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To be completed by the employee contacted

Date and time of contact:	Name of the Employee(s) Contacted (Name and Title)	Brief description of the communication: (attach separate sheet if necessary)
Tuesday, September 22, 2009 10:00 AM	Lori Bettinger Deputy Director, Equity Program Ted Schaffner Director, Equity Program	Forwarding of a letter sent to Sec. Geithner encouraging Treasury to implement the Capital Assistance Program in a way that helps community banks

Name of the Employee(s) who prepared this form:	Date
Lori Bettinger	9/24/09

Registered Lobbyist Name:	Title:	Firm or Organization:, if applicable	Client
Mark Tenhundfeld	Senior Vice President	American Bankers Association	

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September 21, 2009

The Honorable Timothy Geithner
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Geithner:

Earlier this year, the American Bankers Association formed a task force to focus on community bank solutions to the financial crisis. We appreciate the opportunity our bankers had to meet with several Treasury representatives, and we appreciate Treasury's recognition of the vital role that community banks play in our financial system. After those meetings as well as meetings with the bank regulators and significant discussions internally, we have developed specific recommendations for ways the existing Capital Assistance Program (CAP) could be modified to assist well-managed, viable community banks and therefore be more effective in achieving its objectives. These recommendations may be summarized as follows:

- Invest up to $5 billion of Troubled Asset Relief Program (TARP) funds in community banks that did not receive Capital Purchase Program (CPP) funds;
- Limit the maximum CAP investment by Treasury in any one bank to 5% of the bank's risk-weighted assets;
- Require participating banks to issue Treasury senior preferred securities;
- Require participants to show that they have commitments from private equity to match Treasury's investment dollar for dollar; and
- Allow any bank with total assets of $5 billion or less to apply but condition approval upon the submission of an acceptable capital restoration plan.

Background and discussion. Strong capital is essential to helping community banks work through the problems caused by declines in asset values. While conditions have improved over the past year in the economy overall, many community banks are finding that the lagging impacts of job losses and declines in property values are negatively affecting these banks, causing declines in their capital at a time when new capital often is hard to find.

This problem is compounded by the unintended consequences of policies that have the effect of steering private investors to failed banks. For instance, the FDIC announced in June that, while the Legacy Loans Program remained a viable program, the agency intended to scale the program back at least initially to a pilot involving failed banks. The FDIC announced last week that it had selected a winning bidder in a sale of receivership assets and that the bidder would receive FDIC-guaranteed financing. This, coupled with loss-sharing agreements used to entice buyers of failed banks and failed bank assets, is creating incentives for investors to wait until a bank has failed before investing.

Furthermore, the banking agencies are requiring many banks to raise capital at a time when sources of capital are scarce and at precisely the time when capital should be available to absorb losses. This can put these banks in an untenable position, precipitating the failure of a viable bank that has a good franchise and could survive if capital was made available.[1]

The ABA recommends that Treasury modify the criteria for its CAP to assist viable community banks that need help working through their current issues. We propose that Treasury offer assistance to those banks that did not qualify for CPP funds but that nevertheless can demonstrate the ability to operate safely and soundly and survive if given the chance to obtain necessary capital. This ability would be demonstrated in three ways.

- First, a bank would have to present evidence that private investors are contractually committed to match Treasury's investment dollar for dollar.
- Second, the private investors would have to agree to receive securities that are subordinate to Treasury's interests.
- Third, the bank would have to submit a capital restoration plan to its primary regulator that, when factoring in the proposed investments by Treasury and private equity, satisfies the requirements of the "Prompt Corrective Action" rules.[2] As part of that plan, the bank also would have to show that it has adequate management to address its problems.

