PMA™ FINANCIAL NETWORK

CREDIT QUARTERLY

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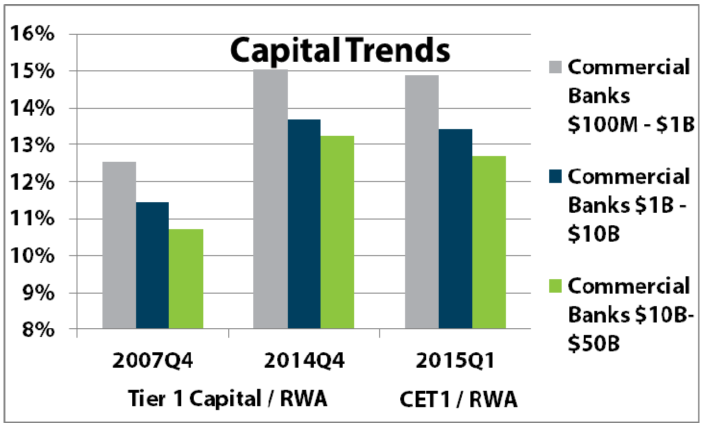
RECENT NEWS

Industry Strengthens Under New Capital Rules

Beginning January 1, 2015, community banks began to report new capital standards, marking the largest change in regulation local banks have been required to comply with since the financial crisis. The Basel Committee (the committee responsible for creating international banking standards) created these new rules several years ago and the U.S.'s largest banks have been adhering to the standards for the last two years. According to the FDIC, the "new capital rule will result in capital requirements that better reflect banks' risk profiles, thereby improving the overall resiliency of the banking system."



Source: SNL Financial

The largest change to the capital rules is the new Common Equity Tier 1 capital (CET1) to total risk-weighted assets ratio. Banks will be required to meet a minimum of 4.5% for this ratio. CET1 is largely comprised of common stock and retained earnings. It is similar to former Tier 1 Capital, but has stricter requirements of qualifying capital. Other changes to the rules include improving the quality of capital by implementing changes to the definition of capital and newly updated thresholds for Prompt Corrective Action (PCA). These revised thresholds illustrate the minimum ratio requirements needed to avoid regulatory intervention. The chart below reflects the PCA changes.

Overall, it will take several quarters of information to determine the full impact of the Basel III regulations and how it affects community banks' capital levels, dividend payments and earnings. We believe these rules will offer strength and stability to the banking industry.

Sources: Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, SNL Financial

CREDIT TRENDS

PROMPT CORRECTIVE ACTION (PCA) THRESHOLD RATIOS:

Effective January 1st, 2015, this chart illustrates the new levels of capital for each capital classification.

Prompt Corrective Action (PCA) Capital Category	Threshold Ratios			
	Total Risk Based Capital Ratio	Tier 1 Risk Based Capital Ratio	Common Equity Tier 1 Risk Based Capital Ratio	Tier 1 Leverage Ratio
Well Capitalized	10%	8%	6.5%	5%
Adequately Capitalized	8%	6%	4.5%	4%
Undercapitalized	< 8%	< 6%	< 4.5%	< 4%
Significantly Undercapitalized	< 6%	< 4%	< 3%	< 3%
Critically Undercapitalized	Tangible Equity / Total Assets ≤ 2%			

Source: Federal Deposit Insurance Corporation

BANKING TRENDS

1st Quarter 2015 Highlights

Community banks' earnings outpaced the rest of the industry, with earnings growing at almost three times the rate of non-community banks since the first quarter of 2014. (16.4% for community banks vs. 6.1% for non-community banks). Overall, the U.S. banking industry saw a total increase in net income of 6.9% year over year. 62.7% of all banks reported higher profits than the previous year and only 5.6% were unprofitable, which is the lowest percentage of unprofitable institutions since the second quarter of 2005.

Total assets increased by 1.4% for the first quarter of 2015, while loan and lease balances rose by 0.6%, with the largest increase from commercial and industrial loans. Credit card and agricultural loans posted seasonal declines and HELOC balances decreased for the 24th consecutive quarter. The new year introduced the new Common Equity Tier 1 (CET1) capital ratio, with 96.8% of all institutions reporting their ratio as identical to their Tier 1 risk-based capital ratio. The average CET1 ratio for the industry at the end of the quarter was 12.65%, compared with an average of 12.75% in the previous quarter.

The first quarter saw the total number of banks fall from 6,509 to 6,419, due to 86 institutions merging and four institutions failing. The number of banks on the FDIC's "Problem List" declined for the 16th consecutive quarter, falling from 291 to 251. Total assets of problem banks fell from $86.7 billion to $60.3 billion.

Source: FDIC: Quarterly Banking Profile

PROFITABILITY

2015	94.4%
2014	93.2%

Percentage of banks generating positive 1st quarter earnings

Source: Federal Deposit Insurance Corporation (FDIC) and SNL Financial

PRUDENT MAN PROCESS

The Prudent Man Analysis

The Prudent Man Process includes four steps which begin with gathering data and analyzing a bank's credit quality and continues with ongoing risk management throughout the life of a deposit. The process helps public funds investors avoid repayment, reinvestment and reputation risk that may be associated with a bank failure.

Step 2: Data Analysis - Qualitative

Bank credit analysis requires insight into a bank's balance sheet, management and regulatory standing. The composition and quality of assets and liabilities are reviewed, as any balance sheet concentrations can provide insight into a bank's risk profile. To determine regulatory standing, analysts search for bank enforcement actions on the FDIC, OCC and Federal Reserve Bank websites. Additionally, if the company is publicly traded, a review of public Securities and Exchange Commission documents is completed.

Qualitative analysis also includes an assessment of industry performance and economic conditions. Banking industry developments are monitored daily and analysts conduct sector analysis within the banking industry to better understand business segments such as commercial real estate, residential mortgages and credit card lending. Economic trends that may affect bank performance are also monitored.

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