

COLONIAL BANGGROUP INC
Form 10-K
March 02, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 1-13508

THE COLONIAL BANGGROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

100 Colonial Bank Blvd.

Montgomery, Alabama

63-0661573
(I.R.S. Employer Identification No.)

36117

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(Address of principal executive offices)

(334) 676-5000

(Zip Code)

(Registrant's telephone number, including area code.)

None

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of each exchange on which registered
Common Stock, \$2.50 par value per share	New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
 (Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of June 30, 2008, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$840,485,626, based on the closing price of \$4.42 per share as reported on the New York Stock Exchange. (For purposes of calculating this amount, all directors, officers and principal shareholders of the registrant are treated as affiliates).

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at February 18, 2009
Common Stock, \$2.50 par value per share	202,449,152 shares

DOCUMENTS INCORPORATED BY REFERENCE

Document	Parts Into Which Incorporated
Portions of Definitive Proxy Statement for 2009 Annual Meeting as specifically referred to herein	Part III

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PART I

Item 1. Business
General

The Registrant, The Colonial BancGroup, Inc. (BancGroup, Colonial or the Company) is a Delaware corporation organized in 1974 as a bank holding company under the Bank Holding Company Act of 1956, as amended (the BHCA). BancGroup was originally organized as Southland Bancorporation, and its name was changed in 1981. Pursuant to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, BancGroup consolidated its various banking subsidiaries into Colonial Bank. Pursuant to the Gramm-Leach-Bliley Financial Services Modernization Act (Gramm-Leach), BancGroup elected to become a financial holding company which allows it to affiliate with securities firms and insurance companies and to engage in other activities that are financial in nature, incidental to such financial activities, or complementary to such activities.

The principal activity of BancGroup is to supervise and coordinate the business of its subsidiaries and to provide them with capital and services. BancGroup derives substantially all of its income from dividends received from Colonial Bank. Various statutory provisions and regulatory policies limit the amount of dividends Colonial Bank may pay without regulatory approval. In addition, federal statutes restrict the ability of Colonial Bank to make loans to BancGroup.

At December 31, 2008, BancGroup and its subsidiaries had 4,808 full-time equivalent employees. BancGroup's principal offices are located at 100 Colonial Bank Blvd., Montgomery, Alabama 36117, and its mailing address is: P.O. Box 241148, Montgomery, Alabama 36124. BancGroup's telephone number at its principal office is (334) 676-5000.

Subsidiary Bank

Colonial Bank was converted into an Alabama state-chartered non-member bank on June 10, 2008. Its legal name was changed to Colonial Bank. As of December 31, 2008, Colonial Bank had a total of 347 branches, with 197 branches in Florida, 90 branches in Alabama, 19 branches in Georgia, 21 branches in Texas and 20 branches in Nevada. Colonial Bank conducts a general commercial banking business in its respective service areas and offers a variety of demand, savings and time deposit products as well as extensions of credit through personal, commercial and mortgage loans within each of its market areas. Colonial Bank also provides additional services to its markets through wealth management services, electronic banking services and credit card services. Through its wealth management area, Colonial Bank's wholly owned subsidiaries, Colonial Investment Services, Inc., Colonial Investment Services of Florida, Georgia, Nevada and Tennessee offer various insurance products and annuities for sale to the public. These subsidiaries are regulated by each state's department of insurance.

Colonial Bank encounters intense competition in its commercial banking business, generally from other banks located in its respective metropolitan and service areas. Colonial Bank competes for interest bearing funds with other banks and with many non-bank issuers of securities. Competition also exists with banks in other metropolitan areas of the United States, many of which are larger in terms of capital resources and personnel. In the conduct of certain aspects of its commercial banking business, Colonial Bank competes with savings and loan associations, credit unions, mortgage banks, factors, insurance companies and other financial institutions. At December 31, 2008, Colonial Bank accounted for approximately 99.3% of BancGroup's consolidated assets.

Other Financial Services Operations

BancGroup's subsidiary Colonial Brokerage, Inc., a Delaware corporation, provides full service and discount brokerage services and investment advice and is a member of and is regulated by the Financial Industry Regulatory Authority.

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Executive Overview of Operations and Condition

The financial services industry in the United States is operating today in an exceptionally difficult, uncertain and rapidly changing environment presenting risks that are difficult to assess and quantify. As of December 31, 2008, BancGroup and Colonial Bank met all applicable regulatory requirements relating to capital. For the year ended December 31, 2008, however, BancGroup reported a net loss of \$880.5 million (including a net goodwill impairment charge of \$534.4 million) compared to net income of \$180.9 million in 2007. During 2008, Colonial charged off \$642.8 million of loans and recorded a provision for loan losses of \$728.9 million, representing substantial increases over the 2007 net charge-offs of \$54.1 million and a loan loss provision of \$106.5 million. The results of operations and financial condition of BancGroup and Colonial Bank led to increased regulatory scrutiny during the fourth quarter.

Because of continued economic uncertainty, the Company elected to apply for participation in the U.S. Treasury Department's Capital Purchase Program (TARP). During the fourth quarter of 2008, the Company received preliminary approval to issue a maximum of \$553 million of TARP preferred stock to the U.S. Treasury Department. The preliminary approval is subject to certain conditions, including the raising of \$300 million in additional capital from unaffiliated parties. As of December 31, 2008, the maximum amount of TARP preferred stock the Company could issue would be approximately \$536 million.

Since receiving preliminary approval, the Company has pursued a number of capital-raising alternatives. On January 27, 2009, SunTx Capital Partners (SunTx) of Dallas, Texas, signed a non-binding letter of intent with BancGroup relating to a potential investment by SunTx and prospective co-investors of up to 24.9% of the Company's proforma capitalization, subject to the negotiation of a definitive agreement, completion of due diligence and obtaining the necessary approvals. In addition, BancGroup is currently in discussions with other third parties regarding potential investments in or other transactions with the Company. The current condition of the banking industry and the overall uncertainty in financial markets have negatively impacted Colonial's capital raising efforts. No assurances can be given that the Company will be able to raise the capital necessary to satisfy the conditions of the TARP preliminary approval or as to the price, terms or structure of any such transactions.

BancGroup's common stock has recently traded below \$1 per share. Raising \$300 million of additional capital through the sale of common equity interests at current prices would therefore dilute existing shareholders to a minority position. Moreover, in the event BancGroup is not successful in raising additional capital in the near term, both Colonial Bank and BancGroup would likely become subject to even greater regulatory supervision, which could result in additional restrictions. Although the New York Stock Exchange, on which BancGroup's stock is traded, has recently announced a proposed temporary suspension through June 30, 2009 of its stock-price rule, the Exchange's existing rules require that a listed company's stock trade at or above \$1 per share.

The preceding discussion is only a brief summary of the Company's condition, results of operations and regulatory categorization and should be read in conjunction with *Risk Factors*, *Legal Proceedings*, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, *Consolidated Financial Statements* and the *Notes to Consolidated Financial Statements*.

Segment Information

The Company has six reportable segments for management reporting—five regional bank segments located in Florida, Alabama, Georgia, Nevada and Texas, and the mortgage warehouse segment headquartered in Orlando, Florida. Each regional bank segment consists of commercial lending and full service branches in its geographic region. The branches provide a full range of traditional banking products as well as wealth management and mortgage banking services. The mortgage warehouse segment provides financing collateralized by residential mortgage loans and other services to mortgage origination companies. Corporate functions not included in these reportable segments include treasury and parent activities, back office operations and intercompany eliminations. These functions are reported together as Corporate/Treasury/Other. For additional information related to segments, see Note 27, *Segment Information*, in the Notes to Consolidated Financial Statements.

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Available Information

BancGroup makes available, free of charge through its Internet website (www.colonialbank.com), the Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports filed or furnished pursuant to Section 13(a) of the Exchange Act as soon as reasonably practicable after electronically filing or furnishing such material with the Securities and Exchange Commission.

Regulatory Environment

The following is a brief summary of the regulatory environment in which BancGroup and Colonial Bank operate and is not designed to be a complete discussion of all statutes and regulations affecting such operations, including those statutes and regulations specifically mentioned herein. Changes in the laws and regulations applicable to BancGroup and Colonial Bank can affect the operating environment in substantial and unpredictable ways. BancGroup cannot accurately predict whether legislation will ultimately be enacted, and if enacted, what the ultimate effect that legislation would have on BancGroup or its subsidiaries' financial condition or results of operations. While banking regulations are material to the operations of BancGroup and Colonial Bank, it should be noted that supervision, regulation and examination of BancGroup and Colonial Bank are intended primarily for the protection of depositors, not security holders.

BancGroup is a registered bank holding company and a financial holding company subject to supervision and regulation by the Board of Governors of the Federal Reserve System (Federal Reserve). As such, it is subject to the Bank Holding Company Act (BHCA) and many of the Federal Reserve's regulations promulgated thereunder. The Federal Reserve has broad enforcement powers over bank holding companies, including the power to impose substantial fines and civil money penalties.

Colonial Bank converted from a national banking association subject to supervision and examination by the Office of the Comptroller of the Currency (OCC) to an Alabama state-chartered bank on June 10, 2008, subject to supervision and examination by the Alabama State Banking Department and the Federal Deposit Insurance Corporation (FDIC). To the extent provided by law, the deposits of Colonial Bank are insured by the FDIC. The FDIC assesses deposit insurance premiums, the amount of which may, in the future, depend in part on the condition of Colonial Bank. Moreover, the FDIC may terminate deposit insurance of Colonial Bank under certain very limited circumstances. The bank regulatory agencies have broad enforcement powers over depository institutions under their jurisdiction, including the power to terminate deposit insurance, to impose fines and other civil and criminal penalties and to appoint a conservator or receiver if any of a number of conditions are met.

Current Regulatory Matters

Due to their current condition and results of operations, BancGroup and Colonial Bank are operating under heightened regulatory scrutiny and have been and will be taking steps which are expected to improve their asset quality and capital. Colonial Bank entered into an informal Memorandum of Understanding (the Bank MOU) with the FDIC and the Alabama State Banking Department on December 15, 2008, and BancGroup entered into an informal Memorandum of Understanding (the BancGroup MOU) with the Federal Reserve Bank of Atlanta on January 6, 2009. Neither the Bank MOU nor the BancGroup MOU is considered to be a written agreement pursuant to Section 8 of the FDI Act.

Key elements of the Bank MOU include: improvement of regulatory capital ratios to an 8% Tier I leverage ratio and a 12% total risk-based capital ratio by March 31, 2009; reduction in classified asset levels by dates beginning June 30, 2009; enhancement of the Company's credit process and prior regulatory approval for the payment of dividends on Colonial Bank common stock.

Key elements of the BancGroup MOU include: utilization of holding company resources to support Colonial Bank in meeting the requirements of the Bank MOU and prior regulatory approval for the issuance of debt, payment of BancGroup dividends, or purchase or redemption of treasury stock.

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As of December 31, 2008, Colonial Bank maintained capital sufficient to meet the minimum capital levels to be categorized as well capitalized under the regulatory framework for prompt corrective action.

The attainment of the targeted capital ratios included in the Bank MOU will require either (1) a significant increase in Colonial Bank's capital, or (2) a substantial decrease in Colonial Bank's asset levels. One means of achieving the significant increase to Colonial Bank's capital is the issuance of preferred stock under the U.S. Treasury Department's Capital Purchase Program. As discussed under *Risk Factors*, Colonial's final approval to sell preferred stock to the U.S. Treasury Department is contingent upon Colonial raising additional capital of \$300 million and the closing conditions set forth in the final definitive agreements.

These matters are a major focus of the attention and efforts of the Board of Directors and management.

Mergers, Acquisitions and Changes in Control

One limitation under the BHCA and the Federal Reserve's regulations requires that BancGroup obtain prior approval of the Federal Reserve before BancGroup acquires, directly or indirectly, more than 5% of any class of voting securities of another bank. Prior approval also must be obtained before BancGroup acquires all or substantially all of the assets of another bank, or before it merges or consolidates with another bank holding company. Because BancGroup is a registered bank holding company, persons seeking to acquire 25% or more of any class of its voting securities must receive the prior approval of the Federal Reserve. Similarly, under certain circumstances, persons seeking to acquire between 5% and 25% also may be required to obtain prior Federal Reserve approval.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, among other things, amended the BHCA to permit bank holding companies, subject to certain limitations, to acquire either control or substantial assets of a bank located in states other than that bank holding company's home state regardless of state law prohibitions. In addition, this legislation also amended the Federal Deposit Insurance Act to permit the merger of insured banks with banks in other states, subject to certain limitations.

