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# THE CONDITION OF FINANCIAL INSTITUTIONS: EXAMINING THE FAILURE AND SEIZURE OF AN AMERICAN BANK

## HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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# THE CONDITION OF FINANCIAL INSTITUTIONS: EXAMINING THE FAILURE AND SEIZURE OF AN AMERICAN BANK

**Thursday, January 21, 2010**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Luis V. Gutierrez [chairman of the subcommittee] presiding.

Members present: Representatives Gutierrez, Maloney, Moore of Kansas, McCarthy of New York, Baca, Green, Clay, Miller of North Carolina, Scott, Ellison, Klein, Foster, Perlmutter, Speier, Minnick; Hensarling, Castle, Jones, Garrett, Neugebauer, Price, Marchant, Lee, Paulsen, and Lance.

Ex officio present: Representative Bachus.

Also present: Representatives Biggert, Davis of Illinois, and Rush.

Chairman GUTIERREZ. This hearing of the Subcommittee on Financial Institutions and Consumer Credit will come to order.

Good morning, and thanks to all of the witnesses for agreeing to appear before the subcommittee today. Today's hearing will examine the current state of the U.S. lending system, with a specific focus on a case study involving the bank holding company FBOP and its affiliated banks, including Park National Bank of Chicago.

The subcommittee has asked our witnesses to address not only the specifics of the case study, but also the overall picture of the health of the lending industry, as well as the process of how insolvent financial institutions are resolved.

Because of the interest of members on this issue, I will be increasing opening statements to 12 minutes per side, with the ranking member's agreement. But, without objection, the record will be held open for all members' opening statements to be made part of the record.

In addition, I ask unanimous consent that Congressman Davis, Congressman Rush, and Congresswoman Biggert and others be empaneled for this hearing, and that they be allowed 5 minutes each to question the panelists after the members of the committee. Hearing no objection, it is so ordered. I yield myself 5 minutes.

Ever since the beginning of this financial crisis in 2008, we have all heard about the big financial firms and the banks that have failed: Bear Stearns; Lehman Brothers; and Merrill Lynch.

But for every large bank that fails, there have been dozens of smaller community banks that have also failed, banks with names like People's First Community Bank and St. Steven's State Bank. Even banks like Park National Bank, that was supported by a largely successful holding company, fail every week.

While the focus of this hearing will be the failure of one particular bank holding company, it is my intention to shed light on lessons learned from recent bank failures and the insolvent bank resolution process. Last year alone, 140 banks failed across this Nation. And so far this year, four banks have failed, including three just last Friday.

Through this hearing, I hope to provide our banks better insight into the factors used by the regulators when they make their decisions, and for the regulators to have a better understanding of the impact that bank closures and consolidations have on our local communities and on civic and community organizations like our schools and faith-based institutions.

We should also examine today the FDIC's flexibility in accounting for factors such as the purchasing bank's knowledge of the market that it's moving into, as well as a bank's record of community investment and support beyond the standard CRA rating. If the FDIC requires a change in the current law to be able to account for our community's well-being, then by all means, we should have that discussion now, before more and more banks fail and consumers suffer even more than they already have.

Finally, I want to stress the importance of banks that focus on lending to our communities, and not simply on using their money to make profits through trading on Wall Street. Real economic growth in this country happens when we invest in Main Street. It is based on old-fashioned lending, through a loan to a bakery to buy a new commercial oven, by helping to finance the expansion of a local school, by helping to put a child through college, or simply by offering them a reasonable, affordable loan to purchase a home.

The economic crisis that we face was created by trading in confusing and all-too-crazy products like credit default swaps and mortgage-backed securities, not by financing the expansion of a hardware store down the street. This kind of trading is still based too much on greed. Just take a look at the decrease in lending last year, and compare that to the increase in bonuses doled out by many of the largest and yet most vulnerable institutions.

And, as our local lenders close all around us, these banks continue to play financial roulette. It's fundamentally backwards, and quite simply, counterintuitive. I believe that in order to stabilize our financial system, we must re-examine what it means to be a successful bank in this country, and encourage a return to fundamentals of lending.

I am glad to hear that President Obama will be addressing this very issue later today when he announces his plans for limiting the ability of commercial banks to conduct proprietary trading with their depository funds.

Finally, I want to thank all of you who came to this hearing—in particular, those who made the long journey by bus. I applaud your interest and your involvement in these important issues, which are vital to the sustainability of our communities. And I look forward to hearing the testimony of those before us today.

I yield Mr. Hensarling 4 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. And thank you for calling what is really a very, very important hearing. I think, although many would agree that the financial stability crisis appears to have passed, clearly, economic recovery has yet to take hold.

Unfortunately, since this Administration has taken office, we continue to be mired in double-digit unemployment, and 3½ million more of our fellow citizens have been put on the unemployment rolls.

We know that we have the highest level of bank failures that we have had, I believe, since the early 1990's: 140 last year, costing the Deposit Insurance Fund $36.5 billion.

We know that for only the second time in history, the Deposit Insurance Fund in September went into the red. The taxpayers of this Nation are being oppressed.

We have now seen, in just the last 2 years, the Federal deficit increase tenfold. Tenfold. We know that we are on a pathway now, under this Administration and this Congress, to triple the national debt in the next 10 years, and it's just a matter of time before they are knocking on the door of the taxpayer yet again to bail out the Deposit Insurance Fund.

We can afford no more bank failures. So I think it is important that we examine what is the cause, and also examine and try to understand why does there still appear to be a relative dampening of lending activity that is out there.

It is interesting, as we look at the case that is before us—and I read, I guess—I believe it was from yesterday's Chicago Tribune; I look forward to Mr. Kelly's testimony, I assume that they got it right—but reading from the 20th edition of the Chicago Tribune, "He," referring to Mr. Kelly, "had stashed $890 million in the preferred stock of government-sponsored mortgage lenders Fannie Mae and Freddie Mac, partly to fund acquisitions. This would be the biggest mistake of Kelly's career. At the time, regulators had created numerous incentives encouraging banks to invest in the so-called GSEs. They were deemed about as risky as government bonds, and were treated favorably when it came to evaluating a bank's capital."

Again, another data point on how the GSEs have simply wreaked havoc with this economy, and how the regulators were actually pushing their paper, creating exemptions for them.

And, speaking of exemptions, as we continue to look at how shocking a number of bonuses are, how about the bonuses for those who run the GSEs? We are paying more money for them to lose more money.

Why was it that the Administration waited until Christmas Eve to simultaneously announce that they are lifting the cap on taxpayer exposure to Fannie and Freddie—apparently $400 billion wasn't enough, apparently they hadn't wrecked enough banks already—lifting taxpayer exposure at the same time they were an-

nouncing $6 million bonus packages for their chief executive officers, $42 million for other execs. Those are the bonus structures that I want to be taking a look at. So, I'm glad that we're having this hearing.

Another thing we need to look at is, why is there a dampening of lending activity? Well, I talked to bankers in the fifth congressional district of Texas that I have the honor and pleasure of representing in Congress. I talked to them all over east Texas.

For example, I speak to Milton McGee, president and CEO of Henderson Citizens Bank Shares in Henderson, Texas. He said, "I think the primary reason we are not seeing much commercial lending is the uncertainty with what is coming out of Washington. The small business owner doesn't know what health care costs are going to do to him, plus any new taxes, as a result of the ever-increasing deficit. Business owners are not going to borrow and invest until they feel comfortable with the economic and political conditions. Way too many mixed signals are coming out of the Administration."

I hear that all over my congressional district. I hear it all over east Texas. I hear it all over America. If you want there to be greater lending activity, there is going to have to be less of a tax burden, and more certainty about the regulatory burden on these businesses.

I thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman GUTIERREZ. Mr. Bachus is recognized for 3 minutes.

Mr. BACHUS. Thank you, Chairman Gutierrez, and I thank you for holding this hearing. I want to focus on the community banks and the regional banks, because for some period of time, I have felt like the rules were being applied more aggressively towards our community banks and our regional banks.

In every part of the country, members are hearing from community bankers, frustrated by new, inconsistent, and often arbitrarily applied mandates from the regulators. This zealousness—or I would call it overzealousness—is stifling meaningful economic recovery. Healthy community banks across the Nation are dealing with conflicting standards, and hearing mixed messages from the regulators.

At the same time that the Administration is advocating for more consumer and small business lending, the bank regulators and the bank examiners are implementing regulatory standards in ways that inhibit responsible bank lending.

Mr. Chairman, no one questions the need for strong safety and soundness regulation of our Nation's banks, particularly those too-big-to-fail institutions that nearly brought down our economy during the recent financial crisis. But there is mounting evidence that pendulum may have swung too far, and that regulatory overreach is preventing our smaller financial institutions and our regional banks from meeting the legitimate credit needs of the communities.

In testimony before the Financial Crisis Inquiry Commission last week, Rusty Kluvier, on behalf of the ICBA, referenced a 2008 interagency statement called, "Meeting the Needs of Credit-Worthy Borrowers," that established a national policy for banks to extend credit. The statement said, "The agencies expect all banking orga-

nizations to fulfill their fundamental role in the economy as intermediaries of credit to businesses, consumers, and creditworthy borrowers."

But if this standard is operative, why is every Member of Congress hearing from bankers that regulators and their actions are undermining their ability to lend? Why are 61 percent of community bankers saying that their most recent safety and soundness exams were significantly tougher than their last?

Actions speak louder than words. These actions stand in sharp contrast to statements by the regulators and the intent of the law. The mixed messages from regulators are impeding economic recovery. However, the mixed message that is coming from this Administration, and many Members of the Majority in Congress are even more harmful.

The Administration and some Members of the Majority chastised banks for not lending, but then pushed legislation that discourages investment and creates uncertainty. Increases in capital gains taxes, the cap and tax bill, government-run health care, as well as the Administration's new bank fee create regulatory uncertainty. When the rules of the game are constantly changing, financial institutions are less willing to invest the capital needed to sustain economic growth.

Thank you for holding this hearing. I look forward to hearing our witnesses testify.

Chairman GUTIERREZ. Mr. Garrett is recognized for 2 minutes.

Mr. GARRETT. Yes, I thank the chairman, and I thank the chairman for holding this important hearing with regard to this one particular bank. But, along with my colleagues, I do believe the larger issue that we need to be looking at is the GSEs, Fannie Mae and Freddie Mac.

Because, as the ranking member said, it was indeed on Christmas Eve that the Obama Administration and the Treasury Department expanded and extended the bailout to Fannie and Freddie, and also approved those now-famous multi-million dollar compensation packages with nary a word from the chairman of this committee.

The CBO is currently projecting losses of over $400 billion by these institutions. So, when you think about it, we will probably end up spending more money on the bailouts for these institutions than what Congress did with TARP.

Since Fannie and Freddie were bailed out, we have had exactly one full committee hearing, and exactly one subcommittee hearing on this issue, entirely. So a lot of people think that this committee has been negligent in its oversight responsibilities in this area.

After Christmas, on December 30th, Ranking Member Bachus and I wrote a letter to the chairman, asking him to hold a hearing on this issue. But here we are, almost a month later, and no response to the hearing request.

I do understand that this topic may cause discomfort to some Members of Congress, considering the role that they played in basically shielding the GSEs from meaningful regulatory scrutiny in the period leading up to their collapse. Nonetheless, we shouldn't let past mistakes lead us from carrying on an oversight responsibility that we have now, going forward.

It was the chairman who did, in fact, announce a hearing on executive compensation for this Friday, tomorrow. But again, he has refused to agree with a request by Ranking Member Bachus to have the heads of Fannie and Freddie here to testify as well, as far as what their role is in all this.

The chairman even stated, "The public, having provided significant support for the purpose of restoring trust and confidence in our country's financial system rightfully insists that large bonuses, such as these awarded by institutions receiving public funds at a time of a serious economic downturn, cannot continue." Well, if that's the case, then it's really unacceptable that this committee has not responded. And we must respond in an appropriate manner.

So, once again, I do call on the chairman of the full committee to hold a hearing on the Obama Administration's expanded bailout of Fannie and Freddie—

Chairman GUTIERREZ. The time of the gentleman has expired.

Mr. GARRETT. —and the approval of their $1 million bonuses—

Chairman GUTIERREZ. Mr. Foster is recognized for 2 minutes.

Mr. FOSTER. I won't use my 2 minutes here. I just want to make it clear once again to everyone that we are dealing with the aftermath of the fact that, in the last year of the last Administration, $17 trillion of money was removed from this economy by the economic policies that were then in place. We should never forget who ran the car into the ditch here. And if you put those $17 trillion of money back into the local communities, back into the local banks, we would not be worrying about this today. I yield back.

[applause]

Chairman GUTIERREZ. I would remind you that you are all guests, and you are not to applaud for the comments of the members.

Dr. Price of Georgia is recognized for 2 minutes.

Mr. PRICE. Thank you, Mr. Chairman. I want to thank you and Representative Hensarling, as well, for holding this important hearing on the anatomy of a bank failure. This issue is of paramount importance, not just to this Nation, but especially to my home State of Georgia.

As you know, Georgia holds the distinction of having the largest number of failed banks in 2009: 25 of the 140. Banks in Georgia employ over 50,000 people, and hold $276 billion in assets. Most of these banks are community banks, which were mere bystanders to the financial and liquidity crisis of the last 2 years.

Understanding how a bank fails is critical to determining if all these failures are necessary, and if policies and procedures are being applied fairly and uniformly by prudential regulators, especially the FDIC. I have grave concerns that the FDIC has taken its mission to protect depositors and used it to promote a world in which there are fewer banks.

FDIC actions in the last 2 years have shuttered over 350 banks, and further concentrated assets in already large depository institutions. As a matter of policy, this is a judgement that should be left to Congress to debate and decide. Congress must ask itself and the FDIC if the United States is best served with deposits concentrated in relatively few banks. FDIC's own reports show that only 112 in-

stitutions have assets over $10 billion, which hold more than 75 percent of all assets at all banks, combined.

So, while Congress is not qualified to resolve failed institutions, and it's not my intention to tell regulators which banks should be closed and which should remain open, Congress must aggressively investigate the FDIC to ensure transparency for the American people from this opaque institution, which is literally destroying communities across our State. In fact, one individual in our home State said, "We're not losing an industry. We're losing communities."

So, today's hearing is just the first step to answer these questions. This committee must commit to doing its due diligence to understand the FDIC's decision-making process in closing financial institutions, and I urge the chairman to hold more hearings on this, and I look forward to those, and this hearing as well. Thank you, Mr. Chairman.

Chairman GUTIERREZ. Thank you. I yield myself 1 minute just to enter into the record, since I was here—I arrived here in the November 1992 election—and then in 1994, the Republicans were in the Majority, in 1996, 1998, 2000, 2002, 2004, and 2006, when finally we were in the Majority.

So, to hear my colleagues say that we shielded everybody, and that we were in charge, it's just not the historical record. As a matter of fact, let me see, President Bush was elected in 2001 and reelected in 2004, and the calamity happened the last year of his Administration. We weren't in charge, again. So, I just wanted to put it in some perspective.

And lastly, bonuses for GSEs? We proposed freezing bonuses for GSEs. That's our proposal. Every one of my colleagues on the other side of the aisle voted against freezing the bonuses of the GSE, but they want the GSE chairman to come before us. So that's kind of the record that we have.

And now we will open to the opening statement of our colleagues—

Mr. BACHUS. Mr. Chairman?

Chairman GUTIERREZ. Yes, sir?

Mr. BACHUS. Could I have a moment to respond?

Chairman GUTIERREZ. It's just that you—we have only used 7 minutes of our time—

Mr. BACHUS. Oh, okay, I see.

Chairman GUTIERREZ. We gave you 12 minutes on your side.

Mr. BACHUS. All right.

Chairman GUTIERREZ. So I am going to just—

Mr. BACHUS. I just wasn't aware of a bill that restricted GSE compensation. I would like a copy of it. Thank you.

Chairman GUTIERREZ. There is a hearing tomorrow on executive compensation, and it will come up tomorrow at the hearing.

Mr. BACHUS. Now I do have legislation to limit the compensation of GSEs—

Chairman GUTIERREZ. Really, really, you will have time.

Mr. BACHUS. Okay, thank you.

Chairman GUTIERREZ. I assure you, when your time comes up, either tomorrow or today, when 5 minutes—but the Majority used 7 minutes, we granted you 12 minutes. And you used your time, and we used our time.

Mr. BACHUS. Thank you very much.

Chairman GUTIERREZ. We are going to proceed. Before we get to the first panel, I would like to enter into the record an article entitled, "Failed Banker Called Local Hero," from yesterday's Chicago Tribune, which Mr. Hensarling quoted from as well, and a letter from the Oak Park mayor, David Pope.

I ask unanimous consent that these two items be entered into the record. Hearing no objection, it is so ordered.

And now, we will go to our witnesses today. Each of them will be recognized for 5 minutes. There is a little clock there, and it will get green, and then it will get yellow, and red means stop. So when you see the yellow, know that you have 60 seconds to kind of wrap it up. We know that we're going to be very gentle up here, in terms of giving you the time necessary.

We are going to start with Steve McCullough. He is the president and CEO of Bethel New Life in Chicago, and is here representing both his organization and the Coalition to Save Community Banking.

Next, we will hear from Michael Kelly, who is the chairman and CEO of FBOP Corporation, and is here representing himself.

After him, we will hear from Richard Hartnack, who is the vice chairman in charge of consumer and small business lending at U.S. Bank.

And finally, Ranking Member Hensarling will introduce Mr. Austin, a fellow Texan, a little bit later on.

Mr. McCullough?

## STATEMENT OF STEVEN McCULLOUGH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BETHEL NEW LIFE INC.

Mr. MCCULLOUGH. To the honorable members of the Subcommittee on Financial Institutions and Consumer Credit, thank you, Chairman Gutierrez, for inviting me to testify today. Thank you to the staff of your office for their support.

One year ago, my wife and daughter, who was then 5-years-old, drove to Washington to witness history. We would never have thought that 1 year later, we would be here again, but this time as an entire community, to reverse a bad decision by our government.

I represent not only myself as a proud resident of the West Side of Chicago, but also as a leader of a community-based organization named Bethel New Life that employs over 250 individuals and serves thousands of residents, and as a humble member of the coalition of citizens who have spontaneously, and in an unscripted manner, come together as a result of the seizure of Park National Bank, and First Bank of Oak Park Corporation, FBOP, in October of 2009.

I am here to speak on behalf of that broad and diverse coalition of community organizations, nonprofits, local leaders, religious institutions, and concerned citizens named "A Coalition to Save Community Banking." My testimony's intent today is to make a case for the reversal of the seizure of Park National Bank and FBOP Corporation by the FDIC, to question the process by which Park National Bank was seized, and to advocate for real reform that supports community banks across rural and urban America.

Park National Bank was a model community-based bank. It was both financially successful and mission-driven. It provided the quality of service, access to capital, and community reinvestment that all financial institutions should aspire to deliver. PNB demonstrated its commitment to the community by employing local residents and investing in new schools, small businesses, and affordable housing. PNB supported the work of local nonprofits and cultural organizations, and exemplified innovation, fairness, and flexibility. All of this is detailed in my written testimony.

Our experiences may be local in nature, but they are national in significance. In 2009 alone, 140 of the Nation's 8,000 local banks failed. And at this moment, more and more are struggling to stay afloat, as the FDIC issues demands for banks to raise capital reserves above standard thresholds. In Illinois, seven community-based banks are at serious risk, if not more.

What is the wisdom of a program like TARP that allows model financial institutions to die, while saving banks that have ignored the call to increase lending and to bank the unbanked? Why was TARP funding allocated to only the largest banks, while smaller banks collectively received a much lesser amount?

If we seek greater economic stability, then how does withholding crucial assistance from community-based banks advance the FDIC's goal of avoiding a future in which banks become too-big-to-fail?

Invoking the cross-guarantee authority, a mechanism used by the FDIC only 6 times in 20 years, the FDIC seized Park National Bank, along with its sister banks under FBOP Corp. Despite the fact that PNB was profitable and well-capitalized, it was unable to compensate for the heavy losses suffered by its subsidiaries in the south and west, which were particularly hard hit by the mortgage crisis. As a result, PNB was sold to U.S. Bancorp, along with FBOP's 8 other banks at a cost to the taxpayers of $2.5 billion. A pillar of our community and an exemplary bank was lost.

The seizure occurred only hours after United States Secretary of the Treasury Timothy Geithner personally awarded $50 million in tax credits to Park National Bank, an indication of confidence in the bank's stability and an acknowledgment of its vital role in community reinvestment and economic recovery.

Furthermore, the FDIC inexplicably disregarded FBOP Corp.'s request for a 1-week grace period following the seizure to formalize the acquisition of $600 million in private equity, which FBOP had secured to help stabilize the struggling banks.

We have come here today to ask why? To the residents of the community served by PNB, this seizure and sale are incomprehensible. Why was a financially successful, model community-based bank not only allowed to die, but prevented from saving itself? Why was the FDIC so inflexible that it would not grant the 7 days it needed to save itself? Why were TARP funds withheld from smaller financial institutions? And why is there still no relief for community-based banks?

We presumed, we hoped, that the buck stops here with the United States Congress and the White House. Imagine our frustration when we learned that, in fact, the buck does not stop here, that there was nothing that our congressional representatives or

the White House could do to alter the FDIC's decision. If the FDIC cannot be held accountable by our congressional representatives, then by whom? By what power? Who is regulating the regulators?

We believe that it's not too late to save our bank. We ask this subcommittee to urge the FDIC to reassess and reverse their actions regarding FBOP. If this cannot be done, we expect U.S. Bancorp, being the sixth largest bank in the United States, to not only meet, but exceed the commitment to our communities that Park made.

We ask that Congress exercise its full power to ensure that other community banks across our Nation do not meet a similar fate to that of PNB.

We rode for 14 hours on a bus to get here.

Chairman GUTIERREZ. Your time has expired.

Mr. MCCULLOUGH. And tonight we will make a 14-hour trip back home, because many of us cannot afford overnight accommodations. That is how important this issue is to our community.

We realize that this issue is bigger than us alone, bigger than—

Chairman GUTIERREZ. Mr. McCullough, your time has expired.

Mr. MCCULLOUGH. —Mike Kelly at Park National Bank and U.S. Bank. These are questions that you can answer for us.

Chairman GUTIERREZ. Mr. McCullough—

Mr. MCCULLOUGH. Our country is waiting for your response and for your leadership. Thank you.

[The prepared statement of Mr. McCullough can be found on page 131 of the appendix.]

Chairman GUTIERREZ. Thank you. I would ask the witnesses—that was almost a minute over—and there is 5 minutes for everyone.

Mr. MCCULLOUGH. I apologize.

Chairman GUTIERREZ. So when you see the yellow light, start summarizing. We are going to ask you questions. If you want to answer a different question than the one we're asking you to make a point—I think you all understand how we can get that done.

Mr. Kelly, you are recognized for 5 minutes.

**STATEMENT OF MICHAEL E. KELLY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FBOP CORPORATION**

Mr. KELLY. Thank you. Good morning. My name is Mike Kelly, and I am chairman of FBOP Corporation. Thank you, Mr. Chairman, and members of the subcommittee for inviting me to testify today.

I would like to give some brief remarks on the background of FBOP Corporation, and the events that led up to the closure of our nine community banks. I would also like to explore ways in which TARP funds might be made available to smaller community banks that are struggling in the current economic environment.

First, a little background on FBOP Corporation. FBOP Corporation was a $19 billion privately held multi-banking holding company headquartered in Oak Park, Illinois. We operated nine separate charter community banks in the States of California, Texas, Arizona, and Illinois. We employed 2,400 people. We were the largest privately held holding company in the United States, and the second-largest bank holding company in Illinois. We posted record

profits for 25 straight years, of exceeding earnings and service to the community, and had never, ever paid a common stock dividend. All earnings were retained within the bank group.

Regulators considered FBOP to be a problem solver, and approved us to acquire 29 institutions, primarily failed or sub-performing banks. We were recognized for best practices in credit administration by our regulators. We were rated as best in class by the largest real estate valuation company in the country as recently as only 6 months ago, and they referred to us as an A underwriter.

One-third of FBOP's 150 branches were located in low- to moderate-income census tracks. Our banks were consistently rated outstanding for their community investment efforts, an honor given to only 8 percent of banks in the United States.

In 2007 and 2008, FBOP Corporation banks made community donations and investments totaling $55 million, which represented 28 percent of our total earnings.

Fannie Mae and Freddie Mac are Government-Sponsored Entities created by Congress, which carried the implied guarantee of the government. Banks like FBOP invested in Fannie Mae and Freddie Mac because it was considered to be a very safe investment. At the time we acquired these investments, they were all AA-rated investments.

Furthermore, the market—in fact, the regulators assigned national banks like FBOP a 20 percent capital risk weighting for Fannie and Freddie preferred stocks, the same risk weighting as U.S. agencies or cash. The regulators considered it so safe that the FDIC permitted banks to invest up to 100 percent of their tier 1 capital in Fannie and Freddie preferred securities.

But on September 7, 2008, the Federal Government took over Fannie Mae and Freddie Mac, and rendered these investments worthless. This takeover created an $885 million impairment loss for FBOP in an investment that it considered to be a safe haven and a conservative investment. It left four of our banks less than well-capitalized.

On the morning of the takeover, Secretary Paulson made a statement to the press, and I want to quote here, if I may: "The agencies encourage depository institutions to contact their primary Federal regulator if they believe that losses on their holdings of Fannie Mae and Freddie Mac common or preferred shares, whether realized or unrealized, are likely to reduce the regulatory capital below well-capitalized. The banking agencies are prepared to work with the affected institutions to develop capital restoration plans consistent with capital regulations." In our case, this did not happen.

I am also here this morning in the hope that other well-run, still-viable community banks are not closed unnecessarily. While more than 100 community banks have failed to date, estimates are that many more are still in danger of failing. Few of these community banks have ever engaged in predatory lending practices, or awarded exorbitant compensation packages to their executives.

The first round of TARP provided a great deal of assistance to the largest banks during the worst financial meltdown since the Depression. Since then, Treasury has now imposed very strict guidelines for access to TARP. These guidelines were not in place

for the larger community banks when they were fully funded in the initial stages of the TARP program.

The small community banks are bearing the brunt of these stricter guidelines. For example, regulators now require that, for a bank to qualify for TARP, they have to be well-capitalized and rated as either a one or a two institution—the top ratings. There are few banks in the United States today that meet that criteria.

The issue of these smaller community banks stem not from poor management, but from their commitment to their communities as an active lender.

Chairman GUTIERREZ. Take 30 seconds and wrap up, Mr. Kelly, please.

Mr. KELLY. I have some other remarks. Hopefully, I will be able to make those in the question stage.

Chairman GUTIERREZ. And your complete statement will be entered into the record without objection.

Mr. KELLY. Thank you.

[The prepared statement of Mr. Kelly can be found on page 112 of the appendix.]

Chairman GUTIERREZ. Thank you, Mr. Kelly.

Mr. Hartnack?

**STATEMENT OF RICHARD C. HARTNACK, VICE CHAIRMAN, U.S. BANK**

Mr. HARTNACK. Thank you very much, Mr. Chairman. And members, I appreciate the time to speak with you today. In the time allotted, I would like to just give a little bit of background on a couple of points that I think are relevant to the discussions here.

First, though, I would like to talk just a little bit about our bank. U.S. Bank has been participating in resolving failed banks because we have maintained a record of superior performance: consistent profitability; strong capital position; and far fewer loan problems than many banks in the country.

To understand U.S. Bank, you should think of us as the largest community bank in America, not the smallest big bank, and certainly not a Wall Street bank. We are headquartered in Minnesota—go Vikings—and our business practices reflect our Midwestern roots and values.

Second, in our view, the FDIC process, subsequent to the decision by the prudential regulator to fail a bank, is a sound, transparent, fair, and value-maximizing process. Our experience has been entirely satisfactory, and we believe we have met all of the obligations for the transactions in which we have participated.

Third, we want you to know that we are in this process of resolving failed banks as an opportunity to invest in communities and expand our community franchise. We are not in this for a quick trade. We are not in this for a fast buck. And, as a result, we pay a lot of attention, in every case, to employment, maintaining branch access in the communities, community relations, and community support. We do everything we can to retain clients, enhance our reputation, and maintain support for the community.

Finally, we believe our track record of financial performance, growth in our customer franchise, well-documented community reinvestment, and community support, and community development

lending and investing all suggest that the FBOP franchise has ended up in capable, caring hands. Thank you, Mr. Chairman.

[The prepared statement of Mr. Hartnack can be found on page 92 of the appendix.]

Chairman GUTIERREZ. Thank you. And Mr. Hensarling will introduce Mr. Austin.

Mr. HENSARLING. Thank you, Mr. Chairman, for the courtesy of introducing our next panelist. Jeff Austin is a fourth-generation banker, and vice chairman of the board of Austin Bank Texas. He also happens to be chairman-elect of the Texas Bankers Association.

He has, in the past, served as: the past chairman of the Tyler Area Chamber of Commerce; a member of the Frankston/Lake Palestine Chamber of Commerce; a member of the development board and the audit committee of the UT Health Science Center in Tyler; a board member of Lon Morris College; a board member and past president of East Texas Area Council Boy Scouts; a member of the Better Business Bureau of East Texas; and a member of the Children's Advocacy Center of Smith County. If we had more time, I could go through the rest of his biography.

But the point I would like to make is there is simply there is very little good that goes on in charity or economic development in east Texas that Mr. Austin is not involved in or knows of. He is a very important voice in banking in east Texas, and a very respected voice in banking in our State.

And, although he is technically not a constituent, I would be proud if he was. I am happy that he has joined us here today. Mr. Chairman, I introduce Mr. Austin.

Chairman GUTIERREZ. And Mr. Austin, you are recognized for 5 minutes.

**STATEMENT OF JEFF AUSTIN III, VICE CHAIRMAN, AUSTIN BANK**

Mr. AUSTIN. Thank you, Congressman Hensarling, Mr. Chairman, and committee members. I am proud to be here this morning. Like many other bankers across the country, we are involved in our communities, and we are on the front line when boards and people call us for involvement.

My message is clear this morning, and I want to state it simply: I am proud to be a banker, and please do not shoot the survivors.

The theme is an underlying and frustrating tone among many bankers across the country. This is also felt by the hundreds of thousands of employees and many other bankers across the country.

The investment banking activities of some of the Wall Street giants that are sometimes loosely referred to as banks, or "the shadow banking system," have been inappropriately blended with banks like ours. There seems to be a populace view that banks are not lending. I just looked in the Washington paper this morning, and it said, "Slow Lending; Cautious Banks."

This is true for banks across the country, but I will say that when the economy slows down and when some of the large banks as stated here in the Washington paper this morning slow down, if they sneeze, smaller banks catch pneumonia.

By saying banks do not want to lend, it's like telling McDonald's they do not want to sell hamburgers. We do want to loan money. That's our mission, that's our purpose. And we ask for your help to help us get back to this without throwing on unnecessary regulations, unnecessary taxes, unnecessary intrusion into compensation, and a lot of distractions that take us away from doing what we are supposed to do.

I would also suggest when you go back into your districts over the next couple of weeks, create a conference call. Talk to your bankers. You're going to hear a lot of other stories like the ones that you have heard here, and the ones that I will share.

Recent exams? They're not like they used to be. There is probably an overkill, looking at recent valuations on real estate that are being applied with distressed values. Banks are having to put up reserves against loans that have not taken losses. We're building them up.

And, in addition, the SEC's rules and proposal from FASB-5 do not work. The intent of that was banks that were building up reserves in good times, they did not want that to happen, where it could come back into earnings. We would like to be allowed to build up reserves in the good times to prepare for the turbulent times that we have right now.

There are a lot of things that are happening in the banking industry. Traditional bankers, as we are—there is a difference—we know our customers. We want to loan to them, we want to be involved with them. We want to work with them through the different and varying economic cycles.

I have submitted my written testimony. I would like to give some time back and make myself available to answer some questions.

But again, we are proud to be bankers. I am proud to be a banker. And please, do not shoot the survivors.

[The prepared statement of Mr. Austin can be found on page 62 of the appendix.]

Chairman GUTIERREZ. Thank you, Mr. Austin. And I will yield myself 5 minutes.

Welcome to everyone, especially those who did come on a bus. I know you will be returning on a bus shortly after this hearing, back to Chicago.

We have work to do. Because, as Mr. Kelly suggests, and I agree with him, Fannie Mae and Freddie Mac, while not guaranteed by the Federal Government, certainly were taken over by the Federal Government, and certainly were institutions that were created by Federal mandate. And I remember when the Secretary said, "Tell us about your losses," and the fact that did not happen in your institution, with nearly $900 million worth of equity that you had in Fannie Mae and Freddie Mac when it all disappeared overnight. So I think that's a very serious issue that we should take a look at.

And I agree with Mr. Kelly when he says that the rules were changed. That is, the bigger, larger institutions were able to access, by signing, actually, just a document, a sheet of paper no larger than—and with probably fewer words than many of the sheets of paper that we have here before us, in terms of our testimony, a simple signature and billions of dollars were transferred to them.

And the rules changed in that smaller institutions that were out in the community didn't have access to that capital at the second place. So I think that's an important issue that we should—so I understand the basic unfairness.

And Park National Bank, within the holding company, obviously had a stellar reputation and condition, in terms of its relationship with the community, the geographical community that it represented. And I think it's fair—it might not be the—in the regulations, you know, it might not be in the law, it might not be what is stated—but it seems fair that if the FDIC sells an institution to—in this case to U.S. Bank—that U.S. Bank consider what that institution was doing within the community when they acquired it.

So, it not only acquires the accounts that were there, and the assets that were there, but it also acquires the history of that institution, and the relationship that institution had with that community. I think that is important.

Because what we're talking about, Mr. Austin, is not affecting your bank. What we're talking about is what you suggested earlier. Many of the larger banks are really investment banking firms, and that's where they're making their money. Because we see many of them, the larger—the ones that got the TARP money, they are lending less money.

