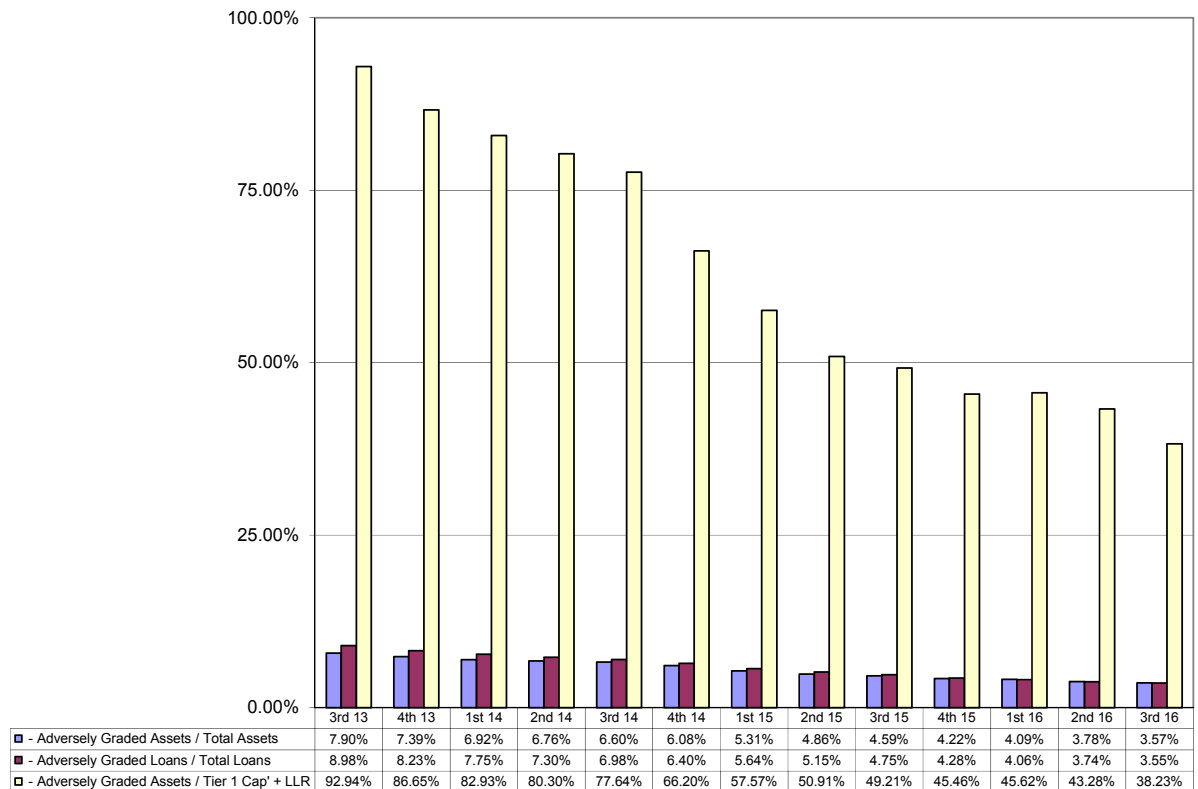


Trends in Asset Quality

**TRENDS IN ASSET QUALITY
AVERAGE LEVEL OF ADVERSELY GRADED ASSETS**

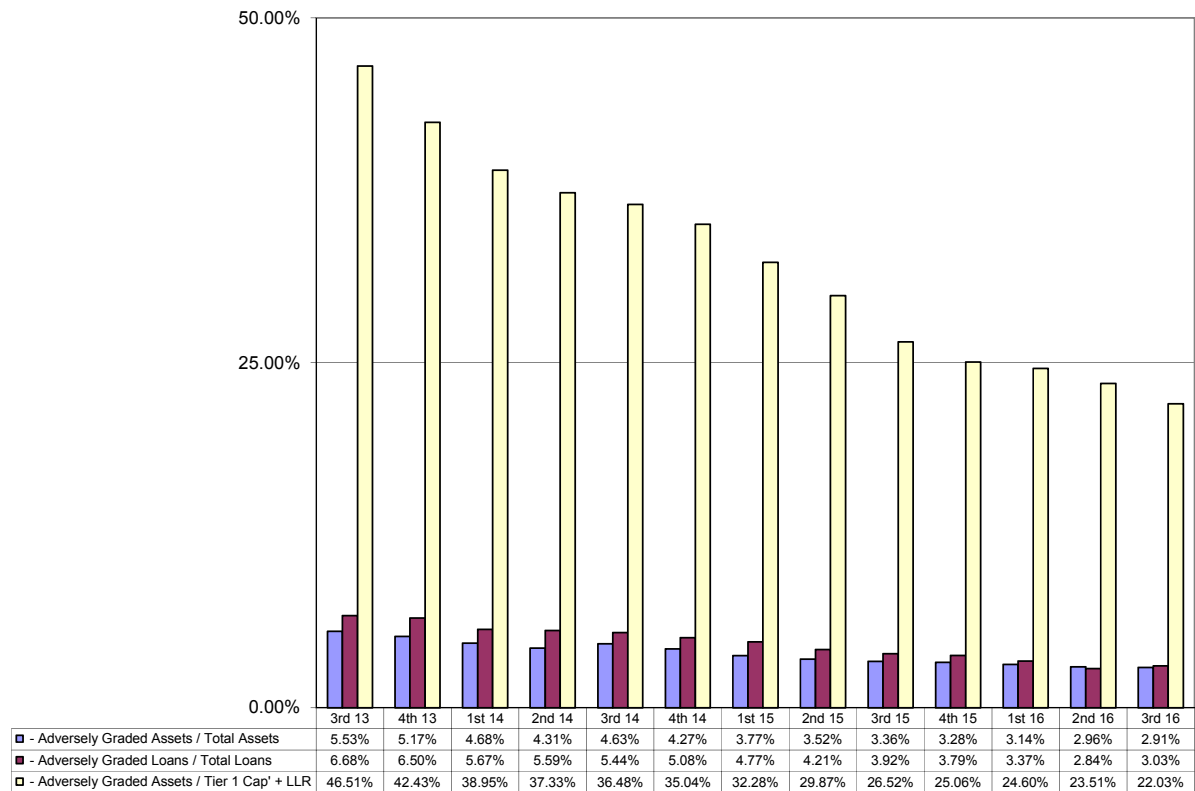


Based on Steve H. Powell & Company client data, during the Third Quarter 2016, the average level of adversely graded assets decreased as a percentage of total assets and capital. Also, the average level of adversely graded loans decreased as a percentage of total loans. Problem assets averaged 3.57% of total assets and 38.23% of tier-one capital plus loan loss reserve as compared to 3.78% of total assets and 43.28% of tier-one capital plus loan loss reserve while problem loans averaged 3.55% of total loans as compared to 3.74% of total loans during the Second Quarter 2016.

Steve H. Powell & Company was founded in August of 1993 by former banker and regulator, Steve H. Powell. With the goal of providing unparalleled asset quality monitoring and regulatory compliance services, the company's clientele base has grown and now exceeds 100 different financial institutions. We also provide our clients with bank charter consulting, due diligence support, regulatory applications, financial analysis, and strategic planning. The staff of Steve H. Powell & Company is comprised of former bankers & regulators who understand the complexities of today's regulatory environment. The unique skill sets possessed by our specialists are derived from extensive review experience in institutions of various sizes and charter types.

Median Level of Problem Assets

TRENDS IN ASSET QUALITY
MEDIAN LEVEL OF ADVERSELY GRADED ASSETS



The median level of problem assets as of Q3 2016 decreased to 22.03% of tier-one capital plus loan loss reserve as compared to 23.51% during Q2 2016. Note the downward trend as overall asset quality continues to improve.

