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Latest U.S. Government Financial Stability Plan Has Potential To Help Banks' Credit Quality

Primary Credit Analysts:
Scott Sprinzen, New York (1) 212-438-7812; scott_sprinzen@standardandpoors.com
Tanya Azarchs, New York (1) 212-438-7365; tanya_azarchs@standardandpoors.com

Secondary Credit Analysts:
Victoria Wagner, New York (1) 212-438-7406; victoria_wagner@standardandpoors.com
John K Bartko, C.P.A., New York (1) 212-438-7368; john_bartko@standardandpoors.com
Rodrigo Quintanilla, New York (1) 212-438-3090; rodrigo_quintanilla@standardandpoors.com

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The Obama Administration, on Feb. 10, outlined its "Financial Stability Plan"--representing the government's renewed effort to contain the ongoing financial crisis. In particular, the measures being developed are intended to replace or enhance existing government programs to bolster the financial condition of the banking system, restore liquidity to the secondary market for certain consumer and commercial finance assets, and stem the deterioration of housing markets. Standard & Poor's Ratings Services understands that many critical details are still being worked out, and will only be defined in coming weeks and months.

Ultimately, if it is fully implemented as preliminarily envisaged, we currently believe the plan should be beneficial to the credit quality of banks. However, we currently believe it would be premature to draw definitive conclusions about the potential implications for the ratings of U.S. financial institutions or, from a broader perspective, regarding prospects for restoring the financial markets and general economy to health.

The most important aspects of the Financial Stability Plan that we will be assessing include the following.

Coordinated Supervisory Review

All financial institutions with more than $100 billion in assets will be required to participate in a coordinated supervisory review process involving the Federal Reserve, FDIC, Office of the Comptroller of the Currency, and Office of Thrift Supervision. This will entail, in part, a "comprehensive stress test that requires an assessment of whether major financial institutions have the capital necessary to continue lending and to absorb the potential losses that could result from a more severe decline in the economy than projected." Financial institutions that have undergone this test will have access to a "capital buffer" provided by the U.S. Treasury (i.e., contingent capital that will be provided in the form of a convertible preferred security investment from Treasury that the companies can convert into common equity if needed to preserve lending in a worse-than-expected economic environment. Many large U.S. financial institutions currently have depleted common equity bases, with hybrid capital issues in different forms comprising a disproportionate amount of their total Tier 1 capital.)

Key issues we will monitor include:

- The nature of the stress testing, including the assumptions to be made, and how stress tolerance thresholds are to be defined and reassessed over time;
- Whether smaller banks will also participate in the stress-testing process in some circumstances;
- The consequences for companies not meeting the thresholds;
- The specific terms of the contingent capital to be provided, including the related dividend/interest rate; and
- The conditions under which companies' ability to meet dividend/interest obligations under existing hybrid capital issues could be constrained.

Banks With $100 Billion Or More In Assets

	Total assets (Mil. $)	Tier 1 ratio (%)
BB&T Corp.	152,015	12.00
Bank of America Corp.	1,817,943	9.15

Banks With $100 Billion Or More In Assets (cont.)		
Bank of New York Mellon Corp.	237,009	13.10
Capital One Financial Corp.	165,981	13.60
Citigroup Inc.	1,945,263	11.80
Fifth Third Bancorp	119,764	10.59
Goldman Sachs Group Inc.	884,547	15.60
JPMorgan Chase & Co.	2,175,052	10.80
KeyCorp	104,531	10.81
Morgan Stanley	658,812	17.90
PNC Financial Services Group	291,081	9.70
Regions Financial Corp.	146,248	10.39
State Street Corp.	173,631	20.74
SunTrust Banks Inc.	189,289	10.85
U.S. Bancorp	265,912	10.60
Wells Fargo & Co.	1,309,639	7.88

Goldman Sachs information is as of Nov. 28, 2008. Morgan Stanley information is as of Nov. 30, 2008. All others are as of Dec. 31, 2008.

The Public-Private Investment Fund

Working together with the FDIC and the Federal Reserve, the Treasury plans to initiate a so-called "Public-Private Investment Fund," combining public and private capital to purchase problematic legacy assets of financial institutions--initially up to $500 billion worth, with the potential to expand to $1 trillion.

Key issues we will monitor include:

- The structure of investor participations in the Investment Fund, and the Investment Fund's ability to attract private capital;
- The mechanism utilized to establish asset-purchase prices;
- How the purchase prices compare to the prior carrying values of assets on sellers' books, because the triggering of losses could impinge on capital levels, absent offsetting actions;
- Contingencies that might continue to be borne by sellers, if any.

The Term Asset-Backed Securities Loan Facility

To restart the securitization market, the Federal Reserve's existing Term Asset-Backed Securities Loan Facility (TALF) is being modified to encompass a wide range of asset types, with its size being increased to up to $1 trillion. The emphasis of the TALF remains on relatively good-quality finance assets, not the "toxic" assets that have been the main source of write-downs during the past year.

Key issues we will monitor include:

- The underwriting standards to be used in connection with the sale of securities included in the TALF; and
- Whether the economics of the TALF are sufficiently attractive to stimulate new lending activity.

Among the various other components of the Financial Stability Plan are additional measures intended to stem foreclosures and encourage the restructuring of troubled mortgages, thereby slowing the downward spiral in the housing sector. Naturally, success with such measures–-to the extent they limit losses on loans and stimulate home sales--would be highly beneficial for financial institutions.

We expect to comment further on the Financial Stability Plan as more information becomes available.