

IRWIN FINANCIAL CORPORATION

Form 10-Q

May 03, 2004

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2004

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____.

Commission File Number: 0-6835

IRWIN FINANCIAL CORPORATION

(Exact Name of Corporation as Specified in its Charter)

Indiana

35-1286807

(State or Other Jurisdiction of Incorporation or Organization)

(I.R.S. Employer Identification No.)

500 Washington Street Columbus, Indiana

47201

(Address of Principal Executive Offices)

(Zip Code)

(812) 376-1909

www.irwinfinancial.com

(Corporation's Telephone Number, Including Area Code)

(Web Site)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes **No**

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act

Yes No

As of April 26, 2004, there were outstanding 28,267,114 common shares, no par value, of the Registrant.

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Table of Contents**PART I. FINANCIAL INFORMATION.****Item 1. Financial Statements.****IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS (Unaudited)**

| | March 31, 2004 | December 31, 2003 |
|---|---|------------------------------|
| | (In thousands except for shares) | |
| Assets: | | |
| Cash and cash equivalents | \$ 175,704 | \$ 140,810 |
| Interest-bearing deposits with financial institutions | 66,608 | 81,166 |
| Residual interests | 69,771 | 71,491 |
| Investment securities - held-to-maturity (Market value: \$35,396 at March 31, 2004 and \$24,971 at December 31, 2003) | 35,356 | 24,956 |
| Investment securities - available-for-sale | 67,411 | 67,569 |
| Loans held for sale | 996,219 | 883,895 |
| Loans and leases, net of unearned income - Note 2 | 3,222,296 | 3,161,054 |
| Less: Allowance for loan and lease losses - Note 3 | (63,681) | (64,285) |
| | <hr/> | <hr/> |
| | 3,158,615 | 3,096,769 |
| Servicing assets - Note 4 | 332,611 | 380,123 |
| Accounts receivable | 65,819 | 62,045 |
| Accrued interest receivable | 14,944 | 15,502 |
| Premises and equipment, net | 30,641 | 32,208 |
| Other assets | 132,471 | 131,825 |
| | <hr/> | <hr/> |
| Total assets | \$5,146,170 | \$4,988,359 |
| Liabilities and Shareholders Equity: | | |
| Deposits | | |
| Noninterest-bearing | \$1,111,581 | \$ 850,529 |
| Interest-bearing | 1,473,812 | 1,352,763 |
| Certificates of deposit over \$100,000 | 723,614 | 696,370 |
| | <hr/> | <hr/> |
| | 3,309,007 | 2,899,662 |
| Short-term borrowings - Note 5 | 297,016 | 429,758 |
| Collateralized debt - Note 6 | 526,325 | 590,131 |
| Other long-term debt - Note 7 | 270,181 | 270,184 |
| Other liabilities | 290,456 | 366,364 |

| | | |
|---|----------------------------|----------------------------|
| Total liabilities | <u>4,692,985</u> | <u>4,556,099</u> |
| Commitments and contingencies - Note 11 | | |
| Shareholders' equity | | |
| Preferred stock, no par value - authorized 4,000,000 shares; none issued as of March 31, 2004 and December 31, 2003 | | |
| Common stock, no par value - authorized 40,000,000 shares; issued 29,612,080 shares as of March 31, 2004 and December 31, 2003, respectively; including 1,356,058 and 1,477,778 shares in treasury as of March 31, 2004 and December 31, 2003, respectively | | |
| | 112,000 | 112,000 |
| Additional paid-in capital | 595 | 1,264 |
| Deferred compensation | (540) | (504) |
| Accumulated other comprehensive income, net of deferred income tax liability of \$57 and \$120 at March 31, 2004 and December 31, 2003, respectively | 90 | 182 |
| Retained earnings | <u>370,728</u> | <u>352,647</u> |
| Less treasury stock, at cost | <u>482,873</u> (29,688) | <u>465,589</u> (33,329) |
| Total shareholders' equity | <u>453,185</u> | <u>432,260</u> |
| Total liabilities and shareholders' equity | <u>\$5,146,170</u> | <u>\$4,988,359</u> |

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents**IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**

| | For the Three Months Ended March 31, | |
|---|---|-------------|
| | 2004 | 2003 |
| | (In thousands, except per share) | |
| Interest income: | | |
| Loans and leases | \$ 61,246 | \$ 58,124 |
| Loans held for sale | 14,072 | 22,896 |
| Residual interests | 3,258 | 6,963 |
| Investment securities | 1,209 | 862 |
| Federal funds sold | 18 | 36 |
| | <hr/> | <hr/> |
| Total interest income | 79,803 | 88,881 |
| | <hr/> | <hr/> |
| Interest expense: | | |
| Deposits | 9,489 | 11,249 |
| Short-term borrowings | 1,623 | 4,067 |
| Collateralized debt | 3,805 | 2,984 |
| Other long-term debt | 5,683 | 582 |
| Preferred securities distribution | | 5,608 |
| | <hr/> | <hr/> |
| Total interest expense | 20,600 | 24,490 |
| | <hr/> | <hr/> |
| Net interest income | 59,203 | 64,391 |
| Provision for loan and lease losses | 8,146 | 9,243 |
| | <hr/> | <hr/> |
| Net interest income after provision for loan and lease losses | 51,057 | 55,148 |
| | <hr/> | <hr/> |
| Other income: | | |
| Loan servicing fees | 32,577 | 21,892 |
| Amortization of servicing assets Note 4 | (31,687) | (30,810) |
| Impairment of servicing assets Note 4 | (47,383) | (3,054) |
| | <hr/> | <hr/> |
| Net loan administration loss | (46,493) | (11,972) |
| Gain from sales of loans | 52,763 | 95,511 |

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| | | |
|---|----------------|---------------|
| Gain on sale of mortgage servicing assets | 6,489 | 4 |
| Trading gains (losses) | 4,673 | (17,789) |
| Derivative gains (losses), net | 58,948 | (6,474) |
| Other | 6,101 | 3,531 |
| | <u>82,481</u> | <u>62,811</u> |
| Other expense: | | |
| Salaries | 49,834 | 56,423 |
| Pension and other employee benefits | 11,747 | 10,824 |
| Office expense | 4,737 | 5,192 |
| Premises and equipment | 10,455 | 10,302 |
| Marketing and development | 3,634 | 3,694 |
| Professional fees | 3,844 | 2,805 |
| Other | 16,212 | 9,572 |
| | <u>100,463</u> | <u>98,812</u> |
| Income before income taxes | 33,075 | 19,147 |
| Provision for income taxes | 12,734 | 7,371 |
| | <u>20,341</u> | <u>11,776</u> |
| Net income | \$ 20,341 | \$ 11,776 |
| Earnings per share: - Note 9 | | |
| Basic | \$ 0.72 | \$ 0.42 |
| | <u>0.72</u> | <u>0.42</u> |
| Diluted | \$ 0.67 | \$ 0.41 |
| | <u>0.67</u> | <u>0.41</u> |
| Dividends per share | \$ 0.08 | \$ 0.07 |
| | <u>0.08</u> | <u>0.07</u> |

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents**IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)
For the Three Months Ended March 31, 2004, and 2003**

| | | Accumulated Other Comprehensive | | Deferred | Additional | Common | Treasury |
|--|------------------|---------------------------------------|------------------|-----------------|--------------------|------------------|-------------------|
| | Total | Retained Earnings | Income (Loss) | Compensation | Paid in Capital | Stock | Stock |
| (In thousands, except shares) | | | | | | | |
| Balance January 1, 2004 | \$432,260 | \$352,647 | \$ 182 | \$ (504) | \$ 1,264 | \$112,000 | \$(33,329) |
| Net income | 20,341 | 20,341 | | | | | |
| Unrealized gain on investment securities net of \$43 tax liability | 64 | | 64 | | | | |
| Unrealized loss on interest rate cap net of \$56 tax benefit | (81) | | (81) | | | | |
| Foreign currency adjustment net of \$50 tax benefit | (75) | | (75) | | | | |
| Total comprehensive income | 20,249 | | | | | | |
| Deferred compensation | (36) | | | (36) | | | |
| Cash dividends | (2,260) | (2,260) | | | | | |
| Tax benefit on stock option exercises | 661 | | | | 661 | | |
| Treasury stock: Purchase of 9,907 shares | (333) | | | | | | (333) |
| Sales of 131,627 shares | 2,644 | | | | (1,330) | | 3,974 |
| Balance March 31, 2004 | <u>\$453,185</u> | <u>\$370,728</u> | <u>\$ 90</u> | <u>\$ (540)</u> | <u>\$ 595</u> | <u>\$112,000</u> | <u>\$(29,688)</u> |
| Balance January 1, 2003 | \$360,555 | \$287,662 | \$(1,142) | \$ (240) | \$ 3,606 | \$112,000 | \$(41,331) |
| Net income | 11,776 | 11,776 | | | | | |
| Unrealized gain on investment securities net of \$15 tax liability | 22 | | 22 | | | | |
| Unrealized loss on | (30) | | (30) | | | | |

| | | | | | | | |
|--|------------------|------------------|-----------------|-----------------|-----------------|------------------|-------------------|
| interest rate cap net of \$20 tax benefit | | | | | | | |
| Foreign currency adjustment net of \$247 tax liability | 370 | | 370 | | | | |
| Minimum SERP liability net of \$170 tax liability | <u>256</u> | | <u>256</u> | | | | |
| | | | | | | | |
| Total comprehensive income | 12,394 | | | | | | |
| Deferred compensation | (318) | | | (318) | | | |
| Cash dividends | (1,948) | (1,948) | | | | | |
| Tax benefit on stock option exercises | 82 | | | | 82 | | |
| Treasury stock: Purchase of 6,672 shares | (115) | | | | | | (115) |
| Sales of 63,211 shares | <u>830</u> | | | | <u>(463)</u> | | <u>1,293</u> |
| | | | | | | | |
| Balance March 31, 2003 | <u>\$371,480</u> | <u>\$297,490</u> | <u>\$ (524)</u> | <u>\$ (558)</u> | <u>\$ 3,225</u> | <u>\$112,000</u> | <u>\$(40,153)</u> |

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents**IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

| | For the Three Months Ended March 31, | |
|--|---|------------------|
| | 2004 | 2003 |
| | (In thousands) | |
| Net income | \$ 20,341 | \$ 11,776 |
| Adjustments to reconcile net income to cash used by operating activities: | | |
| Depreciation, amortization, and accretion, net | 1,582 | 2,754 |
| Amortization and impairment of servicing assets | 79,070 | 33,864 |
| Provision for loan and lease losses | 8,146 | 9,243 |
| Gain on sale of mortgage servicing assets | (6,489) | |
| Gain from sale of loans held for sale | (52,763) | (95,511) |
| Originations of loans held for sale | (3,304,377) | (5,837,368) |
| Proceeds from sale of mortgage servicing assets | 15,606 | |
| Proceeds from the sale of loans held for sale | 3,163,639 | 5,545,358 |
| Net decrease in residual interests | 1,720 | 24,851 |
| (Increase) decrease in accounts receivable | (3,774) | 10,979 |
| Other, net | (36,908) | (11,780) |
| | <u>(114,207)</u> | <u>(305,834)</u> |
| Lending and investing activities: | | |
| Proceeds from maturities/calls of investment securities: | | |
| Held-to-maturity | 20,279 | 383 |
| Available-for-sale | 1,074 | 15,258 |
| Purchase of investment securities: | | |
| Held-to-maturity | (30,897) | (15,440) |
| Available-for-sale | (639) | |
| Net decrease (increase) in interest-bearing deposits with financial institutions | 14,558 | (7,225) |
| Net increase in loans, excluding sales | (83,437) | (1,170,749) |
| Proceeds from the sales of loans | 13,886 | 993,000 |
| Other, net | (308) | (2,060) |
| | <u>(65,484)</u> | <u>(186,833)</u> |
| Financing activities: | | |
| Net increase in deposits | 409,345 | 331,259 |
| Net decrease in short-term borrowings | (132,742) | (182,450) |

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| | | |
|---|-------------------|-------------------|
| Repayments of other long-term debt | (3) | (3) |
| Net (repayments of) proceeds from issuance of collateralized debt | (62,703) | 319,642 |
| Purchase of treasury stock for employee benefit plans | (333) | (115) |
| Proceeds from sale of stock for employee benefit plans | 3,305 | 912 |
| Dividends paid | (2,260) | (1,948) |
| | <u> </u> | <u> </u> |
| Net cash provided by financing activities | 214,609 | 467,297 |
| | <u> </u> | <u> </u> |
| Effect of exchange rate changes on cash | (24) | (69) |
| | <u> </u> | <u> </u> |
| Net increase (decrease) in cash and cash equivalents | 34,894 | (25,439) |
| Cash and cash equivalents at beginning of period | 140,810 | 157,771 |
| | <u> </u> | <u> </u> |
| Cash and cash equivalents at end of period | \$ 175,704 | \$ 132,332 |
| | <u> </u> | <u> </u> |
| Supplemental disclosures of cash flow information: | | |
| Cash flows during the period: | | |
| Interest paid | \$ 20,916 | \$ 24,469 |
| | <u> </u> | <u> </u> |
| Income taxes (received) paid | \$ (21,026) | \$ 13,651 |
| | <u> </u> | <u> </u> |
| Noncash transactions: | | |
| Loans sold, eligible for repurchase | \$ 78,004 | \$ |
| | <u> </u> | <u> </u> |

The accompanying notes are an integral part of the consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Summary of Significant Accounting Policies

Consolidation: Irwin Financial Corporation and its subsidiaries (the Corporation) provide financial services throughout the United States and Canada. We are engaged in the mortgage banking, commercial banking, home equity lending, commercial finance, and venture capital lines of business. Our direct and indirect subsidiaries include Irwin Mortgage Corporation, Irwin Union Bank and Trust Company, Irwin Union Bank, F.S.B., Irwin Home Equity Corporation, Irwin Commercial Finance Corporation, and Irwin Ventures LLC. Intercompany balances and transactions have been eliminated in consolidation. The Corporation does not meet the criteria as primary beneficiary for our wholly-owned trusts holding our company-obligated mandatorily redeemable preferred securities established by Financial Accounting Standards Board (FASB) Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. As a result, these trusts are not consolidated.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Residual Interests: Residual interests are stated at fair value. Unrealized gains and losses are included in earnings. Until the first quarter of 2002, when we sold receivables in securitizations of home equity loans and lines of credit, we retained residual interests, a servicing asset, one or more subordinated tranches, and in some cases a cash reserve account, all of which are retained interests in the securitized receivables. Gain or loss on the sale of the loans depended, in part, on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer.

To obtain fair value of residual interests, quoted market prices are used if available. However, quotes are generally not available for residual interests, so we generally estimate fair value based on the present value of expected cash flows using estimates of the key assumptions—prepayment speeds, credit losses, forward yield curves, and discount rates commensurate with the risks involved—that management believes market participants would use to value similar assets. Adjustments to carrying values are recorded as trading gains or losses.

Cash and Cash Equivalents Defined: For purposes of the statement of cash flows, we consider cash and due from banks and federal funds sold to be cash equivalents.

Stock-Based Employee Compensation: We have two stock-based employee compensation plans. We use the intrinsic value method to account for our plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost is reflected in net income for any of the periods presented, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. To date, the Board of Directors has not chosen to expense stock options. The Board wishes to analyze new guidance from the FASB, Securities and Exchange Commission (SEC) or other relevant authority regarding the standardization of valuation methods, until new requirements become effective. We will continue to disclose the impact of expensing stock options, using our valuation method, which is based on a Black-Scholes model using assumptions management believes to be reasonable. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standard (SFAS) 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

| | For the three months ended March 31, | |
|---|---|-----------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Net income as reported | \$20,341 | \$11,776 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (632) | (647) |
| Pro forma net income | <u>\$19,709</u> | <u>\$11,129</u> |
| Basic earnings per share | | |
| As reported | \$ 0.72 | \$ 0.42 |
| Pro forma | \$ 0.70 | \$ 0.40 |
| Diluted earnings per share | | |
| As reported | \$ 0.67 | \$ 0.41 |
| Pro forma | \$ 0.65 | \$ 0.39 |

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Recent Accounting Developments: We adopted FIN 46 as of December 31, 2003 and as a result, deconsolidated IFC Capital Trust II, IFC Capital Trust III, IFC Capital Trust IV, IFC Capital Trust V, IFC Capital Trust VI, and IFC Statutory Trust VII (IFC Trusts). The sole assets of the IFC Trusts are subordinated debentures of Irwin Financial Corporation. The IFC Trusts' liabilities are represented by Trust Preferred Securities, which have previously been listed as Company-obligated mandatorily redeemable preferred securities of subsidiary trusts on our consolidated balance sheets. Under FIN 46, the subordinated debentures, which are substantially equal in amount to the Trust Preferred Securities, cease to be eliminated in consolidation and are included in other long-term debt in our consolidated balance sheets at December 31, 2003 and March 31, 2004. Details about the IFC Trusts and debentures can be found in Note 7, Other Long-Term Debt.

The Trust Preferred Securities currently qualify as Tier 1 regulatory capital. The subordinated debentures do not qualify as Tier 1 regulatory capital, but do qualify for Tier 2 regulatory capital and we believe would continue to be treated as such should the Federal Reserve modify its capital rules due to FIN 46. The Federal Reserve Board has not reached final conclusion on the continued qualification of deconsolidated Trust Preferred Securities but has indicated that until further notice, these Trust Preferred Securities will continue to count as Tier 1 regulatory capital. Should the Federal Reserve Board reach a conclusion that deconsolidated Trust Preferred Securities would cease to qualify as Tier 1 regulatory capital, our Tier 1 regulatory capital would be reduced by approximately \$151 million. We believe our Total Capital ratios, including Tier 2 Capital, would remain unchanged and we would maintain capital levels above our policy limits.

Reclassifications: Certain amounts in the 2003 consolidated financial statements have been reclassified to conform to the 2004 presentation. These changes had no impact on previously reported net income or shareholders' equity.

Note 2 Loans and Leases

Loans and leases are summarized as follows:

| | March 31, 2004 | December 31, 2003 |
|--|-------------------------------|------------------------------|
| | (Dollars in thousands) | |
| Commercial, financial and agricultural | \$ 1,555,050 | \$ 1,503,619 |
| Real estate-construction | 268,554 | 306,669 |
| Real estate-mortgage | 890,477 | 859,541 |
| Consumer | 28,546 | 27,370 |
| Direct financing leases | | |
| Domestic | 377,433 | 364,413 |
| Foreign | 213,529 | 207,355 |
| Unearned income | | |
| Domestic | (82,126) | (78,875) |
| Foreign | (29,167) | (29,038) |
| | <hr/> | <hr/> |
| Total | \$ 3,222,296 | \$ 3,161,054 |
| | <hr/> | <hr/> |

Note 3 Allowance for Loan and Lease Losses

Changes in the allowance for loan and lease losses are summarized below:

| | As of and for the three months ended March 31, 2004 | As of and for the year ended December 31, 2003 |
|---|--|---|
| | (Dollars in thousands) | |
| Balance at beginning of period | \$64,285 | \$ 50,936 |
| Provision for loan and lease losses | 8,146 | 47,583 |
| Reduction due to sales and reclassification of loans and leases and other | (567) | (924) |
| Foreign currency adjustment | (25) | 582 |
| Recoveries | 1,417 | 3,420 |
| Charge-offs | (9,575) | (37,312) |
| | <u> </u> | <u> </u> |
| Balance at end of period | <u>\$63,681</u> | <u>\$ 64,285</u> |

Table of Contents**Note 4 Servicing Assets**

Included on the consolidated balance sheet at March 31, 2004 and December 31, 2003 are \$332.6 million and \$380.1 million, respectively, of capitalized servicing assets. These amounts relate to the principal balances of mortgage and home equity loans serviced by us for investors. Changes in our capitalized servicing assets, net of valuation allowance, are shown below:

| | As of and for the three months ended March 31, 2004 | As of and for the year ended December 31, 2003 |
|--|--|---|
| | (Dollars in thousands) | |
| Beginning balance | \$380,123 | \$ 174,935 |
| Additions | 40,676 | 296,551 |
| Amortization | (31,687) | (135,519) |
| (Provision for) recovery of impairment | (47,383) | 44,516 |
| Reduction for servicing sales | (9,118) | (360) |
| | <u>\$332,611</u> | <u>\$ 380,123</u> |

We have established a valuation allowance to record servicing assets at their fair value. Changes in the allowance are summarized below:

| | March 31, 2004 | December 31, 2003 |
|--|-------------------------------|------------------------------|
| | (Dollars in thousands) | |
| Balance at beginning of period | \$ 76,869 | \$159,865 |
| Provision for (recovery of) impairment | 47,383 | (44,516) |
| Reduction for servicing sales | (18,204) | |
| Other than temporary impairment ⁽¹⁾ | (6,999) | (38,480) |
| | <u>\$ 99,049</u> | <u>\$ 76,869</u> |

¹⁾ Other than temporary impairment was recorded to reflect our view that the originally recorded value of certain servicing rights and subsequent impairment associated with those rights is unlikely to be recovered in market value.

