IndyMac Bank, F.S.B

Presentation of Examination Findings
Examination Date: January 8, 2007

Meeting Date
March 9, 2007

OFFICE OF THRIFT SUPERVISION

OTS attendees:

Mark Johnson	Assistant Director
Mark Reiley	Examiner-in-charge – Safety & Soundness
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Bruce Hickok	Examiner-in-charge – Holding Company
David Hewes	Examiner
Tom Constantine	Examiner
Kurt Kirch	Examiner
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Introduction

- Full Scope Risk-Based Examination Procedures
- Holding Company Examination
- Comprehensive Federal Regular Examination
    - Compliance Review
    - Safety & Soundness Review

HOLDING COMPANY EXAMINATION

CONCLUSIONS

- Holding company structure remains unchanged since last examination, but there is a decrease in holding company activity compared to the Bank.

- The Board has been effective in its oversight of the holding company. Inter-company transactions have been properly monitored and accounted for in accordance with the Regulations.

- Holding company continues to be dependent on the Bank for earnings.

- Holding company liquidity is maintained at a level to cover one year of the holding company's debt service and cash dividend payments.

- Capital ratios have been maintained above Federal Reserve "well-capitalized" requirements for Bank holding companies and tangible capital, excluding mortgage servicing rights, is being monitored on a quarterly basis.

RECOMMENDATIONS

- None.

COMPOSITE RATING

We assigned a **"Satisfactory"** rating based on the holding company's neutral impact on the Bank.

COMPLIANCE REVIEW

CONCLUSIONS

- IndyMac Bank is in a satisfactory compliance position and has an effective compliance management program.
- Financial Freedom has improved its compliance management position as evidenced by the most current compliance review.
- IndyMac Bank has developed a good system of compliance for Bank Secrecy Act and its related regulations.
- IndyMac Bank needs to continue to develop its fair lending program.

RECOMMENDATIONS

- Continue development of all aspects of its fair lending program as outlined in its strategic plan.
- Further develop of its fair lending analysis and testing, incorporating well designed segmentation and monitoring of the Bank's business channels, loan products, loan offices, loan personnel, and market areas, so that it can identify and control the areas and causes of disparities in pricing and credit decisions.
- Improve its monitoring and control of brokers to manage the associated fair lending risks, particularly in broker compensation and selection of products.

COMPLIANCE RATING

We assigned a Compliance Rating of "2" which reflects the Bank's satisfactory compliance position and effective compliance risk management program.

SAFETY & SOUNDNESS REVIEW

Capital Adequacy

CONCLUSIONS

- While capital ratios continue to trend downwards, the level is adequate to support planned asset size and risk profile. Capital is maintained above previously agreed upon minimum levels.

FDICIA PCA Capital Ratios: (%)	Well Capitalized Standard	September 2006 IndyMac Bank	September 2006 Peer Group Median	September 2006 Difference	September 2005 IndyMac Bank	September 2005 Peer Group Median	September 2005 Difference
Total Risk-Based	10.0	(a)11.70	12.39	-0.69	(a)11.75	12.92	-1.17
Tier 1 Risk-Based	6.0	11.31	11.69	-0.38	11.27	12.02	-0.75
Tier 1 Leverage	5.0	7.60	7.60	0.00	7.51	7.54	-0.03

(a) Total risk-based capital ratio is lowered to 11.62 percent and 11.58 percent after double risk-weighting subprime loans at September 2006 and 2005 respectively.

- At September 30, 2006, total equity capital totaled $2.2 billion. After adjusting for goodwill and allowances for loan and lease losses core capital stands at $2.0 billion or 7.6 percent. Risk based capital represents 11.70 percent of risk weighted assets.

- In June 2006, OTS agreed to management's request to lower the minimum risk based capital ratio to 11.0 percent from 11.25 percent. The minimum Core capital ratio remained at 7.0 percent.

