MESSAGE TO SHAREHOLDERS

M&T BANK CORPORATION 2011 ANNUAL REPORT

REFLECTIONS ON THE STATE OF BANKING AND THE LEADERSHIP CRISIS

As relatively good a year 2011 was for M&T itself, it was far from an easy one. Indeed, it is difficult, for one who has spent more than a generation in the field, to recall a time when banking as a profession has been publicly held in such persistently low esteem. A 2011 Gallup survey found that only a quarter of the American public expressed confidence in the integrity of bankers. We have reached a point at which not only do public demonstrations specifically target the financial industry but when a leading national newspaper would opine that regulation which might lower bank profits would be "a boon to the broader economy." What's worse is that such a view is far from entirely illogical, even if it fails to distinguish between Wall Street banks who, in my view, were central to the financial crisis and continue to distort our economy, and Main Street banks who were often victims of the crisis and are eager, under the right conditions, to extend credit to businesses that need it.

It is no consolation, moreover, to observe that banks and the financial services industry generally were far from alone in sparking the crisis. Nonetheless, it is true, and very much worth keeping in mind, that major institutions in other sectors of the American system – public and private – must be considered complicit, some in ways we are only beginning to learn fully about. As understandable as a search for particular causes, or villains, might be, the truth is that the economic crisis that began in the fall of 2007 implicated a wide range of institutions – not only bankers but their regulators, not only investors but those paid to advise them, not only private finance but its government-sponsored kin. *The wide spectrum of the culpable has left the U.S. and the world with a problem which, although related to the financial crisis, transcends it and must be confronted: the decimation of public trust in once-respected institutions and their leaders.* This has created a fear among those responsible for forming the rules and standards that shape the American financial services industry. And the outcome of this fear-driven rulemaking is likely to burden the efficiency of the American financial system for years to come and will potentially have broader implications for the overall economy.

In telling the story, one must start by looking at the banking industry in which I came of age. A few generations ago, our leading banks – which were then known as the money center banks – had a clear and respected role in the American economy. They focused on providing pure banking services to corporations, banks, and individuals across the United States. Their bankers traveled around the country and provided services to corporate customers and community banks. Their chief executives, in the tradition of John Pierpont Morgan (who famously intervened personally to halt the financial panic of 1907), were viewed as national leaders. Because of their size, sophistication, and quality of leadership, these banks led and were respected by the rest of the banking community, if not the country as a whole. Over time, American

corporations started to trade and invest more overseas and, consequently, money center bankers followed their clients as well. Such institutions also provided arduous and detailed training for future generations of bankers – drawn not only from the ranks of money center bank employees themselves but also from their correspondent banks. These programs were often led by outstanding faculty from major universities. Bank leaders of this era saw public service as part of their obligation to serve the general interest. Notably, during this period, the average compensation in the financial services industry was exactly the same as the average income of a non-farm U.S. worker. A wall, prudently erected in the wake of the Depression, kept investment banks apart from traditional banks, which served the needs of individuals and businesses, and from savings and loan institutions, which focused on housing finance. Each served markets in which they specialized and thoroughly understood.

All this began to change in the 1970s and especially the early 1980s as these banks grew and began a pattern of investing in areas where they possessed little knowledge – a trend, which culminated in money center banks forfeiting their mantle of leadership and tarnishing the reputation of the banking industry as a whole.

One might trace the beginning of this chain of events to the market dislocations caused by the OPEC-led increase in world oil prices. But panics and price bubbles have long been a feature of banking and investing, dating at least from the time of the 1637 Dutch Tulip Mania. Historically, however, the financial system has righted itself, responsibly, in the aftermath of such events. That was not the case, starting in the 1980s.

