The Company assesses the sensitivity of key assumptions at least annually by stressing the assumptions to understand the impact on the model. While management utilizes its best judgment and information available, the ultimate adequacy of our allowance is dependent upon a variety of factors beyond our control which are inherently difficult to predict, the most significant being the macroeconomic forecasts. The Company's forecast of economic conditions considers baseline, favorable, and adverse scenarios. As economic conditions can change, the anticipated amount of estimated loan defaults and losses, and therefore the adequacy of the allowance, could change significantly. Economic conditions more favorable than forecasted could lead to reductions in the amount of the allowance, and conversely conditions more adverse than forecasted could require increases in the amount of the allowance. Changes in economic forecasts may not occur in the same direction or magnitude across all segments of our loan portfolio and deterioration in some quantitative inputs may offset improvement in others. The Company selects the economic forecast that is most reflective of expectations at that point in time, and changes could significantly impact the calculated estimated credit losses.

For segments that rely on a peer group to develop baseline loss rates, statistical regression is utilized to relate historical macro-economic variables to historical credit loss experience of a peer group of banks. These models are then utilized to forecast future expected credit losses based on expected future behavior of the same macro-economic variables. Adjustments to the quantitative results are made using qualitative factors. These factors include: (1) borrower's financial condition; (2) borrower's ability to pay; (3) nature and volume of financial assets; (4) value of the underlying collateral; (5) lending policies and procedures; (6) quality of the loan review system; (7) the experience, ability, and depth of staff; (8) regulatory and legal environment; (9) changes in market conditions; and (10) changes in economic conditions.

For loans that do not share risk characteristics, the Company evaluates these loans on an individual basis based on various factors. Factors that may be considered are borrower delinquency trends and nonaccrual status, probability of foreclosure or note sale, changes in the borrower’s circumstances or cash collections, borrower’s industry, or other facts and circumstances of the loan or collateral. The expected credit loss is measured based on net realizable value, that is, the difference between the discounted value of the expected future cash flows, based on the original effective interest rate, and the amortized cost basis of the loan. For collateral dependent loans, expected credit loss is measured as the difference between the amortized cost basis of the loan and the fair value of the collateral, less estimated costs to sell.

Uncertainties Regarding the Estimate

Estimating the timing and amounts of future credit losses is subject to significant management judgment as these projected cash flows rely upon the estimates discussed above and factors that are reflective of current or future expected conditions. These estimates depend on the duration of current overall economic conditions, industry, borrower, or portfolio specific conditions. Volatility in certain credit metrics and differences between expected and actual outcomes are to be expected.

Customers may not repay their loans according to the original terms, and the collateral securing the payment of those loans may be insufficient to pay any remaining loan balance. Bank regulators periodically review our allowance for credit losses and may require us to increase our provision for credit losses or loan charge-offs.

Impact on Financial Condition and Results of Operations

If our assumptions prove to be incorrect, the allowance for credit losses may not be sufficient to cover expected losses in the loan portfolio, resulting in additions to the allowance. Future additions or reductions to the allowance may be necessary based on changes in economic, market or other conditions. Changes in estimates could result in a material change in the allowance through charges to earnings would materially decrease our net income.

We may experience significant credit losses if borrowers experience financial difficulties, which could have a material adverse effect on our operating results.

In addition, various regulatory agencies, as an integral part of the examination process, periodically review the allowance for credit losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgments of the information available to them at the time of their examination.

Recently Issued Accounting Pronouncements

See Note 2 of our consolidated financial statements, which are included beginning on page 93 of this report for a discussion of recently issued accounting pronouncements that have been or will be adopted by us that will require enhanced disclosures in our financial statements in future periods.