue to be pressured by the still high inventory of distressed properties and despite signs of stabilization, Fitch expects home prices to decline another 10% over the next 12–18 months before prices stabilize.

While the bulk of the losses derived from the higher risk elements of home equity portfolios have already been recognized and the institutions have been working down their home equity portfolios, Fitch is concerned that the large core portions of these portfolios originated during the peak of the housing boom are increasingly at risk due to continued weakness in the housing market. High unemployment rates, the primary driver of delinquency rates, will continue to keep delinquencies elevated, and the continued decline in home values will contribute to higher loss rates. Additionally, the decline in home values is influencing a growing number of strategic defaults, as there is an increasing willingness of borrowers to walk away from their mortgage obligation given that they have negative equity in their house. Fitch's analysis does not attempt to incorporate the success of current loan modification programs, as the impact of these programs is still uncertain given that redefault rates on modified mortgages are high, but does attempt to recognize the potential impact of future government actions, which may accelerate losses.

The loss rate scenarios used in Fitch analysis are one-year and two-year cumulative stress losses. The one-year loss rates represent Fitch's view of peak stress loss rates for these portfolios. Although Fitch believes that losses in these portfolios will remain comparatively high for the next several years, it is Fitch's view that the bulk of losses associated with these portfolios has been taken already and will likely reach their height over the next 12–24 months given the vintage of originations and the typical seasoning of home equity portfolios. As noted earlier, most of the home equity growth occurred in the 2004–2007 period. Furthermore, the majority of the weaker underwritten product was originated during this timeframe, and much of the losses associated with those products have already been realized. Additionally, the affect of government programs on default rates and or loss severity is expected to have a more near-term impact.

The 4.0% and 6.5% one-year loss scenarios reflect Fitch's base and adverse stress scenarios and are not a forecast. These stressed loss scenarios were derived from an assessment of historical loss rates of home equity and closed-end second lien loans over the past 20-year period, but are weighted toward losses in the past several years and consider the rate of change in the level of losses over this recent time period. Based on regulatory (Y9-C) data (excluding filing institutions with less than \$1bn in assets), charge-off rates for home equity and second lien mortgage peaked at 1.75% and 2.92%, respectively, for Fitch-rated institutions during 2009. Also considered was Fitch's forecast default rates and loss severities on prime first lien mortgage RMBS transactions rated by Fitch. Currently, Fitch anticipates that lifetime default rates on prime first mortgages for the weakest vintages (2005 – 2007) in these RMBS transactions could approach 20% with loss severities at or about 40%. It is important to note that these securitized loans are largely nonconforming. The 8% one-year stress scenario factors in the same economic variables as the aforementioned stresses, but also considers that given the continued decline in home values, these loans are becoming less secured and will increasingly exhibit loss severities more similar to unsecured credit. The more severe loss rate also attempts to quantify regulatory risk associated with the government programs geared to slow the pace of foreclosures.

The following stress analyses illustrates loss potential among the banks with the most significant home equity loan exposure and highlights potential impact to total capital under Fitch's stress scenarios. In these examples, assuming credit losses on home equity portfolios rise to 4.0%, 6.5%, or 8.0% of a bank's portfolio over a one-year period

or two-year cumulative loss rates of 7.5%, 11.5%, and 15.0%, respectively, banks' capital levels are not materially impaired by home equity losses. Additionally, over the past several years, banks have been boosting their reserves with regard to home equity and the overall allowance, which should provide them with additional cushion from the prospect of elevated home equity losses. However, if deterioration continues across the loan portfolio, particularly, as Fitch expects, in the commercial real estate segment, provisioning expense needs could increase substantially and thus generate material losses that could weaken capital levels.

