Jack Heath
President and
Chief Operating Officer

March 6, 2009

Office of the Special Inspector General
Troubled Asset Relief Program
1500 Pennsylvania Avenue Northwest Suite 1064
Washington, DC 20220

This letter is in response to your information request dated February 6, 2009, relating to our participation in the Treasury's Capital Purchase Program of TARP ("CPP"). Your letter specifically requests information regarding our use of CPP capital and plans regarding executive compensation. Our transaction under the CPP closed on January 30, 2009, just a week prior to our receipt of your letter. Additionally, the American Recovery and Reinvestment Act of 2009, which contains provisions related to executive compensation, was passed into law on February 17, 2009. This letter will provide an outline of our plan for the deployment of CPP funds and this plan will continue to be refined.

It is important to understand the reasons that led up to the bank's decision to participate in the CPP. So before I address your specific questions, allow me to provide some background information as context to this letter.

BACKGROUND

These are unprecedented economic times, where there are great uncertainties surrounding capital markets, real estate markets, the economy and the financial system. Virtually all business sectors across our geographic footprint are under significant pressure. While we were not immune to these economic forces, we remained confident that our balance sheet strength and earning capacity could see us through the downturn. In evaluating our participation in the CPP, our first inclination was to not participate in the program. We were primarily concerned about the connotation of being the recipient of a "bailout" and the negative implications of participating in a government sponsored program of this type. We were very concerned about the reputation risk to our bank that might follow our participation in the program, and any additional limitations and burdens that might be imposed unilaterally on us by the government.

Prior to deciding whether or not to take CPP capital and in anticipation of a challenging 2009, the bank proactively made some important decisions. Due to the decline in our 2008 earnings, we implemented a salary freeze on all employees, including executives, reduced certain incentive programs, and cut executive bonuses significantly. While nationwide unemployment could easily rise above 10 percent, we took steps to preserve our ability to maintain staffing levels, which will be an important economic stabilizer in our communities. [redacted] All the steps we have taken have focused on preserving profitability and our ability to serve the needs of our customers.

As the CPP was initially rolled out, the public dialogue and commentary from the government emphasized that the CPP was specifically targeted to <u>healthy</u> banks, not troubled institutions. The CPP was positioned as an investment in the nation's healthiest institutions so that those entities could fulfill their role as vital financial intermediaries in the U.S. economy. These banks were to be part of the solution, not considered as part of the problem. The CPP is not a government handout, but a very expensive source of capital. Capital that earns significant dividends from strong financial institutions that have the capacity to ultimately repay these funds to the nation's taxpayers. When combined with business and consumer deposits, this capital provides the foundation for the continued availability of credit that our economy needs. In short, this capital was a stabilizing force for our financial system.

After careful consideration, we elected to participate in this program because of the uncertainty surrounding the length and depth of the economic downturn, and its impact on our customers, our employees, our shareholders, and our community. The uncertainty that economic conditions could worsen, was a concern. Without additional capital, and with a geographic footprint where customers are under significant economic pressures, we could be forced to actually shrink our balance sheet to preserve capital. There was also the uncertainty of future regulatory changes that could impact our bank, such as increasing minimum capital requirements. [redacted] In 2007, our bank's total FDIC assessments were just $320,000.

Beyond addressing possible risks, taking CPP would also position the bank to take advantage of potential opportunities. It would strengthen our competitive position in the marketplace, which is favorable for our customers, employees, shareholders and for the communities we serve. [redacted] Our number one priority will always be to ensure our long term capital strength and financial health.

RESPONSE

<u>Use of TARP Funds</u>

We have observed some misconceptions in the public dialogue about the actual role and use of the TARP CPP capital that banks receive. The CPP funds are capital. Capital's role in a bank's balance sheet is to both provide protection against losses from the risks

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inherent in the banking business and as a financial foundation for balance sheet growth. It would not be prudent for a bank to grow without adequate capital, nor would banking regulations allow it. Moreover, increased regulatory capital can drive incremental loan growth only when combined with customer deposits, which are the actual funding source for the loan. It is our intent to build our deposit base from its current level of $3.08 billion (as of January 31, 2009) and use that funding growth to make new loans to existing and prospective customers across our geographic footprint. By providing a solid capital foundation, the CPP capital helps make that growth possible.