- Sub-prime loans totaling $130.1 million as of September 30, 2006, are subject to supplemental (double) risk weighting that reduced risk based capital by eight basis points to 11.62 percent.

- The Bank has adequate access to additional capital sources such as the parent company and the proposed bank issued non-cumulative preferred stock.

- In March 2007, Moody's upgraded the parent company to Baa3 and the Bank to Baa2 The ratings are now consistent with Standard & Poors and Fitch.

RECOMMENDATIONS

- None.

COMPONENT RATING

A rating of "2" indicates a satisfactory capital level relative to the financial institution's risk profile.

Asset Quality

CONCLUSIONS

- IndyMac Bank generated record loan production, but asset quality trends have deteriorated.
- Although trending up, delinquencies and nonperforming assets are at manageable levels.

	12/31/06		12/31/05		12/31/04	
Category	($000's)	% TA	($000's)	% TA	($000's)	% TA
Delinquent Loans (30-89 days)	292,879	1.09	136,676	0.67	109,122	0.70
Nonperforming Loans	164,757	0.57	63,220	0.31	98,725	0.63
Repossessed Assets	21,638	0.08	8,224	0.04	7,896	0.05
Nonperforming Assets	186,395	0.65	71,444	0.35	106,621	0.68
Special Mention Assets	222,416	0.77	138,299	0.68	123,950	0.79
Classified Assets ("CA")	338,426	1.18	131,783	0.65	138,850	0.89
CA/Core Capital +reserves		15.65		7.69		11.22

- HFI portfolio exhibits less risk than the HFS portfolio.
- Conduit group lacks an environment of strong internal controls as outlined in the latest "needs improvement" internal audit.
- The HBD portfolio is effectively managed but due to the current deteriorating market conditions the portfolio's level of classified assets have significantly increased.
- HCL program appears aggressive: however, we noted recent tightening of standards.
- Layered risk in non-traditional lending appropriately controlled.
- Financial Freedom is controlling weaknesses identified by internal audit.
- Internal asset review and reserves adequate but require increased attention and refinement.
- The commercial and residential appraisal functions are effective. Two minor issues will be addressed outside the scope of this examination, most likely, due to resource constraints.

RECOMMENDATIONS

- The Conduit group must correct the internal audit findings noted in the latest report and ensure the group is operating in a strong internal control environment.
- Establish a policy for the identification of troubled collateral dependent loans.
- Financial Freedom must: (1) develop a contingency plan in the event Congress fails to increase the reverse mortgage loan cap; (2) ensure loan brokers and independent counselors are

effectively performing their duties; and, (3) address and correct the internal audit deficiencies.

COMPONENT RATING

A rating of "**2**" indicates satisfactory asset quality and credit administration practices. The level and severity of classifications and other weaknesses warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's abilities.

Earnings

CONCLUSIONS

- Earnings are adequate. In spite of the fourth quarter downturn in the mortgage market and declining net interest margins due to an inverted yield curve, the Bank reported respectable earnings for the twelve months ended December 31, 2006.

Selected Year End Earnings Data

$ (000's)	2006	2005	2004
Net Income	357,575	306,998	182,808
Profitability Ratios (%AA)	**2006**	**2005**	**2004**
ROAA	1.26	1.52	1.13
ROE	17.91	21.03	15.65
Net Interest Margin	1.93	2.14	2.56
Gains on Loan Sales	2.34	2.94	2.26

Source: 31-Dec-06 UTPR

- For the entire year, IndyMac Bank reported net income of $357.6 million, a return on equity of 17.9 percent and a return on average assets of 126 basis points. While below the 21.0 percent ROE reported for 2005, the Bank's performance was well above the 2006 peer group median ROE of 11.67 percent.

- The Bank missed its fourth quarter earnings forecast by a significant margin due to changes in the interest rate environment, real estate market, and overall economy.

- The business plan for 2007 has been revised downwards to reflect the less robust economic conditions. Projections for asset growth and earnings have been scaled back and cost savings measures are being implemented. Net income is projected at $279 million. Asset growth will be minimal with projected year-end assets of $29.8 billion compared to $29.5 billion at year-end 2006.