FDIC Improvement Act

As a result of enactment of the FDIC Improvement Act (FDICIA) in 1991, banks are subject to increased reporting requirements and more frequent examinations by the bank regulatory agencies. The agencies also have the authority to dictate certain key decisions that formerly were left to management, including, but not limited to, compensation standards, loan underwriting standards, asset growth and payment of dividends. Failure to comply with these standards, or failure to maintain capital above specified levels set by the regulators, could lead to the imposition of penalties or the forced resignation of management. If a bank becomes critically undercapitalized, the banking agencies have the authority to place the institution into receivership.

Consumer Protection Laws

There are a number of laws that govern the relationship between Colonial Bank and its customers. For example, the Community Reinvestment Act (CRA) is designed to promote the offering of products and services to low and moderate income persons and to businesses within the Bank's assessment areas. The Home Mortgage Disclosure Act and the Equal Credit Opportunity Act attempt to minimize lending decisions based on impermissible criteria, such as race or gender. The Truth-in-Lending Act and the Truth-in-Savings Act require banks to provide certain disclosure of relevant terms related to loans and deposit accounts, respectively. Anti-tying restrictions (which prohibit, for instance, conditioning the availability or terms of credit on the purchase of another banking product) further restrict Colonial Bank's relationships with its customers.

Gramm-Leach-Bliley Financial Services Modernization Act (GLBA)

GLBA became effective in March 2000. The primary purpose of GLBA was to eliminate barriers between investment banking and commercial banking and to permit, within certain limitations, the affiliation of financial service providers. Generally, GLBA: (i) repealed the historical restrictions against, and eliminated many federal

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and state law barriers to affiliations among banks, securities firms, insurance companies and other financial service providers; (ii) provided a uniform framework for the activities of banks, savings institutions and their holding companies; (iii) broadened the activities that may be conducted by and through national banks and other banking subsidiaries of bank holding companies; (iv) provided an enhanced framework for protecting the privacy of consumers' information; (v) adopted a number of provisions related to the capitalization, membership, corporate governance and other measures designed to modernize the Federal Home Loan Bank System; (vi) modified the laws governing the implementation of the CRA; and (vii) addressed a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

More specifically, under GLBA, bank holding companies, such as BancGroup, that meet certain management, capital and CRA standards, are permitted to become financial holding companies and, by doing so, to affiliate with securities firms and insurance companies and to engage in other activities that are financial in nature, incidental to such financial activities or complementary to such activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized under the FDICIA prompt corrective action provisions, is well managed and has at least a satisfactory rating under the CRA. The required filing is a declaration that the bank holding company wishes to become a financial holding company and meets all applicable requirements. BancGroup became a financial holding company on May 12, 2000.

Generally, no prior regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities permitted under GLBA. Activities cited by GLBA as being financial in nature include:

securities underwriting, dealing and market making;

sponsoring mutual funds and investment companies;

insurance underwriting and agency;

merchant banking activities; and

activities that the Federal Reserve has determined to be closely related to banking.

Privacy Laws

In 2000, the federal banking regulators issued final regulations implementing certain provisions of GLBA governing the privacy of consumer financial information. The regulations limit the disclosure by financial institutions, such as BancGroup, Colonial Bank and certain of their subsidiaries, of nonpublic personal information about individuals who obtain financial products or services for personal, family or household purposes. Subject to certain exceptions allowed by law, the regulations cover information sharing between financial institutions and nonaffiliated third parties. More specifically, the regulations require financial institutions to (i) provide initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal financial information to nonaffiliated third parties and affiliates; (ii) provide annual notices of their privacy policies to their current customers; and (iii) provide a reasonable method for customers to opt-out of disclosures to nonaffiliated third parties.

The Fair Credit Reporting Act (FCRA) governs the ability of a financial institution to share customer financial information with its affiliates. The FCRA requires financial institutions to provide their customers with notice and an opportunity to opt-out before sharing certain information with its affiliates. In December 2003, the Fair and Accurate Credit Transactions Act of 2003 (FACTA) was enacted. FACTA includes a provision further limiting a financial institution's ability to share customer information with its affiliates for marketing purposes by requiring financial institutions to provide their customers with the ability to opt-out of such sharing of customer information. Regulations implementing this provision of FACTA had a mandatory effective date of October 1, 2008. FACTA section 114, which requires institutions to develop and implement a written program to detect, prevent and mitigate identity theft for certain new and existing accounts, was required to be in place by November 1, 2008.

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Protection of Customer Information

In February 2001, the federal banking regulators issued final regulations implementing the provisions of GLBA relating to the protection of customer information. The regulations, applicable to financial institutions, like Colonial Bank, and certain of their nonbank subsidiaries, and to bank holding companies, like BancGroup, and certain of their nonbank subsidiaries, relate to administrative, technical, and physical safeguards for customer records and information. These safeguards are intended to: (i) ensure the security and confidentiality of customer records and information; (ii) protect against any anticipated threats or hazards to the security or integrity of such records; (iii) protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to any customer; and (iv) ensure the proper disposal of such information.

In March 2005, the federal banking agencies jointly issued Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and Customer Notice. The guidance requires all financial institutions to implement a response program to address security breaches involving customer information. The guidance requires a financial institution's response to include, among other things, procedures for notifying customers about incidents of unauthorized access when certain criteria are met.

Bank Secrecy Act

The Bank Secrecy Act (BSA) is a tool the U.S. government uses to fight drug trafficking, money laundering and other crimes. Under the BSA, financial institutions are required to file certain reports, including suspicious activities reports and currency transaction reports, with the Financial Crimes Enforcement Network under certain circumstances. Financial institutions are also required to have policies and procedures in place to ensure compliance with the BSA. If a financial institution fails to timely file a report or fails to implement its BSA policies and procedures, it could subject the institution to enforcement action or civil money penalties. In July 2007, federal banking regulators issued the Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements to provide greater consistency among the agencies in enforcement decisions in BSA matters and to offer insight into the considerations that form the basis of such BSA enforcement decisions.

On October 26, 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act) was signed into law. The USA PATRIOT Act amended the BSA and broadened the application of anti-money laundering regulations to apply to additional types of financial institutions, such as broker-dealers, and strengthened the ability of the U.S. government to detect and prosecute international money laundering and the financing of terrorism. The principal provisions of Title III of the USA PATRIOT Act require that regulated financial institutions: (i) establish an anti-money laundering program that includes training and audit components; (ii) comply with regulations regarding the verification of the identity of any person seeking to open an account; (iii) take additional required precautions with non-U.S. owned accounts; and (iv) perform certain verification and certification of money laundering risk for their foreign correspondent banking relationships. The USA PATRIOT Act also expanded the conditions under which funds in a U.S. interbank account may be subject to forfeiture and increased the penalties for violation of anti-money laundering regulations. Failure of a financial institution to comply with the USA PATRIOT Act's requirements could have serious legal and reputational consequences for the institution. BancGroup has adopted policies, procedures and controls to address compliance with the requirements of the USA PATRIOT Act under the existing regulations and will continue to revise and update its policies, procedures and controls to reflect changes required by the USA PATRIOT Act and implementing regulations.

Safety and Soundness Standards

Pursuant to FDICIA, the federal banking regulatory agencies have adopted a set of guidelines prescribing safety and soundness standards for depository institutions such as Colonial Bank. The guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit

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excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the agencies adopted regulations that authorize an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If the institution fails to submit an acceptable compliance plan or fails to implement an accepted plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions be taken, including restricting asset growth, restricting interest rates paid on deposits, and requiring an increase in the institution's ratio of tangible equity to assets.

Payment of Dividends and Other Restrictions

BancGroup is a legal entity separate and distinct from its subsidiaries, including Colonial Bank. There are various legal and regulatory limitations on the extent to which BancGroup's subsidiaries can, among other things, finance, or otherwise supply funds to, BancGroup. There are legal restrictions under federal and state law on the payment of dividends by banks. The relevant regulatory agencies also have authority to prohibit BancGroup and Colonial Bank from engaging in what, in the opinion of such regulatory body, constitutes an unsafe or unsound banking practice. The payment of dividends could, depending upon the financial condition of BancGroup and Colonial Bank, be deemed to constitute such an unsafe or unsound practice. As previously discussed, both Colonial Bank and BancGroup are required to receive prior regulatory approval for the payment of dividends on common stock.

In addition, Colonial Bank and its subsidiaries are subject to limitations under Sections 23A and 23B of the Federal Reserve Act with respect to extensions of credit to, investments in, and certain other transactions with, BancGroup and its other subsidiaries. Furthermore, loans and extensions of credit are also subject to various collateral requirements. The Federal Reserve has adopted Regulation W, which combines the Federal Reserve's interpretations and exemptions relating to Sections 23A and 23B of the Federal Reserve Act.

Capital Adequacy

The Federal Reserve has adopted regulations which provide for minimum risk-based and leverage capital guidelines for bank holding companies. The minimum required ratio of total capital to risk-weighted assets (including certain off-balance sheet items, such as standby letters of credit) is 8%, of which 4% must consist of Tier I capital. The minimum required leverage capital ratio is 3% for bank holding companies that meet certain specified criteria, including that they have the highest regulatory rating. A minimum leverage ratio of 4% is required for bank holding companies not meeting these criteria. Generally, bank holding companies are expected to operate well above the minimum capital ratios. Higher capital ratios may be required for any bank holding company if warranted by its particular circumstances or risk profile. Failure to meet capital guidelines can subject a bank holding company to a variety of formal and informal enforcement remedies, including restrictions on its operations and activities.

Regarding depository institutions, the prompt corrective action provisions of the federal banking statutes establish five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized), and impose significant restrictions on the operations of an institution that is not at least adequately capitalized. To be considered well capitalized, an institution must maintain a ratio of total capital to risk weighted assets of at least 10% of which 6% must consist of Tier I capital as well as a Tier I leverage ratio of at least 5%. To be considered adequately capitalized, the institution must maintain those same capital ratios at levels equal to or exceeding 8%, 4% and 4%, respectively. Under certain circumstances, an institution may be downgraded to a category lower than that warranted by its capital levels and subjected to the supervisory restrictions applicable to institutions in the lower capital category. As of December 31, 2008, Colonial Bank met the minimum capital levels to be categorized as well capitalized under the regulatory framework for prompt corrective action. See specific discussion of Colonial Bank's and BancGroup's capital adequacy as previously discussed under *Current Regulatory Matters*.

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An undercapitalized depository institution is subject to restrictions in a number of areas, including capital distributions, payments of management fees and expansion. In addition, an undercapitalized depository institution is required to submit a capital restoration plan. A depository institution's holding company must guarantee the capital plan up to an amount equal to the lesser of 5% of the depository institution's assets at the time it becomes undercapitalized or the amount needed to restore the capital of the institution to the levels required for the institution to be classified as adequately capitalized at the time the institution fails to comply with the plan. A depository institution is treated as if it is significantly undercapitalized if it fails in any material respect to implement a capital restoration plan.

Significantly undercapitalized depository institutions may be subject to a number of additional significant requirements and restrictions, including requirements to sell sufficient voting stock to become adequately capitalized, to improve management, to restrict asset growth, to prohibit acceptance of correspondent bank deposits, to restrict senior executive compensation and to limit transactions with affiliates. Critically undercapitalized depository institutions are further subject to restrictions on paying principal or interest on subordinated debt, making investments, expanding, acquiring or selling assets, extending credit for highly-leveraged transactions, paying excessive compensation, amending their charters or bylaws and making any material changes in accounting methods. In general, a receiver or conservator must be appointed for a depository institution within 90 days after the institution is deemed to be critically undercapitalized.