There was no related direct impact on net income as this other than temporary impairment affected only balance sheet accounts. However, the write-down will result in a reduction of amortization expense and potentially reduced recovery of impairment in future periods.

Note 5 Short-Term Borrowings

Short-term borrowings are summarized as follows:

| | March 31, 2004 | December 31, 2003 |
|--|-------------------------------|----------------------------------|
| | (Dollars in thousands) | |
| Drafts payable related to mortgage loan closings | \$ 137,069 | \$ 72,686 |
| Commercial paper | 15,915 | 16,415 |
| Federal Home Loan Bank borrowings | 106,348 | 286,000 |
| Federal funds | 35,013 | 53,600 |
| Lines of credit and other borrowings | 2,671 | 1,057 |
| | <u>\$297,016</u> | <u>\$429,758</u> |

Drafts payable related to mortgage loan closings are related to mortgage closings that have not been presented to the banks for payment. When presented for payment, these borrowings will be funded internally or by borrowing from the lines of credit.

Commercial paper is payable to a company controlled by a significant shareholder, officer and director of the Corporation.

Federal Home Loan Bank borrowings are collateralized by loans and loans held for sale.

We also have lines of credit available to fund loan originations and operations with variable rates ranging from 1.3% to 3.0% at March 31, 2004.

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We pledge or sell loans structured as secured financings at our home equity and commercial finance lines of business. Sale treatment is precluded on these transactions because we fail the true-sale requirements of SFAS 140 as we maintain effective control over the loans and leases securitized. This type of structure results in cash being received, debt being recorded, and the establishment of an allowance for credit losses. The notes associated with these transactions are collateralized by \$0.6 billion in home equity loans, home equity lines of credit, and leases. The principal and interest on these debt securities are paid using the cash flows from the underlying loans and leases. Accordingly, the timing of the principal payments on these debt securities is dependent on the payments received on the underlying collateral. The interest rates on the bonds are at a floating rate. We have interest only senior notes on both securitizations at the home equity lending line of business that as of March 31, 2004 had a combined notional balance of \$61.7 million (which does not represent the amount at risk). These senior notes pay interest at 10% and mature on December 25, 2004 and September 25, 2005.

Collateralized debt is summarized as follows:

| | Contractual Maturity | Weighted Average Interest Rate at March 31, 2004 | March 31, 2004 | December 31, 2003 |
|---|---------------------------------|---|---------------------------|------------------------------|
| (Dollars in thousands) | | | | |
| <u>Commercial finance line of business</u> | | | | |
| 2003 asset backed note | 07/04/2010 | 2.15% | \$ 45,508 | \$ 51,694 |
| 2003 asset backed note | 11/01/2008 | 3.63 | 69,753 | 77,902 |
| <u>Home equity lending line of business</u> | | | | |
| 2003-1 asset backed notes: | | | | |
| Combined variable rate senior notes | 02/25/2028 | 1.63 | 133,877 | 160,874 |
| Combined variable rate subordinate notes | 02/25/2028 | 3.40 | 68,625 | 61,763 |
| Unamortized premium | | | 3,939 | 4,446 |
| 2002-1 asset backed notes: | | | | |
| | 07/25/2023- | | | |
| Combined variable rate senior notes | 06/25/2029 | 1.37 | 128,466 | 156,699 |
| Combined variable rate subordinate notes | 02/25/2029 | 2.66 | 72,551 | 72,551 |
| Unamortized premium | | | 3,606 | 4,202 |
| Total | | | <u>\$526,325</u> | <u>\$590,131</u> |

Note 7 Other Long-Term Debt

At March 31, 2004 and December 31, 2003 we had \$270 million of other long-term debt. Included in both years is \$30 million of subordinated debt with an interest rate of 7.58% and a maturity date of July 2014 as well as a mortgage note outstanding for \$0.1 million with an interest rate of 8.50% and a maturity date of April 2008.

We also have obligations represented by subordinated debentures at March 31, 2004 of \$240 million. These securities were issued by wholly-owned trusts of Irwin Financial Corporation that were created for the purpose of issuing cumulative trust preferred securities. In accordance with FIN 46 we are not consolidating these trusts. Refer to Note 1 for information regarding the accounting change for these securities. These debentures are the sole assets of these trusts as of March 31, 2004. All debentures and securities are

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callable at par after five years from origination date. The securities are all Tier 1 qualifying capital at March 31, 2004. Highlights about these debentures and the related trusts are listed below:

| Name | Origination Date | Interest Rate at March 31, 2004 | Maturity Date | Subordinated Debt | | Other |
|-------------------------------|------------------|---------------------------------|---------------|-------------------|-------------------|---|
| | | | | March 31, 2004 | December 31, 2003 | |
| (Dollars in thousands) | | | | | | |
| IFC Capital Trust II | Nov 2000 | 10.50% | Sep 2030 | \$ 53,351 | \$ 53,351 | |
| IFC Capital Trust III | Nov 2000 | 8.75 | Sep 2030 | 53,268 | 53,268 | initial conversion ratio of 1.261 shares of common stock to 1 convertible preferred security, currently callable at 15% premium |
| IFC Capital Trust IV | Jul 2001 | 10.25 | Jul 2031 | 15,464 | 15,464 | |
| IFC Capital Trust V | Nov 2001 | 9.95 | Nov 2031 | 30,928 | 30,928 | |
| IFC Capital Trust VI | Oct 2002 | 8.70 | Sep 2032 | 35,567 | 35,567 | |
| IFC Statutory Trust VII | Nov 2003 | 4.01 | Nov 2033 | 51,547 | 51,547 | rate changes quarterly at three month LIBOR plus 290 basis points |
| | | | | \$240,125 | \$ 240,125 | |

Note 8 Employee Retirement Plans

Components of net periodic cost of pension benefit:

| | For the Three Months Ended March 31, | |
|---------------------------------------|---|-------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Service cost | \$ 494 | \$ 396 |
| Interest cost | 455 | 412 |
| Expected return on plan assets | (405) | (313) |
| Amortization of transition obligation | 3 | 3 |
| Amortization of prior service cost | 10 | 10 |
| Amortization of actuarial loss | 175 | 193 |

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| | | |
|---------------------------|--------|--------|
| Net periodic benefit cost | \$ 732 | \$ 701 |
|---------------------------|--------|--------|

As of March 31, 2004, we have not made any contributions to our pension plan and do not expect to contribute to this plan in 2004.

Table of Contents**Note 9 Earnings Per Share**

Earnings Per Share calculations are summarized as follow:

| | Basic Earnings Per Share | Effect of Stock Options | Effect of Preferred Shares | Effect of Convertible Shares | Diluted Earnings Per Share |
|---|---|--|---|---|---|
| (Dollars in thousands, except per share amounts) | | | | | |
| Three Months Ended March 31, 2004 | | | | | |
| Net income | \$20,341 | \$ | \$ | \$ 678 | \$21,019 |
| Shares | 28,191 | 492 | — | 2,607 | 31,290 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Per-share amount | \$ 0.72 | \$(0.01) | \$ | \$ (0.04) | \$ 0.67 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Three Months Ended March 31, 2003 | | | | | |
| Net income | \$11,776 | \$ | \$ | \$ 700 | \$12,476 |
| Shares | 27,786 | 202 | — | 2,610 | 30,598 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Per-share amount | \$ 0.42 | \$ | \$ | \$ (0.01) | \$ 0.41 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

At March 31, 2004 and 2003, 4,000 and 769,534 shares, respectively, related to stock options, were not included in the dilutive earnings per share calculation because they had exercise prices below the stock price as of the respective dates.

Note 10 Industry Segment Information

We have five principal segments that provide a broad range of financial services. The mortgage banking line of business originates, sells, and services residential first mortgage loans. The commercial banking line of business provides commercial banking services. The home equity lending line of business originates and services home equity loans. The commercial finance line of business originates leases and loans against commercial equipment and real estate. The venture capital line of business invests in early-stage technology companies focusing on financial services. Our other segment primarily includes the parent company and eliminations.

The accounting policies of each segment are the same as those described in the Summary of Significant Accounting Policies. Below is a summary of each segment's revenues, net income, and assets for three months ended March 31, 2004, and 2003:

| | <u>Mortgage Banking</u> | <u>Commercial Banking</u> | <u>Home Equity Lending</u> | <u>Commercial Finance</u> | <u>Venture Capital</u> | <u>Other</u> | <u>Consolidated</u> |
|--|-----------------------------|-------------------------------|--------------------------------|-------------------------------|----------------------------|-------------------|---------------------|
| (In thousands) | | | | | | | |
| For the Three Months Ended March 31, 2004 | | | | | | | |
| Net interest income | \$ 9,086 | \$ 19,756 | \$ 27,076 | \$ 6,754 | \$ 4 | \$ (3,473) | \$ 59,203 |
| Intersegment interest | (424) | 790 | (2,380) | | (5) | 2,019 | |
| Provision for loan and lease losses | 107 | (1,200) | (5,899) | (1,153) | | (1) | (8,146) |
| Other revenue | 59,867 | 4,646 | 18,279 | 475 | 9 | (795) | 82,481 |
| Intersegment revenues | | 130 | (624) | | 149 | 345 | |
| Total net revenues | 68,636 | 24,122 | 36,452 | 6,076 | 157 | (1,905) | 133,538 |
| Other expense | 51,603 | 14,634 | 24,662 | 4,052 | 128 | 5,384 | 100,463 |
| Intersegment expenses | 866 | 449 | 724 | 173 | | (2,212) | |
| Net income before taxes | 16,167 | 9,039 | 11,066 | 1,851 | 29 | (5,077) | 33,075 |
| Income taxes | 6,435 | 3,622 | 4,433 | 2,144 | 11 | (3,911) | 12,734 |
| Net income (loss) | \$ 9,732 | \$ 5,417 | \$ 6,633 | \$ (293) | \$ 18 | \$ (1,166) | \$ 20,341 |
| Assets at March 31, 2004 | \$1,330,505 | \$2,311,816 | \$1,107,988 | \$487,769 | \$7,266 | \$(99,174) | \$5,146,170 |

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| | Mortgage Banking | Commercial Banking | Home Equity Lending | Commercial Finance | Venture Capital | Other | Consolidated |
|--|-----------------------------|-------------------------------|--------------------------------|-------------------------------|----------------------------|-------------------|---------------------|
| (In thousands) | | | | | | | |
| For the Three Months Ended March 31, 2003 | | | | | | | |
| Net interest income | \$ 16,065 | \$ 19,757 | \$ 26,412 | \$ 4,807 | \$ 7 | \$ (2,657) | \$ 64,391 |
| Intersegment interest | | (730) | | | | 730 | |
| Provision for loan and lease losses | 53 | (1,580) | (4,880) | (2,864) | | 28 | (9,243) |
| Other revenue | 80,983 | 5,075 | (14,981) | 835 | (2,237) | (6,864) | 62,811 |
| Intersegment revenues | | 54 | | | 125 | (179) | |
| Total net revenues | 97,101 | 22,576 | 6,551 | 2,778 | (2,105) | (8,942) | 117,959 |
| Other expense | 64,522 | 13,454 | 21,415 | 3,218 | 108 | (3,905) | 98,812 |
| Intersegment expenses | 691 | 451 | 966 | 110 | | (2,218) | |
| Net income before taxes | 31,888 | 8,671 | (15,830) | (550) | (2,213) | (2,819) | 19,147 |
| Income taxes | 12,249 | 3,460 | (6,332) | (290) | (885) | (831) | 7,371 |
| Net income (loss) | \$ 19,639 | \$ 5,211 | \$ (9,498) | \$ (260) | \$ (1,328) | \$ (1,988) | \$ 11,776 |
| Assets at March 31, 2003 | \$1,922,008 | \$2,069,174 | \$1,064,626 | \$381,026 | \$ 3,762 | \$(74,664) | \$5,365,932 |

Note 11 Commitments and Contingencies

Our indirect subsidiary, Irwin Mortgage Corporation, is a defendant in a class action lawsuit in the United States District Court for the Northern District of Alabama, filed in April 1996, alleging that Irwin Mortgage violated the federal Real Estate Settlement Procedures Act (RESPA) relating to Irwin Mortgage's payment of broker fees to mortgage brokers. In June 2001, the Court of Appeals for the 11th Circuit upheld the district court's certification of a plaintiff class and the case was remanded for further proceedings in the federal district court.

In November 2001, by order of the district court, the parties filed supplemental briefs analyzing the impact of an October 18, 2001 policy statement issued by the Department of Housing and Urban Development (HUD) that explicitly disagreed with the judicial interpretation of RESPA by the Court of Appeals for the 11th Circuit in its ruling upholding class certification in this case. In response to a motion from Irwin Mortgage, in March 2002, the district court granted Irwin Mortgage's motion to stay proceedings in this case until the 11th Circuit decided the three other RESPA cases originally argued before it with this case.

The 11th Circuit subsequently decided all of the RESPA cases pending in that court. In one of those cases, the 11th Circuit concluded that the trial court had abused its discretion in certifying a class action under RESPA. Further, in that decision, the 11th Circuit expressly recognized it was, in effect, overruling its previous decision upholding class certification in this case. In March 2003, Irwin Mortgage filed a motion to decertify the class and the plaintiffs filed a renewed motion for summary judgment. On October 2, 2003 the case was reassigned to another U.S. district court judge. In response to an order from the court, the parties met and submitted a joint status report at the end of October 2003.

If the class is not decertified and the district court finds that Irwin Mortgage violated RESPA, Irwin Mortgage could be liable for damages equal to three times the amount of that portion of payments made to the mortgage brokers that is ruled unlawful. Based on notices sent by the plaintiffs to date to potential class members and additional notices that might be sent in this case, we believe the class is not likely to exceed 32,000 borrowers who meet the class specifications.

As discussed in prior periodic reports, other cases filed against our mortgage subsidiary alleging RESPA and violations similar to those in this case were settled in 2003 for nonmaterial amounts. Irwin Mortgage intends to defend this lawsuit vigorously and believes it has numerous defenses to the alleged violations. Irwin Mortgage further believes that the 11th Circuit's RESPA rulings in the cases argued before it with this one provide grounds for reversal of the class certification in this case. We have no assurance, however, that Irwin Mortgage will be successful in defeating class certification or will ultimately prevail on the merits. However, we expect that an adverse outcome in this case could result in substantial monetary damages that could be material to our financial position. We have not established any reserves for this case and are unable at this stage of the litigation to form a reasonable estimate of potential loss that we could suffer.

In January 2001, we and Irwin Leasing Corporation (formerly Affiliated Capital Corp.), our indirect subsidiary, and Irwin Equipment Finance Corporation, our direct subsidiary (together, the Irwin companies), were served as defendants in an action filed in the United States District Court for the Middle District of Pennsylvania. The suit alleges that a manufacturer/importer of certain medical devices made misrepresentations to health care professionals and to government officials to improperly obtain Medicare reimbursement for treatments using the devices, and that the Irwin companies, through Affiliated Capital's financing activities, aided in making the alleged misrepresentations. The Irwin companies filed a motion to dismiss on February 12, 2001. On August 10, 2001,

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the court granted our motion in part by dismissing Irwin Financial and Irwin Equipment Finance as defendants in the suit. In June, 2003, Irwin Leasing filed a motion for summary judgment. Oral argument was held on August 27, 2003. On October 8, 2003, the court granted Irwin Leasing's motion for summary judgment, dismissing the plaintiff's complaint. On October 22, 2003, the plaintiff filed a notice of appeal. The appeal is currently in the briefing process. We have not established any reserves for this case. Although we believe the trial court's decision is well-reasoned, we cannot predict at this time whether we will prevail on appeal.

Our subsidiary, Irwin Union Bank and Trust Company, is a defendant in a class action lawsuit, filed in the U.S. District Court in Massachusetts in July 2001. The case involves loans purchased by Irwin Union Bank and Trust from an unaffiliated third-party originator. The plaintiffs allege a failure to comply with certain disclosure provisions of the Truth in Lending Act relating to high rate loans in making second mortgage home equity loans to the plaintiff borrowers. The complaint seeks rescission of the loans and other damages.

On September 30, 2002, the court granted plaintiffs' motion for certification of a class, subject to certain limitations. In October 2002, we filed a motion for reconsideration with the district court and a petition for permission to appeal the class certification decision with the Court of Appeals for the 1st Circuit. In May 2003, the district court denied our motion for summary judgment and denied in part our motion for reconsideration of class decertification. However, the court further restricted membership in the plaintiff class. In October 2003, the court of appeals denied our application for appellate review of the district court's certification of the class. On April 1, 2004, the plaintiffs filed a motion for summary judgment and we filed a motion for summary judgment on class claims.

As originally specified, the plaintiff class was limited to those borrowers who obtained a mortgage loan originated with prepayment penalty provisions by the third-party originator during the three-year period prior to the filing of the suit. As more recently defined by the court, the class has been further restricted to those borrowers who refinanced their loans and paid a prepayment penalty. Only high-rate loans that are subject to the provisions of the Home Ownership and Equity Protection Act of 1994 would be included in the class.

Limited discovery on issues pertaining to class certification and the merits of plaintiffs' individual claim has been conducted. The actual number of plaintiff borrowers will be determined only after a review of loan files. Nevertheless, after performing a limited analysis of the approximately 200 loans acquired directly from the third-party originator and the approximately 7,800 loans acquired from others through bulk acquisitions that may include loans from the third-party originator, we believe that fewer than 100 loans will qualify for inclusion in the class. At the present time, we are unable to form a reasonable estimate of potential loss, if any, and have not established any reserves related to this case.

Our indirect subsidiary, Irwin Mortgage Corporation, is a defendant in a case filed in August 1998 in the Baltimore, Maryland, City Circuit Court. On January 25, 2002, a jury in this case awarded the plaintiffs damages of \$1.4 million jointly and severally against defendants, including Irwin Mortgage. The nine plaintiff borrowers alleged that a home rehabilitation company defrauded the plaintiffs by selling them defective homes at inflated prices and that Irwin Mortgage, which provided the plaintiff borrowers mortgage loans on the home purchases, participated in the fraud. Irwin Mortgage filed an appeal with the Maryland Court of Special Appeals and oral argument was held on January 7, 2003. On February 27, 2004, the Court of Special Appeals ruled against Irwin Mortgage and remanded the case to the trial court for a partial retrial on whether the plaintiffs are entitled to punitive damages. On April 12, 2004, Irwin Mortgage filed a Petition for Writ of Certiorari with the Maryland Court of Appeals, seeking further review. We have reserved for this case based upon the advice of our legal counsel.

In April 2003, our indirect subsidiary, Irwin Mortgage Corporation, was named as a defendant in an action filed in the Marion County, Indiana, Superior Court. The complaint alleges that Irwin Mortgage charged a document preparation fee in violation of Indiana law for services performed by clerical personnel in completing legal documents

related to mortgage loans. The plaintiff is seeking to certify a class consisting of Indiana borrowers who were charged the fee during the six-year period prior to the filing of the lawsuit. Irwin Mortgage filed an answer on June 11, 2003 and a motion for summary judgment on October 27, 2003. On November 3, 2003, the court ruled that a determination on class certification will precede any action on Irwin Mortgage's summary judgment motion. On January 9, 2004, the Plaintiff filed a Supplemental Brief and Submission of Additional Evidence in Support of Class Certification. On March 15, 2004, the court held a hearing on plaintiff's class certification motion. Because the case is in the early stages of litigation, we are unable at this time to form a reasonable estimate of the amount of potential loss, if any, that Irwin Mortgage could suffer. We have not established any reserves for this case.

