IRWIN FINANCIAL CORP
Form 10-Q
October 29, 2004

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

[ ] 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: 0-6835

IRWIN FINANCIAL CORPORATION

(Exact Name of Corporation as Specified in its Charter)

Indiana	**35-1286807**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
500 Washington Street Columbus, Indiana	**47201**
(Address of Principal Executive Offices)	(Zip Code)
(812) 376-1909	**www.irwinfinancial.com**
(Corporation s Telephone Number, Including Area Code)	(Web Site)

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.
[X] Yes [ ] No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act)

[X] Yes **[ ]** No

As of October 25, 2004, there were 28,350,990 outstanding common shares, no par value, of the Registrant.

Table of Contents

FORM 10-Q
TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION.

Item 1. Financial Statements.

IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (Unaudited)

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Assets:		
Cash and cash equivalents	$ 213,458	$ 140,810
Interest-bearing deposits with financial institutions	58,450	81,166
Residual interests	70,968	71,491
Investment securities- held-to-maturity (Market value: $30,175 at September 30, 2004 and $24,971 at December 31, 2003)	30,152	24,956
Investment securities- available-for-sale	77,516	67,569
Loans held for sale	971,357	883,895
Loans and leases, net of unearned income Note 2	3,401,643	3,161,054
Less: Allowance for loan and lease losses Note 3	(47,796)	(64,285)
	3,353,847	3,096,769
Servicing assets Note 4	389,171	380,123
Accounts receivable	84,018	62,045
Accrued interest receivable	16,208	15,502
Premises and equipment, net	31,444	32,208
Other assets	118,982	131,825
Total assets	$5,415,571	$4,988,359
Liabilities and Shareholders Equity:		
Deposits		
Noninterest-bearing	$ 981,327	$ 850,529
Interest-bearing	1,777,900	1,352,763
Certificates of deposit over $100,000	727,230	696,370
	3,486,457	2,899,662
Short-term borrowings Note 5	132,691	429,758
Collateralized debt Note 6	667,797	590,131
Other long-term debt Note 7	270,175	270,184
Other liabilities	372,104	366,364

Total liabilities	4,929,224	4,556,099
Commitments and contingencies Note 11		
Shareholders equity		
Preferred stock, no par value authorized 4,000,000 shares; none issued		
Common stock, no par value authorized 40,000,000 shares; issued 29,612,080 shares as of September 30, 2004 and December 31, 2003, respectively; including 1,277,059 and 1,477,778, shares in treasury as of September 30, 2004 and December 31, 2003, respectively	112,000	112,000
Additional paid-in capital	557	1,264
Deferred compensation	(516)	(504)
Accumulated other comprehensive loss, net of deferred income tax expense of $540 and $120 as of September 30, 2004, and December 31, 2003, respectively	810	182
Retained earnings	401,338	352,647
	514,189	465,589
Less treasury stock, at cost	(27,842)	(33,329)
Total shareholders equity	486,347	432,260
Total liabilities and shareholders equity	$5,415,571	$4,988,359

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Three Months Ended September 30,	
	2004	**2003**
	(Dollars in thousands, except per share)	
Interest income:		
Loans and leases	$ 62,088	$ 59,626
Loans held for sale	23,112	33,978
Residual interests	3,350	4,131
Investment securities	1,371	1,125
Federal funds sold	44	20
Total interest income	89,965	98,880
Interest expense:		
Deposits	11,984	9,873
Short-term borrowings	2,796	3,383
Collateralized debt	3,782	4,045
Other long-term debt - Note 7	5,743	419
Preferred securities distribution - Note 7		5,527
Total interest expense	24,305	23,247
Net interest income	65,660	75,633
Provision for loan and lease losses	1,898	14,778
Net interest income after provision for loan and lease losses	63,762	60,855
Other income:		
Loan servicing fees	34,423	28,523
Amortization of servicing assets - Note 4	(28,070)	(34,064)
(Impairment) recovery of servicing assets - Note 4	(18,358)	41,665
Net loan administration (loss) income	(12,005)	36,124
Gain from sales of loans	48,626	91,569
Gain on sale of mortgage servicing assets	440	7
Trading gains (losses)	4,326	(1,403)
Derivative gains (losses), net	21,045	(28,046)

Other	5,503	6,412
	67,935	104,663
Other expense:		
Salaries	53,986	62,220
Pension and other employee benefits	12,127	9,573
Office expense	3,271	5,330
Premises and equipment	10,096	9,533
Marketing and development	3,103	3,400
Professional fees	5,132	2,980
Other	14,777	21,370
	102,492	114,406
Income before income taxes	29,205	51,112
Provision for income taxes	12,011	19,994
Net income	$ 17,194	$ 31,118
Earnings per share: - Note 9		
Basic	$ 0.61	$ 1.11
Diluted	$ 0.57	$ 1.03
Dividends per share	$ 0.08	$ 0.07

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Nine Months Ended September 30,	
	2004	**2003**
	(Dollars in thousands, except per share)	
Interest income:		
Loans and leases	$ 181,759	$ 179,460
Loans held for sale	59,397	86,800
Residual interests	9,893	17,100
Investment securities	3,733	3,134
Federal funds sold	82	119
Total interest income	254,864	286,613
Interest expense:		
Deposits	31,532	32,679
Short-term borrowings	6,611	12,053
Collateralized debt	10,501	11,569
Other long-term debt Note 7	17,101	1,745
Preferred securities distribution Note 7		16,581
Total interest expense	65,745	74,627
Net interest income	189,119	211,986
Provision for loan and lease losses	11,838	37,655
Net interest income after provision for loan and lease losses	177,281	174,331
Other income:		
Loan servicing fees	100,620	75,231
Amortization of servicing assets Note 4	(89,413)	(102,112)
Recovery (impairment) of servicing assets Note 4	6,210	(1,966)
Net loan administration income (loss)	17,417	(28,847)
Gain from sales of loans	140,669	311,081
Gain on sale of mortgage servicing assets	8,857	7
Trading gains (losses)	15,668	(52,323)
Derivative gains (losses), net	25,869	(15,904)

Other	17,917	16,982
	226,397	230,996
Other expense:		
Salaries	158,602	176,851
Pension and other employee benefits	34,813	31,431
Office expense	12,950	16,200
Premises and equipment	30,890	28,751
Marketing and development	10,670	11,157
Professional fees	14,436	8,664
Other	48,325	40,646
	310,686	313,700
Income before income taxes	92,992	91,627
Provision for income taxes	37,513	35,505
Net income	$ 55,479	$ 56,122
Earnings per share: Note 9		
Basic	$ 1.96	$ 2.01
Diluted	$ 1.84	$ 1.89
Dividends per share	$ 0.24	$ 0.21

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)
Three Months Ended September 30, 2004, and 2003

	Total	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Deferred Compensation	Additional Paid in Capital	Common Stock	Treasury Stock
	(Dollars in thousands)						
Balance at July 1, 2004	$469,486	$386,410	$ 71	$ (538)	$ 579	$112,000	$(29,036)
Net income	17,194	17,194					
Unrealized gain on investment securities net of $142 tax liability	212		212				
Foreign currency adjustment net of $352 tax liability	527		527				
Total comprehensive income	17,933						
Deferred compensation	22			22			
Cash dividends	(2,266)	(2,266)					
Tax benefit on stock option exercises	100				100		
Treasury stock:							
Purchase of 867 shares	(23)						(23)
Sales of 52,342 shares	1,095				(122)		1,217
Balance September 30, 2004	$486,347	$401,338	$ 810	$ (516)	$ 557	$112,000	$(27,842)
Balance at July 1, 2003	$384,835	$308,760	$ (58)	$ (489)	$2,422	$112,000	$(37,800)
Net income	31,118	31,118					
Unrealized loss on investment securities net of $57 tax benefit	(84)		(84)				
Unrealized loss on interest rate cap net of $17 tax liability	26		26				
Foreign currency adjustment net of $16 tax benefit	(24)		(24)				

Total comprehensive income	31,036						
Deferred compensation	68			68			
Cash dividends	(1,959)	(1,959)					
Tax benefit on stock option exercises	22				22		
Treasury stock:							
Purchase of 1,321 shares	(33)						(33)
Sales of 24,766 shares	485				(31)		516
Balance September 30, 2003	$414,454	$337,919	$ (140)	$ (421)	$2,413	$112,000	$(37,317)

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)
Nine Months Ended September 30, 2004, and 2003

	Total	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Deferred Compensation	Additional Paid in Capital	Common Stock	Treasury Stock
	(Dollars in thousands)						
Balance at January 1, 2004	$432,260	$352,647	$ 182	$ (504)	$ 1,264	$112,000	$(33,329)
Net income	55,479	55,479					
Unrealized gain on investment securities net of $93 tax liability	139		139				
Unrealized gain on interest rate cap net of $131 tax liability	196		196				
Foreign currency adjustment net of $195 tax liability	293		293				
Total comprehensive income	56,107						
Deferred compensation	(12)			(12)			
Cash dividends	(6,788)	(6,788)					
Tax benefit on stock option exercises	778				778		
Treasury stock:							
Purchase of 11,307 shares	(370)						(370)
Sales of 212,026 shares	4,372				(1,485)		5,857
Balance at September 30, 2004	$486,347	$401,338	$ 810	$ (516)	$ 557	$112,000	$(27,842)
Balance at January 1, 2003	$360,555	$287,662	$ (1,142)	$ (240)	$ 3,606	$112,000	$(41,331)
Net income	56,122	56,122					
Unrealized loss on investment securities net of $45 tax benefit	(72)		(72)				
Unrealized loss on	(47)		(47)				

interest rate cap net of $31 tax benefit							
Foreign currency adjustment net of $576 tax liability	865		865				
Minimum SERP liability net of $170 tax liability	256		256				
Total comprehensive income	57,124						
Deferred compensation	(181)			(181)			
Cash dividends	(5,865)	(5,865)					
Conversion of 1,700 trust preferred shares to 2,142 common shares	43				(1)		44
Tax benefit on stock option exercises	1,031				1,031		
Treasury stock:							
Purchase of 122,464 shares	(2,822)						(2,822)
Sales of 330,666 shares	4,569				(2,223)		6,792
Balance at September 30, 2003	$414,454	$337,919	$ (140)	$ (421)	$ 2,413	$112,000	$(37,317)

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

IRWIN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
	(Dollars in thousands)	
Net income	$ 55,479	$ 56,122
Adjustments to reconcile net income to cash provided (used) by operating activities:		
Depreciation, amortization, and accretion, net	6,056	8,747
Amortization and impairment of servicing assets	83,203	104,078
Provision for loan and lease losses	11,838	37,655
Gain on sale of mortgage servicing assets	(8,857)	(7)
Gain from sales of loans held for sale	(140,669)	(311,081)
Originations and purchases of loans held for sale	(10,934,035)	(21,131,799)
Proceeds from sales and repayments of loans held for sale	10,873,116	21,590,397
Proceeds from sale of mortgage servicing assets	29,494	
Net decrease in residuals	523	78,368
Net (increase) decrease in accounts receivable	(21,973)	16,554
Other, net	15,567	12,694
Net cash (used) provided by operating activities	(30,258)	461,728
Lending and investing activities:		
Proceeds from maturities/calls of investment securities:		
Held-to-maturity	92,987	495
Available-for-sale	1,399	38,682
Purchase of investment securities:		
Held-to-maturity	(98,395)	(99)
Available-for-sale	(10,958)	(83,253)
Net decrease (increase) in interest-bearing deposits with financial institutions	22,716	(27,777)
Net increase in loans, excluding sales	(303,958)	(379,606)
Proceeds from sale of loans	36,279	33,182
Other, net	(4,857)	(6,125)
Net cash used by lending and investing activities	(264,787)	(424,501)
Financing activities:		
Net increase in deposits	586,795	324,931
Net decrease in short-term borrowings	(297,067)	(550,724)
Repayments of long-term debt	(9)	(8)

Proceeds from issuance of collateralized borrowings		449,223	373,658
Repayments of collateralized borrowings		(369,277)	(176,352)
Purchase of treasury stock for employee benefit plans		(370)	(2,822)
Proceeds from sale of stock for employee benefit plans		5,150	5,600
Dividends paid		(6,788)	(5,865)
Net cash provided (used) by financing activities		367,657	(31,582)
Effect of exchange rate changes on cash		36	(144)
Net decrease in cash and cash equivalents		72,648	5,501
Cash and cash equivalents at beginning of period		140,810	157,771
Cash and cash equivalents at end of period		$ 213,458	$ 163,272
Supplemental disclosures of cash flow information:			
Cash flow during the period:			
Interest paid		$ 65,765	$ 78,052
Income taxes (refund) paid		$ (4,998)	$ 42,928
Noncash transactions:			
Liability for loans held for sale eligible for repurchase	Note 1	$ 67,658	$ 111,390
Conversion of trust preferred stock to common stock		$	$ 43

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Summary of Significant Accounting Policies

Consolidation: Irwin Financial Corporation and its subsidiaries (the Corporation) provide financial services throughout the United States and Canada. We are engaged in the mortgage banking, commercial banking, home equity lending, commercial finance, and venture capital lines of business. Our direct and indirect subsidiaries include Irwin Mortgage Corporation, Irwin Union Bank and Trust Company, Irwin Union Bank, F.S.B., Irwin Home Equity Corporation, Irwin Commercial Finance Corporation and Irwin Ventures, LLC. Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the financial statements reflect all material adjustments necessary for a fair presentation. The Corporation does not meet the criteria as primary beneficiary for our wholly-owned trusts holding our company-obligated mandatorily redeemable preferred securities established by Financial Accounting Standards Board (FASB) Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. As a result, these trusts are not consolidated.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Residual Interests: Residual interests are stated at fair value. Unrealized gains and losses are included in earnings. Until the first quarter of 2002, whenever we sold receivables in securitizations of home equity loans and lines of credit, we sold assets and retained residual interests, one or more subordinated tranches, and in some cases a cash reserve account, all of which are retained interests in the securitized receivables in a manner that qualified for gain-on-sale under Statement of Financial Accounting Standard (SFAS) 140. Gain or loss on the sale of the loans depended, in part, on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer.