[redacted] (b) (4)

The incremental capital provided by the CPP funds bolsters our capital resources and enables the bank to grow the balance sheet through acquisitions as well. The capital infusion provided by the CPP enabled us to submit a bid to the FDIC for substantially all of the assets and liabilities of Pinnacle Bank, Beaverton, Oregon. On February 13, 2009, we closed on our purchase of Pinnacle Bank (the assets acquired totaled $69 million) from the FDIC on a "Whole Bank" basis. The resolution of Pinnacle Bank required no cash from the FDIC. If we didn't have the CPP capital, we likely either would have bid on a "Deposits Only" structure, or not at all.

TARP funds are reflected separately on W.T.B. Financial Corporation's financial statements. The funds residing at the holding company are deposited with the bank. The funds infused into the bank are helping to provide that capital foundation for new loan and balance sheet growth. When the $110 million CPP transaction was funded on January 30, 2009, we immediately infused $40 million into Washington Trust Bank, W.T.B. Financial Corporation's only insured banking subsidiary. An additional $15 million was infused into the bank on February 27, 2009. [redacted] (b) (4) (b) (4)

The CPP funds are anticipated to be used to assist with the following priorities:

1. CPP funds will increase risk based capital to strengthen the balance sheet of Washington Trust Bank in this challenging environment. This will provide additional confidence to our depositors, employees, and community that Washington Trust Bank will be here for the long term due to the well capitalized balance sheet that will buffer our ability to weather any economic challenges that may come our way.

2. Make new loans to new and existing commercial and individual borrowers. [redacted] (b) (4) (b) (4)

[redacted] look for opportunities with existing customers and new customers to do additional transactions. This will allow the bank to continue to grow our balance sheet subject to our ability to effectively leverage the CPP capital by increasing our deposit base while seeking strong credit opportunities. We believe the spirit of the program was for community banks to become an economic catalyst for growth in our community, while continuing to underwrite appropriately and not take on additional significant risk in this challenging economic time.

3. Make loans to home owners for new home purchases and refinances of existing home loans to assist home owners to take advantage of this lower rate environment and lower payments.

4. Work with homeowners who are having challenges to see if we can assist them in working through those financial issues. This additional capital allows our bank more flexibility to work with borrowers who are under pressure, while still mitigating our risk. The CPP capital also provides increased balance sheet flexibility to optimize our collection on troubled assets.

5. [redacted]

6. We will continue to evaluate opportunities to grow our franchise through branching into under-served communities and/or those that provide opportunities to grow our deposit base and thus, increase our lending activities.

7. We will establish a CPP oversight committee to review activities around the bank's goals for effective programs made possible by the receipt of CPP funds. We have established a separate file to segregate and preserve documents relating to participation and planned actions as a result of receiving CPP funds.

8. We will work with our Community Reinvestment Act committee and CPP committee for marketing opportunities to educate consumers about the new home buyer program incentives recently introduced and leverage those programs to provide first time home buyers with financing for homes.

9. We are reviewing our home loan portfolio and lending territories for opportunities to be proactive with potential loan programs and modifications for qualifying borrowers. We are setting specific goals around loan originations, both in the Home Loan Center and the Commercial Division.

We continue to look for other opportunities to grow assets because we believe banks are a catalyst for economic development in our markets. But we must be prudent in the deployment of loan funds to qualified borrowers who have the ability to repay in the long-term. We believe Washington Trust Bank is one of the solutions to the problems in the market today, and that the CPP funds will allow us to address the things outlined above.

Executive Compensation Requirements

As the requirements relate to the Department of Treasury guidelines associated with provisions outlined in the Emergency Economic Stabilization Act of 2008, we believe we are in compliance. Specifically, we are in full compliance with compensation plans not being tied to unnecessary or excessive risk taking. The bank has no golden parachute plans for executives and has made no payments under any such plans in the past.