Fitch One-Year Stress Analysis

(\$000, As of Dec. 31, 2009)

	Institution	2009		Potential Home Equity NCOs			Stress NCO % of Total Capital		
		Home Equity	NCOs	4.00%	6.50%	8.00%	4.00%	6.50%	8.00%
1	First Horizon National Corporation	5,815,497	224,977	232,620	378,007	465,240	4.96	8.06	9.92
2	Webster Financial Corp	2,690,698	74,637	107,628	174,895	215,256	5.77	9.37	11.53
3	PNC Financial Services Group	32,610,858	446,712	1,304,434	2,119,706	2,608,869	3.75	6.09	7.49
4	JPMorgan Chase & Co.	117,905,000	4,650,000	4,716,200	7,663,825	9,432,400	2.66	4.33	5.33
5	TCF Financial	2,614,571	56,087	104,583	169,947	209,166	6.90	11.22	13.81
6	SunTrust Banks, Inc.	21,185,954	755,959	847,438	1,377,087	1,694,876	3.70	6.01	7.40
7	BankAtlantic	679,255	40,552	27,170	44,152	54,340	6.43	10.44	12.85
8	HuntingtonBancshares	6,242,272	113,743	249,691	405,748	499,382	4.01	6.51	8.01
9	Regions Financial Corporation	14,209,019	395,787	568,361	923,586	1,136,722	3.49	5.67	6.97
10	Bank of Hawaii Corp	888,453	12,437	35,538	57,749	71,076	3.94	6.41	7.89
11	KeyCorp	9,704,308	156,957	388,172	630,780	776,345	2.67	4.33	5.33
12	Bank of America Corporation	146,927,123	7,589,693	5,877,085	9,550,263	11,754,170	2.60	4.22	5.20
13	Wells Fargo & Co.	124,751,000	4,859,000	4,990,040	8,108,815	9,980,080	3.71	6.03	7.43
14	Fifth Third Bancorp	11,618,506	317,971	464,740	755,203	929,480	2.64	4.28	5.27
15	FirstMerit Corp	1,015,882	6,696	40,635	66,032	81,271	3.79	6.16	7.58
16	Peoples United Bank	1,979,939	3,066	79,198	128,696	158,395	3.76	6.12	7.53
17	Associated Banc-Corp	1,824,936	48,145	72,997	118,621	145,995	3.35	5.44	6.69
18	Fulton Financial Corporation	1,519,011	11,277	60,760	98,736	121,521	3.20	5.20	6.40
19	M&T Bank Corporation	6,338,449	38,619	253,538	411,999	507,076	3.21	5.22	6.42
20	Citizens Republic Bancorp	929,598	18,484	37,184	60,424	74,368	3.13	5.09	6.27
	Totals	511,450,329	19,820799	20,458,012	33,244,271	40,916,028	—	—	—

Note: Home equity exposure defined as second lien closed-end loans and revolving 1-4 family loans.

Source: Highline Financial and company filings.

While portfolio deterioration is not expected to happen to the same degree across the bank universe, those with riskier portfolios, primarily the national lenders and those with a geographic concentration in weaker markets, could see net charge-offs above 4% in 2010. Fitch anticipates that those companies that have larger exposures to geographic areas, such as California, Florida, and parts of the Midwest, would experience higher provisioning rates than companies that operate in relatively more stable regions due to the prospect of further housing price declines and prolonged unemployment or underemployment.

It is important to note that the following model is a simplified look at potential losses based on the amount of home equity exposure alone and does not consider the quality of the underwriting, an obviously important factor, as the quality of underwriting has been a key determinate of losses to date, particularly as it pertains to origination channel and LTV, which as previously discussed has been a primary driver of losses in home equity portfolios. Also, a high prevalence of piggyback loans in a given portfolio would suggest higher potential losses. Since these loans are second mortgages originated simultaneously with first mortgages, largely for the purpose of allowing the borrower to borrow their down payment on the first mortgage, these loans have high LTVs at origination and were made largely to highly leveraged borrowers. Also, besides underwriting, there are several other factors that will influence the amount of

prospective losses in a given portfolio such as geography, as noted earlier, and the amount of home equity loans that are in a first lien position.