But what is curious to us, and what we want to get down to is, if you are lending less money, but you're giving out billions of dollars of bonuses at the same time you're lending less money, then obviously you're profitable somewhere. But you're not profitable to the people who need, that is, by lending money to people. So you must be making your money somewhere else, while you're FDIC-insured, and while the Federal Government is standing behind you, and why, in many cases, you receive TARP money.

So, that's the—it's really not the community bankers. I think we need to explore how it is we do ease up. But it's the large banks that got the TARP money, that survived, that brought us into this crisis, that today are—you read about it, billions of dollars in bonuses, handing out billions of dollars less in loans.

So, it seems to me you got the money, you're just not lending it. But you're keeping it in-house to give the billions of dollars of bonuses to your top employees, while not creating any economic activity, other than trading in equities, which I imagine is economic activity of a few people on Wall Street, as they trade.

But it doesn't create bakeries, it doesn't create homes. It doesn't create a hardware store. It doesn't create economic activity. It doesn't give somebody a truck that they might need so that they can start a landscaping service, I mean the basic fundamental kinds of things that people need and need access to capital.

So, having said that, Mr. Hartnack, I don't come to U.S. Bank—just so that we understand from the very beginning—in terms of what happened, in terms of making any judgements. But I would like to ask you, what has U.S. Bank done since it acquired the institution to keep that kind of faith and that kind of activity that was so well-known and cherished with Park National Bank? If you could, just speak to that a moment.

Mr. HARTNACK. Thank you, Mr. Chairman. I would like to make sure that the record would reveal that U.S. Bank took TARP—

probably, in 20/20 hindsight, didn't need it—paid it back, and doesn't pay billions of dollars in bonuses. So—

Chairman GUTIERREZ. That's why I tried to not be defensive here.

Mr. HARTNACK. Yes, okay. So I just want to be sure we—

Chairman GUTIERREZ. If you could just speak to that issue, because—

Mr. HARTNACK. Yes—

Chairman GUTIERREZ. —time is up.

Mr. HARTNACK. Yes. With regard to the process of integrating a new institution into our company, we have a process that we follow both in open market transactions and in these FDIC transactions. Fundamentally, we come to the bank, sit down with the management that's there, and begin a process of understanding the bank, in terms of customers on the loan side, customers on the—

Chairman GUTIERREZ. I'm trying to—because the time has expired, my time has expired, here is what I'm going to ask you to do. I'm going to ask you to put in writing to this committee what it is U.S. Bank, since acquiring these assets through the FDIC, since bidding on these assets, what it has done to keep its relationship. Is it keeping—what are your commitments, given the past history of Park National Bank, to the community? If you could, just roll those out. We will have a chance to talk a little bit later.

Mr. Hensarling, you are recognized for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. Mr. Kelly, my first couple of questions will be for you, as I read through your testimony.

My first question is, had the FDIC not had their rule in place, which you cite in your testimony, that allowed 100 percent of Fannie and Freddie preferred stock to count against the tier one capital where other investments are generally restricted to 10 percent, would you have concentrated as large of an investment in Fannie and Freddie?

Mr. KELLY. Absolutely not.

Mr. HENSARLING. Okay. So but for the FDIC rule, you would not have had that concentration. But for—

Mr. KELLY. If I could elaborate on that just for a second?

Mr. HENSARLING. Please.

Mr. KELLY. There were four special regulations put in place by the FDIC and the OCC to specifically encourage banks to buy these instruments. We were allowed to buy no other equity-type instruments, other than this preferred stock. Preferred stock, in this instance, was nothing more than a highly-refined debt instrument. We had unlimited amounts—we were actually given regulatory—lowest regulatory capital, the same as a government issue. And there were a number of incentives for banks to buy this.

We thought this was a safe haven, AA-rated instruments. We were never criticized by our examiners for the investment, or the large concentration in it. This was a terrible mistake on my part, on our part. But there were so many incentives in there to do this.

Mr. HENSARLING. So, in some respect, your mistake was you trusted your government, which told you to go out and invest in Fannie and Freddie?

Mr. KELLY. We did believe that the government backed these instruments. They created the organizations. There was no SEC reporting on these—we could not define and analyze this, as we could with any other investment.

Mr. HENSARLING. So, Mr. Kelly, you said but for the regulators, you would have not had the concentration of Fannie and Freddie. Once you had the concentration of Fannie and Freddie—but for that, would you still own the bank today, had you not concentrated in Fannie and Freddie preferred stock?

Mr. KELLY. Unquestionably. We took a $900 million hit that wiped out over half of our capital on September 7th. We were never able to recover. TARP funding would have been adequate for us to recover and go forward. That was not available to us.

I still don't understand why that wasn't available. We were approved for TARP in October. We were called and told we had received TARP. The next day we were told that, "I'm sorry, there is nothing in place for a privately held bank, only publicly traded banks are eligible for TARP at this time. You will have to apply next month." We did after already being approved, and our request was deferred into January, there was a change in administration, and we never got a yes or a no on TARP.

Mr. HENSARLING. Do you have a personal or professional opinion about the Administration announcing $6 million bonuses for the execs of Fannie and Freddie?

Mr. KELLY. That's a little beyond my scope of expertise. I am going to defer on that.

Mr. HENSARLING. Thank you. Mr. Austin, I would like to turn to you. I believe—hopefully you—I certainly listened to your statement, I hope you listened to mine, as I quoted one of your fellow east Texas bankers, Milton McGee of Henderson Citizens Bank Shares.

I would like to quote another Texas banker from Royse City, president and CEO of Texas Leadership Bank, talking about what he sees as a relative dearth of lending activity. He said, "I would say it's twofold with lenders and borrowers. Borrowers are reluctant to take on additional debt during an uncertain economic period. They are reluctant to invest their liquidity as equity. They are unsure how much additional tax and regulatory burden that the President and the leadership in Congress may place on their business. Lenders are reluctant to take on additional risk during an uncertain economic period. Lenders are focusing their efforts on improving existing asset quality, rather than on new business opportunities, and are reluctant to take on any moderate levels of risk that are under the current intense regulatory scrutiny that may subject the institution to potential criticism."

So, these are just two of the bankers in Texas. Are these fair characterizations, as far as what many of us in Washington perceive to be an inadequacy of lending activity to help get this economy going? Could you elaborate on your views?

Mr. AUSTIN. Sure. Congressman, those statements would be echoed by bankers across the country in every community. We are facing a glut in lending, because our focus has shifted from—we want to continue working with our customers, but we have shifted our focus to focus on the unnecessary regulation, the proposed reg-

ulations that are coming down, and really trying to build up capital reserves. Capital is king.

And taking on unnecessary risk is something that bankers are not going to do. We're cautious by nature. We do want to lend money, but we need to be able to get back in. And looking at some of the exams that are coming from our regulators, we know they have a job to do, and this has nothing to do with the personalities, but the examinations are extremely tedious, looking at the alphabet soup of regulations, and that's taking us away from being able to loan money, which is what we're here to do.

Mr. HENSARLING. Thank you.

Chairman GUTIERREZ. Thank you, Mr. Austin. Congressman Moore, you are recognized for 5 minutes.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman. Mr. Austin, on page four of your testimony, you say that "no examiner or agency wants to be caught not enforcing consumer protections or stated regulations because of the real fear of criticism from the inspector general's office."

Are you saying examiners are only being tough on banks now because an IG might double-check their work to see if they're fully enforcing the law?

Before you respond, I would point out that taxpayers have learned a lot from recent IG audit material loss review reports. For example, the Treasury IG found six examples where OTS was complicit—or even worse, directed banks to back-date capital infusion so they would appear healthier than they really were. One OTS official involved resigned a few weeks after I wrote a letter to the acting director, inquiring why he had not been fired.

So, should Congress eliminate these inspectors general with the hope that the bank examiners will look the other way if there are fewer consumer protection violations?

Mr. AUSTIN. Congressman, thank you for your question. I will say I'm a fourth generation banker.

Mr. MOORE OF KANSAS. Yes, sir.

Mr. AUSTIN. I have read the minutes of a couple of our banks going back to the 1920's and 1930's. Trust me, examiners were tough then, too. That is something that has not changed. And they have a job to do.

We have one of the most sound banking systems in the world, and I think all of us can be proud of that. It's like going to the doctor. They're going to ask you to do some things, and maybe it's going to improve your health, which we need to continue to do. But some of the unnecessary results of swinging the pendulum too far, that's what we are concerned about.

With the proposed creation of a consumer protection agency, I think that's also adding another unnecessary agency that would impose duplication and cause someone else to take a look at the examinations or the regulations, when we already have qualified experts with our regulatory agencies doing that right now.

Mr. MOORE OF KANSAS. How do we protect and assure the public that we're going to make sure what happened in this incident doesn't happen again in the future, then, if we don't put some further regulations in place to make sure that this doesn't happen again?

Mr. AUSTIN. Regulations are good. Unfortunately, some people look at them as suggestions. We do not. And how we interpret these, our banks are profitable. We are staying focused to our core mission, and that's lending back in our communities, working with borrowers that we have known for a long time, and been able to work with them through various cycles. That's what traditional bankers do.

Mr. MOORE OF KANSAS. But what about other bankers you're calling, I suppose, non-traditional? I understand the community banks, and I have talked to my people back home.

What should Congress do? What should this committee do to try to ensure that what happened before doesn't happen again?

Mr. AUSTIN. There are some of the activities that we did not engage in that I can come back with some other responses from other—I think some of the other entities are better qualified to answer that than I am, because we did not engage in those activities for a reason. Some banks do not have the expertise to do it; we did not have the expertise to do that.

What can Congress do? One thing is to take a look at some of the other GSEs. Keep the respective agencies focused with their core mission, and do not allow mission creep. Keep the banking focused on banking. I have been involved in listening to different discussions of, let's put the firewalls back up between traditional banking activities and the other activities. That's something that I think we could take a look at.

Mr. MOORE OF KANSAS. Thank you. Mr. Kelly, I would like you to talk about how the culture of excessive lending and abusive leverage contributed to the financial crisis. Will we ever know what the appropriate level of leverage and use of debt is that would maintain financial stability?

I have heard from many bankers back in Kansas that bank examiners seem to be overcompensating, and not allowing them to loan as much as they prudently could. But how do we, as lawmakers, help strike the right balance of responsible lending that's safe and sustainable, while also giving affordable credit to the small businesses which can help create jobs, get people back to work, and promote economic growth?

Mr. KELLY. That's a lot to answer. My response is that one of the basic things that can be done is allowances for banks to maintain larger loan loss reserves, generally. That's basically prohibited under FASB right now.

Everyone knows that banking is a cyclical industry. There are going to be downturns. There is no cushion allowed right now for loan loss reserves. That has to be changed, so when the bad times come, there are reserves there.

As far as—I am sorry, the other part of your question?

Mr. MOORE OF KANSAS. Well, that was it. And I would just ask you if you have—

Mr. KELLY. That would be my one recommendation.

Mr. MOORE OF KANSAS. If you have any further comments you would like to make, I would appreciate those in writing after this. My time is just about up.

Mr. KELLY. Thank you.

Mr. MOORE OF KANSAS. Thank you. Would anybody like to address that in the few minutes we have left here?

[no response]

Chairman GUTIERREZ. The gentleman's time has expired.

Mr. MOORE OF KANSAS. Thank you.

Chairman GUTIERREZ. Mr. Bachus, you are recognized for 5 minutes.

Mr. BACHUS. Thank you, Mr. Chairman. Mr. Austin, we hear from local bankers that they're being told by examiners in certain cases to require what they consider excessive principal payments that the bankers believe will cause borrowers to default. In other words, they're told, "You need to have a payment on principal," and the bank is actually just collecting interest.

And the banks, you know, a lot of them feel like if they had exercised forbearance until the economy improved, that the borrower could have been able to meet those things. But we hear that examiners are sometimes requiring collateral write-downs, and that both of these things are causing unnecessary loan defaults. Would you like to comment on that?

Mr. AUSTIN. Yes, sir. Thank you for asking that. What you're hearing is reality. I can cite several examples of where we have had good paying customers, we have known them for a long time, they're paying as agreed and on time. But we may—for example, we may have a loan that may be based on a 20-year amortization with a 5-year balloon payment. When it comes time to renew that payment, that amount, examiners are asking us now for a new appraisal.

Let me use an example. Say you purchased a farm for $120,000; we financed $100,000. Maybe you have paid down to $95,000. But when that 5 years comes up, we obtain a new appraisal, as required, but it comes back at $70,000. We're going to have to write that down by creating a reserve of an additional $25,000.

The real heartbreak in this situation comes when we come back to you, as a customer, and we say, "Mr. Customer, would you bring us another $25,000 or $30,000 to pay down, so we can be within the loan limit, or will you bring us additional collateral?" And this comes at a time when many customers are strapped for cash, they're trying to expand, they're trying to keep their own households afloat.

May I add? A lot of these valuations in real estate are also caused by the forensic exams after banks are closed, where, in many parts of the country, even in east Texas, bankers are being asked by the regulators to include—and by the FDIC—to include a liquidation value on real estate. That is depressing the local real estate markets. It is dumping real estate that is really—it's not helping the communities, and it's not helping the banks, and we're creating reserves against unrealized losses.

Mr. BACHUS. Thank you. Yes. I think, in many cases, the regulators or examiners are making underwriting decisions that I think the bank ought to make. And—

Mr. AUSTIN. Yes, sir.

Mr. BACHUS. —as you say, I think it is causing all kinds of problems.

Mr. Kelly, I noticed that a week after your bank was taken over, President Obama signed into law a bill easing the rules on how Fannie and Freddie losses can be realized.

Mr. KELLY. Right.

Mr. BACHUS. Would that—and I know the Chicago Tribune article says that would have dramatically reduced the amount of money that you would have had to have raised.

Mr. KELLY. That's correct. That was worth as much as $200 million in capital to us. It would have raised our capital levels, and it also would have vastly improved our chances to raise outside capital.

Mr. BACHUS. Did—

Mr. KELLY. We knew that was pending, the regulators knew it was pending. We asked for an additional week. It was not granted. We had always been a top-rated bank, one and two in all categories in banking. We had excellent rapport with our regulators prior to the GSE issue. And why we got no accommodation, I still have no answer.

Mr. BACHUS. Yes, that was going to be my next question, you know. You knew it was coming, they knew it was coming. It would have reduced our cost, and yet they didn't extend you a one-week extension.

Mr. KELLY. No, that's a good question. I do not have the answer to that question.

Mr. BACHUS. Yes, I don't, either. I can't imagine.

Mr. Hartnack, when U.S. Bank took over—and I notice you all have taken over several failed institutions—the FDIC took a $2.5 billion write-down. Is that correct?

Mr. HARTNACK. I think those are the numbers that they estimated at the time, yes, sir.

Mr. BACHUS. Yes, and I don't know that you can answer this, but Mr. Kelly was offering a plan that would have cost $600 million. And maybe less, had they waited another week. But it cost $2.5 billion, the deal they made. Is that—

Chairman GUTIERREZ. The ranking member—

Mr. BACHUS. Is that kind of—

Mr. HARTNACK. Yes, I really wouldn't be in a position to address that. I think, you know, we came in after the fact, and—

Chairman GUTIERREZ. The time of the gentleman has expired. The FDIC witness will be here, and I am sure we will ask him those questions.

Mr. BACHUS. Thank you.

Chairman GUTIERREZ. Mrs. McCarthy from New York is recognized for 5 minutes.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman. I appreciate you holding this hearing. I apologize for not being here for the first part of your testimony, though we did go through all the testimony last night.

One of the things, Mr. Austin, that I want to ask you is, in your testimony, you discuss the many hurdles facing the survivors of the recession, and one of them is dramatically higher capital requirements. What are the capital requirements imposed on community banks versus the larger financial institutions? What would you con-

stitute as a fair capital requirement for community banks versus the large banks?

Mr. AUSTIN. Congresswoman, thank you for the question. The capital requirements for FDIC-insured institutions are really basically the same.

Some of the differences are going to be based on the risk weighting of our assets. And I think that is what we need to turn around and look at—for example, some banks maybe are more highly concentrated in commercial real estate versus one-to-four family real estate. One-to-four family real estate has a lower risk weighting than an investment property. And I think that's something—when we look at the—this is one thing that the regulators do come in and review with great intensity, our balance sheets.

In regards to capital standards, one concern that we are seeing is listening to some investors and some others that may want to charter new banks. The FDIC is—we have heard—I have not tried directly, but from some of our members and colleagues—are not allowing new banks to be chartered until they can recapitalize and increase the FDIC Fund.

One consequence from this is that with the new banks that have recently been chartered, they are requiring substantially higher capital ratios.

Mrs. MCCARTHY OF NEW YORK. Thank you. Mr. Austin, the ranking member had actually asked the kind of questions that I was going to be—I'm sorry, Mr. Kelly—what I was going to be asking.

But one of the things—we will have the opportunity this afternoon—is going to be with the regulators, and I think that we can follow up. I think that was one of the reasons we reversed it. We wanted to hear from all of you before we started talking to the regulators because, obviously, the regulators are the ones who are putting you through the hoops, as we say, so that we can take your testimony and then ask the questions.

But on one of the parts that we were looking at, were you given any guidance on how to modify your application, or any changes that were necessary, given the new Administration—going with your testimony to Mr. Bachus earlier?

Mr. KELLY. I would have to say that the Office of the Comptroller of the Currency, our primary regulator, was very supportive, they were very helpful, they were very sympathetic. Right from the beginning, they acknowledged that our issue was GSE only. They referred to us as a well-managed bank with strong asset quality and a good track record.

And they strongly recommended us for TARP approval in October. We were approved for TARP approval by the regulatory committee. But because we were not a publicly traded bank, they had no rules in place to deal with private banks that did not have a stock price.

Therefore, we were deferred, and that deferral took us into January and February. The rules totally changed. The rules became so restrictive that the only way you could get TARP is you had to be well-capitalized. We, by virtue of the GSE losses, were not well-capitalized. Therefore, we didn't qualify. The rules were vastly different for the larger, publicly traded banks than they were subsequently for the smaller banks and privately-traded. And also, the

guidelines were done at a period well into the economic downturn, when everyone's numbers looked much more difficult, as far as loan loss provisions and delinquencies.

Mrs. MCCARTHY OF NEW YORK. And I'm sorry if I missed this part. Could you tell me what happened to your customers? What was the results to your customers?

Mr. KELLY. I think that has yet to be seen. I think we're concerned. We hope that U.S. Bank will step forward and meet the commitments that we had in place, both the donations, the financial institutions—many of our institutions, many of our not-for-profit companies, are totally dependent on the commitments we made to support them. And I am hopeful, and I believe that U.S. Bank will step forward and do that.

But the effect on our customer base, U.S. Bank has a vastly different model than our model. They're a very efficient bank; they run with fewer people. We had 2,400 people, and I am very concerned about how many people will be employed by U.S. Bank a year from now.

Mrs. MCCARTHY OF NEW YORK. Mr. Hartnack, could you follow up on that, on what was just said?

Mr. HARTNACK. I'm sorry. Say it again.

Mrs. MCCARTHY OF NEW YORK. Could you follow up? I was asking what happened to the customers of the banks. It was mentioned that U.S. Bank was now taking over. Could you tell me what's going to affect—

Mr. HARTNACK. Sure. I think we would look at the depositors first, and assure you that we continue to offer the same products. In fact, the products are unchanged at this point. They will be modified during computer conversion, but will be substantially the same.

Interest rates have come down, so depositors are seeing lower rates, but they would have seen those lower rates, even if—

Chairman GUTIERREZ. The time of the gentlelady has expired. Thank you very much.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman.

Chairman GUTIERREZ. Mr. Neugebauer for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I thank our witnesses.

Mr. Austin, I want to go back to something you said, because it's something I have heard from my community bankers not just during this period, but for a number of years, which is that during good times, when earnings were good, and the economy was stable, growing, that attempts to increase, you know, kind of beef up the balance sheet were resisted by the examiners.

But yet they were very quick to come in, when the economy turned down and the asset quality diminished some because the economy, to tell you you needed to build your capital back up. Am I repeating that correctly?

Mr. AUSTIN. Yes, sir. It's capital in reserves, as well. And if I may answer part of that based on our loan loss reserve, I think back many years ago when we, after an exam, we would ask our examiners for what is called a certification letter. That certification letter, on their letterhead—FDIC, State Department of Banking, or

OCC—would really state that, "We're declaring your reserve adequate."

We would, in return, take that to our CPAs to defend, in case of an IRS audit. Because, under the current rules, we're only able to deduct from income taxes the amount that—to the extent of our losses, based on the reserve. That would not allow us to build up—and it was a disincentive to build back up our reserves.

Today, when we are trying to build them back up, it's at the worst time, with depressed earnings. When anything takes a hit to earnings, that takes away from money that we can loan back into our communities, which is what we are geared to do.

Mr. NEUGEBAUER. And, in fact, banks are—like most small businesses—is that the best source and most ready source of capital is earnings, and retaining those earnings. Is that correct?

Mr. AUSTIN. Capital is king, yes, sir.

Mr. NEUGEBAUER. And so, what would be some of your suggestions that we take, moving forward here, to take care of both sides of the ledger there, one, the regulatory side, and the tax side, to allow financial institutions to, in fact, build up those loan loss reserves so that in the event the storm comes again, that they are able to weather those better?

Mr. AUSTIN. There is more than one solution, and this is the beauty of this, but it is going to take working with the SEC, the IRS, and FASB to allow us to do this. By us being able to increase these reserves within a prudent amount by using the banker's judgement, based on their characteristics, their level of risk tolerance, we would like to put that back in the hands of the banks and the bank management, regardless if you're publicly traded or not.

I know of one recent exam from a colleague. One of the examiners asked them, "Well, is your excess or unallocated reserve going to be greater than $15,000? And the reply was, "No, we will get it down to $12,000," because either they were going to find something else to charge off, or they have to back it back into earnings.

Mr. NEUGEBAUER. Thank you. Mr. Kelly, I want to go back to something you said, that except for the portfolio of the preferred stock that you had in Fannie, the rest of your asset quality was found to be acceptable to the examiners. Is that correct?

Mr. KELLY. That's correct. In fact, in August of 2008, one month before the Fannie and Freddie Mac investments were rendered worthless, we were approved by all three regulatory agencies to acquire a $3 billion problem institution in California. They only give that approval to well-managed, well-run banks with good numbers. We received that within 48 hours expedited time. They knew we were a bank that was capable of dealing with problems.

But when we had the $900 million—almost $900 million—impact of the Freddie and Fannie losses, it wiped out more than half of our capital, we had to cancel that acquisition, and we were in a tailspin.

Mr. NEUGEBAUER. If you would have gotten the same deal that some of the people who were holding some of that AIG instrument—you might have come out a little better, mightn't you?

Mr. KELLY. We would have been quite happy just to get our allocation of TARP money, as most of the other banks our size or larger received. That's all we wanted. We were initially approved. Why

we didn't qualify, I have no idea why that was deferred. That will be my question—

Mr. NEUGEBAUER. But if the government had made you whole on those Fannie Mae preferred stock, it would be a different day for you, right?

Mr. KELLY. That would have been nice, yes. Our issues were related to the Fannie and Freddie investments.

Mr. NEUGEBAUER. Yes, and that's the reason that many of us on this side of the aisle are very concerned about the government picking winners and losers. And, unfortunately, this bank was chosen to be a loser, where other financial institutions were chosen to be winners, instead of letting the marketplace do that. And we cannot allow that to continue in the future. It does not promote good behavior, market behavior. And, quite honestly, it's not the right thing to do. And so I hope that—

Chairman GUTIERREZ. The time of the gentleman is expired.

Mr. NEUGEBAUER. —we will do things to prevent that from happening in the future.

Chairman GUTIERREZ. Mr. Clay, you are recognized for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman, and thank you for conducting this hearing. And let me start with Mr. McCullough. Mr. McCullough, can you share with this committee your take on the accelerated home foreclosures in and around the Chicago area? Was it attributable to certain financial institutions steering certain customers to subprime loans instead of conventional mortgages? I would like to hear what you think about that.

Mr. MCCULLOUGH. It's no surprise in our community, like many other communities across the country, that many residents are in distress. Either they have been foreclosed on, or are in the process. In our community, on the west side of Chicago, there are thousands of families who are either in multi-family housing or single-family who have either been foreclosed on or are in process.

In terms of banking—banks and other financial institutions, you know, doing subprime lending, there is a long list. I am just here to say that Park National Bank was not one of them. In fact, Park and Bethel, the organization that I run, have specifically designed banking products to meet the needs of very low-income residents in the community, as well as homeowners. And we were active partners to really address the issues that face the residents in our community.

Mr. CLAY. And in your testimony, you also point out that U.S. Bank—you compare the charitable giving of U.S. Bank versus Park National Bank and FBOP, where you take a number like 27 percent of your profits went back into charitable giving, and then you compared U.S. Bank with a 0.7 percent. And I think that speaks volumes about the service that Park National Bank gave, compared to a company like U.S. Bank.

Mr. MCCULLOUGH. Well, just like all politics is local, all banking—really good banking—is local. And I think to Park National Bank's credit, you know, Mr. Kelly and his staff knew our community, and knows our community, and knows what the challenges and the needs are, and was able to be very targeted, in terms of

not only loans and business transactions, but also charitable giving.

It is yet to be seen what U.S. Bank's commitment is to our community. They do have an existing branch and footprint on the west side of Chicago, but obviously not to the same caliber as Park has been.

Mr. CLAY. Does that charitable giving—does that also include loan modification?

Mr. MCCULLOUGH. It does.

Mr. CLAY. It does?

Mr. MCCULLOUGH. Yes.

Mr. CLAY. In other words, you work with the borrower to make the modification reasonable and something that they can accomplish?

Mr. MCCULLOUGH. Yes. I mean Bethel itself is a HUD-certified counseling agency. We work with homeowners across the area. And Park was, you know, definitely a partner. And some of the members of the coalition who also do homeowner counseling, as well, share the same experience.

Mr. CLAY. Thank you for your response. Mr. Hartnack, tell me, did FBOP have a large number of subprime loans, and was that one of the reasons for its failure?

Mr. HARTNACK. Certainly not in the first mortgage arena, no, sir.

Mr. CLAY. No?

Mr. HARTNACK. Nor did U.S. Bank, for that matter.

Mr. CLAY. Okay, okay. You didn't have anything to comment about the charitable giving, did you?

Mr. HARTNACK. If you looked at it on an apples-to-apples basis, and included our extensive community development—lending, tax credit lending and new market tax credit investing—then the percentages would be a great deal larger than the .7 that was discussed. But we certainly would never have given away 27 percent of our profits.

Mr. CLAY. Okay. Let me move on to Mr. Austin. Mr. Austin, can you share with us your opinion on the treatment by the FDIC with smaller community banks versus banks that are considered too-big-to-fail?

Mr. AUSTIN. We are all governed by a lot of the same rules and regulations. If we were to show you everything that we had, it would fill up this table and probably four or five more.

In regards to too-big-to-fail, I really do not feel any institution is too-large-to-fail, especially in a capitalistic, free market enterprise system like the United States was founded. We need to look at the risk weighting of the different types of these activities that the banks are engaged in.

You know, I appreciate the question to the previous witness regarding communities and contributions. I think if we start looking at those types of measurements, compared to looking at what banks are really doing to lending, that's where we are getting away from our focus.

You know, we are governed by the Community Reinvestment Act, which I think goes too far—

Chairman GUTIERREZ. The gentleman's time has expired. Mr. Paulsen, you are recognized for 5 minutes.

Mr. PAULSEN. Thank you, Mr. Chairman. Mr. Hartnack, I was just curious. It seems like banks are getting a mixed message. Mr. Austin has related this already in some of his comments, too. But, you know, obviously there is encouragement to lend, to provide capital in the marketplace for the business community that wants to expand and grow jobs right now.

But there is also the message out there, at least from the regulators and the anecdotal stories I have had, in terms of communicating with some of my bankers locally—I know you're based in Minnesota, too—but the mixed message is that they're being encouraged to hang on to capital, actually. And that has been discussed a little bit.

I talked to one individual, a small business owner actually, who was going out to get a loan with a bank he had a long-time relationship with. And the bank actually came back and said, "We would like to provide the loan for you. But in order to do that, you're going to have to have 50 percent capital, or 50 percent of your money down."

Well, of course, we commented to each other, "Then you might as well be a bank on your own," when you're in that type of a situation. And I think that expresses some of the frustration people have. But I'm just sort of curious.

You know, one other anecdote too, real quick, is that the regulators then come in and they're putting the squeeze on the banks with some really tough requirements, in terms of new standards. And one community bank I talked to not long ago mentioned that he had some examiners in. I asked, "Was that just three people? Were they in for a week?"

And he said, "No, it's like 14 people, and they were in there for a month-and-a-half." And it seems very overburdensome and a high threshold to cross. So, I'm just curious.

Right now, in general, given the current economic climate, what can banks do to try and be effective partners in their local communities with these challenges that are truly out there?

Mr. HARTNACK. It clearly is a different circumstance in every bank. There are 8,000 community banks in America. And, frankly, many of them are still very strong, financially. But if a bank is in a circumstance where they don't have enough capital, clearly, lending is a very difficult deal for them. If they lend, every dollar they put out requires roughly 10 percent of capital. If you don't have the capital, you're simply digging a deeper hole for yourself.

What we do—and we're in a lucky position of having adequate capital, good earnings to keep replenishing our capital, we just announced quarterly profits yesterday, and we're able to embellish our capital—is we tell our story in every possible place, and try to let the communities that we serve know that we're open for business for good loans. And the terms are, in many cases, not very different from a while back.

In some cases, it is not different at all. It depends on, obviously, the purpose of the loan. And the economy is not as strong, so sometimes additional protection is required. But, you know, what banks in America can do to help their communities is make loans. And as Mr. Austin said, telling a bank to make loans is like telling a McDonald's guy to cook hamburgers. This is what we do for a liv-

ing. Our CO constantly talks to us about the fact that we make dreams come true in America, and we do that by lending people the money to build their business, grow their business, start their business, to educate a kid, to buy a house, all the things that Americans do and want to do. And I think our industry's role is to make that happen to the extent our capital allows us to do it.

Mr. PAULSEN. Mr. Austin, maybe you could provide some additional comments, as well?

Mr. AUSTIN. Absolutely, and thank you. We want to make loans. A joke among bankers is that when we make loans, they're all good. But some bad things happen to good borrowers.

I know, just thinking back to the subprime debacle—and we should note—the overwhelming majority of the subprime loans were made outside the traditional banking industry. And I want to equate this back to after 9/11. One thing the automobile companies did was create special financing units to push and sell their excess inventory, also known as zero percent financing. They took on excessive risk, and they also took on borrowers who normally would not be able to repay.

Today, if you're looking at some of the subprime loans, some in the housing industry also created special financing units, and they packaged those loans and sold them as securitized investments—again, outside the traditional banking system.

We still have—I will quote my grandfather. He told me, "Son, there is a preamble to every promissory note, 'And I do hereby promise to pay.'" We have to keep that in mind to make prudent decisions when we make loans, because our regulators are looking at them, and we also don't want to do something wrong for our customers in extending too much credit.

Mr. PAULSEN. Well, I will just comment, Mr. Chairman, but we need a strong traditional banking system, so I appreciate it.

Chairman GUTIERREZ. Mr. Scott, you are recognized for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman. And thank you for this hearing. It's a very timely hearing. I represent a State where we all—I think it's really the epicenter of this entire situation, regarding the bank closings. And I would like to focus on that for a moment, as we move forward to find solutions. And my State is Georgia.

Over the past year, we have had 25 bank closings. Nationwide, we have had 140. That means that, in my State, 20 percent of the banks that closed—clearly, one-fifth of all the banks—happened in my State. So it might be good for us to look at Georgia to try to figure out what went wrong, and how we correct this.

I guess it focuses on my first question, which is this: We have 300 banks in Georgia. About 100—I think 103—of them were established in the last 10 years. Ninety percent of the banks are small, State-chartered banks, which are overseen by both the FDIC and the State regulators. Seventy percent of their portfolios are all devoted to real estate loans. And they went into this overexuberance, and I think that's what caught them.

But I wonder if you would tell me if it's possible that there were just too many banks to begin with. And did the rise in subprime lending lead to a banking bubble in which banks were established

that lacked the stability and the experience to sustain through the natural cycles of boom and bust, expansion and contradiction?

Should we put some sort of regulation on how much of the portfolio could go into real estate, or could go into one area? Is that risky behavior? And where you have the mixture of State and Federal regulations, what falls where? Should Congress act first, or should States act first?

These are a series of questions I would like to get some answers on. Should we not put some kind of standards on too much going into one area, 70 percent of your portfolio going into one area, putting some kind of criteria on too many banks, and looking at our Georgia case to see how we could use this as some examples of what went wrong to correct?

Right now, in my State of Georgia, there is contemplation of whether or not our State legislature should do anything at all. And many are saying, "Well, let's wait on the Feds to do this."

So, I think this brings us right dead center to answering some of these certain questions, and that's what I would like to put before you today. If you could, respond to my questions.

Mr. HARTNACK. Was that directed to any one of us?

Mr. SCOTT. Yes, either one. I would like to get both of your comments on this. I mean—

Mr. HARTNACK. Real quickly, so I don't take everybody else's time, I would say that the principle of diversification of assets, so there is as little correlation between the behavior of assets on the balance sheet as is practical, is a rock-solid part of prudent banking, and certainly one of the reasons our bank is in good shape today. And I think the regulators understand that.

Whether it was enforced among small new banks or not effectively, I will let you find that out from the regulators. But clearly, the principle of diversification is absolutely rock foundation of good banking.

Mr. AUSTIN. I would like to also share that competition is healthy, I think for everyone, not just in the banking industry, but every industry in our communities.

In regards to your question about what should be done, and what are the regulators doing, one, we appreciate and support a dual banking system, where we have charter choice.

A few years ago, we were up here with the Texas Bankers Association, visiting with the FDIC. And I want to defend them, because they made a very pointed comment to the banking industry: "We see some trends that are beginning to emerge in some sectors of the country. Beware. Let's fix the roof while the sun is shining." They did send us the warnings. Some chose to listen, some chose not to.

In their defense, there are ample regulations and guidance that have been sent out that we look at for commercial real estate limits and construction limits. So we are managing, and they are managing us when they examine us, based on the risk weighting.

