EAST WEST BANCORP INC
Form 10-Q
November 10, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Mark One

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

For the quarterly period ended September 30, 2008

or

o	**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 000-24939

EAST WEST BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-4703316**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

135 N. Los Robles Ave, 7th Floor, Pasadena, California 91101

(Address of principal executive offices) (Zip Code)

(626) 768-6000

(Registrant s telephone number, including area code)

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filed, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer and accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Number of shares outstanding of the issuer s common stock on the latest practicable date: 63,667,222 shares of common stock as of October 31, 2008.

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Forward-Looking Statements

Certain matters discussed in this report may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the 1933 Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and as such, may involve risks and uncertainties. These forward-looking statements relate to, among other things, expectations of the environment in which the Company operates and projections of future performance including future earnings, operating results, financial condition, and cash flows. The Company s actual results, performance, or achievements may differ significantly from the results, performance, or achievements expected or implied in such forward-looking statements as a result of the effect of interest rate and currency exchange fluctuations; competition in the financial services market for both loans and deposits; our ability to incorporate acquisitions into our operations; the effect of regulatory and legislative action; and regional and general economic conditions. Such risk and uncertainties and other factors include, but are not limited to, adverse developments or conditions related to or arising from:

- changes in our borrowers performance on loans;
- changes in the commercial and consumer real estate markets;
- changes in our costs of operation, compliance and expansion;
- changes in the economy, including inflation;
- changes in government interest rate policies;
- changes in laws or the regulatory environment;
- changes in accounting policies or procedures;
- changes in the equity and debt securities markets;
- changes in competitive pressures on financial institutions;

- effect of additional provision for loan losses;
- effect of any goodwill impairment;
- fluctuations in our stock price;
- success and timing of our business strategies;
- changes in our ability to receive dividends from our subsidiaries; and
- political developments, wars, acts of terrorism or natural disasters such as earthquakes or floods.

For a more detailed discussion of some of the factors that might cause such differences, see the Company s 2007 Form 10-K under the heading ITEM 1A. RISK FACTORS. The Company does not undertake, and specifically disclaims any obligation to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EAST WEST BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(Unaudited)

	September 30, 2008	December 31, 2007
ASSETS		
Cash and cash equivalents	$ 527,474	$ 160,347
Short-term investments	495	
Securities purchased under resale agreements	50,000	150,000
Investment securities available-for-sale, at fair value (with amortized cost of $2,172,519 in 2008 and $1,954,140 in 2007)	2,047,244	1,887,136
Loans receivable, net of allowance for loan losses of $177,155 at September 30, 2008 and $88,407 at December 31, 2007	8,111,231	8,750,921
Investment in Federal Home Loan Bank stock, at cost	86,153	84,976
Investment in Federal Reserve Bank stock, at cost	27,589	21,685
Other real estate owned, net	17,607	1,500
Investment in affordable housing partnerships	41,819	44,206
Premises and equipment, net	61,674	64,943
Due from customers on acceptances	8,123	15,941
Premiums on deposits acquired, net	22,314	28,459
Goodwill	337,331	335,366
Cash surrender value of life insurance policies	93,836	88,658
Deferred tax assets	175,591	66,410
Accrued interest receivable and other assets	113,835	151,664
TOTAL	**$ 11,722,316**	**$ 11,852,212**
LIABILITIES AND STOCKHOLDERS EQUITY		
Customer deposit accounts:		
Noninterest-bearing	$ 1,393,480	$ 1,431,730
Interest-bearing	6,142,869	5,847,184
Total customer deposits	7,536,349	7,278,914
Federal funds purchased	30,443	222,275
Federal Home Loan Bank advances	1,538,350	1,808,419
Securities sold under repurchase agreements	999,467	1,001,955
Notes payable	12,150	16,242
Long-term debt	235,570	235,570
Bank acceptances outstanding	8,123	15,941
Accrued interest payable, accrued expenses and other liabilities	96,983	101,073
Total liabilities	10,457,435	10,680,389
COMMITMENTS AND CONTINGENCIES (Note 8)		
STOCKHOLDERS EQUITY		

