

# WesCorp Investment Portfolio Update

September 30, 2008

## ACTIVITY AND EVENTS DURING THE THIRD QUARTER, 2008

The demise of Bear Stearns in March, along with concerns that flared up from time to time about a number of financial institutions, turned out to be only a tremor compared to the earthquake the financial markets experienced by the time September came to a close. In rapid order, Fannie and Freddie were taken over by the government, Lehman Brothers was allowed to fail, Merrill Lynch jumped into the arms of Bank of America, and AIG had to be rescued with government loans. Goldman Sachs and Morgan Stanley transformed themselves from the last stand-alone major dealers to banks. Washington Mutual failed and its assets and liabilities were acquired by JP Morgan Chase, while the approved government assisted purchase of Wachovia by Citibank ended up as part of the Wells Fargo Empire..

These events unfolded in rapid order, and each “fix” by the Treasury or the Fed became less and less effective in calming the markets. It culminated in a flight from money market accounts by individual investors, which resulted in Secretary Paulson’s introduction of the \$700 billion rescue plan. The initial stunning rejection of the bill by the House sent the markets into a tailspin. Subsequently, the bill was passed, but the credit markets still face the challenges of dealing with the time the plan will take to become active and its uncertain degree of success.

Most economic indicators deteriorated over the last two months of the quarter. Small and medium-sized businesses are now being significantly impacted by the credit reduction, and this could lead to further job woes. The Fed is expected to cut the funds rates in the near future, but there are still dislocations in the money markets between major financial institutions.

As the crisis evolved over the span of the quarter, the rating agencies were actively reviewing and downgrading mortgage-related securities in large numbers. As of September 30, WesCorp’s term investment portfolio totaled \$23.2 billion and contained 49 securities, totaling \$1,032 million (4.5 percent), that have been downgraded by their primary rating agency. Of those that have been downgraded, 14 securities totaling \$506 million (2.2 percent) were downgraded below the regulatory minimum rating of BBB. For securities downgraded below regulatory minimums, the NCUA requires that an Investment Action Plan be filed with the agency within 30 days of the date of the downgrade. WesCorp is seeking approval from the NCUA to retain these holdings and has already received such approval for many of the securities. Even with the downgrades, the credit quality of WesCorp’s portfolio remains extremely high. At the end of September more than 94 percent of our investment portfolio was rated “AA” or higher by our primary rating agency.

Both Moody’s and Standard & Poor’s (S&P) have revised their credit rating criteria and are in the process of reviewing all Alt-A and Sub-prime securities issued in the last few years. The changes to their rating methodology include increased projections for losses from various types of mortgage collateral, resulting in an increase of the levels of credit enhancement now needed for ratings across the credit spectrum. As the rating agencies continue their reviews of the Alt-A sector with their revised criteria, WesCorp expects a number of additional downgrades to be forthcoming in the fourth Quarter.

In December 2007, Moody's commented on the intrinsic value of WesCorp's securities in its yearly credit opinion update, saying, "WesCorp had slowed down its purchases of sub-prime RMBS in the later part of 2005, and subsequently ceased buying in 2006. As a result of cautious asset selection and monitoring by WesCorp, credit enhancement coverage of WesCorp's RMBS holdings tends to be very deep and pricing volatility (in "normal" markets) tends to be low. Credit support of its Aa securities at the end of July was 47.6 percent, and support of underlying Aaa sub-prime MBS was at 41.2 percent. Aside from four securities totaling \$35 million, WesCorp's RMBS bonds have been subject to very few rating downgrades." Moody's affirmed its Aa3/Prime-1 debt ratings of WesCorp, citing our "high-grade investment portfolio, liquid balance sheet, strong operating systems and risk management, and adequate levels of profitability and risk-adjusted capitalization" as key factors.

The third quarter saw anxieties about the fallout from the credit crisis grow as the focus of market concerns spread to one institution after another. In this continuing dislocation of the market, valuation of our securities has become increasingly difficult as the only market activity is coming from transactions between distressed sellers forced to sell and "vulture-type" buyers. The depressed prices from these fire sale transactions are affecting pricing inputs and benchmarks, and dragging down portfolio valuations across the board. We believe the depressed fair values are attributable to the dislocation in the securities market caused by the current illiquidity and credit conditions, and not the underlying credit quality of our holdings. Although the securities we hold in our portfolio continue to perform well, the portfolio continues to be affected by the overall mentality that's been paralyzing the markets for some time. While the current environment is challenging for our portfolio, the diligence and care we have exercised in managing our investments has served us well. Our rigorous investment process has helped us avoid many of the issues that have plagued other portfolios by focusing on high-quality securities. This has enabled us to consistently provide value-added investment products and services through ever changing market and economic conditions.

## BACKGROUND TO THE PORTFOLIO'S CURRENT CONDITION

WesCorp has always been diligent in managing the credit quality of the portfolio and its exposure to risk. At the beginning of 2006, as part of our ongoing portfolio management process to ensure continued strong performance, we made a strategic shift in WesCorp's portfolio investment activity. We curtailed activity in the sub-prime mortgage sector and purchased only AAA-rated investments, focusing on the higher-quality Prime, Alt-A and CMBS investment sectors. Consequently, our direct exposure to the 2006 and 2007 "vintage" sub-prime mortgages, the subject of most of today's headlines about mortgage market problems, is very modest. Since 2006, our sub-prime investments have been reduced by \$3.1 billion to \$4.2 billion or 18 percent of the term investment portfolio.

As the portfolio transitioned into buying securities backed by Alt-A collateral, we selected only AAA-rated bonds and sought to maximize favorable collateral characteristics in the securities we purchased. The average borrower FICO score for our Alt-A portfolio is 707. Using the traditional FICO score definitions, where scores above 720 are considered prime and below 620 are considered sub-prime, our Alt-A portfolio scores are near the levels of Prime borrower scores. We also scrutinized these securities for other factors, including seeking the fullest level of borrower documentation to minimize the amount of low/no documentation loans, and the highest percentage of owner-occupied, single-family properties to minimize the riskier investor, vacation and condo properties.

The Alt-A sector is a highly broad and less homogenous market than either the Prime or sub-prime sectors. While the range of underwriting and documentation alternatives coupled with the numerous loan terms, property occupancy, type, and loan purpose make the Alt-A market difficult to classify, WesCorp

has sought to select securities in the top tier of this market. Since WesCorp stepped back from mortgage-related security purchases in July 2007, the Alt-A portfolio has paid down by \$1.3 billion to \$9.7 billion.