In Fitch's one-year and two-year stress loss scenarios, overall exposure of home equity credit losses to capital is moderate. The median affect to capital under the one-year peak loss scenarios were 3.71%, 6.02%, and 7.41, respectively, while the median for two-year cumulative losses were 6.95%, 10.66%, and 13.90%. Only three companies have estimated credit losses that exceed or approach 10% of total capital under the 8% one-year severe loss scenario and 20% of total capital under the two-year cumulative severe loss scenario, which are TCF Financial, BankAtlantic, and Webster. TCF Financial and BankAtlantic are the only two companies that have losses that exceed 10% of total capital under the 6.5% adverse loss scenario. TCF Financial, BankAtlantic, Webster, and First Horizon are the only companies that exceed or approach 15% of total capital under the two-year adverse loss scenario. Under Fitch's base one-year and two-year cumulative loss stress scenario of 4.0% and 7.5%, only TCF, BankAtlantic, and Webster have home equity losses that exceed 5% and 10% of total capital, respectively.

While BankAtlantic's home equity portfolio will likely remain under pressure due to the company's geographic concentration in the troubled Florida market, the portfolio composition of both TCF and Webster will likely mitigate the home equity losses projected by the Fitch stress scenarios. In the case of TCF, while the company does have some moderate exposure to problematic geographic markets, specifically, Michigan, the portfolio was largely branch originated with conservative CLTVs. The portfolio is also very granular, with an average loan amount under \$40,000. Webster benefits from its portfolio being concentrated in less volatile markets in the northeast, and the portfolio is also largely branch originated with an average CLTV of 72%. That said, less than 20% of Webster's home equity portfolio is in a first lien position and the company still has a small portfolio of third-party-originated home equity loans, which are generating outsized losses for the portfolio.

Fitch Two-Year Cumulative Stress

(\$000, As of Dec. 31, 2009)

	Institution	2009		Potential Home Equity NCOs			Stress NCO % of Total Capital		
		Home Equity	NCOs	7.50%	11.50%	15.00%	7.50%	11.50%	15.00%
1	First Horizon National Corporation	5,815,497	224,977	436,162	668,782	872,325	9.30	14.26	18.60
2	Webster Financial Corp	2,690,698	74,637	201,802	309,430	403,605	10.81	16.58	21.62
3	PNC Financial Services Group	32,610,858	446,712	2,445,814	3,750,249	4,891,629	7.03	10.77	14.05
4	JPMorgan Chase & Co.	117,905,000	4,650,000	8,842,875	13,559,075	17,685,750	4.99	7.66	9.99
5	TCF Financial	2,614,571	56,087	196,093	300,676	392,186	12.94	19.85	25.89
6	SunTrust Banks, Inc.	21,185,954	755,959	1,588,947	2,436,385	3,177,893	6.94	10.64	13.88
7	BankAtlantic	679,255	40,552	50,944	78,114	101,888	12.05	18.48	24.10
8	HuntingtonBancshares	6,242,272	113,743	468,170	717,861	936,341	7.51	11.52	15.03
9	Regions Financial Corporation	14,209,019	395,787	1,065,676	1,634,037	2,131,353	6.54	10.02	13.07
10	Bank of Hawaii Corp	888,453	12,437	66,634	102,172	133,268	7.40	11.34	14.79
11	KeyCorp	9,704,308	156,957	727,823	1,115,995	1,455,646	5.00	7.67	10.00
12	Bank of America Corporation	146,927,123	7,589,693	11,019,534	16,896,619	22,039,068	4.87	7.47	9.75
13	Wells Fargo & Co.	124,751,000	4,859,000	9,356,325	14,346,365	18,712,650	6.96	10.67	13.92
14	Fifth Third Bancorp	11,618,506	317,971	871,388	1,336,128	1,742,776	4.94	7.58	9.88
15	FirstMerit Corp	1,015,882	6,696	76,191	116,826	152,382	7.11	10.90	14.22
16	Peoples United Bank	1,979,939	3,066	148,495	227,693	296,991	7.06	10.82	14.11
17	Associated Banc-Corp	1,824,936	48,145	136,870	209,868	273,740	6.28	9.62	12.55
18	Fulton Financial Corporation	1,519,011	11,277	113,926	174,686	227,852	6.00	9.20	12.00
19	M&T Bank Corporation	6,338,449	38,619	475,384	728,922	950,767	6.02	9.24	12.05
20	Citizens Republic Bancorp	929,598	18,484	69,720	106,904	139,440	5.88	9.01	11.76
	Totals	511,450,329	19,820,799	38,358,775	58,816,788	76,717,549	6.95 ^a	10.66 ^a	13.90 ^a

^aMedian. Note: Home equity exposure defined as second lien closed-end loans and revolving 1-4 family loans.
Source: Highline Financial and company filings.