The suggested aggregate investment by Treasury of $5 billion is based on the amount of funds, when matched by private equity on a dollar-for-dollar basis, needed to bring all insured depository institutions with assets under $5 billion to capital levels equal to a Tier 1 risk-based capital ratio of 8% and a total risk-based capital ratio of 12% ***assuming the stressed scenarios used by the banking regulators in the SCAP***. These capital levels significantly exceed the thresholds established by the banking regulators for a bank to be deemed "well capitalized"[3] under the Prompt Correct Action rules and would provide a cushion that could enable participating banks to continue meeting the credit needs of their communities without having to shrink to comply with minimum regulatory capital requirements. A $5 billion commitment by Treasury is well below half of the dividends and warrant repurchases received by Treasury from CPP participants[4] and less than 4% of

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[1] Further information about the role of community banks and the adverse impact that recent governmental actions have had on these banks is discussed in Attachment A.

[2] *See* 12 C.F.R. § 6.5 (Office of the Comptroller of the Currency); 12 C.F.R. § 208.44 (Board of Governors of the Federal Reserve System); 12 C.F.R. § 325.104 (Federal Deposit Insurance Corporation); and 12 C.F.R. § 565.5 (Office of Thrift Supervision).

[3] For a bank to be "well capitalized" under the Prompt Corrective Action rules, it must have total risk-based capital of at least 10%; Tier 1 risk-based capital of at least 6%; a leverage ratio of at least 5%; and not be subject to a written requirement to meet a specific capital level.

[4] "The dividends paid on those [CPP] investments and the repurchases of warrants we received for those investments now total about $12 billion. For the 23 banks that have fully repaid, Treasury has earned an annualized average return of roughly 17 percent." Secretary of the Treasury Timothy F. Geithner, Written Testimony before the Congressional Oversight Panel, September 10, 2009 (available at http://www.ustreas.gov/press/releases/tg283.htm).

the total of CPP funds invested to date.[5] Our projections show that an estimated 2,000 community banks would be potentially eligible (*see* Attachment B), although it is highly unlikely that all 2,000 would choose to, or be approved to, participate.

As noted above, this program would involve matching investments by private equity investors. It is important that private equity qualify regardless of whether it comes from existing shareholders or new investors. Either way, the bank is receiving a strong vote of confidence in its viability from stakeholders who stand to lose their investments. Moreover, current investors and management often are in the best position to judge the prospects of a bank and to determine the advisability of investing in that bank.

We believe that, as a general matter, Treasury could adopt as many of the terms used in the CPP as would be relevant. Thus, for instance, Treasury would receive the same sort of securities, subject to the same conditions, as it has received through the CPP. To make this workable for community banks, we propose two exceptions to this general approach, however. First, given that these funds are intended for viable yet struggling community banks, we believe it would be appropriate for Treasury to agree that any approved banks would not be expected to pay dividends in the first four quarters following Treasury's investment. Second, we renew our request, first raised in the context of the CPP,[6] that investments in S corporations and mutual institutions that do not have holding companies be treated as Tier 1 capital. It is our understanding that these banks' interest in the CPP was significantly diminished by the treatment of CPP investments as Tier 2 capital.

We very much appreciate your consideration of these recommendations. Community banks are the backbone of our economy and are critical to the overall improvement of our economy. For a nominal investment, Treasury can preserve viable community banks, which in turn would preserve jobs and communities. As the former Comptroller Eugene Ludwig wrote in an op-ed on Friday, September 18, 2009 in the American Banker, "Now is the time for regulators to work with the well-managed community banks wherever possible to raise capital and dispose of troubled assets. Regulators must look for ways to help these institutions rather than find reasons to close them."

We would be happy to provide any further information or assistance that you would find helpful.

Sincerely,

Arthur C Johnson

Arthur Johnson

cc: The Hon. Sheila Bair, Chairman, Federal Deposit Insurance Corporation
The Hon. Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System
Mr. John Bowman, Acting Director, Office of Thrift Supervision
The Hon. John Dugan, Comptroller of the Currency

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[5] As reported on the Transactions Report for the period ending September 4, 2009, Treasury has invested slightly over $134 billion through the CPP. *See* http://www.financialstability.gov/docs/transaction-reports/transactions-report_09092009.pdf.