RECOMMENDATIONS

- None.

COMPONENT RATING

A rating of "2" indicates earnings that are satisfactory. Earnings are sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity, and trend of earnings. Earnings that are relatively static, or even experiencing a slight decline, may receive a "2" rating provided the institution's level of earnings is adequate in view of the assessment factors listed above.

Liquidity

CONCLUSIONS

- Liquidity and cash management practices are satisfactory
- Requested corrective action from 2005 examination report to include earnings and capital effects in liquidity stress testing were adequately implemented.
- Total liabilities grew 40 percent between September 30, 2005 and September 30, 2006, from $16.3 billion to $22.9 billion. At September 30, 2006, the mix of total deposits and total borrowings remained stable during the period. Retail deposits represent approximately 45 percent of total liabilities while borrowings represent 55 percent of total liabilities. For the same period in 2005, deposit and borrowing ratios were 46 and 54 percent, respectively. We note that higher cost CDs comprise the largest portion of retail deposits 26 percent of total liabilities.
- Management intends to increase the percentage of retail deposits as IndyMac Bank's branch network expands. We note that the pace of expansion has been curtailed since the prior examination. Strategy calls for a dozen new branches by 2009.
- IndyMac Bank has adequate sources of liquidity including FHLB advances, other borrowings, loan sales, and commercial paper issuance.
- By policy the Bank is to maintain a minimum short-term liquidity ratio of 3.0 percent. While that was achieved on average, we noted five instances where the short-term ratio fell below 3.0 percent with lowest level dropping to 1.2 percent. Management self reported the shortfalls. We request that monitoring be improved to better identify and avoid falling below policy minimums.
- The liquidity policy states that the CLC will meet monthly. Review of CLC minutes indicates only five meetings were held during the examination period. Management stated that the CLC topics are covered in the Treasury meetings. The liquidity policy should be revised to reflect Treasury meetings as acceptable substitutes for CLC meetings to document at least monthly review of liquidity as required by policy.

RECOMMENDATIONS

- We request that short term liquidity monitoring be improved to better identify and avoid falling below policy minimums.
- The liquidity policy should be revised to reflect Treasury meetings as acceptable substitutes for CLC meetings to document at least monthly review of liquidity as required by policy.

COMPONENT RATING

A rating of "2" indicates satisfactory liquidity levels and well developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to present and anticipated liquidity needs.

Sensitivity

CONCLUSIONS

- IndyMac Bank is exposed to a moderate level of market risk.
- Market Risk Management Practices are effective.
- Continued progress was made in instituting a Bank-wide market risk framework.
- Management has addressed recommendations from the previous examination.

RECOMMENDATIONS

- Continue build-out of the Bank's market risk framework.

COMPONENT RATING

A rating of "2" indicates that market risk sensitivity is adequately controlled and that there is only moderate potential that the earnings performance or capital position will be adversely affected. Risk management practices are satisfactory for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide adequate support for the degree of market risk taken by the institution.

Management

CONCLUSIONS

- Oversight of the Board and performance of executive management is considered satisfactory.
- Management has corrected prior examination concerns.
- Enterprise Risk Management (ERM) group continues to strengthen the risk management function and build out the risk management framework. Expectations are, going forward, ERM will also encompass Information Technology and Consumer Compliance in its risk management framework.
- Internal audit continues to be effective.
- Compliance Management is effective.
- Management is already addressing and correcting issues identified in this examination (i.e. Fair Lending program and Conduit Lending internal controls).

RECOMMENDATIONS

- Ensure the findings noted in the report our adequately addressed and corrected.

COMPONENT RATING

A rating of "2" indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk profile. Minor weaknesses may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.

Overview

Composite Rating	2
Capital	2
Asset Quality	2
Management	2
Earnings	2
Liquidity	2
Sensitivity	2
Compliance Rating	2