PMA FINANCIAL NETWORK

CREDIT QUARTERLY

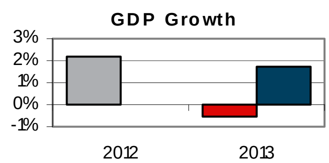
INSIDE THIS ISSUE

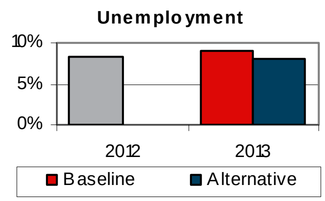
RECENT NEWS

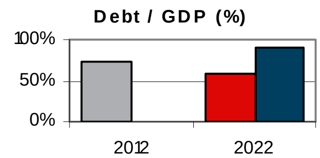
Fiscal Cliff Threatens Growth

Fears of a double dip recession were renewed after the Congressional Budget Office (CBO) released a report predicting a 2.9% contraction in GDP and an increase in unemployment during the first half of 2013 if Congress does not address a number of tax increases and automatic spending cuts, dubbed the "fiscal cliff", which are scheduled to go into effect on January 1.

This baseline scenario would hurt the economy in the near term, but the actions would significantly lower the federal budget deficit in 2013 and reduce the federal debt over the next decade. In an alternative scenario presented by the CBO, where current law is changed and certain unpopular measures of the fiscal cliff are avoided, deficit and debt levels would remain unsustainably high with federal debt reaching 90% of GDP by 2022.







There has been a great deal of criticism of the fiscal cliff with both Democrats and Republicans hoping to come up with an alternative option. Ideally, Congress could introduce a new plan to slowly reduce debt burdens without subjecting the economy to such a significant shock. However, the prospect for compromise seems dismal as both parties remain deadlocked in this election year.

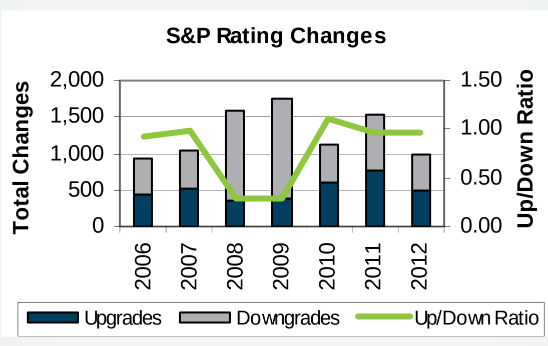
If the issues are not addressed, the U.S. could risk another downgrade of its bond rating. Fitch Ratings warned the nation's 'AAA' credit rating faces a "significant threat" if Congress does not address the debt burden in the first half of 2013.

Sources: Congressional Budget Office, Wall Street Journal, Fitch Ratings

CREDIT TRENDS

S&P RATING CHANGES:

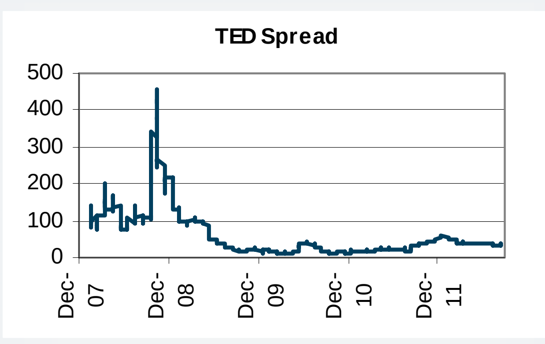
The number of Standard & Poor's U.S. rating changes and the ratio of upgrades to downgrades.



Source: Bloomberg, 8/29/12

U.S. TED SPREAD:

The spread between the 3 month LIBOR yield and the 3 month U.S. Treasury yield.



Source: Bloomberg, 8/29/12

BANK FAILURES

2012	**40**
Georgia	9
Illinois	6
Florida	5
Minnesota	3
Tennessee	3
2011	**92**
Georgia	23
Florida	13
Illinois	9
California	6
Michigan	4

Source: Federal Deposit Insurance Corporation (FDIC)

BANKING TRENDS
2nd Quarter 2012 Highlights

FDIC insured institutions reported net income of $34.5 billion in the 2nd quarter, up 20.7% from the 2nd quarter of 2011. The quarter represented the twelfth consecutive year over year increase in net income. Provisions for loan loss declined 26.2% from the prior year period and represented the smallest quarterly provision in five years. The decline in provisions helped offset a decline in net interest income, as the average net interest margin fell 0.3% to a three year low.

Total assets increased $105 billion, or 0.8%, led by an increase in lending. Loan balances increased $102 billion, or 1.4%, from the year prior period, driven by increases in C&I, residential mortgage, and credit card lending.

Noncurrent loan balances declined by 4.2%, falling in all major loan categories. The quarter represented the ninth consecutive quarter of declining noncurrent loans. Net charge-offs declined by 29.1%, led by declines in credit card charge-offs. The quarter represented the eighth consecutive year over year decline in net charge-offs.

The number of FDIC problem institutions declined to 732 from 772 during the quarter, while total assets of problem institutions fell to $282 billion from $291 billion.

Source: FDIC: Quarterly Banking Profile

PRUDENT MAN PROCESS
The Prudent Man Analysis

The Prudent Man Process includes the initial analysis of a bank's credit quality and the 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.

1 | **BANK CREDIT ANALYSIS**
- **Gather Data**
- **Analyze Data**

2 | **RISK MANAGEMENT**
- **Assign PMA Rating and Deposit Limits**
- **Ongoing Risk Management**

The process begins with gathering bank, industry and economic data from an extensive list of sources. Bank financial data is received from a variety of regulatory filings. Industry tools like Bloomberg and SNL Financial are utilized in obtaining data and other relevant information. Additionally, a number of publications focusing on the banking industry and local and national economy are monitored daily.

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