To obtain fair value of residual interests, quoted market prices are used if available. However, quotes are generally not available for residual interests, so we generally estimate fair value based on the present value of expected cash flows using estimates of the key assumptions prepayment speeds, credit losses, forward yield curves, and discount rates commensurate with the risks involved that management believes market participants would use to value similar assets. Adjustments to carrying values are recorded as trading gains or losses.

Cash and Cash Equivalents Defined: For purposes of the statement of cash flows, we consider cash and due from banks and federal funds sold to be cash equivalents.

Loans Held for Sale: Included in loans held for sale at the mortgage line of business were loans for which we have the right, but not the obligation, to repurchase due to default, under the terms of the government servicing agency contracts. Upon default, we have the non-contingent right to repurchase these loans which causes repurchase accounting under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. The liability associated with these loans is reflected in other liabilities on our Consolidated Balance Sheet.

Stock-Based Employee Compensation: We have two stock-based employee compensation plans. We use the intrinsic value method to account for our plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost is reflected in net income for any of the periods presented, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. To date, the

Board of Directors has not chosen to expense stock options. The Board wishes to analyze new guidance from the FASB, Securities and Exchange Commission (SEC) and other relevant authorities regarding the standardization of valuation methods. Accordingly, we plan to begin expensing options when the new requirements become effective or earlier should the Board of Directors determine it to be in the best interests of our stakeholders. We will continue to disclose the impact of expensing stock options, using our valuation method, which is based on a Black-Scholes model using assumptions management believes to be reasonable. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standard (SFAS) 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

Table of Contents

	Three Months Ended September 30,		Nine months ended September 30,	
	2004	**2003**	**2004**	**2003**
	(Dollars in thousands)			
Net income as reported	$17,194	$31,118	$55,479	$56,122
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(670)	(699)	(1,969)	(2,187)
Pro forma net income	$16,524	$30,419	$53,510	$53,935
Basic earnings per share				
As reported	$ 0.61	$ 1.11	$ 1.96	$ 2.01
Pro forma	$ 0.58	$ 1.09	$ 1.89	$ 1.93
Diluted earnings per share				
As reported	$ 0.57	$ 1.03	$ 1.84	$ 1.89
Pro forma	$ 0.55	$ 1.01	$ 1.78	$ 1.82

Recent Accounting Developments: We adopted FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities as of December 31, 2003 and as a result, deconsolidated IFC Capital Trust II, IFC Capital Trust III, IFC Capital Trust IV, IFC Capital Trust V, IFC Capital Trust VI, and IFC Statutory Trust VII (IFC Trusts). The sole assets of the IFC Trusts are subordinated debentures of Irwin Financial Corporation. The IFC Trusts liabilities are represented by Trust Preferred Securities, which have previously been listed as Company-obligated mandatorily redeemable preferred securities of subsidiary trusts on our consolidated balance sheets. Under FIN 46, the subordinated debentures, which are substantially equal in amount to the Trust Preferred Securities, cease to be eliminated in consolidation and are included in other long-term debt in our consolidated balance sheets at December 31, 2003 and September 30, 2004. Details about the IFC Trusts and debentures can be found in Note 7, Other Long-Term Debt. The Trust Preferred Securities currently qualify as Tier 1 regulatory capital. In May 2004, the Federal Reserve Bank issued proposed rules that retain Tier 1 capital treatment of Trust Preferred Securities for bank holding companies.

Reclassifications: Certain amounts in the 2003 consolidated financial statements have been reclassified to conform to the 2004 presentation. These changes had no impact on previously reported net income or shareholders equity.

Table of Contents

Note 2 Loans and Leases

Loans and leases are summarized as follows:

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Commercial, financial and agricultural	$1,614,983	$1,503,619
Real estate-construction	325,330	306,669
Real estate-mortgage	870,374	859,541
Consumer	30,979	27,370
Direct financing leases		
Domestic	447,737	364,413
Canadian	242,572	207,355
Unearned income		
Domestic	(98,347)	(78,875)
Canadian	(31,985)	(29,038)
Total loans and leases, net of unearned income	$3,401,643	$3,161,054

Note 3 Allowance for Loan and Lease Losses

Changes in the allowance for loan and lease losses are summarized below:

	As of and For the Nine Months Ended September 30, 2004	As of and For the Year Ended December 31, 2003
	(Dollars in thousands)	
Balance at beginning of period	$ 64,285	$ 50,936
Provision for loan and lease losses	11,838	47,583
Charge-offs	(21,040)	(37,312)
Recoveries	3,951	3,420
Reduction due to reclassification of loans to loans held for sale	(10,808)	(690)
Other	(430)	348
Balance at end of period	$ 47,796	$ 64,285

The 2004 provision and allowance for loan and lease losses reflects transactions related to the transfer and sale or pending sale of portfolio loans associated with two portfolio sales at our home equity lending line of business. We transferred $355 million in loans to loans held for sale when the decisions were made to sell these portfolio loans. These loans had an associated allowance of $20.6 million. The loans were transferred with an allowance of $10.8 million to reduce their carrying value to fair market value. After the transfers, the remaining $9.8 million of excess allowance was reversed through the provision for loan and lease losses.

Table of Contents

Note 4 Servicing Assets

Included on the consolidated balance sheet at September 30, 2004 and December 31, 2003 are $389.2 million and $380.1 million, respectively, of capitalized servicing assets. These amounts relate to the mortgage and home equity loans serviced by us for investors. Changes in our capitalized servicing assets, net of valuation allowance, are shown below:

	As of and For the Nine Months Ended September 30, 2004	As of and For the Year Ended December 31, 2003
	(Dollars in thousands)	
Beginning balance	$380,123	$ 174,935
Additions	112,890	296,551
Amortization	(89,413)	(135,519)
Recovery of impairment	6,210	44,516
Reduction for servicing sales	(20,639)	(360)
	$389,171	$ 380,123

We have established a valuation allowance to record servicing assets at their fair market value. Changes in the allowance are summarized below:

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Balance at beginning of year	$ 76,869	$159,865
Recovery of impairment	(6,210)	(44,516)
Reclass for sales of servicing	(18,204)	
Other than temporary impairment [1]	(6,999)	(38,480)
Balance at end of year	$ 45,456	$ 76,869

[1] Other than temporary impairment was recorded to reflect our view that the originally recorded value of certain servicing rights and subsequent impairment associated with those rights is unlikely to be recovered in market value. There was no related direct impact on net income as this other than temporary impairment affected only balance sheet

accounts. However, the write-down will result in a reduction of amortization expense and potentially reduced recovery of impairment in future periods.

Note 5 Short-Term Borrowings

Short-term borrowings are summarized as follows:

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Federal Home Loan Bank borrowings	$ 1,348	$286,000
Drafts payable related to mortgage loan closings	79,446	72,686
Lines of credit and other	51,897	1,057
Federal funds		53,600
Commercial paper		16,415
Total	$132,691	$429,758
Weighted average interest rate	1.25%	1.61%

12

Federal Home Loan Bank borrowings are collateralized by loans and loans held for sale.

Drafts payable related to mortgage loan closings are related to mortgage closings that have not been presented to the banks for payment. When presented for payment, these borrowings will be funded internally or by borrowing from the lines of credit.

We have lines of credit available to fund loan originations and operations with variable rates ranging from 1.6% to 3.0% at September 30, 2004.

Note 6 Collateralized Debt

We pledge or sell loans structured as secured financings at our home equity and commercial finance lines of business. Sale treatment is precluded on these transactions because we fail the true-sale requirements of SFAS 140 as we maintain effective control over the loans and leases securitized. This type of structure results in cash being received (and subsequently used by us to pay-down short-term fundings), debt being recorded, and the establishment of an allowance for credit losses. The notes associated with these transactions are collateralized by $0.7 billion in home equity loans, home equity lines of credit, and leases. The principal and interest on these debt securities are paid using the cash flows from the underlying loans and leases. Accordingly, the timing of the principal payments on these debt securities is dependent on the payments received on the underlying collateral. The interest rates on the bonds are at a floating rate. We have an interest only senior note on the securitization at the home equity lending line of business that as of September 30, 2004 had a notional balance of $30.5 million (which does not represent the amount at risk), pays interest at 10%, and matures on September 25, 2005. The 2002-1 asset backed structure was sold during the second quarter resulting in the recognition of a $2.5 million gain and the removal of $205 million of loans and associated collateralized debt from our balance sheet. The 2003-1 structure will be sold in October. The $150 million of loans in the 2003-1 structure were transferred from loans to loans held for sale as of September 30, resulting in a reversal of $3.5 million in loan loss provision.

Collateralized debt is summarized as follows:

	Maturity	Weighted Average Interest Rate at September 30, 2004	September 30, 2004	December 31, 2003
	(Dollars in thousands)			
Commercial finance line of business				
2003 domestic asset backed note	7/2010	2.70	$ 33,969	$ 51,694
2003 Canadian asset backed note	11/2008	4.07	103,107	77,902
Home equity line of business				
2004-1 asset backed notes:				
Combined variable rate senior note	12/2024-12/2034	1.89	365,196	

Combined variable rate subordinate note	12/2034	2.74	24,775	
2003-1 asset backed notes:				
Combined variable rate senior note	2/2028	2.15	69,099	160,874
Combined variable rate subordinate note	2/2028	3.92	68,625	61,763
Unamortized premium/discount			3,026	4,446
2002-1 asset backed notes:				
Combined variable rate senior note				156,699
Combined variable rate subordinate note				72,551
Unamortized premium/discount				4,202
Total			$667,797	$590,131

Note 7 -Other Long-Term Debt

At September 30, 2004 and December 31, 2003 we had $270 million of other long-term debt. Included in both years is $30 million of subordinated debt with an interest rate of 7.58% and a maturity date of July 2014.

13

Table of Contents

We also have obligations represented by subordinated debentures at September 30, 2004 of $240 million. These securities were issued by wholly-owned trusts of Irwin Financial Corporation that were created for the purpose of issuing cumulative trust preferred securities. In accordance with FIN 46 we are no longer consolidating these trusts. Refer to Note 1 for information regarding the accounting change for these securities implemented in 2003. These debentures are the sole assets of these trusts as of September 30, 2004. All debentures and securities are callable at par after five years from origination date although at this time we have no plans to call. The securities are all Tier 1 qualifying capital at September 30, 2004. Highlights about these debentures and the related trusts are listed below:

Name	Origination Date	Interest Rate at September 30, 2004	Maturity Date	Subordinated Debt September 30, 2004	Subordinated Debt December 31, 2003	Other
				(Dollars in thousands)		
IFC Capital Trust II	Nov 2000	10.50%	Sep 2030	$ 53,351	$ 53,351	
IFC Capital Trust III	Nov 2000	8.75	Sep 2030	53,268	53,268	initial conversion ratio of 1.261 shares of common stock to 1 convertible preferred security, currently callable at 10% premium
IFC Capital Trust IV	Jul 2001	10.25	Jul 2031	15,464	15,464	
IFC Capital Trust V	Nov 2001	9.95	Nov 2031	30,928	30,928	
IFC Capital Trust VI	Oct 2002	8.70	Sep 2032	35,567	35,567	
IFC Statutory Trust VII	Nov 2003	4.88	Nov 2033	51,547	51,547	rate changes quarterly at three month LIBOR plus 290 basis points
				$240,125	$240,125	

Table of Contents

Note 8 Employee Retirement Plans

Components of net periodic cost of pension benefit are as follows:

	Three Months Ended September 30,	
	2004	2003
	(Dollars in thousands)	
Service	$ 762	$ 396
Interest	479	413
Expected return on plan assets	(395)	(314)
Amortization of transition obligation	3	3
Amortization of prior service cost	10	10
Amortization of actuarial loss	204	193
Net periodic benefit cost	$ 1,063	$ 701

	Nine Months Ended September 30,	
	2004	2003
	(Dollars in thousands)	
Service	$ 1,750	$ 1,188
Interest	1,390	1,238
Expected return on plan assets	(1,204)	(939)
Amortization of transition obligation	8	8
Amortization of prior service cost	29	29
Amortization of actuarial loss	555	578
Net periodic benefit cost	$ 2,528	$ 2,102

As of September 30, 2004, we have not made any contributions to our pension plan in 2004. We anticipate making a cash contribution of approximately $3 million to this plan before year end.

Table of Contents

Note 9 Earnings Per Share

Earnings per share calculations are summarized as follows:

	Basic Earnings Per Share	Effect of Stock Options	Effect of Convertible Shares	Diluted Earnings Per Share
	(Dollars in thousands, except per share data)			
Three months ended September 30, 2004				
Net income available to common shareholders	$17,194	$	$ 678	$17,872
Shares	28,293	366	2,607	31,266
Per-Share amount	$ 0.61	$ (0.01)	$ (0.03)	$ 0.57
Three months ended September 30, 2003				
Net income available to common shareholders	$31,118	$	$ 679	$31,797
Shares	27,949	306	2,609	30,864
Per-Share amount	$ 1.11	$ (0.01)	$ (0.07)	$ 1.03
Nine Months ended September 30, 2004				
Net income available to common shareholders	$55,479	$	$2,035	$57,514
Shares	28,244	405	2,607	31,256
Per-Share amount	$ 1.96	$ (0.02)	$ (0.10)	$ 1.84
Nine Months ended September 30, 2003				
Net income available to common shareholders	$56,122	$	$2,037	$58,159
Shares	27,877	272	2,609	30,758
Per-Share amount	$ 2.01	$ (0.01)	$ (0.11)	$ 1.89

At September 30, 2004 and 2003, 94,044 and 705,482 shares, respectively, related to stock options were not included in the dilutive earnings per share calculation because they had exercise prices below the stock price as of the respective dates.