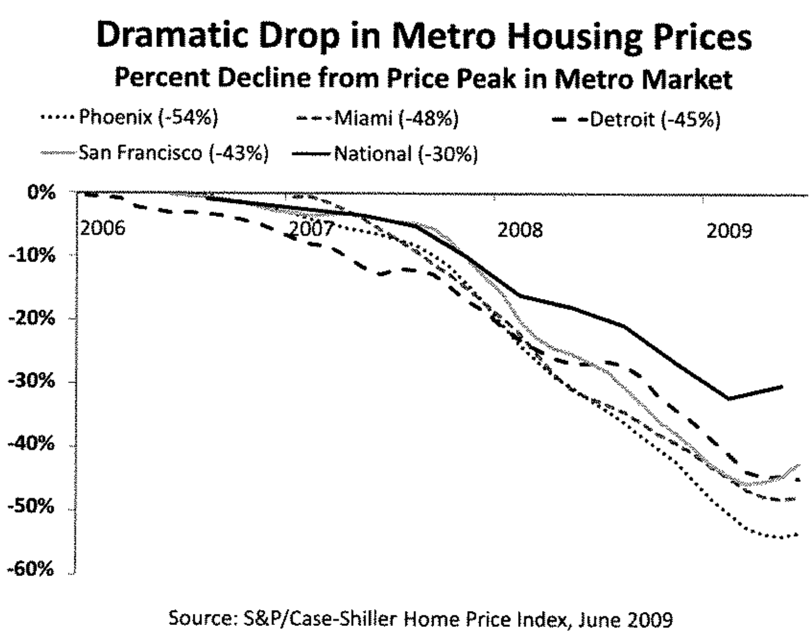
[6] *See* Letter from Diane Casey-Landry to the Hon. Timothy F. Geithner, dated April 16, 2009.

Attachment A

Community banks are central to the economic well-being of the towns and communities they serve across America, providing capital to consumers, small farms, and other small businesses that is crucial for economic development. These banks have been in their communities for decades and intend to be there for many decades to come. In fact, there are over 2,500 banks – representing over 30 percent of the banking industry – that have been in business for more than a century; 62 percent (over 5,000) have been in existence for more than half a century. These numbers tell a dramatic story about the staying power of community banks and their commitment to the communities they serve.

The failure of a community bank can be devastating to its community. Not only do the bank's employees often lose their jobs and the bank's shareholders lose their investments, the town's businesses lose a vital source of credit and a vicious cycle begins. As credit constricts, businesses that depend on financing are unable to expand or, in many instances, even operate. More jobs are lost, causing more people to default on loans with other banks in the community. Property values plummet as residential and commercial properties that served as collateral for the loans are dumped on the market. Surviving banks then are forced to write down the value of the collateral on performing loans, the banks' conditions worsen, and the spiral continues downward.

The precipitous declines in real estate values across the country underlie many community banks' problems. In some of the harder hit areas such as Phoenix, Miami, Detroit, and San Francisco the drops have been devastating to community banks. As the following chart shows, homes in these cities have lost between 43% and 54% of their value in the past few years.



Unfortunately there are many other cities experiencing similar declines in home prices, and banks in these communities face unprecedented pressures on asset quality and collateral values.

The sudden and dramatic declines in property values caught policymakers and bankers alike off guard. Typical of the perceptions at the onset of what became a crisis were the views expressed by Federal Reserve Board Chairman Bernanke, who stated in a speech in May 2007 –

> [G]iven the fundamental factors in place that should support the demand for housing, we believe the effect of the troubles in the subprime sector on the broader housing market will likely be limited, and we do not expect significant spillovers from the subprime market to the rest of the economy or to the financial system.[1]

It is no surprise that many institutions continued to provide loans to consumers and businesses. While we have heard from many banks about their efforts to uphold underwriting standards in the face of market pressures to fund ever more projects, none have been immune to the extraordinary – and extraordinarily swift – decline in asset values.