In a desire to expand their franchises, money center banks sought alternative investments and extended themselves into unchartered territories. Loans to energy companies ("oil patch" loans), shipping firms, and less-developed countries (LDCs) became the flavor of the day. In venturing into these lines of lending, they chose to ignore the strong and prescient 1977 warning by Federal Reserve Board Chairman Arthur Burns, who observed that *"under the circumstances, many countries will be forced to borrow heavily, and lending institutions may well be tempted to extend credit more generously than is prudent."*

The fate of such new exotic ventures established an unfortunate pattern that would recur at every turn. When the oil price bubble burst in 1982, it triggered events that ultimately led to the outright failure of Continental Illinois, then the seventh-largest bank in the United States. The problems of this era spread, as nearly one-third of all oil tankers were scrapped between 1982 and 1985. Money center banks, which had not only lent heavily to shipping companies but also held equity positions in ships, found themselves in significant trouble. As U.S. interest rates and the value of the dollar climbed during the early 1980s, Citibank's Chairman took the view that *"countries don't go bankrupt"* – a hypothesis that was proven erroneous when 27 countries initiated actions to restructure their existing bank debt, leading to devastating implications for their bank creditors. In 1987, these banks began a delayed acknowledgement

and recognition of the losses accruing from loans to developing countries. So great was the reckless foray that a 1993 study conducted by the Federal Reserve Bank of Boston found that had the money center banks truly recognized all the losses inherent in their books in 1984, one major bank would have been insolvent and seven others dangerously close.

So it was that the underpinnings of recurring crises were introduced as the money center banks searched for new opportunities and Wall Street investment banks became more and more creative in the development of financial products. One's cash from deposits and the other's creativity led to a symbiotic relationship, enhanced by the closeness of geography.

The decision to live together culminated in a marriage, made possible by the repeal, in 1999, of the Glass-Steagall Act, which had, at least notionally, kept investment and commercial banking separate. One can argue whether the architects of these new Wall Street institutions themselves created a new culture of greed or whether they merely capitalized on the new arrangements. In either case, this departure from banking as we knew it helped to sow the seeds of crisis and embodied a broader change that, in important and unfortunate ways, continues today.

These trends all came together in 2008 with the sub-prime crisis, characterized by Wall Street banks betting on and borrowing against increasingly opaque financial instruments, built on algorithms rather than underwriting. Like the institutions of the '80s, the major banks created investments they did not understand – and, indeed it seems nobody really understood. In the process, they contorted the overall American economy. The unnatural growth in the industry led the portion of GDP dedicated to insurance, finance and real estate to rise from 11.5 percent in 1950 to 20.6 percent during the decade that began in 2000. In their quest for growth, the Wall Street banks appeared to seek dominance at the expense of leadership and, through acquisition or aggressiveness, sacrificed the latter in order to attain the former. As a result, today the largest six banks own or service roughly 56% of all mortgages and nearly two-thirds of those in foreclosure proceedings. Indeed, we have reached the point where one bank services almost $2 trillion and close to 30% of all mortgages in foreclosure.

Undoubtedly, the crisis with whose aftermath we are still dealing has had wide-ranging effects – for taxpayers, homeowners, small business borrowers and more. But the list of the deeply damaged must also include the good name of banking itself. Since 2002, the six largest banks have been hit by at least 207 separate fines, sanctions or legal awards totaling $47.8 billion. None of these banks had fewer than 22 infractions; in fact one had 39 across seven countries, on three different continents. The public, moreover, has been made well aware of such wrongdoing. According to a study done by M&T, over the past two years, the top six banks have been cited 1,150 times by *The Wall Street Journal* and *The New York Times* in articles about their improper activities. It is not unreasonable to presume that these findings must represent a proxy for the national, if not international, press as a whole.

Public cynicism about the major banks has been further reinforced by the salaries of their top executives, in large part fueled not by lending but by trading. At a time when the American economy is stuck in the doldrums and so many are unemployed or under-employed, the average compensation for the chief executives of four of the six largest banks in 2010 was $17.3 million – more than 262 times that of the average American worker. One bank with 33,000 employees earned a 3.7% return on common equity in 2011, yet its employees received an average compensation of $367,000 – more than five times that of the average U.S. worker. Thus, it is hardly surprising that the public would judge the banking industry harshly – and view Wall Street's executives and their intentions with skepticism.