Note 10 Industry Segment Information

We have five principal segments that provide a broad range of financial services. The mortgage banking line of business originates, sells, and services residential first mortgage loans. The commercial banking line of business provides commercial banking services. The home equity lending line of business originates, sells and services home equity loans and lines of credit. The commercial finance line of business originates leases and loans against commercial equipment and real estate. The venture capital line of business invests in early-stage technology companies focusing on financial services. Our other segment primarily includes the parent company and eliminations.

The accounting policies of each segment are the same as those described in the Summary of Significant Accounting Policies. Below is a summary of each segment s revenues, net income, and assets for three months and nine months ended September 30, 2004, and 2003:

Table of Contents

	Mortgage Banking	Commercial Banking	Home Equity Lending	Commercial Finance	Venture Capital	Other	Consolidated
	(Dollars in thousands)						
Three Months Ended September 30, 2004							
Net interest income	$ 10,598	$23,133	$ 31,523	$ 7,058	$ 3	$(6,655)	$ 65,660
Intersegment interest	(396)	234	(5,156)		(6)	5,324	
Provision for loan and lease losses	67	(607)	232	(1,589)		(1)	(1,898)
Other revenue	49,659	3,672	16,291	1,366	(1)	(3,052)	67,935
Intersegment revenues	(6)	217			150	(361)	
Total net revenues	59,922	26,649	42,890	6,835	146	(4,745)	131,697
Other expense	52,026	17,039	28,332	4,741	99	255	102,492
Intersegment expenses	882	374	718	173		(2,147)	
Income (loss) before taxes	7,014	9,236	13,840	1,921	47	(2,853)	29,205
Income taxes	2,963	3,719	5,581	810	18	(1,080)	12,011
Net income (loss)	$ 4,051	$ 5,517	$ 8,259	$ 1,111	$ 29	$(1,773)	$ 17,194
Three Months Ended September 30, 2003							
Net interest income	$ 27,614	$21,011	$ 28,765	$ 5,822	$ (2)	$(7,577)	$ 75,633
Intersegment interest	(3,288)	(895)	(2,110)	(137)		6,430	
Provision for loan and lease losses	(191)	(1,500)	(10,728)	(2,388)		29	(14,778)
Other revenue	90,758	5,744	8,091	1,181	294	(1,405)	104,663
Intersegment revenues					150	(150)	
Total net revenues	114,893	24,360	24,018	4,478	442	(2,673)	165,518
Other expense	73,519	13,902	18,965	3,708	329	3,983	114,406
Intersegment expenses	691	414	691	121		(1,917)	
Income (loss) before taxes	40,683	10,044	4,362	649	113	(4,739)	51,112
Income taxes	15,648	4,071	1,745	603	48	(2,121)	19,994
Net income (loss)	$ 25,035	$ 5,973	$ 2,617	$ 46	$ 65	$(2,618)	$ 31,118

	Mortgage Banking	Commercial Banking	Home Equity Lending	Commercial Finance	Venture Capital	Other	Consolidated
	(Dollars in thousands)						
Nine months Ended September 30, 2004							
Net interest income	$ 31,593	$ 63,330	$ 88,807	$ 20,692	$ 9	$ (15,312)	$ 189,119
Intersegment interest	(947)	1,774	(11,586)		(15)	10,774	
Provision for loan and lease losses	457	(2,557)	(4,961)	(4,777)			(11,838)
Other revenue	163,374	13,299	48,781	4,437	(314)	(3,180)	226,397
Intersegment revenues	(8)	427			450	(869)	
Total net revenues	194,469	76,273	121,041	20,352	130	(8,587)	403,678
Other expense	159,464	47,015	79,127	13,658	345	11,077	310,686
Intersegment expenses	2,630	1,346	2,164	519		(6,659)	
Income (loss) before taxes	32,375	27,912	39,750	6,175	(215)	(13,005)	92,992
Income taxes	13,077	11,208	15,960	4,040	(83)	(6,689)	37,513
Net income (loss)	$ 19,298	$ 16,704	$ 23,790	$ 2,135	$ (132)	$ (6,316)	$ 55,479
Assets at September 30, 2004	$1,275,251	$2,611,473	$1,163,354	$569,419	$ 7,136	$(211,062)	$5,415,571
Nine months Ended September 30, 2003							
Net interest income	$ 69,285	$ 63,346	$ 86,967	$ 16,413	$ 7	$ (24,032)	$ 211,986
Intersegment interest	(7,991)	(4,764)	(5,678)	(523)		18,956	
Provision for loan and lease losses	(221)	(4,413)	(23,578)	(9,321)	(215)	93	(37,655)

Other revenue	260,566	16,517	(29,383)	4,678	(2,133)	(19,249)	230,996
Intersegment revenues					450	(450)	
Total net revenues	321,639	70,686	28,328	11,247	(1,891)	(24,682)	405,327
Other expense	209,224	40,982	61,730	10,811	440	(9,487)	313,700
Intersegment expenses	2,072	1,205	2,116	400		(5,793)	
Income (loss) before taxes	110,343	28,499	(35,518)	36	(2,331)	(9,402)	91,627
Income taxes	42,427	11,435	(14,207)	251	(932)	(3,469)	35,505
Net income (loss)	$ 67,916	$ 17,064	$ (21,311)	$ (215)	$(1,399)	$ (5,933)	$ 56,122
Assets at September 30, 2003	$1,443,531	$2,195,135	$ 989,479	$425,483	$ 7,803	$ (2,248)	$5,059,183

17

Note 11 Commitments and Contingencies

Culpepper v. Inland Mortgage Corporation

Our indirect subsidiary, Irwin Mortgage Corporation (formerly Inland Mortgage Corporation), is a defendant in a class action lawsuit in the United States District Court for the Northern District of Alabama, filed in April 1996, alleging that Irwin Mortgage violated the federal Real Estate Settlement Procedures Act (RESPA) relating to Irwin Mortgage s payment of broker fees to mortgage brokers. In June 2001, the Court of Appeals for the 11th Circuit upheld the district court s certification of a plaintiff class and the case was remanded for further proceedings in the federal district court.

In November 2001, by order of the district court, the parties filed supplemental briefs analyzing the impact of an October 18, 2001 policy statement issued by the Department of Housing and Urban Development (HUD) that explicitly disagreed with the judicial interpretation of RESPA by the Court of Appeals for the 11th Circuit in its ruling upholding class certification in this case. In response to a motion from Irwin Mortgage, in March 2002, the district court granted Irwin Mortgage s motion to stay proceedings in this case until the 11th Circuit decided the three other RESPA cases originally argued before it with this case.

The 11th Circuit subsequently decided all of the RESPA cases pending in that court. In one of those cases, the 11th Circuit concluded that the trial court had abused its discretion in certifying a class action under RESPA. Further, in that decision, the 11th Circuit expressly recognized it was, in effect, overruling its previous decision upholding class certification in our case. In March 2003, Irwin Mortgage filed a motion to decertify the class and the plaintiffs filed a renewed motion for summary judgment. On October 2, 2003 the case was reassigned to another U.S. district court judge. In response to an order from the court, the parties met and submitted a joint status report at the end of October 2003. On June 14, 2004, at the court s request, the parties engaged in mediation, which was unsuccessful. The court then reassigned this case to a new judge.

If the class is not decertified and the district court finds that Irwin Mortgage violated RESPA, Irwin Mortgage could be liable for damages equal to three times the amount of that portion of payments made to the mortgage brokers that is ruled unlawful. Based on notices sent by the plaintiffs to date to potential class members and additional notices that might be sent in this case, we believe the class is not likely to exceed 32,000 borrowers who meet the class specifications.

As discussed in prior periodic reports, other cases filed against our mortgage subsidiary alleging RESPA and violations similar to those in this case were settled in 2003 for nonmaterial amounts. Irwin Mortgage intends to defend this lawsuit vigorously and believes it has numerous defenses to the alleged violations. Irwin Mortgage further believes that the 11th Circuit s RESPA rulings in the cases argued before it with this one provide grounds for reversal of the class certification in this case. We have no assurance, however, that Irwin Mortgage will be successful in defeating class certification or will ultimately prevail on the merits. However, we expect that an adverse outcome in this case could result in substantial monetary damages that could be material to our financial position. We have not established any reserves for this case and are unable at this stage of the litigation to form a reasonable estimate of potential loss that we could suffer.

United States ex rel. Paranich v. Sorgnard et al.

In January 2001, we and Irwin Leasing Corporation (formerly Affiliated Capital Corp.), our indirect subsidiary, and Irwin Equipment Finance Corporation, our direct subsidiary (together, the Irwin companies), were served as defendants in an action filed in the United States District Court for the Middle District of Pennsylvania. The suit alleges that a manufacturer/importer of certain medical devices made misrepresentations to health care professionals and to government officials to improperly obtain Medicare reimbursement for treatments using the devices, and that the Irwin companies, through Affiliated Capital s financing activities, aided in making the alleged misrepresentations. On August 10, 2001, the court dismissed Irwin Financial and Irwin Equipment Finance as defendants in the suit. The Irwin companies prevailed on a motion for summary judgment in the district court on October 8, 2003, and the plaintiff appealed. The Court of Appeals for the Third Circuit heard oral argument on plaintiff s appeal on September 27, 2004. We cannot predict whether we will prevail on appeal and have not established any reserves for this case.

McIntosh v. Irwin Home Equity Corporation

Our subsidiary, Irwin Union Bank and Trust Company, is a defendant in a class action lawsuit filed in the United States District Court in Massachusetts in July 2001. The case involves loans purchased by Irwin Union Bank and Trust Company from an unaffiliated third-party originator. The plaintiffs allege a failure to comply with certain disclosure provisions of the Truth in Lending Act relating to high-rate loans in making second mortgage home equity loans to the plaintiff borrowers. The complaint seeks rescission of the loans and other damages.

A limited class was certified. As originally specified, the plaintiff class included those borrowers who obtained a mortgage loan originated by the third-party originator with prepayment penalty provisions during the three-year period prior to the filing of the suit. Subsequently, the court further restricted the class to those borrowers with high-rate loans subject to the Home Ownership and Equity Protection Act who refinanced their loans and paid a prepayment penalty. A preliminary analysis led us to conclude that fewer than 100 loans qualified for class membership.

In June 2004, the parties reached an agreement in principle to settle this matter for a nonmaterial amount, which has been reserved. The settlement is contingent upon the negotiation of a final settlement agreement and is subject to the approval of the district court.

Stamper v. A Home of Your Own

Our indirect subsidiary, Irwin Mortgage Corporation, is a defendant in a case filed in August 1998 in the Baltimore, Maryland, City Circuit Court. On January 25, 2002, a jury in this case awarded the plaintiffs damages of $1.434 million jointly and severally against defendants, including Irwin Mortgage. The nine plaintiff borrowers alleged that a home rehabilitation company defrauded the plaintiffs by selling them defective homes at inflated prices and that Irwin Mortgage, which provided the plaintiff borrowers mortgage loans on the home purchases, participated in the fraud. Irwin Mortgage filed an appeal with the Maryland Court of Special Appeals and oral argument was held on January 7, 2003. On February 27, 2004, the Court of Special Appeals ruled against Irwin Mortgage and remanded the case to the trial court for a partial retrial on whether the plaintiffs are entitled to punitive damages. The Maryland Court of Appeals agreed to hear Irwin Mortgage s appeal, and oral argument is scheduled for November 4, 2004. We have reserved for this case based upon the advice of our legal counsel.

Silke v. Irwin Mortgage Corporation

In April 2003, our indirect subsidiary, Irwin Mortgage Corporation, was named as a defendant in a class action lawsuit filed in the Marion County, Indiana, Superior Court. The complaint alleges that Irwin Mortgage charged a document preparation fee in violation of Indiana law for services performed by clerical personnel in completing legal documents related to mortgage loans. Irwin Mortgage filed an answer on June 11, 2003 and a motion for summary judgment on October 27, 2003. On June 18, 2004, the court certified a plaintiff class consisting of Indiana borrowers who were allegedly charged the fee by Irwin Mortgage any time after April 17, 1997. We are unable at this time to form a reasonable estimate of the amount of potential loss, if any, that Irwin Mortgage could suffer. We have not established any reserves for this case.

Gutierrez v. Irwin Mortgage

In April 2003, our indirect subsidiary, Irwin Mortgage Corporation, was named as a defendant in an action filed in the District Court of Nueces County, Texas. The complaint alleges that Irwin Mortgage improperly charged borrowers fees for the services of third-party vendors in excess of Irwin Mortgage s costs, and charged certain fees to which plaintiffs did not agree. The plaintiffs seek to certify a class consisting of similarly situated borrowers. In August 2004, the plaintiffs amended their complaint to remove the allegations that Irwin Mortgage charged excess fees. We are unable at this time to form a reasonable estimate of the amount of potential loss, if any, that Irwin Mortgage could suffer. We have not established any reserves for this case.

Cohens v. Inland Mortgage Corporation

In October 2003, our indirect subsidiary, Irwin Mortgage Corporation (formerly Inland Mortgage Corporation), was named as a defendant, along with others, in an action filed in the Supreme Court of New York, County of Kings. The plaintiffs, a mother and two children, allege they were injured from lead contamination while living in premises allegedly owned by the defendants. The suit seeks approximately $41 million in damages and alleges negligence, breach of implied warranty of habitability and fitness for intended use, loss of services and the cost of medical treatment. Because the case is in the early stages of litigation, we are unable at this time to form a reasonable estimate of the amount of potential loss, if any, that Irwin Mortgage could suffer. The parties agreed to delay the filing of an answer in this case until December 10, 2004. We are attempting to obtain a voluntary dismissal based on our belief that there is insufficient nexus between the cause of the alleged injuries and Irwin Mortgage. We have not established any reserves for this case.