Credit Quality

The credit quality of bank home equity portfolios has deteriorated during 2009, from already historically weaker levels although still remaining manageable for most issuers. For the highlighted issuers, NCOs have increased on average 100 bps from 4Q08 to 4Q09 to 2.61%. Non-accrual loans have increased on average 23 bps to 1.11% and past due loans have declined 10 bps to an average of 1.32%.

Home equity loans and lines past due 30–89 days or more have declined for 12 of the 20 institutions highlighted in this report. The highest level of delinquent loans were at regionally concentrated institutions in depressed real estate markets, including Citizens Republic (Michigan) at 2.26% and BankAtlantic (Florida) at 2.14%. Both institutions have experienced increasing delinquent loans over the past year. The next highest grouping includes the national lenders JPMorgan Chase, Bank of America, and Wells Fargo at 2.03, 1.99, and 1.55%, respectively. These institutions have experienced a declining trend year over year.

Of the 20 institutions, 17 reported a year-over-year increase in the percentage of loans on non-accrual. The highest level of non-accruals loans were at Bank of America, Citizens Republic, Wells Fargo, and SunTrust. Of these institutions, SunTrust was the only one showing a year-over-year decline (91 bps).

Net charge-offs for these highlighted issuers increased an average of 100 bps year over year. Charge-offs averaged 2.61% for 4Q09 down slightly from a recent peak of 2.66% for 3Q09. The large national consumer lenders — JPMorgan, Bank of America, and Wells Fargo — reported the highest level of NCOs, with all three reporting 4Q09 NCOs exceeding 4.25% and all reporting a year-over-year increase exceeding the average. All of these institutions are dealing with the portfolios of acquired institutions with relatively weaker credit metrics. However, purchase accounting mitigates somewhat the challenges in these acquired portfolios.

- Institutions with geographic loan concentrations in markets where home prices have fallen the most have seen a greater level of charge-offs.
- Institutions with a high level of first lien product have performed better.