Nor can one say with any confidence that we have seen a fundamental change in the big bank business approach which helped lead us into crisis and scandal. The Wall Street banks continue to fight against regulation that would limit their capacity to trade for their own accounts – while enjoying the backing of deposit insurance – and thus seek to keep in place a system whichp uts taxpayers at high risk. In 2011, the six largest banks spent $31.5 million on lobbying activities. All told, the six firms employed 234 registered lobbyists. Because the Wall Street juggernaut has tarnished the reputation of banking as a whole, it is difficult if not impossible for bankers – who once were viewed as thoughtful stewards of the overall economy – to plausibly play a leadership role today. *Inevitably, their ideas and proposals to help right our financial system will be viewed as self-interested, not high-minded.*

As noted before, however, the major banks were not the only one simplicated in and tainted by the financial crisis. One can, sadly, go on in this vein to discuss a great many other institutions which have disappointed the American public in similar ways, in the process compromising their own leadership status. They have in common a relationship to the crisis associated with the nation's housing policies, which were themselves shaped over the course of several generations by many parts of the government and both political parties. Those policies marshaled some of the leading government agencies and enterprises, as well as private financial institutions, in the quest to broaden home ownership. Even apart from the collateral damage this pursuit has caused the financial system, it is worth keeping in mind that it was not remarkably successful on its own terms – particularly when today one finds a higher rate of home ownership in countries such as Hungary, Poland and Portugal, where the per capita GDP on average is 56% lower than that of the United States.

While the role of the Wall Street banks in the proliferation of complex investment securities and sub-prime lending has been well publicized, the participation of Government Sponsored Enterprises (GSEs) including Fannie Mae and Freddie Mac in precipitating the financial crisis was just as significant. In the years leading to the housing crisis, between 2005 and 2007, nearly one third of all mortgage originations in

the United States were guaranteed by these entities. In September 2008, when control of Fannie and Freddie was assumed by the U.S. government, they had a combined portfolio of some $195 billion in sub-prime loans, Alt-A loans, and complex derivatives. In total they held or insured $5.3 trillion – roughly half the total mortgage debt in the United States. As of September 2011, of the 2.2 million mortgages undergoing foreclosure, about 730,000 or 33% were owned or guaranteed by these GSEs; of the estimated 850,000 repossessed homes, 182,212 or 21% were held by Fannie and Freddie. Their intimate relationships with elected representatives are legendary, and their lobbying abilities notorious, particularly as Wall Street became successful in infringing on their turf.

So, too, were the good names of credit ratings agencies tarnished – and for good reason – through the course of the housing crisis. These organizations proved to be less watchdogs than enablers, helping to accelerate the financial meltdown, thanks to the favorable ratings they issued for opaque bonds secured by sub-prime residential mortgages – which proved to be no security at all. In a recent M&T study, we looked at a sample of 2,679 residential mortgage-backed issues originated between 2004 and 2007 with a total face value of $564 billion. Of that sample, 2,670 or 99 percent were rated triple-A at origination by S&P. Today, 90 percent of these bonds are rated non-investment grade.

Even the FASB, in their quest for transparency, had engendered an opacity that has done much to scare investors away from the banking industry, because they find its financial statements too difficult to understand. The absurdity of current accounting principles was emphasized in the third quarter of 2011, when the value of the debt issued by five of the largest banks decreased $9 billion, and yet these institutions booked the same amount as profits, representing 44% of their combined $21 billion in pre-tax earnings. For decades, the role of accounting principles was to ensure that a company's financials properly reflected the performance of the business being conducted. Unintuitive results such as these do little to bolster the dwindling confidence in the American financial system.