Table of Contents

Litigation in Connection with Loans Purchased from Community Bank of Northern Virginia

Our subsidiary, Irwin Union Bank and Trust Company, is a defendant in *Hobson v. Irwin Union Bank and Trust Company,* an action filed on July 30, 2004 in the United States District Court for the Northern District of Alabama in connection with loans Irwin Union Bank purchased from Community Bank of Northern Virginia (Community). As amended on August 30, 2004, the complaint, seeks certification of both a plaintiffs and a defendants class and alleges that defendants violated the Truth-in-Lending Act (TILA), the Home Ownership and Equity Protection Act (HOEPA), the Residential Settlement Procedures Act (RESPA) and the Racketeer Influenced and Corrupt Organizations Act (RICO).

The plaintiffs claim that Community was allegedly engaged in a lending arrangement involving the use of its charter by certain third parties who charged high fees that were not representative of the services rendered and not properly disclosed as to the amount or recipient of the fees. The loans in question are allegedly high cost/high interest loans under Section 32 of HOEPA. Plaintiffs allege that Irwin was aware of Community s alleged arrangement when Irwin purchased the loans. Plaintiffs also allege illegal kickbacks and fee splitting and Irwin s participation in a RICO enterprise and conspiracy related to the loans. Because Irwin bought the loans from Community, the plaintiffs are alleging that Irwin has assignee liability under HOEPA.

The putative plaintiff class in *Hobson* excludes borrower plaintiffs who are members of a class certified in another case a class action in Pennsylvania federal court that is a consolidation of cases filed against Community, Residential Funding Corporation (a subsidiary of GMAC), and Guaranty National Bank of Tallahassee, with allegations similar to those in *Hobson*.

If the *Hobson* plaintiffs are successful in establishing a class and prevailing at trial, possible damages could include TILA remedies, such as rescission, actual damages, statutory damages not to exceed the lesser of $500,000 or 1% of the net worth of the creditor, and attorneys fees and costs. Possible HOEPA remedies include the refunding of all closing costs, finance charges and fees paid by the borrower. RESPA remedies could include treble damages for each service for which there was an unearned fee, kickback or overvalued service. RICO remedies could include treble plaintiffs actually proved damages. Under TILA, HOEPA, RESPA and RICO, statutory remedies include recovery of attorneys fees and costs. In addition, plaintiffs are seeking unspecified punitive damages. Under the loan purchase agreement between Irwin and Community, Irwin has the right to demand repurchase of the mortgage loans and indemnification from Community for these claims. On October 12, 2004, we filed a motion to dismiss the claims as untimely filed and substantively defective.

Irwin Union Bank and Trust Company is also a defendant, along with Community, in two individual actions filed on June 9, 2004 in the Circuit Court of Frederick County, Maryland, involving mortgage loans Irwin Union Bank purchased from Community. On July 16, 2004, both of these suits were removed to the United States District Court for the District of Maryland. The complaints allege that the plaintiffs did not receive disclosures required under HOEPA and TILA. The lawsuits also allege violations of Maryland law because the plaintiffs were allegedly charged or contracted for a prepayment penalty fee. Irwin believes the plaintiffs received the required disclosures and that Community, a Virginia-chartered bank, was permitted to charge prepayment fees to Maryland borrowers. Under the loan purchase agreements between Irwin and Community, Irwin has the right to seek indemnification from Community for the claims in these lawsuits.

On September 17, 2004, Irwin made demand for indemnification and a defense as to all three lawsuits. Community denied this request as premature. We have established a reserve for the Community litigation based upon the advice of legal counsel.

Litigation Related to NorVergence, Inc.

Irwin Business Finance, our indirect subsidiary, is involved on a national basis in equipment leasing finance and maintains a diverse portfolio of leases, including leases in the telecommunications field. A portion of Irwin s telecommunications portfolio involves leases of equipment acquired from NorVergence, Inc., a New Jersey-based telecommunications company. After assigning leases to Irwin and other lenders, NorVergence filed for protection in the United States Bankruptcy Court and is currently in dissolution. The sudden failure of NorVergence left many of its customers without telecommunications services and angry with representations they claim were made by NorVergence that remain unfulfilled.

Complaints by former NorVergence customers have led to investigations by the Attorneys General of several states and the filing of a number of lawsuits. Irwin Business Finance has been named as a defendant in several lawsuits connected with NorVergence. *Exquisite Caterers, LLC et al. v. Popular Leasing et al.* is a lawsuit filed in the Superior Court of New Jersey, Monmouth County, and was amended to include Irwin Business Finance and others on September 1, 2004. The *Exquisite Caterers* plaintiffs seek certification of a class of persons who leased network computer equipment from NorVergence, whose leases were assigned to defendants. The complaint alleges that NorVergence misrepresented the services and equipment provided, that the lessees were defrauded and the lease

Table of Contents

agreements should not be enforced. The action alleges violations of, among other things, the New Jersey Consumer Fraud Act; the New Jersey Truth-in-Consumer Contract, Warranty, and Notice Act; the FTC Holder Rule; the FTC Act; and breach of contract and implied warranties. The plaintiffs seek compensatory, statutory and punitive damages, and injunctive relief, including rescission of the leases and cessation of collections.

Irwin Business Finance is also a defendant, along with other lenders, in *Delanco Board of Education et al. v. IFC Credit Corporation,* a lawsuit filed in the Superior Court of New Jersey, Essex County, Chancery Division, in October 2004 in connection with leases assigned to the lenders by NorVergence. (IFC Credit Corporation is not affiliated with Irwin Financial Corporation or Irwin Business Finance.) The suit involves more than one thousand plaintiffs and alleges fraud, misrepresentation and violations of the New Jersey Consumer Fraud law based on alleged conduct similar to that in *Exquisite Caterers,* with the addition of a count under the New Jersey RICO statute. Plaintiffs also allege unjust enrichment and conversion and seek rescission of the leases plus punitive and other damages.

Irwin Business Finance was also named as a defendant, along with other lenders, in *Sterling Asset & Equity Corp. et al. v. Preferred Capital, Inc. et al.*, an action filed in the United States District Court for the Southern District of Florida in October 2004, seeking class certification on behalf of Florida persons or entities who leased equipment from NorVergence and whose agreement was assigned to one of the named lenders. The plaintiffs allege that NorVergence engaged in false, misleading and deceptive sales and billing practices. The complaint alleges violations of the FTC Holder Rule and the Florida Deceptive and Unfair Trade Practices Act, and breach of contract and warranties. Plaintiffs seek, among other relief, compensatory and punitive damages, injunctive and/or declaratory relief prohibiting enforcement of the leases, rescission, return of payments, interest, attorneys fees and costs.

In addition, Irwin Business Finance has been named in several individual lawsuits involving equipment and services leased from NorVergence, where the lease was assigned to Irwin Business Finance. The suits allege fraud and nonfunctional equipment and services. The plaintiffs request rescission, restitution and/or reformation of the leases and/or a declaration of unenforceability. These suits were filed in the following jurisdictions: two actions in the District Court of Dallas County, Texas (July 2004 and October 2004); one action in the Superior Court of California, County of San Diego (August 2004); and one in the Superior Court of Massachusetts (September 2004).

In connection with investigations by various state Attorneys General, Irwin Business Finance and other lenders were asked to produce information about their relationships with NorVergence and to refrain from enforcing NorVergence leases. On October 21, 2004, the Attorney General of Florida filed a complaint against twelve lenders, including Irwin Business Finance, in the Circuit Court of the Second Judicial Circuit, Leon County, Florida *(State of Florida v. Commerce Commercial Leasing, LLC et al.)*. The complaint alleges that the agreements assigned by NorVergence to the lenders are unconscionable under the Florida Deceptive and Unfair Trade Practices Act. The suit seeks to prohibit collection activities by the lenders and asks for repayment of revenues, rescission of the agreements, restitution, recovery of actual damages, and civil money penalties.

We are unable to form a reasonable estimate of potential loss, if any, that Irwin Business Finance could suffer. We have established reserves we believe are appropriate in connection with credit risk on NorVergence-related leases, but have not established additional reserves in connection with NorVergence-related litigation.

We and our subsidiaries are from time to time engaged in various matters of litigation, including the matters described above, other assertions of improper or fraudulent loan practices or lending violations, and other matters, and we have a number of unresolved claims pending. In addition, as part of the ordinary course of business, we and our subsidiaries are parties to litigation involving claims to the ownership of funds in particular accounts, the collection of delinquent accounts, challenges to security interests in collateral, and foreclosure interests, that is incidental to our regular business activities. While the ultimate liability with respect to these other litigation matters and claims cannot be determined at this time, we believe that damages, if any, and other amounts relating to pending matters are not likely to be material to our consolidated financial position or results of operations, except as described above. Reserves are established for these various matters of litigation, when appropriate under SFAS 5, based in part upon the advice of legal counsel.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

About Forward-looking Statements

You should read the following discussion in conjunction with our consolidated financial statements, footnotes, and tables. This discussion and other sections of this report contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and are including this statement for purposes of invoking these safe harbor provisions.

Forward-looking statements are based on management s expectations, estimates, projections, and assumptions. These statements involve inherent risks and uncertainties that are difficult to predict and are not guarantees of future performance. In addition, our past results of operations do not necessarily indicate our future results. Words that convey our beliefs, views, expectations, assumptions, estimates, forecasts, outlook and projections or similar language, or that indicate events we believe could, would, should, may or will occur (or might not occur) or are likely (or unlikely) to occur, and similar expressions, are intended to identify forward-looking statements. These may include, among other things, statements and assumptions about:

- our projected revenues, earnings or earnings per share, as well as management s short-term and long-term performance goals;
- projected trends or potential changes in our asset quality, loan delinquencies, asset valuations, capital ratios or financial performance measures;
- our plans and strategies, including the expected results or impact of implementing such plans and strategies;
- potential litigation developments and the anticipated impact of potential outcomes of pending legal matters;
- the anticipated effects on results of operations or financial condition from recent developments or events; and
- any other projections or expressions that are not historical facts.

Actual future results may differ materially from what is projected due to a variety of factors, including, but not limited to:

- potential changes in and volatility of interest rates, which may affect consumer demand for our products and the management and success of our interest rate risk management strategies;
- staffing and operating cost fluctuations in response to product demand;
- the valuation and management of our servicing and derivative portfolios, including short-term swings in valuation of such portfolios due to quarter-end secondary market interest rates and basis risk, which are inherently volatile;
- borrowers refinancing opportunities, which may affect the prepayment assumptions used in our valuation estimates and which may affect loan demand;
- unanticipated deterioration in the credit quality of our assets;

- unanticipated deterioration in the carrying value of our other assets, including securities;
- difficulties in delivering products to the secondary market as planned;
- difficulties in expanding our businesses and obtaining funding as needed;
- competition from other financial service providers for experienced managers as well as for customers;
- changes in the value of companies in which we invest;
- changes in variable compensation plans related to the performance and valuation of lines of business where we tie compensation systems to line-of-business performance;
- unanticipated outcomes in litigation;
- legislative or regulatory changes, including changes in tax laws or regulations, changes in the interpretation of regulatory capital rules, changes in consumer or commercial lending rules or rules affecting corporate governance, and the availability of resources to address these rules;
- changes in applicable accounting policies or principles or their application to our business; and
- governmental changes in monetary or fiscal policies.

We undertake no obligation to update publicly any of these statements in light of future events, except as required in subsequent periodic reports we file with the Securities and Exchange Commission.

Table of Contents

Consolidated Overview

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income (millions)	$ 17.2	$ 31.1	$ 55.5	$ 56.1
Basic earnings per share	0.61	1.11	1.96	2.01
Diluted earnings per share	0.57	1.03	1.84	1.89
Return on average equity	14.1%	30.4%	15.9%	19.6%
Return on average assets	1.2	2.2	1.4	1.4

We recorded net income of $17.2 million for the three months ended September 30, 2004, down 45% from net income of $31.1 million for the three months ended September 30, 2003. Net income per share (diluted) was $0.57 for the quarter ended September 30, 2004, down 45% from $1.03 per share for the third quarter of 2003. Return on equity was 14.1% for the three months ended September 30, 2004 and 30.4% for the same period in 2003.

For the year to date, we recorded net income of $55.5 million or $1.84 per diluted share. This represents decreases of 1% and 3%, respectively, compared to the same period in 2003. Return on equity for the nine-month period ended September 30, 2004 was 15.9% compared with 19.6% during the same period a year earlier.