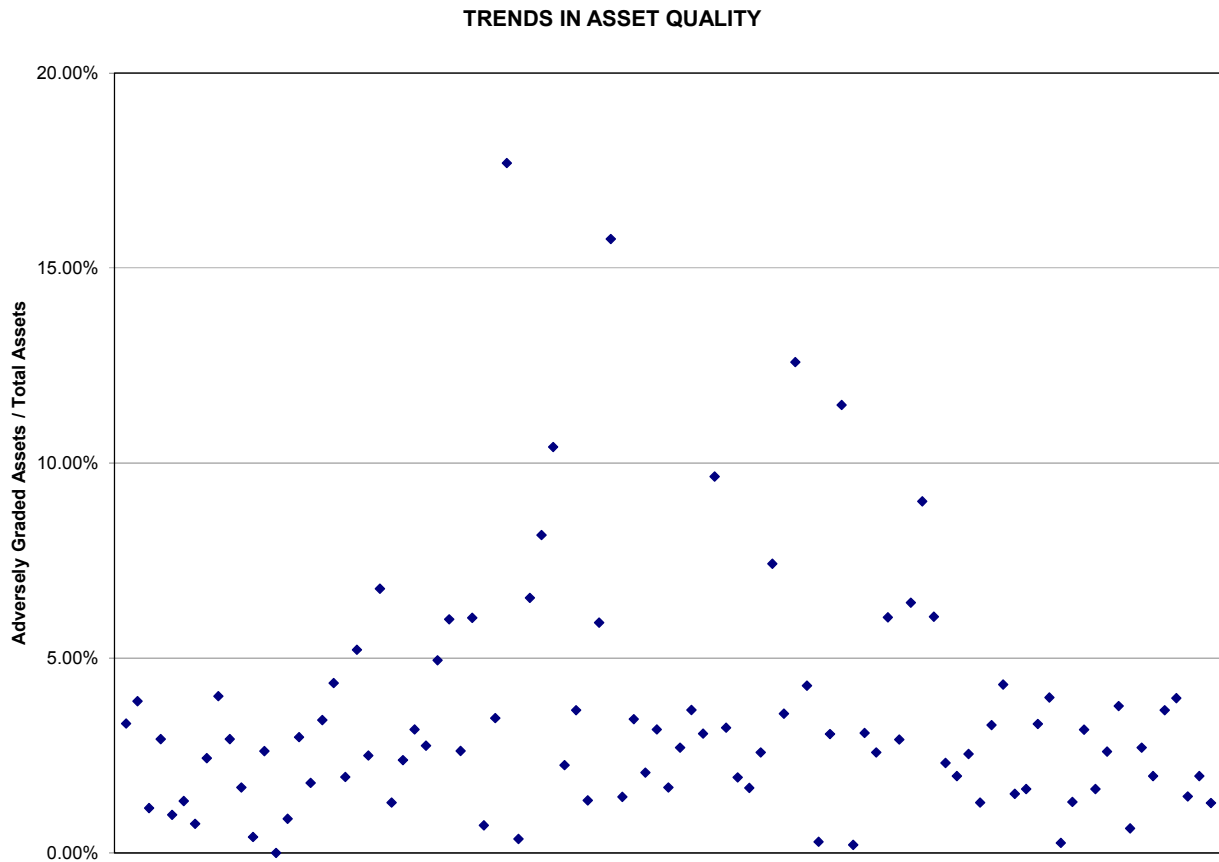
Historical Comparisons

During Q3 2016, increases in problem assets, as measured by adversely graded assets divided by tier-one capital plus loan loss reserve, were noted in approximately 16% of our clients. This quarter's increase compares to:

- 19% during the Second Quarter 2016
- 23% during the First Quarter 2016
- 18% during the Fourth Quarter 2015
- 8% during the Third Quarter 2015
- 11% during the Second Quarter 2015, and
- 15% during the First Quarter 2015