Preferred stock (par value of $0.001 per share)				
Authorized 5,000,000 shares				
Issued 200,000 shares in Series A, convertible preferred stock in 2008 and none in 2007				
Outstanding 197,400 shares in 2008 and none in 2007				
Common stock (par value of $0.001 per share)				
Authorized 200,000,000 shares				
Issued 70,223,189 shares in 2008 and 69,634,811 shares in 2007				
Outstanding 63,623,131 shares in 2008 and 63,137,221 shares in 2007		70		70
Additional paid in capital		858,020		652,297
Retained earnings		581,561		657,183
Treasury stock, at cost 6,600,058 shares in 2008 and 6,497,590 shares in 2007		(102,171)		(98,925)
Accumulated other comprehensive loss, net of tax		(72,599)		(38,802)
Total stockholders equity		1,264,881		1,171,823
TOTAL	**$**	**11,722,316**	**$**	**11,852,212**

See accompanying notes to condensed consolidated financial statements.

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EAST WEST BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
INTEREST AND DIVIDEND INCOME				
Loans receivable, including fees	$ 131,682	$ 167,066	$ 425,113	$ 484,073
Investment securities available-for-sale	23,143	26,235	75,923	72,505
Securities purchased under resale agreements	1,277	4,013	5,094	11,742
Investment in Federal Home Loan Bank stock	1,390	828	4,153	2,457
Short-term investments	1,957	347	3,546	564
Investment in Federal Reserve Bank stock	413	279	1,122	818
Total interest and dividend income	159,862	198,768	514,951	572,159
INTEREST EXPENSE				
Customer deposit accounts	40,757	62,058	136,546	182,144
Federal Home Loan Bank advances	17,140	16,175	54,363	43,555
Securities sold under repurchase agreements	12,063	10,263	33,881	27,675
Long-term debt	2,957	4,101	9,675	11,235
Federal funds purchased	430	2,317	2,176	6,164
Total interest expense	73,347	94,914	236,641	270,773
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	86,515	103,854	278,310	301,386
PROVISION FOR LOAN LOSSES	43,000	3,000	183,000	3,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	43,515	100,854	95,310	298,386
NONINTEREST (LOSS) INCOME				
Impairment writedown on investment securities	(53,567)	(405)	(63,512)	(405)
Branch fees	4,285	3,836	12,725	10,667
Net gain on sale of investment securities available-for-sale		2,772	7,767	5,218
Letters of credit fees and commissions	2,319	2,702	7,472	7,688
Ancillary loan fees	1,783	1,397	3,908	4,164
Income from life insurance policies	1,029	1,132	3,081	3,164
Net gain on sale of loans	144	272	2,272	1,296
Net gain on disposal of fixed assets	44	1,261	221	1,573
Other operating income	413	621	1,867	2,176
Total noninterest (loss) income	(43,550)	13,588	(24,199)	35,541
NONINTEREST EXPENSE				
Compensation and employee benefits	17,520	22,081	66,578	63,511
Occupancy and equipment expense	6,817	6,656	20,364	18,583
Amortization and impairment writedowns of premiums on deposits acquired	1,581	1,767	6,145	4,824
Loan related expense	2,361	708	5,967	1,937
	1,886	1,017	5,521	3,521

Amortization of investments in affordable housing partnerships				
Deposit insurance premiums and regulatory assessments	1,678	350	5,191	1,021
Legal expense	855	653	3,890	1,258
Consulting expense	1,254	992	3,788	2,337
Other real estate owned expense (income)	2,123		3,520	(1,247)
Deposit-related expenses	1,231	1,687	3,416	5,236
Data processing	1,055	1,351	3,386	3,403
Impairment writedown on goodwill	272		858	
Other operating expenses	9,893	9,476	28,447	26,591
Total noninterest expense	48,526	46,738	157,071	130,975
(LOSS) INCOME BEFORE (BENEFIT) PROVISION FOR INCOME TAXES	(48,561)	67,704	(85,960)	202,952
(BENEFIT) PROVISION FOR INCOME TAXES	(17,355)	26,368	(33,911)	79,030
NET (LOSS) INCOME	**(31,206)**	**41,336**	**(52,049)**	**123,922**
PREFERRED STOCK DIVIDENDS	4,089		4,089	
NET (LOSS) INCOME AVAILABLE TO COMMON STOCKHOLDERS	**$ (35,295)**	**$ 41,336**	**$ (56,138)**	**$ 123,922**
(LOSS) EARNINGS PER SHARE AVAILABLE TO COMMON STOCKHOLDERS				
BASIC	$ (0.56)	$ 0.68	$ (0.90)	$ 2.04
DILUTED	$ (0.56)	$ 0.67	$ (0.90)	$ 2.01
DIVIDENDS DECLARED PER COMMON SHARE	$ 0.10	$ 0.10	$ 0.30	$ 0.30
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING				
BASIC	62,675	61,232	62,586	60,754
DILUTED	62,675	62,088	62,586	61,712