The collapse of the sub-prime mortgage market that began in 2007 led to dislocations in all fixed-income markets including AAA-rated and government and agency mortgage-related securities. The ongoing credit issues have brought trading and activity in these sectors to a virtual halt. With markets essentially shut down, investors, along with WesCorp, have been left to struggle with the difficult task of determining the fair value of their holdings. As a result of extremely wide spreads driven by market concerns rather than by fundamental credit characteristics, market valuations have declined, and as of September 30, 2008, WesCorp's term portfolio had an unrealized market value loss of \$1.68 billion or a decline of 7.5 percent.

The unrealized market value depreciation is a reflection of the current market dislocation and not fundamental value. We believe that valuations will recover once the markets stabilize. WesCorp has the intent and ability to hold these securities through the current market turmoil and/or until maturity.

Throughout this period of turmoil, the fundamental credit characteristics of our portfolio remain strong. Our holdings of sub-prime securities are seasoned with credit enhancement that has grown to extremely high levels, increasing to almost three times the original level of protection. More than 93 percent of our Alt-A holdings are "AAA" rated, and our "AAA" rated CMBS portfolio continues to demonstrate excellent credit performance. From the inception of a purchase through the entire time of ownership, WesCorp performs multiple due diligence reviews on its investments.

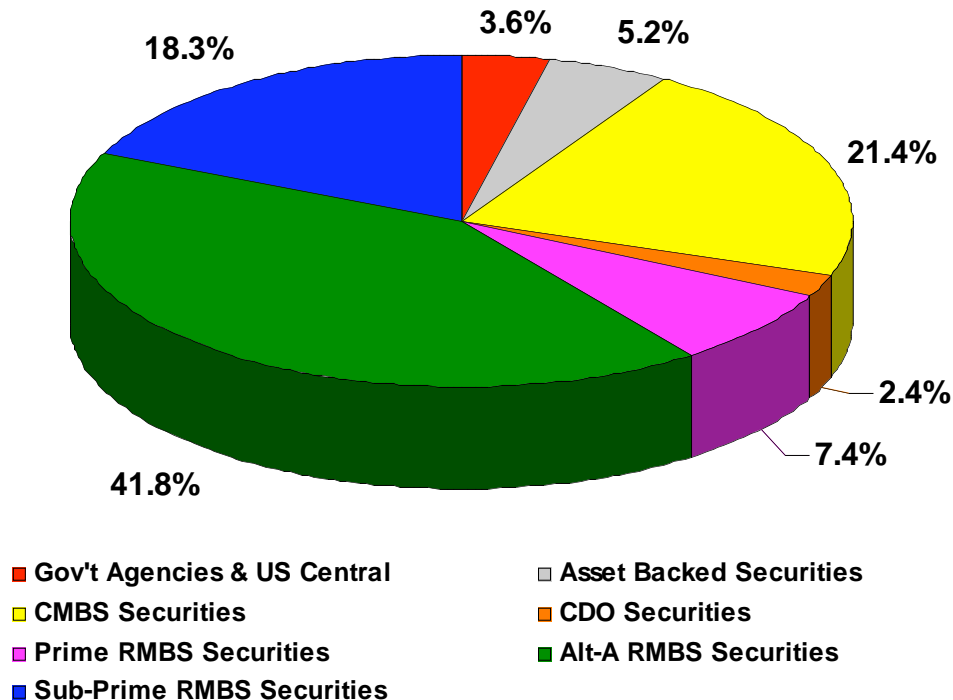
WesCorp's ongoing monitoring process includes:

- A rigorous screening of collateral characteristics and review of bond structures before investment by the Portfolio Management Group
- An independent assessment of credit quality by the Investment Credit Services Group before purchase of any security
- Monitoring the performance of the collateral underlying all of our investment holdings on a monthly basis
- Internal analysis of the integrity of cash flows based on underlying collateral performance
- External validation of our credit assumptions and modeling parameters
- Third-party analysis and review of our holdings

As a result, WesCorp continues to maintain a high-quality investment portfolio that is designed to provide consistent performance and safe returns in ever-changing market conditions.

## TERM INVESTMENT PORTFOLIO COMPOSITION

As of September 30, 2008, WesCorp's term investment portfolio totaled \$23.2 billion, comprised of highly rated investments allocated across a variety of mortgage-backed and asset-backed sectors as noted in the chart below.



*Securities in WesCorp's investment portfolio go through a rigorous analysis before purchase, and are reviewed on a regular schedule throughout the time WesCorp owns them.*

There were no new purchases made for the portfolio during the quarter. Changes in composition were driven by paydowns and liquidations of existing holdings. The current portfolio balance of \$23.2 billion is \$915 million less than the prior quarter-end as a result of \$329 million security liquidations and \$586 million in paydowns. While prepayments on mortgage-backed securities have slowed over recent months as the credit crunch has continued, year-to-date paydowns for the portfolio total \$2.4 billion.

Our Alt-A mortgage holdings comprise approximately 42 percent of our term investment portfolio. With the credit crisis continuing, this sector has been the subject of increasing scrutiny. Delinquencies have risen nationwide for all levels of borrowers causing concern, particularly for Alt-A securities, about the adequacy of the credit enhancement shielding them from losses. While the pipeline of delinquencies has grown for the collateral underlying the securities we own, the credit enhancement of our holdings has also risen to 19 percent on average from 16.3 percent at time of purchase. ***The larger cushion provided by this increase in the level of credit protection is the reason why we expect our securities to maintain their integrity and pay off as scheduled, despite any downgrades the rating agencies may make.*** (Please see Appendix I for a discussion of credit enhancement mechanics.)

Our sub-prime investments comprise 18.3 percent of our portfolio. These bonds are seasoned securities that have accumulated significant amounts of credit protection. The amount of credit enhancement for this sector of the portfolio has risen to more than 43 percent on average, from 16 percent at the time of purchase.