Consolidated Income Statement Analysis

Net Interest Income

Net interest income for the nine months ended September 30, 2004 totaled $189.1 million, down 11% from the 2003 net interest income of $212.0 million for the same period. Year to date net interest margin as of September 30, 2004 was 5.55% compared to 5.99% for the same period in 2003. The decline in margin from 2003 to 2004 was primarily due to the lower interest rate environment in 2004 relative to 2003 that caused yields on variable rate loans to decline at a more rapid pace than underlying funding sources, some of which (e.g., mortgage escrow deposits) have rates close to zero in any interest rate environment and, therefore, cannot reduce in a declining rate environment. In addition, the average balance on our high-yielding residual interests declined 39% in the first nine months of 2004 compared to the same period in 2003 as a result of unrealized trading losses (reflecting valuation impairment). The following table shows our daily average consolidated balance sheet, interest rates and yield at the dates indicated:

Table of Contents

	Nine Months Ended September 30,					
	2004			2003		
	Average Balance	Interest	Annualized Yield/Rate	Average Balance	Interest	Annualized Yield/Rate
	(Dollars in thousands)					
Assets:						
Interest-earning assets:						
Interest bearing deposits with banks	$ 88,208	$ 477	0.72%	$ 70,927	$ 400	0.75%
Federal funds sold	10,962	82	1.00%	26,697	119	0.60%
Residual interests	71,684	9,893	18.43%	118,424	17,100	19.31%
Investment securities	82,777	3,256	5.25%	65,855	2,734	5.55%
Mortgage loans held for sale	1,033,421	59,397	7.68%	1,366,826	86,800	8.49%
Loans and leases, net of unearned income (1)	3,268,099	181,759	7.43%	3,082,603	179,460	7.78%
Total interest earning assets	4,555,151	$254,864	7.47%	4,731,332	$286,613	8.10%
Noninterest-earning assets:						
Cash and due from banks	102,033			106,205		
Premises and equipment, net	31,279			32,408		
Other assets	582,250			405,184		
Less allowance for loan and lease losses	(58,913)			(55,066)		
Total assets	$5,211,800			$5,220,063		
Liabilities and Shareholders Equity						
Interest-bearing liabilities:						
Money market checking	$ 298,014	$ 2,722	1.22%	$ 162,789	$ 632	0.52%
Money market savings	1,048,544	10,262	1.31%	840,509	8,290	1.32%
Regular savings	61,407	663	1.44%	63,384	976	2.06%
Time deposits	922,773	17,885	2.59%	1,009,339	22,781	3.02%
Short-term borrowings	333,143	6,611	2.65%	635,265	12,053	2.54%
Collateralized debt	502,610	10,501	2.79%	585,861	11,569	2.64%
Other long-term debt	270,180	17,101	8.45%	30,066	1,745	7.76%
Preferred securities				232,983	16,581	9.52%

distributions[2]						
Total interest bearing liabilities	$3,436,671	$ 65,745	2.56%	3,560,196	$ 74,627	2.80%
Noninterest-bearing liabilities:						
Demand deposits	997,100			1,089,719		
Other liabilities	311,964			187,695		
Shareholders equity	466,065			382,453		
Total liabilities and shareholders equity	$5,211,800			$5,220,063		
Net interest income		$189,119			$211,986	
Net interest income to average interest earning assets			5.55%			5.99%

(1) For purposes of these computations, nonaccrual loans are included in daily average loan amounts outstanding.

(2) Reclassed to other long-term debt in 2004

Table of Contents

Provision for Loan and Lease Losses

The consolidated provision for loan and lease losses for the three months ended September 30, 2004 was $1.9 million, compared to $14.8 million for the same period in 2003. Year to date, the provision for 2004 was $11.8 million, compared to $37.7 million in 2003. More information on this subject is contained in the section on credit risk.

Noninterest Income

Noninterest income during the three months ended September 30, 2004 totaled $67.9 million, compared to $104.7 million for the same period of 2003. Noninterest income of $226.4 million was recorded for the nine months ended September 30, 2004 and $231.0 million for the same period in 2003. The quarterly decrease in 2004 versus 2003 was primarily a result of a $41.4 million decrease in gains on sale of loans at the mortgage banking line of business.

Noninterest Expense

Noninterest expenses for the three and nine months ended September 30, 2004 totaled $102.5 million and $310.7 million, respectively, compared to $114.4 million and $313.7 million for the same periods in 2003. The decrease in consolidated noninterest expense in 2004 is primarily related to lower personnel costs associated with our decreased production at the mortgage banking line of business. This decline was partially offset by higher personnel costs at the home equity line of business in connection with their improved performance in 2004.

Consolidated Balance Sheet Analysis

Total assets increased to $5.4 billion at September 30, 2004 compared to $5.0 billion at December 31, 2003. The majority of the increase relates to the loan portfolios at the commercial banking and commercial finance lines of business. Average assets year to date for 2004 were $5.2 billion, relatively unchanged from the average assets for 2003.

Loans Held For Sale

Loans held for sale totaled $1.0 billion at September 30, 2004, an increase from a balance of $0.9 billion at December 31, 2003. The increase occurred primarily at our home equity lending line of business where loans held for sale increased from $0.2 billion at December 31, 2003 to $0.3 billion at September 30, 2004.

Loans and Leases

Our commercial loans and leases are originated throughout the United States. Equipment loans and leases are also originated in Canada by our commercial finance line of business. At September 30, 2004, 94% of our loan and lease portfolio was associated with our U.S. operations. We also extend credit to consumers throughout the United States through mortgages, installment loans and revolving credit arrangements. The majority of the remaining portfolio consists of residential mortgage loans (1-4 family dwellings) and mortgage loans on commercial property. Loans by major category for the periods presented were as follows:

	September 30, 2004	December 31, 2003

	(Dollars in thousands)	
Commercial, financial and agricultural	$1,614,983	$1,503,619
Real estate-construction	325,330	306,669
Real estate-mortgage	870,374	859,541
Consumer	30,979	27,370
Direct financing leases		
Domestic	447,737	364,413
Canadian	242,572	207,355
Unearned income		
Domestic	(98,347)	(78,875)
Canadian	(31,985)	(29,038)
Total loans and leases, net of unearned income	$3,401,643	$3,161,054

Table of Contents

Allowance for Loan and Lease Losses

Changes in the allowance for loan and lease losses are summarized below:

	As of and For the Nine Months Ended September 30, 2004	As of and For the Year Ended December 31, 2003
	(Dollars in thousands)	
Balance at beginning of period	$ 64,285	$ 50,936
Provision for loan and lease losses	11,838	47,583
Charge-offs	(21,040)	(37,312)
Recoveries	3,951	3,420
Reduction due to reclassification of loans to loans held for sale	(10,808)	(690)
Other	(430)	348
Balance at end of period	$ 47,796	$ 64,285

The 2004 provision and allowance for loan and lease losses reflects transactions related to the transfer and sale or pending sale of portfolio loans associated with two portfolio sales at our home equity lending line of business. We transferred $355 million in loans to loans held for sale when the decisions were made to sell these portfolio loans. These loans had an associated allowance of $20.6 million. The loans were transferred with an allowance of $10.8 million to reduce their carrying value to fair market value. After the transfers, the remaining $9.8 million of excess allowance was reversed through the provision for loan and lease losses.

Investment Securities

The following table shows the composition of our investment securities at the dates indicated:

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
U.S. Treasury and government obligations	$ 25,166	$ 20,994
Obligations of states and political subdivisions	5,859	3,960
Mortgage-backed securities	9,821	2,039
Federal Reserve stock, Federal Home Loan Bank stock and other	66,822	65,532

Total	$107,668	$ 92,525

Deposits

Total deposits as of September 30, 2004 averaged $3.3 billion compared to deposits at December 31, 2003 that averaged $3.1 billion for the year. Demand deposits averaged $1.0 billion during both periods. A significant portion of demand deposits is related to deposits at Irwin Union Bank and Trust Company, which are associated with escrow accounts held on loans in the servicing portfolio at the mortgage banking line of business. Year to date 2004, these escrow accounts averaged $739.9 million compared to an average of $826.2 million for the year 2003. The decrease in average escrow balances in 2004 relates to the decline in production and refinancing activity at the mortgage banking line of business. More than offsetting this decrease was an increase in core deposits. Core deposits, which exclude jumbo and brokered CDs and public funds, increased to $2.2 billion at September 30, 2004 compared to $1.8 billion at December 31, 2003.

Irwin Union Bank and Trust utilizes institutional broker-sourced deposits as funding to supplement deposits solicited through branches and other wholesale funding sources. At September 30, 2004, institutional broker-sourced deposits totaled $338.0 million, relatively unchanged compared to a balance of $339.4 million at December 31, 2003.

Short-Term Borrowings

Short-term borrowings decreased to $132.7 million at September 30, 2004, compared to $429.8 million at December 31, 2003. The decrease in short-term borrowings at the end of the third quarter relative to year-end relates primarily to a secured financing transaction completed during the third quarter at the home equity lending line of business totaling $0.4 billion. The debt related to the loans is now classified as collateralized debt versus short-term borrowings.

Federal Home Loan Bank borrowings averaged $198.8 million during the nine months ended September 30, 2004, with an average rate of 1.48%. The ending balance was $1.4 million at an interest rate of 1.85%. The maximum outstanding during any month end during 2004 was $536.3 million. At December 31, 2003, Federal Home Loan Bank borrowings averaged $317.2 million, with an average rate of 1.46%. The ending balance was $286.0 million at an interest rate of 1.34%. The maximum outstanding at any month end during 2003 was $977.0 million.

Collateralized and Other Long-Term Debt

Collateralized borrowings totaled $667.8 million at September 30, 2004, compared to $590.1 million at December 31, 2003. The bulk of these borrowings have resulted from securitization structures that result in loans remaining as assets and debt being recorded on the balance sheet. The securitization debt represents match-term funding for these loans and leases. The increased debt relates to a $0.4 billion new secured financing transaction completed during the third quarter. This was partially offset by the sale of portfolio loans at the home equity lending line of business during the second quarter and on-going run-off of the underlying loan portfolio. These transactions are discussed in more detail in the Home Equity Lending section of this document.

Other long-term debt totaled $270.2 million at September 30, 2004, unchanged from December 31, 2003. We had obligations represented by subordinated debentures at September 30, 2004 totaling $240.1 million with our wholly owned trusts that were created for the purpose of issuing trust preferred securities. The subordinated debentures were the sole assets of the trusts at September 30, 2004. In accordance with FIN 46, at the end of 2003 we began deconsolidating the wholly owned trusts that issued the trust preferred securities. As a result, these securities no longer are consolidated on our balance sheet. Instead, the subordinated debentures held by the trusts are disclosed on the balance sheet as other long-term debt.

Capital

Shareholders equity averaged $466.1 million year to date during 2004, up 18% compared to the average for the year 2003. Shareholders equity balance of $486.3 million at September 30, 2004 represented $17.16 per common share, compared to $15.36 per common share at December 31, 2003. We paid $2.3 million and $6.8 million in dividends for the three and nine months ended September 30, 2004, respectively, reflecting an increase of $0.01 per share compared to a year ago.

The following table sets forth our regulatory capital and capital ratios at the dates indicated:

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Tier 1 capital	$ 621,127	$ 556,793
Tier 2 capital	150,802	183,738

Total risk-based capital	$ 771,929	$ 740,531
Risk-weighted assets	$5,286,719	$4,917,622
Risk-based ratios:		
Tier 1 capital	11.8%	11.4%
Total capital	14.6	15.1
Tier 1 leverage ratio	11.2	11.2
Ending shareholders equity to assets	9.0	8.7
Average shareholders equity to assets	9.0	7.6

At September 30, 2004, our total risk-adjusted capital ratio was 14.6% exceeding the 10.0% required to be considered well-capitalized by our state and federal banking regulators and our internal minimum target of 11.0%. At December 31, 2003, our total risk-adjusted capital ratio was 15.1%. Our ending equity to assets ratio at September 30, 2004 was 9.0% up from December 31, 2003 ratio of 8.7%. Our Tier 1 capital totaled $621.1 million as of September 30, 2004, or 11.8% of risk-weighted assets.

Cash Flow Analysis

Our cash and cash equivalents increased $77.2 million year to date during 2004, compared to $5.5 million during the same period in 2003. Cash flows from operating activities resulted in a use of $30.3 million in cash and cash equivalents in the nine months ended September 30, 2004 compared to the same period in 2003 when our operations generated $461.7 million in cash and cash equivalents. Changes in loans held for sale impact cash flows from operations. In a period in which loan production exceeds sales such as we had year to date in 2004, operating cash flows will decrease reflecting our investment in cash generating assets. During this same period in 2003, our loans held for sale increased $87.5 million, thus increasing the cash used by operating activities.

Earnings Outlook

We do not provide quantitative earnings guidance as we do not believe it to be in the best interest of our stakeholders. However, as discussed before, our strategy is to seek opportunities for credit-worthy, profitable growth by serving niche markets and balancing the impact of changes in interest rates and economic conditions on our mortgage banking production with investments in mortgage servicing and in our credit retained portfolios. These investments will typically respond in an opposite and complementary manner. We continue to expect a higher proportion of 2004 and 2005 earnings to come from our commercial banking, home equity lending and commercial finance lines of business than was the case in 2003. We expect segment growth and earnings to be more in line with the long-term trends we have seen at Irwin Financial, rather than the disproportionate contribution provided by mortgage originations during 2002 and 2003. Currently, market conditions for our mortgage banking segment are very difficult. Origination margins are significantly below our long-term expectations and we are not seeing increases in the value of our servicing portfolio as we would typically expect when mortgage origination revenues are declining. In addition, we are subject to basis risk in the management of our servicing portfolio as discussed below. Currently, the basis risk is moving in a manner opposite to historic patterns, negatively affecting fourth quarter management of these assets. As a result, we expect our revenues and thus net income, will be lower in the fourth quarter of 2004 than in the third and our net income for the year to be below the results we produced in 2003. However, we believe we are in a transitory period for mortgage banking and, in light of the good growth we have had in our credit portfolios in 2004, we expect net income in 2005 to return to levels commensurate with our historic performance. These estimates are based on various factors and current assumptions management believes are reasonable, including current industry forecasts of a variety of economic and competitive factors. However, projections are inherently uncertain, and our actual earnings may differ significantly from this estimate due to uncertainties and risks related to our business such as fluctuations in interest rates and other factors mentioned above in the About Forward-Looking Statements section. Over periods of normal economic cycles we strive to meet or exceed our long-term targets of double-digit growth in earnings per share and a return on equity above our cost of capital.