See accompanying notes to condensed consolidated financial statements.

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EAST WEST BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(In thousands, except share data)

(Unaudited)

	Preferred Stock	Common Stock	Additional Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss, Net of Tax	Comprehensive Income (Loss)	Total Stockholders Equity
BALANCE, JANUARY 1, 2007	**$**	**$ 66**	**$ 544,469**	**$ 525,247**	**$ (40,305)**	**$ (10,087)**		**$ 1,019,390**
Comprehensive income								
Net income for the period				123,922			$ 123,922	123,922
Net unrealized loss on investment securities available-for-sale						(895)	(895)	(895)
Total comprehensive income							$ 123,027	
Cumulative effect of change in accounting principle pursuant to adoption of FIN 48				(4,628)				(4,628)
Stock compensation costs			4,891					4,891
Tax benefit from stock option exercises			7,177					7,177
Tax benefit from vested restricted stock			192					192
Issuance of 947,388 shares pursuant to various stock plans and agreements		1	10,056					10,057
Issuance of 5,880 shares pursuant to Director retainer fee			219					219
Issuance of 2,032,816 shares pursuant to Desert Community Bank acquisition		2	78,484					78,486
Cancellation of 71,001 shares due to forfeitures of issued restricted stock			2,591		(2,591)			
Purchase of 22,267 shares of treasury stock due to the vesting of restricted stock					(814)			(814)
Purchase of 1,375,000 shares of treasury stock pursuant to the Stock Repurchase Program					(53,142)			(53,142)
Dividends paid on common stock				(18,300)				(18,300)

BALANCE, SEPTEMBER 30, 2007	**$**	**$ 69**	**$ 648,079**	**$ 626,241**	**$ (96,852)**	**$ (10,982)**		**$ 1,166,555**
BALANCE, JANUARY 1, 2008	**$**	**$ 70**	**$ 652,297**	**$ 657,183**	**$ (98,925)**	**$ (38,802)**		**$ 1,171,823**
Comprehensive loss								
Net loss for the period				(52,049)			$ (52,049)	(52,049)
Net unrealized loss on investment securities available-for-sale						(33,797)	(33,797)	(33,797)
Total comprehensive loss							$ (85,846)	
Cumulative effect of change in accounting principle pursuant to adoption of EITF 06-4				(479)				(479)
Stock compensation costs			4,515					4,515
Tax benefit from stock option exercises			159					159
Tax provision from vested restricted stock			(397)					(397)
Issuance of 200,000 shares Series A convertible preferred stock, net of stock issuance costs			194,068					194,068
Conversion of 2,600 shares of Preferred Stock			(2,523)					(2,523)
Issuance of 168,983 shares of Common Stock from converted 2,600 shares of Preferred Stock			2,523					2,523
Issuance of 400,834 shares pursuant to various stock plans and agreements			1,623					1,623
Issuance of 18,361 shares pursuant to Director retainer fee			219					219
Cancellation of 102,058 shares due to forfeitures of issued restricted stock			3,238		(3,238)			
Purchase accounting adjustment pursuant to DCB Acquisition			2,298					2,298
Purchase of 410 shares of treasury stock due to the vesting of restricted stock					(8)			(8)
Dividends paid on preferred stock				(4,089)				(4,089)
Dividends paid on common stock				(19,005)				(19,005)
BALANCE, SEPTEMBER 30, 2008	**$**	**$ 70**	**$ 858,020**	**$ 581,561**	**$ (102,171)**	**$ (72,599)**		**$ 1,264,881**