Support of Subsidiary Bank

Under Federal Reserve policy, BancGroup is expected to act as a source of financial strength to, and to commit resources to support, Colonial Bank. This support may be required at times when, absent such Federal Reserve policy, BancGroup might not otherwise be inclined to provide it. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

FDIC Insurance Assessments

The FDIC is an independent federal agency established originally to insure the deposits, up to prescribed statutory limits, of federally insured banks and to preserve the safety and soundness of the banking industry. The FDIC has adopted a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities.

Colonial Bank's deposit accounts are insured by the FDIC to the maximum extent permitted by law. Colonial Bank pays deposit insurance premiums to the FDIC based on a risk-based assessment system established by the FDIC for all insured institutions. Institutions considered well-capitalized and financially sound pay the lowest premiums, while those institutions that are less than adequately capitalized and of substantial supervisory concern pay the highest premiums. During 2008, assessment rates for insured institutions ranged from 5 cents per \$100 of assessable deposits for well-capitalized institutions with minor supervisory concerns to 43 cents per \$100 of assessable deposits for undercapitalized institutions with substantial supervisory concerns. In 2009, assessment rates are expected to range between 12 and 50 cents per \$100 of assessable deposits for the first quarter and 8 and 77.5 cents per \$100 of assessable deposits for the remainder of the year. The large premium increase is due to the Emergency Economic Stabilization Act of 2008 and the Temporary Liquidity Guarantee Program, both of which increased the deposit insurance coverage available to Colonial's depositors.

Emergency Economic Stabilization Act of 2008. In October 2008, the Emergency Economic Stabilization Act of 2008 (EESA) was signed into law. The EESA temporarily revises the federal deposit insurance laws by increasing the basic deposit insurance coverage from \$100,000 to \$250,000 per depositor. This revision is currently effective through December 31, 2009.

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Temporary Liquidity Guarantee Program. In order to promote financial stability in the economy, the FDIC adopted the Temporary Liquidity Guarantee Program (TLGP) on October 13, 2008. Participation in the program is voluntary. However, once participation is elected, it can not be revoked. Colonial has chosen to participate in the Transaction Account Guarantee Program component of the TLGP. Under the Transaction Account Guarantee Program, the FDIC will fully insure funds held in noninterest-bearing transaction accounts. Noninterest-bearing transaction accounts are ones that do not accrue or pay interest and for which the institution does not require an advance notice of withdrawal. Also covered are interest on lawyers' trust accounts (IOLTA) and negotiable order of withdrawal (NOW) accounts with interest rates lower than 50 basis points. These revisions are only effective through December 31, 2009.

Federal Deposit Insurance Reform Act of 2005. In February 2006, the Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (collectively, the Reform Act) were signed into law. The Reform Act revised the laws concerning federal deposit insurance by making the following changes: (i) merging the Bank Insurance Fund and the Savings Association Insurance Fund into a new fund, the Deposit Insurance Fund (DIF), effective March 31, 2006; (ii) increasing the deposit insurance coverage for certain retirement accounts to \$250,000 effective April 1, 2006; (iii) beginning in 2010, deposit insurance coverage on individual accounts may be indexed for inflation; (iv) the FDIC will have more discretion in managing deposit insurance assessments; and (v) eligible institutions will receive a one-time initial assessment credit.

The Reform Act authorized the FDIC to revise the risk-based assessment system. Accordingly, insurance premiums are based on a number of factors, including the risk of loss that insured institutions pose to the DIF. The Reform Act replaced the minimum reserve ratio of 1.25% with a range of between 1.15% and 1.50% for the DIF, depending on projected losses, economic changes and assessment rates at the end of each calendar year. In addition, the FDIC is no longer prohibited from charging banks in the lowest risk category when the reserve ratio premium is greater than 1.25%.

In November 2006, the FDIC adopted changes to its risk-based assessment system. Under the new system, the FDIC will evaluate an institution's risk based on supervisory ratings for all insured institutions, financial ratios for most institutions and long-term debt issuer ratings for certain large institutions.

In addition to deposit insurance assessments, the FDIC is authorized to collect assessments against insured deposits to be paid to the Finance Corporation (FICO) to service FICO debt incurred during the 1980's. The FICO assessment rate is adjusted quarterly. The average annual assessment rate in 2008 was 1.12 cents per \$100 for insured deposits. For the first quarter of 2009, the FICO assessment rate for such deposits will be 1.14 cents per \$100 of assessable deposits.

Alabama State Banking Department Assessment

The Alabama State Banking Department imposes a quarterly assessment on all state banks under its supervision. The amount of the quarterly assessment is based on the bank's total assets at the end of the prior quarter. Colonial Bank's state assessment expense for the year ended December 31, 2008 was \$1.2 million. Prior to Colonial Bank converting to a state-chartered bank on June 10, 2008, Colonial paid assessments to the OCC totaling \$1.6 million for the first half of 2008. No assessment was paid to the OCC for the second half of the year.

Other Subsidiary Regulation

Certain subsidiaries of BancGroup and Colonial Bank are regulated by other governmental agencies. Where material, such regulation is disclosed with the disclosure of the subsidiary.

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Additional Information

Additional information, including statistical information concerning the business of BancGroup, is set forth herein. See *Selected Financial Data* and *Selected Quarterly Financial Data 2008-2007* and *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

Executive Officers and Directors

Pursuant to general instruction G, information regarding executive officers of BancGroup is contained herein at Item 10.

Item 1A. Risk Factors

Industry Factors

As a financial services company, our business and earnings are significantly affected by general business and economic conditions, particularly in the real estate industry, and accordingly, our business and earnings could be further harmed in the event of a continuation or deepening of the current U.S. recession or further market deterioration or disruption.

Our business and earnings are sensitive to general business, economic and market conditions in the United States. These conditions include changes in short-term and long-term interest rates, inflation, deflation, fluctuation in the real estate and debt capital markets, developments in national and regional economies and changes in government policies and regulations.

Our business and earnings are particularly sensitive to economic and market conditions affecting the real estate industry because most of our loan portfolio consists of commercial real estate, construction and residential loans. While generally containing lower risk than unsecured loans, commercial real estate and construction loans generally involve higher credit risk than conventional single-family residential loans. Such loans also generally involve larger individual loan balances. In addition, real estate construction loans may be affected to a greater extent than residential loans by adverse conditions in real estate markets or the economy because many real estate construction borrowers' ability to repay their loans is dependent on successful development of their properties, as well as the factors affecting residential real estate borrowers. Risk of loss on a construction loan depends largely upon whether the initial estimate of the property's value at completion of construction equals or exceeds the cost of property construction (including interest) and the availability of permanent take-out financing. During the construction phase, a number of factors can result in delays and cost overruns. Construction and commercial real estate loans also involve greater risk because they may not be fully amortizing over the loan period, but have a balloon payment due at maturity. A borrower's ability to make a balloon payment may depend on the borrower being able to refinance the loan, timely sell the underlying property or liquidate other assets.

The current U.S. recession has resulted in a reduction in the value of the real estate assets securing a large portion of the loans that we hold. An increasing number of borrowers have become delinquent or defaulted on their loans, thereby adversely affecting our results of operations and financial condition, including the value of our intangible assets. A further increase in the number of delinquencies or defaults would result in higher levels of nonperforming assets, net charge-offs and provision for loan losses, adversely affecting our results of operations and financial condition.

The condition of the residential mortgage and related markets and the economy may deteriorate further and adversely affect our business.

Recently, the residential mortgage market in the United States has experienced a variety of worsening economic conditions that have adversely affected the performance and market value of our residential construction and mortgage loans. Across the United States, delinquencies, foreclosures and losses with respect to residential construction and mortgage loans generally have increased and may continue to increase. In addition,

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housing prices and appraisal values in most markets have declined or stopped appreciating. An extended period of flat or declining housing values may result in additional increases in delinquencies and further losses on residential construction and mortgage loans.

Our earnings are significantly affected by the fiscal and monetary policies of the federal government and its agencies.

The Board of Governors of the Federal Reserve System regulates the supply of money and credit in the United States. Its policies determine in large part our cost of funds for lending and investing and the return we earn on those loans and investments, both of which impact our net interest margin, and can materially affect the value of financial instruments we hold, such as debt securities. Its policies also can affect our borrowers, potentially increasing the risk that they may fail to repay their loans. Changes in Federal Reserve Board policies are beyond our control and difficult to predict or anticipate.

The financial services industry is highly competitive.

We operate in a highly competitive industry which has become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can now merge by creating a financial services company called a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. A number of foreign banks have acquired financial services companies in the United States, further increasing competition in the U.S. market. Also, technology has lowered barriers to entry and made it possible for nonbanks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and some have lower cost structures. Many nonbanks have converted to bank holding companies in order to receive government assistance under the U.S. Treasury Department's Capital Purchase Program (TARP). The newly formed bank holding companies are expected to increase competition for deposits and other business traditionally pursued by banks.

The financial services industry is heavily regulated by federal and state agencies.

The Company, its subsidiary bank and certain nonbank subsidiaries are heavily regulated by federal and state agencies. This regulation is to protect depositors, federal deposit insurance funds and the banking system as a whole, not security holders. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways including limiting the types of financial services and products we may offer and/or increasing the ability of nonbanks to offer competing financial services and products. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies and damage to our reputation. For more information, refer to discussions of regulatory considerations contained in Item 1 *Business* and Note 19, *Regulatory Matters and Restrictions*.

The Emergency Economic Stabilization Act of 2008 (EESA) and the American Recovery and Reinvestment Act of 2009 (ARRA) may not stabilize the financial services industry or the U.S. economy.

The EESA was signed into law on October 3, 2008. The legislation was intended to alleviate the financial crisis affecting the U.S. banking system. A number of programs have been and are being developed and implemented under EESA. The EESA may not have the intended effect and therefore the condition of the financial services industry may worsen instead of improve. The failure of the EESA to improve the condition of the U.S. banking system could significantly adversely impact our business, our financial condition, our financial results, our access to funding or capital as well as the trading price of our common stock or other instruments.

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The ARRA was signed into law on February 17, 2009. The legislation was intended to provide immediate and long-term solutions to the current U.S. recession. The ARRA may not have the intended effect; therefore, the current U.S. recession and the condition of the financial services industry may worsen instead of improve. The failure of the ARRA to improve the current U.S. recession and/or improve the condition of the U.S. banking system could significantly adversely impact our business, our financial condition, our financial results, or our access to funding or capital, as well as the trading price of our common stock or other instruments.

Current market volatility and industry developments may adversely affect our business and financial results.

The volatility in the capital and credit markets along with the housing declines during the last year have resulted in significant pressure on the financial services industry. We have experienced a higher level of foreclosures and higher losses upon foreclosure than we have historically. If current volatility and market conditions continue or worsen, there can be no assurance that our industry, results of operations or our business will not continue to be significantly adversely impacted. We may have further increases in loan losses, deterioration of capital or limitations on our access to funding or capital, if needed.

Further, if other financial institutions fail to be adequately capitalized or funded, it may negatively impact our business and financial results. We routinely interact with numerous financial institutions in the ordinary course of business and are therefore exposed to operational and credit risk to those institutions. Failures of such institutions may significantly adversely impact our operations.

Strategies to manage interest rate risk may yield results other than those anticipated.

Changes in the interest rate environment are difficult to predict. Net interest margins can expand or contract which can significantly impact our overall earnings. Changes in interest rates can also adversely affect how we apply critical management estimates, our projected returns on investments, as well as the determination of fair values of certain assets.

Events such as natural disasters, acts of terrorism or war occurring in the U.S. could affect our business and financial results.

Our business and earnings are sensitive to general business, economic and market conditions occurring in the U.S. and particularly in our primary markets. Events such as natural disasters, a terrorist attack or war could result in prolonged business disruption and/or materially impair the value of collateral securing loans, which could adversely impact our business.

Company Factors

The impact on us of recently enacted legislation, in particular the Emergency Economic Stabilization Act of 2008 (EESA), the American Recovery and Reinvestment Act of 2009 (ARRA), and their implementing regulations, and actions by the FDIC, cannot be predicted at this time.