So it is that the crisis was orchestrated by so many who should have, instead, been sounding the alarm – not only bankers but also regulators, rating firms, government agencies, private enterprises and investors. That a former U.S. Senator, Governor and CEO of a big six financial institution was at the helm of MF Global on the eve of its demise due to trading losses, or that the largest-ever Ponzi scheme was run by the former chairman of a major stock exchange will long be remembered by the public. *The repercussions have stretched beyond*

banking, creating an atmosphere of fear affecting and inhibiting those who should be leading us toward a better post-crisis economy.

FEAR-DRIVE RULEMAKING AND ITS BURDEN: In this vacuum of credible leadership, not just in the banking industry but all around it, it is entirely understandable that regulators believe they must proceed with an abundance – perhaps over-abundance – of caution. Inevitably, they feel pressure to eliminate, in its entirety, risk that had been rising for far too long. This tension – based in their understanding that steps aimed at ensuring the safety and soundness of the financial system can stifle its vitality and dynamism – naturally weighs on rule makers and slows the pace of promulgation. They know too, that, in designing regulations, the sort of informal conversations with private institutions and individuals, which were once routine, might now be viewed as suspect, leaving regulators to operate in isolation, without thoughtful guidance as to the overall impact of their actions. When all are suspect, no conversation can be viewed as benign. Ultimately, however, this is neither a recipe to improve public confidence nor a situation likely to facilitate the expeditious design of a regulatory structure which will not hobble the extension of credit. *One must be concerned that a lack of leadership and trust, and an overreliance, instead, on the development of policies, procedures and protocols, has created a level of complexity that will decrease the efficiency of the U.S. financial system for years to come – and hamper the flow of trade and commerce for the foreseeable future.*

The effects on a community bank such as M&T prove to be significant. The cost of compliance with the multiplicity of statutes, standards, and other government mandates under which a comparatively uncomplicated bank like M&T must operate has been tracked and discussed in these Messages for nearly a decade. The news, however, is not getting better. These costs have risen from roughly $50 million in 2003 to $95.1 million in 2011. Add to this, the insurance premium we pay to the FDIC, to maintain and replenish the Deposit Insurance Fund used to liquidate failed banks and repay insured depositors, which increased from just $4.5 million in 2006 to an annualized rate of $107.7 million at the end of 2011. New edicts, which limit our ability to pay overdrafts incurred by customers (Regulation E) and impose price controls on debit card interchange fees (the Durbin Amendment), will reduce our revenues by an estimated $139.8 million on an annualized basis. In total, our likely tally of annual compliance cost and revenue lost from these regulations is $342.6 million and would have represented 28% of pre-tax income in 2011.

Nor is there any apparent end in sight to the imposition of new directives and rules. The Dodd-Frank Act contains, by one estimate, 400 new rulemaking requirements, only 86 of which were finalized by the start of 2012. It is impossible, of course, to assess our full cost to comply with these rules until they are promulgated. By virtue of having more than $50 billion in assets, a measure of size, with no consideration given to the activities in which we engage nor the merits of our actions, M&T has been deemed to be a

"systemically important" financial institution and will be subject to higher capital standards as well as costly new liquidity requirements.

A common feature of many of these new directives is a higher order of complexity than had heretofore been typical, particularly for Main Street banks like M&T which do not engage in excessive risk-taking and rely on fundamental banking services as their primary source of income. Utilization of these opaque and intricate methods as a means to prevent a crisis is at best questionable. It is worth keeping in mind that prior to the financial crisis, the Basel Committee had introduced Basel II international banking standards, which among other things endorsed the use of complex financial models to measure the risks associated with on and off-balance sheet exposures – so-called advanced measurement approaches. These standards proved wholly inadequate in the crucible of the financial crisis. Yet today, despite these failures, models have become more embedded into both regulation and basic accounting, a change which implies substantial increased cost.