A meaningful amount of our earnings comes from activities and mark-to-market accounting requirements tied directly or indirectly to capital market activities. For example, the valuation of our mortgage servicing portfolio is impacted by movements in the bond market. The impact of short-term movements in interest rates on the valuation of our mortgage servicing rights is mitigated by a combination of financial derivatives and changes in income from production of new mortgages likely to be driven by those same movements in interest rates. However, the correlation within short periods of time (such as a single quarter) between interest rate movements that impact the reported value of our mortgage servicing rights at quarter end and the production effects of those interest rate movements which may not be reflected until subsequent quarters can be low. In addition, accounting principles generally accepted in the U.S. (GAAP) impose a lower-of-cost-or-market valuation cap on the value of our servicing asset, while we know of no financial derivatives available in the secondary market with similarly asymmetric value change characteristics. This anomaly in accounting for mortgage servicing assets makes it difficult at times to construct hedges with the desired GAAP accounting outcome, although the economic balance may still exist. Finally, while basis risk exhibits stability over time, over short periods of time there can be separation in the relative spreads of interest rates and indices used to value mortgage servicing rights and the financial derivatives we use to hedge the change in value in mortgage servicing rights. At times this basis risk benefits us and other times, it does not. It is generally not possible to eliminate this basis risk. It is possible, therefore, that our balanced revenue strategy may be successful as measured over several quarters or years, but may have market-based variances if measured over short periods. We also have a large amount of income that is subject to assumptions and pricing for credit risks. We use a variety of methods for estimating the effects of and accounting for credit losses and interest rate changes, but ultimately, we need to make estimates based on imperfect knowledge of future events, which may cause actual results to differ materially from our expectations. For example, if the pace of economic recovery in the U.S. is slower in 2004 and 2005 than currently anticipated by consensus estimates, our credit related costs may increase beyond our current estimates.

Table of Contents

Earnings by Line of Business

Irwin Financial Corporation is composed of five principal lines of business:

Mortgage Banking

Commercial Banking

Home Equity Lending

Commercial Finance

Venture Capital

The following table summarizes our net income (loss) by line of business for the periods indicated. Details for each line of business follows.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(Dollars in thousands)			
Net income (loss):				
Mortgage Banking	$ 4,051	$25,035	$19,298	$ 67,916
Commercial Banking	5,517	5,973	16,704	17,064
Home Equity Lending	8,259	2,617	23,790	(21,311)
Commercial Finance	1,111	46	2,135	(215)
Venture Capital	29	65	(132)	(1,399)
Other (including consolidating entries)	(1,773)	(2,618)	(6,316)	(5,933)
	$17,194	$31,118	$55,479	$ 56,122

29

Table of Contents

Mortgage Banking

The following table shows selected financial information for our mortgage banking line of business:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(Dollars in thousands)			
Selected Income Statement Data:				
Net interest income	$ 10,202	$ 24,326	$ 30,646	$ 61,294
Recovery of (provision for) loan loss	67	(191)	457	(221)
Other income	49,653	90,758	163,366	260,566
Total net revenue	59,922	114,893	194,469	321,639
Operating expense	(52,908)	(74,210)	(162,094)	(211,296)
Income before taxes	7,014	40,683	32,375	110,343
Income taxes	(2,963)	(15,648)	(13,077)	(42,427)
Net income	$ 4,051	$ 25,035	$ 19,298	$ 67,916
Selected Operating Data:				
Mortgage loan originations	$2,973,889	$7,049,363	$9,632,196	$19,764,326
Servicing sold as a % of originations	57.6%	6.5%	58.2%	5.2%

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Selected Balance Sheet Data at End of Period:		
Total assets	$ 1,275,251	$ 1,258,641
Mortgage loans held for sale	670,361	679,360
Mortgage servicing assets	345,185	348,174
Short-term borrowing	104,350	214,877
Shareholder s equity	128,288	122,671
Selected Operating Data:		
Servicing portfolio		

Balance at end of period	$28,531,292	$29,640,122
Weighted average coupon rate	5.70%	5.83%
Weighted average servicing fee	0.34	0.33

Overview

In our mortgage banking line of business, we originate, purchase, sell and service conventional and government agency-backed residential mortgage loans throughout the United States. We also engage in the business of mortgage reinsurance. Because most of our mortgage originations either are insured by an agency of the federal government, such as the Federal Housing Administration (FHA) or the Veterans Administration (VA), or, in the case of conventional mortgages, meet requirements for sale to the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC) or the Federal Home Loan Bank (FHLB), we are able to remove substantially all of the credit risk associated with these loans from our balance sheet. While we securitize and sell mortgage loans to institutional and private investors, we may choose to retain the servicing rights. Loan origination demand and servicing values normally react in opposite directions to changes in interest rates, as explained below. We believe this balance between mortgage loan originations and mortgage loan servicing values assists in managing the risk from interest rate changes, which has helped stabilize our revenue stream.

Our channels for originating loans consist primarily of retail, wholesale, and correspondent lending. The retail channel originates loans through retail branches and identifies potential borrowers mainly through relationships maintained with housing intermediaries, such as realtors, homebuilders and brokers. Our wholesale and correspondent divisions purchase loans from third party sources. The wholesale division purchases primarily from mortgage loan brokers and issues loan proceeds directly to the borrower. The correspondent lending division purchases closed mortgage loans primarily from small mortgage banks and retail banks. We fund our mortgage loan originations using internal funding sources and through credit facilities provided by third parties. Generally within a 30-day period after funding, we sell our mortgage loan originations into the secondary mortgage market either by direct loan sales or by securitization. Our secondary market sources include government-sponsored mortgage entities, nationally sponsored mortgage conduits, and institutional and private investors.

Table of Contents

As mentioned, we believe there is a balance between mortgage loan originations and mortgage loan servicing that assists in managing the risk from interest rate changes and the impact of rate changes on each part of the business. In rising interest rate environments, originations typically decline, while the value of our mortgage servicing portfolio generally increases as prepayment expectations decline. In declining interest rate environments, servicing values typically decrease as prepayment expectations increase, while the economic value of our mortgage production franchise generally increases due to the potential for greater mortgage loan originations. However, the offsetting impact of changes in production income and servicing values may not always be recognized in the same quarter under generally accepted accounting principles due to the application of lower-of-cost-or-market treatment under generally accepted accounting principles to the mortgage servicing asset, with no accounting equivalent for the production franchise causing greater volatility in short-term results than is apparent in longer-term measurements such as annual income. We sell servicing rights periodically for many reasons, including income recognition, cash flow, capital management and servicing portfolio management. Servicing rights sales occur at the time the underlying loans are sold to an investor (in flow sales) or in pools from our seasoned servicing portfolio (in bulk sales). As interest rates have fluctuated in 2004, we have chosen to sell the servicing asset associated with a relatively higher percentage of our current originations due to the changed interest rate risk and expected total return profile of owning servicing on loans with current interest rates as well as to mitigate the growth of servicing assets as a percentage of our consolidated balance sheet, as opposed to our actions over the past several years to add to the portfolio as rates reached historic lows.

Net Income

Net income from mortgage banking for the three months ended September 30, 2004 was $4.1 million, compared to $25.0 million for the same period in 2003, a decrease of 84%. This net income decrease in 2004 primarily relates to a decline in mortgage originations and compressed margins as a result of an increasing interest rate environment that began in the latter half of 2003.

The following table shows the composition of our originations by loan categories for the periods indicated:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2004	**2003**	**2004**	**2003**
	(Dollars in thousands)			
Total originations	$2,973,889	$7,049,363	$9,632,196	$19,764,326
Percent retail loans	20%	25%	21%	26%
Percent wholesale loans	31	38	35	43
Percent correspondent	36	34	33	28
Percent brokered [1]	13	3	11	3
Percent refinances	40	73	52	73

(1) Brokered loans are loans we originate for which we receive loan origination fees, but which are funded, closed and owned by unrelated third parties.

Mortgage loan originations for the three months ended September 30, 2004 totaled $3.0 billion, down 58% from the same period in 2003. For the year, originations totaled $9.6 billion, down 51% from 2003. Refinanced loans accounted for 40% of loan production for the third quarter of 2004 and 52% year to date compared to 73% for both periods in 2003. The decreased originations and refinances as a percent of production in 2004 are a result of the change in the interest rate environment.

Table of Contents

Net Revenue

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(Dollars in thousands)			
Selected Income Statement Data:				
Net interest income	$ 10,202	$ 24,326	$ 30,646	$ 61,294
Recovery of (provision for) loan losses	67	(191)	457	(221)
Gain on sales of loans	39,351	80,775	117,003	283,514
Servicing fees	26,356	22,008	77,937	57,921
Amortization expense	(22,773)	(29,291)	(74,281)	(89,760)
Recovery (impairment) of servicing assets	(17,662)	41,838	5,474	(779)
Gain (loss) on derivatives	22,520	(27,613)	23,064	1,635
Gain on sales of servicing assets	440	7	8,857	7
Other income	1,421	3,034	5,312	8,028
Total net revenue	$ 59,922	$114,893	$194,469	$321,639

Net interest income is generated from the interest earned on mortgage loans before they are sold to investors, less the interest expense incurred on borrowings to fund the loans. Net interest income for the third quarter in 2004 totaled $10.2 million compared to $24.3 million for the third quarter in 2003. Net interest income year to date decreased 50% to $30.6 million. The decrease in net interest income in 2004 is a result of decreased production resulting in a lower average balance of mortgage loans held for sale on our balance sheet during the quarter and for the year.

Gain on sale of loans includes net revenues from three principal sources:

- the valuation of newly-created mortgage servicing rights;
- net loan origination fees, both of which are recognized when loans are pooled and sold into the secondary mortgage market; and,
- changes in fair value of forward contracts and interest rate lock commitments.

Gain on sale of loans for the three months ended September 30, 2004 totaled $39.4 million, compared to $80.8 million for the same period in 2003, a decline of 51%. Gain on sale of loans for the nine months ended September 30, 2004 totaled $117.0 million, compared to $283.5 million for the same period in 2003, a decrease of 59%. This decrease is attributable to decreased originations and reduced secondary market margins as a result of the increasing interest rate environment that began in the latter half of 2003.

Servicing fee income is recognized by collecting fees, which normally range between 25 and 44 basis points annually on the principal amount of the underlying mortgages. Servicing fee income totaled $26.4 million and $77.9 million for the three and nine months ended September 30, 2004, an increase of 20% and 35% from the same periods in 2003, primarily reflecting the growth in the servicing portfolio.

Amortization expense relates to mortgage servicing rights and is based on the proportion of current net servicing income to the total expected for the estimated lives of the underlying loans. Amortization expense totaled $22.8 million for the three months ended September 30, 2004, compared to $29.3 million during the third quarter of 2003. Year-to-date amortization expense totaled $74.3 million and $89.8 million for 2004 and 2003, respectively. The decrease in amortization expense in 2004 relates in part to an other-than-temporary impairment adjustment of $7.0 million taken in the first quarter of 2004 and $38.5 million taken in the fourth quarter of 2003 to reflect our view that the originally recorded value of certain servicing rights, net of amortization, and subsequent impairment associated with those rights is unlikely to be recovered in market value. There was no related direct impact on net income as this other than temporary impairment affected only balance sheet accounts. However, the adjustment has resulted in a reduction of amortization expense. Amortization expense year to date in 2004 has also decreased as a result of an increase in the expected servicing life and cash flows caused by higher interest rates.

Impairment expense is recorded when the book value of the mortgage servicing rights exceeds the fair value on a strata by strata basis. We determined fair value at September 30, 2004, through the use of independent valuations, valuation comparisons to actual servicing sale proceeds, and internal models. Impairment expense totaled $17.7 million and recovery totaled $5.5 million for three and nine months ended September 30, 2004, compared to a recovery of $41.8 million and expense of $0.8 million during the same periods of 2003. The impairment expense in the third quarter of 2004 was a result of higher actual and expected prepayments due to decreasing interest rates during the quarter. To mitigate against the income effect of impairment of the portfolio, we purchase financial instruments designed to change in value in a manner opposite from the servicing asset. These instruments produced a gain of $22.5 million and $23.1 million for us in the third quarter and year to date 2004 compared to a loss of $27.6 million and a gain of $1.6 million in the same periods in 2003. As a result, impairment, net of derivative gains/losses, was a positive $4.9 million and $28.5 million during the three- and nine-month periods ended September 30, 2004, compared to $14.2 million and $0.9 million during the same periods in 2003. The third quarter 2004 net gain of $4.9 million was achieved despite interest rates declining during the quarter, meaning that derivatives gains outpaced impairment losses. A key factor was the basis risk that exists between the mortgage servicing assets and the related derivatives contracts. This basis risk affected earnings positively this quarter, but has been a negative factor in other quarters.

At September 30, 2004, the mortgage line of business held $5.0 billion notional amount of interest rate swaptions to manage the risk associated with our servicing assets. Notional amounts do not represent the amount at risk. The current risk management activities of the mortgage bank related to servicing assets do not satisfy the criteria for hedge accounting under SFAS 133. As a result, these derivatives are accounted for as other assets and other liabilities, and changes in fair value are adjusted through earnings as derivative gains (losses), while the underlying servicing asset is accounted for on a strata-by-strata basis at the lower of cost or market.

Our mortgage banking business maintains the flexibility either to sell servicing for current cash flow through bulk sales or to retain servicing for future cash flow through the retention of ongoing servicing fees. Total servicing sales represented 58% of loan originations during the three and nine months ended September 30, 2004, compared to 6% and 5% for the three and nine months ended September 30, 2003. The decision to sell or retain servicing is based on current market conditions for servicing assets, loan origination levels and production expenses, servicing portfolio management considerations, consolidated capital constraints and the general level of risk tolerance of the mortgage banking line of business and the Corporation. We sold $37 million of bulk servicing during the third quarter and $2.0 billion year to date in 2004, generating a $0.4 million and $8.9 million pre-tax gain, respectively. There were no bulk sales during these periods in 2003. Over the past few years, we have built our servicing portfolio in anticipation of rising interest rates that would result in lower mortgage loan production. We sold servicing this year to manage the size and composition of our investment in mortgage servicing assets.