The programs established or to be established under the EESA, ARRA and Troubled Asset Relief Program are evolving and may have adverse effects on us. We may face increased regulation of our industry. Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities. Also, participation in specific programs may subject us to additional restrictions. For example, participation in the Troubled Asset Relief Program will limit (without the consent of the U.S. Treasury Department) our ability to pay a dividend on common stock or to repurchase our common stock for so long as any securities issued under such program remain outstanding. It will also subject us to additional executive compensation restrictions. Similarly, programs established by the FDIC under the systemic risk exception of the Federal Deposit Act, may have an adverse effect on us, whether or not we participate in the programs. Participation in the FDIC Temporary Liquidity Guarantee Program requires the payment of additional insurance premiums to the FDIC based upon the increased deposit coverage afforded thereunder. Further, we will be required to pay significantly higher Federal

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Deposit Insurance Corporation premiums because market developments have decreased the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits. The full effects of these various programs cannot reliably be determined at this time.

Failure to receive final approval for participation in the U.S. Treasury Department's Capital Purchase Program (TARP) or our inability to raise additional capital on terms and conditions that are satisfactory to us could have a significant impact on our Company.

During the fourth quarter of 2008, we received preliminary approval from the U.S. Treasury Department to participate in its Capital Purchase Program subject to raising additional capital of at least \$300 million. The amount of TARP preferred stock to be issued is subject to a maximum of 3% of our latest bank holding company total risk weighted assets. As of December 31, 2008, if all conditions are satisfied the maximum amount of TARP preferred stock we would expect to issue to the U.S. Treasury Department is approximately \$536 million. The preliminary approval also includes provisions concerning the timely completion of the preferred stock agreements by Colonial, which time has since elapsed. BancGroup has been informed by a representative of the U.S. Treasury Department that the Company will be allowed additional time to satisfy the conditions contained in the preliminary approval. The preliminary approval also contains other provisions which, along with the time constraints, would allow the U.S. Treasury Department to modify or revoke the preliminary approval. While we are actively pursuing a variety of capital raising alternatives to satisfy the preliminary approval conditions to issue TARP preferred stock, we cannot guarantee our success, and therefore we may not receive additional third party capital or issue TARP preferred stock, and could therefore be subject to increased regulatory oversight pursuant to the MOUs discussed in Item 1 and in these Risk Factors below. Failure to adequately address the regulatory concerns in these informal MOUs may result in actions by our banking regulators under the prompt corrective action provisions ranging from a formal written agreement pursuant to Section 8 of the FDIC Improvement Act which would preclude Colonial Bank from being considered well capitalized to the restriction or prohibition of certain activities by BancGroup or Colonial Bank. If Colonial Bank were to be deemed an undercapitalized institution, the banking regulators could require the Bank to submit a plan for restoring Colonial Bank to an acceptable capital category and our failure to adequately comply could eventually allow the banking regulators to appoint a receiver or conservator of Colonial Bank's net assets.

The issuance of preferred stock and convertible warrants to the U.S. Treasury Department as well as any additional capital raised from the private sector would dilute the Company's existing common shareholders.

As discussed above, if the Company is successful in raising additional capital and issues TARP preferred stock and warrants to the U.S. Treasury Department, existing common shareholders will experience significant dilution to their current ownership in the Company.

The holding company and Colonial Bank are subject to heightened regulatory scrutiny and oversight.

Due to their current condition and results of operations, BancGroup and Colonial Bank are operating under heightened regulatory scrutiny and have been and will be taking steps which are expected to improve their asset quality and capital. Colonial Bank entered into an informal Memorandum of Understanding with the FDIC and the Alabama State Banking Department on December 15, 2008, and BancGroup entered into an informal Memorandum of Understanding with the Federal Reserve Bank of Atlanta on January 6, 2009, addressing, among other items, management of asset quality and increased capital for Colonial Bank. Colonial Bank has agreed to increase its Tier I leverage ratio to 8% and its total risk-based capital ratio to 12% by March 31, 2009 and to improve asset quality by dates beginning June 30, 2009. While management is attempting to comply with these deadlines through the capital raising transactions described in Item 1 under *Executive Overview of Operations and Conditions*, failure to do so may result in the consequences described in the following paragraph. Colonial Bank may not pay dividends on its common stock owned by BancGroup without the prior written consent of the FDIC and the Alabama State Banking Department. BancGroup has agreed to use its resources to support Colonial Bank. BancGroup will not pay dividends on its common or preferred stock, purchase or redeem treasury stock, or incur additional debt or refinance existing debt without prior written consent of the Federal Reserve and the Alabama State Banking Department. Additionally, if BancGroup receives the U.S. Treasury

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Department's Capital Purchase Program funds, we will be required to receive approval from the U.S. Treasury Department prior to the payment of any dividend on common stock or the repurchase of any common stock so long as any securities issued under such program remain outstanding. These matters are a major focus of the attention and efforts of the Board of Directors and management.

Failure to adequately address the regulatory concerns in these informal memoranda may result in actions by our banking regulators against BancGroup and/or Colonial Bank such as the imposition of a written agreement or a cease and desist order pursuant to Section 8 of the FDIC Act. Such actions could preclude Colonial Bank from being considered well capitalized and/or impose other restrictions or prohibitions of certain activities by BancGroup or Colonial Bank. If Colonial Bank were to be deemed an undercapitalized institution, the banking regulators could require the Bank to submit a plan for restoring Colonial Bank to an acceptable capital category, and our failure to adequately comply could eventually allow the banking regulators to appoint a receiver or conservator of Colonial Bank's net assets.

Any current or future litigation, regulatory investigations, proceedings, inquiries or changes could have a significant impact on our Company.

The financial services industry, including BancGroup, has experienced unprecedented market value declines caused primarily by the current U.S. recession and real estate market deterioration. As a result of the current market perceptions of shareholder advocacy groups as well as the new U.S. Administration in Washington, D.C., litigation, proceedings, inquiries or regulatory changes are all distinct possibilities for financial institutions. We are, and will in the future be, the subject of shareholder litigation. Such actions or changes could result in significant costs. See *Legal Proceedings* in Item 3 for more information.

The concentration of our assets in Florida makes us sensitive and more susceptible to changes in the economic, demographic and regulatory conditions in that state.

A significant portion of the loans in our portfolio are secured by residential and commercial properties in Florida. Deteriorating real estate market conditions and a significant economic downturn in Florida have negatively impacted our business. Worsening conditions in the Florida real estate markets could continue to adversely affect our borrowers' ability to repay as well as impact the value of the collateral underlying our loans. Real estate values are impacted by various factors, including general economic conditions, governmental rules or policies and natural disasters. The occurrence of a natural disaster, such as a hurricane, could result in a decline in the value or destruction of mortgaged properties and an increase in the risk of delinquencies, foreclosures or loss on the uninsured portions of these loans. These factors may adversely impact our borrowers' ability to make required payments, which in turn, may negatively impact our results.

Negative public opinion could damage our reputation and adversely impact our business and revenues.

As a financial institution, our earnings and capital are subject to risks associated with negative public opinion. Negative public opinion could result from our actual, alleged or perceived conduct in any number of activities, including lending practices, the failure of any product or service sold by us to meet our customers' expectations or applicable regulatory requirements, corporate governance, acquisitions, as a defendant in litigation, or from actions taken by government regulators or community organizations. Negative public opinion can adversely affect our ability to attract and/or retain customers and can expose us to litigation or regulatory action. Negative public opinion could also affect our credit ratings, which are important to our access to certain sources of wholesale borrowings, thereby increasing the cost or reducing, or eliminating, the availability of these sources of funding.

Disruptions in our ability to access capital markets may negatively affect our capital resources and liquidity.

In managing our consolidated balance sheet, we depend on access to capital markets to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, and to accommodate the transaction and cash management needs of our customers. Other sources of funding available to us, and upon

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which we rely as regular components of our liquidity risk management strategy, include deposits, inter-bank borrowings, repurchase agreements and borrowings from the Federal Home Loan Bank of Atlanta and the Federal Reserve discount window. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of depositors, debt purchasers, or counterparties participating in the capital markets, or a downgrade of our debt ratings, may adversely affect our borrowing costs and our liquidity.

Deposit pricing may continue to negatively impact our net interest margin and earnings.

Intense competition for liquidity during 2008 resulted in elevated rates being paid on time deposits, thereby compressing net interest margin and reducing net interest income. A continuation or exacerbation of such competition for time deposits would continue to adversely impact our earnings and financial condition.

Maintaining or increasing our market share depends on market acceptance and regulatory approval of new products and services.

Our success depends, in part, on our ability to adapt our products and services to evolving industry standards. There is increasing pressure on financial services companies to provide products and services at lower prices. This can reduce our net interest margin and revenues from our fee-based products and services. In addition, the widespread adoption of new technologies, including internet-based services, could require us to make substantial expenditures to modify or adapt our existing products and services. We might not successfully introduce new products and services, achieve market acceptance of our products and services and/or develop and maintain loyal customers.

The holding company relies on dividends from its subsidiaries for most of its revenue.

The holding company is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from its subsidiaries. Dividends from Colonial Bank are a significant source of funds for BancGroup to pay any future dividends on the holding company's common stock. Various federal and/or state laws and regulations limit the amount of dividends that our bank and certain of our nonbank subsidiaries may pay to the holding company. Colonial Bank may not currently pay dividends on its common stock without prior written consent of its regulators. Also, the holding company's right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. For more information, refer to *Payment of Dividends and Other Restrictions* in Item 1 and Note 19, *Regulatory Matters and Restrictions*.

Our accounting policies and methods determine how we report our financial condition and results of operations, and they may require management to make estimates about matters that are inherently uncertain.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. Our management must exercise judgment in selecting and applying many of these accounting policies and methods so that not only do they comply with accounting principles generally accepted in the United States but also that they reflect management's judgment as to the most appropriate manner in which to record and report our financial condition and results of operations. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which might be reasonable under the circumstances yet might result in our reporting materially different amounts than would have been reported under a different alternative. Note 1, *Summary of Significant Accounting and Reporting Policies and Basis of Presentation*, describes our significant accounting policies.

We have identified six accounting policies as being critical to the presentation of our financial condition and results of operations because they require management to make particularly subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These critical accounting policies relate to: (1) allowance for loan losses; (2) fair value of financial instruments; (3) purchase accounting and goodwill; (4) income taxes; (5) consolidations; and (6) stock-based compensation. A change in management's assumptions and estimates

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underlying these critical accounting policies could result in a material change to the Company's financial position and results of operations. For more information, refer in this report to *Critical Accounting Policies* in Management's Discussion and Analysis.

Our allowance for loan losses may not be adequate to cover actual loan losses, which may require us to take a charge to our earnings and adversely impact our financial condition and results of operations.

We maintain an allowance for estimated loan losses that we believe is adequate for absorbing the inherent losses in our loan portfolio. Management determines the provision for loan losses based upon an analysis of general market conditions, credit quality of our loan portfolio, and performance of our customers relative to their financial obligations with us. The amount of future losses is susceptible to changes in economic, operating, and other conditions, including changes in interest rates that may be beyond our control and such losses may exceed the allowance for estimated loan losses. Although management believes that the allowance for estimated loan losses is adequate to absorb any inherent losses on existing loans that may become uncollectible, there can be no assurance that the allowance will prove sufficient to cover actual loan losses in the future. Significant increases to the provision for loan losses may be necessary if material adverse changes in general economic conditions occur or the performance of our loan portfolio deteriorates. Additionally, banking regulators, as an integral part of their supervisory function, periodically review the allowance for estimated loan losses. If these regulatory agencies require us to increase the allowance for estimated loan losses, it could have a negative effect on our results of operations and financial condition.

Our financial instruments carried at fair value expose us to certain market risks.

We maintain an available for sale securities portfolio which includes various types of instruments and maturities. In addition, we elected to record selected loans held for sale at fair value. The changes in fair value of the loans held for sale that we have elected to carry at fair value are recognized in earnings. The securities and loans held for sale are exposed to market risks related to changes in interest rates, market liquidity, and market-based credit spreads, as well as to the risk of default by specific borrowers. Changes in the market values of these financial instruments could have a material adverse impact on our financial condition or results of operations. We may elect to carry additional financial assets or financial liabilities at fair value in the future.