Also, the bank is aware of the new and additional requirements and restrictions on executive compensation related to the American Recovery and Reinvestment Act of 2009. The requirements and guidelines mandated in both Acts are being implemented and reviewed for compliance. In addition, required policies and board governance procedures are being developed and will be implemented over the next few months. We will continue to monitor and revise these plans as regulatory guidance dictates.

Attached are communications that we have provided to our employees, our board of directors, our customers, and our shareholders as well as a number of articles about our participation in the CPP program.

While we believe our decision to participate in CPP was sound, we remain concerned about the tenor of the dialogue in Washington and the national media. There are numerous examples of public statements by national figures and the media that denigrate the industry and undermine the notion that CPP recipients are part of the solution. We solicit your help in turning the tide of that negative and counterproductive narrative.

I certify that the above statements or accurate to the best of my knowledge.

Sincerely,

John E. (Jack) Heath
President, COO

Washington Trust Bank

Memo

To: All Employees

From: Pete Stanton

Date: 2/3/2009

I am pleased to announce that on Friday, January 30, 2009, Washington Trust Bank received capital in the amount of $110 million from the U.S. Treasury's Capital Purchase Program (CPP) created as part of the Treasury's TARP.

As I outlined to you all in our recent communications I feel that the best long term strategic decision for Washington Trust Bank is to continue to fortify our balance sheet. A strong balance sheet positions ourselves to remain consistent in our support of our customers and helps provide the unquestioned financial strength we need to seek additional customers that understand and value our relationship banking vision. The additional capital provided by the CPP program assures our employees and our customers that Washington Trust Bank has the current capital to maintain our position as one of the strongest performing bank's in the industry despite the challenges in our economy today. As you know, all of our family's assets are centered in this bank which was founded 107 years ago. It is important we make sure, no matter what economic challenges we face, that our capital position is strong enough to protect our shareholders and our customers now and into the future.

Many of our competitors have accessed additional capital through this program, and as a result, capital ratios across the industry have increased. We feel it prudent to augment our capital even though we are not seeing the levels of asset deterioration that many of our competitors are facing. This capital provides us an insurance policy for both our continuing capital strength, and our ability to maintain our independence.

This capital injection is expensive. Our borrowing rate on the capital funds will be 6.45% non-tax-deductible. The capital's cost to our shareholder's underlines the importance and need for each of us to seek ways to improve our margin, control our costs, and improve our efficiency without diluting our customer experience. It is our goal to repay this capital to the Treasury through retained earnings in the minimum time allowed by the program.

The addition of this capital to our balance sheet not only guarantees the stability and strength of our company going forward, but also puts us in a position to take advantage of opportunities that may present themselves in our markets. Those opportunities include the potential purchase of additional depository delivery systems that would help us expand our footprint, new depository and lending opportunities for our existing clients, and the successful conversion of new clients that value and will pay for our offerings. Most importantly, it positions our company for the next 100 years of operations.

It is important to understand that additional capital helps us to drive the funding that allows us to provide the credit our qualified customers will need, but does not directly provide lendable funds in an amount that makes a meaningful impact in the long term. Our ability to leverage the capital by growing

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our customer funding will be critical in our efforts to effectively support the needs of the clients that bank with us today and into the future. Our success in providing the operating and investment capital our customers need and can support will ultimately be the fuel for the engine that drives our community's economic growth.

Attached is a Q & A on TARP. It is important that you go through this information in detail. If you have any additional questions, please feel free to call me so that we can visit about it.

Thank you for your hard work and support. These are challenging, but opportunistic times. Thank you for your commitment to the effort and teamwork necessary from you as we prepare ourselves for continuing success today and into the future.

TARP Q&A's for WTB Employees

- **What is TARP?** The Troubled Asset Relief Program ("TARP") is a component of the Emergency Economic Stabilization Act of 2008. The broad authorities in this legislation, when combined with existing regulatory authorities and resources, gives broad authority to the Secretary of the Treasury to protect and recapitalize the financial system.