	Nine Months Ended September 30, 2008	**2007**
	(In thousands)	
Disclosure of reclassification amounts:		
Unrealized holding (loss) gain on securities arising during the period, net of tax (benefit) expense of $(47,887) in 2008 and $1,544 in 2007	$ (66,129)	$ 2,131
	32,332	(3,026)

Less: Reclassification adjustment for loss (gain) included in net income, net of tax (benefit) expense of $(23,413) in 2008 and $2,192 in 2007				
Net unrealized loss on securities, net of tax benefit of $24,474 in 2008 and $648 in 2007	$	(33,797)	$	(895)

See accompanying notes to condensed consolidated financial statements.

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EAST WEST BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$ (52,049)	$ 123,922
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	12,754	9,915
Impairment writedown on goodwill	858	
Impairment writedown of investment securities	63,512	405
Stock compensation costs	4,515	4,891
Deferred tax benefit	(78,929)	(15,531)
Provision for loan losses	183,000	3,000
Provision for loss on other real estate owned	2,121	
Net gain on sales of investment securities, loans and other assets	(8,570)	(8,725)
Federal Home Loan Bank stock dividends	(3,777)	(2,691)
Originations of loans held for sale	(42,100)	(29,796)
Proceeds from sale of loans held for sale	42,458	29,806
Tax benefit from stock options exercised	(159)	(7,177)
Tax provision (benefit) from vested restricted stock	397	(192)
Net change in accrued interest receivable and other assets	25,755	32,583
Net change in accrued interest payable, accrued expenses and other liabilities	(5,485)	20,319
Total adjustments	196,350	36,807
Net cash provided by operating activities	144,301	160,729
CASH FLOWS FROM INVESTING ACTIVITIES		
Net loan decrease (increase)	265,375	(964,301)
Purchases of:		
Short term investments	(495)	
Securities purchased under resale agreements		(150,000)
Investment securities available-for-sale	(1,657,219)	(646,750)
Federal Home Loan Bank stock	(9,400)	(23,163)
Federal Reserve Bank stock	(5,904)	(600)
Premises and equipment	(3,173)	(10,812)
Proceeds from sale of:		
Investment securities available-for-sale	376,148	423,738
Securities purchased under resale agreements	100,000	100,000
Loans receivable	148,254	19,612
Real estate owned	28,084	4,130
Premises and equipment	85	6,710
Maturity of interest-bearing deposits in other banks		1,205
Repayments, maturity and redemption of investment securities available-for-sale	1,011,854	971,971
Redemption of Federal Home Loan Bank stock	12,000	31,767
Acquisitions, net of cash acquired	(1,158)	(7,341)
Net cash provided by (used in) investing activities	264,451	(243,834)
CASH FLOWS FROM FINANCING ACTIVITIES		

Net increase (decrease) in deposits		257,435		(263,508)
Net (decrease) increase in federal funds purchased		(191,832)		14,910
Net (decrease) increase in Federal Home Loan Bank advances		(270,000)		291,500
(Repayment) purchases of of securities sold under repurchase agreements		(2,488)		25,837
Repayment of notes payable on affordable housing investments		(7,091)		(6,081)
Proceeds from issuance of long-term debt				50,000
Proceeds from issuance of common stock pursuant to various stock plans and agreements		1,623		10,057
Proceeds from issuance of convertible preferred stock, net of stock issuance costs		194,068		
Tax benefit from stock options exercised		159		7,177
Tax (provision) benefit from vested restricted stock		(397)		192
Dividends paid on preferred stock and common stock		(23,094)		(18,300)
Purchase of treasury shares pursuant to stock repurchase program and vesting of restricted stock		(8)		(53,956)
Net cash (used in) provided by financing activities		(41,625)		57,828
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		367,127		(25,277)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		160,347		192,559
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	527,474	$	167,282
SUPPLEMENTAL CASH FLOW INFORMATION:				
Cash paid during the period for:				
Interest	$	231,717	$	273,217
Income tax payments, net of refunds		39,743		86,605
Noncash investing and financing activities:				
Real estate acquired through foreclosure		46,614		622
Affordable housing investment financed through notes payable		3,000		9,613
Purchase accounting adjustment in connection with acquisition		2,298		
Issuance of common stock in lieu of Board of Director retainer fees		219		219
Guaranteed mortgage loan securitizations				1,067,309
Issuance of common stock in connection with acquisition				78,486
Equity interests in East West Capital Trusts				1,547

See accompanying notes to condensed consolidated financial statements.