Home Equity Delinquencies and Non-Accruals

	Institution	Past Due 30–89 Days				Change		Non-Accruals				Change			
		4Q09	3Q09	2Q09	1Q09	4Q08	YOY	3Q to 4Q	4Q09	3Q09	2Q09	1Q09	4Q08	YOY	3Q to 4Q
1	First Horizon National Corporation	1.44	1.42	1.25	1.21	1.41	0.03	0.02	0.40	0.43	0.47	0.28	0.29	0.11	0.03
2	Webster Financial Corp	1.36	1.54	1.35	1.60	1.70	(0.34)	(0.18)	1.89	1.93	2.04	2.07	1.60	0.29	(0.04)
3	PNC Financial Services Group	1.14	1.15	1.17	1.11	2.53	(1.39)	(0.01)	0.56	0.52	0.53	0.29	0.26	0.30	0.04
4	JPMorgan Chase & Co.	2.03	2.23	2.00	2.15	2.28	(0.25)	(0.23)	1.19	1.11	1.03	1.10	0.92	0.27	0.08
5	TCF Financial	0.99	1.08	0.68	0.72	0.65	0.34	(0.09)	0.91	0.71	0.64	0.62	0.61	0.30	0.20
6	SunTrust Banks, Inc.	1.52	1.63	1.56	1.68	1.87	(0.35)	(0.11)	2.09	2.08	2.31	3.23	3.00	(0.91)	0.01
7	BankAtlantic	2.14	1.94	4.59	1.61	1.53	0.61	(0.20)	1.41	1.21	1.35	1.09	0.90	0.51	0.20
8	Huntington Bancshares	1.31	1.40	1.32	1.24	1.64	(0.33)	(0.09)	0.58	0.63	0.77	0.84	0.52	0.06	(0.05)
9	Regions Financial Corporation	1.33	1.37	1.58	0.70	1.49	(0.16)	(0.04)	0.10	0.07	0.07	0.09	0.08	0.02	0.03
10	Bank of Hawaii Corp	1.02	0.96	0.78	0.65	0.40	0.62	0.06	0.54	0.36	0.32	0.17	0.17	0.37	0.18
11	KeyCorp	1.22	1.21	1.03	1.06	1.19	0.03	0.01	1.10	1.08	1.06	0.99	0.81	0.29	0.02
12	Bank of America Corporation	1.99	2.00	1.84	2.22	2.44	(0.45)	(0.01)	2.62	2.59	2.54	2.43	2.16	0.46	0.03
13	Wells Fargo & Co.	1.55	1.58	1.36	1.96	2.05	(0.50)	(0.03)	2.12	1.84	1.47	1.25	0.84	1.28	0.28
14	Fifth Third Bancorp	1.21	1.33	1.33	1.33	1.37	(0.16)	(0.12)	0.69	0.71	0.66	0.72	1.80	(1.11)	(0.02)
15	FirstMerit Corp	0.79	0.61	0.70	0.49	1.03	(0.24)	0.18	1.13	0.38	0.37	0.36	0.22	0.91	0.75
16	Peoples United Bank	0.48	0.60	0.66	0.70	0.98	(0.50)	(0.12)	0.39	0.41	0.32	0.31	0.21	0.18	(0.02)
17	Associated Banc-Corp	0.78	0.90	1.01	0.91	0.80	(0.02)	(0.12)	1.34	1.34	1.05	1.02	0.87	0.47	—
18	Fulton Financial Corporation	1.16	0.80	0.69	0.62	0.68	0.48	0.36	0.48	0.44	0.75	0.71	0.33	0.15	0.04
19	M&T Bank Corporation	0.58	0.36	0.52	0.40	0.46	0.12	0.22	0.47	0.47	0.54	0.57	0.56	(0.09)	—
20	Citizens Republic Bancorp	2.26	1.98	1.92	1.53	1.85	0.41	0.28	2.21	2.07	1.98	1.78	1.38	0.83	0.14

Notes: Represents loans 90-days past due and includes loans held for sale and securitized. Home equity exposure defined as second lien closed-end loans and revolving 1-4 family loans. N.A. – Not available.
Source: Highline Financial and company filings.

First Horizon with 4Q09 NCOs of 3.61% reflects the previous national lending efforts associated with the company's mortgage operation, which has since been sold. These loans account for about two-thirds of the portfolio and drive an outsized portion of net charge-offs. First Horizon generally charges off loans at 180 days past due and NCOs appeared to have peaked in 2Q09.

The next group of institutions with elevated NCOs tends to have a geographic concentration in more problematic markets.

BankAtlantic reported the highest level of NCOs at 5.68% reflecting its regional concentration in the troubled Florida market which would likely correlate into a high loss given default given poor residential markets in Florida. Approximately 24% of the portfolio is in a first lien position. BankAtlantic writes off a loan at 120 days past due to its estimated collateral value less costs to sell. Additionally, the company does a quarterly evaluation to reflect any further deterioration in collateral value and will establish specific reserves if necessary.

Associated Banc-Corp reported a large spike in NCOs in 4Q09 to 3.55% and the highest year-over-year and quarter-over-quarter increase. Associated's portfolio is largely retail related and concentrated in Wisconsin, Minnesota, and Illinois, with Minnesota and Illinois contributing an outsized portion of NCOs. An increased emphasis on collection efforts may have driven the increased charge-offs for the quarter.

The large southeast concentrated regionals, Regions and SunTrust, both have experienced elevated levels of NCOs, with Florida contributing an outsized portion of losses. SunTrust has been working through loans originated through the broker channels for a number of years. Regions has experienced higher losses especially in its second lien portfolio in Florida. The remaining portfolio, which was largely branch originated, has performed relatively well. Approximately 39% of the portfolio is in a first lien position.