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In April 2003, our indirect subsidiary, Irwin Mortgage Corporation, was named as a defendant in an action filed in the District Court of Nueces County, Texas. The complaint alleges that Irwin Mortgage improperly charged borrowers fees for the services of third-party vendors in excess of Irwin Mortgage's costs, and charged certain fees to which plaintiffs did not agree. The plaintiffs are seeking to certify a class consisting of similarly situated borrowers. Irwin Mortgage filed an answer on July 11, 2003 and responded to plaintiffs' initial discovery requests on December 19, 2003. On February 25, 2004 Irwin Mortgage served its initial discovery requests to the plaintiffs. Because the case is in the early stages of litigation, we are unable at this time to form a reasonable estimate of the amount of potential loss, if any, that Irwin Mortgage could suffer. We have not established any reserves for this case.

In October 2003, our indirect subsidiary, Irwin Mortgage Corporation (formerly Inland Mortgage Corporation), was named as a defendant, along with others, in an action filed in the Supreme Court of New York, County of Kings. The plaintiffs, a mother and two children, allege they were injured from lead contamination while living in premises allegedly owned by the defendants. The suit seeks approximately \$41 million in damages and alleges negligence, breach of implied warranty of habitability and fitness for intended use, loss of services and the cost of medical treatment. Because the case is in the early stages of litigation, we are unable at this time to form a reasonable estimate of the amount of potential loss, if any, that Irwin Mortgage could suffer. However, we are attempting to obtain a voluntary dismissal based on our belief that there is insufficient nexus between the cause of the alleged injuries and Irwin Mortgage. We have not established any reserves for this case.

We and our subsidiaries are from time to time engaged in various matters of litigation, including the matters described above, other assertions of improper or fraudulent loan practices or lending violations, and other matters, and we have a number of unresolved claims pending. In addition, as part of the ordinary course of business, we and our subsidiaries are parties to litigation involving claims to the ownership of funds in particular accounts, the collection of delinquent accounts, challenges to security interests in collateral, and foreclosure interests, that is incidental to our regular business activities. While the ultimate liability with respect to these other litigation matters and claims cannot be determined at this time, we believe that damages, if any, and other amounts relating to pending matters are not likely to be material to our consolidated financial position or results of operations, except as described above. Reserves are established for these various matters of litigation, when appropriate, based upon the advice of legal counsel.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

About Forward-looking Statements

You should read the following discussion in conjunction with our consolidated financial statements, footnotes, and tables. This discussion and other sections of this report contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and are including this statement for purposes of invoking these safe harbor provisions.

Forward-looking statements are based on management's expectations, estimates, projections, and assumptions. These statements involve inherent risks and uncertainties that are difficult to predict and are not guarantees of future performance. In addition, our past results of operations do not necessarily indicate our future results. Words that convey our beliefs, expectations, assumptions, estimates, forecasts, outlook and projections or similar language, or that indicate events we believe could, would, should, may or will occur (or might not occur) or are likely (or unlikely) to occur, and similar expressions, are intended to identify forward-looking statements. These may include, among other things, statements and assumptions about:

our projected revenues, earnings or earnings per share, as well as management's short-term and long-term performance goals;

projected trends or potential changes in our asset quality, loan delinquencies, asset valuations, capital ratios or financial performance measures;

our plans and strategies, including the expected results or impact of implementing such plans and strategies;

potential litigation developments and the anticipated impact of potential outcomes of pending legal matters;

the anticipated effects on results of operations or financial condition from recent developments or events; and

any other projections or expressions that are not historical facts.

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Actual future results may differ materially from what is projected due to a variety of factors, including, but not limited to:

- potential changes in and volatility of interest rates, which may affect consumer demand for our products and the management and success of our interest rate risk management strategies;
- staffing fluctuations in response to product demand;
- the relative profitability of our lending operations;
- the valuation and management of our servicing and derivative portfolios, including short-term swings in valuation of such portfolios due to quarter-end secondary market interest rates, which are inherently volatile;
- borrowers' refinancing opportunities, which may affect the prepayment assumptions used in our valuation estimates and which may affect loan demand;
- unanticipated deterioration in the credit quality of our assets;
- unanticipated deterioration in the carrying value of our other assets, including securities;
- difficulties in delivering products to the secondary market as planned;
- difficulties in expanding our businesses or raising capital and other funding sources as needed;
- competition from other financial service providers for experienced managers as well as for customers;
- changes in the value of companies in which we invest;
- changes in variable compensation plans related to the performance and valuation of lines of business where we tie compensation systems to line-of-business performance;
- legislative or regulatory changes, including changes in tax laws, changes in the interpretation of regulatory capital rules, disclosure or consumer lending rules, or rules affecting corporate governance, and the availability of resources to address these rules;
- changes in applicable accounting policies or principles or their application to our business; and
- governmental changes in monetary or fiscal policies.

We undertake no obligation to update publicly any of these statements in light of future events, except as required in subsequent periodic reports we file with the Securities and Exchange Commission (SEC).

Consolidated Overview

| | For the three months ended March 31, | |
|-----------------------|---|-------------|
| | 2004 | 2003 |
| Net income (millions) | \$ 20.3 | \$ 11.8 |

| | | |
|----------------------------|-------|-------|
| Basic earnings per share | 0.72 | 0.42 |
| Diluted earnings per share | 0.67 | 0.41 |
| Return on average equity | 18.4% | 13.2% |
| Return on average assets | 1.7 | 1.0 |

We recorded net income of \$20.3 million for the three months ended March 31, 2004, up 73% from net income of \$11.8 million for the three months ended March 31, 2003. Net income per share (diluted) was \$0.67 for the quarter ended March 31, 2004, up 63% from \$0.41 per share for the first quarter of 2003. Return on equity was 18.4% for the three months ended March 31, 2004 and 13.2% for the same period in 2003.

Consolidated Income Statement Analysis

Net Interest Income

Net interest income for the three months ended March 31, 2004 totaled \$59.2 million, down 8% from the first quarter 2003 net interest income of \$64.4 million. Net interest margin for the three months ended March 31, 2004 was 5.59% compared to 6.01% for the same period in 2003. The decline in margin from 2003 to 2004 was primarily due to the decline in the average balance of the residual interests. These high-yielding assets declined 52% in the first quarter of 2004 compared to the same period in 2003 as a result of unrealized trading losses (reflecting valuation impairment) during the first half of 2003. Interest from loans held for sale dropped 39% reflecting lower mortgage loan origination activity.

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The following tables show our daily average consolidated balance sheet, interest rates and interest differential at the dates indicated:

| | Three Months Ended March 31, | | | | | |
|--|-------------------------------------|-----------------|------------------------|----------------------------|-----------------|------------------------|
| | 2004 | | | 2003 | | |
| | Average Balance | Interest | Yield/ Rate | Average Balance | Interest | Yield/ Rate |
| | (Dollars in thousands) | | | | | |
| Assets | | | | | | |
| Interest-earning assets | | | | | | |
| Interest-bearing deposits with | | | | | | |
| banks | \$ 75,276 | \$ 137 | 0.73% | \$ 47,083 | \$ 94 | 0.81% |
| Federal funds sold | 8,526 | 18 | 0.85 | 19,101 | 36 | 0.76 |
| Residual interests | 70,716 | 3,258 | 18.53 | 146,155 | 6,963 | 19.32 |
| Investment securities | 77,952 | 1,072 | 5.53 | 57,835 | 768 | 5.39 |
| Loans held for sale | 803,267 | 14,072 | 7.05 | 1,172,443 | 22,896 | 7.92 |
| Loans and leases, net of unearned income ⁽¹⁾ | 3,225,210 | 61,246 | 7.64 | 2,899,186 | 58,124 | 8.13 |
| Total interest earning assets | \$4,260,947 | \$79,803 | 7.05% | \$4,341,803 | \$88,881 | 8.30% |
| Noninterest-earning assets | | | | | | |
| Cash and due from banks | \$ 105,906 | | | \$ 93,705 | | |
| Premises and equipment, net | 31,595 | | | 32,348 | | |
| Other assets | 553,180 | | | 348,690 | | |
| Less allowance for loan and lease losses | (64,447) | | | (52,031) | | |
| Total assets | \$4,887,181 | | | \$4,764,515 | | |
| Liabilities and Shareholders | | | | | | |
| Equity | | | | | | |
| Interest-bearing liabilities | | | | | | |
| Money market checking | \$ 224,708 | \$ 423 | 0.76% | \$ 144,746 | \$ 148 | 0.41% |
| Money market savings | 977,262 | 2,954 | 1.22 | 788,475 | 2,714 | 1.40 |
| Regular savings | 59,368 | 235 | 1.59 | 63,659 | 352 | 2.24 |
| Time deposits | 911,719 | 5,877 | 2.59 | 1,008,944 | 8,035 | 3.23 |
| Short-term borrowings | 273,488 | 1,623 | 2.39 | 708,683 | 4,067 | 2.33 |
| Collateralized debt | 563,049 | 3,805 | 2.72 | 446,454 | 2,984 | 2.71 |
| Other long-term debt | 270,183 | 5,683 | 8.46 | 30,069 | 582 | 7.85 |

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| | | | | | | |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Trust preferred securities | | | | 233,000 | 5,608 | 9.76 |
| | | | | <u> </u> | <u> </u> | <u> </u> |
| Total interest-bearing liabilities | \$3,279,777 | \$20,600 | 2.53% | \$3,424,030 | \$24,490 | 2.90% |
| | <u> </u> | <u> </u> | | <u> </u> | <u> </u> | |
| Noninterest-bearing liabilities | | | | | | |
| Demand deposits | \$ 866,721 | | | \$ 786,196 | | |
| Other liabilities | 296,774 | | | 191,731 | | |
| Shareholders equity | 443,909 | | | 362,558 | | |
| | <u> </u> | | | <u> </u> | | |
| Total liabilities and shareholders equity | \$4,887,181 | | | \$4,764,515 | | |
| | <u> </u> | | | <u> </u> | | |
| Net interest income | | \$59,203 | | | \$64,391 | |
| | | <u> </u> | | | <u> </u> | |
| Net interest income to average interest-earning assets | | | 5.59% | | | 6.01% |
| | | | <u> </u> | | | <u> </u> |

(1) For purposes of these computations, nonaccrual loans are included in daily average loan amounts outstanding.
Provision for Loan and Lease Losses

The consolidated provision for loan and lease losses for the three months ended March 31, 2004 was \$8.1 million, compared to \$9.2 million for the same period in 2003. More information on this subject is contained in the section on credit risk.

Noninterest Income

Noninterest income during the first quarter of 2004 totaled \$82.5 million, compared to \$62.8 million for the first three months of 2003. The increase in 2004 versus 2003 was a result of several factors. At the mortgage banking line of business, higher derivative gains, net of servicing asset impairment, gains from servicing sales and increased loan servicing fees all contributed to the increase. At the home equity lending line of business, we experienced a reversal of impairment on our residual interests during the first quarter of 2004 versus residual impairment in the same period in 2003. Details related to these fluctuations are discussed later in the mortgage banking and home equity lending sections of this document.

Table of Contents*Noninterest Expense*

Noninterest expenses for the three months ended March 31, 2004 totaled \$100.5 million, compared to \$98.8 million for the same period in 2003. The increase in consolidated noninterest expense in 2004 is primarily related to foreign currency transaction losses offset by lower personnel costs associated with our decreased production at the mortgage banking line of business.

Consolidated Balance Sheet Analysis

Total assets at March 31, 2004 were \$5.1 billion, up 3% from December 31, 2003. However, we believe that changes in the average balance sheet are a more accurate reflection of the actual changes in the level of activity on the balance sheet. Average assets for the first quarter of 2004 were \$4.9 billion, down 6% from the average assets in 2003. The decline in the consolidated average balance sheet primarily relates to a decrease in loans held for sale at the mortgage banking line of business during the first quarter as a result of declining production.

Loans and Leases

Our commercial loans and leases are originated throughout the United States. Equipment loans and leases are also originated in Canada by our commercial finance line of business. At March 31, 2004, 94% of our loan and lease portfolio was associated with our U.S. operations. We also extend credit to consumers throughout the United States through mortgages, installment loans and revolving credit arrangements. The majority of the remaining portfolio consists of residential mortgage loans (1-4 family dwellings) and mortgage loans on commercial property. Loans by major category for the periods presented were as follows:

| | March 31, 2004 | December 31, 2003 |
|--|---------------------------|------------------------------|
| | (In thousands) | |
| Commercial, financial and agricultural | \$1,555,050 | \$1,503,619 |
| Real estate construction | 268,554 | 306,669 |
| Real estate mortgage | 890,477 | 859,541 |
| Consumer | 28,546 | 27,370 |
| Direct lease financing: | | |
| Domestic | 377,433 | 364,413 |
| Canadian | 213,529 | 207,355 |
| Unearned income: | | |
| Domestic | (82,126) | (78,875) |
| Canadian | (29,167) | (29,038) |
| | <hr/> | <hr/> |
| Total | \$3,222,296 | \$3,161,054 |
| | <hr/> | <hr/> |

Loans Held For Sale

Loans held for sale totaled \$1.0 billion at March 31, 2004, an increase from a balance of \$0.9 billion at December 31, 2003. The increase occurred primarily at our mortgage banking line of business where first mortgage loans held for sale increased from \$0.7 billion at December 31, 2003 to \$0.8 billion at March 31, 2004.

Investment Securities

The following table shows the composition of our investment securities at the dates indicated:

| | March 31, 2004 | December 31, 2003 |
|--|---------------------------|----------------------------------|
| | (In thousands) | |
| U.S. Treasury and government obligations | \$ 30,183 | \$ 20,994 |
| Obligations of states and political subdivisions | 5,824 | 3,960 |
| Mortgage-backed securities | 2,412 | 2,039 |
| Federal Reserve stock, Federal Home Loan Bank stock and other | 64,348 | 65,532 |
| | <hr/> | <hr/> |
| Total | \$102,767 | \$ 92,525 |
| | <hr/> | <hr/> |

Table of Contents*Deposits*

Total deposits for the first quarter of 2004 averaged \$3.0 billion compared to deposits for the year 2003 that averaged \$3.1 billion. Demand deposits for the first quarter of 2004 averaged \$866.7 million, a 17% decrease over the average balance for the year 2003. A significant portion of demand deposits is related to deposits at Irwin Union Bank and Trust Company, which are associated with escrow accounts held on loans in the servicing portfolio at the mortgage banking line of business. During the first quarter of 2004, these escrow accounts averaged \$635.5 million compared to an average of \$826.2 million for the year 2003. The decrease in average escrow balances in 2004 relates to the decline in production at the mortgage banking line of business.

Irwin Union Bank and Trust utilizes institutional broker-sourced deposits as funding from time to time to supplement deposits solicited through branches and other wholesale funding sources. At March 31, 2004, institutional broker-sourced deposits totaled \$342.5 million compared to a balance of \$339.4 million at December 31, 2003.

Short-Term Borrowings

Short-term borrowings during the first quarter of 2004 averaged \$273.5 million compared to an average of \$595.2 million for the year 2003. Short-term borrowings declined to \$297.0 million at March 31, 2004 compared to \$429.8 million at December 31, 2003. The decrease in short-term borrowings at the end of the first quarter relative to year-end reflects an increase in mortgage escrow deposits (an alternative funding source for our mortgage warehouse) to \$828.8 million, compared to \$566.9 million at year-end.

Other Long-Term and Collateralized Borrowings

Other long-term debt totaled \$270.2 million at March 31, 2004, unchanged from December 31, 2003. We had obligations represented by subordinated debentures at March 31, 2004 totaling \$240.1 million with our wholly-owned trusts that were created for the purpose of issuing trust preferred securities. The subordinated debentures were the sole assets of the trusts at March 31, 2004. In accordance with FIN 46, at the end of 2003 we began deconsolidating the wholly-owned trusts that issued the trust preferred securities. As a result, these securities no longer are consolidated on our balance sheet. Instead, the subordinated debentures held by the trusts are disclosed on the balance sheet as other long-term debt.

Collateralized borrowings totaled \$526.3 million at March 31, 2004, compared to \$590.1 million at December 31, 2003. The decreased debt relates to paydowns on the secured borrowings during the first quarter at our home equity lending and commercial finance lines of business. These securitization structures result in loans remaining as assets and debt borrowings being recorded on the balance sheet. The securitization debt represents match-term funding for these loans and leases.

Capital

Shareholders' equity averaged \$443.9 million during the first quarter of 2004, up 12% compared to the average for the year 2003. Shareholders' equity balance of \$453.2 million at March 31, 2004 represented \$16.04 per common share, compared to \$15.36 per common share at December 31, 2003. We paid \$2.3 million in dividends in the first quarter of 2004, reflecting an increase of \$0.01 per share compared to a year ago.

The following table sets forth our capital and regulatory capital ratios at the dates indicated:

March 31, December 31,

| | 2004 | 2003 |
|--|-----------------------------|-----------------------------|
| | <u> </u> | <u> </u> |
| | (In thousands) | |
| Tier 1 capital | \$ 585,287 | \$ 556,793 |
| Tier 2 capital | 175,906 | 183,738 |
| | <u> </u> | <u> </u> |
| Total risk-based capital | \$ 761,193 | \$ 740,531 |
| | <u> </u> | <u> </u> |
| Risk-weighted assets | \$4,965,752 | \$4,917,622 |
| Risk-based ratios: | | |
| Tier 1 capital | 11.8% | 11.4% |
| Total capital | 15.3 | 15.1 |
| Tier 1 leverage ratio | 11.8 | 11.2 |
| Ending shareholders equity to assets | 8.8 | 8.7 |
| Average shareholders equity to assets | 9.1 | 7.6 |

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At March 31, 2004, our total risk-adjusted capital ratio was 15.3% exceeding the 10.0% required to be considered well-capitalized by our state and federal banking regulators and our internal minimum target of 11.0%. At December 31, 2003, our total risk-adjusted capital ratio was 15.1%. Our ending equity to assets ratio at March 31, 2004 was 8.8% compared to 8.7% at December 31, 2003. Our Tier 1 capital totaled \$585.3 million as of March 31, 2004, or 11.8% of risk-weighted assets.

Cash Flow Analysis

Our cash and cash equivalents increased \$34.9 million during the first quarter of 2004 compared to a decrease of \$25.4 million during the same period in 2003. Cash flows from operating activities resulted in a use of \$114.2 million in cash and cash equivalents in the first quarter of 2004 compared to the first quarter of 2003 when our operations used \$305.8 million in cash and cash equivalents. Changes in loans held for sale impact cash flows from operations. In a period in which loan production exceeds sales such as we had in the first quarter of 2004, operating cash flows will decrease reflecting our investment in cash generating assets. In the first quarter of 2004, our loans held for sale increased \$112.3 million, thus increasing the cash used by operating activities.

Earnings Outlook

We have not provided quantitative earnings guidance for 2004. As discussed before, our strategy is to balance the impact of changes in interest rates and economic conditions on our mortgage banking production with investments in mortgage servicing and in our credit retained portfolios. These investments will typically respond in an opposite and complementary manner. We expect a higher proportion of 2004 earnings to come from our commercial banking, home equity lending and commercial finance lines of business than was the case in 2003. We expect these earnings to be more in line with the long-term growth and segment contribution trends we have seen at Irwin Financial, rather than the disproportionate contribution to revenues that we had from mortgage originations during 2002 and 2003. We believe our credit quality is improving and that our expenses for credit reserves will decline in 2004, allowing us to increase earnings. In addition, in a strengthening economy in which interest rates rise, we believe our net revenues from our mortgage servicing activities should increase. These estimates are based on various factors and current assumptions management believes are reasonable, including current industry forecasts of a variety of economic and competitive factors. However, projections are inherently uncertain, and our actual earnings may differ significantly from this estimate due to uncertainties and risks related to our business such as fluctuations in interest rates and other factors mentioned above in the **About Forward-Looking Statements** section. Our transition off securitization gain-on-sale accounting in our home equity line of business has now had a two-year history at the end of 2003. We assume that the completion of this transition, coupled with the projected growth of our other lines of business, will enable us over time to meet or exceed our long-term targets of double digit growth in earnings per share and 15% return on equity, measured over several years.