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EAST WEST BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended September 30, 2008 and 2007

(Unaudited)

1. BASIS OF PRESENTATION

The condensed consolidated financial statements include the accounts of East West Bancorp, Inc. (referred to herein on an unconsolidated basis as East West and on a consolidated basis as the Company) and its wholly-owned subsidiaries, East West Bank and subsidiaries (the Bank) and East West Insurance Services, Inc. Intercompany transactions and accounts have been eliminated in consolidation. East West also has nine wholly-owned subsidiaries that are statutory business trusts (the Trusts). In accordance with Financial Accounting Standards Board Interpretation No. 46(R), *Consolidation of Variable Interest Entities*, the Trusts are not consolidated into the accounts of East West Bancorp, Inc.

The interim condensed consolidated financial statements, presented in accordance with accounting principles generally accepted in the United States of America (GAAP), are unaudited and reflect all adjustments which, in the opinion of management, are necessary for a fair statement of financial condition and results of operations for the interim periods. All adjustments are of a normal and recurring nature. Results for the nine months ended September 30, 2008 are not necessarily indicative of results that may be expected for any other interim period or for the year as a whole. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company s annual report on Form 10-K for the year ended December 31, 2007.

Certain items in the condensed consolidated statements of operations for the three and nine months ended 2008 and 2007 were reclassified to conform to the year-to-date 2008 presentation. These reclassifications did not affect previously reported net income. In June 2008, the Company reclassified net gain on sale of other real estate owned (OREO) from the caption Noninterest Income to Noninterest Expense in order to present all OREO activity in a single line item. As a result, $1.3 million for the three and nine months ended September 30, 2007, previously included under the caption Noninterest Income was reclassified to OREO expense (income), which is a component of Noninterest Expense. Additionally, during the third quarter of 2008, the Company reclassified impairment writedowns on investment securities from the caption Noninterest Expense to Noninterest Income. As a result, $9.9 million and $405 thousand in other-than-temporary impairment (OTTI) charges recorded during the first six months of 2008 and first nine months ended 2007, respectively, were reclassified from the caption Noninterest Expense to Noninterest Income.

2. SIGNIFICANT ACCOUNTING POLICIES

Recent Accounting Standards

In September 2006, the Emerging Issues Task Force (EITF) issued EITF 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements,* which requires employers to recognize an obligation associated with endorsement split-dollar

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life insurance arrangements that extend into the employee s postretirement period. EITF 06-4 is effective for financial statements issued for fiscal years beginning after December 31, 2007. Upon adoption of EITF 06-4, the Company recorded a net decrease to retained earnings of $479 thousand, net of tax.

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which provides a definition of fair value, establishes a framework for measuring fair value, and requires expanded disclosures about fair value measurements. The standard applies when GAAP requires or allows assets or liabilities to be measured at fair value and, therefore, does not expand the use of fair value in any new circumstance. The Company adopted SFAS 157 on a prospective basis. The adoption of SFAS 157 on January 1, 2008 did not have any impact on the Company s financial condition, results of operations, or cash flows. The adoption of this standard resulted in additional disclosures which are presented in Note 3 of the Company s condensed consolidated financial statements presented elsewhere in this report. In February 2008, the FASB issued SFAS No. 157-2, *Effective Date of FASB Statement No.* 157, which provided for a one-year deferral of the implementation of this standard for other nonfinanical assets and liabilities, effective for fiscal years beginning after November 15, 2008. This additional guidance is not expected to have a material impact on the Company s consolidated financial statements upon adoption.