Our mix of products and customers subjects us to potential concentration risk.

Colonial Bank offers a defined group of products, both retail and commercial, to its customers throughout the branch network. As a result of the products offered and customers served, BancGroup is subject to concentration risk. See the *Concentration* discussion within the *Risk Management* section of Management's Discussion and Analysis for further information.

We depend on the expertise of key personnel. If these individuals leave without effective replacements, operations may suffer.

The future success of our business will be dependent to a large degree on the continued services of executive officers and other key personnel who have extensive experience in the banking industry. If we lose the services of any of these integral personnel and fail to manage a smooth transition to new personnel, our business could be negatively impacted. Current compensation limits for key personnel at institutions receiving any government funds may increase the risk of loss of their services and create a competitive disadvantage with non-U.S. peer institutions or institutions not receiving any government funds.

We may not realize the expected benefits from our Colonial 1st Project.

The Colonial 1st Project, launched in December 2008, is an employee-driven effort to create a more efficient organization that delivers greater value for our shareholders and an enhanced banking experience for our customers. We are still in the early stages of this project and cannot be sure what the ultimate increase to annual pre-tax earnings will be, but other financial institutions of comparable size that have gone through this process

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have reported significant increases. The amounts of efficiency gains and earnings from new revenue growth initiatives are based on estimates and assumptions regarding future business performance and operating expenses. The anticipated cost savings and revenue enhancements from the Colonial 1st Project may not be achieved in their entirety or accomplished within our expected time frame. Accordingly, we cannot guarantee that the anticipated benefits from the Colonial 1st Project will be realized.

Our stock price can be volatile.

Our stock price can fluctuate widely in response to a variety of factors including, but not limited to:

actual or anticipated variations in our quarterly operating results;

recommendations by securities analysts;

short selling of our stock and increased failures to deliver;

new technology used, or services offered, by our competitors;

significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;

failure to integrate our acquisitions or realize anticipated benefits from our acquisitions, or, conversely, a more successful integration or realization of more benefits than anticipated;

operating and stock price performance of other companies that investors deem comparable to us;

news reports relating to trends, concerns and other issues in the financial services industry;

changes in government regulations;

geopolitical conditions such as acts or threats of terrorism or military conflicts; and

potential actions of the banking regulators.

The current price of our common stock is below the minimum allowed by New York Stock Exchange (NYSE) listing requirements.

BancGroup's stock is listed on the NYSE. The NYSE requires that listed stocks trade at or above \$1 per share. The closing price of our stock has recently fallen below \$1 per share for a number of days. If the average closing price is below \$1 per share for 30 consecutive trading days, the NYSE may send us a de-listing notification, which we would disclose in a press release. Within ten days after receiving such notification, we can submit a proposal to the NYSE to bring our stock price above \$1 within six months. However, there can be no assurance we will be successful in implementing such a proposal. If our common stock were to be de-listed from the NYSE, it would be traded over the counter, unless we were able to list it on another exchange. A de-listing by the NYSE would likely cause trading in our stock to be less liquid.

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On February 26, 2009, the NYSE announced a proposed temporary suspension of the stock-price rule through June 30, 2009. Although effective immediately, the rule is subject to a 30-day operative delay under Securities and Exchange Commission rules, for which the NYSE has requested and expects to receive a waiver. As the suspension is currently proposed, if our stock price remains below \$1 per share during the suspension period, the compliance period for the 30 consecutive trading days will resume on July 1, 2009.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, also could cause our stock price to decrease regardless of our operating results.

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Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

BancGroup owns its corporate offices in Montgomery, Alabama. Operations centers in Birmingham, Alabama and Orlando, Florida are leased. BancGroup maintains regional executive offices in Alabama, Florida, Georgia, Nevada and Texas.

As of December 31, 2008, Colonial Bank owned 189 and leased 158 of its full-service branches. For additional information, see Note 1, *Summary of Significant Accounting and Reporting Policies and Basis of Presentation*, Note 10, *Commitments and Contingent Liabilities*, and Note 13, *Premises and Equipment*.

Item 3. *Legal Proceedings*

During the first quarter of 2009, BancGroup, certain officers and directors were named as defendants in purported class action lawsuits filed in the U.S. District Court for the Middle District of Alabama alleging violations of federal securities laws. These lawsuits, brought on behalf of shareholders who purchased BancGroup securities as early as January 23, 2008 and as late as January 27, 2009, allege primarily that the defendants engaged in securities fraud by disseminating materially false and misleading statements during the class period. The lawsuits seek unspecified compensatory damages (including interest), cost and expense, and injunctive relief. The lead plaintiff and class counsel have not been selected. Colonial has until March 4, 2009 to respond to the claims in the first lawsuit.

On February 24, 2009, BancGroup received notice of a shareholder derivative action filed in the Circuit Court of Montgomery County, Alabama, seeking to recover damages caused to the Company by its officers and directors. BancGroup's directors and senior officers are alleged to have breached their fiduciary obligations to the Corporation in connection with the Company's participation in the U.S. Treasury Department's TARP programs. Colonial has until March 24, 2009 to respond to the claims.

Because these lawsuits were recently filed and there are significant uncertainties involved in any potential class action litigation, management is unable to predict the outcome of the purported class action or derivative lawsuits and therefore cannot currently reasonably determine the estimated future impact on the financial condition or results of operations of the Company. BancGroup and its directors and officers intend to vigorously defend each of the lawsuits.

In the opinion of BancGroup, based on review and consultation with legal counsel, the outcome of all other litigation presently pending is not anticipated to have a material adverse effect on BancGroup's consolidated financial statements or results of operations.

Item 4. *Submission of Matters to a Vote of Security Holders*

None.

Index to Financial Statements**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

BancGroup's Common Stock is traded on the New York Stock Exchange under the symbol CNB. As of February 18, 2009, BancGroup had 202,449,152 outstanding shares of Common Stock, with 9,959 registered shareholders.

The following table indicates the high and low sales prices for and dividends paid on Common Stock during 2008 and 2007.

	Sale Price of Common Stock		Dividends Declared On Common Stock (per share)
	High	Low	
2008			
1st Quarter	\$ 16.06	\$ 9.57	\$ 0.190
2nd Quarter	10.67	3.38	0.095
3rd Quarter	10.50	3.05	0.095
4th Quarter	9.50	1.40	0.000
2007			
1st Quarter	\$ 26.80	\$ 23.86	\$ 0.1875
2nd Quarter	25.43	23.49	0.1875
3rd Quarter	25.50	19.30	0.1875
4th Quarter	22.47	12.85	0.1875

In the fourth quarter of 2008, BancGroup's Board of Directors suspended its quarterly dividend. The restrictions imposed upon Colonial Bank in regard to its ability to pay dividends to BancGroup, which in turn limit BancGroup's ability to pay dividends, are described further herein as well as in *Payment of Dividends and Other Restrictions* in Item 1.

The information required by this item concerning Equity Compensation Plans is included in Item 12 and Note 22, *Stock-Based Compensation*, both of which are incorporated herein by reference.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs ⁽¹⁾
Cumulative through December 31, 2007	8,606,800	\$ 24.26	8,606,800	\$ 91,175,000
January 1 - December 31, 2008		\$		\$ 91,175,000
Cumulative through December 31, 2008	8,606,800	\$ 24.26	8,606,800	\$ 91,175,000

(1) Information is as of the end of the period.

In 2006, the Company publicly announced two share repurchase programs to purchase shares of BancGroup Common Stock not to exceed a combined total of \$150 million. During 2007, both of these repurchase programs were completed. On June 11, 2007, the Company publicly

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announced another share repurchase program to purchase shares of BancGroup Common Stock not to exceed \$150 million, of which approximately \$91.2 million has yet to be purchased. This program will terminate on the earlier of its completion or June 8, 2009. BancGroup did not make any purchases during 2008 and is not expected to make any purchases in 2009.

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Shareholder Performance Graph

Set forth below is a line graph comparing the five-year cumulative return of BancGroup common stock, based on an initial investment of \$100 on December 31, 2003 and assuming reinvestment of dividends, with that of the Standard & Poor's 500 Index (the S&P 500) and the S&P 500 Bank Index and the KBW Regional Banks index. The comparisons in this graph are set forth in response to the Securities and Exchange Commission's (the SEC) disclosure requirements, and therefore are not intended to forecast or be indicative of future performance of the common stock.

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The following table sets forth selected financial data for the last five years:

	2008	2007	2006	2005	2004
	(In thousands, except per share amounts)				
Statement of Income:					
Interest income	\$ 1,385,827	\$ 1,556,485	\$ 1,455,585	\$ 1,162,055	\$ 848,017
Interest expense	722,314	795,111	700,318	452,833	280,769
Net interest income	663,513	761,374	755,267	709,222	567,248
Provision for loan losses	728,942	106,450	22,142	26,838	26,994
Net interest income after provision for loan losses	(65,429)	654,924	733,125	682,384	540,254
Noninterest income	203,896	186,224	189,222	175,976	153,201
Noninterest expense excluding goodwill impairment	670,262	559,678	519,601	515,255	431,649
Goodwill impairment	575,000				
Minority interest expense/REIT preferred dividends	21,344	12,984			
Income (loss) before income taxes	(1,128,139)	268,486	402,746	343,105	261,806
Income tax expense (benefit)	(247,667)	87,561	136,933	114,603	88,929
Net Income (Loss)	\$ (880,472)	\$ 180,925	\$ 265,813	\$ 228,502	\$ 172,877

Earnings (loss) Per Common Share:

Net income (loss):					
Basic	\$ (4.71)	\$ 1.18	\$ 1.73	\$ 1.53	\$ 1.32
Diluted	(4.71)	1.17	1.72	1.52	1.31
Average shares outstanding:					
Basic	186,897	153,519	153,598	149,053	131,144
Diluted	186,897	154,391	154,810	150,790	132,315
Cash dividends per common share	\$ 0.38	\$ 0.75	\$ 0.68	\$ 0.61	\$ 0.58

	2008	2007	2006	2005	2004
	(In thousands)				
Statement of Condition data at year end:					
Total assets	\$ 25,816,306	\$ 25,975,989	\$ 22,784,249	\$ 21,426,197	\$ 18,896,610
Interest bearing deposits in banks and the Federal Reserve	1,534,463	28,993	2,200	9,417	3,828
Securities purchased under agreements to resell	1,556,157	2,049,664	605,937	589,902	221,491
Total securities	3,503,380	3,682,510	3,085,488	2,844,354	3,653,554
Loans, net of unearned income	14,530,018	15,923,178	15,478,889	14,899,864	12,857,811
Loans held for sale	2,082,248	1,544,222	1,474,000	1,097,892	678,496
Non-time deposits	7,989,907	9,771,573	9,092,663	9,012,943	7,546,038
Total deposits	18,673,265	18,544,267	16,091,054	15,483,449	11,863,695
Long-term debt	4,043,807	4,023,836	2,522,273	2,338,831	2,260,957
Shareholders' equity	1,344,978	2,273,571	2,057,335	1,932,691	1,398,291
Average balances:					
Total assets	26,761,999	23,845,264	22,237,690	20,682,310	17,433,571
Interest-earning assets	24,308,648	21,636,867	20,409,906	18,943,511	16,173,539
Interest bearing deposits in banks and the Federal Reserve	334,294	10,504	3,887	23,748	7,734
Securities purchased under agreements to resell	2,029,631	1,467,233	592,840	489,688	76,554
Total securities	3,811,537	3,170,823	3,014,453	3,400,782	3,397,000
Loans, net of unearned income	15,454,146	15,290,766	15,339,699	14,139,380	12,148,513
Loans held for sale	2,598,804	1,613,170	1,374,115	823,177	497,315

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Non-time deposits	8,830,863	9,278,950	9,080,151	8,543,542	6,847,334
Total deposits	18,685,112	16,566,120	15,788,319	13,987,525	10,862,040
Shareholders' equity	2,264,692	2,166,296	1,992,772	1,779,081	1,285,772