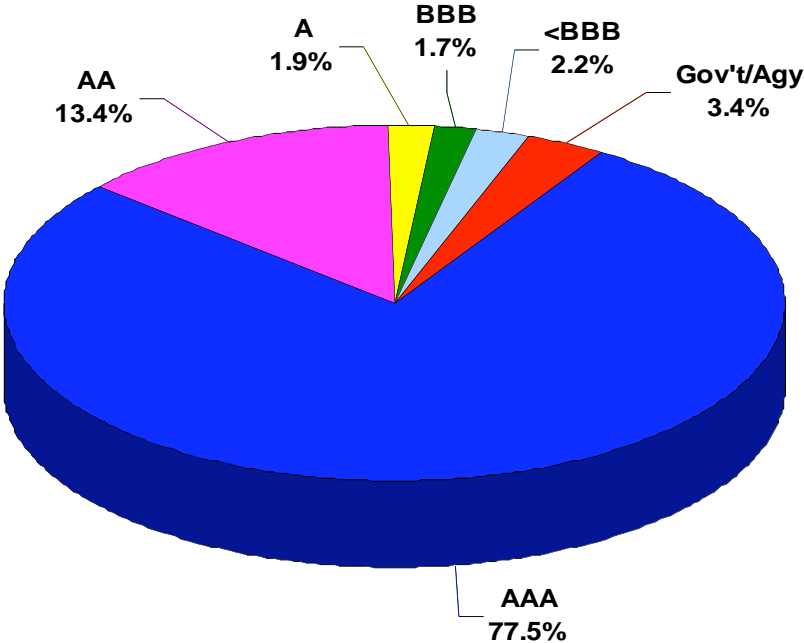
WesCorp’s selection of individual securities for purchase adheres to stringent criteria with respect to the characteristics of the bond, the underlying collateral pool, and the integrity of the bond’s structure. Before the purchase of any investment, our portfolio managers subject all securities to an in-depth analysis. They focus on credit quality, collateral characteristics, cash flow, and the integrity of the bond's credit support and structure. After scrutiny by the portfolio managers, the potential investment is then reviewed and analyzed by WesCorp’s Investment Credit Services (ICS) department for underlying credit quality. Upon completion of its independent review, ICS will either approve or reject the bond for purchase based on its analysis of the investment’s credit quality. The investment portfolio managers may not purchase a bond that is rejected by ICS.

To ensure adequate credit protection, each individual investment is “stressed” before purchase and at regular intervals throughout the time WesCorp owns the security. The collateral performance and credit characteristics of the securities held in WesCorp's investment portfolio are monitored by ICS on a monthly basis. This enables WesCorp to keep on top of changes in the credit performance of each security and act accordingly. In addition, an in-depth review of each bond is conducted at least annually. This process has worked well for us in navigating the ongoing credit turmoil and avoiding securities with weak characteristics.

The sub-prime credit problems that initially sparked the crisis spilled over into other sectors and developed into a marketwide liquidity crisis where only U.S. Treasury securities, guaranteed by the full faith and credit of the United States, have any liquidity. The current crisis has been developing for quite some time, and WesCorp has been closely monitoring these developments and taking steps all along in managing its investment portfolio to protect itself from the fallout.

**PORTFOLIO CREDIT QUALITY AND RATINGS SUMMARY**

The breakdown of the credit quality for our \$23.2 billion term investment portfolio is shown in the chart and table below.



| WesCorp Portfolio as of 9/30/2008 | AAA          | AA           | A           | BBB         | Less Than<br>BBB | Total         |
|-----------------------------------|--------------|--------------|-------------|-------------|------------------|---------------|
| Gov't Agencies & US Central       | 3.4%         | 0.2%         |             |             |                  | 3.6%          |
| Asset Backed Securities           | 4.8%         | 0.5%         |             | 0.1%        |                  | 5.4%          |
| CMBS Securities                   | 21.4%        |              |             |             |                  | 21.4%         |
| CDO Securities                    | 0.1%         |              | 0.2%        | 0.8%        | 1.3%             | 2.4%          |
| Prime RMBS Securities             | 6.9%         | 0.2%         |             | 0.1%        |                  | 7.1%          |
| Alt-A RMBS Securities             | 38.8%        | 0.2%         | 1.4%        | 0.7%        | 0.7%             | 41.8%         |
| Sub-Prime RMBS Securities         | 5.4%         | 12.3%        | 0.2%        | 0.1%        | 0.2%             | 18.3%         |
| <b>Total</b>                      | <b>80.9%</b> | <b>13.4%</b> | <b>1.9%</b> | <b>1.7%</b> | <b>2.2%</b>      | <b>100.0%</b> |

WesCorp has the regulatory authority to invest in securities rated BBB or higher; however, to date, we have only purchased investments in the top two rating categories (AA and AAA) as a strategy to ensure the safety and strength of the portfolio.

As the housing, mortgage and credit dislocation continues, rating companies have been actively reviewing the bonds they rate. Initially, most concerns about credit quality centered on the 2006 and 2007 vintage sub-prime securities that have seen the bulk of the downgrades. However, as the rating agencies have been revising their rating criteria, they have also been applying stricter credit loss assumptions to all vintages across the entire spectrum of Prime, Alt-A and Sub-Prime securities. Fortunately, WesCorp has largely avoided the 2006 and 2007 vintage sub-prime securities that have seen severe downgrades.

In the third quarter of 2008, our primary rating agency, Standard & Poor's, downgraded 32 of our securities holdings totaling \$745 million as follows:

- 14 bonds: \$138 million of older vintage (predominantly sub-prime) holdings downgraded to 'AA' as a result of downgrades to bond insurers
- 5 bonds: \$117 million of Alt-A holdings downgraded to 'A'
- 5 bonds: \$138 million of mostly CDO holdings downgraded to 'BBB'
- 8 bonds: \$352 million of CDO and Alt-A holdings downgraded below the regulatory minimum rating of BBB

Previously, Standard & Poor's cited the rise in delinquencies and foreclosures in the housing market as the rationale for incorporating more severe credit loss assumptions into their models. These changes in assumptions were the factors leading to the downgrades. The bonds downgraded in the third quarter included a broad range of vintages from 1999 to 2007. Excluding the insured holdings, the average credit enhancement for the downgraded bonds is more than 19 percent of the outstanding balance. We are monitoring these bonds closely and, based on our analyses, expect to receive full payment from these holdings. Any security that falls below WesCorp's internal AA rating guideline is individually reviewed by WesCorp's board of directors. The securities that have been downgraded have been approved by the board for retention in the portfolio.