Home Equity Net Charge-Offs

	Institution	Net Charge-Offs					Change	
		4Q09	3Q09	2Q09	1Q09	4Q08	YOY	3Q to 4Q
1	First Horizon National Corporation	3.61	4.13	4.19	2.90	2.09	1.52	(0.52)
2	Webster Financial Corp	2.63	3.23	2.82	2.12	1.65	0.98	(0.60)
3	PNC Financial Services Group	1.61	1.92	1.23	0.73	0.30	1.31	(0.31)
4	JPMorgan Chase & Co.	4.26	3.61	3.86	3.41	2.16	2.10	0.65
5	TCF Financial	2.34	2.35	2.05	1.80	1.63	0.71	(0.01)
6	SunTrust Banks, Inc.	3.12	3.92	3.59	3.21	2.70	0.42	(0.80)
7	BankAtlantic	5.68	6.83	5.84	4.76	4.61	1.07	(1.15)
8	HuntingtonBancshares	2.45	2.00	1.68	1.14	2.10	0.35	0.45
9	Regions Financial Corporation	3.02	2.48	3.02	2.48	1.71	1.31	0.54
10	Bank of Hawaii Corp	1.52	1.53	1.37	0.94	0.29	1.23	(0.01)
11	KeyCorp	1.85	1.68	1.65	1.24	1.23	0.62	0.17
12	Bank of America Corporation	4.67	5.85	5.25	4.57	3.02	1.65	(1.18)
13	Wells Fargo & Co.	4.40	4.30	3.97	2.69	2.25	2.15	0.10
14	Fifth Third Bancorp	2.96	2.59	2.86	2.34	2.16	0.80	0.37
15	FirstMerit Corp	0.81	0.71	0.54	0.57	0.23	0.58	0.10
16	Peoples United Bank	0.24	0.21	0.13	0.04	0.04	0.20	0.03
17	Associated Banc-Corp	3.55	2.37	2.09	2.14	1.15	2.40	1.18
18	Fulton Financial Corporation	0.86	0.65	0.86	0.60	0.48	0.38	0.21
19	M&T Bank Corporation	0.59	0.73	0.57	0.66	0.59	—	(0.14)
20	Citizens Republic Bancorp	2.03	2.02	2.18	1.38	1.58	0.45	0.01

Note: Home equity exposure defined as second lien closed-end loans and revolving 1-4 family loans.
Source: Highline Financial and company filings.

Second-Lien Modification Program

Clouding the outlook for losses further is regulatory risk which could accelerate losses in these portfolios. The Homeowners Affordable Mortgage Program (HAMP) and the Second-Lien Modification Program (ZMP), a government program intended to ease the modification of these loans in conjunction with a first lien loan modification is in the works. The four largest bank servicers have agreed to participate in this program with more participants expected to be added over time. For eligible loans, under ZMP a mortgage servicer with the guidance of their investor, may reduce the interest rate on the loan to 1% or 2%, extend the term of the loan to 40 years, and must forbear at least an equal amount of debt as the first lien loan if the principal was forgiven. Among other things, a second lien loan is eligible if the corresponding first lien loan has been modified under the HAMP and the second lien servicer is participating in the ZMP program. Additionally, servicers and investors may receive an incentive for extinguishing a second lien by forgiving all the debt a homeowner owes. Prior to the implementation of this program, some lenders have been active modifying second mortgages regardless of their involvement in the first mortgage.

Rating Impact

Fitch expects that future bank rating action to be limited and will not likely be the result of home equity weakness alone, but in combination with other factors. Additionally, most issuers are currently performing significantly below Fitch stress scenarios. However, Fitch remains concerned that loss rates will remain elevated across most consumer portfolios as well as higher losses anticipated in commercial real estate portfolios. The mitigating rating factors are that through the credit crisis institutions have built substantial loan loss reserves and have augmented their capital positions. Furthermore, liquidity and funding profiles for most institutions have improved and are quite strong.

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