A meaningful amount of our earnings comes from activities and mark-to-market accounting requirements tied directly or indirectly to capital market activities. For example, the valuation of our mortgage servicing portfolio is impacted by movements in the bond market. The impact of short-term movements in interest rates on the valuation of our mortgage servicing rights is mitigated by a combination of financial derivatives and changes in income from production of new mortgages likely to be driven by those same movements in interest rates. However, the correlation within short periods of time (such as a single quarter) between interest rate movements that impact the reported value of our mortgage servicing rights at quarter end and the production effects of those interest rate movements which may not be reflected until the following quarter can be low. In addition, U.S. generally accepted accounting principles (GAAP) imposes a lower-of-cost-or-market valuation cap on the value of our servicing asset, while we know of no financial derivatives available in the secondary market with similarly asymmetric value change characteristics. This anomaly in accounting for mortgage servicing assets makes it difficult at times to construct hedges with the desired GAAP accounting outcome, although the economic balance may still exist. It is possible, therefore, that our balanced

revenue strategy may be successful as measured over several quarters or years, but may have market-based variances if measured over short periods. We also have a large amount of income that is subject to assumptions and pricing for credit risks. We use a variety of methods for estimating the effects of and accounting for credit losses, but ultimately, we need to make estimates based on imperfect knowledge of future events, which may cause actual results to differ materially from our expectations. For example, if the pace of economic recovery in the U.S. is slower in 2004 than currently anticipated by consensus estimates, our credit related costs may increase beyond our current estimates.

Table of Contents**Earnings by Line of Business**

Irwin Financial Corporation is composed of five principal lines of business:

Mortgage Banking

Commercial Banking

Home Equity Lending

Commercial Finance

Venture Capital

The following table summarizes our net income (loss) by line of business for the periods indicated:

| | Three Months Ended March 31, | |
|---|-------------------------------------|------------------|
| | 2004 | 2003 |
| | (In thousands) | |
| Net income (loss): | | |
| Mortgage Banking | \$ 9,732 | \$ 19,639 |
| Commercial Banking | 5,417 | 5,211 |
| Home Equity Lending | 6,633 | (9,498) |
| Commercial Finance | (293) | (260) |
| Venture Capital | 18 | (1,328) |
| Other (including consolidating entries) | (1,166) | (1,988) |
| | <u>\$ 20,341</u> | <u>\$ 11,776</u> |

Mortgage Banking

The following table shows selected financial information for our mortgage banking line of business:

| | Three Months Ended March 31, | |
|--|-------------------------------------|-----------------------------|
| | 2004 | 2003 |
| | (In thousands) | |
| Selected Income Statement Data: | | |
| Net interest income | \$ 8,662 | \$ 16,065 |
| Recovery of loan losses | 107 | 53 |
| Other income | 59,867 | 80,983 |
| | <u> </u> | <u> </u> |

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| | | |
|---------------------|----------|-----------|
| Total net revenue | 68,636 | 97,101 |
| Operating expense | (52,469) | (65,213) |
| | <hr/> | <hr/> |
| Income before taxes | 16,167 | 31,888 |
| Income taxes | (6,435) | (12,249) |
| | <hr/> | <hr/> |
| Net income | \$ 9,732 | \$ 19,639 |
| | <hr/> | <hr/> |

Selected Operating Data:

| | | |
|---------------------------------------|--------------|--------------|
| Mortgage loan originations | \$ 2,930,716 | \$ 5,477,292 |
| Servicing sold as a % of originations | 50.6% | 4.5% |

| | | |
|--|---------------------------|------------------------------|
| Selected Balance Sheet Data at End of Period: | March 31, 2004 | December 31, 2003 |
| <hr/> | <hr/> | <hr/> |

| | | |
|------------------------------|--------------|--------------|
| Total assets | \$ 1,330,505 | \$ 1,258,641 |
| Mortgage loans held for sale | 781,224 | 679,360 |
| Mortgage servicing assets | 298,486 | 348,174 |
| Short-term debt | 83,913 | 214,877 |
| Shareholder s equity | 125,490 | 122,671 |

Selected Operating Data:

| | | |
|--------------------------------|------------|------------|
| Servicing portfolio: | | |
| Balance at end of period | 29,563,330 | 29,640,122 |
| Weighted average coupon rate | 5.73% | 5.83% |
| Weighted average servicing fee | 0.32 | 0.33 |

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Overview

In our mortgage banking line of business, we originate, purchase, sell and service conventional and government agency-backed residential mortgage loans throughout the United States. We also engage in the business of mortgage reinsurance. Because most of our mortgage originations either are insured by an agency of the federal government, such as the Federal Housing Administration (FHA) or the Veterans Administration (VA), or, in the case of conventional mortgages, meet requirements for sale to Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC) or the Federal Home Loan Bank (FHLB), we are able to remove substantially all of the credit risk associated with these loans from our balance sheet. While we securitize and sell mortgage loans to institutional and private investors, we may choose to retain the servicing rights. Loan origination demand and servicing values react in opposite directions to changes in interest rates, as explained below. We believe this balance between mortgage loan originations and mortgage loan servicing values assists in managing the risk from interest rate changes, which has helped stabilize our revenue stream.

Our mortgage banking line of business is currently our largest contributor to revenue, comprising 51% of our total net revenues for the first quarter in 2004, compared to 82% for the first quarter in 2003. Our mortgage banking line of business contributed 48% of our net income this quarter, compared to 167% for the first quarter last year.

Our channels for originating loans consist primarily of retail, wholesale, and correspondent lending. The retail channel originates loans through retail branches and identifies potential borrowers mainly through relationships maintained with housing intermediaries, such as realtors, homebuilders and brokers. Our wholesale and correspondent divisions purchase loans from third party sources. The wholesale division purchases primarily from mortgage loan brokers and issues loan proceeds directly to the borrower. The correspondent lending division purchases closed mortgage loans primarily from small mortgage banks and retail banks. We fund our mortgage loan originations using internal funding sources and through credit facilities provided by third parties. Generally within a 30-day period after funding, we sell our mortgage loan originations into the secondary mortgage market by either direct loan sales or by securitization. Our secondary market sources include government-sponsored mortgage entities, nationally-sponsored mortgage conduits, and institutional and private investors.

As mentioned, we believe there is a balance between mortgage loan originations and mortgage loan servicing that assists in managing the risk from interest rate changes and the impact of rate changes on each part of the business. In rising interest rate environments, originations typically decline, while the unrealized value of our mortgage servicing portfolio generally increases as prepayment expectations decline. In declining interest rate environments, unrealized servicing values typically decrease as prepayment expectations increase, while the economic value of our mortgage production franchise generally increases due to the potential for greater mortgage loan originations. However, the offsetting impact of changes in production income and servicing values may not always be recognized in the same quarter under generally accepted accounting principles - due to the application of lower-of-cost-or-market treatment under generally accepted accounting principles to the mortgage servicing asset, but not its equivalent to the production franchise causing greater volatility in short-term results than is apparent in longer-term measurements such as annual income. We sell servicing rights periodically for many reasons, including income recognition, cash flow, capital management and servicing portfolio management. Servicing rights sales occur at the time the underlying loans are sold to an investor (in flow sales) or in pools from our seasoned servicing portfolio (in bulk sales).

Net Income

Net income from mortgage banking for the three months ended March 31, 2004 was \$9.7 million, compared to \$19.6 million for the same period in 2003, a decrease of 50%. This net income decrease in 2004 primarily relates to a decline in mortgage originations as a result of an increasing interest rate environment that began in the latter half of 2003.

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The following table shows the composition of our originations by loan categories for the periods indicated:

| | Three Months Ended March 31, | |
|---------------------------------|-------------------------------------|-------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Total originations | \$2,930,716 | \$5,477,292 |
| Percent retail loans | 23% | 27% |
| Percent wholesale loans | 43 | 49 |
| Percent correspondent | 25 | 21 |
| Percent brokered ⁽¹⁾ | 9 | 3 |
| Percent refinances | 61 | 70 |

⁽¹⁾ Brokered loans are loans we originate for which we receive loan origination fees, but which are funded, closed and owned by unrelated third parties.

Mortgage loan originations for the three months ended March 31, 2004 totaled \$2.9 billion, down 46% from the same period in 2003 as a result of the increasing interest rate environment. Refinanced loans accounted for 61% of loan production for the first quarter of 2004 compared to 70% for the same period in 2003.

Net Revenue

| | Three Months Ended March 31, | |
|--|-------------------------------------|------------------|
| | 2004 | 2003 |
| | (In thousands) | |
| Selected Income Statement Data: | | |
| Net interest income | \$ 8,662 | \$ 16,065 |
| Recovery of loan losses | 107 | 53 |
| Gain on sales of loans | 42,782 | 91,228 |
| Servicing fees | 25,899 | 16,755 |
| Amortization expense | (27,310) | (27,235) |
| Impairment of servicing assets | (48,184) | (1,954) |
| Gain on derivatives | 58,352 | 321 |
| Gain on sales of servicing assets | 6,489 | 4 |
| Other income | 1,839 | 1,864 |
| | <hr/> | <hr/> |
| Total net revenue | \$ 68,636 | \$ 97,101 |

Net interest income is generated from the interest earned on mortgage loans before they are sold to investors, less the interest expense incurred on borrowings to fund the loans. Net interest income for the first quarter in 2004 totaled \$8.7 million compared to \$16.1 million for the first quarter in 2003. The decrease in net interest income in 2004 is a

result of decreased production resulting in a lower average balance of mortgage loans held for sale on our balance sheet during the quarter.

Gain on sale of loans includes the valuation of newly created mortgage servicing rights and net loan origination fees and is recognized when loans are pooled and sold into the secondary mortgage market. Also included in gain on sale of loans are fair value adjustments to forward contracts and interest rate lock commitments. Gain on sale of loans for the three months ended March 31, 2004 totaled \$42.8 million, compared to \$91.2 million for the same period in 2003, a decline of 53%. This decrease is attributable to decreased originations and slightly reduced secondary market margins as a result of the increasing interest rate environment during the latter half of 2003.

Servicing fee income is recognized by collecting fees, which normally range between 25 and 44 basis points annually on the principal amount of the underlying mortgages. Servicing fee income totaled \$25.9 million for the first quarter of 2004, an increase of 55% from first quarter of 2003, primarily reflecting the growth in the servicing portfolio.

Amortization expense relates to mortgage servicing rights and is based on the proportion of current net servicing income to the total expected for the estimated lives of the underlying loans. Amortization expense totaled \$27.3 million for the three months ended March 31, 2004, relatively unchanged compared to \$27.2 million during the first quarter of 2003. Due to changes in our amortization methodology in the first quarter of 2003 and a \$38 million other-than-temporary impairment adjustment recorded in the fourth quarter of 2003, our amortization expense was relatively unchanged on a year-over-year basis, notwithstanding the increase in our servicing portfolio.

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Impairment expense is recorded when the book value of the mortgage servicing rights exceeds the fair value on a strata by strata basis. We determined fair value at March 31, 2004, through the use of internal models, valuation comparisons to actual servicing sale proceeds, and independent valuations (each of which produced approximately the same valuation result) performed by third parties at the end of February and the end of March. We made various changes to assumptions used in our internal models to ensure our valuation was consistent with market evidence obtained. Impairment expense totaled \$48.2 million during the first quarter of 2004, compared to \$2.0 million during the same period of 2003. The impairment expense in 2004 was a result of higher loan prepayment expectations trends from declining interest rates during the first quarter of 2004. Derivative gains of \$58.4 million were recorded during the same period. Derivative gains of \$0.3 million were recorded during the first quarter of 2003. Although mortgage servicing rights valuations declined in both periods, impairment net of derivative gains/losses in the first quarter of 2004 was a positive \$10.2 million compared to a negative \$1.6 million in the same period a year earlier, reflecting larger offsetting gains in derivatives in 2004.

At March 31, 2004, the mortgage line of business held \$10.8 billion notional amount of interest rate swaptions to manage the risk associated with our servicing assets. Notional amounts do not represent the amount at risk. The current risk management activities of the mortgage bank related to servicing assets do not satisfy the criteria for hedge accounting under SFAS 133. As a result, these derivatives are accounted for as other assets and other liabilities, and changes in fair value are adjusted through earnings as derivative gains (losses), while the underlying servicing asset is accounted for on a strata-by-strata basis at the lower of cost or market.

In the first quarter of 2004, we recorded an other-than-temporary impairment adjustment of \$7.0 million to reflect our view that the originally recorded value of certain servicing rights, net of amortization, and subsequent impairment associated with those rights is unlikely to be recovered in market value. There was no related direct impact on net income as this other than temporary impairment affected only balance sheet accounts. However, the adjustment will result in a reduction of amortization expense and potentially reduced recovery of impairment in future periods.

Our mortgage banking business maintains the flexibility either to sell servicing for current cash flow through bulk sales or to retain servicing for future cash flow through the retention of ongoing servicing fees. Total servicing sales represented 51% of loan originations during the first quarter of 2004, compared to 4% during the first quarter of 2003. The decision to sell or retain servicing is based on current market conditions for servicing assets, loan origination levels and production expenses, servicing portfolio management considerations, consolidated capital constraints and the general level of risk tolerance of the mortgage banking line of business and the Corporation. We sold \$1.1 billion of servicing during the first quarter of 2004, generating a \$6.5 million pre-tax gain. There were no bulk sales during the first quarter of 2003. Over the past few years, we have built our servicing portfolio in anticipation of rising interest rates that would result in lower mortgage loan production. We sold servicing this quarter to counteract the effect of declines in production income, as we do in periods of rising interest rates, as well as to manage the size and composition of our investment in mortgage servicing assets.

Operating Expenses

The following table sets forth operating expenses for our mortgage banking line of business for the periods indicated:

| Three Months Ended March 31, | |
|---|-------------|
| 2004 | 2003 |
| | |

| | (Dollars in thousands) | |
|--|-------------------------------|------------------|
| Salaries and employee benefits | \$ 19,740 | \$ 17,999 |
| Incentive and commission pay | 9,788 | 23,014 |
| Other expenses | <u>22,941</u> | <u>24,200</u> |
| | | |
| Total operating expenses | <u>\$ 52,469</u> | <u>\$ 65,213</u> |
| | | |
| Number of employees at period end ⁽¹⁾ | 2,012 | 2,055 |

⁽¹⁾ On a full time equivalent basis

Operating expenses for the three months ended March 31, 2004 totaled \$52.5 million, a 20% decrease over the same period in 2003. Salaries and employee benefits including incentive and commission pay declined 28% during the first quarter of 2004 compared to the same period in 2003. These fluctuations reflect significant decreases in production activities in 2004 versus 2003.

Table of Contents*Mortgage Servicing*

The following table shows information about our managed mortgage servicing portfolio, including mortgage loans held for sale, for the periods indicated:

| | Three Months Ended March 31, 2004 | Year Ended December 31, 2003 |
|--|--|---|
| | (Portfolio in billions) | |
| Beginning servicing portfolio | \$ 29.6 | \$ 16.8 |
| Mortgage loan closings | 2.7 | 21.9 |
| Sales of servicing rights | (1.2) | (0.6) |
| Run-off ⁽¹⁾ | (1.5) | (8.5) |
| | <hr/> | <hr/> |
| Ending servicing portfolio | \$ 29.6 | \$ 29.6 |
| | <hr/> | <hr/> |
| Number of loans (end of period) | 226,714 | 229,983 |
| Average loan size | \$130,399 | \$128,880 |
| Weighted average coupon rate | 5.73% | 5.83% |
| Percent Government National Mortgage Association (GNMA) and state housing programs | 23% | 26% |
| Percent conventional and other | 77 | 74 |
| Delinquency ratio | 2.7 | 4.6 |
| Mortgage servicing assets to related servicing portfolio ⁽²⁾ | 1.02 | 1.19 |

⁽¹⁾ Run-off is primarily the reduction in principal balance of the servicing portfolio due to regular principal payments made by mortgagees and early repayments of entire loans.

⁽²⁾ For this calculation, deferred service release premiums on warehouse loans are excluded from mortgage servicing assets and loans held for sale (i.e. warehouse loans) are excluded from the servicing portfolio.

We record originated mortgage servicing assets at allocated cost basis when the loans are sold and record purchased servicing assets at fair value. Thereafter, servicing rights are accounted for at the lower of their cost or fair value. We record a valuation allowance for any impairment on a disaggregated basis. We determine fair value on a monthly basis based on a discounted cash flow analysis. These cash flows are projected over the life of the servicing using prepayment, default, discount rate and cost to service assumptions that we believe market participants would use to value similar assets. We then assess these modeled assumptions for reasonableness through independent third-party valuations, periodic servicing asset sales and through the use of industry surveys. At March 31, 2004, we estimated the fair value of these assets to be \$302.8 million in the aggregate, or \$4.3 million greater than the carrying value on the balance sheet, the difference between carrying value and market value being the result of a cap under generally accepted accounting principles at the lower of cost or market for these assets. At December 31, 2003, we estimated the

fair value of these assets to be \$358.9 million in the aggregate, or \$10.7 million greater than the carrying value on the balance sheet.

Table of Contents**Commercial Banking**

The following table shows selected financial information for our commercial banking line of business:

| | Three Months Ended March 31, | |
|--|-------------------------------------|-----------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Selected Income Statement Data: | | |
| Interest income | \$ 28,385 | \$ 27,630 |
| Interest expense | (7,839) | (8,603) |
| Net interest income | 20,546 | 19,027 |
| Provision for loan and lease losses | (1,200) | (1,580) |
| Noninterest income | 4,776 | 5,129 |
| Operating expense | (15,083) | (13,905) |
| Income before taxes | 9,039 | 8,671 |
| Income taxes | (3,622) | (3,460) |
| Net income | <u>\$ 5,417</u> | <u>\$ 5,211</u> |

| Selected Balance Sheet Data at End of Period | March 31, | December |
|---|------------------|-----------------|
| | 2004 | 31, |
| | | 2003 |
| Total assets | \$2,311,816 | \$2,203,965 |
| Loans | 2,007,917 | 1,988,633 |
| Allowance for loan and lease losses | 22,086 | 22,055 |
| Deposits | 2,082,557 | 1,964,274 |
| Shareholder's equity | 161,676 | 162,050 |

| Year to Date Daily Averages: | March 31, | December 31, |
|-------------------------------------|------------------|---------------------|
| | 2004 | 2004 |
| Assets | \$2,256,645 | \$2,119,944 |
| Loans | 1,996,261 | 1,914,608 |
| Allowance for loan and lease losses | 22,310 | 21,895 |
| Deposits | 2,020,300 | 1,894,406 |
| Shareholder's equity | 156,677 | 147,886 |
| Shareholder's equity to assets | 6.94% | 6.98% |

Overview

Our commercial banking line of business focuses on providing credit, cash management and personal banking products to small businesses and business owners. We offer commercial banking services through our banking subsidiaries, Irwin Union Bank and Trust, an Indiana state-chartered commercial bank, and Irwin Union Bank, F.S.B., a federal savings bank.

Net Income

Commercial banking net income increased to \$5.4 million during the first quarter of 2004, compared to \$5.2 million for the same period in 2003.

Net Interest Income

The following table shows information about net interest income for our commercial banking line of business:

| | Three Months Ended March 31, | |
|---------------------------------|-------------------------------------|-------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Net interest income | \$ 20,546 | \$ 19,027 |
| Average interest earning assets | 2,178,870 | 1,916,236 |
| Net interest margin | 3.79% | 4.03% |

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Net interest income was \$20.5 million for the first quarter of 2004, an increase of 8% over first quarter of 2003. The 2004 improvement in net interest income resulted primarily from an increase in our commercial banking loan portfolio as a result of growth and expansion efforts. Net interest margin is computed by dividing net interest income by average interest earning assets. Net interest margin for the three months ended March 31, 2004 was 3.79%, compared to 4.03% for the same period in 2003. The reduction in 2004 margin is due to slower than anticipated loan growth which has led to greater than planned excess liquidity, as well as funding sources which have hit contractual or competitive rate floors at a greater rate than our loan assets.

Provision for Loan and Lease Losses

Provision for loan and lease losses declined to \$1.2 million during the first quarter of 2004, compared to a provision of \$1.6 million during the same period in 2003. The declining provision relates to a combination of improving economic conditions, slower loan growth, improved overall loan quality, and a lower level of potential loss exposure. See further discussion in the *Credit Quality* section below.

Noninterest Income

The following table shows the components of noninterest income for our commercial banking line of business:

| | Three Months Ended March 31, | |
|---|---|-------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Trust fees | \$ 518 | \$ 477 |
| Service charges on deposit accounts | 1,459 | 1,217 |
| Insurance commissions, fees and premiums | 665 | 608 |
| Gain from sales of loans | 862 | 2,312 |
| Loan servicing fees | 328 | 284 |
| Amortization and impairment of servicing assets | (540) | (774) |
| Brokerage fees | 430 | 262 |
| Other | 1,054 | 743 |
| | <hr/> | <hr/> |
| Total noninterest income | \$ 4,776 | \$ 5,129 |
| | <hr/> | <hr/> |
| Total noninterest income to total net revenues | 19.8% | 22.7% |

Noninterest income during the first quarter of 2004 decreased 7% over 2003. This decrease was due primarily to lower gains from sales of loans related to decreased mortgage production. The commercial banking line of business has a first mortgage servicing portfolio totaling \$448.9 million, principally a result of mortgage loan production in its south-central Indiana markets. Servicing rights are carried on the balance sheet at the lower of cost or market, estimated at March 31, 2004 to be \$3.3 million.