In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158), which amends SFAS No. 87, *Employers Accounting for Pensions;* SFAS No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits;* SFAS No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions;* and SFAS No. 132(R), *Employers Disclosures about Pensions and Other Postretirement Benefits* (revised 2003). This Statement requires companies to recognize an asset or liability for the overfunded or underfunded status of their benefit plans in their financial statements. The asset or liability is the offset to other accumulated comprehensive income, consisting of previously unrecognized prior service costs and credits, actuarial gains or losses, and accumulated transition obligations and assets. SFAS 158 also requires the measurement date for plan assets and liabilities to coincide with the sponsor s year-end. The standard provides two transition alternatives for companies to make the measurement-date provisions. The Company adopted the recognition and disclosure elements of SFAS 158, effective January 1, 2008, which did not have a material effect on its financial position, results of operations, or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 would allow the Company a one-time irrevocable election to measure certain financial assets and liabilities on the balance sheet at fair value and report the unrealized gains and losses on the elected items in earnings at each subsequent reporting date. This Statement requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the Company s choice to use fair value on its earnings.SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company has elected not to measure any new financial instruments at fair value, as permitted in SFAS 159, but to continue recording its financial instruments in accordance with current practice.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)), which replaces FASB Statement No. 141, *Business Combinations*. SFAS 141(R) establishes principles and requirements for how an acquiring company (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree, (2) recognizes and measures the goodwill acquired in the business combination

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or a gain from a bargain purchase, and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for business combinations occurring on or after the beginning of the fiscal year beginning on or after December 15, 2008. SFAS 141(R), effective for the Company on January 1, 2009, and applies to all transactions or other events in which the Company obtains control in one or more businesses. Management will assess each transaction on a case-by-case basis as they occur.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51* (SFAS 160). This Statement requires that noncontrolling or minority interests in subsidiaries be presented in the consolidated statement of financial position within equity, but separate from the parents equity, and that the amount of the consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company does not expect this guidance to have a material effect on its financial condition, results of operations, or cash flows.

In February 2008, the FASB issued FASB Staff Position FAS No. 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (FSP No. 140-3), which provides a consistent framework for the evaluation of a transfer of a financial asset and subsequent repurchase agreement entered into with the same counterparty. FSP FAS No. 140-3 provides guidelines that must be met in order for an initial transfer and subsequent repurchase agreement to not be considered linked for evaluation. If the transactions do not meet the specified criteria, they are required to be accounted for as one transaction. This FSP is effective for fiscal years beginning after November 15, 2008, and shall be applied prospectively to initial transfers and repurchase financings for which the initial transfer is executed on or after adoption. The Company does not expect this guidance to have a material effect on its financial condition, results of operations, or cash flows.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 requires specific disclosures regarding the location and amounts of derivative instruments in the financial statements; how derivative instruments and related hedged items are accounted for; and how derivative instruments and related hedged items affect the financial position, financial performance, and cash flows of the Company. It is effective for financial statements issued for fiscal years beginning after November 15, 2008, with early adoption encouraged. The Company does not expect this guidance to have a material effect on its financial condition, results of operations, or cash flows.

In April 2008, the FASB directed the FASB Staff to issue FSP No. FAS 142-3, *Determination of the Useful Life of Intangible Assets*. FSP No. FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used for purposes of determining the useful life of a recognized intangible asset under SFAS 142, *Goodwill and Other Intangible Assets* (SFAS 142). FSP No. FAS 142-3 is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R) and other GAAP. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. Earlier application is not permitted. The Company does not expect this guidance to have a material effect on its financial condition, results of operations, or cash flows.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). SFAS 162 identifies a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles for nongovernmental entities (the Hierarchy). The

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Hierarchy within SFAS 162 is consistent with that previously defined in the AICPA Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles* (SAS 69). SFAS 162 is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles.* The Company does not expect this guidance to have a material effect on its financial condition, results of operations, or cash flows.

In June 2008, the FASB issued FSP EITF 03-06-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.* FSP EITF 03-06-1 requires all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends to be considered participating securities and requires entities to apply the two-class method of computing basic and diluted earnings per share. This FSP is effective for fiscal years beginning after December 31, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company is currently evaluating the impact that this FSP will have on the Company s consolidated financial statements.

In October 2008, the FASB issued FSP SFAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*. FSP SFAS 157 157-3 clarified the application of SFAS 157 in an inactive market. It demonstrated how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP SFAS 157-3 was effective upon issuance, including prior periods for which financial statements had not been issued as of September 30, 2008. The adoption of this guidance did not have a material effect on the Company s financial condition, results of operations, or cash flows.

