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November 26, 2008

The Honorable Henry M. Paulson, Jr.  
Secretary  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

RE: TARP-CPP for Non-Public Banks

Dear Secretary Paulson:

The utilization of TARP funds for the Capital Purchase Program (CPP) provides a very effective means to provide up to \$250 billion of immediate capital and liquidity to the US banking system and when combined with future bank deposit growth the CPP will support up to \$2 trillion of increased credit capacity for stimulating future economic growth.

In addition, the CPP (if fully invested) will pay \$62.5 billion in dividends to Treasury over the next 5 years – a net gain of over \$30 billion after the cost of funding the CPP investment program is considered. The CPP is clearly a financially sound program for the financial system, the economy and the American taxpayer.

To be effective for both Wall Street and Main Street the CPP investment program must be made available to all 8,308 financial institutions (as reported by the American Banker), except those that would not be viable even with the maximum CPP investment from Treasury.

Publicly Traded	932	11%
Privately Held	4,302	52%
Subchapter S	2,519	30%
Mutual Institutions	<u>555</u>	<u>7%</u>
Total Institutions	8,308	100%

The vast majority of community banks are profitable, well-capitalized and did not make, package nor do they hold the sub-prime mortgage loans that have created today's financial crisis. However, community banks and their local economies are now feeling the impact of the economic downturn created by the Wall Street financial crisis and their communities would clearly benefit if their local banks participated in the CPP.

The AABD was pleased Treasury's announcement earlier this week that CPP will now be available to 4,302 non-public community banks. We are disappointed that no announcement for mutual or Sub-S institutions was also forthcoming.

AABD proposes that Treasury also provide the following CPP structure (CPP-Debenture) that will work better for all non-public, mutual and sub-s institutions. This CPP-Debenture could be offered by Treasury as an alternative investment to the existing program. This instrument would supplant both the senior preferred stock and the warrants for additional preferred at the election of the participating financial institution.

- Treasury purchases a CPP-Debenture that pays 6.5% for the first 5 years and 10% after 5 years. (Equivalent to the economic terms announced).
- Each financial institution by the terms of the CPP-Debenture agrees not to deduct interest payments on CPP on the institutions tax return.
- Bank regulators agree to recognize the CPP-Debenture as tier 1 capital.

The CPP-Debenture offers the following benefits.

- Boards can negotiate a CPP-Debenture arrangement in a timely manner rather than being forced to request shareholder approval for issuance of a new preferred stock.
- A CPP-Debenture is a form of investment that may be utilized by non-public, mutual and Sub-S institutions with and without holding companies.
- CPP-Debentures are easy to understand by board members and shareholders of community banks that frequently do not have relationships with the sophisticated investment banking or national accounting firms required to explain complex financial instruments.

Feedback received from community bankers at the recent AABD Annual Conference and the American Bankers Association Annual Conference indicated that less than a third of the community banks in attendance planned to participate in the CPP. The following points were among the reasons expressed for non-participation in CPP:

- Section 5.3 of the Securities Purchase Agreement, that provides Treasury with unlimited unilateral ability to modify any term of the agreement after it is signed, is a major concern to healthy institutions. Many healthy community banks have indicated to the AABD that they don't need or want capital from the government with unknown future requirements. This provision should be eliminated.
- Some banks that could use CPP but have certain financial weaknesses fear that they will not be approved for participation. Banks have expressed concern that Treasury will utilize tougher qualifying criteria for smaller community institutions than for large regional or money-center banks.
- Many banks fear that Treasury denial of a bank CPP application will be viewed as a negative and will create customer concerns and deposit withdrawals. Because Treasury selection criteria are unclear, some banks have concluded that they are better not to ask than risk denial. This issue could be ameliorated by publishing clear criteria on qualification standards for CPP.
- Additional feedback suggests that the complex terms (as summarized on the attachment) announced last week will further discourage participation by healthy community banks.

The Honorable Henry M. Paulson, Jr.  
Page Three  
November 26, 2008

The AABD requests that Treasury seriously consider utilizing a CPP-Debenture as a means of providing a simple alternative that could be used by all non-publicly traded financial institutions and publishing the criteria being used to determine whether a bank qualifies for CPP.

Respectfully submitted,

/s/ *Charles J Thayer*

Charles J Thayer  
Chairman

The Hon. Sheila Bair, Chairman, Federal Deposit Insurance Corporation  
The Hon. Ben S. Bernanke, Chairman, Board of Governors, Federal Reserve System  
The Hon. John Dugan, Comptroller of the Currency  
The Hon. John M. Reich, Director, Office of Thrift Supervision  
The Hon. Barney Frank, Chairman, House Committee on Financial Services  
The Hon. Christopher Dodd, Chairman, Senate Committee on Banking  
The Hon. Spencer Bachus, Ranking Minority Member, House Committee on Financial Services  
The Hon. Richard Shelby, Ranking Minority Member, Senate Committee on Banking

## Private Bank TARP Thoughts

### Factors to Consider

- Capital availability may serve as an insurance policy in uncertain times
- Consideration must be given to future sources of repayment of TARP capital
- Regulatory oversight TARP participants and limitations on use of funds appears to be a moving target
- TARP preferred's after-tax cost of 6.4% (see table below) is equivalent to a 10.2% pre-tax trust preferred rate (assuming 37% tax rate) over the first five years, climbing to an after-tax cost of 9.9% after year five which is equivalent to a 15.8% pre-tax trust preferred rate

### Sample Financial Terms

	Amount (1)	Repayment at Year 5		Repayment at Year 10	
		Yield	Weighted Yield	Yield	Weighted Yield
TARP Capital	\$3,000,000	5.0%	5.00%	9.0%	9.00%
Warrant Preferred	150,000	9.0%	0.45%	9.0%	0.45%
Subtotal			5.45%		9.45%
Warrant Value Amortization			0.98%		0.49%
Total After-Tax Cost			6.43%		9.94%

(1) Assumes a \$100 million risk-weighted asset bank raises the full 3% of TARP capital.

### Impact to Capital Over First Five Years

Assumptions	
Total risk-weighted assets	\$100,000,000
Return on assets	1.00%
Common dividend payout ratio	30.0%
TARP capital	\$3,000,000
Asset growth rate	7.5%

	Today	Year 1 (1)	Year 2	Year 3	Year 4	Year 5
Total Risk-Weighted Assets	\$ 100,000,000	\$ 110,500,000	\$ 118,787,500	\$ 127,696,563	\$ 137,273,805	\$ 147,569,340
Pre-Dividend Earnings		\$ 1,105,000	\$ 1,187,875	\$ 1,276,966	\$ 1,372,738	\$ 1,475,693
TARP Dividend		\$ (163,500)	\$ (163,500)	\$ (163,500)	\$ (163,500)	\$ (163,500)
Common Dividend		\$ (331,500)	\$ (356,363)	\$ (383,090)	\$ (411,821)	\$ (442,708)
Retained Earnings		\$ 610,000	\$ 668,013	\$ 730,376	\$ 797,417	\$ 869,485
Total Risk-Based Capital	11,000,000	\$ 14,610,000	\$ 15,278,013	\$ 16,008,388	\$ 16,805,805	\$ 17,675,290
Total RBC Ratio	11.00%	13.22%	12.86%	12.54%	12.24%	11.98%

Total RBC ratio assuming repayment of TARP

10.06%

(1) TARP capital added to total risk-weighted assets and total risk-based capital.