Operating Expenses

The following table sets forth operating expenses for our mortgage banking line of business for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(Dollars in thousands)			
Salaries and employee benefits	$19,848	$21,445	$ 59,847	$ 60,176
Incentive and commission pay	11,110	23,794	32,293	70,882
Other expenses	21,950	28,971	69,954	80,238
Total operating expenses	$52,908	$74,210	$162,094	$211,296

Number of employees at period end [1]			1,871	2,307

(1) On a full time equivalent basis

Operating expenses for the three and nine months ended September 30, 2004 totaled $52.9 million and $162.1 million, a 29% and 23% decrease over the same periods in 2003. These decreases in operating expenses reflect significant decreases in production activities in 2004 versus 2003. However, the relative decreases in operating expenses is less than the relative decreases in production due to the fixed and semi-variable nature of certain operating expenses and the impact of investments in various process improvement initiatives.

Table of Contents

Mortgage Servicing

The following table shows information about our managed mortgage servicing portfolio, including mortgage loans held for sale, for the periods indicated:

	Nine Months Ended September 30, 2004	Year Ended December 31, 2003
	(Portfolio in billions)	
Beginning servicing portfolio	$ 29.6	$ 16.8
Mortgage loan closings	8.6	21.9
Sales of servicing rights	(4.5)	(0.6)
Run-off[1]	(5.2)	(8.5)
Ending servicing portfolio	$ 28.5	$ 29.6
Number of loans (end of period)	222,261	229,983
Average loan size	$128,368	$128,880
Weighted average coupon rate	5.70%	5.83%
Percent Government National Mortgage Association (GNMA) and state housing programs	27	26
Percent conventional and other	73	74
Delinquency ratio	4.0	4.6
Mortgage servicing assets to related servicing portfolio[2]	1.20	1.19

(1) Run-off is primarily the reduction in principal balance of the servicing portfolio due to regular principal payments made by mortgagees and early repayments of entire loans.
(2) For this calculation, deferred service release premiums on warehouse loans are excluded from mortgage servicing assets, and loans held for sale (i.e. warehouse loans) are excluded from the servicing portfolio.

We record originated mortgage servicing assets at allocated cost basis when the loans are sold and record purchased servicing assets at fair value. Thereafter, servicing rights are accounted for at the lower of their cost or fair value. We record a valuation allowance for any impairment on a disaggregated basis. We determine fair value on a monthly basis based on a discounted cash flow analysis. These cash flows are projected over the life of the servicing using prepayment, default, discount rate and cost to service assumptions that we believe market participants would use to value similar assets. We then assess these modeled assumptions for reasonableness through independent third-party valuations, periodic servicing asset sales and through the use of industry surveys. At September 30, 2004, we estimated the fair value of these assets to be $352.3 million in the aggregate, or $7.1 million greater than the carrying value on the balance sheet. The difference between carrying value and market value is the result of a cap under generally accepted accounting principles at the lower of cost or market for these assets. At December 31, 2003, we estimated the fair value of these assets to be $358.9 million in the aggregate, or $10.7 million greater than the carrying value on the balance sheet.

Table of Contents

Commercial Banking

The following table shows selected financial information for our commercial banking line of business:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
	(Dollars in thousands)			
Selected Income Statement Data:				
Interest income	$ 33,245	$ 28,359	$ 91,237	$ 84,146
Interest expense	(9,878)	(8,243)	(26,133)	(25,564)
Net interest income	23,367	20,116	65,104	58,582
Provision for loan and lease losses	(607)	(1,500)	(2,557)	(4,413)
Other income	3,889	5,744	13,726	16,517
Total net revenue	26,649	24,360	76,273	70,686
Operating expense	(17,413)	(14,316)	(48,361)	(42,187)
Income before taxes	9,236	10,044	27,912	28,499
Income taxes	(3,719)	(4,071)	(11,208)	(11,435)
Net income	$ 5,517	$ 5,973	$ 16,704	$ 17,064

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Selected Balance Sheet Data at End of Period:		
Assets	$2,611,473	$2,203,965
Securities and short-term investments[1]	358,109	107,668
Loans and leases	2,159,976	1,988,633
Allowance for loan and lease losses	(22,045)	(22,055)
Deposits	2,410,275	1,964,274
Shareholder s equity	139,436	162,050
Year to Date Daily Averages		
Assets	$2,416,025	$2,119,944

Securities and short-term investments	276,411	131,137
Loans and leases	2,056,997	1,914,608
Allowance for loan and lease losses	(22,319)	(21,895)
Deposits	2,193,693	1,894,406
Shareholder s equity	150,259	147,886
Shareholder s equity to assets	6.22%	6.98%

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(1) Includes $293 million of inter-company investments, the result of excess liquidity at the commercial banking line of business related to deposit growth in excess of their asset deployment needs. The funds have been redeployed in earning assets at our other lines of business. Earnings credited to the commercial banking line of business from these investments approximate alternative external investment rates.

Table of Contents

Overview

Our commercial banking line of business focuses on providing credit, cash management and personal banking products to small businesses and business owners. We offer commercial banking services through our banking subsidiaries, Irwin Union Bank and Trust Company, an Indiana state-chartered commercial bank, and Irwin Union Bank, F.S.B., a federal savings bank. Earlier in the year, Irwin Union Bank, F.S.B. sold two of its branches Las Vegas, Nevada, and Salt Lake City, Utah to Irwin Union Bank and Trust. On June 3, 2004, we established a new branch of Irwin Union Bank, F.S.B. in Brookfield, Wisconsin (near Milwaukee). In October 2004, we submitted an application to the Office of Thrift Supervision to establish a branch of Irwin Union Bank, F.S.B. in Sacramento, California.

Net Income

Commercial banking net income of $5.5 million during the third quarter of 2004 was slightly less than $6.0 million for the same period in 2003. Year-to-date net income totaled $16.7 million in 2004 compared to net income of $17.1 million in 2003.

Net Interest Income

The following table shows information about net interest income for our commercial banking line of business:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
	(Dollars in thousands)			
Net interest income	$ 23,367	$ 20,116	$ 65,104	$ 58,582
Average interest earning assets	2,482,449	2,086,725	2,334,660	2,006,601
Net interest margin	3.74%	3.82%	3.72%	3.90%

Net interest income was $23.4 million for the third quarter of 2004, an increase of 16% over third quarter of 2003. Net interest income year to date in 2004 also improved 11% over the same period in 2003. The 2004 improvement in net interest income resulted primarily from an increase in our commercial banking loan portfolio as a result of growth and expansion efforts. Net interest margin, the ratio of net interest income divided by average interest earning assets, for the three months ended September 30, 2004 was 3.74%, compared to 3.82% for the same period in 2003. Year-to-date net interest margin for 2004 was 3.72%, compared to 3.90% for 2003. The reduction in 2004 margin is due to slower than anticipated loan growth, which has led to greater than planned excess liquidity invested in lower yielding assets.

Provision for Loan and Lease Losses

Year to date provision for loan and lease losses declined to $2.6 million during 2004, compared to a provision of $4.4 million during the same period in 2003. The declining provision relates to a combination of improved overall credit quality, improving economic conditions and slower loan growth. See further discussion in the Credit Quality section below.

Table of Contents

Noninterest Income

The following table shows the components of noninterest income for our commercial banking line of business:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
	(Dollars in thousands)			
Trust fees	$ 438	$ 463	$ 1,433	$ 1,349
Service charges on deposit accounts	1,215	1,299	3,964	3,804
Insurance commissions, fees and premiums	482	446	1,568	1,589
Gain from sales of loans	616	2,454	2,323	7,127
Loan servicing fees	353	321	1,020	903
Amortization of servicing assets	(323)	(964)	(1,204)	(2,340)
Recovery (impairment) of servicing assets	(247)	326	341	394
Brokerage fees	299	336	1,148	883
Other	1,056	1,063	3,133	2,808
Total noninterest income	$3,889	$5,744	$13,726	$16,517

Noninterest income during the three and nine months ended September 30, 2004 decreased 32% and 17% over the same periods in 2003, respectively. This decrease was due primarily to lower gains from sales of loans related to decreased mortgage production, partially offset by lower servicing asset amortization. The commercial banking line of business has a first mortgage servicing portfolio totaling $444.5 million at September 30, 2004, principally a result of mortgage loan production in its south-central Indiana markets. Servicing rights related to this portfolio are carried on the balance sheet at the lower of cost or market, estimated at September 30, 2004 to be $3.6 million.

Operating Expenses

The following table shows the components of operating expenses for our commercial banking line of business:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
	(Dollars in thousands)			
Salaries and employee benefits	$11,124	$ 8,498	$30,111	$26,139
Other expenses	6,289	5,818	18,250	16,048

Total operating expenses	$17,413	$14,316	$48,361	$42,187
Efficiency ratio	63.9%	55.4%	61.4%	56.2%
Number of employees at period end[1]			444	450

(1) On a full time equivalent basis.

Operating expenses for the three and nine months ended September 30, 2004 totaled $17.4 million and $48.4 million, an increase of 22% and 14% over the same periods in 2003, respectively. The increase in salaries and benefits is primarily attributable to higher incentive compensation driven by a higher return on equity at this line of business in 2004 and increased personnel costs related to new market expansion and support staff.

Balance Sheet

Total assets year to date through September 30, 2004 averaged $2.4 billion compared to $2.1 billion for the year ended December 31, 2003. Year to date earning assets as of September 30, 2004 averaged $2.3 billion compared to $2.0 billion for the year 2003. The 2004 increase included commercial loans as a result of the commercial bank s continued growth and expansion efforts into new markets. Average core deposits (deposits less jumbo and brokered certificates of deposits and public funds) for the third quarter of 2004 totaled $2.1 billion, an annualized increase of 8% over average core deposits in the second quarter 2004.

Table of Contents

Credit Quality

Nonperforming assets to total assets and the allowance for loan losses to total loans both decreased at September 30, 2004, compared to December 31, 2003. The decline in nonperformings in 2004 was primarily the result of satisfactory management of delinquent loans and collections made to nonperforming relationships during the past nine months. Nonperforming loans are not significantly concentrated in any industry category. The following table shows information about our nonperforming assets in this line of business and our allowance for loan losses:

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Nonperforming loans	$19,691	$ 25,614
Other real estate owned	1,324	995
Total nonperforming assets	$21,015	$ 26,609
Nonperforming assets to total assets	0.80%	1.21%
Allowance for loan losses	$22,045	$ 22,055
Allowance for loan losses to total loans	1.02%	1.11%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(Dollars in thousands)			
Provision for loan losses	$ 607	$1,500	$2,557	$4,413
Net charge-offs	611	994	2,567	3,107
Annualized net charge-offs to average loans	0.11%	0.20%	0.17%	0.22%

Table of Contents

Home Equity Lending

The following table shows selected financial information for the home equity lending line of business:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(Dollars in thousands)			
Selected Income Statement Data:				
Net interest income	$ 26,367	$ 26,655	$ 77,221	$ 81,289
Recovery (provision) for loan and lease losses	232	(10,728)	(4,961)	(23,578)
Other income	16,291	8,091	48,781	(29,383)
Total net revenue	42,890	24,018	121,041	28,328
Operating expense	(29,050)	(19,656)	(81,291)	(63,846)
Income (loss) before taxes	13,840	4,362	39,750	(35,518)
Income taxes	(5,581)	(1,745)	(15,960)	14,207
Net income (loss)	$ 8,259	$ 2,617	$ 23,790	$ (21,311)
Selected Operating Data:				
Loan volume:				
Lines of credit	$172,724	$ 72,400	$402,361	$236,278
Loans	224,052	195,215	705,115	608,842
Net home equity charge-offs to average managed portfolio	1.42	4.22	2.56	4.13

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Selected Balance Sheet Data at End of Period:		
Home equity loans and lines of credit	$ 668,633	$ 692,637
Allowance for loan and lease losses	(13,179)	(29,251)
Home equity loans held for sale	300,171	202,627
Residual interests	68,584	70,519
Mortgage servicing assets	40,356	28,425
Short-term borrowings	343,188	368,640

Collateralized debt	530,722	460,535
Shareholders equity	148,203	128,555
Selected Operating Data at End of Period		
Total managed portfolio balance	$1,395,721	$1,513,289
Delinquency ratio	4.6%	5.9%
Weighted average coupon rate:		
Lines of credit	8.77%	10.21%
Loans	12.15	12.89

Overview

Our home equity lending line of business originates, purchases, sells and services a variety of home equity lines of credit and fixed-rate home equity loan products nationwide to certain qualified borrowers. We market our home equity products (generally using second mortgage liens) through a combination of direct mail, brokers, the Internet, and correspondent channels. We target creditworthy homeowners who are active credit users. Customers are underwritten using proprietary models based on several criteria, including the customers previous use of credit.

We offer home equity loans with combined loan-to-value (CLTV) ratios of up to 125% of their collateral value. Home equity loans are priced taking into account, among other factors, the credit history of our customer, the disposable income of the borrower, and the relative loan-to-value (LTV) ratio of the loan at origination. For example, all else being equal, those loans with loan-to-value ratios greater than 100% (high LTV, or HLTVs) are priced with higher coupons than home equity loans with loan-to-value ratios less than 100% to compensate for increased expected losses through default. For the nine-month period ended September 30, 2004, HLTV home equity loans constituted 46% of our loan originations versus 51% during the same period in 2003. HLTVs constituted 48% of our managed portfolio at September 30, 2004 compared to 64% at December 31, 2003. In an effort to manage portfolio concentration risk and to comply with existing banking regulations, we have policies in place governing the size of our investment in loans secured by real estate where the LTV is greater than 90%. In accordance with regulatory guidance set forth in Supervision and Regulation Letter 01-4 and in consultation with our banking regulators, we made a risk-weighting adjustment in our regulatory Consolidated Report of Condition and Income, beginning with the third quarter of 2003. This adjustment reflects a risk weighting of 200 percent for certain HLTV assets (approximately $112 million at September 30, 2004 compared with $184 million at June 30) that are described in the guidance as subprime. The designation of certain loans as subprime and the additional capital requirement for those loans was a principal driver in our decision to respond to secondary market demand for seasoned home equity product and sell a portion of our portfolio (approximately $205 million) in the second quarter. This is also the principal reason we plan to sell existing loans (approximately $150 million) in the fourth quarter rather than selling exclusively from current production.