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	2008	2007	2006	2005	2004
Selected Financial Measures:					
Net income to:					
Average assets	NM	0.76%	1.20%	1.10%	0.99%
Average shareholders' equity	NM	8.35	13.34	12.84	13.45
Noninterest income/average assets	0.76%	0.78	0.85	0.85	0.88
Noninterest expense/average assets	4.65	2.35	2.34	2.49	2.48
Efficiency ratio ⁽¹⁾	142.17	58.68	54.94	58.11	59.76
Dividend payout ratio	NM	64.10	39.53	40.13	44.27
Shareholders' equity to assets	5.21	8.75	9.03	9.02	7.40
Tangible common equity ratio	3.41	4.83	6.26	5.97	5.43
Tangible capital ratio	4.56	6.00	6.26	5.97	5.43
Book value per share	\$ 6.64	\$ 14.44	\$ 13.46	\$ 12.53	\$ 10.45
Tangible book value per share	\$ 4.26	\$ 7.63	\$ 9.05	\$ 8.02	\$ 7.50
Risk-based capital: ⁽²⁾					
Tier I	8.58%	8.22%	9.09%	9.15%	8.80%
Total	12.88	11.01	11.77	12.17	11.39
Tier I leverage ⁽²⁾	5.90	6.67	7.81	7.77	7.16
Total nonperforming assets to net loans, other real estate and repossessions ⁽³⁾					
	4.83	0.86	0.16	0.21	0.29
Net charge-offs to average loans					
	4.16	0.35	0.12	0.14	0.19
Allowance for loan losses to total loans (net of unearned income)					
	2.24	1.50	1.13	1.15	1.16
Allowance for loan losses to nonperforming loans ⁽³⁾					
	61	196	1247	662	548
Non-GAAP Measures: ⁽⁴⁾					
Core noninterest income/average assets ⁽⁵⁾	0.75	0.88	0.82	0.85	0.84
Core noninterest expense/average assets ⁽⁶⁾	2.46	2.27	2.33	2.42	2.42
Core efficiency ratio ⁽⁷⁾	75.52	55.49	55.34	56.58	59.04

(1) Includes a goodwill impairment charge of \$575.0 million for 2008. Refer to Note 14, *Goodwill and Other Intangible Assets*, in the Notes to Consolidated Financial Statements for additional information.

(2) Refer to Note 19, *Regulatory Matters and Restrictions*, in the Notes to Consolidated Financial Statements for additional information.

(3) Nonperforming loans and nonperforming assets are shown as defined in the *Risk Management* section of Management's Discussion and Analysis.

(4) Management believes that these non-GAAP measures provide information that is useful to investors in understanding the performance of the Company's underlying operations and performance trends. Specifically, these measures permit evaluation and comparison of results for ongoing business operations, and it is on this basis that Management internally assesses the Company's performance.

(5) Excluded from core noninterest income are securities and derivatives gains (losses), net totaling \$3.0 million, \$4.0 million, \$4.8 million, (\$24.7) million, and \$7.5 million for 2008, 2007, 2006, 2005, and 2004, respectively; securities restructuring charges of (\$36.0) million for 2007; gain on sale of mortgages and businesses of \$8.8 million and \$2.8 million for 2007 and 2006, respectively; gain on sale of branches of \$37.0 million for 2005; and changes in fair value of swap derivatives of (\$12.1) million for 2005 and (\$0.4) million for 2004.

(6) Excluded from core noninterest expense are severance expense of \$786,000, \$6.6 million and \$413,000 for 2008, 2007 and 2006, respectively; merger related expenses of \$4.0 million, \$4.2 million, and \$2.0 million for 2007, 2005, and 2004, respectively; net losses related to the early extinguishment of debt of \$10.3 million, \$6.9 million, \$9.6 million and \$7.4 million for 2008, 2007, 2005 and 2004, respectively; and goodwill impairment of \$575.0 million for 2008.

(7) This ratio utilizes core noninterest income and core noninterest expense as detailed in notes (5) and (6) above.

NM Not meaningful

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	2008				2007			
	Dec. 31	Sept. 30	June 30	March 31	Dec. 31	Sept. 30	June 30	March 31
	(In thousands, except per share amounts)							
Interest income	\$ 318,133	\$ 336,417	\$ 347,740	\$ 383,537	\$ 400,197	\$ 395,534	\$ 383,874	\$ 376,880
Interest expense	177,417	169,668	173,316	201,913	204,996	199,523	193,657	196,935
Net interest income	140,716	166,749	174,424	181,624	195,201	196,011	190,217	179,945
Provision for loan losses	455,000	159,399	79,000	35,543	93,295	4,800	6,105	2,250
Net interest income after provision for loan losses	(314,284)	7,350	95,424	146,081	101,906	191,211	184,112	177,695
Noninterest income	44,786	45,640	55,723	57,747	59,266	52,958	58,781	15,219
Noninterest expense excluding goodwill impairment	179,680	162,439	164,167	163,978	145,102	134,951	141,484	138,141
Goodwill impairment	575,000							
Minority interest expense/REIT preferred dividends	5,336	5,336	5,336	5,336	5,336	5,336	2,312	
Income tax expense (benefit)	(204,409)	(43,575)	(9,400)	9,717	1,762	34,527	32,978	18,294
Net income (loss)	\$ (825,105)	\$ (71,210)	\$ (8,956)	\$ 24,797	\$ 8,972	\$ 69,355	\$ 66,119	\$ 36,479

Earnings (Loss) Per Share:

Net income (loss)									
Basic	\$ (4.11)	\$ (0.35)	\$ (0.05)	\$ 0.16	\$ 0.06	\$ 0.45	\$ 0.43	\$ 0.24	
Diluted	\$ (4.11)	\$ (0.35)	\$ (0.05)	\$ 0.16	\$ 0.06	\$ 0.45	\$ 0.43	\$ 0.24	

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This annual report to shareholders, the Annual Report on Form 10-K and the information incorporated by reference contain forward-looking statements within the meaning of the federal securities laws. Words such as *believes*, *estimates*, *plans*, *expects*, *should*, *may*, *might*, *could*, *outlook*, *potential*, *would*, *anticipates*, the negative of these terms and similar expressions as they relate to BancGroup (including its subsidiaries and its management), are intended to identify forward-looking statements. The forward-looking statements in these reports are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in or implied by the statements.

In addition to factors mentioned elsewhere in this annual report or previously disclosed in BancGroup's SEC reports (accessible on the SEC's website at www.sec.gov or on BancGroup's website at www.colonialbank.com), the following factors, among others, could cause actual results to differ materially from forward-looking statements, and future results could differ materially from historical performance. These factors are not exclusive:

losses in our loan portfolio are greater than estimated or expected;

an inability to raise additional capital on terms and conditions that are satisfactory;

failure to receive final approval for the U.S. Treasury Department's Capital Purchase Program;

the impact of current economic conditions and the impact of our results of operations on our ability to borrow additional funds to meet our liquidity needs;

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economic conditions affecting real estate values and transactions in BancGroup's market and/or general economic conditions, either nationally or regionally, that are less favorable or take longer to recover than expected;

changes in the interest rate environment which expand or reduce margins or adversely affect critical estimates as applied and projected returns on investments and fair values of assets;

continued or sustained deterioration of market and economic conditions or business performance could increase the likelihood that we would have an additional goodwill impairment charge;

deposit attrition, customer loss or revenue loss in the ordinary course of business;

increases in competitive pressure in the banking industry and from non-banks;

costs or difficulties related to the integration of the businesses of BancGroup and institutions it acquires are greater than expected;

the inability of BancGroup to realize elements of its strategic and operating plans for 2009 and beyond;

natural disasters in BancGroup's primary market areas result in prolonged business disruption or materially impair the value of collateral securing loans;

management's assumptions and estimates underlying critical accounting policies prove to be inadequate or materially incorrect or are not borne out by subsequent events;

the impact of recent and future federal and state regulatory changes;

current or future litigation, regulatory investigations, proceedings or inquiries;

strategies to manage interest rate risk may yield results other than those anticipated;

changes which may occur in the regulatory environment;

a significant rate of inflation (deflation);

unanticipated litigation or claims;

changes in the securities markets;

acts of terrorism or war; and

details of the recently enacted Emergency Economic Stabilization Act of 2008, the American Recovery and Reinvestment Act of 2009 and various announced and unannounced programs implemented by the U.S. Treasury Department and bank regulators to address capital and liquidity concerns in the banking system, are still being finalized and may have a significant effect on the financial services industry and BancGroup.

Many of these factors are beyond BancGroup's control. The reader is cautioned not to place undue reliance on any forward looking statements made by or on behalf of BancGroup. Any such statement speaks only as of the date the statement was made or as of such date that may be referenced within the statement. BancGroup does not undertake any obligation to update or revise any forward-looking statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations is presented on the following pages. The principal purpose of this review is to provide the reader of the attached financial statements and accompanying notes with a detailed analysis of the financial results of The Colonial BancGroup, Inc. and subsidiaries.

Index to Financial Statements**EXECUTIVE OVERVIEW**

The Colonial BancGroup, Inc. is a \$25.8 billion financial services company providing diversified services including retail and commercial banking, wealth management services, mortgage banking and insurance products through its branch network, private banking offices or officers, ATMs and the internet as well as other distribution channels to consumers and businesses. At December 31, 2008, BancGroup had 347 branches in Florida, Alabama, Georgia, Nevada and Texas.

The following chart includes the Company's assets, deposits and branches by state as of December 31, 2008.

	Assets		Deposits		Branches	
	Amount	%	Amount	%	Number	%
	(Dollars in millions)					
Florida	\$ 15,949	62%	\$ 10,770	58%	197	57%
Alabama	4,422	17%	4,224	23%	90	26%
Georgia	1,286	5%	775	4%	19	5%
Texas	1,778	7%	793	4%	21	6%
Nevada	976	4%	833	4%	20	6%
Corporate/Other	1,405	5%	1,278	7%		
Total	\$ 25,816	100%	\$ 18,673	100%	347	100%

Strategy

BancGroup is built upon the foundation of a community banking philosophy that emphasizes local responsibility for customer relationships. The local market personnel are supported by centralized operations, which allow the local banking officers to concentrate on serving their customers. Through this structure of local customer relationship responsibility and centralized operations, the local banking officers generally have customer level decision making capability while at the same time having an operational support structure.

Overview of Financial Condition and Earnings*Earnings*

Colonial incurred a net loss for the year ended December 31, 2008 of \$4.71 per diluted share, a significant decrease from the \$1.17 earned in 2007. Colonial's net loss for the year was \$880 million compared to net income of \$181 million for 2007. The 2008 loss was driven by credit costs and goodwill impairment which are more fully described below.

Colonial's net interest income decreased 13% from 2007, driven by a 79 basis point compression of net interest margin. The net interest margin for 2008 was 2.76% compared to 3.55% for 2007. The margin compression was driven by these primary factors: (1) a 35 basis point reduction from the impact of customer preference for certificates of deposits, which resulted in a mix change to higher cost deposits from low cost deposits and fierce deposit pricing competition during 2008 which kept deposit rates high compared to other market rates; (2) a 20 basis point reduction from the impact of credit related reductions on interest income, including interest reversals when loans are placed on nonaccrual status as well as a lack of income while those loans remain on nonaccrual status and (3) a 16 basis point reduction from a decrease in loans which were replaced with lower yielding assets. These factors caused yields on interest earning assets to contract by 148 basis points while the cost of deposits only decreased 69 basis points despite a decrease of 296 basis points in the average Federal Funds rate.

Noninterest income for 2008 increased 9% from 2007. Mortgage warehouse fees decreased by \$17.0 million as a result of discontinuing the sales of assets to the commercial paper conduits in January 2008. Other income

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also declined by \$6.2 million due to less income from joint ventures and gains on the sales of assets. These decreases were partially offset by increases in mortgage banking origination and sales of \$15.0 million and wealth management revenues of \$1.2 million. Non-core items increased over 2007 by \$26.3 million, primarily due to the securities restructuring charges of \$36.0 million recognized in 2007.