Mr. ELLISON. [presiding] Mr. Marchant from Texas is recognized.

Mr. MARCHANT. Thank you, Mr. Chairman. It's good to see you here, Mr. Austin. And it seems to me that when regulators leave your banks these days, the greatest concern is not whether you are equipped and motivated to loan money into the community, but

that the FDIC Insurance Fund will have little or no exposure to loss.

In the old days, they were there to help guide you on how to stay healthy and profitable. It's my contention that until that approach is moderated, adjusted, changed, and we get more back to the original purpose, that we will not have a recovery, we will not have new jobs, and we will—and our banks will remain on the sidelines, investing in treasuries and offering .65 percent on a 5-year CD, and making their spreads the safest way possible that presents the absolute least risk to the FDIC Insurance Fund.

Now, it seems to me like that is the issue that we are dealing with.

Mr. AUSTIN. Wow, there is a lot there. I could speak for hours on that. Let me say, when the examiners come in, the primary focus is safety and soundness to protect the Fund. And we don't disagree with a lot of that.

But I will say our bank is fortunate. We have extremely good relations with our examiners because, one, we have reached out and they have reached out to listen, help give us guidance. We meet with them. We have taken a proactive approach to visit with them on a quarterly basis. We would encourage many banks to do that. But not everybody can say that.

If you talk about competition and .65, the treasuries—in some cases lower—one area that we're competing against is you, the government. Specifically, I call it a ward of the government, which is GMAC's new bank, also known as Allied Bank, which advertised at all the football games. They're paying exorbitantly high rates because of their backing from the government. That's hard for us to compete against.

Mr. MARCHANT. Let me ask you for my second question—both you and U.S. Bank—about the policy that the FDIC is using now, as far as acquisition of banks that they are closing.

I know that in this—I believe it was in this recent transaction—there were three small banks in Texas that didn't have anything—that really weren't in the geographical areas—I think they were your banks, weren't they, Mr. Kelly? Yet the FDIC, instead of saying, "Let's keep U.S. Bank in this area, and let's let these three banks in Texas—let's find a legitimate buyer there," instead they just take the position, "You have to take everything." And then I think, in this case, U.S. Bank turned around and sold those three banks off.

It seems to me that the FDIC needs to take a little bit more flexible position on that. And I believe that they try to match up the sales of the banks with entities that are healthy and have some proximity to the market. And I would encourage them—and I will, the next panel—to give some consideration to not having that be a two or three-step process, where local banks end up having the opportunity to take over local banks.

Mr. AUSTIN. I would like to comment. I know we—one of our affiliate banks was within 60 or 70 miles of one of those institutions that was well-capitalized. We did contact the FDIC and ask if that particular bank could be sold separately. The response was, "No, we prefer to sell them as one group."

The advantage, by allowing someone to purchase that locally, or with closer proximity to that community, would be the great advantage, one, to the customers in that community, because they know who they are. In Texas, that means we have lost three charters. And I think we look at a lot of—we hear a lot of bankers who are discouraged by what's going on, and probably want to exit out of banking. And that's not good for the local communities—

Mr. MARCHANT. It seems like a local bank might give a higher bid to the FDIC for that, and actually benefit the Fund.

Mr. ELLISON. The gentleman from Texas, Mr. Green, is recognized.

Mr. GREEN. Thank you, Mr. Chairman. And I thank the witnesses for appearing today. I would like to take just a moment to see if I can provide a limited amount of ocularity to this obviously difficult problem.

The community banks are of the opinion—and there seems to be some body of empirical evidence to support their contention—that they were not the cause of the crisis. That seems to be the prevailing opinion among community bankers. They also seem to be of the opinion that, because they didn't cause the crisis, they should not have to account for the sins of those who did cause the crisis. Community banks did not engage in 3/27s, 2/28s, teaser rates that coincided with pre-payment penalties.

Generally speaking, community banks make the argument that they knew who they were dealing with. They were dealing with people who were regular customers, to a great extent, people that they knew in the community, people that they have to meet in the shopping center, and so they had a better understanding of who they were working with. And, as a result, they made better loans. Many of their loans, they contend, were maintained on their portfolio. They didn't engage in a wholesale pushing of loans to someone else, such that they would qualify persons for teaser rates but would not qualify them for adjusted rates.

And, generally speaking, they maintained a good capital ratio. The capital ratio is important, because you don't lend money from the capital. The money that you lend comes from the money that you take in by way of deposits. So you have to be well-capitalized to lend money.

So, the community banks find themselves in the position of saying, "Someone ought to look at our circumstance and understand that there should be a greater degree of flexibility as it relates to what we do."

The example that I encounter most regularly is that of a good loan that was made in good times, but now the borrower finds himself with an inability to make a payment or two. And the contention is that when the examiners come in, they don't accept the notion from the community banker that, "I know this person. This person is going to catch up. This person is going to maintain this loan, such that this is not really a bad loan, it's just that these are bad times."

And somehow, this ought to be considered, so that we don't find the bank having to increase its capital, and if it does not, then it can't do as much lending. And apparently, this concern is some-

thing that a number of my colleagues have heard, because I hear colleagues on both sides talking about it.

So, my question is this, with reference to the community banks. When you differ with the examiner, tell me about the process that allows you to appeal to an ombudsman or someone such that you may—your opinion that is different, for reasons that you contend are legitimate—how does that process serve you?

And I will start with, if I may, Mr. Austin. Do you have an opinion on the appeal process, please?

Mr. AUSTIN. Yes, sir. And, Congressman Green, thank you. I know you have always been a leader in listening. And I want to say thank you for your efforts in financial literacy and working with banks.

There is a difference—we have not really gone through the appeal process, because we try to work it out locally with the examiners. And I think that's usually the best practice. We do ask for them to rely on our judgement, because we know the customers, and are familiar with them, and we are sitting on the desk, looking at them eyeball-to-eyeball. We are also visiting their businesses, looking at their trends, and knowing what's going on.

Where we have some issues are the conflicting types of accounting policies and practices, from regulatory accounting—I call it RAP. You have GAAP, and there is probably another one that applies that rhymes with it pretty well.

Mr. GREEN. Would someone else care to give a comment?

[No response.]

Mr. GREEN. I will conclude by thanking you, Mr. Chairman, for the time. Thank you.

Mr. ELLISON. The gentleman from Colorado.

Mr. PERLMUTTER. Thanks, Mr. Chairman. And I thank the panel for being here today. Mr. Kelly, I am sorry for the plight. We are—I am working on some pieces of legislation to take a look at capital, to take a look at TARP being available to community banks, smaller banks, to take—you know, to look at the regulations that really now say you have too much concentration in real estate or too many restaurant loans, or you're working with too many auto dealers, because this financial crisis—which was because of a lot of gambling on Wall Street, in my opinion—caught everybody short, you know, whether you're the restaurant owner or you're the auto dealer, or you're the banker—unless you were the guys on Wall Street, and I don't think any of you were.

And I don't know what we can do to unring the bell in your situation, but I'm trying, and we are going to work on ways to provide some cushion to local banks and smaller banks, so that they can give a little cushion to their borrowers, as we work our way through this mess.

Do you feel—and I would say that I don't think you were the only one caught short with Fannie Mae and Freddie Mac pieces of paper. A lot of credit unions, central credit unions, particularly in California, Nevada, and the southwest had a lot of that paper and they went down.

What—let me ask you a question, then I want to talk to my friend from U.S. Bank, Mr. Hartnack—and I do want to say to some of my friends on this side of the aisle that U.S. Bank and its

predecessor, Colorado National Banks, have a long history in Colorado of community service and community involvement. And so I just want to have that on the record and make it clear that they are considered to be a good neighbor in our area.

So, what would you have us do, Mr. Kelly? Today, as legislators trying to get, you know—your situation is what it is. What would you have us do to correct things?

Mr. KELLY. This could be corrected very easily. Treasury has the ability, under TARP, they have total latitude as to what type of program they want to create.

If the Treasury Department would take a small percentage of the dollar amount that was advanced in the first few weeks to the largest banks—over $125 billion—if they would reserve only 20 percent of those funds for viable community banks that have a shortage of capital, and change the rules that exist right now—right now, there was a tremendous reaction, community reaction, public reaction, negative, to the large dollars being given to the larger banks. As a result of that, all of the rules were tightened up very tightly.

The problem was, all the big banks—

Mr. PERLMUTTER. Before it got to the community banks?

Mr. KELLY. All the money had already gone out. Now the community banks are there. Now there is a whole different set of regulations.

Mr. PERLMUTTER. Okay.

Mr. KELLY. That has to be changed. And that can be done. The regulators—the test should be: if they receive TARP, will they be a viable institution?

Nobody wants to give money to a bank that is ultimately going to fail. But right now, you have to prove that you're viable before you qualify for TARP, which basically means you have to show that you don't need the money at the outset. What bankers have always been accused of, "You prove that you don't need the loan, and then I will make it," this is basically what is happening.

Mr. PERLMUTTER. Okay. Mr. Hartnack?

Mr. HARTNACK. I think that the situation is so complex. But if I was a legislator, what I would be looking for is to make sure the prudential regulation keeps an eye on the ball all the way along.

Where things went wrong was organizations were inventing products, selling the products to people who couldn't repay it, and packaging the resulting loan and selling it to people who shouldn't have been investing in it. And that just should never happen again. And, you know, for the record, U.S. Bank wasn't involved in that.

Mr. PERLMUTTER. Mr. Austin?

Mr. AUSTIN. None of our banks actually applied, the banks that we're involved with, and we did not want to. I will be honest with you. We didn't want the government intervention, additional regulation and oversight. We wanted to try to raise capital privately, if we needed to.

Mr. PERLMUTTER. Okay.

Mr. AUSTIN. And I agree—I concur with the previous comments.

Mr. PERLMUTTER. What about just some of the regulatory—not just the TARP piece, but capital requirements. Do you see, in your area, capital going from 10 percent—in the old days, capital, statutory capital, was 5 percent. Now, regulatory capital is 10 percent,

and then you have risk-based capital, which I still don't understand, at 13 percent.

Are you seeing capital moving? And what would you have me do about it?

Mr. AUSTIN. This is a complex question with multiple answers. I think, one, you look at the different capital components that you just mentioned. That also dictates how we are assessed on our FDIC premiums. Let me give you an example—

Mr. ELLISON. The gentleman from Illinois, Mr. Davis, is recognized.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman. And let me, first of all, thank Chairman Gutierrez and Ranking Member Hensarling for giving me the opportunity to be here, although I am not a member of this subcommittee.

I also would like to note that Congressman Bobby Rush, whom I left at something else, expects to join us in a few minutes, and I know that he is on his way.

Let me also thank all of the witnesses for coming, and all of the people who have traveled all the way from Chicago, most of whom live in my congressional district, where Park National Bank is located, which sort of spearheaded the interest and the concern, and the whole business of trying to take a look at what has happened in this situation.

As we interacted and interfaced with the problem, we were a bit concerned, basically because Mr. Kelly, who is a member of the panel, is recognized by our community as simply an outstanding banker, a tremendous civic leader, a man of great astuteness, from a business vantage point, and of tremendous community interest. And while we knew that there were problems existing and troubles brewing, we also were hopeful that we would be able to experience I guess what one calls a "work-out."

Mr. Kelly, could I ask you, from your vantage point, what do you think perhaps could have happened, or could have happened differently, that would have generated the ability of you and your associates to retain control and ownership of Park National?

Mr. KELLY. Thank you. We were approved for TARP funds in October. TARP funds would have been adequate for us to put back capital, and also would have enabled us to have access to other outside capital.

Although we were approved, we were not a publicly traded bank. The rules did not exist at that time for a non-publicly traded bank. We were deferred, we were deferred, and we were deferred, to the point where new rules were put in place, and we no longer qualified.

All of the other, larger institutions were funded without the requirements in place that we were later held to. The fact that TARP—before TARP came out, we were in the public markets in New York. We were out soliciting private capital. We had a preliminary $600 million capital injection available to us. But when TARP was announced, that was all obsolete.

Once you had—once the TARP fund was there, everybody would say, "Well, why wouldn't you get the TARP money?" And so that was our sole goal. For 5 months, our only capital plan was the receipt of TARP, and that was with the full approval of our primary

regulator, the OCC. And then, in February, we were told we didn't qualify for TARP. At that point, we were dead. We had no other option. We had to go out and find private equity in the worst capital markets available, and with the stigma that we had not been eligible for TARP. That was the kiss of death.

After that, we tried a number of things, but we came up short at the end.

Mr. DAVIS OF ILLINOIS. Are you of the opinion that, should the regulations be changed that would encompass institutions like yours, that it would be very helpful to them, perhaps in the future, even if it's not helpful to Park National?

Mr. KELLY. Absolutely. I think the Treasury has the ability to change the rules with no further legislation, or legislation can be passed to encourage that, that funds can be available to banks that, after the receipt of TARP, with their qualifying TARP amount, would be viable institutions. If they meet that test—and that should be a test that the regulators primarily make—that then they should be eligible for TARP.

There is basically a bar right now. You have to be a top-rated institution and well-capitalized to qualify for TARP. Any bank that meets that requirement doesn't want TARP.

Mr. DAVIS OF ILLINOIS. Thank you very much. Mr. Hartnack, as you can see, the primary location of Park National sits in a hotbed of community activism. That is, I often say that the people in my congressional distract are more proactive than what you will find in many places throughout the country, which healthy, good, and creates tremendous movement.

Based upon your interactions already—and I am sure that there have been many recommendations that they have provided, I am sure they have tried to understand—

Chairman GUTIERREZ. The time of the gentleman—

Mr. DAVIS OF ILLINOIS. My time has expired? Thank you very much, Mr. Chairman.

Chairman GUTIERREZ. We recognize the gentlelady from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman. You know, it seems—it's nice to see you, Mr. Kelly. I had three of your banks that were in my district, so I—regulators are adding to the problem by insisting on tighter credit standards, mark-to-market in what is not a normal market, by any acceptable standard, increased reserves for loan losses, and capital increases.

And all the while, the banks' earnings are dramatically down, and the cost of obtaining additional capital is upwards of 10, 12 to 14 percent, with a prime rate of 3.25 percent, and Federal funds are at a rate of 0 to 0.25 percent. Qualified buyers are scared off, and not borrowing.

What are we going to do with these issues, like mark-to-market and just the increased regulations? And this is something that a community banker in my district wrote in a letter. Have the regulators overreacted? Whomever would like to talk about that?

[No response.]

Mrs. BIGGERT. It's not a problem?

Mr. AUSTIN. I will take it.

Mrs. BIGGERT. Yes, Mr. Austin.

Mr. AUSTIN. Some of these issues are beyond our control. When FDIC/OCC comes into our bank, they are actually reviewing, based on FASB policies. And I think that's where we need to really work with them to try to come up with some reasonable policies.

You know, just like with overregulation, we're marketing to market loans based on a perceived value that has not actually been realized, or liquidation values for loans. We are setting up additional reserves. That is a problem.

Mrs. BIGGERT. But, as you do that, then it cuts out credit. And how are we going to jump-start this economy? We have been trying to do it. Is it us who should be saying—you know, changing the law? Is it—one reason maybe that cash flow isn't being counted, or does mark-to-market need an overhaul?

Mr. AUSTIN. I think we need to look at a multitude of issues, and that's something that we would be happy to work with your office and the committee, to come back and bring some viable recommendations.

Mrs. BIGGERT. Okay, thank you. I yield back.

Chairman GUTIERREZ. The gentlelady yields back. Mr. Bobby Rush.

Mr. RUSH. Thank you, Mr. Chairman. I want to say to you how delighted I am that you have convened this hearing. I used to be on this committee, and I haven't been here in this room for quite a while, but it's certainly good to be back.

I want to associate my remarks with—most of my remarks—with my colleague from the seventh congressional district, although I want to make sure that he understands that I am not in agreement with him when he talks about his district. I don't want him to leave my district out. We are vying for where the hotbed of activism really lies, in the first or the seventh district. But that is a good competition, and I think all the people benefit from that.

I only have limited time, so I want to, first of all—Mr. Kelly, good to see you. And, as you know, in the final hours, we worked together quite vigorously to try to get the governmental institution—at the Federal level—to respond. I think the request was a simple request, and to me it was a doable request. All you needed was another week to present your case to the Federal regulators. And they would not even grant you that week. And they had the authority to grant you that week extension before they made a final decision.

I have learned—and others have indicated—that your investment in Fannie Mae and Freddie Mac was mainly at the behest of the Federal Government, that they encouraged you, and highly encouraged you to make that type of investment.

And I am also confused—not confused, but astounded at the fact that, at 10 a.m., the Federal Government and the Secretary of the Treasury was in town, giving you a check for $50 million at 10 a.m., and at 10 p.m., he was putting padlocks on your door. So that was sending some kind of a mixed message of the worst sort, in my estimation.

As you reflected on that, is there anything that this Congress can do that could—that you would recommend, so that we would have more consistency at the level of Treasury, especially as it relates to community banks?

And before you answer that question, I want to just take a moment just to say how much your bank has meant to the people of the south side of the City of Chicago. You know I—Inglewood, which is a fine organization here, friends of mine, they do a great job. And you have been there, you know, the heart and soul of that effort.

And I have been assured—I'm going to ask this question as a follow-up—that we don't want to leave a gaping hole in our communities, especially those communities that are struggling. We don't want to leave a gaping hole. And I am not in any way casting any kind of predictions on U.S. Bank or anything like that. But we know what you—what Park National has done, and you set a standard very, very high for banks. And we want to make sure that whoever, be it U.S. Bank or anybody else, that they meet that particular standard, because these are hurting communities.

Again, my question is, as you reflected on this over a period of weeks now, what do you think could have been done by the Federal regulators that would have—that would guarantee that, going into the future, no other good community-based, community-related bank with the community at the heart of its interests, that they have to undergo the same kind of experiences?

Mr. KELLY. I have thought about that quite a bit, obviously. We had asked for a one-week extension from the FDIC. It was not granted. We had asked for a meeting with the FDIC in Washington with the investors that we had lined up in the last weeks before the closure. That meeting was not granted.

I believe—and this is strictly my perception—that the regulators already had U.S. Bank lined up. They had marshaled the forces, they were ready to close the bank. They have a big job to do, there are lots of banks out there, and they basically just did not want to extend more time.

I don't understand, with one week later, knowing that there was a change that would make up to $200 million difference in our capital structure, why we couldn't have been granted one more week extension. I don't have the answer to that.

Mr. RUSH. I want to ask—okay. I yield back the balance of my time.

Chairman GUTIERREZ. We have votes going on, on the House Floor. I wanted to say thank you to the first panel, to all of the members of the first panel. I want to thank Congressman Danny Davis and Congressman Bobby Rush and Congresswoman Biggert—she's a member of the Financial Services Committee—for coming, and for speaking to me and bringing the issue of Park National Bank to my attention.

We are going to recess until after the votes—that could take probably a good 45 minutes to 60 minutes before we vote—and come back. When we do reconvene, we are going to have the regulators come before the committee. And I assure you, I have some interesting questions to ask them about Park National Bank, especially the FDIC.

Thank you so much. We will be back. We are at recess until immediately after the votes.

[recess]

Chairman GUTIERREZ. We will reconvene at this point. And we will have the second panel.

First, we have David Miller, who is the Director of Investments for the Department of the Treasury. Jennifer Kelly is the Senior Deputy Comptroller for Midsize and Community Bank Supervision at the Office of the Comptroller of the Currency. And last, but certainly not least, Mitchell Glassman is the Director of the Division of Resolutions and Receiverships at the Federal Deposit Insurance Corporation.

Mr. Miller, you are recognized for 5 minutes. Please proceed.

**STATEMENT OF DAVID N. MILLER, ACTING CHIEF INVESTMENT OFFICER, OFFICE OF FINANCIAL STABILITY, U.S. DEPARTMENT OF THE TREASURY**

Mr. MILLER. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, thank you for the opportunity to testify today regarding participation of small banks in the trouble asset relief program.

Small and medium-sized banks play a vital role in the economic fabric of our society, and will be essential to the long-term success of the economy as a whole. As such, the Administration has strived to recognize the importance of, and protect the health of smaller institutions throughout the implementation of TARP.

Treasury designed the Capital Purchase Program, the first and largest program implemented under TARP, to provide capital to financial institutions of all sizes with equal treatment on economic terms. Smaller financial institutions make up the vast majority of participants in CPP, which is consistent with smaller financial institutions constituting the majority of financial institutions in the country.

Of the 707 CPP applications that were approved and funded, 473, or 67 percent, were institutions with less than $1 billion in total assets. In May 2009, the Administration reopened the application window for CPP only to institutions with less than $500 million in assets. And to ensure adequate funding levels, Treasury also increased the amount of capital these institutions could receive to 5 percent of risk-weighted assets, up from 3 percent.

Let me now turn briefly to CPP eligibility and the application process. CPP was designed to promote financial stability, while also protecting the taxpayer, by injecting capital into viable financial institutions. An institution wishing to participate in the program applied to its primary banking regulator, which then made a viability assessment for the financial institution.

If a financial institution is deemed viable by its primary regulator, the regulator forwarded the application it recommends for funding to Treasury's office of financial stability for further review. In certain cases, applications were first forwarded to a council of Federal banking regulators for review, prior to submission to Treasury.

Once an application was received by Treasury, experienced examiners from the various Federal banking regulators onsite at Treasury assisted in reviewing the application. Applications were then presented to an internal Treasury investment committee, consisting of high-level officials who reviewed the application in its en-

tirety, and recommended an action to the Assistant Secretary for Financial Stability.

Treasury has not approved any application for funding without a determination of viability from the primary regulator. This approach ensures program consistency and fairness to institutions, regardless of size. Treasury has invested in 650 small and medium-size financial institutions through the CPP.

The Administration believes that more can be done to build upon these important efforts. On October 21, 2009, the President outlined a new program designed to provide lower-cost funds to viable small banks, with the goal of increasing lending to small businesses. As President Obama explained, to spur lending to small businesses, it is essential that we make more credit available to the smaller banks and community financial institutions that these businesses depend on.

Administration officials have been working diligently to design a program that will provide the maximum benefit to small businesses, while simultaneously providing taxpayer protection and encouraging credit markets. We plan to release the full details of the program soon.

In addition to the small business lending initiative, Treasury is also developing a program that will make low-cost capital available to community development financial institutions, which provide more than 60 percent of their lending in economic development services to low-income and underserved communities.

We look forward to finalizing these programs in the near future, and working with you to meet the challenge of helping our businesses and communities flourish. Thank you.

[The prepared statement of Mr. Miller can be found on page 147 of the appendix.]

Chairman GUTIERREZ. Thank you.

Ms. Kelly, you are recognized for 5 minutes.

**STATEMENT OF JENNIFER KELLY, SENIOR DEPUTY COMPTROLLER FOR MIDSIZE AND COMMUNITY BANK SUPERVISION, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)**

Ms. KELLY. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, my name is Jennifer Kelly, and I am the Senior Deputy Comptroller for Midsize and Community Bank Supervision at the Office of the Comptroller of the Currency. I appreciate the opportunity to describe the OCC's role in the supervision of national banks, and in the resolution of severely troubled banks.

The primary mission of the OCC is to ensure that national banks remain safe and sound, comply with applicable laws, and support the needs of their customers through fair access to credit and financial products. We recognize the important role that credit availability and prudent lending play in our Nation's economy, particularly in the current environment.

However, banks cannot support their communities unless they operate in a safe and sound manner, and have sufficient capital to support lending to creditworthy borrowers. Even in today's strained economy, most national banks are in sound condition, and have the

capacity to weather the current economic environment. Some, however, are experiencing significant difficulties. While most banks that develop problems are restored to a safe and sound condition, some are not.

When a bank cannot be rehabilitated, the OCC has a statutory responsibility, as do the other Federal banking agencies, to work with the FDIC to minimize both the cost to the Deposit Insurance Fund, and disruption to the bank's customers.

With regard to the FBOP banks, the circumstances and events surrounding their failure were unique and extremely complex. My written testimony provides a detailed account of OCC's actions and decisions that I will briefly summarize for you.

FBOP was a financial holding company that owned 6 national banks and 3 State banks, with combined assets of approximately $19 billion and operations in California, Illinois, Arizona, and Texas. The FBOP banks were an interrelated enterprise with business strategies largely determined on a corporate-wide basis.

Beginning in late 2007, FBOP made several strategic decisions that exposed its banks to elevated risk, and ultimately led to their failure. Specifically, the company invested heavily in the stock of Fannie Mae and Freddie Mac, as well as the securities of Washington Mutual Bank and other financial sector firms. At the same time, as the credit and real estate markets began to deteriorate, FBOP embarked on a strategy of aggressive loan growth. This was a business model that had proven very successful for the organization during previous market downturns.

In the third quarter of 2008, the GSEs were placed into conservatorship. And shortly thereafter, WaMu failed. The loss to FBOP as a result of these 2 events represented 63 percent of the consolidated bank's tier one capital.

Over the course of the following 14 months, the OCC worked closely with FBOP, as it pursued a variety of plans for obtaining the capital it desperately needed. These options included attracting new outside investors, applying for TARP capital, and selling one or more of the banks in the group. Despite intensive efforts, FBOP was not able to reach any definitive agreement to recapitalize the banks.

FBOP's inability to raise new capital, coupled with the rapidly deteriorating condition of all six national banks, triggered regulatory requirements under prompt corrective action. Two of the FBOP banks became critically undercapitalized on July 30, 2009, requiring that they be placed into receivership within 90 days. We also determined that deterioration of two of the other national banks had reached the point where it was necessary to close them, as well.

Park National Bank and Citizens National Bank were in a somewhat different status. Their condition was seriously deteriorating. But at that time, it was not clear that there were grounds to close them. On October 30, 2009, the OCC and the States of Illinois and Texas placed 7 of the 9 FBOP banks into receivership.

Then, under its cross-guarantee authority, the FDIC presented the two remaining national banks with orders to immediately pay assessments equal to the anticipated losses to the Deposit Insurance Fund. Since this cross-guarantee liability greatly exceeded

their capital, Park and Citizens became overwhelmingly insolvent. On that basis, the OCC appointed the FDIC as a receiver for both banks.

The OCC's decisions to place FBOP's national banks into receivership were made only after thorough internal deliberation, extensive efforts to work toward a solution with FBOP management, and close consultation with the FDIC. Our actions were consistent with not only the requirements of prompt, corrective action, but also with the statutory framework Congress put in place to resolve the failure of banks at the least cost to the Deposit Insurance Fund.

Again, I appreciate the opportunity to appear before the subcommittee today, and look forward to your questions.

[The prepared statement of Ms. Kelly can be found on page 98 of the appendix.]

Chairman GUTIERREZ. Mr. Glassman?

**STATEMENT OF MITCHELL L. GLASSMAN, DIRECTOR, DIVISION OF RESOLUTIONS AND RECEIVERSHIPS, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)**

Mr. GLASSMAN. Thank you. Good afternoon, Chairman Gutierrez, and Ranking Member Hensarling. I appreciate the opportunity to testify on behalf of the FDIC on our bank resolution process and related matters.

My first experience with a closed depository institution was in 1975. I was working at Swope Parkway National Bank in Kansas City, Missouri, when that bank failed and the FDIC was named receiver. Because I worked for this bank, like many of the people in this hearing room today, I know firsthand the importance of a community bank.

The FDIC normally uses two basic resolution techniques: a purchase and assumption transaction, known as a P&A; and a deposit payoff. A P&A occurs when a healthy institution purchases some or all of the assets of a failed bank or thrift, and assumes some or all of the liabilities, including insured deposits. In a P&A transaction, the acquirer usually reopens the institution the next business day, and the customers of the failed institution automatically become customers of the acquiring institution, with full access to their insured deposits. Almost all of our resolutions are structured as P&A. A deposit payoff occurs when there are no potential acquirers for the failing institution.

When an institution gets into trouble, and is at risk of becoming insolvent, the FDIC works closely with the primary Federal regulator or State regulator, and often participates with that regulator in an onsite examination.

Once the FDIC receives notice that the chartering authority is closing the institution, the FDIC contacts the CEO of the failing institution, gathers necessary data and information to value the assets, determines the resolution options to be offered, and prepares an information package for potential bidders. Based on recommendations by the FDIC staff, the FDIC Board approves the least costly resolution options to be used for the failing institution.

In 1989, Congress adopted amendments to allow the FDIC to recoup losses to the Insurance Fund by assessing a claim against the insured institutions under common control for losses caused by the

failure of an affiliated insured depository institution. The cross-guarantee authority allows the FDIC to recover losses on a failed, commonly-controlled financial institution by assessing any of the commonly-controlled depository institutions that remain open. The FDIC's cross-guarantee authority is designed to result in a least-cost to the DIF for resolving the problems of a commonly controlled group.

On October 30, 2009, the FDIC entered into a P&A agreement with U.S. Bank of Minneapolis, Minnesota, to assume all the deposits, and purchase essentially all of the assets of the nine failed banks owned by FBOP. The FDIC received notification of intent to close seven of the nine subsidiary banks from the chartering authorities.

The resolution transaction was a culmination of a marketing process where the banks were offered on a stand-alone basis, or linked with any combination of the seven. The FDIC later offered Park National Bank and Citizens National Bank on a stand-alone basis without loss share, or as a linked bid for all nine institutions with loss share.

Neither Park nor Citizens National Bank would have qualified for a waiver or any delay in the assessment of a cross-guarantee liability, because this would have resulted in a higher cost to the DIF, since both banks had serious problems, and were in deteriorating condition, and were very likely to fail. As a result, the cross-guarantee assessment was made, and the OCC closed the institution and appointed the FDIC as receiver. The overall least costly bid was received from a single bank to acquire all nine institutions.

We expect a continued high level of failures during 2010. Over the past several years, the Division of Resolutions and Receiverships of the FDIC has enhanced in staffing levels, in response to the increased workload. I know that our staff has the full backing of our Board of Directors to provide us with the resources to do the job.

Fortunately, the FDIC is well-positioned to carry out its responsibilities to protect and insure depositors, and maintain stability and public confidence in our banking system.

Thank you. I would be pleased to answer any questions.

[The prepared statement of Mr. Glassman can be found on page 81 of the appendix.]

Chairman GUTIERREZ. Thank you. We will now open up for a round of questions from the members.

First of all, I would like to welcome you all here. Mr. Glassman, do you ever talk to Mr. Miller?

Mr. GLASSMAN. This is the first time I have met Mr. Miller.

Chairman GUTIERREZ. Okay. Do you talk to anybody at Treasury before the FDIC closes down a bank?

Mr. GLASSMAN. No, I do not talk with anybody at Treasury.

Chairman GUTIERREZ. You don't? Do you talk to Ms. Kelly?

Mr. GLASSMAN. I do have conversations with Ms. Kelly.

Chairman GUTIERREZ. Did you talk to Ms. Kelly about Park National Bank and the other affiliated banks?

Mr. GLASSMAN. Not directly, but staff would have had a lot of conversations with the OCC.

Chairman GUTIERREZ. So, in other words, we ask for a hearing to talk about this, and we have two other people who have come here that you haven't spoken to about this transaction.

And, Mr. Miller, you didn't say a darn word about the whole thing in your testimony. That surprises me. Do you usually come to hearings, Mr. Miller, in which you're asked questions about a specific transaction, such as Park National, and then not speak to the issue?

Mr. MILLER. The—

Chairman GUTIERREZ. Or did I miss something? Because I listened to you attentively, and at least—

Mr. MILLER. Yes, I think it's—

Chairman GUTIERREZ. —Ms. Kelly and Mr. Glassman, at least they attempted to try to talk about what they did vis a vis Park National Bank. But you didn't say a single word.

Mr. MILLER. The issue of Park National—the Troubled Asset Relief Program is obviously not a banking regulator. And so their application to TARP, as I tried to describe in our process—

Chairman GUTIERREZ. How long have you been at Treasury, Mr. Miller?

Mr. MILLER. Since December 2008.

Chairman GUTIERREZ. Since December of 2008. So you were there when the former Treasury Secretary was there.

Mr. MILLER. Correct.

Chairman GUTIERREZ. All right. And he said—I remember—that, "If you have Fannie Mae and Freddie Mac, and you have just lost, I, the Treasury Secretary, am going to make sure that you don't suffer any undue hardship, in terms of what that money does to the viability of your financial institution." Do you remember that?

Mr. MILLER. Yes, I believe it's in section 103.6.

Chairman GUTIERREZ. Okay, so it wasn't something that Mr. Kelly and the rest of us just kind of remembered, but maybe didn't happen. It actually did happen?

But it didn't seem to happen here in this case. And I think that's part of the problem, as I see it. I listened to the three of you, and there is this large institution that was sold to U.S. Bank, and different people aren't speaking to different people.

So, once you decided, Mr. Glassman of the FDIC, you decided that—just so that we have this clear, how many of them? There were seven different banks all involved in this thing, seven?

Mr. GLASSMAN. In the FBOP family, there were nine institutions.

Chairman GUTIERREZ. There were nine.

Mr. GLASSMAN. We were notified—

Chairman GUTIERREZ. And there were two in Illinois, Citizens and Park National, that were still operating, that you couldn't find a reason to shut down. But then you said, "Oh, we want those two that are still alive to pay," right, "the assessments for the other seven that we have declared dead," is that correct?

Mr. GLASSMAN. Under the statute, we are required to conduct a least-cost resolution.

Chairman GUTIERREZ. You applied that statute—

Mr. GLASSMAN. —to protect the Deposit Insurance Fund.

Chairman GUTIERREZ. Okay. You applied that statute. You are not required to apply that statute. That's a statute that you decided to apply to this case.

Mr. GLASSMAN. The statute asks us to protect the Deposit Insurance Fund.

Chairman GUTIERREZ. I understand that. But you see, you didn't have to apply that statute. Is that correct?

Mr. GLASSMAN. In order to protect the Fund—

Chairman GUTIERREZ. I understand. You made a decision that, in order to protect the taxpayers—your way of looking at it—that you would apply that statute. Is that correct? You made that determination.

