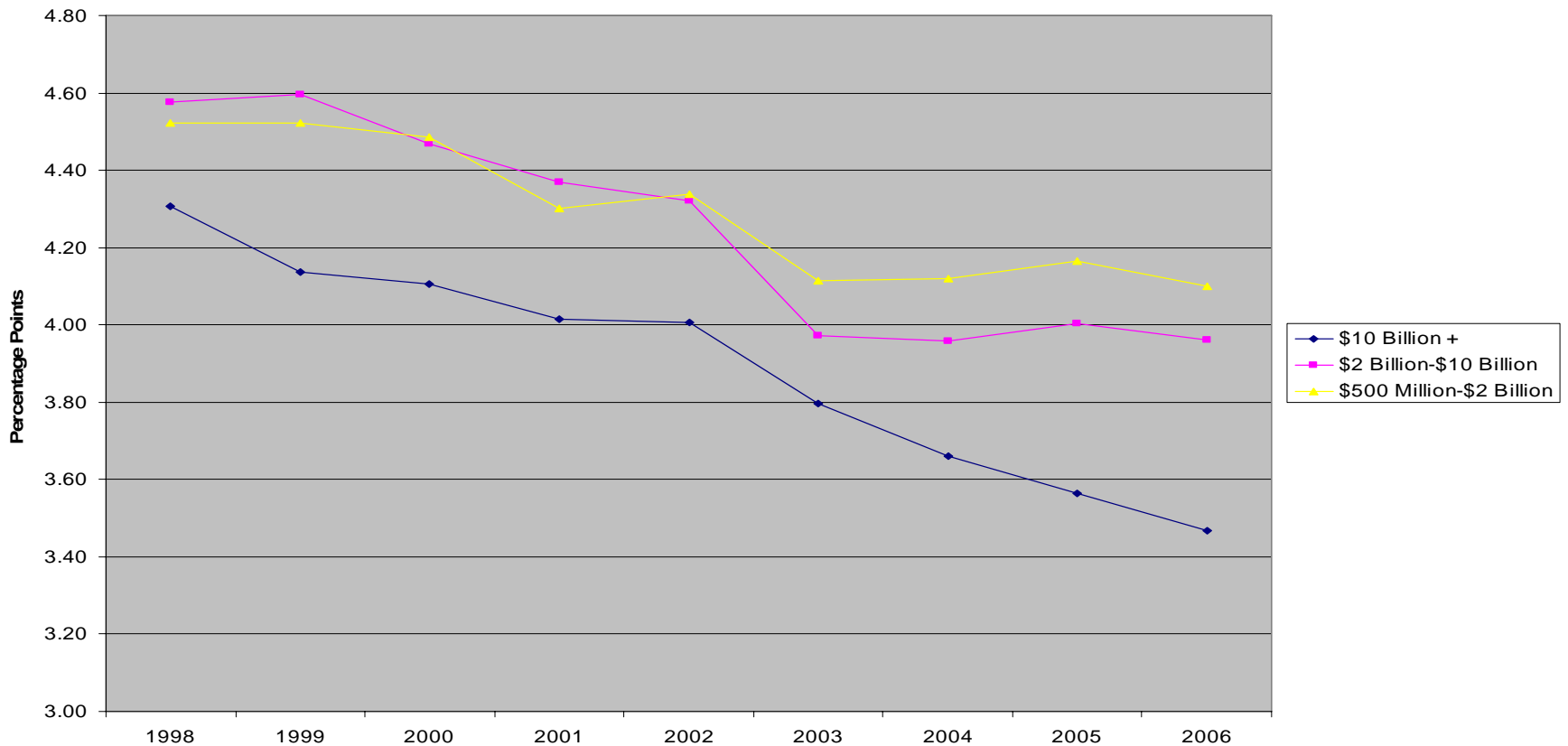

Western Independent Bankers
CFO, Investments & Operational Risk Conference
June 3-6, 2007

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Managing Director
Citigroup Global Markets, Inc.