Governmental actions in addition to the ones noted in the accompanying letter have exacerbated community banks' problems and in so doing have made it harder for them to raise capital. For instance:

- The decision to place Fannie Mae and Freddie Mac into receivership caused a sudden and unexpected loss of billions of dollars to the banks that held shares of Fannie's and Freddie's stock.[2]

- The serial implementation of the Capital Purchase Program (CPP) meant that the applications of many non-public financial institutions were not considered until further into the recession.[3] As a result, banks that perhaps would have qualified for CPP funds early in the process were denied the opportunity to participate once a deteriorating economy started to adversely affect the banks' condition.

- The government's investment of billions of dollars in the largest financial institutions has improved the competitive position of these institutions, making it easier for them to raise capital and issue debt. However, the relative condition of many of the community banks that did not receive CPP funds has looked worse as a result.

- The government's treatment of "reciprocal deposits"[4] as brokered significantly impedes many community banks' ability to compete with larger banks for deposits. As explained in a

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[1] Chairman Ben S. Bernanke, at the Federal Reserve Bank of Chicago's 43rd Annual Conference on Bank Structure and Competition, Chicago, Illinois, May 17, 2007.

[2] We note that the banking agencies proposed, but have not yet finalized, a lowering of the risk weight of claims on, or guaranteed by, Fannie Mae and Freddie Mac. 73 *Fed. Reg.* 63656 (Oct. 27, 2008). Lowering the risk weights for all Government Sponsored Enterprise debt and guarantees would provide significant relief to affected banks.

[3] The term sheets were issued on the following dates: 10/14/08 for publicly traded institutions; 11/17/08 for non-publicly traded institutions (excluding S corporations and mutual institutions); 1/14/09 for S corporations; 4/7/09 for mutual holding companies; and 4/17/09 for stand-alone mutual depository institutions.

[4] These deposits are available to customers of banks that are members of a group of insured depository institutions, where each member of the group sets the interest rate to be paid on the entire amount of funds it places with other

letter from the ABA to the FDIC regarding reciprocal deposits offered by Promontory Interfinancial Network, these deposits exhibit the characteristics of "core" funding.[5] Notwithstanding these characteristics, the current statute governing brokered deposits, as implemented by the FDIC, creates instability in an otherwise very stable source of funding.

- Many of the programs to date have not helped struggling community banks. In addition to the issues noted above with the CPP and to the issues with the Legacy Loans Program discussed in the letter accompanying this attachment, we note the following:
  - The Legacy Securities Program has yet to result in a single transaction.
  - The Capital Assistance Program (CAP) has not been used to fund any institution.
  - The stress test conducted as part of the CAP served to bolster confidence in the largest 19 banks but had the unintended consequence of causing questions to be raised about the stability of smaller banks.
  - The CPP treatment of investments in stand-alone S corporations and mutual institutions as Tier 2 capital made that capital of considerably less value to those banks.
  - Some community banks that sought to participate in the Term Auction Facility have been denied the opportunity.

There are discrete actions the government can take to assist viable community banks to stop this downward spiral. The success of many local economies – and, by extension, the success of the broader national economy – depends in large part on the success of these banks. The accompanying letter outlines one such approach.

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group members and then swaps deposits with other group members. Such an arrangement enables a bank to offer its customers a convenient way to obtain FDIC insurance on large deposits by working solely with the bank with whom the customer has a relationship. As a result, the bank is able to attract and retain large deposits without having to post collateral, which in turn makes more funds available to meet the credit needs of the bank's community.

[5] Letter from Edward L. Yingling to the Hon. Sheila Bair, dated July 29, 2008.

Attachment B

Q2 2009 Capital Analysis for Bank under $5 Billion in Assets

$ in 000s

Capital Thresholds	# of Banks Below Threshold*	Amount of Capital to Reach Threshold
T1 - 8%	232	$2,352,917
TRBC - 12%	2,017	$10,970,676

* Eliminated 17 banks with negative capital ratios

Source: FDIC Call Report Data, Q2 2009