Operating Expenses

The following table shows the components of operating expenses for our commercial banking line of business:

| | Three Months Ended March 31, | |
|--|---|-------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Salaries and employee benefits | \$ 9,322 | \$ 8,925 |
| Other expenses | 5,761 | 4,980 |
| | <hr/> | <hr/> |
| Total operating expenses | \$ 15,083 | \$ 13,905 |
| | <hr/> | <hr/> |
| Efficiency ratio | 59.6% | 57.6% |
| Number of employees at period end ⁽¹⁾ | 499 | 467 |

⁽¹⁾ On a full time equivalent basis.

Operating expenses for the three months ended March 31, 2004 totaled \$15.1 million, an increase of 8% over the same period in 2003.

Table of Contents*Balance Sheet*

Total assets for the quarter ended March 31, 2004 averaged \$2.3 billion compared to \$2.1 billion for the year ended December 31, 2003. Average earning assets for the quarter ended March 31, 2004 averaged \$2.2 billion compared to \$2.0 billion for the year 2003. The most significant component of the increase in 2004 was an increase in commercial loans as a result of the commercial bank's continued growth and expansion efforts into new markets. Average core deposits for the first quarter of 2004 totaled \$1.8 billion, an increase of 3% over average core deposits in the fourth quarter 2003.

Credit Quality

Nonperforming assets to total assets and the allowance for loan losses to total loans both decreased in 2004 over 2003. The decline in nonperformings is primarily the result of a satisfactory resolution of a single nonperforming relationship. Nonperforming loans are not significantly concentrated in any industry category. The following table shows information about our nonperforming assets in this line of business and our allowance for loan losses:

| | March 31, 2004 | December 31, 2003 |
|---|-------------------------------|------------------------------|
| | (Dollars in thousands) | |
| Nonperforming loans | \$20,435 | \$ 25,614 |
| Other real estate owned | 1,255 | 995 |
| | <u> </u> | <u> </u> |
| Total nonperforming assets | \$21,690 | \$ 26,609 |
| | <u> </u> | <u> </u> |
| Nonperforming assets to total assets | 0.94% | 1.21% |
| Allowance for loan losses | \$22,086 | \$ 22,055 |
| Allowance for loan losses to total loans | 1.10% | 1.11% |
| | March 31, 2004 | March 31, 2003 |
| For the Period Ended: | <u> </u> | <u> </u> |
| Provision for loan losses | \$ 1,200 | \$ 1,580 |
| Net charge-offs | 1,170 | 946 |
| Annualized net charge-offs to average loans | 0.24% | 0.21% |

Table of Contents**Home Equity Lending**

The following table shows selected financial information for the home equity lending line of business:

| | Three Months Ended March 31, | |
|--|-------------------------------------|---------------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Selected Income Statement Data | | |
| Net interest income | \$ 24,696 | \$ 26,412 |
| Provision for loan losses | (5,899) | (4,880) |
| Other income | 17,655 | (14,981) |
| | <hr/> | <hr/> |
| Total net revenues | 36,452 | 6,551 |
| Operating expenses | (25,386) | (22,381) |
| | <hr/> | <hr/> |
| Income (loss) before taxes | 11,066 | (15,830) |
| Income taxes | (4,433) | 6,332 |
| | <hr/> | <hr/> |
| Net income (loss) | \$ 6,633 | \$ (9,498) |
| | <hr/> | <hr/> |
| Selected Operating Data: | | |
| Loan volume (quarterly): | | |
| Lines of credit | \$ 94,825 | \$ 73,459 |
| Loans | 212,052 | 205,091 |
| Gain on sale of loans to whole loans sold | 4.29% | 2.29% |
| | <hr/> | <hr/> |
| | March 31, | December 31, |
| | 2004 | 2003 |
| | <hr/> | <hr/> |
| Selected Balance Sheet Data: | | |
| Home equity loans and lines of credit ⁽¹⁾ | \$ 721,685 | \$ 692,637 |
| Allowance for loan losses | (29,456) | (29,251) |
| Home equity loans held for sale | 213,864 | 202,627 |
| Residual interests ⁽²⁾ | 68,692 | 70,519 |
| Short-term debt | 451,296 | 368,640 |
| Collateralized borrowings | 411,064 | 460,535 |
| Shareholders' equity | 135,351 | 128,555 |
| Selected Operating Data: | | |
| Total managed portfolio balance at end of period | 1,473,356 | 1,513,289 |
| Delinquency ratio | 4.7% | 5.9% |
| | <hr/> | <hr/> |
| | \$2,610,459 | \$2,568,356 |

| | | |
|---|-------|-------|
| Total managed portfolio including credit risk sold balance at end of period | | |
| Weighted average coupon rate: | | |
| Lines of credit | 9.47% | 9.71% |
| Loans | 11.91 | 12.07 |
| Net home equity charge-offs to average managed portfolio | 4.07 | 4.79 |

⁽¹⁾ Includes \$427.0 million and \$478.7 million of collateralized loans at March 31, 2004 and December 31, 2003, respectively, as part of securitized financings.

⁽²⁾ Includes \$12.9 million and \$12.4 million of residual interests at March 31, 2004 and December 31, 2003, respectively, that are considered credit-enhancing interest-only strips (CEIOS) under federal banking regulations.

Overview

Our home equity lending line of business originates, purchases, sells and services a variety of home equity lines of credit and fixed-rate home equity loan products nationwide. We market our home equity products (generally using second mortgage liens) through a combination of direct mail, brokers, the Internet, and correspondent channels. We target creditworthy homeowners who are active credit users. Customers are underwritten using proprietary models based on several criteria, including the customers' previous use of credit.

We offer home equity loans with combined loan-to-value (CLTV) ratios of up to 125% of their collateral value. Home equity loans are priced taking into account, among other factors, the credit history of our customer and the relative loan-to-value (LTV) ratio of the loan at origination. For example, all else being equal, those loans with loan-to-value ratios greater than 100% (high LTV or HLTVs) are priced with higher coupons than home equity loans with loan-to-value ratios less than 100% to compensate for increased expected losses through default. For the quarter ended March 31, 2004, HLTV home equity loans constituted 55% of our loan originations and 62% of our managed portfolio in this line of business. In an effort to manage portfolio concentration risk and to comply with existing banking regulations, we have policies in place governing the size of our investment in loans secured by real estate where the LTV is greater than 90%. In accordance with regulatory guidance set forth in Supervision and Regulation Letter 01-4 and in consultation with our banking regulators, we made a risk-weighting adjustment in our regulatory Consolidated Report of Condition and Income, beginning with the third quarter of 2003. This adjustment reflects a risk-weighting of 200 percent for certain HLTV assets (approximately \$219 million at March 31, 2004) that are described in the guidance as subprime.

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For most of our home equity product offerings, we offer customers the choice to accept an early repayment fee in exchange for a lower interest rate. A typical early repayment option provides for a fee equal to up to six months interest that is payable if the borrower chooses to repay the loan during the first three to five years of its term. Approximately 84%, or \$1.2 billion, of our home equity managed portfolio at March 31, 2004 have early repayment provisions, reflecting such customer choice.

The following table provides a breakdown of our home equity lending managed portfolio by product type, outstanding principal balance and weighted average coupon as of March 31, 2004:

| | <u>Amount</u> | <u>% of Total</u> | <u>Weight Average Coupon</u> |
|---|--------------------|-------------------|--------------------------------------|
| | (In thousands) | | |
| Home equity loans <= 100% CLTV | \$ 155,962 | 10.59% | 10.76% |
| Home equity lines of credit <= 100% CLTV | <u>376,930</u> | <u>25.58</u> | <u>8.19</u> |
| Total <= 100% CLTV | 532,892 | 36.17 | 8.94 |
| Home equity loans > 100% CLTV | 542,997 | 36.85 | 13.62 |
| Home equity lines of credit > 100% CLTV | <u>345,827</u> | <u>23.48</u> | <u>11.38</u> |
| Total > 100% CLTV | 888,824 | 60.33 | 12.75 |
| First mortgages | 24,030 | 1.63 | 7.77 |
| Other (including Immediate Credit) | <u>27,610</u> | <u>1.87</u> | <u>13.91</u> |
| Total | <u>\$1,473,356</u> | <u>100.00%</u> | <u>11.31%</u> |

Net Income

Our home equity lending business recorded net income of \$6.6 million during the three months ended March 31, 2004, compared to a net loss for the same period in 2003 of \$9.5 million. The increased earnings in the first quarter of 2004 relate primarily to improving credit quality and resulting differences in fair value adjustments to our residual interests through Trading Gains/Losses in the respective quarters.

Net Revenue

Net revenue for the three months ended March 31, 2004 totaled \$36.5 million, compared to net revenue for the three months ended March 31, 2003 of \$6.6 million. The increase in revenues is primarily a result of increased trading gains related to differences in marking the residual interests to fair value in the respective quarters, reflecting expectation of improved credit quality of the underlying loan portfolios represented by these residuals. Trading gains

during the three months ended March 31, 2004 totaled \$4.6 million compared to trading losses of \$17.8 million during the same period in 2003. Cash flow received from the residual assets during the quarter totaled \$9.7 million compared to our previously modeled estimate of \$7.4 million. Losses on the loans underlying the residual assets occurred at an annualized rate of 6.28% during the first quarter of 2004, as compared to our December 31, 2003, projection for the first quarter of 9%.

We recognized greater gain on sales of loans during the quarter. We sold a total of \$202 million of loans during the first quarter of 2004, or 66% of the quarter's production, compared to \$86 million or 31% of production in the first quarter of 2003.

During the first quarter of 2004, our home equity lending business produced \$306.9 million of home equity loans, compared to \$278.6 million during the same period in 2003. Our home equity lending business had \$906.1 million of net loans and loans held for sale at March 31, 2004, compared to \$866.0 million at December 31, 2003. Included in the loan balance at March 31, 2004 were \$427.0 million of collateralized loans as part of secured financings.

The following table sets forth certain information regarding net revenue for the periods indicated:

| | Three Months Ended March 31, | |
|---|---|-------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Net interest income | \$ 24,696 | \$ 26,412 |
| Provision for loan losses | (5,899) | (4,880) |
| Gain on sales of loans | 8,683 | 1,971 |
| Loan servicing fees | 6,101 | 4,673 |
| Amortization of servicing assets | (3,977) | (2,884) |
| Recovery (impairment) of servicing assets | 940 | (1,017) |
| Trading gains (losses) | 4,641 | (17,789) |
| Other income | 1,267 | 65 |
| | <hr/> | <hr/> |
| Total net revenue | \$ 36,452 | \$ 6,551 |
| | <hr/> | <hr/> |

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Net interest income decreased to \$24.7 million for the three months ended March 31, 2004, compared to \$26.4 million for the same period in 2003. This line of business earns interest income on loans held on the balance sheet and the accretion of the discount applied to its residual interests. Accretion totaled \$3.3 million during the first three months of 2004 versus \$7.0 million for the same period in 2003. The reduced accretion relates to the 48% reduction in our residual interests at March 31, 2004 compared to the same period a year earlier. The increase in the non-accretion interest income from \$19.4 million in the first quarter of 2003 to \$21.4 million in the first quarter of 2004 is a result of the buildup of our on-balance sheet loan portfolio which grew from \$851.8 million at March 31, 2003 to \$935.5 million at March 31, 2004.

Provision for loan losses increased to \$5.9 million during the quarter ended March 31, 2004 compared to \$4.9 million during the same period in 2003. The increased provision relates to seasoning of the loan portfolio.

Gains on sales of loans for the three months ended March 31, 2004 totaled \$8.7 million, compared to \$2.0 million during the same period in 2003. The increase in gains in 2004 relates to a higher volume of loan sales and improved margins on those sales. The gain on sales of loans relative to the principal balance of loans sold increased during the first quarter of 2004 compared to the same period in 2003 due to secondary market demand, product mix between Home Equity Loan (HEL) and Home Equity Lines of Credit (HELOC) product, and cost factors among our various channels. We had a securitization of \$0.3 billion of loans during the first quarter of 2003 that we accounted for as a secured financing with no gain on sale. We completed whole loan sales during the first quarter of 2004 of \$202.4 million resulting in a gain of \$8.7 million. The majority of the loans sold in the first quarter of 2004 were recently originated and funded using short-term, warehouse facilities.

We do not record a residual interest as a result of these whole loan sales as we do not retain a credit loss interest after the sale. These are cash sales for which we receive a premium, generally record a servicing asset, and recognize any points and fees at the time of sale. We are provided the right to an incentive servicing fee that will provide cash payments to us if we meet certain loan credit and servicing performance metrics. These contracts are treated as derivatives and classified in other assets. At March 31, 2004, we were receiving incentive fees for one transaction that had met these performance metrics. Included in other income was \$1.8 million related to these incentive servicing fees based upon actual and projected performance of the underlying pools of loans. Of the \$1.8 million recognized during the quarter, \$0.5 million was the result of cash collections and \$1.3 million represented the projected value of future cash payments, discounted at 30%.

Loan servicing fees totaled \$6.1 million during the first quarter of 2004 compared to \$4.7 million during the same period in 2003. The servicing portfolio underlying the mortgage servicing asset at our home equity lending line of business totaled \$1.670 billion and \$1.692 billion at March 31, 2004 and 2003, respectively. The increase in loan servicing fees in 2004 relates to increased servicing income on our whole loans portfolio as well as increased early repayment fees which totaled \$2.4 million during the quarter ended March 31, 2004 compared to \$1.2 million during the same period in 2003 on the portfolio underlying the mortgage servicing asset.

Amortization and impairment of servicing assets includes amortization expenses and valuation adjustments relating to the carrying value of servicing assets. Our home equity lending business determines fair value of its servicing asset using discounted cash flows and assumptions as to estimated future servicing income and cost that we believe market participants would use to value similar assets. In addition, we assess these modeled assumptions for reasonableness through independent third-party valuations. At March 31, 2004, net servicing assets totaled \$30.9 million, compared to a balance of \$28.4 million at December 31, 2003. Servicing asset amortization and impairment expense totaled \$3.0 million during the first quarter of 2004, compared to \$3.9 million for the three months ended March 31, 2003.

Trading gains (losses) represent unrealized gains (losses) as a result of adjustments to the carrying values of our residual interests. Trading gains totaled \$4.6 million in the first quarter of 2004 compared to losses of \$17.8 million

for the same period in 2003. Residual interests had a balance of \$68.7 million at March 31, 2004 and \$70.5 million at December 31, 2003. The \$68.7 million valuation at March 31, 2004 reflects \$87.0 million of anticipated undiscounted cash flows of which \$71.6 million represents existing securitization overcollateralization and reserve funds, and the remaining \$15.4 million represents expected future net spread and prepayment penalties. Included in the valuation are assumptions for estimated prepayments, expected losses, and discount rates that we believe market participants would use to value similar assets. To the extent our expectations of future loss rates, prepayment speeds and other factors change as we gather additional data over time, these residual valuations may be subject to additional adjustments in the future. These adjustments could have a material effect on our earnings. The increased unrealized trading gains in the first quarter of 2004 principally reflect lower expected loss rates than previously modeled. These lower expected loss rates reflect the strengthening economy and recent actual experience. Our forward loss assumptions are reevaluated monthly and, as such, our residual asset valuations will be adjusted monthly to reflect changes in actual and expected loss rates in our portfolio.

Table of Contents*Operating Expenses*

The following table shows operating expenses for our home equity lending line of business for the periods indicated:

| | Three Months Ended March 31, | |
|--|---|------------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Salaries and employee benefits | \$ 16,126 | \$ 13,062 |
| Other | 9,260 | 9,319 |
| Total operating expenses | <u>\$ 25,386</u> | <u>\$ 22,381</u> |
| Number of employees at period end ⁽¹⁾ | 639 | 686 |

⁽¹⁾ On a full time equivalent basis.

Operating expenses were \$25.4 million for the three months ended March 31, 2004, compared to \$22.4 million for the same period in 2003. Operating expenses during the first quarter of 2004 included \$2.8 million of compensation expense related to minority ownership interests at the home equity lending line of business which are accounted for on a mark to market basis. During the same period in 2003, we had a reversal of approximately \$31 thousand due to the decline in the value of the minority ownership interest during that period.

Home Equity Servicing

Our home equity lending business continues to service a majority of the loans it has securitized and sold. We earn a servicing fee of approximately 50 to 100 basis points of the outstanding principal balance of the loans treated as sales under generally accepted accounting principles. For whole loans sold with servicing retained, we capitalize servicing fees including rights to future early repayment fees. These loans are included below in managed portfolio including credit risk sold. In addition, where applicable, we have the opportunity to earn additional future servicing incentive fees. Included below in the category whole loan sales are \$961.8 million of loans for which we have the opportunity to earn an incentive servicing fee.

Our managed including credit risk sold portfolio is separated into \$1.7 billion of loans and lines of credit originated, securitized, and treated as sold loans under SFAS 140 and \$0.9 billion of loans originated, generally since 2002, and held on balance sheet either as loans held for investment or loans held for sale. Generally, loans originated prior to 2002 and treated as sold under SFAS 140 have a reserve methodology that reflects life of account loss expectations, whereas our policy for on-balance sheet loans requires that we hold at a minimum, sufficient reserves for potential losses inherent in the portfolio at the balance sheet date. Such losses for on-balance sheet loans manifest themselves over a period which management believes approximates twelve months. The following table sets forth certain information for each of these portfolios.

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| Managed Portfolio Including Credit | March 31, 2004 | December 31, 2003 |
|---|---------------------------|------------------------------|
| Risk Sold | | |
| Total Loans | \$2,610,459 | \$2,568,356 |
| 30 days past due | 3.76% | 4.65% |
| 90 days past due | 1.64 | 1.86 |
| Annualized QTD Net Chargeoff Rate | 2.97 | 3.65 |
| Managed Portfolio | | |
| Total Loans | \$1,473,356 | \$1,513,289 |
| 30 days past due | 4.72% | 5.87% |
| 90 days past due | 2.02 | 2.43 |
| Annualized QTD Net Chargeoff Rate | 4.07 | 4.79 |
| Unsold Loans | | |
| Total Loans ⁽¹⁾ | \$ 935,479 | \$ 897,227 |
| 30 days past due | 2.46% | 2.91% |
| 90 days past due | 1.04 | 1.25 |
| Annualized QTD Net Chargeoff Rate | 2.61 | 3.03 |
| Loan Loss Reserve | \$ 29,456 | \$ 29,251 |
| Owned Residual | | |
| Total Loans | \$ 537,877 | \$ 616,062 |
| 30 days past due | 8.65% | 10.18% |
| 90 days past due | 3.73 | 4.15 |
| Annualized QTD Net Chargeoff Rate | 6.28 | 7.13 |
| Residual Undiscounted Losses | \$ 55,220 | \$ 64,598 |
| Credit Risk Sold | | |
| Total Loans | \$1,137,103 | \$1,055,068 |
| 30 days past due | 2.52% | 2.90% |
| 90 days past due | 1.15 | 1.03 |
| Whole Loan Sales | | |
| Total Loans | \$1,083,837 | \$ 993,467 |
| 30 days past due | 2.08% | 2.20% |
| 90 days past due | 0.92 | 0.70 |
| Sold Residuals | | |
| Total Loans | \$ 53,266 | \$ 61,601 |
| 30 days past due | 11.57% | 14.16% |
| 90 days past due | 5.98 | 6.38 |

⁽¹⁾ Excludes deferred fees and costs.

In our home equity lending business, we generally have retained credit risk on loans we originate, whether funded on- or off-balance sheet. The managed portfolio amounts listed above include those loans we service with credit risk retained. Delinquency rates and losses on our managed portfolio result from a variety of factors, including loan seasoning, portfolio mix and general economic conditions. The 30-day and greater delinquency ratio on our managed portfolio was 4.7% at March 31, 2004, and 5.9% at December 31, 2003.