- **What is CPP?** The Capital Purchase Program ("CPP"), a TARP component, is a voluntary program designed to encourage healthy U.S. financial institutions to build capital. Building capital in the financial system bolsters consumer confidence in their financial institutions, increases the flow of credit to U.S. businesses and consumers, and supports the U.S. economy. The CPP capital injected into the banking system provides the financial foundation, together with increased funding in the form of deposits from consumers and businesses, for greater lending activity.
- **How much capital can the US Treasury inject into the financial system?** The US Treasury will invest up to $225 billion in banks through the Capital Purchase Program. That figure represents approximately 3% of the total risk-weighted assets of all U.S. banks.

- **What are the implications for shareholders of a private bank**? There are no common stock ownership or voting rights involved. The form of the US Treasury's investment will be Preferred Stock and Warrant Preferred. Until the funds have been repaid there are certain constraints that will apply related to common shareholder dividends and common share repurchases.

- **What are the key financial terms of the CPP?** For all privately held banks that are approved by the US Treasury and the banking regulators to receive capital, the terms of the CPP are the same. The form of capital for private banks is Preferred Stock equaling 1% to 3% of risk weighted assets, with Warrant Preferred equal to 5% of the Preferred Stock. The Preferred Stock bears an initial dividend yield of 5.00 percent, while the Warrant Preferred bears a dividend yield of 9.00 percent.

- **If the CPP is targeted towards healthy institutions, how do banks benefit from the capital injection?** The intention of the CPP is to improve confidence in the banking system by bolstering capital levels at the nation's healthiest institutions. That increased confidence will enhance the industry's ability to attract deposits that will result in increased lending to businesses and consumers. The combination of increased levels of capital and market confidence positions the banking industry to fulfill its crucial role in the American economy.

WTB specific:

- **How much capital did Washington Trust issue as part of the CPP?** Washington Trust issued $110 million in Preferred stock under the CPP, which equals roughly 3 percent of the bank's risk weighted assets as of September 30, 2008.

- **If WTB is stable, why is it taking CPP money?** It was a major step for WTB to participate in the CPP, and there are many factors that influenced our decision. Although WTB believes that even during these unprecedented economic times we can maintain the bank's financial standing without the additional capital, we also believe that our clients will be best served if we compete from a position of unquestioned strength. Our longstanding commitment to carefully and strategically grow our bank and always remain a key financial partner with our customers is only enhanced by our participation in the CPP.

- **How is Washington Trust's financial position?** While there is no question that the current extraordinary market conditions have challenged all banks, our financial position and performance remains strong. Washington Trust finished 2008 above all regulatory well capitalized minimums, with a strong loan loss reserve position and positive earnings.

- **Is Washington Trust actively making loans?** Yes. Washington Trust has a broad family of banking products and services that are designed to meet the needs of both our commercial and consumer customers. The bank remains active making a wide variety of loans to our existing customers and is always looking to establish new client relationships. The bank's loan portfolio grew by more than $300 million in 2008.

February 6, 2009

To our shareholders:

I am pleased to announce that on Friday, January 30, 2009, Washington Trust Bank received capital in the amount of $110 million from the U.S. Treasury's Capital Purchase Program (CPP) created as part of the Treasury's TARP.

Attached is a Q and A regarding the TARP program which I would encourage you to read and call either Pete or myself to discuss in more detail. As mentioned in the Q and A, we are prevented from repurchasing additional stock from shareholders and while dividends can continue to be paid, they cannot be increased for three years.

As we outlined to you in recent communications we feel that the best long term strategic decision for Washington Trust Bank is to continue to fortify our balance sheet. A strong balance sheet positions ourselves to remain consistent in our support of our customers and helps provide the unquestioned financial strength we need to seek additional customers that understand and value our relationship banking vision. The additional capital provided by the CPP program assures our shareholders, employees and customers that Washington Trust Bank has the current capital to maintain our position as one of the strongest performing bank's in the industry despite the challenges in our economy today. It is important we make sure, no matter what economic challenges we face, that our capital position is strong enough to protect our shareholders and our customers now and into the future.