Since January 2006, WesCorp purchased only AAA rated securities for the portfolio. The downgraded securities in our portfolio were originally assigned AAA ratings by the rating agencies. The subsequent changes in rating methodology made by Moody's and S&P have resulted in more burdensome criteria for previously AAA-rated securities, and also in the mass number of downgrades the companies have been handing out. When S&P announced the changes they were implementing into their rating methodology, they also commented that they believed the bonds they previously rated AAA would not incur any losses

despite the new ratings assigned. As the economic environment and turbulent credit situation unfolds, we continue to diligently monitor our securities closely for any changes in performance.

## PERFORMANCE OF COLLATERAL UNDERLYING OUR MORTGAGE-BACKED INVESTMENTS

In general, economic conditions have deteriorated throughout America and as a consequence, delinquencies have risen across the board for all categories of mortgages. In response to the troubles, the government has made unprecedented efforts to alleviate the credit crisis, including the creation of numerous programs designed to inject liquidity, thereby guaranteeing transactions to unfreeze the markets. The much publicized \$700 billion bailout program known as TARP (Troubled Asset Relief Program) is one of those efforts.

Market participants are assessing the probable impact of the government programs on the mortgage market. However, based on recent reported industry statistics of mortgage sector credit performance, market analysts forecast that loan default rates will rise in all categories of borrowers before the relief programs produce some improvement. While delinquency pipelines have grown for all residential collateral in WesCorp's portfolio, cumulative losses remain at extremely modest levels. Even in a stress scenario assuming the forecasted level of default rates, or in an extreme case where less than 25 cents on the dollar is recovered, the credit support in our portfolio remains more than sufficient to withstand such projected levels of loss from the underlying mortgages.

The following table shows the *weighted-average performance of WesCorp-owned securities* by rating and sector. Total delinquencies are the sum of the unpaid balance in the pipeline of delinquencies, including 60-89 day, 90 day+, foreclosures, bankruptcies, and REO. Once a mortgage loan has transitioned through this pipeline, the collateral is normally sold, at which point a loss may be realized based on the amount of the sale proceeds and the unpaid balance on the loan. Some or all of this loss may be absorbed by property mortgage insurance where applicable. The sum of actual losses for each mortgage pool is shown in cumulative losses.

| September 2008 | Delinquencies % |      |     |    |     |       | CUM<br>LOSS % | STRESS<br>LOSS % | CREDIT SUPPORT |         |
|----------------|-----------------|------|-----|----|-----|-------|---------------|------------------|----------------|---------|
|                | 60-89D          | 90D+ | FCL | BK | REO | TOTAL |               |                  | ORIG           | CURRENT |

### Prime Mortgage Collateral

|             |      |      |      |      |      |       |      |      |       |       |
|-------------|------|------|------|------|------|-------|------|------|-------|-------|
| AAA Rated:  | 1.22 | 1.66 | 2.98 | 0.49 | 1.31 | 7.66  | 0.25 | 2.67 | 6.43  | 10.71 |
| AA Rated:   | 0.74 | 2.27 | 3.79 | 0.37 | 4.39 | 11.57 | 0.24 | 4.24 | 46.87 | 50.84 |
| BBB Rated:  | 0.94 | 2.99 | 2.49 | 0.12 | 0.89 | 7.43  | 0.23 | 2.46 | 4.50  | 5.47  |
| Total Prime | 1.21 | 1.68 | 3.00 | 0.48 | 1.38 | 7.74  | 0.25 | 2.70 | 7.29  | 11.55 |

### Alt-A Mortgage Collateral

|                      |      |      |       |      |       |       |      |      |       |       |
|----------------------|------|------|-------|------|-------|-------|------|------|-------|-------|
| AAA Rated:           | 3.01 | 4.97 | 9.15  | 1.25 | 4.05  | 22.44 | 0.88 | 7.90 | 16.71 | 19.32 |
| AA Rated:            | 1.98 | 2.60 | 9.19  | 0.79 | 11.16 | 25.72 | 0.70 | 9.66 | 9.21  | 15.70 |
| A Rated:             | 2.11 | 3.71 | 10.43 | 1.60 | 4.30  | 22.15 | 0.46 | 8.08 | 11.73 | 13.49 |
| BBB Rated:           | 5.17 | 5.57 | 10.97 | 1.60 | 5.36  | 28.67 | 1.32 | 9.97 | 11.17 | 12.78 |
| Less Than BBB Rated: | 1.93 | 2.32 | 10.94 | 1.44 | 8.98  | 25.61 | 1.17 | 9.66 | 13.94 | 14.39 |
| Total Alt-A          | 3.00 | 4.88 | 9.26  | 1.27 | 4.20  | 22.61 | 0.87 | 7.98 | 16.37 | 18.91 |

### Sub-Prime Mortgage Collateral

|                      |      |      |       |      |      |       |      |       |       |       |
|----------------------|------|------|-------|------|------|-------|------|-------|-------|-------|
| AAA Rated:           | 1.75 | 3.33 | 6.66  | 2.67 | 4.90 | 19.30 | 2.13 | 7.03  | 20.71 | 46.60 |
| AA Rated:            | 2.40 | 4.29 | 8.52  | 4.23 | 6.88 | 26.32 | 2.50 | 9.63  | 13.45 | 42.56 |
| A Rated:             | 1.84 | 4.08 | 10.15 | 6.74 | 7.08 | 29.89 | 3.52 | 11.17 | 13.11 | 27.08 |
| BBB Rated:           | 3.08 | 5.00 | 4.41  | 7.25 | 5.06 | 24.81 | 1.48 | 8.83  | 6.88  | 12.28 |
| Less Than BBB Rated: | 1.60 | 2.63 | 8.04  | 7.84 | 8.23 | 28.35 | 3.92 | 10.77 | 12.39 | 23.94 |
| Total Sub-Prime      | 2.19 | 3.99 | 7.97  | 3.86 | 6.31 | 24.31 | 2.42 | 8.89  | 15.55 | 43.20 |

While WesCorp's portfolio has also seen an increase in delinquencies, we are reviewing the impact of this build up of delinquencies on each of our holdings on a monthly basis. Currently, our analyses indicate that all of our holdings have sufficient credit enhancement to absorb any losses from the underlying pool of mortgages and that our bonds will cash-flow the full amount of principal and interest.