Net Interest Margins Have Been Under Pressure For A Decade

Net Interest Margin



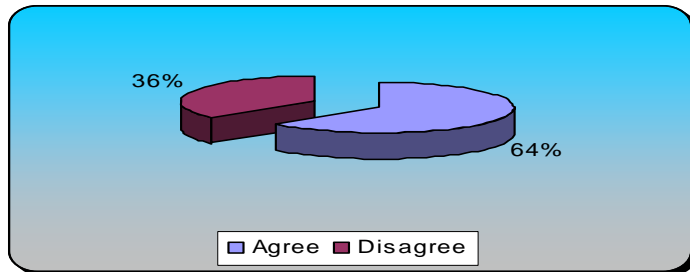
Source: Highline Financial



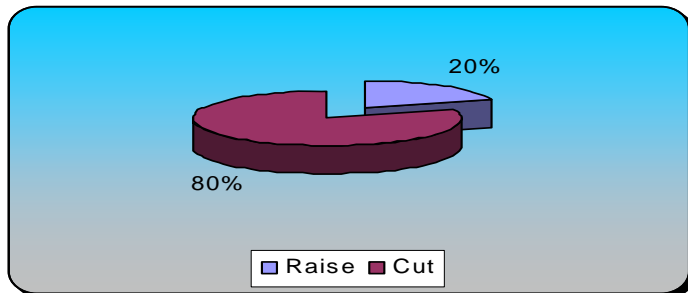
Structured Solutions—What's The Problem?

- ◆ Bank net interest margins have been in a secular decline for a decade.
- ◆ What's different now?
 - Overall level of interest rates lower than in prior cycles.
 - Yield curve remaining flat to inverted much longer than in previous cycles.
 - Competition for the asset and liability sides of the balance sheet intensifying, keeping spreads at historical tights.
 - Accounting rules more intrusive today in the ALCO process.
 - Credit cycle may be turning, limiting the option of “going down in credit” to pick up yield.
 - Option volatility continues to grind in.
 - Greater transparency in the market than at any time in modern history.

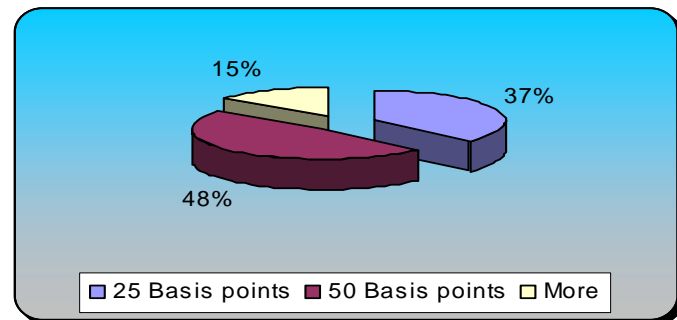
Bank Treasurers See A Range-Bound Rate World For The Foreseeable Future



- ◆ The Fed will be on hold for the next 12 months.

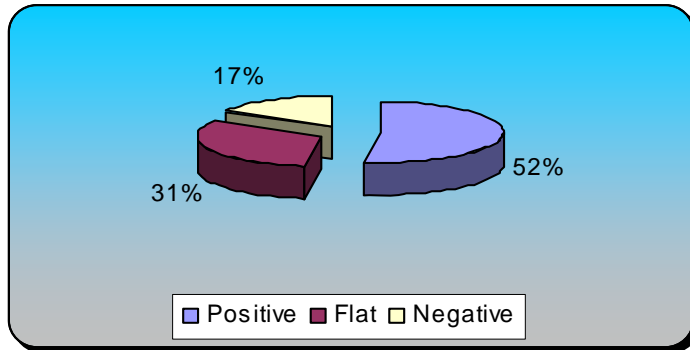


- ◆ The Fed's next rate change is cut or raise?