Many of our competitors have accessed additional capital through this program, and as a result, capital ratios across the industry have increased. We feel it prudent to augment our capital even though we are not seeing the levels of asset deterioration to the extent that many of our competitors are facing. This capital provides us an insurance policy for both our continuing capital strength, and our ability to maintain our independence.

This capital injection is expensive. Our borrowing rate on the capital funds will be 6.45% non-tax-deductible. The capital's cost to our shareholder's underlines the importance and need for all of our employees to seek ways to improve our margin, control our costs, and improve our efficiency without diluting our customer experience. It is our goal to repay this capital to the Treasury through retained earnings in the minimum time allowed by the program.

The addition of this capital to our balance sheet not only guarantees the stability and strength of our company going forward, but also puts us in a position to take advantage of opportunities that may present themselves in our markets. Those opportunities include the potential purchase of additional depository delivery systems that would help us expand our footprint, new depository and lending opportunities for our existing clients, and the successful conversion of new clients that value and will

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pay for our offerings. Most importantly, it positions our company for the next 100 years of operations.

It is important to understand that additional capital helps us to drive the funding that allows us to provide the credit our qualified customers will need, but is is not a direct source of funding for loans. Our ability to leverage the capital by growing our customer funding will be critical in our efforts to effectively support the needs of the clients that bank with us today and into the future. Our success in providing the operating and investment capital our customers need and can support will ultimately be the fuel for the engine that drives our community's economic growth.

Attached is a Q & A on TARP. It is important that you go through this information in detail. If you have any additional questions, please feel free to call me so that we can visit about it.

Thank you for your continued support and if we can be of any additional assistance please let us know.

Sincerely,

John E. (Jack) Heath
President and Chief Operating Officer

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IN THE NEWS

Since we last published

Feb. 10 / Hecla completes stock offering

Hecla Mining Co., of Coeur d'Alene, announced it had netted $71.3 million in an un-lerwriting of 36.8 million shares of its stock and warrants to buy an additional 18.4 mil-ion shares. Hecla said it will use the proceeds from the offering to repay a $40 million oan and for other purposes. Separately, the company said it expects to report a net loss ıpplicable to common shareholders of about $40 million to $42 million, or 24 cents to 25 cents a share, for its 2008 fourth quarter.

Feb. 7 / Avista customers stage protest

About 115 people gathered outside Avista Corp.'s headquarters at 1411 E. Mission to protest recent utility bills and a rate hike that's under appeal by the public counsel sec-tion of the state attorney general's office, the Spokane-based energy company said. The peaceful protest, organized by college student Jenna Cassidy, provided a forum for the company to hear from its customers and talk about their concerns, Avista said.

Feb. 6 / Nonstop Spokane-San Francisco flights to resume

Spokane International Airport said that United Airlines will begin nonstop service to San Francisco International Airport on June 4. The twice-daily United Express flights, long a priority of the business community here, will be on 66-seat Canadair 700 and 50-seat Canadair 200 regional jets. Spokane hasn't had nonstop air service to San Francisco since 2001.

Feb. 3 / Washington Trust parent receives TARP funds

WTB Financial Corp., the Spokane-based bank-holding company that owns Washington Trust Bank, said the U.S. Department of the Treasury had invested $110 million in the bank's preferred stock through the federal Troubled Asset Relief Program. The funds will ensure the bank's loan growth, help enable it to seek new cus-tomers, and possibly help it obtain a charter for full branch powers in Oregon to expand the bank's presence there, said Jack Heath, the bank's president.

Jan. 29 / Key Tronic posts small profit

Key Tronic Corp., the Spokane Valley-based contract manufacturer, reported net in-come of $106,000, or 1 cent a diluted share, for its fiscal 2009 second quarter ended Dec. 27, down from $1.6 million, or 16 cents a share, in the year-earlier quarter. Revenues were $47 million, down from $50.8 million. Results for the latest quarter in-cluded an $800,000 charge for goodwill impairment, while results for the 2008 second quarter included a gain of about $1 million from the sale of a facility.