Mr. GLASSMAN. We made a determination—

Chairman GUTIERREZ. But that's a subjective determination that you made. There isn't a law that said, "Voila, there are these nine institutions. We must apply this statute to them." There isn't. You made that subjective decision. I'm not saying you're right or wrong, but you made that decision.

Mr. GLASSMAN. We made a decision to apply the assessment—

Chairman GUTIERREZ. Very good.

Mr. GLASSMAN. —against these two banks—

Chairman GUTIERREZ. You made the decision to apply it in a subjective manner. The law did not require you in this instance to do that. What you said was, "There are these seven institutions, they are not doing well, so we are going to make the two institutions that are already wobbling on the brink of disaster pay for the assessments of the other seven."

Okay. So you are asking two people—it's like asking two people who are almost drowned to come and help the other seven who have already drowned. That's what you, in essence, did, killing any opportunity.

The reason I raise that is because when you did that, it's like this chain of events that just destroyed an institution that maybe didn't—because in your determination, it was the most effective. How much did we lose? How much money did we lose?

Mr. GLASSMAN. Well, when the 7 banks did fail, $1.8 billion was lost.

Chairman GUTIERREZ. How much?

Mr. GLASSMAN. $1.8 billion.

Chairman GUTIERREZ. $1.8 billion was lost—

Mr. GLASSMAN. —lost to the Insurance Fund for this transaction.

Chairman GUTIERREZ. —in this transaction. So, $900 million—

Mr. GLASSMAN. For the seven banks.

Chairman GUTIERREZ. I'm sorry?

Mr. GLASSMAN. I'm sorry, for the seven banks that failed.

Chairman GUTIERREZ. The seven banks that did fail. And Park National and the other, what was the total amount?

Mr. GLASSMAN. We went out for individual bids for Park, and the inherent loss in Park and Citizens was close—approximately $1 billion.

Chairman GUTIERREZ. So, $2.8 billion, total? That's what it cost?

Mr. GLASSMAN. Approximately $2.5 billion, thereabouts.

Chairman GUTIERREZ. Okay, $2.5 billion. And you see, here is my problem. And here is why, in the future, I am not going to

delay in calling the FDIC. I am not going to delay in calling the OCC and Treasury. Because you guys don't like it when Members of the House, particularly Members who have jurisdiction over you, call you and ask you. But it is clear that somebody has to watch the people who are watching. Somebody has to watch the regulators.

Somebody has to call you, because, oh, we're going to talk about the Chicago Tribune article—and, Mr. Kelly, what a nice article—I know what the Chicago Tribune does if Congressman Bobby Rush and I call you. All the sudden there is an article, "Oh, Gutierrez and Bobby, they're meddling in the affairs, the internal affairs."

Well, maybe we need to meddle a little more in the internal affairs of the executive part of government, because I really think what you did was really unfair, unfair to an institution that was handing out tens of millions of dollars every year, doing their job. And you know something? Almost $900 million they lost, because, between the 3 of you, you told them it was okay to have 25 percent of their money. And we voted to give big banks lots of money, and they couldn't get the TARP money.

There were a lot of instances, but in the very instance when you could put that dagger right through their heart, you decided to do the cross-thing on them with the other seven institutions and say, "Pay for the other seven institutions." So that's it, because I am over my time.

Mr. Hensarling, you are recognized for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. I would like to ask the panelists all one question. Did you hear the witnesses from the earlier panel? Mr. Miller, were you here?

Mr. MILLER. Yes.

Mr. HENSARLING. So you heard it. Ms. Kelly?

Ms. KELLY. Yes.

Mr. HENSARLING. Mr. Glassman? Okay. So, then, you are well acquainted with the subject matter of today's hearing.

Mr. Miller, my first question is for you. Mr. Kelly had testified—well, actually, about the concentration of his bank holding company in Fannie and Freddie preferred stock. That, number one, he was incented to do so by the FDIC, so I have a question for the FDIC.

But my question to you, Mr. Miller, is this is not the only bank in America that has either become insolvent, had troubles because of their concentration in Fannie and Freddie preferred stock. Already, as you are well aware, the taxpayer has been called upon to bail out Fannie and Freddie with $110 billion. They were, according to the testimony of the gentleman who headed up the bank holding company, they were the reason that this bank failed, and all the good things they had done throughout the community.

Why, Mr. Miller, on Christmas Eve, did the Treasury Department of this Administration lift the limit on taxpayer exposure to Fannie and Freddie, and simultaneously announce bonus packages of $6 million apiece for the CEOs, $42 million of bonuses—oh, by the way, to be paid in cash, not stock, as everybody else is supposed to be incented, but in cash? Why did they announce that on Christmas Eve, to reward an institution that is costing the taxpayer billions and billions of dollars, and caused the failure of this bank?

Mr. MILLER. Thank you for the question.

Mr. HENSARLING. I'm not sure you really mean that, but please, I'm interested in the answer.

Mr. MILLER. I think you are raising some important issues. I do have to remind you that the Office of Financial Stability is not responsible for the GSEs, does not have an investment in them, and so we play no role in those decisions.

Mr. HENSARLING. Well, I guess, unfortunately, you just have Treasury on your business card. We will certainly ask this question, then, of other representatives of the Treasury. I would like to get to the bottom of this, and understand why this is happening.

Mr. Miller, you spoke about protecting smaller banks under the TARP program. I have the testimony before me of Jeff Austin, who is the chairman-elect of the Texas Bankers Association. I represent a district in Texas. One of the aspects of his testimony—I know you don't have it in front of you, and I do—he talks about the concern, specifically, that GMAC "took away some of the bread-and-butter consumer loans from traditional banks." I might point out that in recent months, TARP money has been channeled to automotive financing, to keep this unfair practice going."

So, I have at least one community banker who has been elected to represent all community banks in my home State saying that, at least with respect to your bailouts of GMAC, you're not helping the community banks, you're hurting the community banks. What is your response?

Mr. MILLER. We do not get involved in the day-to-day operations of the companies with which we have an investment—that goes for TARP banks, or—as well as GMAC. I think the issue you're referring to is they were paying slightly higher levels of interest on their deposits to their customers. I believe the FDIC looked into this, discussed it with them. But again, we do not manage, as an active shareholder, we're not managing their day-to-day decisions on what they set interest rates at.

Mr. HENSARLING. Okay. Finally—I see my time is starting to wind down—I know that recently the President has announced a new bank tax.

Now, let me read further from the testimony of Mr. Austin: "I want to point out that while the proposed bank tax is initially aimed at penalizing larger banks, it will also have an impact on smaller ones. When the big banks sneeze, we run the risk of catching pneumonia. We rely on them for correspondence services, check clearing, wire transfers, letters of credit, and many other services. And this will only increase the prices for these services, which will be passed on to consumers and small business." Again, a gentleman who has been in banking for four generations, now has been elected to represent all the community banks in Texas.

Did the Treasury, in announcing this particular new proposed tax, consider its impact on smaller community banks and small businesses?

Mr. MILLER. The issue of the responsibility fee, I would like to point out, under section 134 of the Emergency Economic Stabilization Act, there is specifically a section that instructs the President to put a fee on the financial industry in place to recoup TARP funds. I think that's the purpose of this fee.

The structure of it is specifically on institutions that are large institutions, greater than $50 billion in assets. I think the purpose here is to target those that have the highest leverage, that were taking the excessive risks, and therefore—

Mr. HENSARLING. Mr. Miller, I see I'm out of time. But if you quit bailing them out, you don't have to recoup the cost. I yield back.

Chairman GUTIERREZ. The gentleman yields back. Mr. Perlmutter is recognized for 5 minutes.

Mr. PERLMUTTER. Thanks, Mr. Chairman. And I would like to ask the panel—I just want to go back a year-and-a-half to July of 2008, when the Bush Administration and Secretary Paulson, sitting where you are sitting, asked for some additional powers with respect to Fannie Mae and Freddie Mac, even though they had sort of coddled Fannie Mae and Freddie Mac for years, according to the prior chairman of this committee, Mr. Oxley—and we can get into that.

But they came and said, "We would like to be able to put Fannie Mae or Freddie Mac into either conservatorship or receivership, but we're not going to use those powers." One month later, Secretary Paulson places Fannie Mae and Freddie Mac into conservatorship. And Mr. Kelly, who testified earlier, he and his bank, as well as other financial institutions across the country, had worthless paper. At that point, that caused them to immediately become undercapitalized.

So, Secretary Paulson and President Bush felt that was an appropriate step. Fine. We went forward, and we did TARP, to be made available to banks to help them stabilize themselves, and keep the banking system in place.

Now, Mr. Kelly's testimony—and I think you all heard it—was that originally his bank was approved for TARP in October of 2008. I want to ask just a very straightforward question. Why, in October of 2008, after he had been approved for TARP, was he then denied TARP? Mr. Miller?

Mr. MILLER. I think it is important to clarify the sequence of events. I think the term "approved" that he was using was being used incorrectly. He was originally recommended by his primary regulator. At the time, there was no program for private institutions. Several weeks later, there was a term sheet put out. At that time, the regulator who was recommending it brought it to what's called the council of regulators for more due diligence and review.

At that point, they went and did other work, but we did not get their recommendation where we would then go forward and fund the institution. Their recommendation—

Mr. PERLMUTTER. The council—OCC recommended that the bank receive TARP, but the council—

Mr. MILLER. Yes, there is a council—

Mr. PERLMUTTER. —declined?

Mr. MILLER. There is a council of the other regulators—

Mr. PERLMUTTER. Who makes up the council?

Mr. MILLER. There is a council of the OCC, the Fed, the OTS, and the FDIC.

Mr. PERLMUTTER. Okay. And do you know what the reason was that the OCC, which—you know, when they have been in front of

this committee, they have been pretty hard-nosed about the banks under their jurisdiction. So I'm surprised that if the OCC is making the recommendation that this bank get TARP money, that under the Bush Administration, they would be denied TARP money. What caused that?

Mr. MILLER. We followed a very consistent process over 1,000 applications. And a recommendation from either the primary regulator or the council forwarding the application up was a requirement for us to move forward.

Again, as I said, if you did not get a recommendation and a statement that said, "This institution is viable without TARP funds," we did not review the application and fund. And that was consistently—

Mr. PERLMUTTER. Do you know whether that statement was made as to Mr. Kelly's bank?

Mr. MILLER. My understanding is the council could never make that statement, and so we did not have any further involvement in the institution, going forward.

Mr. PERLMUTTER. All right. Let's now move forward in time. So, over time, they're trying to get capital, because they have $900 million of worthless Fannie Mae and Freddie Mac paper. They're trying to do that. They were working with the FDIC, as I understood the testimony.

When did the FDIC start this, you know, deciding that this is a deteriorating—I think your term, it was deteriorating condition, and then, bang, close them and sell it to U.S. Bank? When did that all occur, Mr. Glassman?

Mr. GLASSMAN. Conversations with the primary regulator, the OCC, were ongoing. But when the seven banks—seven out of the nine banks were told that they were going to become insolvent, and that they would be placed under receivership, we then had to take a look at the total family. But the conversations were ongoing.

Mr. PERLMUTTER. Why?

Mr. GLASSMAN. —with the OCC—

Mr. PERLMUTTER. Why? Why do you have to take a look at the total family? Why can't you save one or two banks out of nine banks?

Mr. GLASSMAN. Well, our intent was never to try to look for any type of institution to fail. But the statute is very clear about protecting the Deposit Insurance Fund.

Mr. PERLMUTTER. Right.

Mr. GLASSMAN. With the two other banks that were part of the family—according to the statute—we have a right to assess liability for the losses.

Chairman GUTIERREZ. Time has expired. Mr. Bachus, you are recognized for 5 minutes.

Mr. BACHUS. The Chicago Tribune article says that when the government took over Fannie and Freddie in September 2008, it wiped out the value of the company's equity overnight. FBOP suffered an $885 million loss, blowing a gaping hole in its reserves. That's pretty—that's true, is it not? Ms. Kelly?

Ms. KELLY. Yes, that is.

Mr. BACHUS. Okay. That's true? Okay. Ms. Kelly, you all had a full-time examiner at FBOP?

Ms. KELLY. Yes, we had one examiner who was overseeing all six of the national banks that were part of that group.

Mr. BACHUS. Right. At any time did that examiner, or did the OCC become concerned about Fannie and Freddie and their solvency?

Ms. KELLY. We were well aware of the size of the concentration of the investment that they had in the Fannie and Freddie stock, and our examiner was having conversations with them. As the value of that stock was dropping before the conservatorship, we were obviously watching that closely. And the examiner had conversations with bank management about the need to develop capital contingency plans in the event the value fell even further.

Mr. BACHUS. At any point did the Federal regulators—you had a regulation which allowed these banks to—really, a regulatory bias towards holding Fannie and Freddie preferred stock. You acknowledge that?

Ms. KELLY. I'm not sure what you mean by a "regulatory bias."

Mr. BACHUS. Well, you allowed them to count the preferred stock in Fannie and Freddie as if it were Treasury.

Ms. KELLY. It had a 20 percent risk weight.

Mr. BACHUS. That's true?

Ms. KELLY. Yes, that's true.

Mr. BACHUS. Yes, which—now you would agree, in hindsight, that was almost a foolish assessment of their risk, would you not?

Ms. KELLY. Well, we certainly have a different view now, given events that have transpired, yes.

Mr. BACHUS. Right. At any time did you all change your regulations and tell the banks that was no longer going to be the case, or try to back out of that—what I call, you know, a terrible regulation?

Ms. KELLY. The 20 percent risk weight?

Mr. BACHUS. Yes.

Mr. KELLY. No.

Mr. BACHUS. Okay. Well, you saw the value of the stock, and you know, Treasury was seeing it, and the FDIC. I'm sure you all were at some point all aware, prior to becoming—September 2008—into the perilous condition of Fannie and Freddie. In fact, you know, by that time Secretary Paulson had come before the Congress and asked for as much as $300 billion to inject into Fannie and Freddie.

Well, you know, you didn't—there was no advance warning by the regulators. You all were here in Washington. You acknowledge that? No change in regulation? And I'm not just talking about Ms. Kelly. Mr. Glassman?

Ms. KELLY. No, we didn't make any change in our risk weighting.

Mr. BACHUS. All right. And that caused a tremendous problem for them.

They also—you know, the Tribune points out that just the week—you took them over, and in that same week legislation was going to the President's desk that would have allowed them to realize the Fannie and Freddie losses immediately, which would have greatly helped them, would it not, Mr. Glassman or Ms. Kelly?

Ms. KELLY. I think you're speaking about the loss carry-back—

Mr. BACHUS. That's right.

Ms. KELLY. Yes, this could have generated some additional capital. However, the way that would have worked is the benefits would have had to have been spread across the nine charters and—

Mr. BACHUS. Right.

Ms. KELLY. —the two banks that were critically undercapitalized, they needed $178 million—

Mr. BACHUS. Oh, I know. But it would have helped the group substantially. Right?

Ms. KELLY. I know $200 million seems like a lot of money, but—

Mr. BACHUS. Yes, it does.

Ms. KELLY. —given the situation that those charters were in, it was insignificant to helping them fix the problem.

Mr. BACHUS. Well, yes. Now, Mr. Kelly apparently offered you all a deal which would have cost about $600 million. Is that correct, Mr. Glassman?

Mr. GLASSMAN. Go ahead.

Ms. KELLY. He didn't offer—he was trying to raise capital.

Mr. BACHUS. This article says that he actually made a proposal that a private equity group would inject $600 million, and the FDIC would either contribute a similar amount or share losses up to $600 million. Is that accurate or not accurate?

Ms. KELLY. That was not something the OCC was involved in.

Mr. GLASSMAN. And I am not familiar with it.

Mr. BACHUS. So, would—did you read that article? Was that the first time you were aware of this proposal?

Chairman GUTIERREZ. The time of the gentleman has expired.

Mr. BACHUS. Thank you.

Chairman GUTIERREZ. Mr. Minnick, you are recognized for 5 minutes.

Mr. MINNICK. My concern is procyclical regulation. I have a number of financial institutions that do business or are headquartered in my district that have been through a scenario where they will have an examination by the FDIC or the OCC. The asset values supporting commercial lending are in the examinations based upon the latest distress sale, which may be at $.20 or $.30 on the replacement cost because they are valued—assets are valued so low.

The loan is then classified, and they have to take additional reserves, which eats into their tier one capital. They are then required to go out and raise substantial additional capital, and the request is usually not just the capital required to get them up to the regulatory minimum, but, in light of the bad experience they have just had with commercial lending, let's raise another 2 or 3 percent above that lending.

My question to Mr. Glassman and Ms. Kelly is, do you think it is reasonable for your fair market value bank examinations, evaluations of collateral values in this market, to be based only at the last distressed sale price for comparable property when that bears no relationship, either to a normal functioning fair market valuation or to replacement value?

Ms. KELLY. That's a very complicated issue that you are raising. We previously sent a letter to you explaining our position on this. We are trying to take a very balanced approach in our supervision. However, we have to be cognizant of the environment that we're in

now, and the problems that the banks are having. And it's important for us to ensure that banks are—

Mr. MINNICK. But the problems are largely of your creation, because of this valuation. You are driving banks that would otherwise be perfectly sound and functioning and lending in our community into bankruptcy. You are the cause of the problem, to a substantial extent.

Ms. KELLY. Well, we—

Mr. MINNICK. In my opinion.

Ms. KELLY. Do you want me to respond to that?

Mr. MINNICK. Yes, please.

Ms. KELLY. Okay. We need to look at the quality of the assets that the bank has. And if borrowers are having trouble repaying their loan, then bankers need to recognize that, and they need to work with the borrowers to try to have the loans repaid. But just ignoring the problems doesn't make them go away.

Mr. MINNICK. Many of these loans are fully performing. And the problem is your valuations being so far below any reasonable market value or replacement value or likely value, if they are allowed to be sold over a meaningful period of time, that you are forcing banks to set up reserves that bear no relationship to what they really need against fully performing loans.

Ms. KELLY. I would say that's an oversimplification of the way that our OCC examiners look at loans.

If there is a specific situation that we could discuss further, we would be happy to get into the details. Every situation is different, and we need to look at it.

But if a borrower has full ability to repay the loan, just the fact that the value of the collateral declined is not going to force us to take action on that loan. We're looking at the ability of the bank to collect that loan. And if the borrower can repay it, regardless of what has happened to the value of the collateral, then that's what we are focusing—

Mr. MINNICK. So, whether or not the lender can repay the loan is relevant to the issue of fair market value?

Ms. KELLY. A—

Mr. MINNICK. Because I don't think that, in fact, is what is happening. But I am delighted if that is the case, because that is a way of dealing with this issue and keeping some banks from being—going insolvent that are teetering on the very edge right now, because of your regulatory focus.

Ms. KELLY. If the loan can be repaid on reasonable terms, that's what we are looking for. But again, there are a lot of nuances to these situations. We would really have to talk in more specifics to get at some of the cases that you may be hearing about. And we would be happy to provide more information, and have that conversation.

Mr. MINNICK. Mr. Glassman?

Mr. GLASSMAN. I am not on the examination side, but I would like to have a response provided to you by our examiners and the folks who deal with the safety and soundness issues regarding your question. So if you would allow us to give you a written answer back, I will make sure it gets done.

Mr. MINNICK. Well, it's a complaint. And it may be an oversimplification, but we have limited time. But it's a complaint that has been brought to me by the CEOs of a whole host of banks in my district. And what we hear from you, at your level, is quite different from the experience they are having on the ground with your field personnel.

Your field personnel never get criticized for being overly conservative. They only get criticized if they are not—

Chairman GUTIERREZ. The time of the gentleman has expired. The gentleman from Georgia, Mr. Price.

Mr. PRICE. Thank you, Mr. Chairman. I want to follow up on the comments that were just being made.

The American people are angry, and they are fearful, and they are concerned about what's going on, because they don't believe their government gives a hoot about them any more. I mentioned in my opening statement the FDIC is destroying communities, and that is what you are doing. You are destroying communities. And it's wrong. It's wrong.

All the failures in our State, the State of Georgia now, with 25 bank failures last year, all those failures were community banks. Now, some of them were young, undercapitalized, and appropriately, in this environment, probably should have been closed. But now you all are moving into more and more of the older, established banks, some banks that are very well-capitalized with performing loans that would be an envy to some other banks that are allowed to stay open right now. Private capital is sitting on the sidelines, because you all are changing the rules day in and day out, and it's wrong.

I have read statements, Mr. Glassman, from you, and you have testified before our committee that you believe there are too many banks, too many banks. I also read your 53-page statement last week to the Financial Crisis Inquiry Commission where you made not one single reference to community banks.

So, what I would like you to do for us, please, is to clarify whether it is the FDIC's position, on why you feel that we have too many banks, and what obstacles, either legislatively or by rule, tie your hands to keep you from providing more flexibility to these struggling, established community banks. Does the FDIC believe we have too many banks?

Mr. GLASSMAN. Congressman, this is the first time I have been on the Hill in some time, so I'm not certain who has testified or whether that was our Chairman. But, again, I would like to get back with you on that, on the particulars of your question. The staff behind me will do that.

Mr. PRICE. Does the FDIC believe there are too many banks?

Mr. GLASSMAN. I do not believe there are too many banks.

Mr. PRICE. From banker after banker after banker, as Mr. Minnick has said, they are being required to come up with real capital to cover theoretical losses in communities all across this Nation. And when they are unable to come up with that real capital because private capital is sitting on the sidelines because of what you all are doing, then you sell them to one of the big boys.

And that may be a good solution for the government, but it's not a good solution for that community, because the people in that

community will no longer have access to local resources, local money. And those communities will die. These are real people out there that you are harming with the decisions that you are making.

I understand that the reserve over losses timeline that is being used currently for community banks is now down to 6 months, and that is something that apparently you all have control over. Is that correct?

Ms. KELLY. Are you referring to the reserve for loan losses?

Mr. PRICE. Yes.

Ms. KELLY. Those are accounting standards. That was what was talked about on the previous panel quite a bit, and that's something that the Comptroller has been outspoken about, that we would like to see some changes in how that's done.

Mr. PRICE. Is the OCC unable to change that right now of your own accord?

Ms. KELLY. Banks have to operate in compliance with accounting standards, and we have to honor those accounting standards. We are working closely with the standard setters.

Mr. PRICE. Do you have any flexibility with those standards right now?

Ms. KELLY. We certainly work with the banks to ensure that they have a good calculation for their loan loss reserve. But they still have to be in compliance with the accounting standards.

Mr. PRICE. And is there any accounting standard that says that the timeframe for which properties need to be evaluated in this instance for these, for the reserves, is a 6-month period of time for the valuation of the property?

Ms. KELLY. No, it's not stated that way.

Mr. PRICE. Is that what you're using?

Ms. KELLY. No.

Mr. PRICE. You're not using 6 months?

Ms. KELLY. I'm not entirely sure what you are referring to. Six months' anticipated losses, or what?

Mr. PRICE. The timeframe under which a property is valued, to determine whether or not there is appropriate capitalization within the bank itself.

Ms. KELLY. A property that the bank has lent money on?

Mr. PRICE. Yes.

Ms. KELLY. So the collateral underlying—

Mr. PRICE. Yes.

Ms. KELLY. Oh, the value of the underlying collateral.

Mr. PRICE. Yes.

Ms. KELLY. That's what we're talking about.

Mr. PRICE. Yes.

Ms. KELLY. Okay. I'm sorry. I misunderstood your question.

Mr. PRICE. I'm sorry I wasn't clear.

Ms. KELLY. In Georgia, as you know, there are areas of the country where the real estate markets have—

Chairman GUTIERREZ. The time of the gentleman has expired. Mr. Bobby Rush is recognized for 5 minutes.

Mr. RUSH. Thank you, Mr. Chairman. And, again, I want to thank you for your courtesy in allowing me to, as a non-committee member, to be a part of this hearing.

I think this question should be directed to Ms. Kelly. Ms. Kelly, there are severely and moderately unbanked communities throughout this Nation. And, has been indicated by various testimony earlier today and on—by my colleagues who are on the committee here, communities are hurting.

Is there a policy that the OCC has that would take into consideration the lives and interests of those residents of communities where there is meager and non-existent banking services? What kind of proactive policies do you all have to address the concerns of citizens in minority—mostly minority, low income, and moderately or severely unbanked communities?

Ms. KELLY. We examine banks' compliance with the Community Reinvestment Act in a variety of our offices around the country. We have community affairs officers who work with both the community groups and national banks to try and help banks—

Mr. RUSH. Did the Community Reinvestment Act play any role in the decision in Park National?

Ms. KELLY. Our decision to place Park into receivership?

Mr. RUSH. Right.

Ms. KELLY. No.

Mr. RUSH. It didn't?

Ms. KELLY. No, it didn't.

Mr. RUSH. So—

Ms. KELLY. The bank was insolvent.

Mr. RUSH. So the Community Reinvestment Act becomes silent when you close banks, community banks, is that correct?

Ms. KELLY. Our objective is to ensure banks operate in safe and sound conditions so they can service their communities. The Community Reinvestment Act is how well they service their communities—

Mr. RUSH. So, sometimes you find yourself at cross purposes with the Community Reinvestment Act, is that correct?

Ms. KELLY. But if a bank is not in a safe and sound condition, it impairs its ability to service.

Mr. RUSH. Okay. If there are any ancillary conditions or responsibilities, shared responsibilities other than the decisions of the local banker—if the—if you, as the Federal agency, or any other Federal agency, is culpable, in terms of the decisions of that bank, do you assume any responsibility for that bank not being safe and sound, or is it strictly up to the bank?

Ms. KELLY. We work with the bank to ensure they are operating in a safe and sound manner. If the bank's condition deteriorates, then we have various tools we can use, enforcement acts and such—

Mr. RUSH. Okay. Let me ask you this question, speaking specifically to Park National. When did the FDIC make their decision about the closure of Park National? What date?

Ms. KELLY. To—

Mr. RUSH. To close—

Ms. KELLY. To assess them for the liability? Or when did they make the decision—

Mr. RUSH. To close it.

Ms. KELLY. You would really have to ask the FDIC when that decision was made.

Mr. RUSH. Okay. Mr. Glassman, when did you all make that decision?

Mr. GLASSMAN. That decision was not made until late October, before its failure. And it was only made after we had put both Park—and there was another bank called Citizens—out for bid to see if there was value. But the bids came back, the market came back and said that there was not any value.

We were already looking at a $1.8 billion loss to the Insurance Fund.

Mr. RUSH. So do you know specifically what date in October?

Mr. GLASSMAN. I don't have it on my notes, but it was shortly before the closure.

Mr. RUSH. Okay, when did you begin—

Mr. GLASSMAN. I'm—

Mr. RUSH. When did you begin discussions with U.S. Bank of the possibility of the close of PNB's seizure? When did you begin those discussions with U.S. Bank? What date?

Mr. GLASSMAN. Well, that would have been October 30th, when the banks were declared insolvent.

Mr. RUSH. Was that prior to your making the decision to seize Park National?

Mr. GLASSMAN. October 30th was the day that the banks' charters were going to be pulled. But the seven banks that were part of the family had failed.

Mr. MINNICK. [presiding] The Chair grants the gentleman one additional minute.

Mr. RUSH. Thank you.

Mr. GLASSMAN. The seven banks had failed first, and we then applied the guarantee to both Park and Citizens, asking for reimbursement for those losses. And on that basis, the OCC then had to pull the charter for those two national banks on October 30, 2009.

Mr. RUSH. Thank you, Mr. Chairman. I yield back.

Mr. MINNICK. The Chair grants the gentleman from New Jersey, Mr. Lance, 5 minutes.

Mr. LANCE. Thank you, Mr. Chairman. I yield my time to Dr. Price.

Mr. PRICE. I thank the gentleman. And I want to follow up on the line of questioning that we were on before in a little different light.

It's my understanding that community banks now are required to determine the appraised value of a property within the last year, the worst year of performance. And that results in the need for higher capitalization, for them to not get in the cross-hairs of OCC and FDIC.

It's also my understanding that you all have the ability to decouple the accounting of those assets from the capitalization requirements for the bank. Is that true?

Ms. KELLY. I'm sorry, I'm not clear on what the question is.

Mr. PRICE. Because the OCC and the FDIC are requiring greater capitalization, more—the raising of greater capital because the assets on a bank sheet are decreasing in their value—

Ms. KELLY. Okay.

Mr. PRICE. —banks that are—the loans that are performing normally—the only thing that's different is the value of the property that you all are requiring the banks to assign to it—bring the bank into jeopardy of being foreclosed.

It's my understanding that you all have the ability to divorce, to decouple, the determination of the value of an asset from the capitalization requirements. Is that true?

Ms. KELLY. Well, we do have the ability to set individual capital requirements for banks, based on our assessment of their risk profile. And, obviously, the volume of problem assets they have, meaning loans that are in danger of not being collected, that maybe have to be charged off—

Mr. PRICE. And on loans that are performing—

Ms. KELLY. Yes.

Mr. PRICE. —how do you determine, on loans that are performing, that they will not perform in the future, and therefore use them as your justification for saying that the bank is in danger?

Ms. KELLY. Well, that determination about the likelihood of a loan performing in the future is based on an analysis of the available financial information on the borrower—

Mr. PRICE. And—

Ms. KELLY. —the value of the collateral, if that is a repayment source. It is a complex process. The banks do it themselves, and then the regulators come in and check the bank's assessment of the quality of its assets.

Mr. PRICE. And that's where the rub is coming, because what you all are deciding in bank after bank after bank—this isn't an isolated incident.

We have one billion plus banks—banks with one billion plus capitalization—that are in your cross-hairs right now, and with performing loans. And then you all close it down, you sell it to somebody else, and you expose the taxpayer to $200 million to $300 million in liability, when if you just worked with the bank they would work it through. They have done it before.

Ms. KELLY. And we do encourage banks to work with their borrowers who are troubled, and try to find a way to work it out. But—

Mr. PRICE. That's not what is happening. Ms. Kelly, in your testimony you stated, "Where rehabilitation is not achievable, it's the OCC's goal to affect early and least cost resolution," etc. How do you determine whether resolution is achievable or not?

Ms. KELLY. We have to make a determination about the likelihood that the bank can be rehabilitated, that it's going to be able to get more capital, it's going to be able to overcome the problems it has.

Some banks have been purchased by other banks and merged together. There are a variety of ways that problems can be worked out.

Mr. PRICE. You understand that the consequences of closing a community bank that is functioning well, that is well-capitalized, the consequences of that destroy communities.

Ms. KELLY. We do not close banks that are well-capitalized.

Mr. PRICE. Ms. Kelly, that is not true. That is simply not true. And when we raised that issue with the FDIC, and asked for a spe-

cific meeting of a bank with the FDIC, we were told by the FDIC—Mr. Glassman, I would be interested in your comment on this—told by the FDIC that it was inappropriate for a Member of Congress to ask for a meeting between the bank and the FDIC. Do you believe that?

Mr. GLASSMAN. I'm not familiar with that, but the FDIC is the insurer of the banks. I just can't imagine why we would not speak to any bank that has our deposit insurance.

Mr. PRICE. Well, we will get back with you on that. But this is a very troubling situation, and you all are affecting real lives and real people in an adverse way. And it's wrong.

Ms. KELLY. I would just like to say if you feel that we are closing banks that are well-capitalized—

Chairman GUTIERREZ. The time has expired. Mr. Danny Davis, you are recognized for 5 minutes.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman, and I certainly want to thank you again for the opportunity to participate in this hearing.

Mr. Glassman, let me ask you, do you feel that Park National was given ample time to correct its deficiency before engagement took place with the U.S. Bank?

Mr. GLASSMAN. My colleague from the OCC may be in a better position to respond, but the history of this institution showed that there was a lot of involvement by the primary regulator for over 14 months to try to raise capital, and to try to put the bank in a healthy posture. By the time it got to where the FDIC had to be involved, it was inevitable that it was a potential near failure where insured depositors were being placed at risk.

Mr. DAVIS OF ILLINOIS. Ms. Kelly, let me ask you, based upon information that was going back and forth, and information that I had received, and I guess others had received, and—the feeling that we had gotten was that Park National was on the verge of being able to rectify its financial situation with a new private investment. And the investment was basically agreed to, except the T's had to be crossed and the I's dotted. All of the nuances of the agreement had to be worked out, but the basic agreement and the basic ability had occurred for a new investor to come in with the resources that they needed.

Was that inaccurate information that was coming out, or was there any accuracy to that, or—

Ms. KELLY. Our assessment of the situation was that it was not, at that point, close to just dotting I's and crossing T's. There certainly were discussions under way, but it had not reached the point of a definitive agreement that the new capital was coming in, which is what we had made clear we needed.

Mr. DAVIS OF ILLINOIS. Oh, so there was—the question of flexibility also was a question under discussion by interested entities and interested parties at that time, relative to—what kind of flexibility did the OCC, did the FDIC—what kind of flexibility existed, if any, that this one week of time that was being asked for by Park National—or had it reached the point where the decision had really already been made, that U.S. Bank was going to be the receiver, and that they were just kind of blowing in the wind at that point?

Ms. KELLY. I'll start with that, and then perhaps Mr. Glassman would like to follow up. But from the OCC perspective, it's important to understand we had been working with the bank for almost 14 months, since the time the GSEs were placed into conservatorship and they had that immediate need for capital.

And I feel, in terms of flexibility, we had been working closely with the FBOP management. We had been looking at numerous proposals, providing feedback on those proposals. We did support their TARP application. We did everything we could to try and find a solution for this group of banks.

When we got to the point where two of the banks went under the critical undercapitalized level, that triggers the 90-day clock that we have to put the banks in receivership. And so, we were operating under that 90-day clock at that point in time, and we made it clear that the only thing that would allow us to stop that was a signed, definitive agreement, and we did not have that.

Do you have anything you want to add to that?

Mr. GLASSMAN. You know, the other point, as far as flexibility, is also the fact that we are the deposit insurer. This family of banks had close to a half-a-million accounts. A lot of them needed to have the deposit insurance applied so they would be able to continue their banking needs.

So, for us, the fact is that—

Chairman GUTIERREZ. The time of the gentleman has expired. I would encourage the witnesses to answer in writing any questions that they might not have had the time or opportunity to answer.