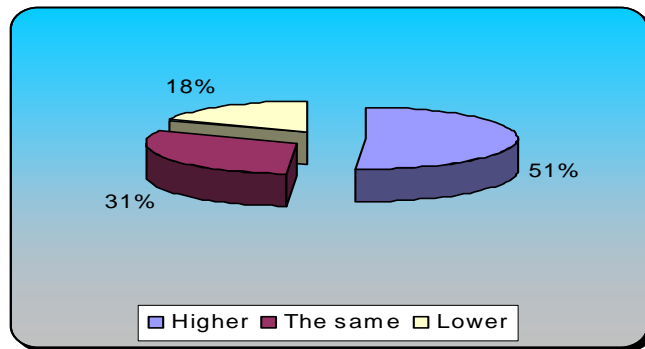


- ◆ If the Fed does raise rates, the increase will be:

Bank Treasurers Also Expect The Yield Curve To Remain Flat, And Volatility To Be Contained



- ◆ Over the next year, you expect the yield curve to be



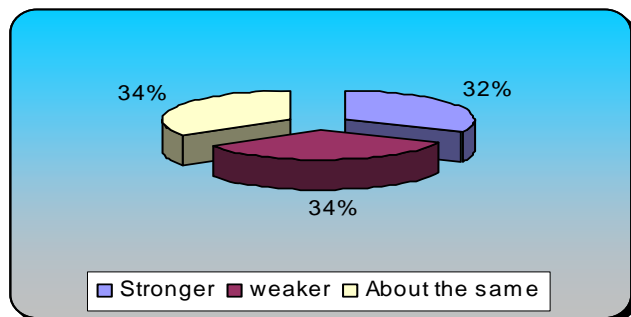
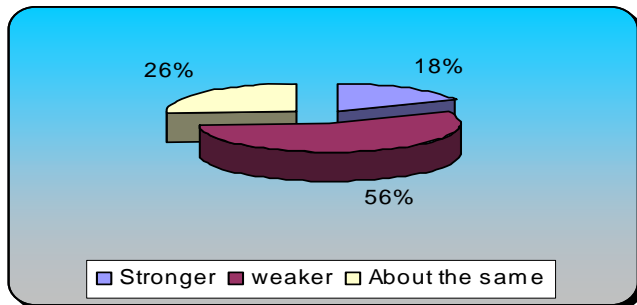
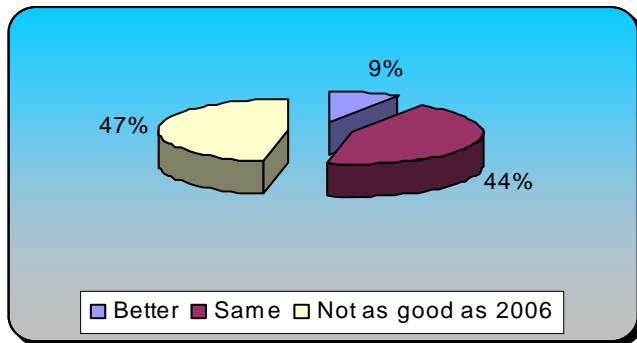
- ◆ Implied vol, as measured by the 2yr/10yr straddle, will be

Meanwhile, Banks Are Challenged In Their Lending & Deposit-Taking Businesses

◆ The deposit environment will be:

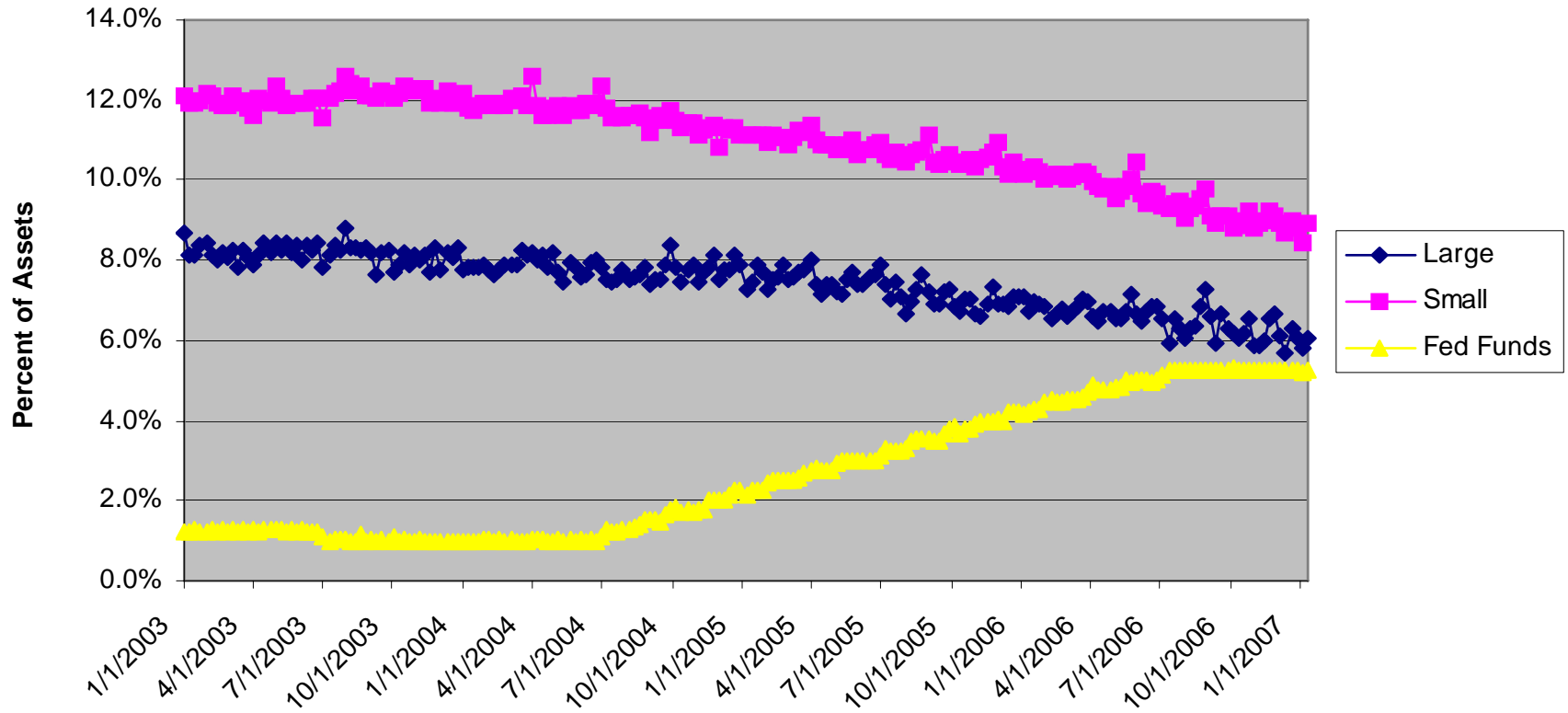
◆ Consumer loan demand will be:

◆ Commercial loan demand will be:



Depositors Shifting From Checking...