Jan. 28 / Passenger, cargo numbers drop at SIA

A total of 250,000 airline passengers arrived and departed at Spokane International Airport in December, 16.2 percent fewer than in the year-earlier month. For all of 2008, total passenger numbers at the airport decreased to 3.42 million, down 1.4 percent from 3.47 million in 2007. Inbound and outbound air-cargo tonnage fell to a total of 4,640 tons in December, down 7.3 percent from December of 2007, while shipments for 2008 totaled 54,800 tons, down just under 5 percent.

Washington Trust gets capital infusion

BY BERT CALDWELL
Staff writer

The U.S. Treasury Department announced Tuesday it will invest $110 million in W.T.B. Financial Corp., the corporate parent of Washington Trust Bank.

Washington Trust President Jack Heath said the privately held Spokane bank will use the money to make loans and expand, possibly by buying other, weaker banks, or their assets.

He said the money will be expensive – the interest rate works out to about 6.65 percent – but for banks that need capital to grow in a tight credit environment, Treasury is the only game in town.

"We think there are going to be some humungous opportunities out there to expand our footprint," Heath said, noting that Washington Trust has coveted an Oregon state charter for some time.

"That's a real priority for us," he said.

He said the bank made 102 home mortgage loans worth a total $22 million in January, twice its volume in January 2008, and wants to be able to do more.

Heath said Washington Trust earned a profit in 2008 and had about $240 million in capital at the end of the year. But with so much uncertainty, he added, Washington Trust officials sought the Treasury money to build a "bulletproof" capital position.

Heath said the capital will also reassure the many Washington Trust customers whose deposits far exceed the $250,000 insured by the Federal Deposit Insurance Corp.

The Treasury money comes with strings attached: no dividends to shareholders for three years, and no executive compensation of more than $500,000.

"For us, that won't be an issue," Heath said.

Washington Trust was one of 42 banks in the country awarded a total of nearly $1.2 billion Tuesday under Treasury's Capital Purchase Program, a subset of the Troubled Asset Relief Program that so far has infused $195.3 billion into 359 financial institutions. Washington Trust was the only Northwest bank to receive funds in the latest round.

Sterling Financial Corp. in December received $303 million in TARP money.

Final

Washington Trust Bank
Member FDIC

W.T.B. FINANCIAL CORPORATION RECEIVES $110 MILLION IN TARP FUNDS

Latest Treasury investment in "healthy local banks Nationwide" intended to provide capital for continued lending activity

W.T.B. Financial Corporation, parent company of Washington Trust Bank, announced today that it received $110 million as an approved participant in the U.S. Treasury Department's TARP Capital Purchase Program. The Treasury Department termed the latest release of capital as "funding to bolster 42 healthy, local banks nationwide."

In the course of participation, Washington Trust Bank issued $110 million in Preferred Stock to the Treasury under the Capital Purchase Program, which equals roughly three percent of the Bank's risk-weighted assets as of September 30, 2008.

The Capital Purchase Program, created by the U.S. Treasury, is a voluntary program in which selected healthy financial institutions were encouraged to participate. Such participation is intended to support the economic development of the community and thereby help to restore the health of the local and national economy.

Chairman and Chief Executive Officer of Washington Trust Bank, Peter Stanton said, "I am pleased the Treasury has placed its confidence behind Washington Trust Bank, enhancing our position of strength and stability. The additional capital will further strengthen our balance sheet, allowing us to seek out additional deposit and lending opportunities with our customers in the communities we serve and continue to grow our client base with those who seek and value our relationship banking approach."

While no bank has remained unaffected by current extraordinary market conditions, Washington Trust Bank's financial position and performance remains positive. The Bank finished 2008 above all regulatory well-capitalized minimums, with a strong loan loss reserve position and positive earnings of $15.8 million. "We attribute our positive performance and 2008 loan growth of more than $300 million to the strong relationships we have developed with our diversified client base and long time focus on commercial, retail, private banking, and wealth management customers," said Stanton.