Noninterest expense increased in 2008 by 122%, or \$685.6 million, compared to 2007. The increase reflects a noncash goodwill impairment charge of \$575.0 million in 2008, increased losses and expenses on other real estate of \$27.2 million, increased losses on equity investments of \$13.9 million, increased FDIC insurance and other regulatory fees of \$11.8 million as 2007 fees were substantially offset by credits, increased costs related to the addition of branches through acquisition and de novo expansion and a net loss on early extinguishment of debt totaling \$10.3 million. Reductions in severance expense and merger related expenses of \$5.8 million and \$4.0 million, respectively, partially offset the increases.

Colonial recorded a noncash charge of \$575.0 million in the fourth quarter of 2008 for goodwill impairment. Goodwill recorded on past acquisitions in Florida and Nevada became impaired in the fourth quarter primarily due to declining bank market valuations and increased credit costs. Refer to the *Goodwill* section of Management's Discussion and Analysis for additional information.

Colonial's loan loss provision was \$728.9 million in 2008 compared to \$106.5 million in 2007. The Company provided for net charge-offs of \$642.8 million in 2008 and increased its allowance for loan losses by \$86.2 million to \$325.0 million, or 2.24% of net loans, at December 31, 2008 compared to \$238.8 million, or 1.50% of net loans, at December 31, 2007.

Asset Quality

For the year ended December 31, 2008, Colonial charged off \$642.8 million of loans compared to \$54.1 million for 2007, and recorded provision for loan losses of \$728.9 million, compared to \$106.5 million for 2007. With provision exceeding net charge-offs, the allowance for loan losses increased to 2.24% of net loans at December 31, 2008, from 1.50% at December 31, 2007. Nonperforming assets were \$710.5 million, or 4.83%, of loans, net of unearned income, and other real estate, at December 31, 2008, compared to \$137.6 million, or 0.86%, at December 31, 2007. At December 31, 2008, 79% of Colonial's nonperforming assets were real estate construction-related. During 2008, Colonial reduced real estate construction loans to \$4.9 billion, a \$1.4 billion, or 22%, reduction compared to December 31, 2007.

Liquidity

The Company's liquidity position at December 31, 2008 exceeded the Company's forecasted cash uses for 2009.

The Company's primary source of funding is deposits which funded 72% of total assets at December 31, 2008. During 2008, deposits increased \$129.0 million to \$18.7 billion, with retail deposits comprising \$17.4 billion of the total. Colonial has chosen to participate in the deposit insurance component of the Temporary Liquidity Guarantee Program (TLGP) and as such, the FDIC insures up to \$250,000 per deposit relationship and provides unlimited deposit insurance for certain transaction accounts. All banks that participate in the TLGP deposit insurance program have the same FDIC insurance coverage. Time deposits of \$9.4 billion that mature during 2009 are expected to be renewed or substantially replaced by new originations. Total deposits increased after year end to \$19.5 billion on February 28, 2009.

During 2009, only \$42.4 million of the Company's long-term debt will mature. The Company expects to repay the debt as it becomes due.

In response to the significant market and economic uncertainty in the United States, Colonial had cash and interest bearing deposits in banks and the Federal Reserve of over \$2.0 billion at December 31, 2008.

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Capital

BancGroup's total risk-based capital ratio at December 31, 2008 was 12.88%, and its Tier I risk-based capital ratio was 8.58%, exceeding the regulatory definitional guidelines for well capitalized of 10% and 6%, respectively. The Company's total and Tier I risk-based capital ratios at December 31, 2007 were 11.01% and 8.22%, respectively. The Company's Tier I leverage ratios were 5.90% and 6.67% at December 31, 2008 and 2007, respectively, also exceeding the regulatory guidelines for well capitalized of 5%.

Dividends

In 2008, the Company paid dividends of \$68.4 million, or \$0.38 per share to its shareholders, compared to \$115.0 million, or \$0.75 per share, in 2007. The Company suspended dividend payments in the fourth quarter of 2008.

Business Combinations

While Colonial did not make any acquisitions during 2008, the Company made two acquisitions in 2007 – Miami, Florida based Commercial Bankshares, Inc. and its subsidiary Commercial Bank of Florida, and Lakeland, Florida based Citrus & Chemical Bancorporation, Inc. and its subsidiary Citrus & Chemical Bank. For more information about the 2007 acquisitions, refer to Note 4, *Business Combinations*, in the Notes to Consolidated Financial Statements.

CRITICAL ACCOUNTING POLICIES

BancGroup's significant accounting and reporting policies are presented in Note 1, *Summary of Significant Accounting and Reporting Policies and Basis of Presentation*. These policies, along with the disclosures presented in the other notes, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Those accounting policies involving significant estimates and assumptions by management, which have, or could have, a material impact on the carrying value of certain assets and impact comprehensive income, are considered critical accounting policies. BancGroup recognizes the following as critical accounting policies: Allowance for Loan Losses, Fair Value of Financial Instruments, Purchase Accounting and Goodwill, Income Taxes, Consolidations and Stock-Based Compensation.

Allowance for Loan Losses

Management's ongoing evaluation of the adequacy of the allowance considers both impaired and unimpaired loans and takes into consideration the Company's past loan loss experience, known and inherent risks in the portfolio, existing adverse situations that may affect the borrowers ability to repay, estimated value of any underlying collateral, an analysis of existing guarantees and an analysis of current economic conditions. While management believes that it has exercised prudent judgment and applied reasonable assumptions which have resulted in an allowance presented in accordance with generally accepted accounting principles, there can be no assurance that in the future, adverse economic conditions, increased nonperforming loans or other factors will not require further increases in the allowance. A more detailed discussion of BancGroup's allowance for loan losses is included in the *Risk Management* section of Management's Discussion and Analysis as well as Note 1, *Summary of Significant Accounting and Reporting Policies and Basis of Presentation*.

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The table below illustrates BancGroup's sensitivity to changes in certain factors used in the determination of the allowance for loan losses.

Factors	Estimated Effect on 2008 Provision Expense Assuming the Following Changes in Each Determining Factor ⁽²⁾	
	+10%	-10%
	(In thousands)	
Loan portfolio size	\$ 25,160	\$ (25,160)
Net charge-offs	20,625	(20,625)
Criticized loans ⁽¹⁾	9,107	(9,107)

(1) Criticized loans include all loans rated special mention or worse.

(2) These computations do not contemplate any action BancGroup could or would undertake in response to changes in each of these risk factors.

Fair Value of Financial Instruments

A portion of BancGroup's assets and liabilities are measured at fair value on a recurring basis, including securities available for sale, loans held for sale for which BancGroup has elected the fair value option, and derivative assets and liabilities. Certain other assets are measured at fair value on a nonrecurring basis. These adjustments to fair value usually result from application of lower of cost or fair value accounting or write-downs of individual assets due to impairment. Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about assets and liabilities measured at fair value. SFAS 157 defines fair value as the price that would be received to sell a financial asset or to transfer a financial liability in an orderly transaction between market participants at the measurement date. SFAS 157 establishes a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. This classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used in the measurement are observable or unobservable. Observable inputs reflect market-driven or market-based information obtained from independent sources, while unobservable inputs reflect the Company's estimates about market data. These three levels of inputs that may be used to measure fair value are:

- Level 1** Quoted prices in active markets for identical assets or liabilities.
- Level 2** Directly or indirectly observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates); or inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities would include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

In accordance with SFAS 157, it is the Company's policy to maximize the use of observable inputs and to minimize the use of unobservable inputs when developing fair value measurements. When active markets exist, quoted market prices for identical or similar financial instruments are used to measure fair value. In the absence of active markets, management determines the fair value of BancGroup's assets and liabilities using models which are based on management's judgment, assumptions and estimates regarding credit quality, liquidity,

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interest rates and other relevant inputs. A substantial portion of the Company's financial instruments are measured using Level 1 or Level 2 inputs. However, in certain cases, when market observable prices and inputs are not based on actively traded instruments, judgments must be made about assumptions market participants would use in estimating the fair value of the financial instrument.

The degree of judgment involved in determining the fair value of a financial instrument depends on the availability of quoted market prices or observable market data from active markets. For financial instruments that trade actively and have quoted market prices or observable market data, there is minimal subjectivity. When observable market data from active markets is not available, judgment is necessary to estimate fair value. In addition, changes in market conditions may reduce the availability of quoted market prices or observable market data. For example, reduced liquidity in the capital markets or changes in secondary market activity could result in observable market data becoming unavailable. Therefore, when market data is not available, the Company uses valuation methods requiring more management judgment to estimate fair value.

Carrying financial assets and liabilities at fair value inherently results in more financial statement volatility as compared to carrying such assets and liabilities at historical or amortized cost. At December 31, 2008, \$5.1 billion, or 19.6%, of BancGroup's total assets were measured at fair value on a recurring basis. Approximately 76.2% of these assets were classified as Level 1 or Level 2 within the fair value hierarchy. At December 31, 2008, \$27.3 million, or 0.1%, of BancGroup's total liabilities were measured at fair value on a recurring basis. Approximately 1.5% of these liabilities were classified as Level 1 or Level 2 within the fair value hierarchy. The measurement of these financial instruments therefore is less subjective to judgment than those classified as Level 3 as they are based upon quoted market prices or observable market-driven or market-based information.

At December 31, 2008, \$378.5 million, or 1.5%, of BancGroup's total assets were measured at fair value on a nonrecurring basis. Approximately 1.9% of these assets were classified as Level 1 or Level 2. At December 31, 2008, there were no liabilities measured at fair value on a nonrecurring basis.

Level 3 assets measured at fair value on a recurring basis were 23.8% of total assets measured at fair value and 4.7% of total assets at December 31, 2008. Level 3 liabilities measured at fair value on a recurring basis were 98.5% of total liabilities measured at fair value and 0.1% of total liabilities at December 31, 2008.

Level 3 assets and liabilities measured at fair value on a recurring basis as of December 31, 2008 include the following: the Company's call options related to interests in short-term participations in mortgage loans, interest rate lock commitments and the related forward sales commitments which were transferred into Level 3 during the second quarter of 2008 due to the significance of unobservable inputs (such as the probability of funding) to the overall value of these instruments; and, the Company's non-agency mortgage-backed securities which were transferred into Level 3 in the third quarter of 2008. The transfer of these securities available for sale into Level 3 was based on a significant reduction in market liquidity for these securities. In valuing Level 3 assets and liabilities, significant inputs include market interest rates, future cash flows, the fair value of underlying mortgages (call options, interest rate lock commitments and forward sales commitments) and pull through rates (interest rate lock commitments and forward sales commitments). For further discussion on Level 3 instruments, see Note 5, *Fair Value Measurements*.

Imprecision in estimating unobservable market inputs can impact the amount of income or loss recorded for a particular fair value measurement. Furthermore, while BancGroup believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. For a detailed discussion of the determination of fair value for individual financial instruments, see Note 5, *Fair Value Measurements*.

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Purchase Accounting and Goodwill

For an acquisition, BancGroup is generally required to record the assets acquired, including identified intangible assets, and liabilities assumed at their fair value, which often involves estimates based on third-party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques, which are inherently subjective. The amortization of identifiable intangible assets is based upon the estimated economic benefits to be received, which is also subjective. These estimates also include the establishment of various accruals and allowances based on planned facility dispositions and employee severance considerations, as well as other acquisition-related items.

BancGroup records goodwill in an amount equal to the excess of the cost of an acquisition over the fair value of the net assets acquired. BancGroup tests goodwill for impairment on an annual basis, or more often if events or circumstances indicate that there may be impairment. The Company has elected to perform its annual testing as of September 30 each year. The goodwill impairment test is a two-step process, which requires management to make judgments in determining the assumptions used in the calculations. The first step involves estimating the fair value of each reporting unit and comparing it to the reporting unit's carrying value, which includes the allocated goodwill. If the estimated fair value is less than the carrying value, then a second step is performed to measure the actual amount of goodwill impairment. The second step initially involves determining the implied fair value of goodwill. This requires the Company to allocate the estimated fair value to all the assets and liabilities of the reporting unit. Any unallocated fair value represents the implied fair value of goodwill which is compared to its corresponding carrying value. If the implied fair value is less than the carrying value, an impairment loss is recognized in an amount equal to that deficit.