### **Prime Mortgage Collateral**

This collateral continues to show excellent performance. The weighted-average serious delinquencies have risen to 7.74 percent compared to current credit enhancement of 11.55 percent. The AA-rated portion of the portfolio includes bonds with insurance, which are reported at 100 percent credit enhancement. Excluding the effect of insurance, current credit enhancement for this sector is 11.73 percent. During the quarter, S&P downgraded one security to BBB. Total delinquencies for this security are similar to the delinquencies for the AAA portion of the Prime portfolio. Our measure of stress losses total 2.46 percent, compared to current credit enhancement of 5.47 percent for this bond.

### **Alt-A Mortgage Collateral**

The Alt-A mortgage category encompasses a broad range of borrower and loan characteristics. As described previously, WesCorp has sought to maximize borrower FICO scores and minimize LTV characteristics in the securities we have purchased in this sector. The vast majority of our Alt-A holdings are AAA-rated. WesCorp holds \$44 million of Alt-A securities rated AA and \$696 million rated below AA, which represent 0.2 percent and 2.8 percent of the portfolio, respectively. Serious delinquencies for these classifications are 25.7 percent and 24.7 percent, respectively; however, cumulative losses remain negligible at 0.70 percent and 0.86 percent.

Meanwhile, credit support has risen to more than 19 percent for this sector. The delinquencies for these holdings have grown as the housing market difficulties have continued. However, as noted above, despite the higher delinquencies, actual cumulative losses remain extremely modest. The fact that delinquencies have not translated into actual losses is likely due to a variety of factors. The most notable factors include: the array of government programs to alleviate the credit crisis, loan modifications granted by lenders, the presence of mortgage insurance, and loan servicers working with delinquent borrowers. Our Investment Credit team is monitoring these and all of our holdings closely.

### **Sub-Prime Mortgage Collateral**

Consistent with lower FICO borrower credit profiles and characteristics, this category shows the highest levels of delinquencies versus prime and Alt-A collateral. This is not unexpected for this category and, even with the higher delinquencies, cumulative losses on the underlying mortgage pool remain at extremely low levels of 2.1 percent for AAA, 2.5 percent for AA and 3.4 percent for our bonds rated lower than AA. Since our holdings in this sector are older and seasoned, credit support has increased dramatically to 46 percent for AAA and 42 percent for AA. We have \$125 million in sub-prime holdings that have been downgraded below AA. As the pipeline of delinquencies has grown, cumulative losses from the collateral at 3.4 percent are moderately above our other sub-prime securities at 2.4 percent. While our holdings rated lower than AA have the highest level of delinquencies, credit support for these bonds remains solid at 24 percent.

Even in a stress scenario assuming 50 percent of the underlying mortgages default, the credit support on our holdings is more than sufficient to withstand such projected losses from the underlying mortgages. Applying our stress loss analysis where we assume 50 percent of the loans default, the losses on the collateral for our lowest rated securities would have to exceed 50 percent severity (i.e., recover less than 50 cents on the dollar). For our AA- and AAA-rated securities, the loss severities would have to exceed 85 percent before our portfolio would begin to take losses. A loss of this magnitude is equivalent to cumulative losses in excess of 35 times current realized losses in the collateral underlying our AAA- and AA-rated holdings, and more than 14 times the current cumulative losses for our lowest rated holdings.

Even at this level of loss, our current credit support provides ample coverage needed to cover these types of losses. These stress scenario losses are easily absorbed by the credit support for these holdings.

## INSURED HOLDINGS

Bond insurers initially came under considerable scrutiny in the first quarter of 2008 because of concerns over their ability to pay claims for mortgage-backed bonds and CDOs they had insured. As a result of their insurance exposures, all of the companies were put on watch with negative implications, and AMBAC and FGIC were downgraded. While the insurers may be challenged with regard to capital adequacy to maintain their AAA ratings amid the ongoing deterioration in the housing market, WesCorp's exposure to the bond insurers is extremely limited and the underlying securities continue to perform to expectations without the need for support from the insurers. WesCorp's total exposure to insured bonds is \$571 million.

The table below summarizes the performance of the securities guaranteed by these insurers, as of September 30, 2008. These securities are mostly well-seasoned and are performing to expectations, with manageable cumulative losses and stressed losses (our estimate of future pool losses under stressed scenarios) remaining in the pools. Current levels of underlying credit support (primarily from over collateralization) provide more than ample coverage with respect to both current losses and our stress analysis projection of losses.

| Insurer              | Balance            | Cumulative Loss | CREDIT SUPPORT EXCLUDING INSURANCE |               |                 |
|----------------------|--------------------|-----------------|------------------------------------|---------------|-----------------|
|                      |                    |                 | ORIG                               | CURR          | STRESS ANALYSIS |
| AMBAC                | 285,504,424        | 0.76%           | 6.37%                              | 10.24%        | 5.02%           |
| FSA                  | 100,461,387        | 0.82%           | 8.68%                              | 18.03%        | 11.11%          |
| FGIC                 | 90,913,765         | 1.62%           | 0.13%                              | 16.01%        | 14.67%          |
| MBIA                 | 35,424,631         | 3.28%           | 16.33%                             | 65.25%        | 61.30%          |
| RADIAN               | 22,987,743         | 0.06%           | 15.70%                             | 38.70%        | 34.42%          |
| XL CAPITAL           | 1,906,439          | 10.80%          | 18.50%                             | 73.70%        | 69.37%          |
| <b>TOTAL INSURED</b> | <b>537,198,389</b> | <b>1.09%</b>    | <b>6.85%</b>                       | <b>17.74%</b> | <b>12.99%</b>   |

Most of our insured portfolio is comprised of older vintages that have paid down to a fraction of their original balances. WesCorp has not made many purchases of insured securities during the past three to four years. Some of the more recent insured purchases are deals that were evaluated and approved without any reliance on insurance where the underwriter added insurance to meet the needs of other investors. Our insured holdings carry ample levels of credit support on a stand-alone basis, and we expect our securities to perform to expectations without need for assistance from the insurer.

## CDO HOLDINGS

As of September 30, 2008, WesCorp owns ten Collateralized Debt Obligations (CDOs) for a total of \$551 million or 2.4 percent of our portfolio. Our CDO investments are comprised of the highest-rated tranches in each deal, also known as "Super/Senior," and are backed by a wide range of collateral, including CMBS, Prime, Alt-A, and sub-prime MBS. The Prime and Alt-A collateral comprise 67.4 percent of the underlying portfolio, sub-prime MBS comprises 22.2 percent and CMBS and other ABS comprise the remaining 10.4 percent.