Table of Contents**Commercial Finance**

The following table shows selected financial information for our commercial finance line of business for the periods indicated:

| | Three Months Ended March 31, | |
|--|-------------------------------------|-----------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Selected Income Statement Data: | | |
| Net interest income | \$ 6,754 | \$ 4,807 |
| Provision for loan and lease losses | (1,153) | (2,864) |
| Noninterest income | 475 | 835 |
| | <hr/> | <hr/> |
| Total net revenues | 6,076 | 2,778 |
| Operating expense | (4,225) | (3,328) |
| | <hr/> | <hr/> |
| Income (loss) before taxes | 1,851 | (550) |
| Income taxes | (2,144) | 290 |
| | <hr/> | <hr/> |
| Net loss | \$ (293) | \$ (260) |
| | <hr/> | <hr/> |
| Selected Operating Data: | | |
| Net charge-offs | \$ 1,294 | \$ 1,812 |
| Net interest margin | 5.74% | 5.47% |
| Total fundings of loans and leases | \$ 71,652 | \$ 57,609 |
| | <hr/> | <hr/> |
| Selected Balance Sheet Data at End of Period: | | |
| | March 31, | December |
| | 2004 | 31, |
| | 2003 | 2003 |
| | <hr/> | <hr/> |
| Total assets | \$487,769 | \$ 474,915 |
| Loans and leases | 479,364 | 463,423 |
| Allowance for loan and lease losses | (10,962) | (11,445) |
| Shareholders' equity | 44,127 | 44,255 |

Overview

In our commercial finance line of business, we originate small-ticket equipment leases through established U.S. and Canadian relationships with vendors, manufacturers and third-party originators, and provide financing for franchisees of selected quick service and casual dining restaurant concepts. The majority of our leases are full payout (no residual), small-ticket assets secured by commercial equipment. Within the franchise channel, the majority of our

contracts are loans and are full payout with higher transaction sizes than in our small-ticket channel. The franchise channel may also finance real estate for select franchise systems. We finance a variety of commercial and office equipment types and try to limit the concentrations in our loan and lease portfolios.

Net Income

During the three months ended March 31, 2004, the commercial finance line of business incurred a loss of \$0.3 million, relatively unchanged from the same period in the prior year. Pre-tax earnings increased to \$1.9 million for the quarter ended March 31, 2004, compared to a pre-tax loss of \$0.6 million during the same period in 2003. The 2004 pre-tax improvement in earnings is attributable to portfolio growth, improvements in credit quality, and gains from the sale of whole loans. Net income was negatively affected by a one-time income tax charge of \$1.7 million during the first quarter reflecting the cumulative impact of tax liabilities acquired, but not recorded on the books of the company at the time of our purchase of our Canadian operations from a now bankrupt seller. The impact of this adjustment would not have been material to any prior reporting periods.

Net Interest Income

The following table shows information about net interest income for our commercial finance line of business:

| | Three Months Ended March 31, | |
|---------------------------------|-------------------------------------|-------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Net interest income | \$ 6,754 | \$ 4,807 |
| Average interest earning assets | 472,883 | 356,692 |
| Net interest margin | 5.74% | 5.47% |

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Net interest income was \$6.8 million for the quarter ended March 31, 2004, an increase of 41% over 2003. The improvement in net interest income resulted primarily from an increase in our commercial finance portfolio. The total loan and lease portfolio has increased to \$479.4 million at March 31, 2004, an increase of 3% over year-end 2003 and an increase of 26% over March 31, 2003. This line of business originated \$71.7 million in loans and leases during the first quarter of 2004, compared to \$57.6 million during the same period of 2003.

Net interest margin is computed by dividing net interest income by average interest earning assets. Net interest margin for the first quarter of 2004 was 5.74%, compared to 5.47% in 2003 for the same period. The increase in 2004 margin is due primarily to changes in product mix and intercompany funding changes.

Provision for Loan and Lease Losses

The provision for loan and lease losses decreased to \$1.2 million during the first three months in 2004 compared to \$2.9 million for the same period in 2003. The decreased provisioning levels relate primarily to improvements in credit quality and reduction in the broker-based, small-ticket portion of our domestic portfolio. As previously announced, we largely exited the broker-sourced channel a year ago.

Noninterest Income

Noninterest income during the three months ended March 31, 2004 decreased 67% over the same period in 2003. This decrease was due primarily to derivative losses offset partially by gains from sales of whole loans in our franchise unit during the quarter ended March 31, 2004. We had no derivative losses and no loan sales for this line of business during the same period in 2003.

Operating Expenses

The following table shows the components of operating expenses for our commercial finance line of business:

| | Three Months Ended March 31, | |
|--|---|-----------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Salaries and employee benefits | \$ 3,362 | \$ 2,606 |
| Other | 863 | 722 |
| Total operating expenses | <u>\$ 4,225</u> | <u>\$ 3,328</u> |
| Number of employees at period end ⁽¹⁾ | 137 | 131 |

⁽¹⁾ On a full time equivalent basis.

Operating expenses during the first quarter in 2004 totaled \$4.2 million, an increase of 27% over the same period in 2003. The increased operating expenses relate to the continued growth in this business since its inception in 1999, including compensation costs related to higher originations and the achievement of pre-tax profitability.

Credit Quality

The commercial finance line of business had nonperforming loans and leases at March 31, 2004 of \$3.4 million compared to \$4.1 million as of December 31, 2003. Net charge-offs recorded by this line of business totaled \$1.3 million for the first quarter of 2004 compared to \$1.8 million for the first quarter of 2003. The improvement in nonperformings and net charge-offs relates primarily to our broker-based domestic lease portfolio. As noted above, we exited this business channel in mid-2003 and will now manage the portfolio as it runs off while focusing our efforts in originating vendor-sourced small ticket leases in the U.S. Our allowance for loan and lease losses at March 31, 2004 totaled \$11.0 million, representing 2.29% of loans and leases, compared to a balance at December 31, 2003 of \$11.4 million, representing 2.47% of loans and leases.

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The following table shows information about our nonperforming loans and leases in this line of business and our allowance for loan and lease losses:

| | March 31, 2004 | December 31, 2003 |
|---|-------------------------------|------------------------------|
| | (Dollars in thousands) | |
| Nonperforming loans | \$ 3,393 | \$ 4,083 |
| Allowance for loan losses | \$ 10,962 | \$ 11,445 |
| Allowance for loan losses to total loans | 2.29% | 2.47% |
| | March 31, 2004 | March 31, 2003 |
| For the Period Ended: | | |
| Provision for loan losses | \$ 1,153 | \$ 2,864 |
| Net charge-offs | \$ 1,294 | \$ 1,812 |
| Annualized net charge-offs to average loans | 1.11% | 2.06% |

The following table provides certain information about the loan and lease portfolio of our commercial finance line of business at the dates shown:

| | March 31, 2004 | December 31, 2003 |
|--------------------------------|-------------------------------|------------------------------|
| | (Dollars in thousands) | |
| Franchise loans | \$ 157,505 | \$ 150,505 |
| Weighted average yield | 8.24% | 8.45% |
| Delinquency ratio | 0.30 | 0.45 |
| Domestic leases | \$ 137,497 | \$ 134,602 |
| Weighted average yield | 9.44% | 9.54% |
| Delinquency ratio | 1.17 | 1.32 |
| Canadian leases ⁽¹⁾ | \$ 184,362 | \$ 178,316 |
| Weighted average yield | 9.95% | 10.12% |
| Delinquency ratio | 1.26 | 0.89 |

⁽¹⁾ In U.S. dollars.

Venture Capital

The following table shows selected financial information for our venture capital line of business for the periods indicated:

| Three Months Ended March 31, | |
|---|-------------|
| 2004 | 2003 |

(In thousands)

Selected Income Statement Data:

| | | |
|--|-------------------|-------------------|
| Net interest income | \$ (1) | \$ 7 |
| Mark-to-market adjustment on investments | 9 | (2,259) |
| Noninterest income | 149 | 147 |
| | <u> </u> | <u> </u> |
| Total net revenues | 157 | (2,105) |
| Operating expense | (128) | (108) |
| | <u> </u> | <u> </u> |
| Income (loss) before taxes | 29 | (2,213) |
| Income taxes | (11) | 885 |
| | <u> </u> | <u> </u> |
| Net income (loss) | \$ 18 | \$ (1,328) |
| | <u> </u> | <u> </u> |

| | March 31, 2004 | December 31, 2003 |
|--|---------------------------|----------------------------------|
| Selected Balance Sheet Data at End of Period: | | |
| | <u> </u> | <u> </u> |
| Investment in portfolio companies (cost) | \$ 14,592 | \$ 14,601 |
| Mark-to-market adjustment | (11,068) | (11,077) |
| | <u> </u> | <u> </u> |
| Carrying value of portfolio companies | \$ 3,524 | \$ 3,524 |
| | <u> </u> | <u> </u> |

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Overview

In our venture capital line of business, we make minority investments in early stage companies in the financial services industry and related fields that intend to use technology as a key component of their competitive strategy. We provide Irwin Ventures' portfolio companies the benefit of our management experience in the financial services industry. In addition, we expect that contacts made through venture activities may benefit management of our other lines of business through the sharing of technologies and market opportunities. Our venture capital line of business had investments in seven private companies as of March 31, 2004, with an aggregate investment cost of \$14.6 million and a carrying value of \$3.5 million. Our carrying value for investments in three of the seven has been reduced through valuation adjustments to zero.

During the three months ended March 31, 2004, the venture capital line of business had net income of \$18 thousand, compared to a net loss of \$1.3 million for the first quarter in 2003. The 2003 loss was due to valuation adjustments to reflect the company's portfolio investments at market value.

Parent and Other

Results at the parent company and other businesses totaled a net loss of \$1.2 million for the three months ended March 31, 2004, compared to a loss of \$2.0 million during the same period in 2003. These losses at the parent company primarily relate to operating expenses in excess of management fees charged to the lines of business and interest income earned on intracompany loans. Included in parent and other expense were compensation charges related to key employee retention initiatives at the home equity lending line of business totaling \$1.2 million for the quarter ended March 31, 2004. We recognized a \$45 thousand benefit with respect to this initiative during the first quarter of 2003. Also included in parent company operating results are allocations to our subsidiaries of interest expense related to our interest-bearing capital obligations. During the quarter ended March 31, 2004, we allocated \$3.3 million of these expenses to our subsidiaries, compared to \$3.7 million during the first quarter of 2003.

During the first quarter, we released a \$1.7 million tax reserve relating to Canadian tax issues and re-examined other exposures relating to potential challenges from tax authorities. After reviewing the exposures and computing the required level of tax reserves, the Parent released an additional \$0.5 million to adjust the reserve balance to a level commensurate with identified tax exposures.

Each subsidiary pays taxes to us at the statutory rate. Subsidiaries also pay fees to us to cover direct and indirect services. In addition, certain services are provided from one subsidiary to another. Intercompany income and expenses are calculated on an arm's-length, external market basis and are eliminated in consolidation.

Risk Management

We are engaged in businesses that involve the assumption of financial risks including:

Credit risk

Liquidity risk

Interest rate risk

Operational risk

Each line of business that assumes financial risk uses a formal process to manage this risk. In all cases, the objectives are to ensure that risk is contained within prudent levels and that we are adequately compensated for the

level of risk assumed.

Our Chairman, Executive Vice President, Senior Vice Presidents (including the Chief Financial Officer), and Chief Risk Officer meet on a regularly scheduled basis (or more frequently as appropriate) as an Enterprise-wide Risk Management Committee (ERMC), reporting to the Board of Directors Audit and Risk Management Committee. The ERMC and its subcommittees oversee all aspects of our financial, credit, and operational risks. The ERMC provides senior-level review and enhancement of line manager risk processes and oversight of our risk reporting, surveillance and model parameter changes.

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Credit Risk

The assumption of credit risk is a key source of earnings for the home equity lending, commercial banking and commercial finance lines of business. The mortgage banking line of business assumes limited credit risk as its mortgages typically are insured and are sold within a short period of time after origination.

The credit risk in the loan portfolios of the home equity lending, commercial finance and commercial banking lines of business has the most potential for a significant effect on our consolidated financial performance. These lines of business each have a Chief Credit Officer specific to the product line and manage credit risk through various combinations of the use of lending policies, credit analysis and approval procedures, periodic loan reviews, servicing activities, and/or personal contact with borrowers. Commercial loans over a certain size are reviewed by a loan committee prior to approval. We perform independent loan review across the Corporation through a function that reports directly to the Audit and Risk Management Committee.

The allowance for loan and lease losses is an estimate based on our judgment applying the principles of SFAS 5, Accounting for Contingencies, SFAS 114, Accounting by Creditors for Impairment of a Loan, and SFAS 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures. The allowance is maintained at a level we believe is adequate to absorb probable losses inherent in the loan and lease portfolio. We perform an assessment of the adequacy of the allowance no less frequently than on a quarterly basis.

Within the allowance, there are specific and expected loss components. The specific loss component is based on a regular analysis of all loans over a fixed-dollar amount where the internal credit rating is at or below a predetermined classification. From this analysis we determine the loans that we believe to be impaired in accordance with SFAS 114. Management has defined impaired as nonaccrual loans. An allowance is established when the collateral value, observable market price or discounted cash flows of an impaired loan is lower than the carrying value of that loan. In addition to establishing allowance levels for specifically identified higher risk graded loans, management determines an allowance for all other loans in the portfolio for which historical or projected experience indicates that certain losses exist. These loans are segregated by major product type, and in some instances, by aging, with an estimated loss ratio or migration pattern applied against each product type and aging category. For portfolios that are too new to have adequate historical experience on which to base a loss estimate, we use estimates derived from industry experience and management's judgment. The loss ratio or migration patterns are generally based upon historic loss experience or historic rate migration behaviors, respectively, for each loan type adjusted for certain environmental factors management believes to be relevant.

Net charge-offs for the three months ended March 31, 2004 were \$8.2 million, or 1.0% of average loans, compared to \$6.1 million, or 0.9% of average loans during the same period in 2003. The increase in charge-offs is a result of loan growth and deteriorating credit quality in late 2003 manifesting itself as higher charge-offs in early 2004 as portfolios season. At March 31, 2004, the allowance for loan and lease losses was 2.0% of outstanding loans and leases, unchanged from year end 2003.

Total nonperforming loans and leases at March 31, 2004, were \$36.1 million, compared to \$44.4 million at December 31, 2003. Nonperforming loans and leases as a percent of total loans and leases at March 31, 2004 were 1.1%, compared to 1.4% at December 31, 2003. The 2004 decrease occurred primarily at the commercial banking line of business where nonperforming loans decreased to \$20.4 million at March 31, 2004, compared to \$25.6 million at the end of 2003. The majority of this decrease was due to satisfactory resolution of a single nonperforming relationship at the commercial banking line of business.

Other real estate we owned totaled \$6.3 million at March 31, 2004, down from \$6.4 million at December 31, 2003. Total nonperforming assets at March 31, 2004 were \$44.9 million, or 0.87% of total assets compared to

nonperforming assets at December 31, 2003, of \$52.5 million, or 1.1% of total assets.

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The following table shows information about our nonperforming assets at the dates shown:

| | March 31, 2004 | December 31, 2003 |
|--|---------------------------|----------------------------------|
| | (In thousands) | |
| Accruing loans past due 90 days or more: | | |
| Commercial, financial and agricultural loans | \$ 559 | \$ 4,172 |
| Real estate mortgages | | |
| Consumer loans | 62 | 226 |
| Lease financing: | | |
| Domestic | 142 | 159 |
| Canadian | 188 | 70 |
| | <u>951</u> | <u>4,627</u> |
| Nonaccrual loans and leases: | | |
| Commercial, financial and agricultural loans | 19,104 | 20,447 |
| Real estate mortgages | 12,270 | 14,663 |
| Consumer loans | 709 | 769 |
| Lease financing: | | |
| Domestic | 1,380 | 1,916 |
| Canadian | 1,682 | 1,943 |
| | <u>35,145</u> | <u>39,738</u> |
| Total nonperforming loans and leases | <u>36,096</u> | <u>44,365</u> |
| Other real estate owned: | | |
| Nonperforming loans held for sale not guaranteed | 2,456 | 1,695 |
| Other real estate owned | 6,309 | 6,431 |
| | <u>\$44,861</u> | <u>\$ 52,491</u> |
| Nonperforming loans and leases to total loans and leases | <u>1.1%</u> | <u>1.4%</u> |
| Nonperforming assets to total assets | 0.9% | 1.1% |

For the periods presented, the balances of any restructured loans are reflected in the table above either in the amounts shown for accruing loans past due 90 days or more or in the amounts shown for nonaccrual loans and leases.

Loans that are past due 90 days or more are placed on nonaccrual status unless, in management's opinion, there is sufficient collateral value to offset both principal and accrued interest. The nonperforming assets at March 31, 2004 and December 31, 2003 were held at our lines of business as follows:

| | March 31, 2004 | December 31, 2003 |
|---------------------|-------------------------------|----------------------------------|
| | (In millions) | |
| Mortgage banking | \$ 7.6 | \$ 6.8 |
| Commercial banking | 21.7 | 26.6 |
| Home equity lending | 12.2 | 15.0 |
| Commercial finance | 3.4 | 4.1 |

Generally, the accrual of income is discontinued when the full collection of principal or interest is in doubt, or when the payment of principal or interest has become contractually 90 days past due unless the obligation is both well secured and in the process of collection.

Liquidity Risk

Liquidity is the availability of funds to meet the daily requirements of our business. For financial institutions, demand for funds results principally from extensions of credit and withdrawal of deposits. Liquidity is provided through deposits and short-term and long-term borrowings, by asset maturities or sales, and through equity capital.

The objectives of liquidity management are to ensure that funds will be available to meet current and future demands and that funds are available at a reasonable cost. We manage liquidity via daily interaction with the lines of business and periodic liquidity planning sessions. Since loans are less marketable than securities, the ratio of total loans to total deposits is a traditional measure of liquidity for banks and bank holding companies. At March 31, 2004, the ratio of loans and loans held for sale to total deposits was 127%. We are comfortable with this relatively high level due to our position in first mortgage loans held for sale (\$0.8 billion) and second mortgage loans and leases financed through matched-term secured financing (\$0.6 billion). The first mortgage loans carry an interest rate at or near current market rates for first mortgage loans and are generally sold within a short period. Excluding these two items, our loans to deposit ratio at March 31, 2004 was 84%.

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The mortgage banking line of business sells virtually all of its mortgage loan originations within 30 days of funding, taking them off our balance sheet. Therefore, the on-balance sheet funding of first mortgage loans is for the brief period of time from origination to sale/securitization. In the first quarter of 2004, the home equity lending line of business produced \$0.3 billion and home equity loan sales totaled \$0.2 billion, thus requiring increases in funding facilities for this line of business of \$0.1 billion.

Deposits consist of three primary types: non-maturity transaction account deposits, certificates of deposit, and escrow account deposits. Non-maturity transaction account deposits are generated by our commercial banking line of business and include deposits placed into checking, savings, money market and other types of deposit accounts by our customers. These types of deposits have no contractual maturity date and may be withdrawn at any time. While these balances fluctuate daily, a large percentage typically remains for much longer. At March 31, 2004, these deposit types totaled \$1.5 billion, an increase of \$0.4 billion from December 31, 2003.

Certificates of deposit (CDs) differ from non-contractual maturity accounts in that they do have contractual maturity dates. We issue CDs both directly to customers and through brokers. As of March 31, 2004, CDs issued directly to customers totaled \$0.6 billion, which was up slightly from December 31, 2003. Brokered CDs are typically considered to have higher liquidity (renewal) risk than CDs issued directly to customers, since brokered CDs are often done in large blocks and since a direct relationship does not exist with the depositor. In recognition of this, we manage the size and maturity structure of brokered CDs closely. For example, the maturities of brokered CDs are laddered to mitigate liquidity risk. CDs issued through brokers totaled \$0.3 billion at March 31, 2004, and had an average remaining life of 15 months, as compared to \$0.3 billion outstanding with an 18 month average remaining life at December 31, 2003.

Escrow account deposits are related to the servicing of our originated first mortgage loans. When a first mortgage borrower makes a monthly mortgage payment, consisting of interest and principal due on the loan and often a real estate tax and insurance portion, we hold the payment on a non-interest earning basis, except where otherwise required by law, until the payment is remitted to the current owner of the loan or the proper tax authority and insurance carrier. Escrow deposits may also include proceeds from the payoff of loans in our servicing portfolio prior to the transmission of those proceeds to investors. At March 31, 2004, these escrow balances totaled \$0.8 billion, which was up \$0.2 billion from December 31, 2003.