For most of our home equity product offerings, we offer customers the choice to accept an early repayment fee in exchange for a lower interest rate. A typical early repayment option provides for a fee equal to up to six months interest that is payable if the borrower chooses to repay the loan during the first three to five years of its term. Approximately 80%, or $1.1 billion, of our home equity managed portfolio at September 30, 2004 have early repayment provisions, reflecting such customer choice.

The following table provides a breakdown of our home equity lending managed portfolio by product type, outstanding principal balance and weighted average coupon as of September 30, 2004:

	Amount	% of Total	Weighted Average Coupon
	(In thousands)		
Home equity loans < = 100% CLTV	$ 157,902	11.31%	10.43%
Home equity lines of credit < = 100% CLTV	521,944	37.40	7.26
Total <= 100% CLTV	679,846	48.71	8.00
Home equity loans > 100% CLTV	402,836	28.86	13.34
Home equity lines of credit > 100% CLTV	249,372	17.87	11.49
Total > 100% CLTV	652,208	46.73	12.63
First mortgages	42,756	3.06	7.40
Other	20,911	1.50	13.91
Total	$1,395,721	100.00%	10.23%

Net Income

Our home equity lending business recorded net income of $8.3 million during the three months ended September 30, 2004, compared to net income for the same period in 2003 of $2.6 million. Year to date income of $23.8 million was recorded through September 30, 2004, compared to a net loss of $21.3 million during the same period a year earlier. The most significant factor in the increased earnings during 2004 was improving credit quality that drove modest increases in the fair value of our residual interests recorded through trading gains/losses, instead of the significant write downs of these assets suffered in the first half of 2003.

Net Revenue

Net revenue for the three and nine months ended September 30, 2004 totaled $42.9 million and $121.0 million, respectively, compared to net revenue for the same periods in 2003 of $24.0 million and $28.3 million, respectively. The increase in revenues is primarily a result of the change from trading losses to trading gains related to adjustments made in marking the residual interests to fair value in the respective periods, reflecting improved credit quality trends in the underlying loan portfolios represented by these residuals, and of the recognition of incentive servicing fees. Trading gains during the three and nine months ended September 30, 2004 totaled $4.3 million and $15.6 million, compared to trading losses of $1.4 million and $52.3 million during the same periods in 2003. Incentive servicing fee gains during the three and nine months ended September 30, 2004 totaled $2.3 million and $3.8 million, respectively, compared with no incentive servicing fee income during 2003.

During the third quarter of 2004, our home equity lending business produced $396.8 million of home equity loans, compared to $267.6 million during the same period in 2003. Our home equity lending business had $969 million of net loans and loans held for sale at September 30, 2004, compared to $895 million at December 31, 2003. Included in the loan and loan held for sale balances at September 30, 2004 were $0.5 billion of collateralized loans as part of secured financings.

Table of Contents

The following table sets forth certain information regarding net revenue for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
	(Dollars in thousands)			
Net interest income	$26,367	$ 26,655	$ 77,221	$ 81,289
Recovery of (provision for) loan losses	232	(10,728)	(4,961)	(23,578)
Gain on sales of loans	8,438	8,108	20,163	18,358
Loan servicing fees	7,482	6,001	20,968	15,832
Amortization of servicing assets	(4,975)	(3,808)	(13,927)	(10,013)
Recovery (impairment) of servicing assets	(449)	(499)	394	(1,581)
Trading gains (losses)	4,310	(1,376)	15,640	(52,296)
Other income	1,485	(335)	5,543	317
Total net revenue	$42,890	$ 24,018	$121,041	$ 28,328

Net interest income decreased to $26.4 million for the three months ended September 30, 2004, compared to $26.7 million for the same period in 2003. Year-to-date net interest income for 2004 was $77.2 million, compared to $81.3 million for 2003. This line of business earns interest income on loans held on the balance sheet and the accretion of the discount applied to its residual interests. Accretion totaled $3.3 million and $9.9 million during the three and nine months ended September 30, 2004, versus $4.1 million and $17.1 million for the same periods in 2003. The reduced accretion relates to the reduction in our residual interests in 2004 compared to the prior year. The year to date increase in the non-accretion interest income from $64.2 million in 2003 to $67.3 million in 2004 is a result of the buildup of our on-balance sheet loan portfolio, which grew from $0.8 billion at September 30, 2003 to $1.0 billion at September 30, 2004.

Year to date, the provision for loan losses decreased to $5.0 million in 2004, compared to $23.6 million in 2003. The decreased provision relates to improvements in the credit quality of the loan portfolio. In addition, we transferred $355 million in loans to loans held for sale when the decisions were made to sell these portfolio loans. These loans had an associated allowance of $20.6 million. The loans were transferred with an allowance of $10.8 million to reduce their carrying value to fair market value. After the transfers, the remaining $9.8 million of excess allowance was reversed through the provision for loan and lease losses.

Gains on sales of loans for the three months ended September 30, 2004 totaled $8.4 million, compared to $8.1 million during the same period in 2003. The gain relative to the amount of loans sold was lower than we have seen in recent quarters due to product mix sold and the related loan yields. Gains on sales of loans for the nine months ended September 30, 2004 totaled $20.2 million, compared to $18.4 million during the same period in 2003.

We do not record a residual interest as a result of whole loan sales as we do not retain a credit loss interest after the sale. These are cash sales for which we receive a premium, generally record a servicing asset, and recognize any points and fees at the time of sale. For certain sales, we have the right to an incentive servicing fee that will provide cash payments to us if a pre-established return for the certificate holders and certain structure-specific loan credit and servicing performance metrics are met. These incentive servicing fee contracts are treated as derivatives and classified in other assets. At September 30, 2004, we recorded incentive fees for two transactions that had already met or were projected to meet these performance metrics within the next twelve months. Included in other income during nine months of 2004 was $3.8 million related to these incentive-servicing fees based upon actual and projected performance of the underlying pools of loans.

Loan servicing fees totaled $7.5 million during the third quarter of 2004, compared to $6.0 million during the same period in 2003. Year to date, loan servicing fees totaled $21.0 million, compared to $15.8 million during the same period in 2003. The servicing portfolio underlying the mortgage servicing asset at our home equity lending line of business totaled $2.2 billion and $1.7 billion at September 30, 2004 and 2003, respectively. The increase in loan servicing fees in 2004 relates to increased early repayment fees which totaled $10.1 million during the nine months ended September 30, 2004, compared to $5.8 million during the same period in 2003.

Amortization and impairment of servicing assets includes amortization expenses and valuation adjustments relating to the carrying value of servicing assets. Our home equity lending business determines fair value of its servicing asset using discounted cash flows and assumptions as to estimated future servicing income and cost that we believe market participants would use to value similar assets. In addition, we periodically assess these modeled assumptions for reasonableness through independent third-party valuations. At September 30, 2004, net servicing assets totaled $40.4 million, compared to a balance of $28.4 million at December 31, 2003.

Table of Contents

Servicing asset amortization and impairment expense totaled $13.5 million year to date during 2004, compared to $11.6 million for the same period in 2003. The increased expense relates to the increased size of the underlying servicing asset.

Trading gains (losses) represent unrealized gains (losses) as a result of adjustments to the carrying values of our residual interests. Trading gains totaled $4.3 million in the third quarter of 2004, compared to losses of $1.4 million for the same period in 2003. Year-to-date trading gains totaled $15.6 million for 2004, compared to losses of $52.3 million for the same period in 2003. Losses on the loans underlying the residual assets occurred at an annualized rate of 3.19% during the third quarter of 2004, as compared to our June 30, 2004 projection for the third quarter of 7.62%. As a result, cash flow received from the residual assets during the third quarter totaled $12.3 million compared to our previously modeled estimate of $8.0 million. Residual interests had a balance of $68.6 million at September 30, 2004 and $70.5 million at December 31, 2003. The decrease reflects a combination of runoff, performance-based valuation adjustments and the second quarter repurchase of $5.3 million of residuals we had sold between 1999 and 2001. Included in the valuation are assumptions for estimated prepayments, expected losses, and discount rates that we believe market participants would use to value similar assets. To the extent our expectations of future loss rates, prepayment speeds and other factors change as we gather additional data over time, these residual valuations may be subject to additional adjustments in the future. These adjustments could have a material effect on our reported earnings. The increased unrealized trading gains in 2004 principally reflect lower actual loss rates than those previously modeled. These lower loss rates reflect lower credit losses and higher recoveries. Our forward loss assumptions are reevaluated monthly and, as such, our residual asset valuations are adjusted monthly to reflect changes in actual and expected loss rates in our portfolio.

Operating Expenses

The following table shows operating expenses for our home equity lending line of business for the periods indicated:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
	(Dollars in thousands)			
Salaries and employee benefits	$18,627	$12,593	$52,618	$38,318
Other	10,423	7,063	28,673	25,528
Total operating expenses	$29,050	$19,656	$81,291	$63,846
Number of employees at period end [(1)]			681	663

(1) On a full time equivalent basis.

Operating expenses were $29.1 million and $81.3 million for the three and nine months ended September 30, 2004, compared to $19.7 million and $63.8 million for the same periods in 2003. Year to date, operating expenses in 2004 included $6.9 million of compensation expense related to minority ownership interests at the home equity lending line of business which are accounted for on a mark-to-market basis. During the same period in 2003, we had a reversal of approximately $37 thousand due to the decline in the value of the minority ownership interest during that period.

Home Equity Servicing

Our home equity lending business continues to service a majority of the loans it has securitized and sold. We earn a servicing fee of approximately 50 to 100 basis points of the outstanding principal balance of the loans treated as sales under generally accepted accounting principles. The total servicing portfolio was $2.8 billion at September 30, 2004 and $2.6 billion at December 31, 2003. For whole loans sold with servicing retained totaling $1.2 billion at September 30, 2004 and $1.0 billion at December 31, 2003, we capitalize servicing fees including rights to future early repayment fees. The servicing asset at September 30, 2004 was $40.4 million up from $28.4 million at December 31, 2004 reflecting additional secondary market sales and financings.

Our Managed Portfolio, representing that portion of the servicing portfolio on which we have retained credit risk, is separated into two categories: $1.0 billion of loans originated, generally since 2002, and held on balance sheet either as loans held for investment or loans held for sale, and $0.4 billion of loans and lines of credit securitized for which we retained a residual interest. Generally, these loans categorized as Owned Residual were originated prior to 2002 and treated as sold under SFAS 140 and have a reserve methodology that reflects life of account loss expectations; whereas our policy for on-balance sheet loans requires that we hold at a minimum, sufficient reserves for potential losses inherent in the portfolio at the balance sheet date. Such losses for on-balance sheet loans manifest themselves over a period which management believes approximates twelve months.

In addition, where applicable, we have the opportunity to earn additional future servicing incentive fees. Included below in the category Credit Risk Sold, Potential Incentive Servicing Fee Retained Portfolio are $1.1 billion of loans at September 30, 2004 and $0.8 billion at December 31, 2003 for which we have the opportunity to earn an incentive servicing fee. The following table sets forth certain information for each of these portfolios.

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Managed Portfolio		
Total Loans	$1,395,721	$1,513,289
30 days past due	4.59%	5.87%
90 days past due	1.78	2.43
Annualized QTD Net Chargeoff Rate	1.42	4.79
Unsold Loans		
Total Loans (1)	$ 970,271	$ 897,227
30 days past due	1.87%	2.91%
90 days past due	0.72	1.25
Annualized QTD Net Chargeoff Rate	0.68	3.03
Loan Loss Reserve	$ 13,179	$ 29,251
Owned Residual		
Total Loans	$ 425,450	$ 616,062
30 days past due	10.78%	10.18%
90 days past due	4.20	4.15
Annualized QTD Net Chargeoff Rate	3.19	7.13
Residual Undiscounted Losses	$ 25,447	$ 64,598
Credit Risk Sold, Potential Incentive Servicing Fee Retained Portfolio		
Total Loans	$1,131,250	$ 849,264
30 days past due	2.38%	2.44%
90 days past due	0.91	0.72

(1) Excludes deferred fees and costs.

The managed portfolio amounts listed above include those loans we service with credit risk retained. Delinquency rates and losses on our managed portfolio result from a variety of factors, including loan seasoning, portfolio mix, our servicing practices, and general economic conditions. The 30-day and greater delinquency ratio on our managed portfolio was 4.6% at September 30, 2004, and 5.9% at December 31, 2003.

Table of Contents

Commercial Finance

The following table shows selected financial information for our commercial finance line of business for the periods indicated:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
	(Dollars in thousands)			
Selected Income Statement Data:				
Net interest income	$ 7,058	$ 5,685	$ 20,692	$ 15,890
Provision for loan and lease losses	(1,589)	(2,388)	(4,777)	(9,321)
Noninterest income	1,366	1,181	4,437	4,678
Total net revenue	6,835	4,478	20,352	11,247
Operating expense	(4,914)	(3,829)	(14,177)	(11,211)
Income before taxes	1,921	649	6,175	36
Income taxes	(810)	(603)	(4,040)	(251)
Net income (loss)	$ 1,111	$ 46	$ 2,135	$ (215)
Selected Operating Data:				
Net charge-offs	$ 1,958	$ 2,034	$ 4,303	$ 6,505
Net interest margin	5.25%	5.44%	5.53%	5.45%
Total funding of loans and leases	$90,966	$61,679	$251,204	$185,588

	September 30, 2004	December 31, 2003
	(Dollars in thousands)	
Selected Balance Sheet Data at End of Period:		
Total assets	$569,419	$474,915
Loans and leases	559,801	463,423
Allowance for loan and lease losses	(11,488)	(11,445)