Since the market turmoil broke last year, CDOs have been the hardest hit in terms of downgrades from the rating agencies. We've seen severe declines in valuations as broker/dealers and investors have backed away. There has been no break in the downward spiral in this sector. Declines in home prices

have led to increased loss estimates for MBS. In turn, the higher loss estimates further depress the prices of MBS. Lower valuations then increase the size of write-offs, reducing capital levels. Lenders increase underwriting standards to counter eroding capital. Mortgage lending becomes more constrained and leads to fewer qualifying buyers for homes. With reduced buying activity, home prices move further down the spiral.

During the past year, this difficult environment has seen rating agencies downgrade the collateral underlying CDOs, and ultimately downgrade the CDO bonds themselves. S&P has downgraded seven of our holdings from their original AAA rating as follows:

- A-rated, one bond totaling \$ 54.8 million
- BBB-rated, three bonds totaling \$182.2 million
- Less than BBB-rated, three bonds totaling \$292.9 million

CDOs are complex instruments to analyze, and as a result of the downgrades, WesCorp obtains independent third-party analyses of these securities from RiskSpan, a provider of comprehensive assessments and detailed evaluations for complex and structured securities. RiskSpan utilizes a detailed bottom-up approach to the analysis where individual loans in the underlying collateral are evaluated based on their specific characteristics.

WesCorp also engages a Wall Street dealer to evaluate the cash flows based on externally generated default and loss severity expectations. We obtained assumptions for collateral performance from one dealer and provided those assumptions to a second dealer to run the analysis. To date, all analyses we have run indicate that the bonds continue to provide full cash flow and that the structural protections remain intact. For the three CDOs downgraded below regulatory minimums, we filed detailed performance analyses with the NCUA with requests to retain those securities. We have received approval from the NCUA to retain the holdings rated below the regulatory minimum.

Our CDO portfolio possesses more than 30 percent credit enhancement that is primarily provided by subordination of the lower tranches in each deal. If the performance of the collateral underlying our CDO holdings were to decline to the point where losses began to be realized by the CDO bonds, it would be the lowest rated, most subordinate bonds that would incur the losses before our holdings would be impacted. Given the level of credit enhancement for our bonds, the underlying collateral would have to have a 30 percent loss to erode the layers of protection in our bonds. WesCorp's Investment Credit department continues to review the performance of the underlying portfolios on a monthly basis, and we continue to work with third-party providers to obtain detailed analytics for these holdings.

## PORTFOLIO MONITORING AND STRESS TEST ANALYSIS

WesCorp has implemented a comprehensive process for monitoring its portfolio of securities. The purpose of the portfolio monitoring process is to identify securities with a potential risk of loss and to subject those securities to an advanced level of analysis. If the analysis indicates that the risk of loss is probable in a reasonable scenario incorporating the housing market stress, then WesCorp will write the security down to fair value.

On a monthly basis all securities will be reviewed for additional analysis utilizing three separate screening criteria.

- A security downgraded below BBB by any of the rating companies (Standard & Poor's, Moody's, or Fitch)
- A security's stress loss (calculated by WesCorp's Investment Credit Services) that exceeds 95 percent of current credit support
- A security that fails the Portfolio Stress Loss Analysis Test indicating that the bond may not return principal in full (Alt-A portfolio only) utilizing the RiskSpan analytic model

If a security does not pass any one of the preceding tests, it will be subjected to an advanced, more in-depth analysis. WesCorp will either perform a bond-specific, internal cash flow analysis for each security or engage a third party to perform a bottom-up (loan level detail) analysis. Currently the results of all bonds that have been subjected to the additional analysis indicate that they will pay back 100 percent of their outstanding balances.

In addition to the three screening tests and analyses we perform individually, an alternate methodology to assess the credit strength of the portfolio incorporates an additional component into the analysis that protects against loss: the Loan-To-Value (LTV) ratio of the underlying mortgages. When incorporating the LTV cushion and credit enhancement levels into a stress analysis, the decline in the housing market values (i.e., loss severity) would have to reach extreme levels before foreclosures and losses from property price declines would negatively affect the receipt of full repayment of principal. To demonstrate, the table below summarizes the statistics of our security holdings backed by residential mortgages listed by collateral type Prime, Alt-A and Sub-Prime. For purposes of the stress analysis, default rates of 30 percent, 40 percent and 50 percent were applied to the categories respectively. Assuming all defaulted houses are sold, the maximum losses on the underlying collateral that could occur, *before* any portfolio losses would be incurred, are calculated and highlighted in the yellow column in the following table:

|           | Rating    | Balance (Mln) | Cumulative  |                |     | LT  | FICO | Loan Defaults | Cumulative        |                |
|-----------|-----------|---------------|-------------|----------------|-----|-----|------|---------------|-------------------|----------------|
|           |           |               | Pool Losses | Credit Support |     |     |      |               | Collateral Losses | Portfolio Loss |
| Prime     | AAA       | 1,609         | 0.25        | 10.7%          | 70% | 731 | 30%  | -54%          | 0%                |                |
|           | AA        | 36            | 0.24        | 11.7%          | 73% | 719 |      | -53%          | 0%                |                |
|           | A & Below | 12            | 0.23        | 5.5%           | 72% | 740 |      | -41%          | 0%                |                |
| Alt-A     | AAA       | 9,001         | 0.88        | 19.3%          | 79% | 707 | 40%  | -59%          | 0%                |                |
|           | AA        | 44            | 0.70        | 15.7%          | 74% | 708 |      | -55%          | 0%                |                |
|           | A & Below | 652           | 0.86        | 13.6%          | 82% | 700 |      | -45%          | 0%                |                |
| Sub Prime | AAA       | 1,249         | 2.13        | 46.6%          | 78% | 634 | 50%  | -94%          | 0%                |                |
|           | AA        | 2,858         | 2.50        | 42.6%          | 79% | 625 |      | -88%          | 0%                |                |
|           | A & Below | 125           | 3.42        | 23.9%          | 87% | 640 |      | -54%          | 0%                |                |

According to the Case-Schiller USA Housing Price Index, housing prices have declined approximately 18 percent from the peak in 2006. Assuming an 18 percent decline in housing prices across the board for each bond in the portfolio, the resulting portfolio LTV would rise to approximately 96 percent. Extending the analysis further and assuming there was no LTV equity cushion left in the portfolio (i.e., 100 percent LTV), cumulative collateral losses of 18 percent for Prime, 34 percent for Alt-A and 45 percent for Sub-prime would still not result in a loss to the portfolio. In aggregate, housing prices would have to have a total decline in value between -36 percent and -63 percent to reach the point where the portfolio would be negatively affected. As the preceding analysis indicates, the Cumulative Collateral Losses that would be necessary to result in portfolio losses continue to be significant, far surpassing the predictions of most of the pessimistic analysts who forecast further declines of -15 percent to -20 percent. WesCorp has been diligent in screening collateral characteristics, keeping LTV ratios within reasonable levels and selecting those securities based on the optimal combination of factors. As the above analysis demonstrates, WesCorp's portfolio continues to possess strong levels of credit protection.