3. FAIR VALUE MEASUREMENT

The Company adopted SFAS 157 and SFAS 159, effective January 1, 2008. SFAS 157 provides a framework for measuring fair value under GAAP. This standard applies to all financial assets and liabilities that are being measured and reported at fair value on a recurring and non-recurring basis. For the Company, this includes the investment securities available-for-sale (AFS) portfolio, equity swap agreements, derivatives payable, mortgage servicing assets, and impaired loans**.**

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market and income approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability. These inputs can be readily observable, market corroborated, or generally unobservable firm inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The hierarchy ranks the quality and reliability of the information used to determine fair values. The hierarchy gives the highest priority to quoted prices available in active markets and the lowest priority to data lacking transparency. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

- Level 1 Quoted prices for identical instruments that are highly liquid, observable and actively traded in over-the-counter markets. Level 1 financial instruments typically include U.S. Treasury securities.

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• Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable and can be corroborated by market data. Level 2 financial instruments typically include U.S. Government and agency mortgage-backed securities, U.S. Government sponsored enterprise preferred stock securities, trust preferred securities, and equity swap agreements.

• Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category typically includes mortgage servicing assets, impaired loans, private label mortgage-backed securities, retained residual interests in securitizations, pooled trust preferred securities, and derivatives payable.

In determining the appropriate levels, the Company performs a detailed analysis of assets and liabilities that are subject to SFAS 157. The following table presents financial assets and liabilities that are measured at fair value on a recurring and non-recurring basis. These assets and liabilities are reported on the condensed consolidated balance sheets at their fair values as of September 30, 2008. As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to their fair value measurement.

Assets (Liabilities) Measured at Fair Value on a Recurring Basis as of September 30, 2008

	Fair Value Measurements September 30, 2008	Quoted Prices in Active Markets for Identifical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(In Thousands)		
Investment Securities (AFS)	$ 2,047,244	$ 5,083	$ 1,349,070	$ 693,091
Equity Swap Agreements	14,979		14,979	
Derivatives Payable	(15,093)			(15,093)

Assets Measured at Fair Value on a Non-Recurring Basis as of September 30, 2008

	Fair Value Measurements September 30, 2008	Quoted Prices in Active Markets for Identifical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(In Thousands)		
Mortgage Servicing Assets	$ 18,782	$	$	$ 18,782
Impaired Loans	174,864			174,864

At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3. The following table provides a reconciliation of the beginning and ending balances for asset categories measured at fair value using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2008:

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	Investment Securities Available for Sale	Mortgage Servicing Assets	Impaired Loans	Derivatives Payable
		(In Thousands)		
Beginning balance, July 1, 2008	$ 607,484	$ 19,391	$ 157,461	$
Total gains or losses (1)				
Included in earnings (realized)	952	(667)	22,821	
Included in other comprehensive loss (unrealized) (2)	31,340			
Purchases, issuances, sales, settlements (3)	(27,469)	58		
Transfers in and/or out of Level 3 (4)	80,784		(5,418)	(15,093)
Ending balance September 30, 2008	$ 693,091	$ 18,782	$ 174,864	$ (15,093)
Changes in unrealized losses included in earnings relating to assets and liabilities still held at September 30, 2008 (4)	$ (6,618)	$	$	$

	Investment Securities Available for Sale	Mortgage Servicing Assets	Impaired Loans	Derivatives Payable
		(In Thousands)		
Beginning balance, January 1, 2008	$ 700,434	$ 21,558	$ 107,544	$
Total gains or losses (1)				
Included in earnings (realized)	4,423	(3,699)	(16,587)	
Included in other comprehensive loss (unrealized) (2)	(4,625)			
Purchases, issuances, sales, settlements (3)	(87,925)	923		
Transfers in and/or out of Level 3 (4)	80,784		83,907	(15,093
Ending balance September 30, 2008	$ 693,091	$ 18,782	$ 174,864	$ (15,093
Changes in unrealized losses included in earnings relating to assets and liabilities still held at September 30, 2008 (4)	$ (8,192)	$	$	$