It is no small irony – it is, dare I say, a bitter one – that these costly requirements have been visited on a company such as ours and hundreds, if not thousands, like us who did little or nothing to cause the financial crisis – and were, in fact, in many ways victims of it. *And, of course, the higher costs along with higher capital and liquidity requirements will inevitably diminish the availability and increase the cost of credit to business owners, entrepreneurs and innovators of our community.* Indeed, one has the sense that little or no thought has been given to the cumulative effect of new directives, both on costs and operations. One wishes, thus far in vain, for a clear, complete, simple and straightforward regulatory regime in which both consumers and banks know what to expect and could proceed accordingly, at reasonable expense.

BROADER IMPACTS AND UNINTENDED CONSEQUENCES: In this context, one has to be concerned about the accumulated effects of new mandates beyond the narrow terms of how they affect banks. More broadly, there is reason to believe that regulation may provide incentives that distort the allocation of capital in ways that could be harmful to economic recovery. Specifically, there are incentives for commercial banks to divert from their traditional roles – the same sort of activities which helped spark the housing bubble. The proposed Basel III liquidity rules, for instance, call for banks to significantly increase their investments in government securities, leaving less capital for community-based loans which hold the most promise for potential economic progress. Such an unintended outcome is reminiscent of that which emerged from the 1992 Basel Accord, providing an incentive to invest in government debt, whether domestic or foreign, and in highly-rated derivative securities of all types including those backed by residential mortgages – all of which turned out to be more, not less, risky. The presumption that certain prescribed assets would inherently carry less risk, a thesis clearly disproved in the recent crisis, along with

the new proposed minimum level of government bond holdings, would continue the trend of driving resources away from commercial lending – with negative ramifications for fulfilling legitimate credit needs.

New formulae from the FDIC are likely to have similar inadvertent consequences for the economy. Last spring, the FDIC began assessing insurance premiums based on assets rather than deposits, which it had done since its inception in 1933. As a result, a loan to finance the construction of a company's new building, an activity that produces jobs, carries insurance premiums that are three to four times as high as for commercial loans extended for unspecified purposes with no need for employment creation – arguably the greatest necessity of the current economy. Even more troubling is the fact that, under this formula, the mere association with real estate deems construction lending more risky regardless of how sturdy one's underwriting or how much "skin in the game" the entrepreneur is willing to commit.

Ironically, new regulations may not only undermine economic recovery by diverting capital from traditional, community-based investment – they may well fail in their stated purpose of broadening the scope of supervision in the financial services industry. The proposal under Basel III to essentially cap the amount of mortgage servicing rights that can be held by a regulated financial institution will likely push servicing away from banks and toward unregulated institutions. Initially, this activity will shift to hedge funds and other non-banking institutions. Even companies like IBM have displayed their intent to move into mortgage servicing. By limiting the boundaries of the traditional banking system, these regulations reduce the value of its franchise and increase the size of the shadow banking system which carries with it attendant consequences that were so vividly demonstrated in the great recession.

Nor is the damage from new mandates and regulation merely projected or prospective. Many are already proving to be counterproductive for businesses and consumers alike. The Durbin Amendment, for instance, was supposed to reduce costs for merchants. Instead it has resulted in higher transaction processing fees for some small business owners. According to The Wall Street Journal, many business owners who sell low priced goods like coffee and candy bars are now paying higher rates, when customers use their debit card for transactions that are less than $10. These small merchants now are left with some hard choices, such as raising prices, encouraging customers to pay in cash or dropping card payments altogether.

The breathtakingly rapid pace of changing regulations makes it challenging for banks and regulators alike to understand the changes, let alone react to them in an efficient manner. The fact that there are so

many masters to whom banks today report makes it difficult for one hand to know what the other is doing, whether it relates to coordination among the various regulatory bodies or even among the various divisions within a single agency.