Short-term borrowings consist of borrowings from several sources. Our largest borrowing source is the Federal Home Loan Bank of Indianapolis (FHLBI), of which we are an active member. We utilize their collateralized borrowing programs to help fund qualifying first mortgage, home equity and commercial real estate loans. As of March 31, 2004, FHLBI borrowings outstanding totaled \$0.1 billion, a \$0.2 billion decrease from December 31, 2003. We had sufficient collateral pledged to FHLBI at March 31, 2004 to borrow an additional \$0.7 billion, if needed.

In addition to borrowings from the FHLBI, we use other lines of credit as needed. At March 31, 2004, the amount of short-term borrowings outstanding on our major credit lines and the total amount of the borrowing lines were as follows:

Warehouse lines of credit to fund first mortgages and home equity loans: none outstanding on a \$300 million borrowing facility, of which \$150 million is committed

Warehouse borrowing facilities to fund first mortgage loans: \$1 million outstanding on a \$150 million committed borrowing facility

Lines of credit with correspondent banks, including fed funds lines: \$26 million outstanding out of \$205 million available but not committed

Line of credit with a correspondent bank collateralized by mortgage servicing rights: none outstanding out of \$75 million committed borrowing facility

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In addition to short-term borrowings from the aforementioned credit lines, sale facilities are used to effect sale of Government Sponsored Enterprise (GSE) conforming first mortgage loans before scheduled GSE settlement dates. The first two of these sale facilities listed below have specific dollar limits as noted. The size of the third facility is limited only by the amount of mortgage-backed securities we can package for purchase by the facility provider. At March 31, 2004, the amount unsettled by the GSE on these facilities and the total facility amount were as follows:

Committed warehouse sale facility: \$133 million unsettled on a \$600 million facility

Uncommitted warehouse sale facility: \$64 million unsettled on a \$150 million facility

Investor warehouse sale facility: \$150 million unsettled

Interest Rate Risk

Because all of our assets are not perfectly match funded with like-term liabilities, our earnings are affected by interest rate changes. Interest rate risk is measured by the sensitivity of both net interest income and fair market value of net interest sensitive assets to changes in interest rates.

An asset/liability management committee (ALMC) at each of our lines of business that has interest rate risk monitors the repricing structure of assets, liabilities and off-balance sheet items and uses a financial simulation model to measure interest rate risk over multiple interest rate scenarios. Our parent company ALMC oversees the interest rate risk profile of all of our lines of business as a whole and is represented on each of the line of business ALMCs. We incorporate many factors into the financial model, including prepayment speeds, net interest margin, fee income and a comprehensive mark-to-market valuation process. We reevaluate risk measures and assumptions regularly and enhance modeling tools as needed.

Our commercial banking, home equity lending, and commercial finance lines of business assume interest rate risk in the pricing structure of their loans and leases, and manage this risk by adjusting the duration of their interest sensitive liabilities and through the use of hedging using purchases and sales of financial derivatives.

Our mortgage banking line of business assumes interest rate risk by entering into commitments to extend loans to borrowers at a fixed rate for a limited period of time. We hold closed loans only temporarily until a pool is formed and sold in a securitization or under a flow sale arrangement. To mitigate the risk that interest rates will rise between loan origination and sale, the mortgage bank buys commitments to deliver loans at a fixed price for a portion of our pipeline.

Our mortgage, commercial banking and home equity lending lines of business also are exposed to the risk that interest rates will decline, increasing prepayment speeds on loans and decreasing the value of servicing assets and residual interests. Some offsets to these exposures exist in the form of strong production operations, selective sales of servicing rights, match-funded asset-backed securities sales and the use of financial instruments to manage the economic performance of the assets. Since there are accounting timing differences between the recognition of gains or losses on financial derivatives and the realization of economic gains or losses on certain offsetting exposures (e.g., strong production operations), our decisions on the degree to which we manage risk with derivative instruments to insulate against short-term price volatility depends on a variety of factors, including:

the type of risk we are trying to mitigate;

offsetting factors elsewhere in the Corporation;

the level of current capital above our target minimums;

time remaining in the quarter (i.e., days until quarter-end);

current level of derivative gain or loss relative to accounting and economic basis;

basis risk: the degree to which the interest rates underlying our derivative instruments might not move parallel to the interest rate driving our asset valuation; and

convexity: the degree to which asset values, or risk management derivative instrument values, do not change in a linear fashion as interest rates change.

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This strategy may, at times, result in variability in quarterly results that are not reflective of underlying trends for the Corporation.

The following tables reflect our estimate of the present value of interest sensitive assets, liabilities, and off-balance sheet items at March 31, 2004. In addition to showing the estimated fair market value at current rates, they also provide estimates of the fair market values of interest sensitive items based upon a hypothetical instantaneous move both up and down 100 and 200 basis points in the entire yield curve.

The first table is an economic analysis showing the present value impact of changes in interest rates, assuming a comprehensive mark-to-market environment. The second table is an accounting analysis showing the same net present value impact, adjusted for expected GAAP treatment. Neither analysis takes into account the book values of the noninterest sensitive assets and liabilities (such as cash, accounts receivable, and fixed assets), the values of which are not directly determined by interest rates.

The analyses are based on discounted cash flows over the remaining estimated lives of the financial instruments. The interest rate sensitivities apply only to transactions booked as of March 31, 2004, although certain accounts such as Official Checks and Due From are normalized whereby the three- or six-month average balance is included rather than the quarter-end balance in order to avoid having the analysis skewed by a significant increase or decrease to an account balance at quarter-end.

The net asset value sensitivities do not necessarily represent the changes in the lines of business net asset value that would actually occur under the given interest rate scenarios, as sensitivities do not reflect changes in value of the companies as a going concern, nor consider potential rebalancing or other hedging actions that might be taken in the future under asset/liability management as interest rates change.

Specifically, the volume of derivative contracts entered into to manage the risk of mortgage servicing rights (MSRs) fluctuates from quarter to quarter, depending upon market conditions, the size of our MSR portfolio and various additional factors. We monitor derivative positions frequently and rebalance them as needed. Therefore, our derivative positions, shown in the table below as of March 31, 2004, may or may not be representative of our risk position during the succeeding quarter. Additionally, it is unlikely that the volume of derivative positions would remain constant over large fluctuations in interest rates, although the tables below assume they do. MSR risk management derivative contracts appear under the category Interest Sensitive Financial Derivatives in the tables below.

Economic Value Change Method**Present Value at March 31, 2004,
Change in Interest Rates of:**

| | -2% | -1% | Current | +1% | +2% |
|--|-----------------------|--------------|----------------|--------------|--------------|
| | (In thousands) | | | | |
| Interest Sensitive Assets | | | | | |
| Loans and other assets | \$ 3,545,810 | \$ 3,517,231 | \$ 3,482,667 | \$ 3,447,669 | \$ 3,412,675 |
| Loans held for sale | 1,007,890 | 1,003,023 | 996,219 | 988,914 | 980,634 |
| Mortgage servicing rights | 168,919 | 209,656 | 336,859 | 500,781 | 585,084 |
| Residual interests | 74,587 | 72,867 | 69,771 | 66,234 | 61,972 |
| Interest sensitive financial derivatives | 35,799 | 38,822 | 23,025 | (58,759) | (243,970) |

| | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|
| Total interest sensitive assets | \$ 4,833,005 | \$ 4,841,599 | \$ 4,908,541 | \$ 4,944,839 | \$ 4,796,395 |
| Interest Sensitive Liabilities | | | | | |
| Deposits | (3,328,446) | (3,311,811) | (3,294,563) | (3,280,315) | (3,267,158) |
| Short-term borrowings ⁽¹⁾ | (397,631) | (397,530) | (397,185) | (396,820) | (396,461) |
| Long-term debt | (706,164) | (698,282) | (687,511) | (675,862) | (664,131) |
| Total interest sensitive liabilities | (4,432,241) | (4,407,623) | (4,379,259) | (4,352,997) | (4,327,750) |
| Net market value as of March 31, 2004 | \$ 400,764 | \$ 433,976 | \$ 529,282 | \$ 591,842 | \$ 468,645 |
| Change from current | \$ (128,518) | \$ (95,306) | \$ | \$ 62,560 | \$ (60,637) |
| Net market value as of December 31, 2003 | \$ 531,596 | \$ 567,923 | \$ 575,450 | \$ 645,981 | \$ 635,791 |
| Potential change | \$ (43,854) | \$ (7,527) | \$ | \$ 70,531 | \$ 60,341 |

(1) Includes certain debt which is categorized as collateralized borrowings in other sections of this document.

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| | Present Value at March 31, 2004, Change in Interest Rates of: | | | | |
|---|--|-------------------|-------------------|-------------------|-------------------|
| | -2% | -1% | Current | +1% | +2% |
| | (In thousands) | | | | |
| Interest Sensitive Assets | | | | | |
| Loans and other assets ⁽¹⁾ | \$ | \$ | \$ | \$ | \$ |
| Loans held for sale | 996,219 | 996,219 | 996,219 | 988,914 | 980,634 |
| Mortgage servicing rights | 168,920 | 209,481 | 332,611 | 410,068 | 422,854 |
| Residual interests | 74,587 | 72,867 | 69,771 | 66,234 | 61,972 |
| Interest sensitive financial derivatives | 35,799 | 38,822 | 23,025 | (58,759) | (243,970) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total interest sensitive assets | \$1,275,525 | \$1,317,389 | \$1,421,626 | \$1,406,457 | \$1,221,490 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Interest Sensitive Liabilities | | | | | |
| Deposits ⁽¹⁾ | | | | | |
| Short-term borrowings ⁽¹⁾ | | | | | |
| Long-term debt ⁽¹⁾ | | | | | |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total interest sensitive liabilities ⁽¹⁾ | | | | | |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net market value as of March 31, 2004 | \$1,275,525 | \$1,317,389 | \$1,421,626 | \$1,406,457 | \$1,221,490 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Potential change | \$ (146,101) | \$ (104,237) | \$ | \$ (15,169) | \$ (200,136) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net market value as of December 31, 2003 | \$1,260,307 | \$1,303,782 | \$1,313,410 | \$1,279,691 | \$1,222,645 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Potential change | \$ (53,103) | \$ (9,628) | \$ | \$ (33,719) | \$ (90,765) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

(1) Value does not change in GAAP presentation.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Irwin Financial, like other financial services organizations, is exposed to a variety of operational risks. These risks include regulatory, reputational and legal risks, as well as the potential for processing errors, internal or external fraud, failure of computer systems, and external events that are beyond the control of the Corporation, such as natural disasters.

Our Board of Directors has ultimate accountability for the level of operational risk assumed by us. The Board guides management by approving our business strategy and significant policies. Our management and Board have also established and continue to improve a control environment that encourages a high degree of awareness and proactivity in alerting senior management and the Board to potential control issues on a timely basis.

The Board has directed that primary responsibility for the management of operational risk rests with the managers of our business units, who are responsible for establishing and maintaining internal control procedures that are appropriate for their operations. In 2002, we started implementing a multi-year program to provide a more integrated firm-wide approach for the identification, measurement, monitoring and mitigation of operational risk. The new enterprise-wide operational risk oversight function reports to the Audit and Risk Management Committee of our Board of Directors and to our Enterprise-Wide Risk Management Committee, which is led by the Chairman of the Board of Directors. We recently established an enterprise-wide compliance oversight function to devote increased attention and resources to banking regulatory compliance as we have grown more complex and as our home equity, commercial finance and mortgage banking businesses are now all being conducted under Irwin Union Bank and Trust Company. The compliance oversight function reports to our Chief Risk Officer, who in turn reports to the Audit and Risk Management Committee of the Board of Directors. We have identified 75 key processes in the Corporation for which we have Risk and Control Summaries (RACS) for line managers to identify operational risks, internal controls and residual or unmitigated risks. These RACS constitute an integral part of our Board(s), CEO and CFO's oversight and assessment of the adequacy of our internal controls.

The financial services business is highly regulated. Failure to comply with these regulations could result in substantial monetary or other damages that could be material to our financial position. Statutes and regulations may change in the future. We cannot predict what effect these changes, if made, will have on our operations. It should be noted that the supervision, regulation and examination of banks, thrifts and mortgage companies by regulatory agencies are intended primarily for the protection of depositors and other customers rather than shareholders of these institutions.

We are registered as a bank holding company with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956, as amended, and the related regulations. We are subject to regulation, supervision and examination by the Federal Reserve, and as part of this process we must file reports and additional information with the Federal Reserve. The regulation, supervision and examinations occur at the local, state and federal levels and involve, but are not limited to minimum capital requirements, consumer protection, community reinvestment, and deposit insurance.

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Off-Balance Sheet Instruments

In the normal course of our business as a provider of financial services, we are party to certain financial instruments with off-balance sheet risk to meet the financial needs of our customers. These financial instruments include loan commitments and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized on the consolidated balance sheet.

Our exposure to credit loss, in the form of nonperformance by the counterparty on commitments to extend credit and standby letters of credit, is represented by the contractual amount of those instruments. Collateral pledged for standby letters of credit and commitments varies but may include accounts receivable; inventory; property, plant, and equipment; and residential real estate. Total outstanding commitments to extend credit at March 31, 2004 and December 31, 2003, respectively, were \$543.6 million and \$546.5 million. We had \$30.0 million and \$30.8 million in irrevocable standby letters of credit outstanding at March 31, 2004 and December 31, 2003, respectively.

Derivative Financial Instruments

Financial derivatives are used as part of the overall asset/liability risk management process. We use certain derivative instruments that do not qualify for hedge accounting treatment under SFAS 133. These derivatives are classified as other assets and other liabilities and marked to market on the income statement. While we do not seek GAAP hedge accounting treatment for the assets that these instruments are hedging, the economic purpose of these instruments is to manage the risk inherent in existing exposures to either interest rate risk or foreign currency risk.

We entered into an interest rate swap that has a notional amount (which does not represent the amount at risk) of \$25 million as of March 31, 2004. Under the terms of the swap agreement, we receive a fixed rate of interest and pay a floating rate of interest based upon one-month LIBOR. We recognized a gain of \$0.1 million included in derivative gains during the quarter ended March 31, 2004 related to this swap. By receiving a fixed rate of interest and paying a floating rate on the swap, we are converting the economics of a \$25 million fixed rate funding source into a floating rate funding source.

We enter into forward contracts to protect against interest rate fluctuations from the date of mortgage loan commitment until the loans are sold. At March 31, 2004, we designated the portion of these transactions hedging the closed mortgage loans as hedges that qualify for hedge accounting treatment under SFAS 133. The notional amount of our forward contracts (which does not represent the amount at risk) totaled \$1.8 billion at March 31, 2004. The closed mortgage loans hedged by forward contracts qualify for hedge accounting treatment under SFAS 133. The basis of the hedged closed loans is adjusted for change in value associated with the risk being hedged. We value closed loan contracts at period end based upon the current secondary market value of securities with similar characteristics. The unrealized gain on our forward contracts at March 31, 2004 was \$3.7 million and the hedge ineffectiveness for the quarter then ended was a gain of \$0.3 million. The effect of these hedging activities was recorded through earnings as a component of gain from sale of loans.

We enter into commitments to originate loans whereby the interest rate on the loan is determined prior to funding (rate lock commitments). Rate lock commitments on loans intended to be sold are considered to be derivatives and are recorded at fair value. We value these commitments at period end based upon the current secondary market value of securities with similar characteristics. A net decrease in fair value of these derivatives totaling \$0.7 million was recorded in the first quarter 2004 in gain from sale of loans. At March 31, 2004, we had a notional amount of rate lock commitments outstanding totaling \$1.7 billion with a fair value of \$3.0 million. Notional amounts do not represent the amount of risk.

Our commercial finance line of business delivered fixed rate leases into conduits that fund them using floating rate commercial paper, which creates an interest rate risk mismatch.

In two instances, this funding mismatch is lessened by a combination of amortizing interest rate caps and Eurodollar futures contracts. The interest rate caps have a strike price of 5% and provide protection against a large increase in short-term interest rates. As of March 31, 2004, the notional value and year-to-date loss on the interest rate caps were \$41.4 million and \$27 thousand, respectively. In addition, we also used Eurodollar futures contracts to hedge rate risk in this structure. As of March 31, 2004, the total notional amount and year-to-date loss on the Eurodollar futures were \$120.0 million and \$0.2 million, respectively.

In the fourth quarter of 2003, we delivered fixed rate leases into a second commercial paper conduit. Although the leases and funding were in Canadian dollars (CAD), the interest rate mismatch was similar in nature to that described above. To lessen the

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repricing mismatch between fixed rate CAD-denominated leases and floating rate CAD commercial paper, a series of three amortizing CAD interest rate swaps were executed, although Irwin was only a counterparty on two of the swaps. The third swap was between the commercial paper conduit and an outside party, but has an impact on us as it affects the conduit funding cost. Of the first of the two swaps on Irwin's books, we pay a fixed rate of interest and receive a floating rate. The U.S. dollar-equivalents of the CAD-based notional and year-to-date loss on this swap at March 31, 2004 were \$68.9 million and \$0.8 million, respectively. For the second swap, we pay a floating rate of interest and receive a fixed rate. The U.S. dollar-equivalents of the CAD-based notional and year-to-date gain on this swap at March 31, 2004 are \$69.6 million and \$0.5 million, respectively.

Our home equity line of business originates a relatively small amount of first mortgage loans. We enter into forward commitments to protect against interest rate fluctuation between the date of origination until a sale price is locked in. These loans are typically sold within a month of origination. As of March 31, 2004, we had no outstanding commitments. We recorded a derivative loss on this activity of \$6 thousand in the first quarter of 2004.

Certain of our home equity fixed rate residual interests are funded with floating rate liabilities. To manage such mismatches, we own three interest rate caps and, in the first quarter of 2004, entered into Eurodollar futures contracts. The interest rate caps had a fair value of \$0.3 million and a notional amount of \$55.9 million at March 31, 2004. We classify interest rate caps as other assets on the consolidated balance sheets and carry them at their fair values. Two of the interest rate caps qualify for cash flow hedge accounting treatment under SFAS 133. As a result, a negative adjustment to fair value of \$81 thousand net of tax on these cash flow derivatives was recorded through accumulated other comprehensive income in the first quarter of 2004. We record adjustments to fair value for the third interest rate cap (and the Eurodollar futures), which does not qualify for hedge accounting, as derivative gain or losses on the consolidated income statements. For the quarter ended March 31, 2004, we recorded a \$3 thousand loss related to this cap. We entered into Eurodollar futures contracts with a notional value of \$840 million with expiration dates ranging from June 2004 through June 2006. As of March 31, 2004, the fair value and year-to-date loss recorded on these contracts were (\$0.6 million) and \$0.6 million, respectively.

In connection with certain of our whole loan servicing retained second mortgage sales we have the opportunity to earn an additional incentive servicing fee (ISF) in the future. The whole loan sales have been to firms, (the buyer) who securitize the loans and contract with us to service the loans. We recognize a mortgage servicing asset or liability for these contracts. As a part of the buyer's securitization, the buyer issues an Incentive Servicing Agreement to us as Master Servicer. Once a pre-established return for the certificate holders has been met, the ISF provides potential cash payments to us in the event certain structure-specific loan credit and servicing performance metrics are met. We have characterized these contracts as derivative instruments. The first of these deals was dated September 27, 2002 for loans that were sold March 28, 2002. Included in derivative gains or losses in the first quarter of 2004 was \$1.8 million related to these incentive servicing fees based upon actual and projected performance of the underlying pools of loans. Of the \$1.8 million recognized during the quarter, \$0.5 million was the result of cash collections and \$1.3 million represented the projected value of future cash payments, discounted at 30%. The pool of loans which we service underlying the derivative contract we valued this quarter was \$98.3 million. In total, we have sold \$1.0 billion for which we hold such derivative contracts. Our accounting policy is to recognize a derivative asset on a mark-to-market basis at such time that the credit and prepayment performance models we use for valuing like pools of loans indicate that we are likely to receive cash payments on the derivatives within a twelve-month period. We use assumptions to value the ISFs that we believe market participants would use to value similar assets. As of March 31, 2004, only one of five whole loan sales with this derivative has met this expected performance trigger.

We manage the interest rate risk associated with our mortgage servicing rights through the use of Eurodollar futures contracts and interest rate options. The financial instrument underlying the Eurodollar futures contracts is based on the three-month LIBOR rate. For the first quarter of 2004, we recorded losses of \$2.4 million on these derivatives. Both the futures contracts and options were marked-to-market and included in other assets with changes

in value recorded in the consolidated income statements as derivative gains or losses. At March 31, 2004, we held open swaption positions with a notional value totaling \$10.8 billion at March 31, 2004, with a final maturity of April 1, 2004. For the quarter ended March 31, 2004, we recorded gains on swaptions, including premiums paid, totaling \$60.8 million. The size and mix of these positions change during the year, so period-end positions may not be indicative of our net risk exposure throughout the year. Notional amounts do not represent the amount at risk.