I want to thank the witnesses and the members for their participation. The Chair notes that some members may have additional questions for the witnesses, which they may wish to submit in writing. Therefore, without objection, the hearing record will remain open for 30 days for members to submit written questions to the witnesses, and to place their responses in the record.

This subcommittee hearing is now adjourned.

[Whereupon, at 2:07 p.m., the hearing was adjourned.]

# A P P E N D I X

January 21, 2010

# Gutierrez Statement: Hearing Evaluates State of Banking Industry within Our Local Communities

**(Washington DC)** Today, Rep. Luis V. Gutierrez, Chair of the Subcommittee on Financial Institutions and Consumer Credit made the following opening statement at a hearing entitled, "The Condition of Financial Institutions: Examining the Failure and Seizure of an American Bank."

Ever since the beginning of this financial crisis in 2008 we have all heard about the big financial firms and banks that have failed: Bear Stearns, Lehman Brothers, Merrill Lynch. But for every large bank that fails, there have been dozens of smaller, community banks that have also failed. Banks with names like People's First Community Bank, St. Stephen State Bank and even banks like Park National Bank, that was supported by a largely successful holding company, fail every week.

While the focus of this hearing is the failure of one particular bank holding company, it is my intention to shed light on lessons learned from recent bank failures and the insolvent bank resolution process. Last year alone 140 banks failed across this nation, and so far this year four banks have failed, including three just last Friday. Through this hearing I hope to provide our banks better insight into the factors used by their regulators when they make these decisions, and for the regulators to have a better understanding of the impact that bank closures and consolidation have on our local communities and civic and community organizations like our schools and faith-based institutions.

We should also examine today the FDIC's flexibility in accounting for factors such as a purchasing bank's knowledge of the market it is moving into, as well as a bank's record of community investment and support beyond the standard CRA rating. If the FDIC requires a change in the current laws to be able to account for our communities' well being, then by all means we should have that discussion now, before more and more banks fail and consumers suffer even more than they already have.

Finally, I want to stress the importance of banks that focus on lending to their communities and not simply on using their money to make profits through trading on Wall Street. Real economic growth in this country happens when we invest in Main Street. It is based on old-fashioned lending: through a loan to a bakery to buy a new commercial oven; helping to finance the expansion of a local school; helping to put a child through college; or simply offering them a reasonable and affordable loan.

The economic crisis that we face was created by trading in confusing and all too ephemeral products like credit default swaps and mortgage backed securities, not by financing the expansion of the hardware store down the street. This kind of trading is still based too much on greed. Just take a look at the decrease in lending last year, and compare that to the increase in bonuses doled out by many of the largest —and yet most vulnerable— institutions. And as our local lenders close all around us, these banks

continue to play financial roulette. It's fundamentally backwards and quite simply counterintuitive. I believe that in order to stabilize our financial system we must re-examine what it means to be a successful bank in this country and encourage a return to the fundamentals of lending. I am glad to hear that President Obama will be addressing this very issue later today when he announces his plans for limiting the ability of commercial banks to conduct proprietary trading with their depository funds.

Finally, I want to thank all of you who came to this hearing, in particular those who made the long journey by bus. I applaud your interest and your involvement in these important issues which are vital to the sustainability of all our communities. I look forward to hearing the testimony of those before us today.

Invited Testimony of

**Jeff Austin III**

Vice-Chairman, Austin Bank Texas, NA, Jacksonville, Texas
Chairman-Elect, Texas Bankers Association

*Before the*

The Sub-Committee on Financial Institutions and Consumer Credit

United States House of Representatives

January 21, 2010

**Invited Testimony**

**U.S. House of Representatives**
**The Sub-Committee on Financial Institutions and Consumer Credit**
*By*
**Jeff Austin III**
**Vice Chairman, Austin Bank Texas, NA, Jacksonville, Texas**
**Chairman-Elect, Texas Bankers Association**

Good morning Mr. Chairman and fellow Committee members. My name is Jeff Austin III and I am Proud to be a Banker!

I am Vice Chairman of Austin Bank Texas, NA which is a community bank in East Texas with 28 locations and $1 billion in assets. I am also affiliated with three other banks, First State Bank of Athens, Texas ($330 million in assets), First State Bank of Frankston, Texas ($145 million in assets) and Capital Bank outside of Houston, Texas ($230 million in assets). Each bank was profitable last year because of a great team we have in place and because we did not take excessive risk on our balance sheet. In addition to my bank duties, I am also Chairman Elect of the Texas Bankers Association. The TBA is one of the largest State Associations in the country with over 600 members composed of FDIC Insured depository institutions of all sizes with the majority being community-minded traditional banks. 85% of all the banks in Texas are members of the Texas Bankers Association and they comprise approximately 95% of the assets in the State.

It is an honor to be before you this morning as our Country tries to make sense of a financial debacle and out of control perceptions of what has happened and is happening to our country's banking system. I share my perspective with you this morning as a fourth generation banker, whose family and related institutions have survived many economic cycles. In 2009, our family celebrated 100 years in the Texas banking industry.

My first message is stated simply this:

**"I am proud to be a Banker and Please, and Do not shoot the survivors!"**

This theme is an underlying and frustrating tone among the thousands of traditional and community minded and traditional banking entities and hundreds of thousands of employees, all across the country. It is important for the purposes of my comments that we separate a traditional bank from the FIGS (the new name for investment Banks -Financial Institution Groups). The investment banking activities of some Wall Street giants, that are sometimes loosely referred to as banks, and the shadow banking system which includes many non traditional banking activities have been inappropriately blended with the activities of banks like ours.

One of the issues of today's hearing is the closure of FBOP and its subsidiary banks. One of our related banks contacted the FDIC to attempt to bid on one of the single banks in Texas and we were discouraged since the FDIC wanted to sell all the banks in the Holding Company to a single purchaser. This discouraged local and area banks who know the customers and the region from submitting a bid. The ultimate purchaser then sold three Texas banks to another Texas based institution.

Community banks, traditional banks, are perplexed by regulatory practices that often seem to disadvantage us and favor much larger institutions or even non-banks, making it harder for us to serve our communities. We are also negatively impacted by public attitudes, often fed by less than careful reporting in the media that in practice harm our ability to serve our customers and communities. I will discuss some examples in my remarks.

Let me turn to an example of lending issues. **There seems to be a populist view that banks are not lending and do not want to lend.** This is like saying McDonalds does not want to sell Hamburgers. My bank is still in business, as are many of my colleagues throughout the country, because our doors are still open to lending and because we follow the injunction to make good loans, with a good likelihood of repayment. My grandfather reminded customers that there is a preamble to every promissory note: "I do hereby promise to repay."

While many small businesses and consumers are faced with declining credit scores, loss of jobs, loss of income and declining collateral values, banks still are statutorily required to make prudent lending decisions to protect the safety and soundness of the bank and the Deposit Insurance Fund. When a bank goes out of

business, it provides no more services to its customers. Staying in business means earning a profit and continuing to serve our communities because we make a profit.

It seems, however, that bank regulation, economic forecasts, and the general attitudes in the public are almost intend to make banks scared to lend money. Our shareholders get nervous when the examiners get nervous. Overregulation and aggressive enforcement actions by regulators and new costly mandates by Congress are- intentionally or not- are directly affecting the ability of banks to do what they were created to do – loan money and provide other important financial services in their communities. Traditional banks are the cornerstone in every community and in the Nation's economy.

The banking industry has been hit by the recession, no doubt about it. Over 140 banks failed last year, and the FDIC predicts that the situation this year could be equally grim. But regulatory action can make it harder for the survivor banks to do their jobs. Today, the survivors are being shot. With the proposed new bank tax, increased FDIC insurance premiums, excessive regulations and far reaching practices by many of the regulatory agencies that make decisions above stated regulatory minimums – such as dramatically higher capital requirements, harsh valuation requirements on performing loans (the return of the non-performing performing loan that made the 1990s credit crunch famous) and the like—these practices are feeding a potential credit crunch that we as community bankers are working hard to avoid. All banks struggle to achieve profitability in such uncertain times.

I have been exposed to recent exams from the OCC, the Federal Reserve, the FDIC and the Texas Department of Banking. While there are a lot of similarities, there are many differences from what is said in Washington DC and the interpretations we face from local and regional examiners. No examiner or agency wants to be caught *not* enforcing consumer protections or stated regulations because of the real fear of criticism from the Inspector General's Office.

This problem is reinforced because of the forensic exams performed after banks have been closed by the FDIC. Specifically, we can point to the valuation of real estate. For example, if a loan has been performing and paying as agreed for a few years and was a "PASS" or satisfactory credit in previous exams, the post-closure

valuation is drastically different. Bankers and investors alike have shared stories that the FDIC is requiring an immediate liquidation value to be applied which further deteriorates an institution's values for its 1-4 family and commercial real estate portfolios. The examiners are then using those distressed valuations to apply to the other performing loans resulting in banks being required to allocate additional and unnecessary reserves for subjective valuations. Appraisers have no choice but to use those appraisals as "comps" which hurts even healthy properties. This factor alone is one of the main detractors from banks wishing to make loans in their community.

**Restated: over regulation and aggressive stances by regulators are resulting in distressed earnings among the traditional banks.** Coupled with the large FDIC insurance premiums collected from the "survivors," which lowers an institution's liquidity position, a bank's capital position also comes under increased risk and pressure which takes away from the ability to make loans. The real heartbreak is when a customer is asked by their bank to pay down the loan to meet the new valuation, or put up additional collateral to reduce the over loan-to-value to the new valuation amount. This comes at a time when our borrowers and homeowners cash reserves and liquidity depressed. If this continues, it will be a death spiral that will be hard to reverse.

In the next couple weeks when you go back home, may I encourage you to visit with the bankers in your district to validate these same concerns. Let them tell you their stories in their own words.

Banking is, and always has been, at the foundation of our economy. Banks that believe in small businesses want to invest in new technology, expand their locations or invest in new equipment, etc. Bankers will continue to believe in small businesses and invest in them. In return, the multiplier effect of their investments creates jobs within their community. One of my colleagues has just committed to loan $6 million to construct a manufacturing facility that will create 350 jobs in Texas.

I would like to turn to the shadow banking system, and its impact on traditional banking. In recent decades, the auto industry created financing arms that created special incentives-including such products like "zero-percent financing" offers (where at least in some cases the credit buy down was paid for in the price of the

cars)— to move and sell the products from their manufacturing units. All too often, many people qualified for loans that they normally could not. These large captive finance companies like GMAC, Chrysler Credit and Ford Motor Credit assumed larger risks, but in doing so also took away some of the "bread and butter" consumer loans from traditional banks. I might point out that in recent months TARP money has been channeled to automotive financing to keep this unfair practice going, a practice which the Administration is now proposing that the banking industry pay for.

I bring this up because many in the housing industry created in-house finance operations by working with the shadow banking industry to create low teaser-rates and adjustable rate and hybrid mortgages for consumers who could not otherwise qualify for a loan through a traditional bank. Their financing units in many cases sold loans in packages to Freddie (FHLMC) and Fannie (FNMA) who securitized and sold them. The large investment banks also assisted with the packaging of these sub-prime loans and finding buyers for these securities. **The overwhelming majority of the sub-prime and risky mortgages with minimal down payments and questionable qualifications were made outside the traditional banking system.** The traditional banking system should not be held responsible for the failures of the investment funds, the investment banks, the auto companies or the mortgage servicing companies. Again, the survivors are being shot!

It is important to discuss again the differences of traditional banks vs. the Wall Street investment banks, captive finance companies and other "want-to-be financial institutions." Traditional banks are depository institutions that are insured by the FDIC. We are also different in the types of activities we pursue. Traditional banks are invested in the long-term and are more likely to engage in lending and in long-term financial relationships with our customers. In short, traditional banks have deep roots.

That affects the attitude of our business. A traditional bank is a deposit taker, a loan maker and a facilitator of payment systems. We know our customers. Banks will continue to be the first responders to the call for volunteers for civic organizations and for financial support for numerous non-profit organizations in their communities.

Our challenges are real, both internal and external. First, the internal issues are things that we used to be able to control but which are progressively being taken out of our control, such as how to manage our balance sheet risk, our liquidity position, and our products. Increasingly, control of these are being handed to people outside of the bank, whether regulators or external professionals, such as external auditors following new mandates from the Financial Accounting Standards Board (FASB).

This trend is increasing with the possible creation of the proposed (CFPA) Consumer Financial Protection Agency, banks will be regulated across the country like a Utility and the free market system will not prevail because banks will have to pay more attention to the new consumer regulator than they will to their own consumers.

If you have ever seen a pre-exam package from any of the bank regulatory agencies, you would be amazed at what they review and examine during the course of a regular examination. This includes all stated regulations whether consumer or compliance related. For decades, bank Boards and management have faced the possibility of fines for non-compliance with such items as the newly implemented Reg. Z requirements, BSA, Call-Report revisions, Reg. DD, Fair lending issues, and Truth-in-lending issues and on and on. In essence – the whole alphabet soup of regulations. Increasingly, however, **we are being asked to become the Police agency for the Government** by collecting Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs), and yet often it seems as if we bankers are more at risk to enforcement action than the crooks are. When the $10,000 limit was put in place in 1972 that was a relevant amount. Today, if deflated, that is an equivalent amount of about $3,500. Did you know that when each of you go on vacation or give out a Christmas bonus, that your bank is required to record information about any transaction that is over $3,000?

Additionally, the growing likelihood of intrusion into the compensation practices of banks has created a real fear among traditional bankers. With the camel's nose under the tent, bankers are afraid that it will go too far. We do not object to concern with anything that raises valid safety and soundness issues. We are afraid that new regulations will affect what we can even pay a teller. Would Congress trade their pension plans for a government implemented and managed Social Security system?

Continuing on the issue of compensation, many banks are using a "Stakeholder Model" which is similar to Robert Kaplan's "Balanced Scorecard." It factors in and balances the key drivers of earnings, quality, efficiency, growth and loss mitigation based on actual results. For example, it has deductions for past dues, declining credit quality, and charge offs. Too much intrusion and excessive micro-management of capitalistic markets can only do more harm.

Another example of an external threat is that of GMAC's Ally Bank. They have been allowed to run nationwide television ads offering above market deposit rates driving up all banks' cost of funds. For example, on 1/19/10, Ally was offering a 1.74% APY for a one year certificate of deposit. This compares with the cost of an average bank's 1 year CD rate of 0.65%. It appears the GMAC and Ally Bank continues to need to raise cash, regardless of the cost or consequences. The FDIC has issued guidance against this practice but it seems that it is ignored. GMAC, as a ward of the government, is bringing more risk to the DIF Deposit Insurance Fund by offering ridiculously high rates that we cannot compete against to protect the safety and soundness of our bank. We can't compete against you-the Government. Your are killing us!

Other impacts of the recent regulatory overkill include the recent FAS 5 requirements from the SEC and FASB regarding the valuation of Loan Loss Reserves. It does not allow banks to build up reserves in the good times to a reasonable amount based on the banker's good judgment. We were taught by our parents to save for a "rainy day." Reserves are built by improving credit quality, reducing past due loans, and through stable earnings. The overkill and swinging of the pendulum has now caused banks to take a larger hit to earnings, when times are tougher, to replenish the reserves at the bottom of the cycle. It is clear to all of us, that SEC's and the accounting industry's position were off-base by not allowing banks to build loan-loss reserves in the good times.

In years past, banks would ask the examiners at the conclusion of the exam for a Certification letter. This letter would basically state that they agree and certify that the level of loan loss reserves is adequate and necessary. In return, the bank would furnish this letter to their accountants so the entire amount of the provision could be deducted for income tax purposes. In reality today, banks can

only deduct the amount of actual losses against the provision, not the excess allocations base on future or unrealized losses.

The impact of FAS 166, implemented by the FASB which addressed loan participation agreements, will hurt banks ability to find a participating partner for larger loans for their customers. You will hear this again when businesses say "My bank will not make loans" because they are not big enough. We partner with fellow banks to assist with the lending needs of our larger customers. FAS 166 will drive that business away from community banks who will not be able to compete with larger banks for the middle business lending market.

Should lawmakers pass the proposed bank tax legislation, it will result in higher fees to the consumers and small businesses. Any ongoing business pays all of its costs from the money that it earns from its customers; you cannot get around that without going out of business. Moreover, why is the proposed tax exempting banking competitors in the shadow banking world? Why are we exempting GM, AIG, and Chrysler? Instead, the Administration is looking to the banks; the very banks that are the leaders in business, construction, consumer and small business lending, and whose lending operations are still under severe pressure from the recession, with loan delinquency and default rates at very high levels?

Some have said that the big firms on Wall Street have a big share of the blame and it s fair for them to pay – but what about those of us as survivors on Main Street? Does anyone really believe that these taxes will not continue to be extended and will not find their way down to community banks?

I believe that the Treasury Department itself has reported, when the decision was made last month to extend the TARP program, that the government isn't expected to lose money on TARP aid to banks. The losses are coming from the auto companies and AIG, banking competitors in the shadow banking world. The banks are paying back their investment, at an expect $20 billion profit to the government, and now the banking industry is being called upon to pay the beer tab for our competitors. Not only is that unfair, but it is likely to make it harder for banks of all kinds to attract the capital needed to fund increased lending.

I want to point out that while the proposed bank tax is initially aimed at penalizing larger banks, it will also have an impact on smaller ones. When the big

banks sneeze, we run the risk of catching pneumonia. We rely on them for correspondent services – check clearing, wire transfers, letters of credit and many other services and this will only increase the prices for these services which will be passed on to consumers and small business. Moreover, by exempting insured deposits, it increases the incentive for large banks to increase their competition with community banks for scarce deposits. Community banks traditionally rely upon deposits as our chief form of liquidity, while larger banks have raised as much as 50% or more of their funding from non-deposit sources. Taxing those sources will just drive the largest banks, with their large advertising resources, right into community bank markets.

Traditional bankers and smaller banks are fearful that this tax will soon be expanded to include all banks – again, "shooting the survivors!" Why should this be a special tax on one industry that is so punitive, and not include the largest culprits such as GM, Chrysler, Freddie & Fannie? Yes, this may exempt the small banks outside the top 50 – but we need to separate the traditional banking model from the investment banking model.

Finally, allow me to list some of the key challenges to the continuation of the traditional banking role of community banks. Many challenges traditional banks are facing include:

- An uncertain and constantly changing regulatory environment;
- New regulatory burden imposed by Congress;
- New regulatory burden imposed by the FASB;
- Greater internal compliance costs from FDIC, and other regulatory agencies;
- The Excessive bookkeeping and record keeping requirements that are redundant and unnecessary;
- Proposed new taxes on the banking industry; and
- Negative public perception caused by the media and other public commentators and public officials.
- Members of Congress have had to cast votes during a crisis before all the facts were brought forth.

As I said earlier, traditional banks have a depth of management and expertise coupled with knowledge of THEIR customers and the ability of those customers to perform over the long haul and through challenging economic cycles. This

overrides any national statistics, predictions or perceptions. We know our customers. We know their character, their capacity, their collateral, and their cash flow. Let us serve them and work with them.

In summary, YES, I AM PROUD TO BE A TRADITIONAL BANKER! Thank you Congressman Hensarling and to the Committee for inviting me here today and the opportunity to share with you the views of this community banker, which I believe are reflective of views of my many colleagues all across the nation. I will be happy to answer any questions.

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TexasBankers
Association
*One Industry. One Vision. One Voice.*

January 15, 2010

The Honorable Kay Bailey Hutchison
284 Russell Senate Office Building
Washington, D.C. 20510

The Honorable John Cornyn
517 Hart Senate Office Building
Washington, D.C. 20510

Dear Senators Hutchison and Cornyn:

As members of the Texas Bankers Association, Texas' oldest and largest banking trade association, each of the undersigned banks is committed to ensuring that Texas maintains its strong and viable position in the banking industry. Our Association is comprised of 600 of the 685 FDIC-insured institutions operating in the State of Texas with 5,000 branch locations and 97% of all bank assets and deposits. We truly represent all banking interests in the State of Texas and firmly believe it is incumbent upon each of us to make good business decisions that serve our communities.

However, given the agenda the Obama Administration is advocating in **H.R. 4173**, The Wall Street Reform and Consumer Protection Act, the purported intent of which is to restructure the financial regulatory system for the commercial banking industry, we fear our ability to serve our customers will be severely hampered. Simply stated, this bill will do more harm than good to the banking industry. Because we feel Main Street community bankers are not being included in the discussions about the content and merits of this legislation, we offer the following points for your consideration as clarification about our position on the bill:

1. Traditional community banks and thrifts did not cause the collapse of the nation's housing market and the near-collapse of the financial services system itself in 2008. They cannot and do not support punitive measures for their business model – funding local loans with local deposits – that did not create the current economic problems we all face together.

2. The traditional bank model had nothing to do with causing "consumer abuses" that have been alleged. Credit card fees and overdraft protection programs did not bring the nation to the edge of the financial abyss.

3. Traditional community banks and thrifts in every state support regulatory reform, including a consumer protection mechanism, for the abusers that have never been subject to an effective regulatory process and that fell outside of the current system which exists for FDIC- and NCUA-insured institutions.

4. We support creating a "Systemic Dissolution Fund" and establishing a clear mechanism to resolve "too-big-to-fail" institutions, thus ending this abusive and discriminatory national policy.

5. Traditional community banks and thrifts support an effective risk-based system for purposes of assessing FDIC insurance premiums. Insured depository institutions which engage in

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more risky transactions as a part of their business model should pay more to the Deposit Insurance Fund for that additional risk.

6. Traditional community banks and thrifts support simplified disclosures for all customers, whether the activity involves lending or opening new accounts. In this regard, we call on Congress and bank regulatory agencies to review current laws and regulations that are burdensome to consumers.

We pledge to work closely with you and your staffs in a collective effort to accomplish these goals together as the bill moves toward passage. However, the undersigned banks cannot support **H.R. 4173,** The Wall Street Reform and Consumer Protection Act of 2009, in its current form.

Respectfully,

Citizens Bank, N.A., Abilene
First Financial Bank, N.A., Abilene
First State Bank, Abilene
Liberty Capital Bank, Addison
First National Bank Albany/Breckenridge, Albany
Texas Champion Bank, Alice
First National Bank of Alvin, Alvin
Texas Advantage Community Bank, N.A., Alvin
Amarillo National Bank, Amarillo
FirstBank Southwest, Amarillo
Herring Bank, Amarillo
First National Bank of Amherst, Amherst
Anahuac National Bank, Anahuac
Security State Bank, Anahuac
First National Bank of Anderson, Anderson
Commercial State Bank, Andrews
The National Bank of Andrews, Andrews
Citizens State Bank, Anton
The Bank Arlington, Arlington
American State Bank, Arp
First National Bank of Aspermont, Aspermont
First State Bank, Athens
Bank of Texas, Austin
Business Bank of Texas, N.A., Austin
Community State Bank, Austin
Horizon Bank, SSB, Austin
Independent Bank of Austin, SSB, Austin
Libertad Bank, SSB, Austin
Treaty Oak Bank, Austin
The First State Bank, Avinger
First National Bank of Baird, Baird
Ballinger National Bank, Ballinger
First National Bank, Ballinger
Bandera Bank, Bandera
Bandera First State Bank, Bandera
First National Bank of Bastrop, Bastrop
CommunityBank of Texas, N.A., Beaumont
MidSouth Bank, N.A., Beaumont
First National Bank Mid-Cities, Bedford
First State Bank of Bedias, Bedias
The First National Bank of Beeville, Beeville
Community National Bank, Bellaire
Austin County State Bank, Bellville
The First National Bank of Bellville, Bellville
First State Bank of Ben Wheeler, Ben Wheeler
Farmers State Bank, Bertram
The State National Bank, Big Spring
The Blanco National Bank, Blanco
Fannin Bank, Bonham
Legend Bank, N.A., Bowie
Brady National Bank, Brady
The Commercial National Bank of Brady, Brady
Citizens National Bank of Breckenridge, Breckenridge
First Star Bank, S.S.B., Bremond
Brenham National Bank, Brenham
Bridge City State Bank, Bridge City
The Community Bank, Bridgeport
The First State Bank, Brownsboro
International Bank of Commerce, Brownsville

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Citizens National Bank, Brownwood
Texas Bank, Brownwood
Texas Enterprise Bank, Bryan
The Buckholts State Bank, Buckholts
Citizens State Bank, Buffalo
First Bank, Burkburnett
First National Bank of Burleson, Burleson
First State Bank of Burnet, Burnet
Burton State Bank, Burton
First National Bank of Byers, Byers
Citizens National Bank, Cameron
Classic Bank, N.A., Cameron
First State Bank of Canadian, N.A., Canadian
Carmine State Bank, Carmine
Capital Bank of Texas, Carrizo Springs
First State Bank & Trust Co., Carthage
Panola National Bank, Carthage
Castroville State Bank, Castroville
The First Bank of Celeste, Celeste
Farmers State Bank, Center
Shelby Savings Bank, SSB, Center
Chappell Hill Bank, Chappell Hill
First State Bank, Chico
First Bank and Trust, Childress
First National Bank of Chillicothe, Chillicothe
The Donley County State Bank of Clarendon, Clarendon
First Financial Bank, N.A., Cleburne
First State Bank, Clute
Texas Gulf Bank, N.A., Clute
First Bank of West Texas, Coahoma
The Bank of San Jacinto County, Coldspring
Coleman County State Bank, Coleman
First Coleman National Bank, Coleman
Brazos Valley Bank, N.A., College Station
Spirit of Texas Bank, SSB, College Station
First National Bank of Colorado City, Colorado City
The City National Bank, Colorado City
The First State Bank, Columbus
The Comanche National Bank, Comanche
First Bank of Conroe, N.A., Conroe
Charter Alliance Bank, Corpus Christi
First Community Bank, Corpus Christi
Citizens State Bank, Corrigan
Community National Bank & Trust of Texas, Corsicana
Stockmens National Bank in Cotulla, Cotulla
First Security State Bank, Cranfills Gap
Citizens National Bank, Crosbyton
Texas Heritage Bank, Cross Plains
The Crowell State Bank, Crowell
Zavala County Bank, Crystal City
TrustTexas Bank, SSB, Cuero
D'Hanis State Bank, D Hanis
Texas Heritage National Bank, Daingerfield
Dalhart Federal Savings & Loan Association, Dalhart
First National Bank in Dalhart, Dalhart
American Bank, N.A., Dallas
Bank of Texas, N.A., Dallas
Comerica Bank, Dallas
Community Trust Bank of Texas, Dallas
Coppermark Bank, Dallas
Dallas City Bank, Dallas
First Associations Bank, Dallas
First Private Bank of Texas, Dallas
Grand Bank, Dallas
Inwood National Bank, Dallas
La Jolla Bank, FSB, Dallas
Live Oak State Bank, Dallas
Mutual of Omaha Bank, Dallas
North Dallas Bank & Trust Co., Dallas
One World Bank, Dallas
Park Cities Bank, Dallas
Preston National Bank, Dallas
Professional Bank, N.A., Dallas
Southwest Securities, FSB, Dallas
Sovereign Bank, Dallas
Texas Capital Bank, N.A., Dallas
The F&M Bank & Trust Company, Dallas
United Texas Bank, Dallas
Wilshire State Bank, Dallas
First Bank & Trust Company, Dawson
State Bank of De Kalb, De Kalb
Farmers & Merchants Bank, De Leon
North Texas Bank, N.A., Decatur
Amistad Bank, Del Rio
The Bank and Trust SSB, Del Rio
Access 1st Capital Bank, Denton
NorthStar Bank of Texas, Denton
The Bank of Texas, Devine
First Bank & Trust East Texas, Diboll
Dilley State Bank, Dilley
First United Bank, Dimmitt
Pioneer Bank, SSB, Dripping Springs

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The Dublin National Bank, Dublin
The First National Bank of Eagle Lake, Eagle Lake
First Financial Bank, N.A., Eastland
The Eden State Bank, Eden
First National Bank, Edinburg
Commercial State Bank of El Campo, El Campo
NewFirst National Bank, El Campo
Bank of the West, El Paso
Capital Bank, SSB, El Paso
First Savings Bank, FSB, El Paso
The First National Bank of Eldorado, Eldorado
Frontier Bank of Texas, Elgin
The Elkhart State Bank, Elkhart
Elsa State Bank & Trust Company, Elsa
The First National Bank of Emory, Emory
The First National Bank of Evant, Evant
Falfurrias State Bank, Falfurrias
Greater South Texas Bank, Falfurrias
The First National Bank in Falfurrias, Falfurrias
Fayetteville Bank, Fayetteville
Union State Bank, Florence
First Security Bank, N.A., Flower Mound
First National Bank, Floydada
Fort Davis State Bank, Fort Davis
Fort Hood National Bank, Fort Hood
First National Bank of Fort Stockton, Fort Stockton
The Pecos County State Bank, Fort Stockton
Carlile Bank, N.A., Fort Worth
Colonial Savings, F.A., Fort Worth
First Command Bank, Fort Worth
Meridian Bank Texas, Fort Worth
OmniAmerican Bank, Fort Worth
RiverBend Bank, Fort Worth
Southwest Bank, Fort Worth
Star Bank of Texas, Fort Worth
The National Bank of Texas at Fort Worth, Fort Worth
West Side Bank and Trust, Fort Worth
Woodhaven National Bank, Fort Worth
First State Bank, Frankston
Security State Bank & Trust, Fredericksburg
Friona State Bank, N.A., Friona
Collin Bank, Frisco
SNB Bank of Dallas, Frisco
Texas Republic Bank, N.A., Frisco
First State Bank, Gainesville
Moody National Bank, Galveston
United Central Bank, Garland
National Bank, Gatesville
First National Bank, George West
First National Bank of Giddings, Giddings
First National Bank of Gilmer, Gilmer
Gilmer National Bank, Gilmer
Gladewater National Bank, Gladewater
Mills County State Bank, Goldthwaite
Sage Capital Bank, N.A., Gonzales
Titan Bank, N.A., Graford
First National Bank in Graham, Graham
First State Bank, Graham
Graham National Bank, Graham
Graham Savings and Loan, FA, Graham
Community Bank, Granbury
The First National Bank, Granbury
Grand Bank of Texas, Grand Prairie
Grandview Bank, Grandview
Premier Bank Texas, Grapevine
First National Bank, Groesbeck
The Farmers State Bank, Groesbeck
The State National Bank, Groom
Peoples State Bank of Hallettsville, Hallettsville
The First State Bank, Hallsville
Hamlin National Bank, Hamlin
Haskell National Bank, Haskell
The First National Bank of Hebbronville, Hebbronville
Henderson Federal Savings Bank, Henderson
First Financial Bank, Hereford
The First National Bank, Hico
United Community Bank, N.A., Highland Village
Citizens National Bank of Hillsboro, Hillsboro
Community National Bank, Hondo
The Hondo National Bank, Hondo
Allegiance Bank Texas, Houston
American First National Bank, Houston
Bank of Houston, Houston
Capital Bank, Houston
Central Bank, Houston
Chasewood Bank, Houston

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Encore Bank, N.A., Houston
Enterprise Bank, Houston
Golden Bank, N.A., Houston
Green Bank, N.A., Houston
Houston Business Bank, Houston
Houston Community Bank, N.A., Houston
Icon Bank of Texas, N.A., Houston
Independence Bank, N.A., Houston
Integrity Bank, SSB, Houston
JPMorgan Chase Bank, N.A., Houston
Lone Star Bank, Houston
Memorial City Bank, Houston
Mercantil Commercebank, N.A., Houston
MetroBank, N.A., Houston
North Houston Bank, Houston
Oasis Bank, SSB, Houston
OMNIBANK, N.A., Houston
Patriot Bank, Houston
Post Oak Bank, N.A., Houston
Preferred Bank, Houston
Southwestern National Bank, Houston
Sterling Bank, Houston
The Bank of River Oaks, Houston
The State Bank of Texas, Houston
Tradition Bank, Houston
Unity National Bank, Houston
Vista Bank Texas, Houston
Wells Fargo Bank, N.A., Houston
Woodforest National Bank, Houston
Hull State Bank, Hull
Plains State Bank, Humble
Third Coast Bank, SSB, Humble
Huntington State Bank, Huntington
First National Bank of Huntsville, Huntsville
Industry State Bank, Industry
State National Bank of Texas, Iowa Park
TransPecos Banks-Iraan, Iraan
Bank of Bombay, Irving
Bank of Las Colinas, Irving
Independent Bank of Texas, Irving
State Bank of Texas, Irving
TIB-The Independent BankersBank, Irving
The First National Bank, Jacksboro
The Jacksboro National Bank, Jacksboro
Austin Bank, Texas N.A., Jacksonville
Texas National Bank of Jacksonville, Jacksonville
Eagle Bank, Jarrell
First National Bank, Jasper
Texas State Bank, Joaquin
Johnson City Bank, Johnson City
Jourdanton State Bank, Jourdanton
First State Bank, Junction
Junction National Bank, Junction
Justin State Bank, Justin
Karnes County National Bank, Karnes City
Westbound Bank, Katy
Pinnacle Bank, Keene
American Bank, N.A., Keller
First National Bank of Kemp, Kemp
Guadalupe National Bank, Kerrville
Citizens Bank, Kilgore
Kilgore National Bank, Kilgore
First National Bank Texas, Killeen
Main Street Bank, Kingwood
The Mint National Bank, Kingwood
Kress National Bank, Kress
La Coste National Bank, La Coste
Fayette Savings Bank, SSB, La Grange
National Bank & Trust, La Grange
Texas Country Bank, Lakeway
The Lamesa National Bank, Lamesa
Commerce Bank, Laredo
Falcon International Bank, Laredo
International Bank of Commerce, Laredo
Texas Community Bank, N.A., Laredo
The First Liberty National Bank, Liberty
Lindale State Bank, Lindale
Texana Bank, N.A., Linden
First National Bank, Lipan
AimBank, Littlefield
First Federal Bank Littlefield ssb, Littlefield
Security State Bank, Littlefield
First National Bank of Livingston, Livingston
First State Bank, Livingston
Arrowhead Bank, Llano
Llano National Bank, Llano
First-Lockhart National Bank, Lockhart
Lone Star State Bank, Lone Star
BancorpSouth Bank, Longview
Community Bank, Longview
Spring Hill State Bank, Longview
Texas Bank and Trust Company, Longview
Texas Star Bank, S.S.B., Lott
The First State Bank, Louise
Lovelady State Bank, Lovelady
City Bank, Lubbock
First Bank & Trust Company, Lubbock

