

# VERIBANC, Inc.

1-800-442-2657

## THE NATION'S FIRST BANK RATING SERVICE

### VERIBANC®'s RATING SYSTEM

*"It's simple and it works!"*

VERIBANC, Inc.'s two-part color code and star classification system rates financial institutions from two perspectives -- present standing and future outlook. It takes into account many financial ratios and measures, including all six factors Federal regulators utilize in determining the government's "CAMELS" ratings. These factors include an institution's Capital strength, Asset quality, Management ability, Earnings sufficiency, Liquidity, and Sensitivity to market risk.

**Colors** - The color code part of the VERIBANC rating system addresses the **current financial condition** of each institution. A green code means the institution meets high capital standards and is operating profitably. A yellow code means the institution's equity capital protection is marginal and/or it has recently reported a net loss. Such a situation merits your attention. A red code signifies the institution has a serious shortage of equity capital and/or it has recently suffered a serious net loss. The reason(s) why an institution has been assigned a red code deserves your close attention.

**Stars** - The second part of the VERIBANC rating system uses three stars, two stars, one star, or no stars to assess an institution's **future prospects**. The star classification examines (as appropriate for each kind of institution) threats offered by problem loans, overvalued securities, delinquent derivative contracts, failure to meet government capital requirements, significant asset growth/loss, insider lending, weakness of the holding company, recent regulatory sanctions and other criteria. Deficiencies in these areas could cause future concerns. A three stars rating is the most preferred. (See Exhibit A for a more detailed description of the rating criteria.)

**A Warning Signal** - If VERIBANC's rating system produces a high rating in the color code but confers a low score in the star classification, a warning signal exists. In such a case, the color code indicates the institution's reported basic financials appear strong but the star classification projects some possible deficiencies in other areas. Since the two parts of the rating system examine different criteria, the full color and star rating often hints about the specific nature of an institution's problems.

**An Investment Grade Rating or Better** - In 1994, the VERIBANC Green, Three Stars rating was recognized by the Office of Management and Budget as an investment grade or better rating and as such was acceptable for a letter of credit in which the U.S. Government is the beneficiary.

## **BLUE RIBBON BANK COMMENDATION OF EXCELLENCE**

The VERIBANC Blue Ribbon Bank Commendation of Excellence is the country's oldest formal recognition of banks which have met exceptionally high standards. Based on Federal Reserve Board data and other criteria, this designation is accorded to those institutions that demonstrate exceptional attention to safety, soundness and financial strength. For a bank to qualify for the Blue Ribbon, it must receive VERIBANC's highest Green, Three Stars rating in our eight level rating system, **and** it must satisfy additional safety related criteria. Our clients who have relied on Blue Ribbon Banks (only one has ever failed\*) have had their risk of bank failure virtually eliminated. Nothing beats a Blue Ribbon.

\* Fraud committed by the president whereby he was surreptitiously diverting deposits for his personal use.

## **MORE ABOUT CAMELS**

Federal banking supervisors review **six** critical aspects of a bank's operation and condition in their examination rating procedure (the Uniform Interagency Bank Rating System), commonly called the CAMELS ratings. The relationship between VERIBANC's color and star risk ratings and the "estimated CAMELS" score is tabulated as follows:

Color & Star Ratings	Estimated CAMELS Score <sup>†</sup>
Green, Three Stars with Blue Ribbon recognition	CAMELS 1
Green, Three Stars without Blue Ribbon recognition	BETWEEN 1 AND 2 (not directly comparable)
Green, Two Stars	CAMELS 2
Yellow, Two Stars	BETWEEN 2 AND 3 (not directly comparable)
Green, One Star Green, No Stars	CAMELS 3
Yellow, One Star Yellow, No Stars	CAMELS 4
Red, No Stars	CAMELS 5

**PLEASE NOTE:** Only the government and the institution itself, by law, have access to the “official CAMELS” ratings. Our studies have shown that our “estimated CAMELS” is close. Most other rating services and agencies consider only three, four or five of the six “CAMELS” factors. (Originally, there were only five CAMEL factors. The sixth one, “sensitivity to market risk,” was added by regulators several years ago.) VERIBANC takes all six into account.

## VERIBANC’s TRACK RECORD

The accuracy of VERIBANC’s rating system is unmatched by any other company in the country. As an example of VERIBANC’s track record, the last thirteen years of bank failures and the associated ratings provided to clients are presented below. VERIBANC provides exact data on the accuracy of past ratings. (No other bank rating service or credit risk rating agency tells you *exactly* how accurate their ratings are. Some bank raters selectively tell you about their successes. VERIBANC believes that you should have enough information so that you can make up your own mind as to which bank to use -- and which bank rating firm to use.) The ratings in the table that follows are the ones which were being furnished to VERIBANC’s customers before, and at the time, each bank failed. There are eight rating categories in VERIBANC’s system.

Average Number of Banks in Each Color and Star Classification  
With Failure Rates Between 1991 and 2003

Color Code and Star Rating	Average Number of Banks In Category	Average Percentage of Banks in Category	Annualized Failure Rate <sup>†</sup>
Green ***	8348	82.53	0.03
Green **	924	9.13	0.08
Green *	53	0.52	2.20
Green, none	8	0.08	2.50 <sup>††</sup>
Yellow **	632	6.25	0.24
Yellow *	69	0.68	4.20
Yellow, none	27	0.26	13.74
Red, none	56	0.55	91.28

<sup>†</sup> 1991 through 2003 - chances per 1,000 banks per year.

<sup>††</sup> Statistical variance due to small sample of failures during this epoch.

Note that the combinations Yellow \*\*\*, Red\*\*\*, Red \*\*, and Red\* are not used.