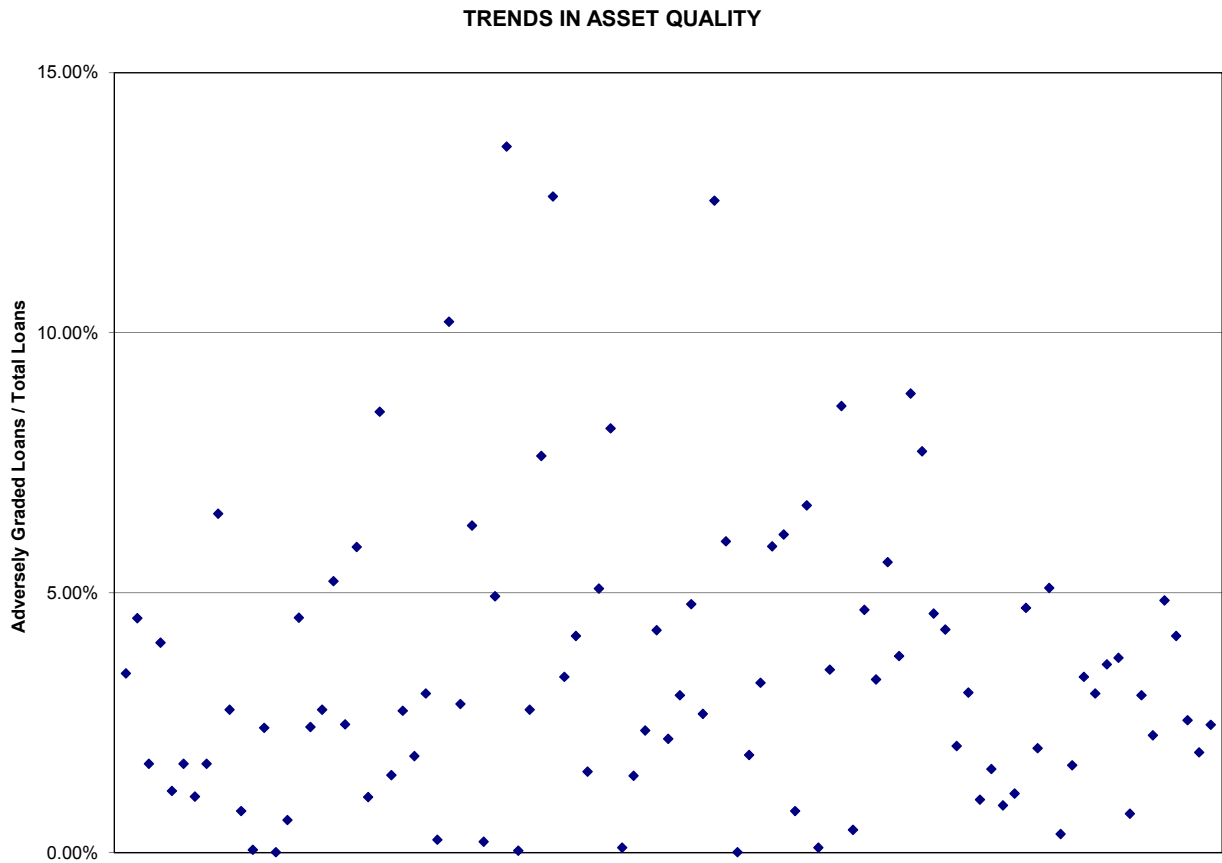
A higher level of volatility in the percentage of increases may be expected as overall asset quality stabilizes; however, increases may indicate a rise in portfolio risk.