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Lone Star State Bank of West Texas, Lubbock
Lubbock National Bank, Lubbock
Peoples Bank, Lubbock
Platinum Bank, Lubbock
Western Bank, Lubbock
Angelina Savings Bank, F.S.B., Lufkin
Citizens State Bank, Luling
The Lytle State Bank of Lytle, Lytle
Madisonville State Bank, Madisonville
Big Bend Banks, N.A., Marfa
Marion State Bank, Marion
The Commercial Bank, Mason
The Cowboy Bank of Texas, Maypearl
Bank of South Texas, McAllen
Border Capital Bank, N.A., McAllen
Rio Bank, McAllen
First National Bank of McGregor, McGregor
First United Bank and Trust Company, McKinney
Synergy Bank, SSB, McKinney
Valliance Bank, McKinney
First Bank and Trust, Memphis
Memphis State Bank, Memphis
First National Bank of Mertzon, Mertzon
Incommons Bank, N.A., Mexia
First State Bank of Miami, Miami
Community National Bank, Midland
First National Bank of Midland, Midland
Citizens State Bank, Miles
Mineola Community Bank, S.S.B., Mineola
The First National Bank of Mineola, Mineola
First Financial Bank, N.A., Mineral Wells
The First State Bank of Mobeetie, Mobeetie
Lone Star Bank, S.S.B., Moulton
American National Bank, Mount Pleasant
Guaranty Bond Bank, Mount Pleasant
Muenster State Bank, Muenster
First Bank of Muleshoe, Muleshoe
First National Bank in Munday, Munday
Commercial Bank of Texas, N.A., Nacogdoches
First State Bank, New Braunfels
Farmers National Bank of Newcastle, Newcastle
Nixon State Bank, Nixon
Normangee State Bank, Normangee
Liberty Bank, North Richland Hills
The Oakwood State Bank, Oakwood
First State Bank of Odem, Odem
Security Bank, Odessa
Southwest Bank, Odessa
West Texas State Bank, Odessa
Western National Bank, Odessa
First National Bank of Olney, Olney
Orange Savings Bank, SSB, Orange
Security State Bank, N.A., Ore City
First State Bank, Overton
Crockett National Bank, Ozona
Ozona National Bank, Ozona
First National Bank, Paducah
First State Bank of Paint Rock, Paint Rock
City State Bank, Palacios
East Texas National Bank, Palestine
Commercial State Bank of Palmer, Palmer
National Bank of Commerce, an Office of First National Bank Waupaca, WI, Pampa
First Federal Community Bank, Paris
Liberty National Bank in Paris, Paris
Texas Citizens Bank, N.A., Pasadena
Heritage Bank, N.A., Pearland
Pearland State Bank, Pearland
Interstate Bank, ssb, Perryton
Perryton National Bank, Perryton
Cypress Bank, FSB, Pittsburg
HCSB, a State Banking Association, Plainview
Benchmark Bank, Plano
First International Bank, Plano
LegacyTexas Bank, Plano
Share Plus Federal Bank, Plano
ViewPoint Bank, Plano
First National Bank in Port Lavaca, Port Lavaca
Powell State Bank, Powell
Citizens State Bank, Princeton
Prosper Bank, Prosper
First National Bank in Quanah, Quanah
First National Bank, Quitaque
Wood County National Bank, Quitman
Vista Bank, Ralls
San Antonio National Bank, Refugio
Woodforest Bank, FSB, Refugio
First State Bank, Rice
Pavillion Bank, Richardson
Vision Bank - Texas, Richardson
Brazos National Bank, Richwood
Robert Lee State Bank, Robert Lee

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Peoples State Bank, Rocksprings
Citizens State Bank, Roma
Roscoe State Bank, Roscoe
The First National Bank, Rotan
Cattleman's National Bank, Round Mountain
R Bank Texas, Round Rock
Round Top State Bank, Round Top
Texas Leadership Bank, Royse City
First Financial Bank, N.A., San Angelo
Texas State Bank, San Angelo
Broadway National Bank, San Antonio
Farm Bureau Bank, FSB, San Antonio
Frost National Bank, San Antonio
Jefferson Bank, San Antonio
Lone Star Capital Bank, N.A., San Antonio
The Bank of San Antonio, San Antonio
The Trust Company, San Antonio
First Community Bank, N.A., San Benito
First State Bank of San Diego, San Diego
City National Bank, San Saba
Sanger Bank, Sanger
Santa Anna National Bank, Santa Anna
Schwertner State Bank, Schwertner
HomeBank @, Seagoville
Citizens State Bank, Sealy
First Commercial Bank, N.A., Seguin
The Farmers National Bank, Seymour
The First National Bank of Seymour, Seymour
First State Bank, Shallowater
Peoples State Bank, Shepherd
First National Bank of Shiner, Shiner
Citizens Bank, Slaton
Community Bank of Snyder, Snyder
Texas Savings Bank, s.s.b., Snyder
West Texas State Bank, Snyder
Citizens State Bank, Somerville
First National Bank of Sonora, Sonora
First National Bank of South Padre Island, South Padre Island
First Financial Bank, N.A., Southlake
First National Bank, Spearman
First State Bank, Spearman
Spur Security Bank, Spur
First National Bank of Stanton, Stanton
First Financial Bank, N.A., Stephenville
Town and Country Bank, Stephenville
First State Bank, Stratford
Bank of Fort Bend, Sugar Land
Founders Bank, SSB, Sugar Land
The City National Bank of Sulphur Springs, Sulphur Springs
Sundown State Bank, Sundown
First Financial Bank, N.A., Sweetwater
Texas National Bank, Sweetwater
The First National Bank, Tahoka
Extraco Banks, N.A., Temple
First State Bank Central Texas, Temple
Citizens State Bank, Tenaha
Peoples State Bank, Texarkana
Texarkana First Bank A Division of First National Bank, Texarkana
Texas Community Bank, N.A., The Woodlands
First State Bank, Three Rivers
First National Bank, Throckmorton
First National Bank of Tom Bean, Tom Bean
The First National Bank of Trenton, Trenton
The First National Bank, Trinity
First State Bank in Tuscola, Tuscola
Citizens 1st Bank, Tyler
Citizens State Bank, Tyler
First Federal Bank Texas, Tyler
Southside Bank, Tyler
TexStar National Bank, Universal City
Uvalde National Bank, Uvalde
First National Bank of Bosque County, Valley Mills
First State Bank, Van
Texas Star Bank, Van Alstyne
The Waggoner National Bank, Vernon
First Victoria National Bank, Victoria
Alliance Bank Central Texas, Waco
Community Bank & Trust, Waco
Fidelity Bank of Texas, Waco
Wallis State Bank, Wallis
Citizens National Bank of Texas, Waxahachie
Vintage Bank, Waxahachie
First Financial Bank, N.A., Weatherford
First National Bank of Weatherford, Weatherford
The Bank, Weatherford
Hill Bank and Trust Company, Weimar
Wellington State Bank, Wellington
POINTWEST Bank, West
White Oak State Bank, White Oak

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The First National Bank in Whitney, Whitney
American National Bank, Wichita Falls
Fidelity Bank, Wichita Falls
First National Bank, Wichita Falls
Citizens National Bank, Wills Point
First National Bank of Winnsboro, Winnsboro

The Security State Bank, Winters
The First National Bank, Woodsboro
First State Bank, Yoakum
Yoakum National Bank, Yoakum
International Bank of Commerce, Zapata
Zapata National Bank, Zapata

**EMBARGOED UNTIL DELIVERY**

**STATEMENT OF**

**MITCHELL L. GLASSMAN**
**DIRECTOR, DIVISION OF RESOLUTIONS AND RECEIVERSHIPS**
**FEDERAL DEPOSIT INSURANCE CORPORATION**

**on**

# THE CONDITION OF FINANCIAL INSTITUTIONS: EXAMINING THE FAILURE AND SEIZURE OF AN AMERICAN BANK

**before the**

**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS**
**AND CONSUMER CREDIT**
**HOUSE COMMITTEE ON FINANCIAL SERVICES**

**January 21, 2010**
**2128 Rayburn House Office Building**

Chairman Gutierrez, Ranking Member Hensarling and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the resolution process used when an insured depository institution fails. These hearings are an important way for Congress and the public to understand the statutorily-driven process for resolving depository institution failures and the work we do to ensure that there is minimal disruption to bank customers and the communities these institutions serve.

In 2009, the FDIC resolved 140 insured institutions with over $171 billion in total assets. While the economy is showing signs of improvement, recovery in the banking industry tends to lag behind other sectors. We expect to see the level of failures continue to be high during 2010.

My testimony will describe the FDIC's basic process for handling the failure of insured depository institutions. In addition, I will explain the FDIC's cross-guarantee authority and how it is applied, with specific reference to the resolution of nine insured depository institutions commonly controlled by FBOP Corporation, a registered bank holding company headquartered in Oak Park, Illinois (FBOP). Finally, I will discuss how the FDIC continues to position itself to ensure it has the necessary resources and expertise to handle the level of bank failures expected over the near term.

**Overview of the Resolution Process**

Insured depository institutions that fail are administered in a manner that fosters stability of the banking system and fulfills the FDIC's obligations to the failed institution's customers who have insured deposits. This responsibility is basically administered through two steps:

- The *resolution process* involves collecting information on the assets, liabilities and franchise value of a failing insured depository institution, marketing strategies, soliciting and accepting bids for the sale of the institution, determining which bid is least costly to the Deposit Insurance Fund (DIF) and working with acquiring institution(s) through the closing process (or paying insured deposits in the event there is no acquirer).

- The *receivership process* involves performing the closing function at the failed institution, liquidating any failed institution assets not purchased by the acquirer and distributing any proceeds of the liquidation to the FDIC, to the failed institution's customers who had uninsured deposit amounts and, if there are sufficient funds, to other creditors with approved claims.

The goals of the resolution and receivership processes are to:

- Provide depositors timely access to their insured funds.

- Resolve failing institutions in the least-costly manner, as required by law.[1]
- Manage receiverships to maximize net return in order to fulfill our statutory obligation to all creditors of the receivership.

The FDIC normally uses, depending on the circumstances, two basic resolution techniques:

- A *purchase and assumption (P&A) transaction* occurs when a healthy institution (generally referred to as the acquiring or assuming institution) purchases some or all of the assets of a failed bank or thrift and assumes some or all of the liabilities, including insured deposits. Typically the acquiring institution will receive assistance from the FDIC to complete the transaction. As described in more detail later, the FDIC approaches a wide pool of potential acquirers with terms of the P&A transaction to solicit bids. The acquirer may pay a premium to the FDIC for the assumed deposits, which decreases the total resolution costs. If timing considerations do not allow the FDIC to have an acquirer on hand at the point of failure, a bridge institution may be established as an interim step to preserve the failed institution's franchise.

- A *deposit payoff* occurs when there are no potential acquirers for the failing institution willing to bid more than it costs the FDIC to simply pay insured depositors. In this transaction the FDIC pays all of the failed institution's depositors the full amount of their insured deposits either by writing checks or by having a paying agent assume the deposits.

  In a deposit payoff, and in some P&A transactions, depositors with uninsured funds and other general creditors (such as suppliers and service providers) of the failed institution do not receive either immediate or full reimbursement; instead the FDIC as receiver issues them receivership certificates. Receivership certificates are paid under the priority system established by statute. A receivership certificate entitles its holder to a pro rata share of the receiver's collections on the failed institution's assets. If the FDIC believes it will be able to receive enough funds from winding down the failed bank, we will make advance payments on receivership certificates.

The FDIC is the primary federal regulator for the majority of FDIC insured institutions. The FDIC also has backup enforcement and examination authority over all institutions it insures. We work closely with the primary federal regulators and, where deterioration of an institution is noted, the FDIC often participates with the primary regulator in an on-site examination. Thus the FDIC becomes familiar with the issues confronting troubled institutions. This enables us to do some pre-planning in the event the institution fails.

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[1] Section 13(c)(4) of the Federal Deposit Insurance Act, 12 USC 1823 (c)(4).

The FDIC normally begins its formal resolution process upon contact from the troubled institution's chartering authority advising of the bank's expected failure. Once the FDIC receives notification, staff contacts the chief executive officer of the failing institution to discuss logistics, to address senior management's involvement in the resolution activities and to request loan and deposit data from the institution or its data processing servicer.

After the FDIC receives the requested data, a team of FDIC resolution specialists visits the institution to gather additional information. The FDIC values assets of the institution, determines the resolution options to be offered, and prepares an information package for potential bidders to access through a secured website. Based on recommendations by the FDIC staff, the FDIC's Board of Directors approves the resolution options to be used for the failing institution.

Once the necessary information has been gathered and possible resolution options are determined, the FDIC begins marketing the failing institution as widely as possible to encourage competition among prospective bidders, which are primarily existing financial institutions. A list of prospective bidders is assembled based on initial criteria that include a prospective bidding institution's overall condition, size and capital level; business plan; geographic market; and minority-owned status. The FDIC also considers the institution's safety and soundness rating, as well as the ratings pertaining to information technology, anti-money laundering, consumer compliance, and community reinvestment. The resulting list of potential bidders will then be notified of a potential acquisition opportunity. Private investors that do not already control a bank charter must obtain clearance from a chartering authority, satisfy any holding company requirements, and be in the process of obtaining deposit insurance before being allowed to participate in the bid process.

After executing confidentiality agreements, all qualified bidders have access to the information package on the FDIC's secure website, which includes financial data on the institution, legal documents and descriptions of the resolution options being offered, the due diligence process, and the bidding process. The FDIC resolution options typically will include an option to assume all deposits or only insured deposits. The FDIC also advises the bidders about the types and amounts of assets that will pass to an acquirer, which assets the FDIC plans to retain, the terms of the asset sale (such as loss sharing arrangements[2] and optional asset pools[3]) and other significant conditions that are part of the proposed resolution method.

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[2] Loss share is an arrangement whereby a pool of problem assets is sold to an acquirer under an agreement that the FDIC will share a portion of the losses. This structure allows the FDIC to reduce the immediate cash outlays for a P&A transaction and maximize asset recoveries.

[3] Under certain transaction structures the FDIC will segregate assets of the failing institution into pools each containing similarly situated assets. The prospective acquirer may submit a bid to purchase one or more of these pools, specifying the price bid for each pool to be acquired.

After reviewing the information provided on the secure website, interested bidders may also perform on-site due diligence to inspect the books and records of the failing institution to assess the value of the franchise. This process ensures that each bidder is well informed about the circumstances of the failing institution.

After due diligence, bidders submit their proposals to the FDIC by a specific bid deadline. This generally occurs one week prior to the scheduled closing. Bids consist of two parts: (1) the premium the bidder is willing to pay for the failing institution's franchise and (2) the amount the bidder is willing to pay to acquire the failing institution's assets.

The FDIC will analyze all bids to determine whether they conform to the bidding instructions and assess the cost of each bid to the DIF. The FDIC determines the least-costly resolution transaction by evaluating all possible resolution alternatives and computing costs on a net present value basis. The FDIC is required by law to use a realistic discount rate and document any assumptions used in the evaluation, including any assumptions with regard to interest rates, asset recovery rates, asset holding costs, and payment of contingent liabilities.

Once the least-costly transaction is determined, FDIC staff notifies the acquirer(s), all unsuccessful bidders, and the acquirer's chartering authority makes its final regulatory decisions about the transaction. The FDIC then arranges for the acquirer(s) to sign the appropriate legal documents before the institution's closure.

The chartering authority closes the institution and appoints the FDIC as receiver, usually on a Friday. The FDIC as receiver then begins the process for settling the affairs of the closed institution. Generally, this includes balancing the accounts of the institution immediately after closing, transferring certain assets and liabilities to the new owner and determining the exact amount of payment due to the acquirer.

In a P&A transaction, the acquirer usually reopens the institution the next business day, and the customers of the failed institution automatically become customers of the acquiring institution with access to their insured deposits (or all deposits, depending on the nature of the transaction). If the FDIC cannot arrange for an acquirer to assume the insured deposits, the FDIC will take steps to get insured depositors their funds as soon as possible. In some cases, the FDIC will arrange for insured depositors to be paid, usually by check or through a paying agent (such as another insured institution). In other cases, the FDIC may create a temporary new depository institution to give insured depositors continued checking and other deposit services while they arrange to transfer their accounts to other local banks.[4]

The FDIC is responsible for operating the receivership, including managing and selling any assets retained by the receiver, and to the extent possible, satisfying the creditor claims against the receivership. In cases where the FDIC has an ongoing involvement with the acquirer, such as in a loss sharing transaction, the FDIC will

[4] Section 11(m) of the Federal Deposit Insurance Act, 12 U.S.C. 1821(m).

administer the loss reimbursements and monitor the acquirer's performance for the duration of the agreement, typically over several years.

**Cross-Guarantee Authority**

As part of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Congress adopted amendments to allow the FDIC to recoup losses to the insurance fund by assessing a claim against insured institutions under common control for losses caused by the failure of an affiliated insured depository institution.[5] The cross-guarantee authority was designed, in part, to prevent the insurance fund from suffering losses, such as those incurred in the 1980's in multi-bank holding companies in Texas. The closings of the subsidiary banks of First RepublicBank Corporation and MCorp, bank holding companies headquartered in Dallas, Texas, are two such examples.

In these two cases most, but not all, of the subsidiary insured depository institutions were closed by the chartering authorities with losses absorbed by the FDIC. The other subsidiary banks remained open, with their value retained by the parent holding company. At that time, the FDIC was unable to require the commonly controlled institutions to cover the losses from the failed institutions. The subsidiary banks of First RepublicBank Corporation, which were closed in 1988, resulted in a loss of $3.9 billion. The MCorp failures, in 1989, cost the insurance fund $2.8 billion. At that time, these were the FDIC's two most expensive bank failures. Both cases illustrated a gap that the owners were able to exploit where the owners retained value in their surviving banks, while at the same time the FDIC absorbed all of the losses in the failed banks.

The 1989 cross-guarantee provisions in FIRREA allow the FDIC to require other insured depository institutions that are commonly controlled by the same company to cover these losses. As with its other decisions about the resolution transaction for a failed insured institution, the FDIC's manner of utilizing its cross-guarantee authority is designed to result in the least-cost to the DIF of resolving the problems of the commonly controlled group. The cross-guarantee statute allows the FDIC, based on its analysis of a particular situation, to pursue an immediate assessment of cross-guarantee liability on the commonly controlled institutions, to postpone the assessment for as much as two years after the default has occurred, or to provide waivers for any insured depository institution from the cross-guarantee liability. Exercise of the cross-guarantee authority can lead to the closing of a commonly controlled insured institution(s) if the amount assessed for the failure costs of the other insured depository institution(s) cannot be paid. However, the FDIC may postpone or waive the assessment if, in the FDIC's judgment, doing so would be in the FDIC's best interest to better achieve the least-costly resolution of the commonly controlled insured institutions. In making this decision, the FDIC must analyze the circumstances surrounding the impact on the institution that results in a potential cross-guarantee assessment to determine what action is in the best interests of the DIF.

[5] Section 5(e) of the Federal Deposit Insurance Act, 12 U.S.C. 1815(e).

In applying this standard, some of the key considerations in pursuing a cross-guarantee include whether the FDIC would achieve a higher return if the institution were sold as an open bank; whether any commonly controlled institutions are likely to fail at a later date and thereby increase the losses to the DIF; or, whether by postponing the assessment, the loss would be expected to grow and value available to the FDIC would dissipate.[6]

**FBOP Corporation Closures**

On October 30, 2009, the FDIC entered into a P&A agreement with U.S. Bank National Association of Minneapolis, Minnesota, a wholly-owned subsidiary of U.S. Bancorp, to assume all of the deposits and purchase essentially all of the assets of nine failed banks owned by FBOP.[7] These insured depository institutions are shown in Table 1 in descending order by total assets.

**Table 1. FBOP Corporation Subsidiary Depository Institutions (10/30/09)**

| | Name | City | State | Total Assets ($ Millions) |
|---|---|---|---|---|
| 1 | California National Bank | Los Angeles | CA | $6,989.4 |
| 2 | Park National Bank | Chicago | IL | 4,701.0 |
| 3 | San Diego National Bank | San Diego | CA | 3,560.0 |
| 4 | Pacific National Bank | San Francisco | CA | 2,086.2 |
| 5 | North Houston Bank | Houston | TX | 325.3 |
| 6 | Madisonville State Bank | Madisonville | TX | 237.8 |
| 7 | Bank USA, NA | Phoenix | AZ | 194.0 |
| 8 | Citizens National Bank | Teague | TX | 120.7 |
| 9 | Community Bank of Lemont | Lemont | IL | 85.0 |
| | | | | $18,299.3 |

The FDIC received notification of intent to close seven of the nine subsidiary banks from the chartering authorities (the Comptroller of the Currency (OCC), the Texas Department of Banking, and the Illinois Department of Financial and Professional Regulation). Notification was not received for Park National Bank and Citizens National

[6] FDIC, *Statement of Policy Regarding Liability of Commonly Controlled Depository Institutions*, as amended, 1998.

[7] The FDIC and U.S. Bank entered into a loss-share transaction on approximately $14.4 billion of the combined purchased assets of $18.2 billion. U.S. Bank will share in the losses on the asset pools covered under the loss-share agreement. The loss-sharing arrangement is projected to maximize returns on the assets covered by keeping them in the private sector.

Bank. However, the FDIC was aware that these two institutions were in deteriorating financial condition and had poor future prospects.

The OCC had identified Park National Bank as a deteriorating problem institution with financial and managerial weaknesses, such that it posed a distinct possibility of failure. Citizens National Bank was also deteriorating and had close financial links to the other FBOP banks. Park National Bank, because of its problems, was subject to an OCC Consent Order, addressing weaknesses in capital, the allowance for losses, liquidity, and asset quality. Further, weaknesses in the organizational structure and business activities of FBOP created significant interdependence among all nine institutions and the holding company. For example, loan participations among the nine commonly controlled institutions were extensive. Park National Bank and Citizens National Bank had substantial volumes of loans purchased from and serviced by other commonly controlled institutions within the FBOP organization. Because of significant interdependence, the ongoing operations of both banks would have been adversely impacted by the failure of their seven commonly controlled institutions.

FBOP had engaged in extensive efforts to sell one or more of the subsidiary banks or branches and had attempted to raise new capital for itself and its subsidiary banks through a sale of a minority stake in FBOP Corporation and other means. These efforts were unsuccessful.

In early September 2009, the FDIC began marketing the seven institutions for which it had received notice of imminent failure. The banks were offered on a stand-alone basis or linked with any combination of the seven. One of the transaction options offered each of the seven institutions as a whole bank (acquirer assumes either all or insured deposits only) with a loss-share arrangement on the assets.

In late September, after analysis, the FDIC also offered Park National Bank and Citizens National Bank on a stand-alone basis without loss share or as a linked bid for all nine institutions with loss share. Offering these two banks without loss share was done to determine if any bidder believed the institutions had positive value and would be willing to acquire them without any assistance from the FDIC. No bidder was interested in purchasing either institution without FDIC assistance. In light of this lack of interest, and given FBOP Corporation's financial condition, which the Federal Reserve had rated unsatisfactory, as well as the condition of its subsidiary banks, the FDIC concluded that any further efforts by FBOP to sell the banks and/or raise capital had little chance of success.

On October 20, 2009, the FDIC received 41 bids from 18 bidders for some or all of the nine FBOP institutions. The least costly bid for the seven commonly controlled institutions alone would have cost the FDIC $1.85 billion. As demonstrated by the bids, if the FDIC did not apply cross-guarantee to Park National Bank and Citizens National Bank – and those banks would have closed separately in the foreseeable future – the total cost to the FDIC would be $2.91 billion. By contrast, application of the cross-guarantee allowed for the resolution of the entire group for $2.54 billion. This avoided an

additional loss to the DIF of $316 million. These bids confirmed that absent substantial assistance from the FDIC, no other institution was willing to acquire Park National or Citizens National and that the immediate assessment of the cross-guarantee was least-costly to the DIF.

Neither Park National Bank nor Citizens National Bank would have qualified for a waiver or any delay in the assessment of the cross-guarantee liability because this would have resulted in higher costs to the DIF since both banks had serious problems and were in deteriorating condition and were very likely to fail. If Park National Bank or Citizens National Bank could have repaid the losses incurred by the DIF from the failure of the other group members, their charters would not have been revoked and the institutions would have remained open. However, neither institution had the ability to pay the assessment that the FDIC issued on October 30, 2009. As a result, the OCC made the determination to close the institutions and appoint the FDIC as receiver. As it turned out, the overall least-costly bid for all nine FBOP banks was for all nine institutions jointly. Table 2 shows the expected losses to the DIF resulting from the failure of all nine FBOP commonly controlled institutions.

As mentioned earlier, the FDIC is required by law to choose the least-costly transaction available when resolving failing banks. The FDIC goes to great lengths to ensure the process of marketing failing banks is open, fair and competitive. All potential buyers with access to a transaction have the same competitive opportunity, with the final selection being the bid that is least-costly to the DIF.

**Table 2. Estimated Deposit Insurance Fund Losses (12/31/09)**

| | | ($ Millions) | | | |
|---|---|---|---|---|---|
| | Name | Assets | Deposits | Estimated Loss | Loss as a % of Deposits |
| 1 | California National Bank | $6,989.4 | $6,133.2 | $951.1 | 15.5% |
| 2 | Park National Bank | 4,701.0 | 3,687.2 | 667.6 | 18.1% |
| 3 | San Diego National Bank | 3,560.0 | 2,897.8 | 374.2 | 12.9% |
| 4 | Pacific National Bank | 2,086.2 | 1,722.6 | 220.2 | 12.8% |
| 5 | North Houston Bank | 325.3 | 304.0 | 48.0 | 15.8% |
| 6 | Madisonville State Bank | 237.8 | 226.0 | 32.3 | 14.3% |
| 7 | Bank USA, NA | 194.0 | 167.8 | 20.8 | 12.4% |
| 8 | Citizens National Bank | 120.7 | 98.2 | 24.9 | 25.4% |
| 9 | Community Bank of Lemont | 85.0 | 68.0 | 23.3 | 34.3% |
| | | $18,299.3 | $15,304.8 | $2,362.5 | 15.4% |

**Resolution Capacity and Tools**

As I mentioned earlier, we expect a continued high level of failures during 2010. Over the past several years the Division of Resolutions and Receiverships has enhanced its staffing levels in response to the increased workloads. The Division started 2009 with approximately 400 employees -- steadily increasing that number throughout the year to the current staffing level of 1,161. The FDIC Board of Directors in December approved a further increase in the Division's staffing to 2,310 for 2010. Most of these new employees have been hired on non-permanent appointments with terms of up to five years, so that we will be able to downsize our workforce appropriately when the current workload subsides. Through our re-employed annuitant program, we also were able to bring back a significant number of experienced retirees, who brought competencies and operational expertise needed to meet the mission requirements of the agency.

In addition, we use a large number of private contractors and outside law firms to help us respond quickly to immediate workload requirements related to the closing of failed institutions. Last year, we significantly expanded our workforce of Receivership Assistance Contractors. The eight receivership assistance firms under contract to us recruited and trained over 5,700 staff from banking and finance to address our workload needs.

We have also expanded geographically by opening temporary satellite offices on both the West and East Coasts to manage the bank closing and receivership activities throughout the country. The West Coast office, located in Irvine, California, became operational in April 2009 and is now staffed with approximately 500 FDIC employees and contractors. The East Coast office, located in Jacksonville, Florida, became operational in November 2009 and also has approximately 500 FDIC employees and contractors.

The FDIC Board of Directors recently authorized another temporary satellite office in Chicago. That office will become operational during the second quarter of this year and will have approximately 400 FDIC employees.

Throughout this period, staffing for closing-related activities has been supplemented by the temporary assignment of employees from other divisions within the FDIC, such as bank examiners and other employees identified on a "ready reserve list." These employees supplement our workforce on the weekends to help us ensure that the closing process goes smoothly, then return to their regular jobs during the week.

To summarize, the FDIC has the experience, the geographic footprint, and the skilled professionals that will enable us to meet our statutory responsibility to the depositors, creditors and shareholders of a failed financial institution to minimize losses by achieving maximum recovery from the assets of a receivership.

**Conclusion**

As outlined in this testimony, the FDIC has standard procedures that go into effect when an FDIC-insured financial institution is in danger of failing. The best scenario is for a troubled institution to successfully take measures to become viable, profitable and to continue to lend and contribute to its community. Unfortunately, we are seeing more situations were institutions cannot recover from the losses imbedded in their balance sheets. Fortunately, the FDIC is well-positioned to carry out its responsibility to protect insured depositors, and maintain stability and public confidence in our banking system. Perhaps the greatest benefit of the FDIC's process is the quick reallocation of resources. It is a process that can be painful to shareholders, creditors and other stakeholders, but experience has shown that early recognition of losses with closure and sale of non-viable institutions is the fastest path back to economic health.

With respect to the FBOP failures, the FDIC believes its actions were consistent with these goals. Depositors of all nine commonly controlled insured depository institutions had immediate access to all of their funds and all book assets were left in the private sector.

Finally, we have the capacity and tools necessary to effectively and efficiently handle the expected 2010 level of insured depository institution failures. As Director of Resolutions and Receiverships, I know our staff has the full backing of our Board of Directors to provide us with the resources to do our job.

I would be pleased to answer any questions from the Subcommittee.

*Testimony of*

**Richard C. Hartnack**
**Vice Chairman**
**U.S. Bank**

*Before the*

**Subcommittee on Financial Institutions and Consumer Credit**

*Of the*

**Committee on Financial Services**

**United States House of Representatives**

*January 21, 2010*

Testimony of Richard C. Hartnack, Vice Chairman, U. S. Bank before Subcommittee on Financial Institutions and Consumer Credit, January 21, 2010

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Thank you for the opportunity to address this committee. My name is Richard Hartnack and I am the Vice Chairman in charge of consumer and small business banking at U. S. Bank.

Let me first provide my personal background. I was educated at UCLA (BA Economics) and Stanford University Graduate School of Business (MBA with a concentration in Finance). I have been active in the banking industry since 1971, with the exception of the time I was in graduate school. I am a veteran of the Vietnam War and flew 220 combat missions during that conflict as a Captain in the United States Marine Corps.

I have worked for 4 banking institutions—First Interstate Bank from 1971 to 1982, First National Bank of Chicago from 1982 to 1991, Union Bank of California from 1991 to 2005 and U. S. Bank from 2005 until the present.

I have worked in corporate, small business and consumer banking during my career and have personally managed mortgage operations at my employer institutions since the 1980s.

I have personally managed the Community Reinvestment Act compliance program at my employer institutions since 1982 and have consistently received "outstanding" ratings.

I have been actively engaged in both FDIC and open market bank acquisitions since the early 1980s and have personally managed more than 25 acquisition transactions. I executed acquisitions in Chicago during the 1980s and worked with some of the same groups testifying today. I worked with Greenlining and California Reinvestment Committee in California in both my current role with U.S. Bank and previously at Union Bank.

Of equal importance in this testimony is the track record of U.S. Bank and in that regard I would like to provide some information on our bank:

- We are the sixth largest commercial bank in the America with total assets in excess of $265 billion.
- We are headquartered in Minneapolis, Minnesota and operate branches in 24 contiguous states from Ohio to California.
- We serve over 15 million clients and operate over 3,000 branch offices.
- Most observers would agree that we are the highest performing and strongest bank in the country.
    - We scored highest on the government "stress test"
    - *Global Finance* listed us among the World's Safest Banks
    - *Barron's* named us one of the Most Respected Companies
    - *Euromoney* magazine called us the "Best Bank in the United States"
    - *Ponemon Institute* named us the #1 most trusted bank for the 4th straight year.

And, finally, U. S. Bank avoided participating in the mortgage lending practices that precipitated the current economic crisis. This, along with other prudent management practices, has enabled us to be consistently profitable throughout this crisis period, has allowed us to build our capital, grow our revenue, retain our people, avoid lay-offs and to be strong enough to be a competitive bidder for troubled franchises being marketed by the FDIC.

In the following subsections, we have endeavored to specifically address the questions submitted by staff in the formal invitation to these proceedings as well as other questions posed by staff close to this process.

**U. S. Bank Involvement in the FBOP/Park National Case**

This case developed, from the perspective of U. S. Bank, in the same manner as virtually all cases we have been involved with since 2008.

We had previously registered our interest in reviewing franchise sales with the FDIC. As is typical, our Director of Corporate Development received an email, that presumably was sent simultaneously to other interested parties, informing us that this institution was potentially going to be sold by the FDIC.

The process then proceeds along these lines (all from the perspective of U.S. Bank). We are presented and execute a confidentiality agreement covering the potential transaction. We are given access to a "data room" on a secured web site where a limited number of registered users from our company are able to perform the typical acquisition "due diligence" process. Following that we are granted a limited and tightly controlled opportunity to visit with management of the subject bank. We then perform a valuation exercise that leads to our developing a bid that conforms to the specific bidding conditions on the property in question.

The bid is submitted to the FDIC. Once the final decision is reached by the regulator of record to take control of the failed institution, the FDIC is named receiver and then the receiver completes the sale to the winning bidder.

As additional perspective we have actively engaged in the bidding process on seven occasions. We have declined to bid on numerous other occasions because our investigation suggested that the offered franchise was not a good fit with our organization. We have been the successful bidder on 4 of the 7 occasions on which we bid.

It certainly appears to us that the process is well run, transparent and very business-like in all regards. My personal observation is that it maximizes value and minimizes the losses from the insurance fund. Bidding is competitive and the fact that there are no second chances on these auctions causes all bidders to put their best bid on the table at the first (and only) opportunity.

**U.S. Bank Plans for Park National Bank Assets**

Simply stated, our objective with regard to the acquired loan assets is to maximize value for our shareholders over the long run. We very much view this process as a long term investment in expanding our franchise by investing in client relationships and the communities served by the acquired branches. We are not after a "fast buck" or a quick trade.