Transaction Deposits

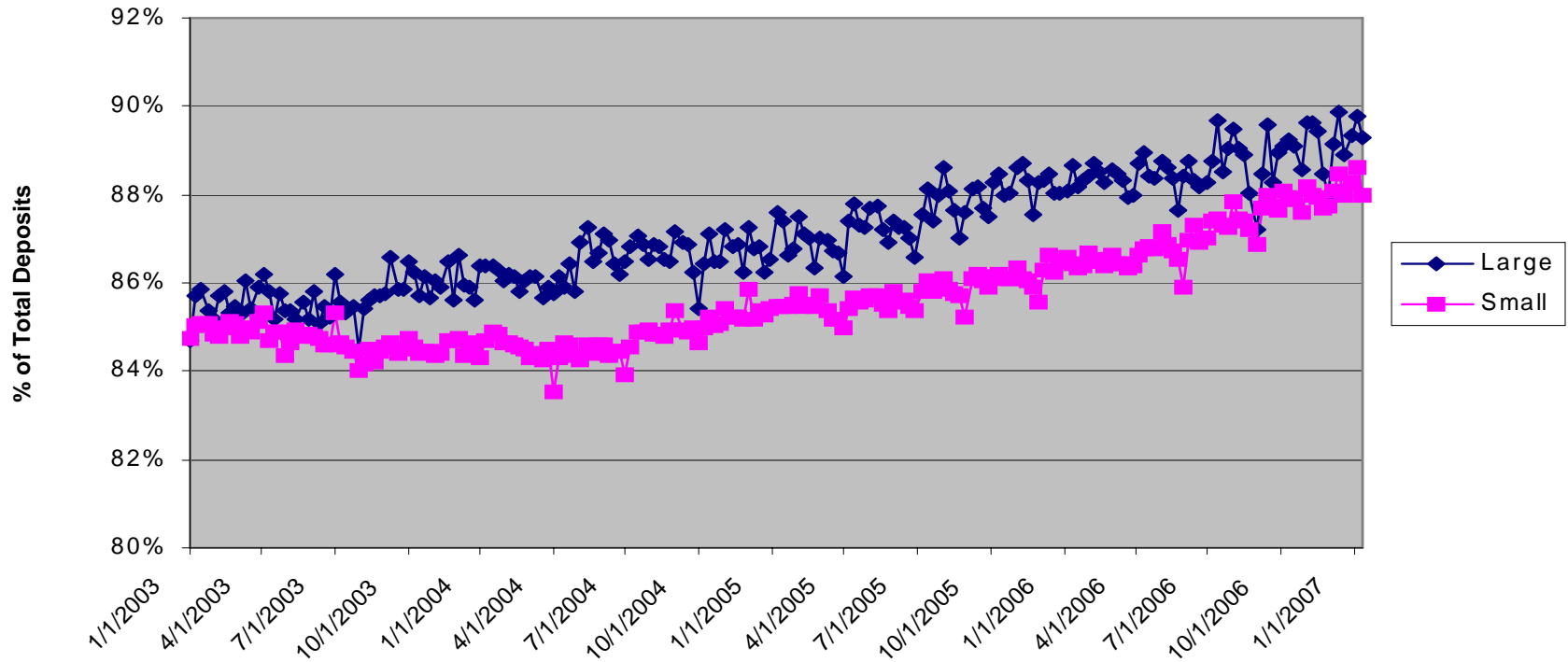


Source: Federal Reserve



...To Fixed Rate Time Deposits

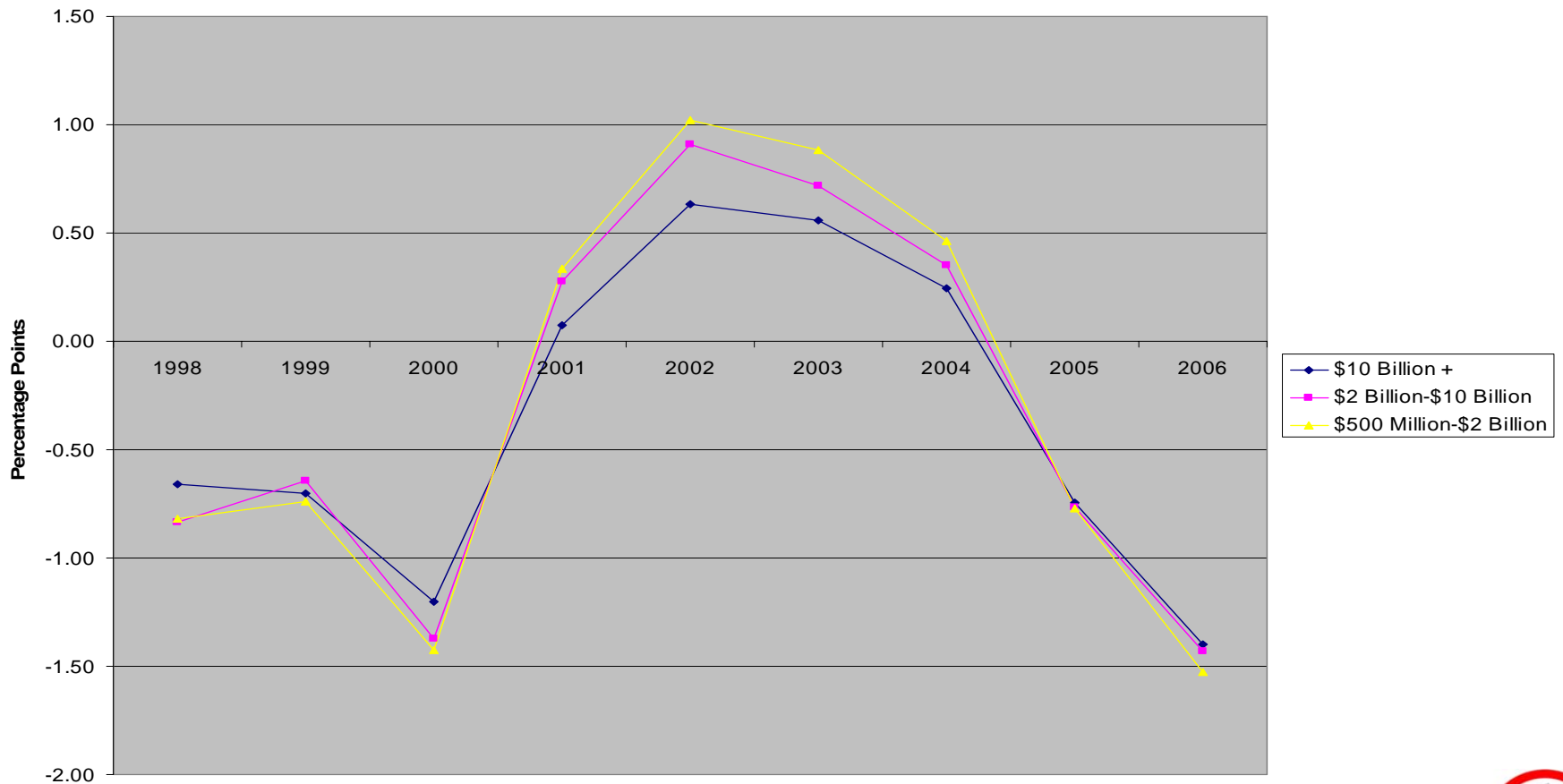
Nontransaction Deposits



Source: Federal Reserve

Bank Deposit Pricing May Become Negatively Convex