Dispersion of Problem Assets as a Percentage of Total Assets



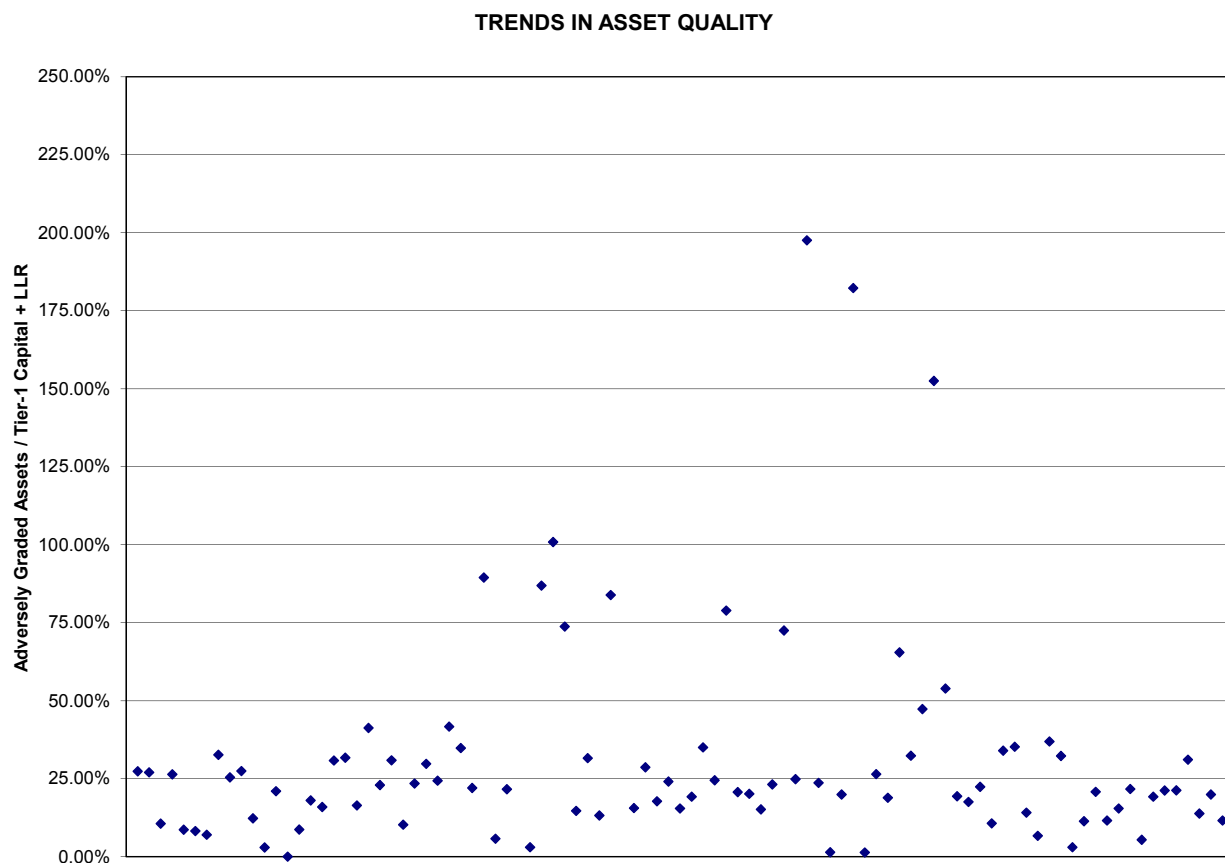
The above graph shows the dispersion of problem assets as a percentage of total assets. A traditional benchmark for significant asset quality concern is adversely graded assets that exceed 10% of total assets.

Dispersion of Problem Loans as a Percentage of Total Loans



A traditional benchmark for significant asset quality concern is adversely graded loans that exceed 10% of total loans.

Problem Assets as a Percentage of Tier-One Capital & Reserves



Historical Comparisons

Our sample group includes thirteen (13) banks with problem assets exceeding 60% of tier-one capital plus loan loss reserve. This number compares to:

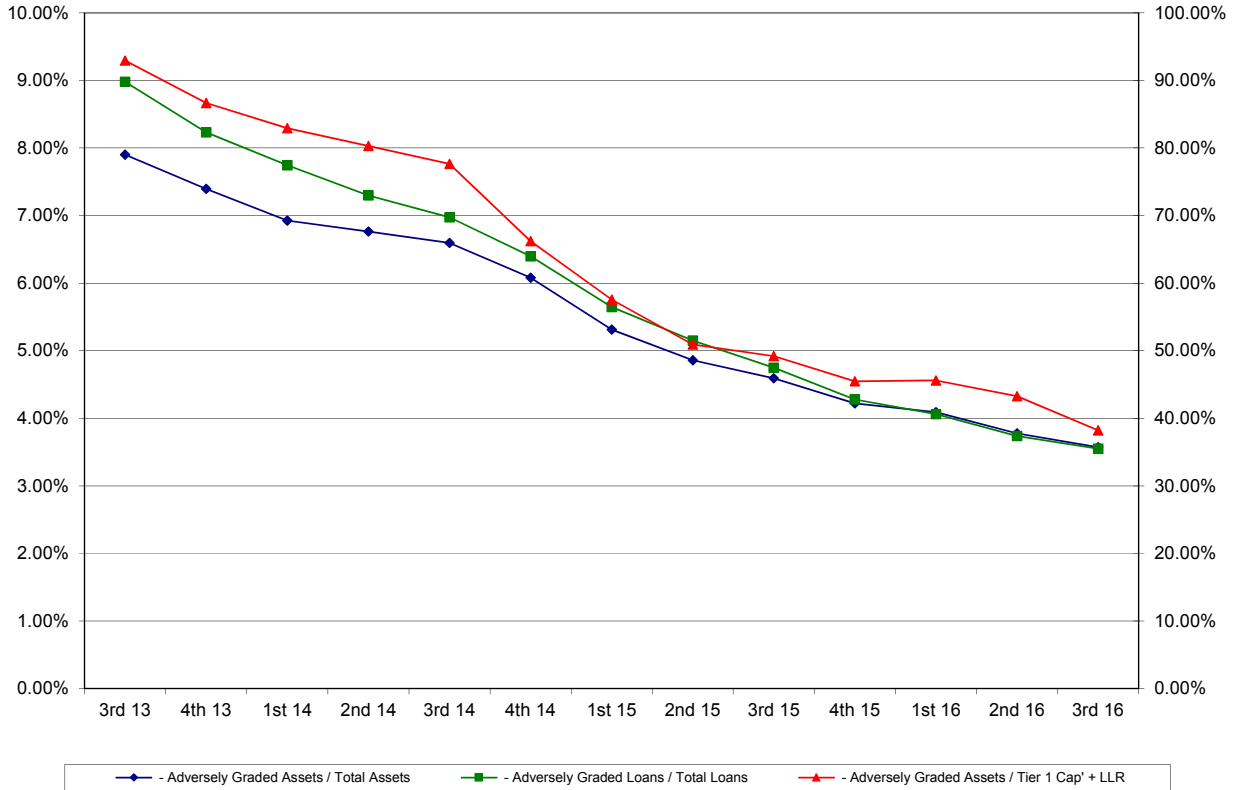
- Fourteen (14) during the Second Quarter 2016
- Sixteen (16) during the First Quarter 2016
- Sixteen (16) during the Fourth Quarter 2015, and
- Fifteen (15) during the Third Quarter 2015

Nine (9) banks now exceed 80% of tier-one capital plus loan loss reserve – a level normally associated with some form of formal regulatory action – as compared to:

- Ten (10) during the Second Quarter 2016
- Nine (9) during the First Quarter 2016
- Nine (9) during the Fourth Quarter 2015
- Ten (10) during the Third Quarter 2015

Problem Asset Trend Analysis

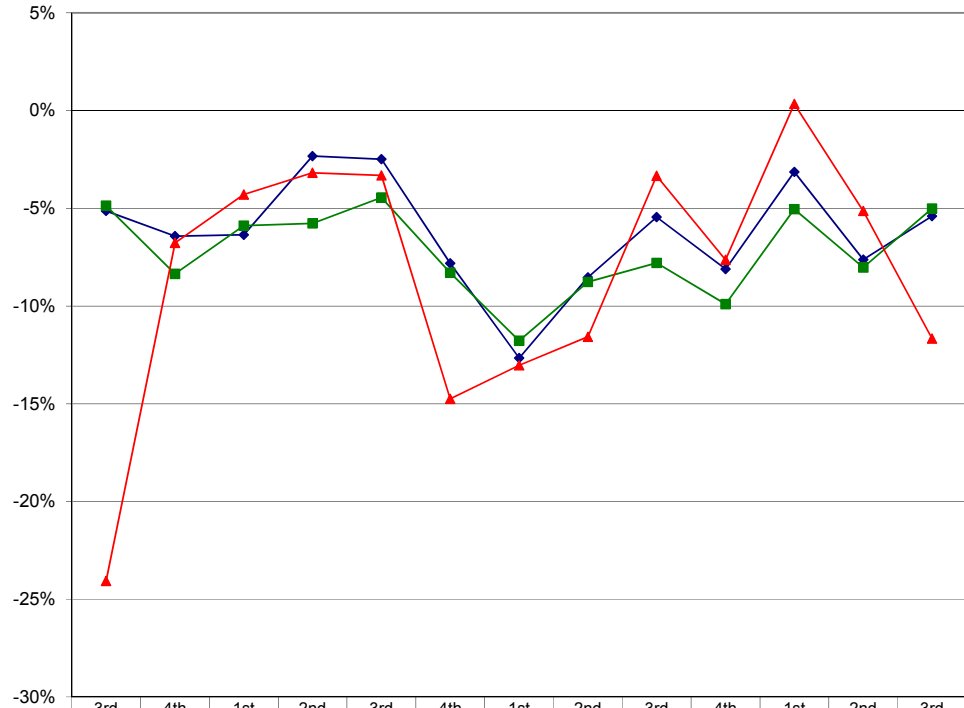
PROBLEM ASSET TREND ANALYSIS



The above graph again shows the trend in asset quality over the past three years as measured by adversely graded assets to total assets, adversely graded loans to total loans, and adversely graded assets to tier-one capital plus LLR.