## EXTERNAL REVIEW

WesCorp continues to utilize a third-party vendor, RiskSpan, to provide an independent evaluation of the majority of our sub-prime RMBS and CDO holdings in order to validate our existing internal analyses. The analysis RiskSpan performs externally utilizes a bottom-up approach that analyzes the collateral at the loan level and incorporates a proprietary credit model that assesses the future performance of each loan in the collateral pool based on its individual characteristics. The analysis also takes into account the impact of mortgage insurance, geographic location of the properties and differing loss severities based on a projection of further declines in housing prices into 2009. During the quarter WesCorp expanded the scope of the external analysis performed by RiskSpan and included our holdings of Alt-A securities to the analyses they perform. The sub-prime analysis, covering our most credit sensitive holdings, is completed every month. The results, covering approximately 75 percent of the sub-prime portfolio, confirm that every security analyzed would cash flow fully with no losses incurred by our holdings. Our CDO holdings, while a small percentage of the portfolio, are the most complex securities to analyze and the analyses are the most time consuming to complete as each CDO may contain 100 or more structured securities as collateral for the bond. The analysis of these holdings is currently in process and we expect to receive the results for these holdings within the next few weeks.

The current market dislocation has now lasted for more than 14 months. As the market dislocation continues to drag, it is likely WesCorp will face other than temporary impairment (OTTI) on some portion of the \$551 million CDO portfolio. We continue to closely monitor the CDO portfolio performance, and will be able to update their performance upon receiving the latest results from RiskSpan.

## ACCOUNTING

In March, WesCorp moved to Level 3 pricing for certain sectors of our portfolio, and we have designated a portion of the portfolio as "Held-to-Maturity." The ongoing turmoil in the markets has caused external pricing services that were in use to become unreliable. The changes implemented by WesCorp have no effect on our operating flexibility and more accurately reflect our intent and ability to hold them to maturity. WesCorp continues to monitor all securities and performs our monthly NEV analysis, which more closely represents the economic value of the entire balance sheet.

## Valuation

Pricing information received from data vendors has become increasingly unreliable as evidenced by their erratic and inconsistent pricing among similar securities. The Level 3 pricing schema has been discussed with NCUA and our external auditors, and is based on the actively traded ABX index and on observable inputs for credit spreads based on Bloomberg Loss Coverage Ratios. Loss coverage ratios are widely used by investors to evaluate existing holdings and potential acquisitions. They appear to be the predominant driver of prices in today's markets. During September, we engaged a third party consulting firm, Protiviti, to perform a review of our Level 3 pricing schema to independently ensure that our methodology is both reasonable and consistently applied.

Basically, there is not a functioning market for private label residential or commercial mortgages. Any sales that do take place are as a result of forced liquidations. The prices obtained from such sales are clearly distressed prices. Everyone now recognizes the difficulty of proving "fair market" values for investment portfolios as required by GAAP. The only "active" market are the indices created by "Markit" (refer *markit.com*) for a limited selection of sub-prime and commercial mortgage-backed securities ("MBS"). These market indices are the benchmark used in valuing and settling credit default swaps.

We recognized the potential problems in pricing, and therefore commissioned RiskSpan to analyze and set prices based on the ABX index for our larger (more than \$10 million) holdings of AA sub-prime. RiskSpan runs projected cash flows based on credit loss severity on a bottom up basis (at the individual loan level). Then the ABX index is decomposed to ascertain a spread and a price. We have been using their pricing for the last several months.

When we recognized that our historical pricing service was generating significant price volatility, we changed to S&P to obtain a "second opinion." It became clear that S&P had similar problems—problems that affected all matrix pricing processes in the current environment. At a recent pricing seminar offered by the S&P pricing service, it was clear they priced to model using spreads and /or prices based on actual (distressed) sales with judgment applied in order to derive non-distressed prices. This generates Level 3 pricing under GAAP rules. As S&P prices some 2.9 million securities everyday, it groups "like" securities in buckets for pricing purposes. The ability to exercise quality control in the current volatile market is a recognized problem, and S&P invites challenges to its prices. The company is also adding staff with market experience and knowledge to supplement its ability to apply "judgment" to available market data.

For several months, we have been using internally generated prices where the difference with the S&P price is five points or more. Our internal pricing has been based on spread data obtained from market sources and the CMBX index for commercial mortgage backed securities. Market data is now simply not obtainable in a reasonable time frame. Therefore, we have adopted a Level 3 methodology for generating internal pricing for certain sectors of our portfolio or where the S&P price appears significantly out of line with our internally generated price. We continue to use RiskSpan and S&P as pricing sources, in addition to internally generated pricing.

The Financial Accounting Standards Board ("FASB") issued FASB Staff Position 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active," which would allow for the use of an internal discounted cash flow methodology for Level 3 assets where the market is inactive. We believe such a methodology may be beneficial to us and have taken steps to work with our third party valuation vendor, RiskSpan, and our external auditors to further explore the development of a reasonable and consistent Level 3 discounted cash flow methodology for certain of our assets by year-end.

## **Classification**

In March, WesCorp re-designated \$9.7 billion in securities, formerly classified as “Available-for-Sale,” to “Held-to-Maturity.” These securities comprised WesCorp’s entire holdings of mortgage securities backed by Alt-A collateral and the bulk of WesCorp’s CDO holdings. Both of these markets remain highly illiquid and this re-classification more accurately reflects WesCorp’s intent and ability to hold them to maturity. WesCorp continues to monitor all securities and performs our monthly NEV analysis, which more closely represents the economic value of the entire balance sheet.