We own foreign currency forward contracts to protect the U.S. dollar value of intercompany loans made to Onset Capital Corporation that are denominated in Canadian dollars. We had a notional amount of \$97 million in forward contracts outstanding as of March 31, 2004. For the quarter ended March 31, 2004, we recognized losses on these contracts of \$0.2 million. These contracts are marked-to-market with gains and losses included in derivative gains or losses on the consolidated income statements. The foreign currency transaction loss on the intercompany loans was \$0.9 million during the quarter ended March 31, 2004.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk.

The quantitative and qualitative disclosures about market risk are reported in the Interest Rate Risk section of Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations found on pages 41 through 43.

Item 4. Controls and Procedures.

In the ordinary course of internal process and control review by management, internal and external audit, we will periodically identify processes and controls that need improvement. When these are identified, we have procedures in place to bring the matter to the attention of the appropriate management and Board committees and to put into place project plans to address the improvement opportunity.

As of March 31, 2004, we performed an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)). Based on that evaluation, our management, including the CEO and CFO, concluded that our disclosure controls and procedures were effective as of March 31, 2004, to ensure that material information relating to the Corporation would be made known to them by others within the Corporation.

There have been no changes since the fourth quarter of 2003 in our internal controls that have materially affected or are reasonably likely to materially affect the Corporation's internal control over financial reporting.

Item 5. Other Information.

Executive Officers

Our executive officers are elected annually by the Board of Directors and serve for a term of one year or until their successors are elected and qualified. In addition to our Chairman and Chief Executive Officer, Mr. Miller, who also serves as a director, the executive officers designated by the Board at their meeting on February 20, 2004 are listed below.

Richard Barbercheck (45) has been a Vice President of Irwin Financial Corporation since October 2003. He was an officer of Irwin Union Bank and Trust since March 1998.

Claude E. Davis (43) has been Chairman of Irwin Union Bank and Trust and Senior Vice President of Irwin Financial Corporation since May 2003. He served as President of Irwin Union Bank and Trust from January 1996 to May 2003. He has been an officer since 1988. He was elected to the Federal Home Loan Bank of Indianapolis (FHLBI) Board of Directors in 2003. We are a member of the FHLBI.

Elena Delgado (48) has been President and Chief Executive Officer of Irwin Home Equity since September 1994.

Gregory F. Ehlinger (41) has been our Senior Vice President and Chief Financial Officer since August of 1999. He has been one of our officers since August 1992.

Paul D. Freudenthaler (39) was recently promoted to Chief Risk Officer in December 2003. He was Vice President Financial Risk Management from December 2001 to December 2003. From September 2000 through November 2001,

he was Corporate Controller for America Online Latin America, an Internet service provider. From July 2000 to August 2000 he served as Senior Vice President Treasurer of Telscape International, Inc., a development stage telecommunications company. Prior thereto, he held the position of Chief Accounting Officer of Telscape from July 1999 until June 2000. Subsequent to his departure from Telscape, Telscape filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code on April 27, 2001. From February 1999 through June 1999, he was Director International of Bank United, F.S.B. From January 1994 through January 1999, he was Director International of Irwin Mortgage Corporation, our indirect subsidiary.

Jose M. Gonzalez (45) has been our Vice President Internal Audit since October 1995.

Robert H. Griffith (46) has been President and Chief Executive Officer of Irwin Mortgage since January 2001. He has been an officer of Irwin Mortgage since 1993.

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Bradley J. Kime (43) has been President of Irwin Union Bank's commercial line of business since May 2003. He has been President of Irwin Union Bank F.S.B. since December 2000. He has been an officer of Irwin Union Bank and Trust since 1987, and one of our officers since 1986.

Joseph R. LaLeggia (42) has been President of Irwin Commercial Finance Corporation since July of 2002. He has been the President and Chief Executive Officer of Onset Capital Corporation since April 1998. From January 1997 until April of 1998 he was President of AT&T Capital Canada Inc.

Matthew F. Souza (47) has been our Senior Vice President - Ethics since August 1999 and our Secretary since 1986. He has been one of our officers since 1986.

Thomas D. Washburn (57) has been our Executive Vice President since August 1999 and has been one of our officers since 1976. From 1981 to August 1999 he served as our Senior Vice President and Chief Financial Officer.

PART II. Other Information.

Item 1. Legal Proceedings.

Since the time of filing our report on Form 10-K for the year ended December 31, 2003, we experienced developments as noted in the litigation described below:

McIntosh v. Irwin Home Equity Corporation

Our subsidiary, Irwin Union Bank and Trust Company, is a defendant in a class action lawsuit filed in the U.S. District Court in Massachusetts in July 2001. The case involves loans purchased by Irwin Union Bank from FirstPlus, an unaffiliated third-party lender. The plaintiffs allege a failure to comply with certain disclosure provisions of the Truth in Lending Act relating to high rate loans in making second mortgage home equity loans to the plaintiff borrowers. The complaint seeks rescission of the loans and other damages.

On September 30, 2002, the court granted plaintiffs' motion for certification of a class subject to certain limitations. In October 2002, we filed a motion for reconsideration with the district court and a petition for permission to appeal the class certification decision with the Court of Appeals for the 1st Circuit. In May 2003, the district court denied our motion for summary judgment and denied in part our motion for reconsideration of class decertification. However, the court further restricted membership in the plaintiff class. In October 2003, the court of appeals denied our application for appellate review of the district court's certification of the class. On April 1, 2004, the plaintiffs filed a motion for summary judgment and we filed a motion for summary judgment on class claims.

As originally specified, the plaintiff class was limited to those borrowers who obtained a mortgage loan originated with prepayment penalty provisions by FirstPlus during the three-year period prior to the filing of the suit. As more recently defined by the court, the class has been further restricted to those borrowers who refinanced their loans and paid a prepayment penalty. Only high-rate loans that are subject to the provisions of the Home Ownership and Equity Protection Act of 1994 would be included in the class.

Limited discovery on issues pertaining to class certification and the merits of plaintiffs' individual claim has been conducted. The actual number of plaintiff borrowers will be determined only after a review of loan files. Nevertheless, after performing a limited analysis of the approximately 200 loans acquired directly from FirstPlus through our correspondent lending channel and the approximately 7,800 loans acquired from others through bulk acquisitions that

may include FirstPlus originations, we believe that fewer than 100 loans will qualify for inclusion in the class. We believe we have available numerous defenses to the allegations and intend to vigorously defend this lawsuit. At the present time, we are unable to form a reasonable estimate of potential loss, if any, and have not established any reserves related to this case.

Stamper v. A Home of Your Own, Inc.

On January 25, 2002, a jury in this case awarded the plaintiffs damages of \$1.434 million, jointly and severally, against defendants, including our indirect subsidiary, Irwin Mortgage Corporation. The case was filed in August 1998 in the Baltimore, Maryland, City Circuit Court. The nine plaintiff borrowers alleged that A Home of Your Own, Inc., a home rehabilitation company,

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and its principal, Robert Beeman, defrauded the plaintiffs by selling them defective homes at inflated prices and that Irwin Mortgage, which provided the plaintiff borrowers mortgage loans on the home purchases, participated in the fraud. Irwin Mortgage filed an appeal with the Maryland Court of Special Appeals, and oral argument was held on January 7, 2003. On February 27, 2004, the Court of Special Appeals ruled against Irwin Mortgage and remanded the case to the trial court for a partial retrial on whether the plaintiffs are entitled to punitive damages. On April 12, 2004, Irwin Mortgage filed a Petition for Writ of Certiorari with the Maryland Court of Appeals, seeking further review. We have reserved for this case based upon the advice of our legal counsel.

Silke v. Irwin Mortgage Corporation

In April 2003, our indirect subsidiary, Irwin Mortgage Corporation, was named as a defendant in an action filed in the Marion County, Indiana, Superior Court. The complaint alleges that Irwin Mortgage charged a document preparation fee in violation of Indiana law for services performed by clerical personnel in completing legal documents related to mortgage loans. The plaintiff is seeking to certify a class consisting of Indiana borrowers who were charged the fee during the six-year period prior to the filing of the lawsuit. Irwin Mortgage filed an answer on June 11, 2003 and a motion for summary judgment on October 27, 2003. On November 3, 2003, the court ruled that a determination of class certification will precede any action on Irwin Mortgage's summary judgment motion. On January 9, 2004, the plaintiff filed a Supplemental Brief and Submission of Additional Evidence in Support of Class Certification. On March 15, 2004, the court held a hearing on plaintiff's class certification motion. Because the case is in the early stages of litigation, we are unable at this time to form a reasonable estimate of the amount of potential loss, if any, that Irwin Mortgage could suffer. We have not established any reserves for this case.

Gutierrez v. Irwin Mortgage Corporation

In April 2003, our indirect subsidiary, Irwin Mortgage Corporation, was named as a defendant in an action filed in the District Court of Nueces County, Texas. The complaint alleges that Irwin Mortgage improperly charged borrowers fees for the services of third-party vendors in excess of Irwin Mortgage's costs, and charged certain fees to which plaintiffs did not agree. The plaintiffs are seeking to certify a class consisting of similarly situated borrowers. Irwin Mortgage filed an answer on July 11, 2003 and responded to plaintiffs' initial discovery requests on December 19, 2003. On February 25, 2004 Irwin Mortgage served its initial discovery requests on the plaintiffs. Because the case is in the early stages of litigation, we are unable at this time to form a reasonable estimate of the amount of potential loss, if any, that Irwin Mortgage could suffer. We have not established any reserves for this case.

We and our subsidiaries are from time to time engaged in various matters of litigation, including the matters described above, and other assertions of improper or fraudulent loan practices or lending violations, and other matters, and we have a number of unresolved claims pending. In addition, as part of the ordinary course of business, we and our subsidiaries are parties to litigation involving claims to the ownership of funds in particular accounts, the collection of delinquent accounts, challenges to security interests in collateral, and foreclosure interests, that is incidental to our regular business activities. While the ultimate liability with respect to these other litigation matters and claims cannot be determined at this time, we believe that damages, if any, and other amounts relating to pending matters are not likely to be material to our consolidated financial position or results of operations, except as described above. Reserves are established for these various matters of litigation, when appropriate, based upon the advice of legal counsel.

Item 2. Changes in Securities and Use of Proceeds.

(c) The Corporation issued shares of common stock pursuant to elections made by four out of the nine of our outside directors to receive board compensation under the 1999 Outside Director Restricted Stock Compensation Plan

in lieu of cash fees as indicated in the table below. All of these shares were issued in reliance on the private placement exemption from registration provided in Section 4(2) of the Securities Act.

| Date Issued | Number of Shares |
|--------------------|-----------------------------|
| December 31, 2003 | 531 |
| January 2, 2004 | 3,184 |
| February 24, 2004 | 1,658 |
| March 31, 2004 | 582 |

Table of Contents**Item 6. Exhibits and Reports on Form 8-K.****(a) Exhibits.**

| Exhibit Number | Description of Exhibit |
|---------------------------|---|
| 3.1 | Restated Articles of Incorporation of Irwin Financial Corporation. (Incorporated by reference to Exhibit 3(a) to Form 10-K Report for year ended December 31, 2000, File No. 0-06835.) |
| 3.2 | Articles of Amendment to Restated Articles of Incorporation of Irwin Financial Corporation dated March 2, 2001. (Incorporated by reference to Exhibit 3(b) to Form 10-K Report for year ended December 31, 2000, File No. 0-06835.) |
| 3.3 | Code of By-laws of Irwin Financial Corporation. (Incorporated by reference to Exhibit 3.3 to Form 10-K for period ended December 31, 2003, File No. 0-06835.) |
| 4.1 | Specimen Common Stock Certificate. (Incorporated by reference to Exhibit 4(a) to Form 10-K report for year ended December 31, 1994, File No. 0-06835.) |
| 4.2 | Certain instruments defining the rights of the holders of long-term debt of Irwin Financial Corporation and certain of its subsidiaries, none of which authorize a total amount of indebtedness in excess of 10% of the total assets of the Corporation and its subsidiaries on a consolidated basis, have not been filed as Exhibits. The Corporation hereby agrees to furnish a copy of any of these agreements to the Commission upon request. |
| 4.3 | Rights Agreement, dated as of March 1, 2001, between Irwin Financial Corporation and Irwin Union Bank and Trust. (Incorporated by reference to Exhibit 4.1 to Form 8-A filed March 2, 2001, File No. 0-06835.) |
| 4.4 | Appointment of Successor Rights Agent dated as of May 11, 2001 between Irwin Financial Corporation and National City Bank. (Incorporated by reference to Exhibit 4.5 to Form S-8 filed on September 7, 2001, File No. 333-69156.) |
| 10.1 | *Amended 1986 Stock Option Plan. (Incorporated by reference to Exhibit 10(b) to Form 10-K Report for year ended December 31, 1991, File No. 0-06835.) |
| 10.2 | *Irwin Financial Corporation 1992 Stock Option Plan. (Incorporated by reference to Exhibit 10(h) to Form 10-K Report for year ended December 31, 1992, File No. 0-06835.) |
| 10.3 | |

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- *Irwin Financial Corporation 1997 Stock Option Plan. (Incorporated by reference to Exhibit 10 to Form 10-Q Report for period ended June 30, 1994, File No. 0-06835.)
- 10.4 *Amendment to Irwin Financial Corporation 1997 Stock Option Plan. (Incorporated by reference to Exhibit 10(i) to Form 10-Q Report for period ended June 30, 1997, File No. 0-06835.)
- 10.5 *Irwin Financial Corporation 2001 Stock Plan. (Incorporated by reference to Exhibit 10.18 to Form S-1/A filed February 14, 2002, File No. 333-69586.)
- 10.6 *Amended Irwin Financial Corporation Outside Directors Restricted Stock Compensation Plan. (Incorporated by reference to Exhibit 10(g) to Form 10-K Report for year ended December 31, 1991, File No. 0-06835.)
- 10.7 *Irwin Financial Corporation Outside Directors Restricted Stock Compensation Plan. (Incorporated by reference to Exhibit 10(i) to Form 10-K Report for year ended December 31, 1995, File No. 0-06835.)

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| Exhibit Number | Description of Exhibit |
|---------------------------|--|
| 10.8 | *1999 Outside Director Restricted Stock Compensation Plan. (Incorporated by reference to Exhibit 10(b) to Form 10-Q Report for period ended June 30, 1999, File No. 0-06835.) |
| 10.9 | *Irwin Financial Corporation Employees Stock Purchase Plan. (Incorporated by reference to Exhibit 10(d) to Form 10-K Report for year ended December 31, 1991, File No. 0-06835.) |
| 10.10 | *Employee Stock Purchase Plan II. (Incorporated by reference to Exhibit 10(f) to Form 10-K Report for year ended December 31, 1994, File No. 0-06835.) |
| 10.11 | *Employee Stock Purchase Plan III. (Incorporated by reference to Exhibit 10(a) to Form 10-Q Report for period ended June 30, 1999, File No. 0-06835.) |
| 10.12 | *Long-Term Management Performance Plan. (Incorporated by reference to Exhibit 10(a) to Form 10-K Report for year ended December 31, 1986, File No. 0-06835.) |
| 10.13 | *Long-Term Incentive Plan-Summary of Terms. (Incorporated by reference to Exhibit 10(a) to Form 10-K Report for year ended December 31, 1986, File No. 0-06835.) |
| 10.14 | *Inland Mortgage Corporation Long-Term Incentive Plan. (Incorporated by reference to Exhibit 10(j) to Form 10-K Report for year ended December 31, 1995, File No. 0-06835.) |
| 10.15 | *Amended and Restated Management Bonus Plan. (Incorporated by reference to Exhibit 10(a) to Form 10-K Report for year ended December 31, 1986, File No. 0-06835.) |
| 10.16 | *Limited Liability Company Agreement of Irwin Ventures LLC. (Incorporated by reference to Exhibit 10(a) to Form 10-Q/A Report for period ended March 31, 2001, File No. 0-06835.) |
| 10.17 | *Limited Liability Company Agreement of Irwin Ventures Co-Investment Fund LLC, effective as of April 20, 2001. (Incorporated by reference to Exhibit 10.17 to Form S-1/A filed February 14, 2002, File No. 333-69586.) |
| 10.18 | *Irwin Home Equity Corporation Shareholder Agreement and Amendments. (Incorporated by reference to Exhibit 10(b) to Form 10-Q/A Report for period ended March 31, 2001, File No. 0-06835.) |
| 10.19 | |

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- *Promissory Note dated January 30, 2002 from Elena Delgado to Irwin Financial Corporation. (Incorporated by reference to Exhibit 10.19 to Form S-1/A filed February 14, 2002, File No. 333-69586.)
- 10.20 *Consumer Pledge Agreement dated January 30, 2002 between Elena Delgado and Irwin Financial Corporation. (Incorporated by reference to Exhibit 10.20 to Form S-1/A filed February 14, 2002, File No. 333-69586.)
- 10.21 *Irwin Financial Corporation Short Term Incentive Plan effective January 1, 2002. (Incorporated by reference to Exhibit 10.21 to Form 10-Q Report for period ended March 31, 2002, File No. 0-06835.)
- 10.22 *Irwin Union Bank Short Term Incentive Plan effective January 1, 2002. (Incorporated by reference to Exhibit 10.22 to Form 10-Q Report for period ended March 31, 2002, File No. 0-06835.)
- 10.24 *Irwin Mortgage Corporation Short Term Incentive Plan effective January 1, 2002. (Incorporated by reference to Exhibit 10.24 to Form 10-Q Report for period ended March 31, 2002, File No. 0-06835.)

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| Exhibit Number | Description of Exhibit |
|---------------------------|---|
| 10.25 | *Irwin Capital Holdings Short Term Incentive Plan effective January 1, 2002. (Incorporated by reference to Exhibit 10.25 to Form 10-Q Report for period ended March 31, 2002, File No. 0-06835.) |
| 10.26 | *Onset Capital Corporation Employment Agreement. (Incorporated by reference to Exhibit 10.26 to Form 10-Q Report for period ended June 30, 2002, File No. 0-06835.) |
| 10.27 | *Irwin Financial Corporation Restated Supplemental Executive Retirement Plan for Named Executives. (Incorporated by reference to Exhibit 10.27 to Form 10-Q Report for period ended June 30, 2002, File No. 0-06835.) |
| 10.28 | *Irwin Financial Corporation Supplemental Executive Retirement Plan for Named Executives. (Incorporated by reference to Exhibit 10.28 to Form 10-Q Report for period ended June 30, 2002, File No. 0-06835.) |
| 10.29 | *Onset Capital Corporation Shareholders Agreement (Incorporated by reference to Exhibit 10.29 to Form 10-K Report for year ended December 31, 2002, File No. 0-06835.) |
| 11.1 | Computation of earnings per share is included in the footnotes to the financial statements. |
| 31.1 | Certification of the Chief Executive Officer under Section 302 of the Sarbanes Oxley Act of 2002. |
| 31.2 | Certification of the Chief Financial Officer under Section 302 of the Sarbanes Oxley Act of 2002. |
| 32.1 | Certification of the Chief Executive Officer under Section 906 of the Sarbanes Oxley Act of 2002. |
| 32.2 | Certification of the Chief Financial Officer under Section 906 of the Sarbanes Oxley Act of 2002. |

* Indicates management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K.

| | | |
|-----|---------------------|--|
| 8-K | January 22, 2004 | IFC Announces 2003 Fourth Quarter and Annual Earnings Conference Call. |
| 8-K | January 23, 2004 | IFC Announces 2003 Fourth Quarter Earnings and Management Succession. |

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| | | |
|-----|----------------------|---|
| 8-K | February 20, 2004 | IFC Announces First Quarter Dividend . |
| 8-K | February 20, 2004 | IFC Announces Addition to Board of Directors . |
| 8-K | March 22, 2004 | IFC Announces Retirement of John T. Hackett from the Board of Directors. |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

IRWIN FINANCIAL CORPORATION

DATE: May 3, 2004

BY: /s/ Gregory F. Ehlinger

GREGORY F. EHLINGER
CHIEF FINANCIAL OFFICER

BY: /s/ Jody A. Littrell

JODY A. LITTRELL
CORPORATE CONTROLLER
(Chief Accounting Officer)