## **HIGHLIGHTS OF VERIBANC's TRACK RECORD**

**During the last thirteen years, most of the failures (332 bank failures) occurred among the Red, No Stars group which represented only 0.55% of the industry.**

**Only One Failure in Over Twenty Years For Blue Ribbon Banks** - Additional support for VERIBANC's exemplary track record derives from the almost **zero failure rate** for banks receiving the Blue Ribbon Bank designation. **Since its introduction in 1982, only one Blue Ribbon Bank has ever failed.**

**For over twenty years, our clients who have relied on Blue Ribbon Banks have had their risk of bank failure virtually eliminated.**

**Timeliness** - Another factor which heightens rating effectiveness is timeliness. Each quarter, when new data for all banks is released by the Federal Reserve Board, **VERIBANC is the first organization (often by several weeks or more) to make this information and our associated analyses available to the public.** Why do we place such urgency on rapid updating? Quite simply because we have found that **the latest indicators of an institution's performance are the best predictors of how it will do in the future.** Our studies have shown that a lot can change in three months. Some organizations do not associate a date with their information. As you might imagine, they are often "behind" -- by six months or more.

**Adjustments To Ratings** - VERIBANC ratings and analysis have been subjected to exhaustive external critique for more than 20 years. We have invited review by observers ranging from industry experts to university researchers. Financial institutions are encouraged to contact us if they have more current data or unusual circumstances which they believe could or should affect their VERIBANC risk rating. We constantly monitor institutions and adjust, update and review ratings between quarters when appropriate. The purpose is to provide our clients with the best measure of banking risk that is possible.

**It is because of our rating system's unmatched track record that VERIBANC is considered to be the nation's premier bank rating service.**

## Exhibit A

### **DESCRIPTION OF RATING CRITERIA**

#### ***COLOR CLASSIFICATION***

VERIBANC's color code is a quick-look measure of an institution's condition based on its equity strength and profitability. Three color categories are used — GREEN, YELLOW, and RED. The criteria used by VERIBANC to determine the color category assigned to an institution are as follows:

- GREEN**      The institution's equity is five or more percent of its assets and it was profitable during the most recent reporting period. Of the three color categories, this is the highest based on the criteria described.
- YELLOW**     The institution's equity is between three and five percent of its assets or it incurred a net loss during the most recent reporting period. Both of these conditions may apply. If there was a net loss, the loss was not sufficient to erode a significant portion of the institution's equity. The items which result in a YELLOW classification merit your attention.
- RED**         The institution's equity is less than three percent of its assets or it incurred a significant net loss during the most recent reporting period (or both). The item or items which result in a RED classification deserve your close attention.

#### ***STAR CLASSIFICATION***

In addition to the color code, VERIBANC assigns each institution three stars (\*\*\*) , two stars (\*\*), one star (\*) or no stars (U). The star rating considers future trends and contingencies not accounted for in the color classification. The criteria used by VERIBANC to determine the number of stars assigned to an institution are as follows:

- \*\*\*      The institution must meet the following primary conditions: equity which is five or more percent of assets, equity which is four or more percent of assets after deducting problem loans, securities and derivatives contracts in excess of its loan loss reserves and positive net income for the most recent reporting period. Banks and thrifts must also satisfy all three regulatory capital requirements (see below) and not have any recent, serious regulatory sanctions against them. In addition, insider lending at banks and thrifts must not exceed 35 percent of equity. If the bank is owned by a holding company, all of the holding company's banks, taken together as if they were a single bank, must meet the criteria necessary to receive at least a two stars rating. A bank may only have two or fewer volatile periods of asset growth over the past ten quarters. For banks and credit unions, problem investments also include investments that, if sold, would realize less than their cost.
- \*\*        The institution meets any two of the three primary conditions for the three stars category. It also has equity which meets or exceeds its unreserved problem loans, securities and derivatives contracts. If the institution has a net loss during the most recent reporting quarter, the loss was not significant. Banks and thrifts must also satisfy all three regulatory capital requirements (see below) and not have any recent, serious regulatory sanctions against them. Additionally, if the bank is owned by a holding company, all of the holding company's banks, taken together as if they were a single bank, must meet the criteria necessary to receive at least a two stars rating. A bank may only have three volatile periods of asset growth over the past ten quarters. For banks and credit unions that have investments with a current market value that is less than their cost, that difference must not exceed equity.

- \* The institution meets at least one of the primary conditions required for the three stars category. It reports equity which is both three or more percent of assets and also meets or exceeds unreserved problem loans, securities and derivatives contracts. If the institution has a net loss during the most recent reporting quarter, the loss was not significant. Moreover, if the institution is a bank or a thrift, it meets at least two of the three federal capital requirements for tier one (core) capital, total capital and capital as a percentage of risk weighted assets. A bank may receive no higher than a one star rating if it has been subject to a recent serious regulatory sanction, or if all of the banks in its holding company, taken together as if they were a single bank, receive a one star or a no stars rating, or has four or more volatile periods of asset growth over the past ten quarters.. Also, a bank or credit union may receive a one star rating if, absent other reasons for downrating as stated above, the difference between the cost and current market value of its investments exceeds the institution's equity.

**None** The institution does not meet the criteria stated above.

† A quarterly loss is considered significant when it exceeds 18.75% of an institution's equity. A semi-annual loss which exceeds 37.5% of a credit union's equity may also be considered significant. If a bank, S&L or credit union's loss continues to exceed 18.75% of its equity every quarter (or, 37.5% of its equity every six months), the institution could become insolvent within one year. VERIBANC has no way to know whether or not losses at an institution will continue.

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