To accomplish this, we try to understand the entire situation surrounding each loan. We want to understand the borrower, the collateral, the original purpose of the loan, the performance of the borrower on the loan and any other relevant facts.

For loans that are current and performing our objective is a smooth conversion to U.S. Bank and then, if appropriate, we try to expand our relationship with the client by exploring other ways we can serve that client—additional loans, deposit and investment products, or by offering the other financial services our firm makes available to our clients.

For loans experiencing difficulty, we attempt to find a mutually satisfactory work out plan that is custom tailored to each client's situation. Tactics used include refinancing, interest rate modifications, payment restructurings, and principal write downs. We work with clients for staged liquidation of collateral to reduce the loan when that is appropriate and possible. Our last choice is always to foreclose on property or to take title to other assets pledged to secure a loan.

**Past Involvement with FDIC Seized Institutions**

As indicated above, we have been the successful bidder on 3 other institutions---Downey Savings, PFF Bank and First Bank of Idaho. In addition, we purchased the Nevada branches of the former Colonial Bank that were purchased by BB&T and subsequently offered in a spin off transaction. We, in turn, have announced our intention to spin off the Texas banks we acquired in the FBOP transaction. That transaction has not been completed.

We believe we have executed these transactions in an entirely satisfactory manner. We have met all our contractual obligations to the FDIC, we have kept the maximum number of offices open under the circumstances, we have offered as many jobs as possible, including employment opportunities to virtually all customer facing branch employees regardless of the fate of their particular office and we have honored all contractual obligations for charitable giving and have maintained the historic level of giving in the community after the acquisition.

**Mortgage Lending, Modifications, Foreclosure, OREO and our role as Trustee**

- Mortgage Lending: U.S. Bank is now the 5th largest mortgage lender in the United States. Our company holds $668.4 million in first mortgage loans on our books across the six county Chicagoland area. This represents 4,166 separate loans.
- Delinquency: In Chicagoland, about 4 percent of the mortgage debt is 60 days or more past due.
- Foreclosures: U.S. Bank has 109 loans it owns currently in the process of foreclosure.

- OREO: We currently own 20 properties where foreclosure has been completed and where the properties have not yet sold. We endeavor to assure these properties are properly cared for as this assures the best price at sale and that is directly in the interest of our shareholders.
- Modification: U.S. Bank participates in the HAMP program for loans we own and for loans serviced for FannieMae, FreddieMac and GinnieMae. In addition, we offer the FDIC program that was part of our purchase contract on the Downey and PFF properties. Finally, we have executed several thousand mortgage modifications on loans that we own and service for our own portfolio.
- Trustee Role: A source of confusion is our role as a Trustee for investors who invested in mortgage backed investment vehicles. In the Trustee role we represent the investors by holding the loans or, in the case of foreclosure, the property originally tied to the loans that back the securities the investors bought. In this role, we have no rights or obligations with regard to the borrower or the property. The servicer has the responsibility for all actions related to the borrowers and the properties. In our role as Trustee we are placed in title to the property upon foreclosure to protect the investors, but, again, we have no contractual rights to act in anyway on the property or the original loan or to deal with the borrower.

**Community Development Arm of Park National Bank**

Park Bank Initiatives is an Illinois non-profit organization focused on community development.

We have not completed our evaluation of all the economic feasibility issues, legal issues, tax issues and organizational issues involved in all the possible options available for managing this entity. However, we have reached some conclusions that are important to know at this stage.

1. The mission of the entity is consistent with our corporate strategy for community involvement and community development within the communities served by our branches.
2. Our corporate objective is to see that the NMTC allocation given Park National is deployed to support economically viable Chicago-based investments in community development as originally intended.
3. We believe it is critical that all involved—U.S.Bank, community groups, local government and the citizens of the communities affected—work together to ensure that the projects are managed by skilled staff with adequate resources, that sufficient working capital and human resources are available, that projects are well designed and broadly supported and that, in the end, all projects are both economically feasible at the outset and successful against a broad set of measures in the long run.

U.S. Bank intends to play an active and very supportive role in helping these development concepts become reality.

**Disposition of Acquired Branches**

Of the 31 branch offices acquired in the Chicagoland area, 5 will be closed and consolidated into existing U.S. Bank offices. In all cases, the branches are very close to each other (usually on the same street and within sight of each other) so there will be no reduction in service available to the population. In no case will a traditional Park National branch be consolidated into a grocery store office at U.S. Bank. Indeed, the grocery store branch network of U.S. Bank will result in Park National clients gaining 7 day a week, extended hour access to their accounts.

In two cases, U. S. Bank branches will be consolidated into former Park National offices.

All qualified customer facing employees in the branches have already been offered permanent employment with U.S. Bank. In nearly all cases the employment will be at the same branch they have been working at or another one in their neighborhood.

Thank you very much for the opportunity to participate in these proceedings.

For Release Upon Delivery
10:00 a.m., January 21, 2010

TESTIMONY OF

JENNIFER KELLY

SENIOR DEPUTY COMPTROLLER

FOR MIDSIZE AND COMMUNITY BANK SUPERVISION

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

UNITED STATES HOUSE OF REPRESENTATIVES

January 21, 2010

Statement Required by 12 U.S.C. § 250:
The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

## I. Introduction

Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee, my name is Jennifer Kelly. I have been a commissioned national bank examiner for 26 years, and I am currently the Senior Deputy Comptroller for Midsize and Community Bank Supervision for the Office of the Comptroller of the Currency ("OCC"). I appreciate the opportunity to describe the OCC's roles and responsibilities in the supervision of national banks and the process for resolution of severely troubled banks.

My testimony begins with an overview of the OCC's role in the supervision of national banks, followed by a description of the process for dealing with troubled banks and, when necessary, the appointment of a receiver for those institutions. I will conclude with a discussion of the circumstances surrounding the failure of the FBOP national banks.

## II. OCC's Role in the Supervision of National Banks

The OCC supervises 1,564 national banks and 51 federally licensed branches of foreign banks. As of September 30, 2009, this constituted approximately 18 percent by number of all federally insured banks and thrifts, holding 61 percent of all bank and thrift assets. These nationally chartered institutions include 15 of the very largest U.S. banks, with assets generally exceeding $100 billion; 23 mid-sized banks, with assets generally ranging between $10 billion and $100 billion; and over 1,400 community banks and trust banks, with assets between $1.5 million and $10 billion. In recognition of the varying challenges presented by these three

different types of national banks, the OCC has distinct and dedicated supervisory programs for each group that are tailored to the unique challenges that each faces.

OCC Oversight of National Banks

The primary mission of the OCC is to ensure that the national banking system remains safe and sound and fully able to support the needs of its customers. Our goal in supervising banks of all sizes is to ensure that they operate in a safe and sound manner and in compliance with laws requiring fair treatment of their customers and fair access to credit and financial products. In addition, Congress has charged the banking agencies with responsibility for protecting the FDIC Deposit Insurance Fund.

All of us – supervisors, bankers, and members of this Committee – recognize the important role that credit availability and prudent lending plays in our nation's economy, and we all share the goal of ensuring that banks can continue to meet the credit needs of their customers. Community banks play a vital role in that regard, and we recognize and address the particular challenges they face through our dedicated program of supervision of national community banks.

Fundamentally, we believe that the best way to ensure that national banks are making credit available in their communities is to assure that they are safe and sound and have capital available to lend to creditworthy borrowers. Conversely, it also must be recognized that seriously troubled banks cannot effectively serve the needs of their communities.

We actively encourage national banks to work constructively with borrowers who may be facing difficulties and to make new loans to creditworthy borrowers. It is our responsibility, however, to ensure that they do so in a safe and sound manner and that they recognize and address their problems on a timely basis. And just as it must be recognized that the difficult economic times are impacting existing borrowers and causing deterioration in the banks' loan portfolios, it is also the case that more borrowers are having difficulty qualifying for credit under appropriate credit underwriting standards. With that in mind, during this stressful period we are cognizant of the need to take a balanced approach in our supervision of national banks, and we have repeatedly conveyed that message to our examiners in the field. However, balanced supervision does not mean turning a blind eye to credit and market conditions, or simply allowing banks to forestall recognizing problems in the hope that markets or borrowers may turn around.

It is the OCC's long-standing policy that regulatory capital levels established by Prompt Corrective Action ("PCA") are minimum capital requirements. In fact, most well-run, healthy banks maintain capital significantly in excess of the PCA "well capitalized" level. Regulators expect banks with significant credit concentrations or deteriorating asset quality to hold higher capital levels to compensate for their risk profile. A bank's ability to lend diminishes as its capital is impaired by losses and poor asset quality. In other words, depletion of capital by losses and elevated risk are key drivers causing a constriction in the ability of some individual banks to lend. Conversely, an increase in capital increases a bank's ability to lend.

The combination of deteriorating credit quality, lower yields on earning assets, and reduced loan demand from creditworthy borrowers is currently affecting the earnings of many banks. Nonetheless, the vast majority of national banks today are in sound condition and have the financial capacity and management skills to weather the current economic environment. Moreover, it is important to understand that most banks that develop problems are restored to a safe and sound condition. Some cannot be however, and as discussed below, when necessary, the Federal Deposit Insurance Corporation Improvement Act charges the OCC with taking timely action that will enable a severely troubled bank to be resolved at the "least cost" to the Deposit Insurance Fund.[1]

The Problem Bank Resolution Process

In problem situations, the OCC's goal is to intervene at an early stage and take actions that will lead to a national bank's rehabilitation. Where rehabilitation is not achievable, it is the OCC's goal to effect early and least cost resolution of the institution in an orderly manner that minimizes the impact on depositors and customers.

Under the PCA framework that Congress established, the OCC is authorized, and in some cases required, to place a national bank into receivership on the basis of capital inadequacy, certain unsafe and unsound practices, illiquidity, and other grounds specified in the Federal Deposit Insurance Act. The decision to place a national bank into receivership is made only following scrupulous deliberation. We consider the overall viability of the bank including the

[1] The Federal Deposit Insurance Corporation Improvement Act of 1991 requires that all possible resolution alternatives be considered and evaluated, and that the FDIC choose the option that has the lowest cost for the Deposit Insurance Fund.

status of recapitalization efforts, earnings and liquidity trends, competence of the board and management, and the existence of other factors such as fraud or insider abuse, where delay in closing the bank would increase the cost to the Deposit Insurance Fund.

While we work closely with other regulators during all phases of problem bank resolution, our interaction is virtually continuous when a bank's condition is deteriorating. In particular, we have a very good working relationship with the FDIC on problem banks. Our communication and work with the FDIC increases as a bank's condition deteriorates, but the FDIC essentially has an open invitation to participate in our supervisory activities of our problem banks. When a national bank reaches a stage where its viability is doubtful, our contact with the FDIC is often daily and ongoing.

When we have determined that a problem bank has exhausted all reasonable options, including the prospect for raising capital, is facing insurmountable liquidity problems, or for other reasons is no longer viable, the FDIC's Division of Resolution and Receivership ("DRR") joins our examiners on-site in the bank to begin preparing for receivership. The OCC's goal is to provide the DRR with early access to the bank and the maximum amount of time possible to prepare for the closing in order to minimize disruption to the depositors and customers of the bank and the FDIC's cost to resolve the bank.

## III. The FBOP Situation

Let me now turn to the Subcommittee's questions regarding the failure of the FBOP banks. The background described above provides the framework for how the OCC supervised the national bank subsidiaries of FBOP and ultimately made the decision to appoint the FDIC as receiver of those banks.

FBOP was a financial holding company that owned six national banks and three state banks.[2] Total assets of all nine banks were approximately $19 billion. Through these banks, FBOP operated in California, Illinois, Arizona, and Texas. The FBOP banks were an interrelated enterprise. In large part, business strategies were determined on a corporate-wide basis. Because of FBOP's size, geographic scope, and complexity, the OCC supervised the national bank subsidiaries of FBOP centrally as an enterprise within the OCC's Midsize Supervision Department, which reports to me. An Examiner-in-Charge supervised these banks on a full-time basis.

FBOP's business model was successful for many years, but a combination of circumstances exposed vulnerabilities that the banks were not able to overcome. Previously, during periods of stress, FBOP focused on acquiring troubled financial institutions at attractive prices. Since 1990, FBOP completed over 30 acquisitions. The company successfully resolved

[2] California National Bank, Los Angeles, CA; Park National Bank, Chicago, IL; San Diego National Bank, San Diego, CA; Pacific National Bank, San Francisco, CA; North Houston Bank, Houston, TX; Madisonville State Bank, Madisonville, TX; Bank USA, National Association, Phoenix, AZ; Citizens National Bank, Teague, TX; and Community Bank of Lemont, Lemont, IL.

the acquired institutions' problems and integrated them into the organization. This business model proved successful from 1990 into 2008, and yielded a consistently profitable organization that became a sizable company.

However, from the fourth quarter of 2007 through the first half of 2008, FBOP implemented strategic decisions that, in retrospect, diminished the company's financial flexibility and exposed the banks in the company to ultimate failure. Two decisions proved to be particularly critical. First, various bank subsidiaries of FBOP purchased nearly $900 million of FNMA ("Fannie Mae") and FHLMC ("Freddie Mac") preferred stock. FBOP perceived the purchase of this Government Sponsored Enterprise ("GSE") stock as a safe way to deploy its liquidity sources given its perception of implicit government backing. While these investments were generally viewed as having little credit risk at the time they were made, the extent of the investment made by FBOP was high relative to the combined capital of the FBOP banks. In addition, the FBOP banks purchased securities and corporate bonds – then rated investment grade – of certain companies in the financial sector, including Washington Mutual Bank ("WAMU").

Second, consistent with its historical approach, FBOP initiated a loan portfolio growth strategy in late 2007, as the credit and real estate markets deteriorated. From September 30, 2007 to September 30, 2008, consolidated banking subsidiary loans grew approximately 35 percent, from approximately $10 billion to almost $14 billion. In taking this approach, FBOP took advantage of others' unwillingness to finance commercial real estate ("CRE") given the market turmoil.

Despite the growth of the FBOP banks through the second quarter of 2008, overall the company remained in satisfactory financial condition. However, the growth limited FBOP's financial flexibility and ability to absorb losses due to unforeseen adverse events. In the third quarter of 2008, two devastating financial events occurred from which FBOP ultimately was not able to recover. First, and most significantly, Fannie Mae and Freddie Mac were placed into conservatorship, rendering the nearly $900 million in preferred stock investments by the FBOP banks almost worthless. On the heels of this event, WAMU failed, causing approximately $100 million in additional losses. These two events caused losses (on a pre-tax basis) of approximately $989 million or 63% of the consolidated banking subsidiaries' Tier 1 capital. As a consequence, the four largest national banks, representing more than 90% of FBOP's banking assets, became less than well-capitalized for PCA purposes.

At this point, the company was in a significantly distressed condition and its ability to withstand further adversity was eroding. Unfortunately, late 2008 marked the beginning of an unprecedented series of severe credit and market events. The combination of FBOP's business strategies and these market events pushed FBOP into a "perfect storm."

It is important to emphasize that as soon the GSE conservatorships occurred, FBOP (and the OCC) appreciated the critical need to bring in new capital. Initially, FBOP committed to increasing the capital in each of the banks to well-capitalized status by September 30, 2008. This was the first in a series of commitments to raise capital that FBOP was unable to meet. In the period immediately following the GSE write-downs, FBOP had serious investor interest.

However, the initiation of the Treasury Department's Capital Purchase Program ("CPP") as part of the Troubled Asset Recovery Program ("TARP") created uncertainty for investors as to what their ultimate stake in the company would be, which had the practical effect of sidetracking the private capital option. CPP did not have an option available to non-public companies when it began in mid-October, 2008, and so obtaining TARP capital initially was foreclosed as an option for FBOP.

When the private company TARP option became available in mid-November, FBOP formally applied for funds. After consideration of the application, and in recognition of the significant impact that the GSE write-downs had on the FBOP banks, the OCC submitted a recommendation for approval of FBOP's application to the interagency council that evaluated certain applications prior to their review and decision by the Treasury Department.[3] As a result of the Council's deliberations, FBOP was requested to provide additional information before a recommendation could be made to Treasury. During this period, the condition of many of the FBOP banks began to decline precipitously, and the OCC determined that FBOP was no longer able to meet the approval standards established by the Treasury Department.

Deterioration of the loan portfolio, especially the commercial real estate loan portfolio, accelerated. To address the need for additional capital and the safety and soundness deficiencies at the banks, the OCC placed informal and formal actions on all of the national banks, except Citizens National Bank, Teague, Texas ("Citizens"). California National Bank and San Diego National Bank, due to their tangible equity ratios, became critically undercapitalized for PCA

[3] The Initial Report to the Congress of the Office of the Special Inspector General for the Troubled Asset Relief Program (February 6, 2009) includes a description of the process used by the federal banking agencies in evaluating applications and forwarding recommendations for approval to the Treasury Department.

purposes on July 30, 2009. Under PCA, the OCC is required to place a critically undercapitalized bank into receivership within 90 days of it reaching that status. So, by the third quarter of 2009, time was running short for a number of the FBOP banks.

As described above, the OCC worked closely with FBOP for almost 14 months in its efforts to raise capital and to address the multitude of issues that confronted the FBOP national bank subsidiaries. FBOP presented numerous proposals for capital throughout this period. In addition, informally and then later as required by Individual Minimum Capital Ratios established by the OCC, and eventually by formal OCC Consent Orders, FBOP committed to timeframes to raise sufficient capital. Notwithstanding the OCC's decision to extend these deadlines several times, FBOP was never able to raise the needed capital. As 2009 progressed, the continuing increase in adversely classified loans impaired the FBOP banks' ability to attract external capital. Although numerous proposals were put forth, FBOP was never able to reach a definitive agreement with investors that would provide sufficient capital to make the enterprise viable.

The FDIC was promptly informed of the impact of the GSE losses on FBOP. Subsequently, we provided regular updates to the FDIC on the condition of the banks as well as the status of efforts to recapitalize the company. As FBOP's condition deteriorated, the frequency of our interactions with the FDIC increased.

In October 2009, the OCC concluded that after 14 months of effort by FBOP, the banks' problems and the stressed environment made it unrealistic to expect that a viable private capital solution could be achieved. Moreover, as noted above, the condition of two of the national

banks had so deteriorated that they were on the statutorily mandated clock for closure. At that point, the OCC and the FDIC began focusing on an orderly resolution. The OCC determined that it could support the closure of California National Bank, San Diego National Bank, Pacific National Bank, and Bank USA, National Association, based on safety and soundness and capital grounds. In addition, the state banking departments of Texas and Illinois came to similar conclusions with respect to North Houston Bank, Houston, TX, Madisonville State Bank, Madisonville, TX, and Community Bank of Lemont, Lemont, IL.

However, Park National Bank ("Park") and Citizens were in a somewhat different status. While both the OCC and the FDIC recognized that Park had serious troubles, as evidenced by the bank's financial condition and the Consent Order entered into with the OCC to address the safety and soundness deficiencies at the bank, the OCC concluded that statutory grounds did not yet exist to support the appointment of a receiver. However, absent a dramatic – and unforeseen – reversal of its trends and current condition, it was evident that grounds would soon exist for the resolution of Park as well.

In early October 2009, the FDIC notified the OCC that it was considering whether immediate assessment of "cross guaranty liability" against Park and Citizens would result in the least cost to the Deposit Insurance Fund. In situations in which banks are commonly controlled, generally through bank holding company structures such as FBOP's, the FDIC is authorized to assess banks that have not failed for the anticipated losses to the Deposit Insurance Fund caused by the failure of affiliated banks. This is generally known as "cross guaranty liability." The

FDIC has up to two years to make the assessment, but when it determines that it is in the best interest of the Deposit Insurance Fund, it may make the assessment immediately payable.

As required by the statute, the FDIC consulted with the OCC regarding its determination to immediately assess Park and Citizens for the anticipated losses of the other FBOP banks. We responded that we did not object to the FDIC's plan to immediately invoke the cross-guaranty claim if the FDIC determined it would result in least cost to the Deposit Insurance Fund.

On October 30, 2009, the OCC appointed the FDIC as receiver of California National Bank, San Diego National Bank, Pacific National Bank, and Bank USA, National Association, based on safety and soundness and capital grounds. On the same day, the states of Illinois and Texas placed the three state chartered FBOP banks into receivership. The FDIC determined to immediately assess Park and Citizens for the anticipated losses for the seven failed banks and presented Park and Citizens with an order to immediately pay such assessment. As a result of the assessment, Park and Citizens immediately became insolvent, and the OCC appointed the FDIC as receiver.

In this chronology of the FBOP banks' demise several points stand out. First, FBOP's business strategy—which had previously been successful—left the bank vulnerable to the perfect storm of events that the FBOP banks could not survive, including unforeseen and devastating GSE losses. Second, and most importantly, the determinations to place the FBOP banks into receivership were consistent with, or required by, the statutory scheme Congress put in place in 1991 to resolve banks, or groups of banks, at least cost to the Deposit Insurance Fund.

**IV. Conclusion**

I appreciate the opportunity to appear before the Subcommittee today to describe the OCC's oversight of national banks and its role, when necessary, in the appointment of a receiver for those banks.

I would be happy to answer any questions from the members of the Subcommittee.

**Testimony of**
**Michael E. Kelly**
**FBOP Corporation**

**Before the**
**Committee on Financial Services**
**Subcommittee on Financial Institutions and Consumer Credit**

**United States House of Representatives**

**January 21, 2010**

Good Morning. I would like to thank Chairman Luis Gutierrez, Ranking Member Jeb Hensarling, and Members of the Subcommittee for inviting me to testify.

The purpose of my testimony this morning is to provide a short summary of the events that led to the closure of nine community banks owned by FBOP Corporation on October 30, 2009. I would also like to give some of my thoughts on policy changes that are needed to help community banks facing similar capital issues.

**FBOP Background**

First, some background on FBOP Corporation. FBOP Corporation was a $19 billion privately held multi-bank holding company headquartered in Oak Park, IL. FBOP was the largest privately held bank holding company in the U.S. and the second largest bank holding company headquartered in Illinois. The nine subsidiary banks included California National Bank in Los Angeles, Park National Bank in Chicago, San Diego National Bank in San Diego, Pacific National Bank in San Francisco, BankUSA in Phoenix, North Houston Bank in Houston, Madisonville State Bank in Madisonville, TX, Community Bank of Lemont in Lemont, IL, and Citizens National Bank in Teague, TX.

Over its history, FBOP enjoyed a solid reputation among its peers and regulators at it posted record profits for 25 straight years. Because of the proven strength of the organization and its demonstrated abilities as a "problem solver", FBOP was granted regulatory approval to acquire 29 institutions, primarily failed or subperforming banks and thrifts. Throughout its history, FBOP never paid a common stock dividend.

FBOP has always been an active community lender, with a primary focus on a variety of real estate lending. Nationally recognized real estate experts have praised the underwriting of its loans as "A quality" and "best in class". Its credit administration practices have been praised as "best practices" by the regulatory community. FBOP's historical net loan losses have been approximately ¼ of industry averages, primarily due to the strength of its underwriting and credit

administration practices, even though its portfolios have traditionally contained higher than peer percentage of past due loans.

FBOP subsidiary banks included 150 branches, with about one-third of those branches located in low-to-moderate income census tracts. FBOP employed approximately 2,400 people, including 1,385 in California and 840 in Illinois. We took great pride in the fact that although we were a large bank holding company, our banks were operated as community banks committed to providing financial products and services to individuals, businesses, and not-for-profit corporations. Six of our banks, including all our larger banks, were designated as "Outstanding" for their CRE efforts, which less than 8% of the banks are so rated. We also were very proud of our support of local organizations in the communities we served. In 2007 and 2008, FBOP banks made community donations and investments totaling $55 million, which represented 28% of the profits in those two years. In addition to the contributions from its banks, FBOP made $17 million in contributions at the holding company level.

**GSE Losses**

FBOP banks had a history of being well-managed banks with strong earnings and good regulatory ratings. Prior to the September 7, 2008, FBOP's subsidiary banks were all "well capitalized" and considered to be well managed with solid regulatory ratings. However, on September 7, 2008, the federal government's takeover of Fannie and Freddie created an $885 million impairment loss for FBOP on the Fannie Mae and Freddie Mac preferred securities it held in these investments at its subsidiary banks. The result was a $756 million capital charge at the subsidiary banks, leaving four of its banks less than well-capitalized.

On the morning of the government takeover of Fannie Mae and Freddie Mac, Treasury Secretary Henry Paulson said:

*"The agencies encourage depository institutions to contact their primary federal regulator if they believe that losses on their holdings of Fannie Mae and Freddie Mac common or preferred shares, whether realized or unrealized, are likely to reduce their regulatory capital below "well capitalized". The banking agencies are prepared to work with the affected institutions to develop capital restoration plans consistent with capital regulations "*

The investment in Fannie Mae and Freddie Mac preferred stock was considered to be relatively risk-free by the markets, the rating agencies, as well as the regulatory community. National banks were assigned a 20% capital risk weighting for Fannie and Freddie preferred stock, the same risk weighting category as U.S. bonds, AAA rated investments or cash in the bank. In addition, banks were permitted by the FDIC to invest up to 100% of their Tier 1 capital in Fannie and Freddie preferred securities, while other investments were generally restricted to 10% of Tier 1 capital.

After the Fannie and Freddie loss, FBOP immediately began to work to recapitalize in the worst capital environment in decades. The announcement of the Troubled Asset Relief Program (TARP) in October, 2008, and the

encouragement of our regulators that TARP funds would be available to help recapitalize FBOP led us to believe that we had found a solution to our GSE losses.

**TARP Applications**

One of the original goals of TARP was to assist banks adversely affected by GSE investments, particularly those such as FBOP with strong earnings, good asset quality, and solid management. With the strong urgings of its regulators, FBOP submitted an application for TARP funds in October, 2008. After receiving verbal assurance that it would be approved for TARP, regulators acknowledged that the Treasury's first round of TARP funds did not contemplate a mechanism for determining a pricing model for non-public banks. We were told that the guidelines for non-public banks would be issued shortly.

In late November, 2008, the US Treasury Department issued TARP guidelines for non-public banks. FBOP's proposal for $544 million in TARP funds was submitted, considered but then deferred for additional information. In January, 2009, FBOP updated its TARP application and agreed to infuse $150 million in capital into its subsidiary banks in addition to any TARP infusion. FBOP's application was again deferred pending guidance from Treasury following the change in administrations.

In February, 2009, FBOP was notified that its eligibility for TARP funds would require a matching equity infusion. FBOP spent the next months searching for private equity investors in a very challenging capital market. In July, investors were identified and due diligence work began. Completion of the due diligence by third parties confirmed that the loans were strongly underwritten, the credit problems were manageable and that the banks' allowance for loan losses was adequate to cover the embedded losses in the portfolio.

In the last week in October, 2009, we submitted a proposal that would have injected $600 million in private equity into FBOP, but our proposal was not accepted, nor was our request to extend our deadline by one more week. Ultimately, the banks were closed on October 30. Ironically, it was the same day that our community development subsidiary, Park National Bank Initiatives, was awarded $50 million in New Markets Tax Credits by the US Treasury to help finance schools, health facilities, community centers, and retail development in low income census tracts.

**The Future of Community Banks**

My main reason for testifying this morning is to use my experiences of the last year to help preserve other community banks at-risk of closure. The community banking model is very different than that of the large Wall Street banks, and it was not effective to lump both types of banks together in a one-size-fits all model for TARP funding.

The first round of the TARP program quickly provided a great deal of assistance to the largest banks in the country at a time when this funding was desperately needed to prevent a complete financial meltdown. As the program evolved, more guidelines were put in place to ensure the appropriate and proper use of

taxpayer dollars by financial institutions receiving TARP. Certainly, there is a great deal of public anger about taxpayer dollars being used to help wealthy bankers, and the recent discussion about proposed bonuses on Wall Street has rightfully fueled this outrage.

However, what people fail to understand is that most community banks did not engage in risky lending and excessive executive compensation. In fact, many community banks remain profitable with adequate cash flow to meet their ongoing operating obligations. Their issues stem from erosion of capital reserves due to the current economic climate. Community banks that have been making loans in their communities have suffered from the depressed economy and real estate market, but the loans made by these banks were not subprime or exotic, but rather were prudent business loans to local entrepreneurs and business owners.

These small banks could remain viable lenders in their communities with small infusions of capital. These community banks do not have ready access to equity and debt markets as the major banks and requiring them to be well capitalized and rated 1 or 2 before they can access TARP funds compounds the problem.

There needs to be a new viability test or criteria that would not look mainly at capital, but rather whether the infusion of TARP capital would allow the small banks to be viable. Certainly, it is no one's goal to use scarce resources to re-capitalize troubled banks that are destined to fail. But there is an opportunity to protect small, viable community banks that are vital to local economies.

**Conclusion**

FBOP's nine banks are now part of US Bank. While we appreciate the public sentiment about the closure, the FBOP story is over. We are proud of our 28 plus years of community banking and the investments in the communities we served.

Through the federal takeover, US Bank has received an incredible opportunity with the FBOP banks. My hope is that US Bank will honor the commitments of FBOP banks, and our commitments to our communities, including the low or zero interest school loans, the multi-year funding commitments to not-for-profit organizations, and the commitment to community lending. Many of the institutions involved are fully dependent on these commitments for their survival. We are hopeful that these commitments will be honored and expanded. To whom much has been given, much is expected.

Thank you again for the opportunity to talk to you this morning. My hope that the FBOP story will challenge elected officials, policy makers, and regulators to better understand the contributions and challenges of community banks. We need creative and flexible strategies to preserve these vital banking institutions.

**FBOP Corporation**
**Fact Sheet**

**Overview:**
FBOP Corporation was a $19 billion privately held multi-bank holding company headquartered in Oak Park, IL FBOP was the largest privately held bank holding company in the U S and the second largest bank holding company headquartered in Illinois. FBOP subsidiary banks included 150 branches, with about one-third of those branches located in low-income census tracts FBOP employed approximately 2,400 people, including 1,385 in California and 840 in Illinois

**FBOP Banks:**

| | |
|---|---|
| California National Bank | Los Angeles, CA |
| Park National Bank | Chicago, IL |
| San Diego National Bank | San Diego, CA |
| Pacific National Bank | San Francisco, CA |
| North Houston Bank | Houston, TX |
| Madisonville State Bank | Madisonville, TX |
| Bank USA | Phoenix, AZ |
| Community Bank of Lemont | Lemont, IL |
| Citizens National Bank | Teague, TX |

**FBOP History of Strong Earnings and Good Asset Quality**
FBOP enjoyed 25 straight years of record earnings as the organization grew from $60 million in total assets to $19 billion FBOP's net loan losses averaged less than 25% of its peers even though the amount of its nonperforming assets historically was consistently above peer levels These results were due primarily to strong underwriting (cited by third parties as "A quality") and robust credit systems and practices (recognized as "best in class") Because of the demonstrated strength of the organization, FBOP received regulatory approval to acquire 29 institutions, which were primarily failed or subperforming banks and thrifts, which it successfully integrated into its banking franchise.

**FBOP was an Active Lender:**
In 2007 and 2008, FBOP banks made home purchase, refinance, home improvement and multifamily loans totaling $1 billion and an additional $1 billion in small business loans FBOP never engaged in subprime or predatory lending practices.

**FBOP was "Outstanding" at Reinvesting in its Communities:**
FBOP banks were community-oriented full-service financial institutions that provided a full range of retail and commercial banking services and products to meet the needs of individuals and businesses in their respective communities Six of its nine banks including its four largest banks carried "Outstanding" Community Reinvestment Act (CRA) ratings, and the other three banks carried "Satisfactory" CRA ratings Less than 8% of banks in the country hold the Outstanding CRA rating

The major factors supporting the "Outstanding" CRA rating included a solid volume of residential, consumer, and small business lending activity to individuals and businesses in the communities where the banks were located, a distribution of loans among individuals and businesses of different income levels, a high level of community development lending within the banks' assessment areas having a positive impact on the community, the demonstration of innovative and flexible lending practices, and an excellent level of investments serving the banks' communities.