At September 30, 2008, the carrying value of the Held-To-Maturity portfolio was \$9.4 billion.

## **SUMMARY**

There is no doubt that the mortgage credit turmoil and housing market troubles are continuing to roil through the markets for much longer than anyone anticipated. The government has taken unprecedented measures to address the crisis, yet the full impact of the initiatives to address these challenges remains to be seen. Once the government stabilizes the housing market and the credit crisis is contained, the investment landscape will be significantly impacted. Throughout the entire crisis, WesCorp has closely monitored all market developments and continues its ongoing surveillance of the securities we own to ensure that our portfolio continues to perform throughout these changing market conditions.

The credit performance of all of our holdings is reviewed continuously by our Risk Assessment division, which is independent of the Investment department. Their analyses are reported to management and ALCO on a monthly basis. The fundamental credit quality of our portfolio remains strong. More than 94 percent of our portfolio is rated AA or higher by our primary rating agency, and WesCorp has not been required to take any write downs on any holdings as a result of any “other than temporary impairment” according to FASB Statements 115-1 and FAS 124-1. Thus far analyses show all bonds are money good, yet as noted earlier, continued deterioration in the housing market makes it likely that WesCorp will face some “Other Than Temporary impairment at some point in the future. While prepayments have slowed during recent months, paydowns from the portfolio continue to reduce exposures and provide liquidity that has exceeded \$2 billion year to date.

WesCorp continues to follow a conservative investment management strategy. Throughout 2006, 2007 and 2008, the portfolio purchased only AAA-rated investments, of which virtually all were floating-rate. We believe that the majority of our securities will cash flow and that WesCorp has the capital and liquidity required to hold our existing securities holdings through the current market dislocation.

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## APPENDIX I – Credit Enhancement Mechanics

### CREDIT ENHANCEMENT

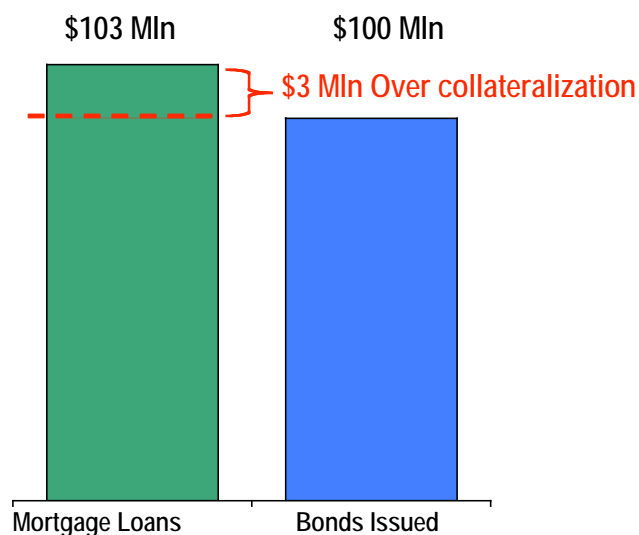
It is important to note that **WesCorp owns securities backed by pools of mortgages** that include substantial levels of credit support. We do not own the mortgages directly. These pools of mortgages are financed with a capital structure that includes a series of bonds rated from “AAA” down to “B.” Below is an example of a typical sub-prime transaction:

|                | <u>% of Capitalization</u> | <u>Credit Support</u> |
|----------------|----------------------------|-----------------------|
| AAA securities | 80%                        | 20%                   |
| AA securities  | 6%                         | 14%                   |
| A securities   | 5%                         | 9%                    |
| BBB securities | 4%                         | 5%                    |
| BB securities  | 3%                         | 2%                    |
| B securities   | 2%                         | -                     |

In the table above, “AAA” bonds are the highest rated securities and are the first to receive principal payments, while the “B” bonds are the lowest rated securities and are the last to receive principal payments. For securities such as those listed above, there are typically three sources of credit enhancement for the bonds: over collateralization, subordination and excess spread.

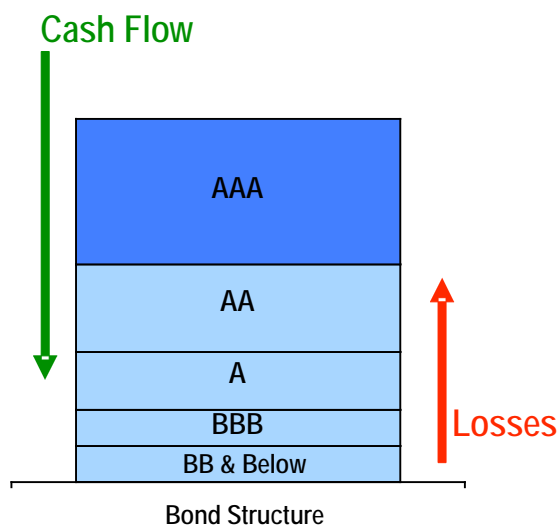
**Over collateralization**—The balance of the underlying pool of mortgages is greater than the balance of securities issued. For example, in Figure 1 there are \$100 million of securities that are backed by \$103 million of mortgages. The excess balance of mortgages provides a layer of protection for the securities from any losses on the mortgage pool.

**Figure 1**



**Subordination**—The "AAA" bonds are the highest rated securities and are the first to receive principal payments, while the lowest rated securities are typically the last to receive principal payments. These lower-rated securities are the first to absorb any losses from the mortgage pool and the first to provide credit support for the higher rated bonds. As the mortgage pool provides prepayments of principal, this cash flow is used to pay off the AAA bonds first as indicated in Figure 2. As payments from the underlying pool of mortgages pay down the amount of AAA bonds outstanding, their credit support increases, because their portion of the capital structure is reduced in size, while the underlying subordinated bondholders positions remain the same.

**Figure 2**



For example, if the AAA bonds in Figure 2 were initially structured with 20 percent credit enhancement from subordination and were subsequently paid down to half of their original balance, the credit support for the remaining AAA bonds would increase from 20 percent to 33 percent. When the AAA bonds are completely paid off, the AA bonds would then become the senior security, and their credit support would have also risen substantially.

**Excess Spread**—The interest earned on the underlying pool of mortgages exceeds the interest paid on the securities issued. This excess spread (the difference between the two amounts of interest) accumulates and increases the amount of funds providing protection for the securities. This credit enhancement grows over time as payments are made.

**Figure 3**