FINDING A NEW WAY

So it is that the effects of crisis, combined with a void of leadership, weigh on banks such as ours – and encumber the economy. We find ourselves at a point at which, we face not only the question of what approaches are right but how, in light of a leadership vacuum, can we restore our capacity to work together constructively and productively. It is no small task, given the number of agencies involved and the decibel level of politicians and the public at large. We will not, in my own view, be able to make progress absent two key ingredients: trust and leadership. We must again have the sense that leaders, both public and private, will do their best to propose and consider ideas that will serve the general interest, not their own agendas.

To help recognize and preempt emerging new threats, it is crucial that there be an ongoing, at times informal, dialogue among bankers and regulators. Such exchanges would plausibly put focus on rising issues like cyber-crime that has already cost the American banking industry some $15 billion over the last five years. More importantly, these discussions should be premised not on confrontation nor framed by fear but, rather, based on the understanding that a safe and secure financial services system is a prerequisite for a healthy economy – arguably our most important, shared national goal. I know that we would be eager to share our own collective learning with the Federal Reserve and other regulators in order to allow them to understand the extent to which regulatory changes are likely to affect the general well-being of our economy. I am sure other Main Street banks would be eager to do the same. Our goal is not to seek favors or special dispensation – but rather to have the chance to do our part in helping to craft a regulatory regime that does not impede, but rather enables sustainable economic growth.

In reflecting on my years in banking and the situation we confront today, I am mindful of the fact that banks have traditionally played a clear, if limited, role in the economy: to gather savings and to finance industry and commerce. Trading and speculation were nowhere included – nor should they be. Historically, bankers, moreover, were viewed as among the more responsible and ethical members of their communities. In my view, the vast majority still are and have been ill-served by those whose non-traditional approach have caused banks to be the targets of public opprobrium. Such is the case of the British banker who was recently stripped of his knighthood in the wake of his role in the financial crisis. It is time for regulators and, yes, protestors, to understand that all banks

have not been equally culpable for the problems we face today. In other words, give us back our good name – and we will do our best to deserve it.

ADAPTING TO CHANGE

For our part, at M&T we remain optimistic about our ability to retain our position among the ranks of the highest-performing banks, as gauged by return on tangible common equity. It is an assessment based on the quality of our employees, our underwriting standards, our overall culture and our demonstrated ability, over the decades, to be a company that adapts, successfully, to changed circumstances. Our employees are forever working to do the right thing for our customers, communities and shareholders. Assuredly, no set of circumstances was as trying as those encountered last summer as we worked to complete our acquisition of Wilmington Trust. As any M&T veteran would attest, a conversion weekend is a series of carefully choreographed, interconnected events. Every hour of each day is accounted for and everyone has a clear role to play. On August 26th, after months of careful preparation, over 300 of M&T's best traveled to the Delaware market to convert nearly 50 branches and over 200 ATMs. Hurricane Irene arrived at precisely the same time, bringing with it the potential to put a damper on our carefully laid plans. From closed roads to flash floods and power outages, our employees stayed flexible to ensure that conversion activities proceeded on schedule. When branches opened on Monday it was business as usual for former Wilmington Trust customers. For M&T employees, it was more of the same.

Successful adaptation to change has been the norm at M&T for our customers,
employees, and investors alike. We are confident, though never over-confident, that record of success will continue. Robert J. Bennett, Michael D. Buckley and Donald E. Foley will have completed their service on the Board of Directors of M&T Bank Corporation after conclusion of the Annual Shareholders' meeting on April 17, 2012. Messrs. Bennett and Buckley played a central role in expanding M&T into the regional community bank that we know today, helping architect our expansion into Syracuse and Pennsylvania, and building the leading market share franchise in Maryland and the Mid-Atlantic. We thank both for their stewardship, guidance and counsel for those many years and wish them well. We will continue to benefit from Mr. Foley's counsel and guidance through his presence on the Trust and Investment Committee, as well as the New York City Advisory Board. Finally, I would also like to thank M&T's 15,666 employees who do a wonderful job day in, day out, confronting and resolving issues and problems that they never had to deal with before.

Robert G. Wilmers
Chairman of the Board
and Chief Executive Officer