Fair values of reporting units are estimated using discounted cash flow models derived from internal earnings forecasts. The key assumptions used to estimate the fair value of each reporting unit include earnings forecasts for five years, terminal values based on estimated future growth rates and discount rates that reflect the range of the Company's market capitalization plus a control premium.

The more significant fair value adjustments in the second step of the impairment test were to loans in each of the reporting units. These adjustments reflect current market conditions and include significant liquidity discounts. Also, the step two analysis included adjustments to previously recorded identifiable intangible assets to reflect them at fair value and also included the fair value of additional intangibles not previously recognized. The adjustments to measure the assets, liabilities and intangibles at fair value are for the purpose of measuring the implied fair value of goodwill and such adjustments are not reflected in the Consolidated Statements of Condition.

The Company's annual goodwill impairment test was performed as of September 30, 2008. As a result of the annual impairment test, even though four reporting units were required to perform a second step analysis, management determined that no goodwill impairment charge was required at that time, as the implied fair value of goodwill for each tested reporting unit exceeded its carrying value. Due to the decline in market valuations for financial institutions, including Colonial, and an increase in credit costs during the fourth quarter of 2008, an interim impairment test was performed as of December 31, 2008. As a result of the interim impairment test, the Company computed and recorded a \$575.0 million goodwill impairment loss in the fourth quarter of 2008, reducing the balance of goodwill to the implied fair value from the second step of the impairment test. See Note 14, *Goodwill and Other Intangible Assets*, for additional information.

Due to the ongoing uncertainty in market conditions, which may continue to negatively impact the performance of BancGroup's reporting units as well as the market valuations of financial institutions, including Colonial, management will continue to monitor and evaluate the carrying value of goodwill. Additional goodwill impairment could be recorded in future periods and such impairment could be material to the Company's results of operations.

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The table below illustrates BancGroup's sensitivity to changes in the rates used in discounting the estimated future cash flows. The sensitivity analysis was based on information available as of the interim test date of December 31, 2008. Further discussion regarding BancGroup's accounting for goodwill is included at Note 1, *Summary of Significant Accounting and Reporting Policies and Basis of Presentation*.

	Sensitivity of Goodwill Impairment Analysis		
	Results Assuming the Following Changes in		
	Discount Rates⁽¹⁾		
	No Change	+10%	- 10%
	(In thousands)		
Total goodwill impairment	\$ 575,000	\$ 676,970	\$ 416,365

(1) These computations do not take into account changes in the forecasted cash flows and future annual growth rates. Further, the computations do not contemplate any action BancGroup could undertake in response to changes in the risks associated with the operations of each reporting unit.

Income Taxes

BancGroup uses the asset and liability method of accounting for income taxes. Determination of the deferred and current provision requires analysis by management of certain transactions and the related tax laws and regulations. Management exercises significant judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets. Those judgments and estimates are re-evaluated on a continual basis as regulatory and business factors change.

The Company periodically reviews the carrying amount of its deferred tax assets to determine if the establishment of a valuation allowance is necessary. If, based on the available evidence in future periods, it is more likely than not that all or a portion of the Company's deferred tax assets will not be realized, a deferred tax valuation allowance would be established and could be material to the results of operations. Consideration is given to all positive and negative evidence related to the realization of the deferred tax assets.

In evaluating the available evidence, management considers historical financial performance, expectation of future earnings, the ability to carryback losses to recoup taxes previously paid, length of statutory carryforward periods, experience with operating loss and tax credit carryforwards not expiring unused, tax planning strategies and timing of reversals of temporary differences. Significant judgment is required in assessing future earnings trends and the timing of reversals of temporary differences. The Company's evaluation is based on current tax laws as well as management's expectations of future performance based on its strategic initiatives. Changes in existing tax laws and future results that differ from expectations may result in significant changes in the deferred tax asset valuation allowance. See Note 25, *Income Taxes*, for additional information.

Effective January 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) 48, *Accounting for Uncertainty in Income Taxes*, which establishes a two-step process for recognizing and measuring tax benefits. FIN 48 applies to all tax positions within the scope of SFAS 109, *Accounting for Income Taxes*. Under FIN 48, tax benefits can only be recognized in BancGroup's financial statements if it is more likely than not that the benefits would be sustained after full review by the relevant taxing authority.

The application of income tax law is inherently complex. Laws and regulations in this area are voluminous, are often ambiguous and are frequently amended. Colonial is required to make many subjective assumptions and judgments regarding income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations change over time. As such, changes in the Company's subjective assumptions and judgments can materially affect amounts recognized in the consolidated balance sheets and statements of income.

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Consolidations

The Company enters into a variety of financing and investing arrangements in the normal course of business. Financing arrangements are entered into to meet balance sheet management, funding, liquidity and market or credit risk management needs. Investing arrangements are entered into in order to earn a return on investment. Because certain financing arrangements are made through legal entities and certain investments are in separate legal entities, the Company must evaluate whether or not these entities should be consolidated into the Company for financial reporting. In determining whether the entities involved in these arrangements should be consolidated, the Company first considers the guidance in Accounting Research Bulletin 51, *Consolidated Financial Statements*, which requires a company's consolidated financial statements to include subsidiaries in which the company has a controlling financial interest. This requirement is usually applied to subsidiaries in which a company has a majority voting interest. However, for entities that are not controllable through voting interests or in which the equity investors do not bear the residual economic risks, the Company follows the guidance in FIN 46(R), *Consolidation of Variable Interest Entities*. Determining whether a variable interest entity (VIE) should be consolidated requires the Company to make estimates about the VIE's expected losses and expected residual returns, as well as the extent to which those expected losses and expected residual returns will be absorbed by the Company. If the Company absorbs a majority of either, it is considered the primary beneficiary and is required to consolidate the VIE.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted SFAS 123(R), *Share-Based Payment*, which requires all stock-based payments to employees to be recognized in the income statement based on their fair values. Prior to January 1, 2006, the Company accounted for stock-based-compensation under the intrinsic value method prescribed by Accounting Principles Board (APB) Opinion 25, which only required the recognition of compensation cost for the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. As such, under APB 25 the Company generally recognized no compensation expense for stock options since the exercise prices equaled the market prices of BancGroup common stock on the grant dates. The Company did, however, recognize compensation cost for restricted stock awards since such awards have no exercise price. Also, under APB 25 the Company accounted for forfeitures as they occurred. Under SFAS 123(R), the Company is required to estimate forfeitures for awards which are not expected to vest.

The Company adopted SFAS 123(R) using the modified prospective transition method which did not require the restatement of prior periods to reflect the fair value method of expensing stock-based compensation. SFAS 123(R) did require a cumulative effect adjustment of previously recognized compensation expense in order to estimate forfeitures for awards outstanding on the adoption date. The cumulative effect adjustment was immaterial.

The Company estimates the fair value of stock options using the Black-Scholes valuation model, which requires the input of subjective assumptions including expected option term and expected stock price volatility. Further, the Company now estimates forfeitures for awards granted which are not expected to vest. Changes in these assumptions and estimates can materially affect the calculated fair value of stock-based compensation and the related expense to be recognized. As a result of implementing SFAS 123(R), the Company refined its process for estimating option term and expected stock price volatility.

For options granted during 2008, 2007 and 2006, the expected option term was determined based upon analysis of the Company's historical experience with exercise and post-vesting termination behavior of employees. The resulting expected option term was 5.33 years. The expected volatility was determined based upon historical daily prices of the Company's common stock over the most recent period equal to the expected option term, as well as implied price volatility based on the Company's exchange traded options. The indicated historical and implied volatilities were weighted 75% and 25%, respectively. Less emphasis was placed on

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implied volatility compared to historical volatility because the volume of exchange traded options is relatively low. The resulting weighted average expected volatility was 34.9%, 21.4% and 22.8% in 2008, 2007 and 2006, respectively. The expected forfeiture rate was determined based on analysis of the Company's historical experience with employees' pre-vesting termination behavior.

As of December 31, 2008, the total unrecognized compensation cost related to nonvested awards was \$11.8 million. The unrecognized compensation cost is expected to be recognized over a weighted average period of 3.1 years.

REVIEW OF RESULTS OF OPERATIONS

The Company reported a net loss of \$880.5 million in 2008 compared to net income of \$180.9 million for 2007, representing a loss per diluted share of \$4.71 and earnings per diluted share of \$1.17 for 2008 and 2007, respectively.

Net Interest Income

Net interest income is the Company's primary source of revenue. Net interest income represents the difference between interest and fee income generated from earning assets and the interest expense paid on deposits and borrowed funds. Interest rate volatility, which impacts the volume and mix of earning assets and interest bearing liabilities as well as their rates, can significantly impact net interest income. The net interest margin is fully tax equivalent net interest income expressed as a percentage of average earning assets for the period being measured. The net interest margin is presented on a fully tax equivalent basis to consistently reflect income from taxable and tax-exempt loans and securities.

Beginning in late 2007 and early 2008, the yield curve returned to a more normalized level after remaining flat or inverted since late 2005. Short-term rates were driven by rate decreases by the Federal Reserve, while long-term rates were driven by market supply and demand for debt instruments. After remaining constant at 5.25% from June 2006 to September 2007, the Federal Reserve Board lowered the Federal Funds rate resulting in a Federal Funds rate at December 31, 2008 between zero and 0.25%. Due to intense competition for deposits from financial services companies, the cost of funds in the financial sector has not declined in tandem or commensurate with the decrease in the Federal Funds rate. The following table shows the Federal Funds rate and U.S. Treasury yield curve at each quarter end during the past two years.

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For the twelve months ended December 31, 2008, the Company's net interest income, on a tax equivalent basis, decreased \$95.6 million, or 12.5%, as compared to the same period of the prior year. The yield on average earning assets decreased 61 basis points more than the decrease in the rate on average interest bearing liabilities causing net interest margin to contract 79 basis points. The impact to net interest income caused by net interest margin contraction was somewhat mitigated by \$334.2 million in net proceeds from the issuance of 43.7 million shares of BancGroup common stock in April 2008.

Net interest income was negatively impacted by a 296 basis point decline in the average Wall Street Journal Prime rate and a 258 basis point decline in the average 1 Month LIBOR rate for the twelve months ended December 2008, as compared to the same period of the prior year. For the twelve months ended December 31, 2008 and December 31, 2007, approximately 64% and 63%, respectively, of Colonial's earning assets were variable, adjustable, or short-term in nature. In addition, Colonial's deposit costs did not decline in tandem with the decline in prime and LIBOR rates due to intense competition for deposits from financial services companies. The average cost of deposits exceeded the average Federal Funds rate by at least 57 basis points for the twelve months ended December 31, 2008, as compared to the twelve months ended December 31, 2007, when the average cost of deposits was lower than the average Federal Funds rate by 170 basis points. The spread between the average Federal Funds rate and the average cost of deposits increased throughout 2008 as the average cost of deposits was 26 basis points less than the average Federal Funds rate in the first quarter of 2008 and was 155 basis points greater than the average Federal Funds rate for the fourth quarter of 2008.

In an effort to mitigate the impact to earnings from the Company's asset sensitive balance sheet, Colonial added interest rate floors on certain mortgage warehouse assets during 2008 and slowed the decline in Colonial's base rate. At December 31, 2008, approximately \$4.3 billion, or 16.5%, of total assets had a weighted average floor of 5.10%. In addition, Colonial did not reduce its base rate at the same pace as the Wall Street Journal Prime Rate. Colonial's average base rate of 8.05% for 2007 equaled the Wall Street Journal Prime Rate while Colonial's average base rate of 5.71% for 2008 was greater than the Wall Street Journal Prime Rate by 62 basis points. At December 31, 2008, approximately \$2.9 billion, or 12.2%, of earning assets were tied to Colonial's base rate of 4.5%. The following table shows average rates for selected balance sheet categories as well as selected market rates:

Analysis of Average Rates

	Twelve Months Ended		Increase/ (Decrease)
	December 31,		
	2008	2007	
Loans, net of unearned income	6.02%	7.64%	(1.62)%
Loans held for sale	5.12%	6.87%	(1.75)%
Securities	5.78%	5.66%	0.12