Cost Of Interest-Bearing Funds Less Fed Funds Rate

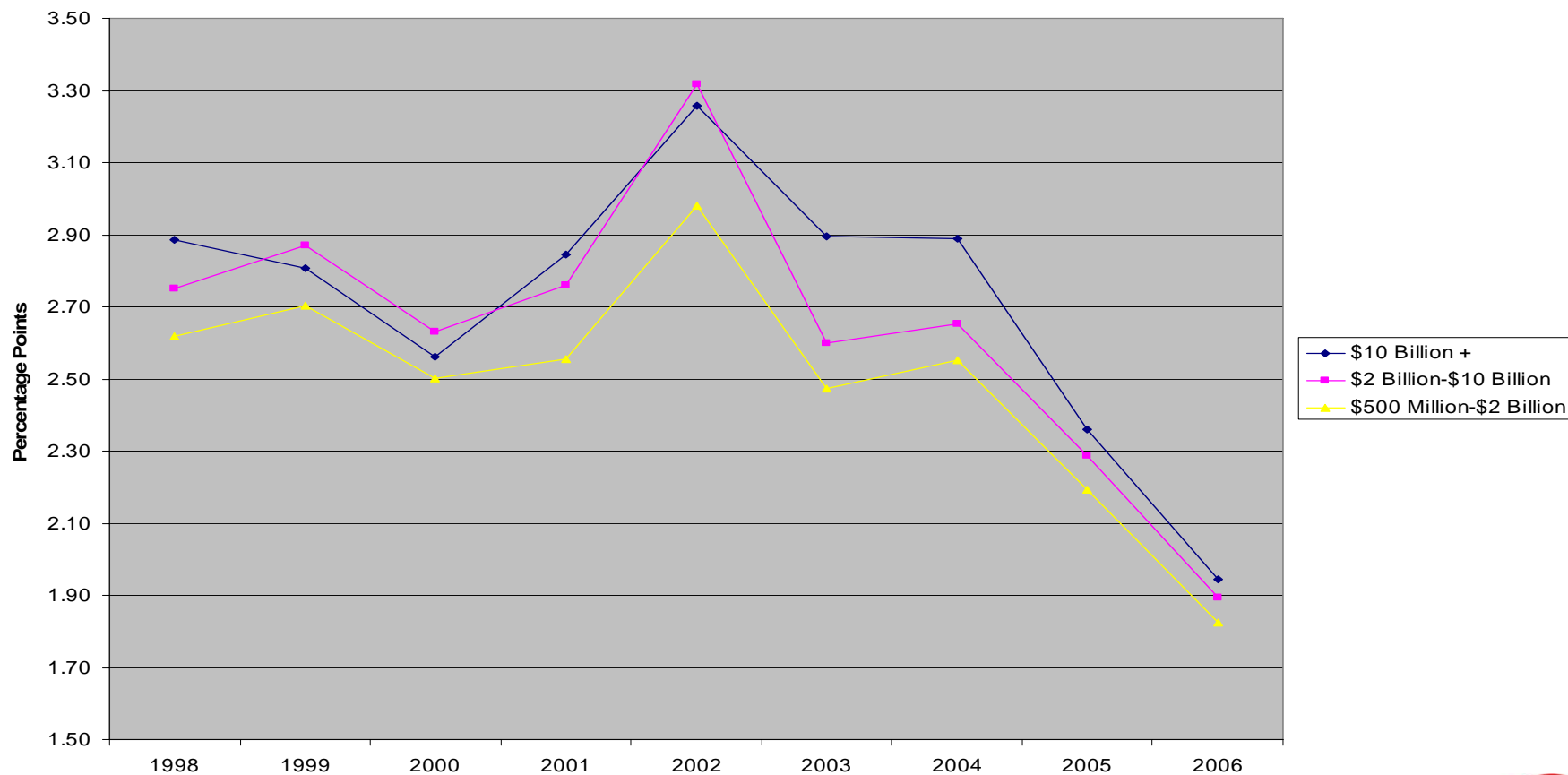


Source: Highline Data



The Carry Trade Has Been Detrimental To Net Interest Margin

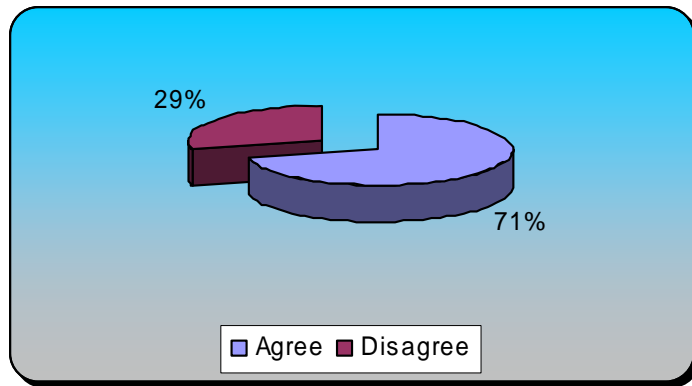
Yield On Securities Less Weighted Cost Of Interest-Bearing Funds



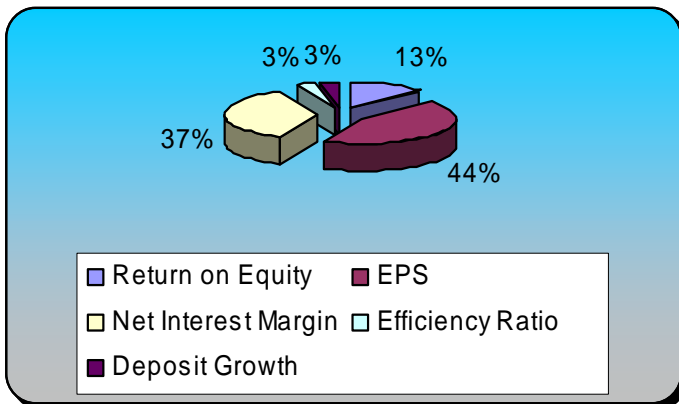
Source: Highline Data



How Can Bank Treasurers Generate Profits For Their Banks?



- ◆ Treasury is regarded at my bank as a source of profits.