Comparative Percentage Change in Adversely Graded Assets

COMPARATIVE % CHANGE IN ADVERSELY CLASSIFIED ASSETS
 Comparative to Assets, Loans and Tier One Capital + LLR



	3rd 13	4th 13	1st 14	2nd 14	3rd 14	4th 14	1st 15	2nd 15	3rd 15	4th 15	1st 16	2nd 16	3rd 16
◆ % Change in ACA/TA	-5.12%	-6.42%	-6.35%	-2.33%	-2.48%	-7.82%	-12.66%	-8.53%	-5.44%	-8.10%	-3.13%	-7.62%	-5.40%
■ % Change in ACL/TL	-4.86%	-8.35%	-5.88%	-5.77%	-4.44%	-8.29%	-11.77%	-8.76%	-7.79%	-9.90%	-5.04%	-8.02%	-5.01%
▲ % Change in ACA/Tier 1 Cap + LLR	-24.06%	-6.76%	-4.29%	-3.17%	-3.31%	-14.74%	-13.03%	-11.57%	-3.33%	-7.63%	0.35%	-5.13%	-11.66%

The above graph shows the pace of asset quality deterioration or improvement. The calculation is based on the percent change of problem asset levels from one quarter to the next. The graph indicates a favorable trend in asset quality ratios. Please note any data points below 0% indicate improvement in asset quality.

Modified Peer Data Analysis

We again performed an analysis in which a total of six outlier data points were excluded – the three lowest and the three highest data points, as based on classifications as a percentage of tier-one capital plus loan loss reserve.

With the outlier data points excluded, problem assets (or loans when compared to total loans) averaged 3.29% of total assets, 3.53% of total loans, and 30.12% of tier-one capital plus loan loss reserve. Third Quarter 2016 modified data compares to the following Second Quarter 2016 modified average data set:

- 3.42% of total assets
- 3.67% of total loans, and
- 34.22% of tier-one capital plus loan loss reserve

Median asset quality ratios within the modified data set were 2.91% of total assets, 3.03% of total loans, and 22.03% of tier-one capital plus loan loss reserve. Third Quarter 2016 modified data compares to the following Second Quarter 2016 modified median data set:

- 2.96% of total assets
 - 2.99% of total loans, and
 - 23.51% of tier-one capital plus loan loss reserve
-

Bank Accounting Advisory Series (BAAS)

The OCC's Bank Accounting Advisory Series was updated in August 2016. Per the OCC:

'The BAAS expresses the office's views on accounting topics relevant to national banks and federal savings associations (collectively, banks or institutions, unless otherwise specified). We hope that you find this publication useful.'

'This edition of the BAAS incorporates the Financial Accounting Standards Board's Accounting Standards Updates that became effective as of January 2016.'

The BAAS offers many accounting examples on a variety of topics – largely targeted at bank management, accounting departments, and investors; however, discussion of loan impairment, accrual status, and Troubled Debt Restructures can be valuable for all lenders.

A prior Powell & Co. article (Q3 2015) addresses some of these issues and can be found [here](#).

Also per the OCC:

'Banks are reminded that the BAAS does not represent official rules or regulations of the Office of the Comptroller of the Currency (OCC). Rather, the BAAS represents the OCC Office of the Chief Accountant's interpretations of generally accepted accounting principles and regulatory guidance based on the facts and circumstances presented. Nevertheless, banks that deviate from these stated interpretations may be required to justify those departures to the OCC.'

The materials included in this newsletter are provided for informational purposes only and do not constitute legal advice. You should not act or rely on any information contained in this publication without first seeking the advice of an attorney.

For more information about Steve H. Powell & Company, please visit our website at www.shpco.net