- ◆ The most important metric used to measure Treasury's value-added profits is:

To Sum Up The Current Picture

- ◆ Cost of funds rising faster than yields on earning assets
- ◆ Competition putting pressure on yields, deposits
- ◆ Loan volume mostly in the M&A sphere, working capital needs are limited, customers are flush with liquidity.
- ◆ Adverse shift in the mix of deposits putting pressure on cost of funds.
- ◆ Inverted yield curve putting pressure on net interest margins.
- ◆ When the Fed eventually does cut rates, banks will be limited in how much and how fast they could cut their deposit rates.
- ◆ Subprime market already under stress. Credit problems in prime housing more a concern for 2008-2009 when ARMs begin to reset.
 - Countrywide on watch for upgrade!

The Number One Response To This State Of Affairs

- ◆ Shrink the bank
 - Deleverage the securities portfolio and pay down borrowings
 - Restructure the securities portfolio
 - Gets applause from the analysts
 - Buy back shares
- ◆ How can you generate EPS growth when you shrink your balance sheet?
 - You can't!

Structured Solutions

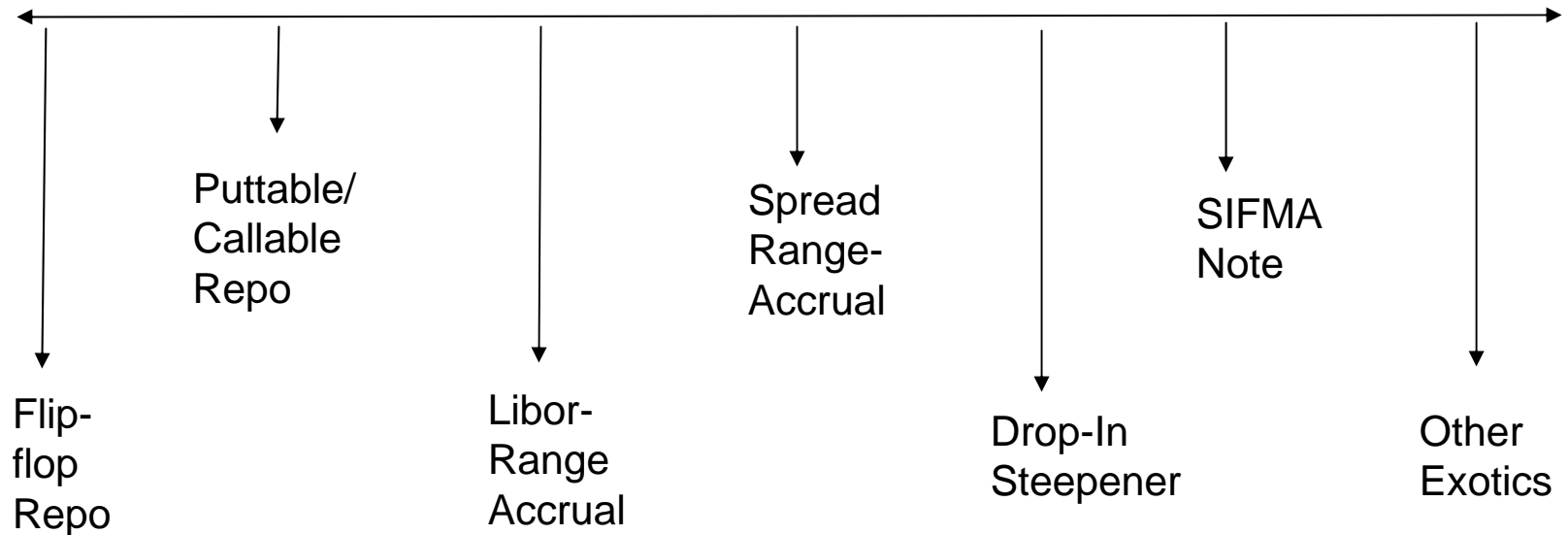
◆ Pros

- Focused response to challenges of ALCO
- Enhance yield of earning assets/reduce funding expense
- Accounting-friendly
- Utilize digital options for maximum value
- Increasing liquidity
- Portfolio diversification
- Flexible application-note, repo asset or liability, or embedded in mortgage product
- Better payoff for less balance sheet usage

◆ Almost Pros

- There's no free lunch—you pay for what you get
- Regulatory scrutiny—TB-13A
- Board of director resistance
- Learning curve
- Structure makes “sense” in accrual accounting.

Structured Solutions Across A Spectrum From Simple To Complex



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