**FBOP Community Development Lending:**
FBOP banks made community development loans for many large projects that positively impacted local communities These loans increased the availability of affordable housing, stabilized communities by providing small business loans and supporting projects for economic development and job creation In 2007 and 2008, FBOP banks made community development loans totaling $583 million. (See Exhibit A ) Some of these projects included:

- In Los Angeles, California National Bank provided a $150 million loan to construct a hotel, convention and residential center that is part of the City Center Redevelopment Project and part of the Los Angeles Enterprise Zone
- In San Diego, San Diego National Bank loaned $70 million to a redevelopment agency to provide tax increment financing (TIF) to fund affordable housing
- In Chicago, Park National Bank extended a $20 million line of credit to the non-profit Community Investment Corporation for the purchase and rehabilitation of troubled, multi-family properties in low-income neighborhoods

The FBOP banks also offered an array of business lending products and participated in various state programs to assist small businesses with financing in order to encourage job growth and stabilize communities

**FBOP Gave Back To Its Communities Through Innovative Programs**
To achieve its mission of community investment, FBOP worked with community partners to identify needs and develop innovative programs Some examples included:

- **Park Bank Initiatives:**
  Park National Bank created Park Bank Initiatives, a not-for-profit with a mission to foster community development in low and moderate income neighborhoods This subsidiary acted as an affordable housing developer, invested equity, advanced planning and predevelopment costs, and coordinated community and government involvement in the economically distressed communities of Pullman, Roseland, Englewood, and Maywood Activities included the rehabilitation of historic rowhomes, the construction of new affordable housing, and the acquisition of 200 acres of former industrial property for mixed use redevelopment.
- **Banking the Unbanked:**
  Park National Bank created a Community Savings Center in the West Garfield Community in partnership with two faith-based, not-for-profit organizations, Bethel New Life and Thrivent Financial The Center gave consumers access to low-cost financial products as well as individual and group financial counseling, employment training, and home buying workshops A savings account for low to moderate income customers featured a two to one match of dollars saved. The Center also offered a Flex Loan product – an unsecured loan with a flexible repayment schedule – as an alternative to payday lending California National Bank established a branch dedicated to

"banking the unbanked" in the Hispanic, low to moderate income area of Maywood. That branch, in partnership with a not-for-profit organization, Operation Hope, offered low cost banking products and financial education programs

- **Zero Interest Construction Loans for Educational Projects:**
  FBOP's Chicago subsidiary, Park National Bank, committed a number of zero interest construction loans to support educational endeavors The bank funded a $27 million construction loan at zero interest to build a high school campus for Christ the King Jesuit College Prep, a newly opened high school on the west side of Chicago The bank provided similar loans to several charter and private elementary schools including $5 million to Catalyst Charter School/Rock of Salvation Church, and $4 million to Chicago Jesuit Academy, both on the west side of Chicago.
- **Foreclosure Rescue Programs And Affordable Mortgage Programs:**
  Park Initiatives created and was a leading partner with a local community group, Neighborhood Housing Services, in a Foreclosure Rescue Program and Park committed $20 Million to assist consumers in need of refinancing The FBOP banks also offered additional affordable mortgage programs both as direct loans and in partnership with various government and community organizations. The programs were targeted to consumers of low or moderate income and featured a low down-payment requirement, a long-term fixed rate and often contained a grant element to assist with down payment or closing costs
- **Donations And Investments Supporting FBOP Communities:**
  In 2007 and 2008, FBOP banks made community donations and investments totaling $55 million, which represented 28 percent of profits for those two years (See Exhibits B and C for lists of donations and investments ) One such investment included a $2 5 million donation to San Miguel schools, a catalyst for new inner city elementary schools FBOP donated $450,000 to support Link Unlimited, a not-for-profit organization that provides tuition and educational services to low income African American high school students. FBOP paid the students' tuition at private high schools, and approximately twenty FBOP employees served as mentors FBOP also participated in an innovative program in which it employed twelve high school students attending Christ the King or Cristo Rey Jesuit High Schools in Chicago and Verbum Dei in Los Angeles The students rely on the employment to fund, in part, the tuition at the schools

## Community Development Loan

Community development loan means a loan that:

(1) Has as its primary purpose community development; and

(i) Has not been reported or collected by the bank or an affiliate for consideration in the bank's assessment as a home mortgage, small business, small farm, or consumer loan, unless it is a multifamily dwelling loan; and

(ii) Benefits the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

Community development means:

(1) Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;

(2) Community services targeted to low- or moderate-income individuals;

(3) Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs or have gross annual revenues of $1 million or less; or

(4) Activities that revitalize or stabilize

(i) Low- or moderate-income geographies;

(ii) Designated disaster areas; or

(iii) Distressed or underserved nonmetropolitan middle-income geographies designated by the Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, based on—

(A) Rates of poverty, unemployment, and population loss; or

(B) Population size, density, and dispersion. Activities revitalize and stabilize geographies designated based on population size, density, and dispersion if they help to meet essential community needs, including needs of low- and moderate-income individuals.

Exhibit A

**FBOP Corporation**

**2007-2008 Community Development Loans**

| Bank | Borrower | Description of Community Development Loan | Loan Amount |
|---|---|---|---|
| Cal National | Olympic & Georgia Partners | A loan to construct a 64-story building that is part of the City Center Redevelopment Project and part of the Los Angeles Enterprise Zone. | $150,000,000 |
| SDNB | Redevelopment Agency of the City of San Diego | Redevelopment Agency tax increment financing to fund Affordable Housing Projects. There are 6 loans to the organization – $20 million, $16 million, $11 million, $8.6 million, $7.3 million, $7.1 million | $70,000,000 |
| Cal National | Snyder NoHo III, LLC | A loan to construct an office building located within the North Hollywood Redevelopment Project Area and in the Los Angeles Enterprise Zone. | $36,973,000 |
| Park | Community Initiatives, Inc. (CII) | The program is operated through the Troubled Buildings Initiative working to prevent properties from being demolished and promote the recovery and rehab of buildings. Three loans were made, two for $3 million and one for $20 million. | $26,000,000 |
| Cal National | Hollywood Ardmore Cooperative Inc | A loan to refinance a 206-unit multifamily building located in an area subject to the Los Angeles City rent control ordinance. | $22,500,000 |
| Cal National | 701 S. Hill, LLC | A loan to acquire and reposition a Jewelry Design Center located within the Central Business District Redevelopment Project Area and in the Los Angeles Enterprise Zone. | $17,700,000 |
| Cal National | Little Tokyo Associates, LLC | A loan to refinance a 10-story office building located in the Little Tokyo Redevelopment Project Area and in the Los Angeles Enterprise Zone. | $16,000,000 |
| Pacific | ROEM Development Corporation | A construction loan for 32 unit attached townhomes consisting of 16 below market rate units that will be sold to families earning 80%-100% of area median income. | $15,300,000 |
| Cal National | 4811 Airport Plaza, LLC | A new loan to acquire a 8-story office building located in the City of Long Beach Development District and Enterprise Zone. | $12,200,000 |
| Park | Chicago Jesuit Academy | The Chicago Jesuit Academy provides tuition-free education to students from modest economic backgrounds on the West Side of Chicago. There were three loans made, one for $4.2 million, one for $1 million and another for $2.8 million. | $8,000,000 |
| North Houston | North American Equities, LP | A loan to purchase and renovate an affordable multifamily apartment building. | $7,000,000 |
| North Houston | Creekstone Holdings III LLC | A loan to purchase and renovate an affordable multifamily apartment building. | $5,404,000 |
| Cal National | Crystal Plaza, LLC | A construction loan for a new retail center that is part of the Westlake Recovery Redevelopment Project and is part of the Los Angeles Enterprise Zone. | $5,400,000 |
| SDNB | St. Madeleine Sophie's Center | Employment re-entry training of developmentally disabled individuals. Five loans were made, $2,734,000, $2,214,000, $2,121,000, $270,000 and $200,000. | $7,539,000 |
| Cal National | CFRI-NCA Hollywood Venture II, LLC | To refinance a 2-story office building. The Building is located in the Hollywood Redevelopment Project Area and in the Los Angeles Enterprise Zone. | $4,850,000 |
| Cal National | Grove Station, LLC | A loan to construct 38 residential units, 12 of which will be affordable housing. | $3,680,000 |
| Park | Ray Graham Association for People with Disabilities | The organization provides affordable housing to people with disabilities in DuPage County and employment services to assist developmentally disabled adults. | $3,500,000 |
| Park | New Life Covenant | The organization offers youth ministries that include after school programs which provide youth with an alternative to life on the streets and gangs. | $3,300,000 |
| SDNB | John L. Baldwin | Rehab and preservation of 38 multifamily rental units in low-mod income areas | $3,000,000 |
| BankUSA | Camelot Condominiums | A refinance of an 80 unit apartment complex/ Property located in Buckeye AZ. The property demonstrates the preservation of affordable rental housing. | $3,000,000 |
| North Houston | DED LLC | Term loan for construction of a retail shopping center targeting the Latino demographic and provides economic development for the area. | $2,700,000 |
| Park | Beth-Anne Campus Holdings | The center provides community services and housing to area low to moderate income individuals. Two loans were made, one for $2,546,361 and $1,325,000. | $3,871,361 |
| Park | Eldorado, Madison & Mayfield, LLC. | A loan to refinance first and second loans on an affordable multifamily apartment building. | $2,252,250 |
| North Houston | Haole Partners | A loan to purchase and renovate an affordable multifamily apartment building. | $2,132,000 |
| Park | St. Bernard – PBI Housing, LLC | A line of credit for the non-profit organization to develop new homes in the 6th Ward of the Englewood Community. | $2,050,000 |
| Park | New Birth–PBI Partnership | A line of credit for the non-profit organization to develop new homes in the 17th Ward of the Englewood community. | $2,050,000 |
| Park | Roseland New Homes Phase II LLC | A renewal of a loan to construct 15 affordable single family homes and 20 affordable two flat homes in the Roseland neighborhood of Chicago. | $2,000,000 |
| Park | Christ the King Jesuit College Preparatory School | The school will operate a co-ed, college preparatory school drawing students from the low and moderate income areas of Austin and Lawndale. Two loans were made, one for $2,000,000 and another for $1,000,000 | $3,000,000 |
| | | All other Community Development Loans from FBOP banks | $141,753,774 |

Total 2007-2008 Community Development Loans $583,155,385

## Community Development Donations

**Community development donation** means a grant or charitable contribution that has as its primary purpose community development.

**Community development means:**

(1) Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;

(2) Community services targeted to low- or moderate-income individuals;

(3) Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs or have gross annual revenues of $1 million or less; or

(4) Activities that revitalize or stabilize

(i) Low- or moderate-income geographies;

(ii) Designated disaster areas; or

(iii) Distressed or underserved nonmetropolitan middle-income geographies designated by the Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, based on—

(A) Rates of poverty, unemployment, and population loss; or

(B) Population size, density, and dispersion. Activities revitalize and stabilize geographies designated based on population size, density, and dispersion if they help to meet essential community needs, including needs of low- and moderate-income individuals.

Exhibit B

FBOP Corporation
2007-2008 Community Development Donations

| Bank | Organization | Description | Amount |
|---|---|---|---|
| Park National | Park Bank Initiatives | Founded to develop innovative projects and provide the necessary solutions required to restore and revitalize economically distressed communities of Chicago. | $30,517,297 |
| Park National | San Miguel School | Provides college preparatory education for children of low to moderate income inner-city families through two schools one predominately serving a Hispanic community and the other serving an African American community. | $2,500,000 |
| Park National | LINK Unlimited | Provides educational services and mentoring to low-income African American youth from Chicago's inner city | $454,850 |
| Park National | United Way | Identifies the greatest need in each local community and provides the leadership and resources required to address those needs | $380,000 |
| Park National | Austin Career Education Center | Provides young, predominately African American, adults in the Austin District with basic education and skills necessary to increase employability | $285,884 |
| Park National | Cristo Rey Jesuit High School | Provides a college preparatory education to low and moderate income predominately Hispanic families. | $251,050 |
| Park National | Family Service & Mental Health Center of Oak Park River Forest | Provides counseling and education to low and moderate income families | $228,472 |
| Park National | Accion Chicago | Provides credit and other business services to predominately Hispanic small business owners who do not have access to traditional sources of financing | $152,500 |
| Park National | Oak Park River Forest Community Foundation | Manages and disperses funds to community organizations in Oak Park and River Forest. | $144,250 |
| Park National | Park National Bank Scholarship Program | A Scholarship Program to benefit local high school seniors who showed academic talent and who need financial aid to pursue their college careers | $140,000 |
| Park National | St Bernard Hospital | Community hospital serving the health care needs of the Englewood community, a predominately African American community. | $107,000 |
| Park National | Neighborhood Housing Services | Rebuilds and restores Chicagoland's underserved neighborhoods | $104,250 |
| Park National | Calumet Area Industrial Council | Association with purpose of attracting, developing, and retaining industry within the Calumet region, a low income area | $101,997 |
| Park National | Hales Franciscan High School | Addresses the needs of underserved communities, especially African-American males, to provide a quality educational experience at an affordable cost. | $101,000 |
| Park National | The CARA Program | Assists the homeless and at-risk populations by providing comprehensive training, permanent job placement and critical support services | $100,000 |
| Park National | Teach for America | Organization that places teachers in schools in Low/Moderate income communities | $100,000 |
| SDNB | SDNB Scholarship Fund | Scholarships to low- and moderate income HS students attending college | $90,000 |
| Cal National | VDHS Work Study INC. | Support for school & intro to work for students | $88,948 |
| SDNB | Junior Achievement | Financial literacy training to low to moderate income middle school students. | $63,000 |
| Cal National | Operation Hope | Operation HOPE's mission is to eradicate poverty in our lifetime | $60,000 |
| Cal National | CalNational Bank Scholarship Program | Scholarships to low-income HS students attending college | $59,500 |
| Cal National | Various Universities & Community Colleges | Scholarships to graduating high school students from low to moderate income families. | $48,500 |
| Cal National | Los Angeles Area Council for The BSA | Assist children in low-income communities to participate in Boy Scouts programs | $45,000 |
| SDNB | St. Madeleine Sophie's Center | Teaches marketable skills for employment to developmentally disabled adults. | $42,048 |
| Pacific | Tenderloin Neighborhood Development Corporation | Non-profit organization that houses low-income residents | $32,000 |
| SDNB | LISC San Diego | Operating grant support for affordable housing finance & CDC capacity building support | $27,500 |
| SDNB | SDSU HTM Scholarship Fund | Scholarships to low and moderate income HS students attending San Diego State University | $25,000 |
| Pacific | Cal Performances | Non-profit organization that sponsors educational outreach programs for underprivileged school children in the Bay Area. | $22,000 |
| Pacific | Pacific National Bank College Scholarship Program | Scholarships to low- and moderate income HS students attending college | $20,320 |
| SDNB | AVID | College education for low to moderate income "first-timers" | $20,000 |
| SDNB | YWCA of San Diego County | Support for homeless women and children who are victims of domestic abuse | $20,000 |
| Madisonville | Madisonville State Bank Affordable Housing Program | Provides affordable housing to low income Madison County residents | $19,902 |
| North Houston | Aldine Independent School District | Provides education to a student population that is 78% economically disadvantaged | $10,950 |
| | | All other Donations from FBOP Banks | $299,916 |

Total 2007-2008 Community Development Donations $36,661,134

## Community Development Investments

Community development qualified investment means a lawful investment, deposit, or membership share that has as its primary purpose community development.

Community development means:

(1) Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;

(2) Community services targeted to low- or moderate-income individuals;

(3) Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs or have gross annual revenues of $1 million or less; or

(4) Activities that revitalize or stabilize

(i) Low- or moderate-income geographies;

(ii) Designated disaster areas; or

(iii) Distressed or underserved nonmetropolitan middle-income geographies designated by the Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, based on—

(A) Rates of poverty, unemployment, and population loss; or

(B) Population size, density, and dispersion. Activities revitalize and stabilize geographies designated based on population size, density, and dispersion if they help to meet essential community needs, including needs of low- and moderate-income individuals.

Exhibit C

## FBOP Corporation
## 2007-2008 Community Development Investments

| Bank | Investment | Description | Commitment Amount |
|---|---|---|---|
| Cal National | Pembrook | Pembrook seeks to serve as a pioneer in community investments, providing capital to underserved property sectors and underserved geographic locations such as assets in urban locations, affordable housing and other community-related investments. | $5,000,000 |
| Cal National | Pembrook | Pembrook seeks to serve as a pioneer in community investments, providing capital to underserved property sectors and underserved geographic locations such as assets in urban locations, affordable housing and other community-related investments. | $3,500,000 |
| SDNB | Pembrook Community Investors, LLC | Pembrook seeks to serve as a pioneer in community investments, providing capital to underserved property sectors and underserved geographic locations such as assets in urban locations, affordable housing and other community-related investments. | $3,000,000 |
| Park National | Shorebank CD | Investment in a one year certificate of deposit in ShoreBank's Mission Based Deposit. ShoreBank is a certified *Community Development Financial Institution (CDFI)* | $2,153,950 |
| SDNB | Neighborhood National Bancorp CDFI | As a CDFI, NNB's commitment and mission is to rebuild and generate growth in underserved San Diego neighborhoods. | $2,000,000 |
| Cal National | Pembrook | Pembrook seeks to serve as a pioneer in community investments, providing capital to underserved property sectors and underserved geographic locations such as assets in urban locations, affordable housing and other community-related investments. | $1,500,000 |
| Madisonville | Federal Home Loan Mortgage Corp Pool #A80031Gold | Investment in home loans for low-to-moderate income individuals. | $1,083,099 |
| Park National | Illinois Facilities Fund 2007 | The IFF is the only statewide community development financial institution (CDFI) in Illinois and the only one of its kind to offer combined financial and real estate services needed by nonprofits | $300,000 |
| Park National | Illinois Facilities Fund 2008 | The IFF is the only statewide community development financial institution (CDFI) in Illinois and the only one of its kind to offer combined financial and real estate services needed by nonprofits. | $250,000 |
| SDNB | SPIN | Supportive Parents Info Network Emergency Loan Fund | $7,000 |

**Total 2007-2008 Community Development Investments** **$18,794,049**

***FBOP Corporation and its Community Banks***

FBOP Corporation was a privately held bank holding company headquartered in Oak Park, Illinois. FBOP owned nine banks with larger banks located in Chicago, Los Angeles, San Diego and San Francisco as well as smaller banks in Texas and Arizona. Thirty percent of its banking facilities were located in low to moderate census tracts. Over the years, FBOP enjoyed a solid reputation among its peers and its regulators as it posted record profits for 25 straight years During this time, FBOP grew from a $60 million bank to a $19 billion organization. Because of the proven strength of the organization and its demonstrated abilities as a "problem solver", FBOP was granted regulatory permission to acquire 29 institutions, primarily failed or subperforming banks and thrifts. Throughout its history, FBOP has never paid a common stock dividend.

FBOP has always been an active community lender, with a primary focus on a variety of real estate lending Nationally recognized real estate experts have praised the underwriting of these loans as "A quality" and "best in class". Its credit administration practices have also been cited as "best practices" by the regulatory community. FBOP's historical net loan charge-offs have been approximately ¼ of industry averages, primarily due to FBOP's underwriting and credit administration practices, even though its loan portfolios have traditionally contained a higher than peer percentage of past due credits. Additionally, FBOP never engaged in subprime lending or predatory lending practices.

FBOP takes pride in its role of being a good corporate citizen. Its banks donated 28% of their profits in 2007 and 2008, or $55 million, to local community entities by way of investments and donations, and FBOP contributed an additional $17 million at the holding company level. In addition, the community reinvestment efforts ("CRA") of FBOP's four large banks, which represented approximately 94% of its total assets, were designated to be "Outstanding". Less than 8% of banks in the country hold the "Outstanding" CRA rating designation.

***Investments in Fannie Mae and Freddie Mac Preferred Securities***

Like many banks, over the years FBOP Corporation invested in perpetual preferred stock in Fannie Mae and Freddie Mac. These investments were for regulatory purposes considered to be relatively risk-free and carried the same capital risk weighting as similarly viewed risk assets such as U.S Government Agencies and cash in bank. The market and rating agencies as well as notable economists also viewed these investments as relatively risk-free due to an assumption that these securities carried the implicit guarantee of the U.S Government. This assumption later proved to be incorrect.

On September 7, 2008, FBOP Corporation had a total investment of $896 million in Fannie Mae and Freddie Mac preferred securities. During the years it had held these investments, neither the size nor nature of the investment had been criticized by any regulator. FBOP and all of its subsidiary banks were "well capitalized" and had solid CAMELS ratings from all its regulators On September 7, FBOP was working on

finalizing its purchase of a large troubled financial institution in Southern California which had received preliminary approval by the appropriate banking regulators.

*Fannie Mae and Freddie Mac Conservatorship*

On September 7, 2008, the Federal Housing Finance Agency, a department of the U.S. Treasury, placed Fannie Mae and Freddie Mac ("GSE") into conservatorship, concurrently wiping out virtually all the value of the outstanding preferred stock in the two companies. FBOP Corporation lost $885 million in this single federal government action. The recognized loss on the GSEs resulted in a reduction of FBOP's Tier 1 capital from $1.540 billion to $784 million with its four largest banks' capital levels immediately falling below "well capitalized" standards.

On the morning of the government takeover of Fannie Mae and Freddie Mac, Treasury Secretary Henry Paulson said:

> *"The agencies encourage depository institutions to contact their primary federal regulator if they believe that losses on their holdings of Fannie Mae and Freddie Mac common or preferred shares, whether realized or unrealized, are likely to reduce their regulatory capital below "well capitalized". The banking agencies are prepared to work with the affected institutions to develop capital restoration plans consistent with capital regulations "*

It was later acknowledged by a Federal Reserve Governor that the extent of bank holdings of Fannie Mae and Freddie Mac preferred stock was not accurately know at the time these organizations were placed into receivership.

On September 9, 2008, FBOP Corporation began to work with its investment bankers, Sandler O'Neill and Keefe, Bruyette & Woods, in an effort to raise $600 million in capital to offset the Fannie and Freddie losses. In later September and early October, management of FBOP met with a series of potential investors. Despite the market's general antipathy at that time for bank capital instruments, the FBOP story resonated with investors and was favorably received

*Troubled Asset Relief Program (TARP):*

On October 14, 2008 the Treasury Department announced the Troubled Asset Relief Program (TARP) for financial institutions which was designed "to build capital and increase the flow of financing to US businesses and consumers to support the US economy". Special provisions were made in the Program to give preference to financial institutions which suffered losses on Fannie Mae and Freddie Mac securities. The nine largest financial institutions in the United States were immediately approved for TARP investments However, an unintended consequence that resulted from the introduction of TARP was that private capital and debt markets froze and obtaining private capital infusions for institutions like FBOP became impossible over the near to mid-term.

With the strong encouragement of its primary regulator, the Office of the Comptroller of the Currency ("OCC"), FBOP submitted on October 14, 2008, an application to Treasury for a TARP investment. The investment would have brought all but one of its subsidiary banks back to "well capitalized" status with the remaining bank projected to be "well capitalized" by the end of the first quarter, 2009. The FBOP TARP application was presented to Treasury along with a group consisting of a tier of large banks throughout the country. FBOP understands that most if not all the publicly traded banks in this tier received TARP funds. FBOP received a verbal assurance on October 20th from the OCC that its application had been approved. However, on October 21st, FBOP was notified that its application had in fact been deferred by Treasury as it was the only privately held institution recommended at that time for TARP funding and no mechanism existed for valuing private companies' warrants associated with the preferred stock investment

On November 17, 2008, the Treasury issued TARP guidelines for non-publicly traded financial institutions. Again with the encouragement of the OCC, FBOP resubmitted its application for $544 million of TARP funding The application included an FBOP commitment to raise an additional $100 million of funding that would be used as capital contributions to the subsidiary banks The OCC took this application to the TARP interagency committee and recommend its approval on December 17, 2008. However, during this period, the political landscape and the direction from Treasury began to change as well as the perceived criteria for qualifying for TARP. As a result of these changes, the committee deferred the FBOP TARP application into January. A slightly modified FBOP application, which in included a commitment to raise additional funds for bank capital purposes, was subsequently deferred by the committee into February.

***Proposed Five Year Net Operating Loss Carryback:***

On February 12, 2009, the congressional budget conference committee eliminated the five year net operating loss carryback provision for all but small business entities. The carryback provision for the Fannie Mae and Freddie Mac losses, which had previously passed both houses, would have resulted in $200 million of additional capital for the FBOP subsidiary banks.

***Capital Raising Efforts:***

In late February, the OCC recommended that FBOP raise matching equity funds to be eligible to receive TARP funding. With this direction, FBOP Corporation re-entered a capital market that had been unreceptive to privately held bank capital needs, particularly for organizations stigmatized by not receiving TARP Announced FDIC loss sharing agreements on failed institutions made the raise even more difficult. Nevertheless, by July, 2009, FBOP Corporation identified a group of willing investors and entered into negotiations for a common stock capital infusion which would have resulted in a change in ownership of FBOP. Due diligence work was undertaken and third parties engaged to review the banks' loan portfolios These reviews confirmed management's representations and regulatory conclusions that the loans were well underwritten and that banks' loan loss reserves were adequate to absorb the embedded losses in the portfolios.

The September, 2009 FDIC request for bids on the nine FBOP Corporation dramatically changed the tone and tenor of the final negotiations with investors. The identified investors began to investigate and later would require a loss sharing arrangement with the FDIC on potential losses in the loan portfolio On October 26, 2009, the investors and FBOP agreed to terms on a $600 million equity investment. The agreed upon terms would have put the existing shareholder's equity at risk before any loss to the FDIC. Based upon the due diligence work performed and FBOP's acknowledged expertise in working through problem credits, the ultimate amount of any loss paid by the FDIC, regardless of scenarios selected, was projected to be significantly less than the losses that would be incurred by placing banks into receivership.

On October 30, 2009, Treasury Secretary Timothy Geithner awards $50 million in New Market Tax Credits to Park National Bank Initiatives, a subsidiary of FBOP Corporation, in recognition of the work it does in the community it serves.

On October 30, 2009 the nine FBOP banks were placed into receivership.

*Aftermath:*

As was widely anticipated, on November 6, 2009 President Obama signed the Workers, Homeowners, and Business Assistance Act of 2009. Among other incentives, the legislation would have allowed banks like FBOP to carry back the Fannie Mae and Freddie Mac losses for five years, resulting in the realization of approximately $150 million of additional capital to the FBOP banks. The capital recognition realized from this Act would have substantially enhanced the capital of the FBOP's subsidiary banks and insured the success of its capital raise efforts.

***Other Observations:***

The level of nonperforming assets in FBOP Corporation's loan portfolio increased dramatically during 2009, rising to $880 million as of September 20, 2009, primarily due to its historical concentration in real estate lending Despite the increased level of nonperforming loans, the 2009 loan losses recognized during this time remained at peer level. The embedded losses in the loan portfolios were projected to continue to remain manageable due primarily to the recognized strong underwriting of the credits and the acknowledged robust credit workout systems and practices Third party reviews performed during the third quarter of 2009 found the Corporation's $329 million allowance for loan losses to be adequate to absorb all present and future losses contained in the current portfolio. Significant recoveries were also identified on properties held in its Real Estate Owned portfolio. Also, the subsidiary banks had $1.030 billion of equity GAAP capital on their respective balance sheets at quarter end to further absorb potential losses.

FBOP's problems and ultimate placement of its subsidiary banks into receivership were the direct result of its investment in the government sponsored entities Fannie Mae and Freddie Mac. It is unfortunate that a TARP investment, which was initially designed in part to aid banks with GSE losses, was not made into FBOP. Given its track record for strong performance, we believe that the TARP funding would have been a safe and profitable investment for the Treasury. More importantly, with such an investment, FBOP's subsidiary banks would have been able to continue the role they had been often recognized for performing so well...being local community banks that bank, lend, and service the variety of needs ..be it financial or other ..of the local community.

## INCENTIVES FOR BANKS TO BUY FANNIE MAE AND FREDDIE MAC PREFERRED STOCK

1 National banks could invest, "without limitation", in perpetual preferred stock of Fannie Mae and Freddie Mac (12 USC 24(Seventh)). Except in rare instances, banks are not allowed to invest in equity investments. In addition, U S Government and Agency bonds are the only other assets a bank may invest in without dollar limitations
2. The FDIC permitted banks to invest up to 100% of their Tier 1 capital in Fannie Mae and Freddie Mac preferred securities (FDIC.gov/regulations/laws bankdecisions/Invest.Activity/miscellaneous). Other investments were generally restricted to 10% of Tier 1 capital.
3. Fannie Mae and Freddie Mac preferred stock investment was considered to be relatively risk-free. National banks were assigned a 20% capital risk weighting for Fannie Mae and Freddie Mac perpetual preferred stock, the same risk weighting as U.S. Agencies bonds, AAA rated investments or cash in bank (OCC Interpretive Letter No. 964). Most other investments have a 50% or a 100% capital risk weighting, reflecting the perceived inherent risk of the investment
4. The FDIC had stated that investments in Fannie Mae and Freddie Mac preferred stock "does not represent a significant risk to the Deposit Insurance Fund" (12 CFR 362.3(b)(2)(iii)
5 Fannie Mae and Freddie Mac perpetual preferred stock were perceived by the market to have the implicit guarantee of the U.S. Government. Until August, 2008, the three major rating agencies classified these government sponsored enterprises' abilities to meet their financial obligations as strong.

Testimony of

# Steven McCullough

President and CEO, Bethel New Life Inc.
Chicago, Illinois

On Behalf of
**The Coalition to Save Community Banking**

Before the
Congress of The United States
House of Representatives
Subcommittee on Financial Institutions and Consumer Credit

Hearing on

**"The Condition of Financial Institutions:
Examining the Failure and Seizure of an American Bank"**

January 21st 2010
Washington, D.C.

To the Honorable Members of the Subcommittee on Financial Institutions and Consumer Credit:

Thank you for inviting me to testify today. As President and CEO of Bethel New Life Inc. (BNL), I am here to speak on behalf of a broad and diverse coalition of community organizations, non-profits, local leaders, religious institutions, and concerned citizens. My testimony focuses on the FDIC seizure and forced sale of Park National Bank (PNB) and its parent company First Bank of Oak Park (FBOP). The federal takeover of FBOP, and the sale of its assets to U.S. Bancorp will profoundly impact communities across Chicago. This action is of especially grave concern to the economically distressed areas in which my organization operates.

Bethel New Life, Inc. is a faith-based community development corporation located on Chicago's West Side. Bethel began in 1979 as a housing ministry of Bethel Lutheran Church to rebuild neighborhoods left in ruins after the 1968 civil rights riots. Our mission is: "Realize God's vision of a restored society by empowering individuals, strengthening families, and building neighborhoods through community-driven, solution-oriented, and value-centered approaches." Bethel offers nearly 20 programs through four divisions – Community of Elders, Housing & Economic Development, Family & Individual Support, and Community Development.

Bethel is nationally known for its pioneering community development initiatives. We strive to transform the West Side of Chicago into a Community of Choice- a community in which people choose to live, work and do business. Such a community provides existing residents with the services and resources found in any healthy, vibrant community while also providing amenities to attract future residents. To achieve this community concept, Bethel uses a framework that aims to employ, build, retain, and invest in local residents and assets.

Throughout this process, Park National Bank has stood at our side as a partner in mission and vision. Now, due to federal action our trusted partner has been lost. Today I will attempt to convey the essential and irreplaceable role that Park National Bank has served in our community. In doing so, I will address broader issues which concern our nation as a whole:

*Community-based banks (CBBs) are fundamental to the health of our national economy, and they are at risk. They are threatened by overly powerful and unaccountable regulatory agencies, as well by unbalanced and inequitable policies- such as the Troubled Asset Relief Program (TARP). Community-based banks are a central component of any sustainable economic recovery, and it is imperative that congress act to support CBBs through meaningful regulatory oversight and legislative reform.*

**Park National Bank: A Pillar of the Community**

Park National Bank was a model community-based bank. It was both financially successful and mission-driven. It provided the quality of service, access to capital, and community reinvestment that all financial institutions should aspire to deliver. PNB demonstrated its commitment to the community by employing local residents and investing in new schools, small businesses, and affordable housing. PNB supported the work of local non-profits and cultural organizations, and exemplified innovation, fairness, and flexibility.

I use the term community-based bank to distinguish superlative institutions such as Park National Bank and FBOP from those "community banks" that are defined more by their size than by their actions. Although they tend to be smaller, with deposit holdings under $10 billion, community-based banks cannot be defined by a number. It is fully possible for a small bank to ignore or even exploit its community, just as it is possible for a larger local bank to retain a "community-based" mentality by increasing local reinvestment along with its assets. Even as PNB and FBOP grew, they remained community-based.

I challenge you to find any financial institution whose level of community investment and support is proportional to that of Park National Bank and FBOP. As FBOP was privately held, I am not privy to the full extent and details of its generosity. However, our experience and all available information is sufficient to support the estimate that FBOP consistently dedicated roughly *27 percent of annual profits* to charitable giving in its communities. Such a figure could only be made possible by FBOP's status as a privately held company. Comparatively FBOP's purchaser, U.S. Bancorp, posted a profit of $2.94 billion in 2008.[1] Yet its foundation gave only $20.7 million, or 0.7 percent of profits, in charitable grants.[2]

The following data and stories demonstrate Park National Bank and FBOP's exceptional history of service and support for Bethel New Life and other organizations in our community.

**PNB Community Investment and Support: Our Experience**

Implementing programs to address the root causes of poverty has been a central focus of Bethel New Life (BNL) since its inception in 1979. Lack of mainstream financial services combine with inadequate financial education in our community to perpetuate a cycle of poverty. Park National Bank and FBOP understood the need to address poverty in the communities it served. As such, FBOP partnered with BNL in one of our primary programs to combat poverty and increase financial literacy: the Smart Savers 2 Individual Development Account matched savings program.

The First Bank of Oak Park partnered with BNL in 2005 to open a Financial Service Center in West Garfield Park, offering services and products to individuals traditionally underserved by mainstream financial institutions. Operated under Park National Bank, this branch location brought essential financial services to the West Side, and housed the BNL Smart Savers IDA

[1] Hutchenson, Martin. "The Top U.S. Banks, from Zombies to Hidden Gems." *Money Morning*. Feb. 18, 2009. http://moneymorning.com/2009/02/18/us-banks/ (Accessed January 2010)
[2] US Bancorp. "2008 Community Highlights." *Community Profile*. 2008: 1.

program. The Smart Savers program offers participants incentive savings matches, personal finance and money management education, peer and staff support, asset-specific training, credit repair assistance, and individual homeownership counseling. As part of this partnership, FBOP has provided more than $150 thousand of in-kind services.

At the time of seizure, BNL had roughly $1.8 million deposited in Park National Bank.[3] In recent years, BNL has received over $5.1 million in resources from Park National Bank, including $1.3 million in zero-interest loans, $1.4 million in low-cost loans, $2.25 million in New Markets Tax Credits, and $158 thousand of in-kind services.[4]

**PNB Community Investment and Support: Coalition Experience**

Our fellow Coalition members have likewise experienced and outstanding history of partnership and support from Park National Bank (PNB). At last count, coalition organizations have received over $35.6 million in resources from PNB in the form of in-kind services, charitable contributions, low-cost or zero interest loans, and future commitments from the bank.[5] Furthermore, this data only reflects loans that are currently active, commitments made at the time of seizure, and resources received during FY 08-09. It cannot begin to capture the full impact of Park National Bank in our communities over the years. Nor can it capture the future returns that our communities have lost along with our Bank.

An example of the charitable investment characteristic of PNB is detailed in a copy of letter held by one of our coalition members. Written by PNB Chairman and FBOP President Michael Kelly, the letter is addressed to Chicago Mayor Richard M. Daley. The letter states PNB's desire and willingness to purchase the former site of the Brach Candy Factory in Austin, and *donate* it to Chicago Public Schools for the construction of a new Austin High School and YMCA. Mr. Kelly's letter criticizes a speculative proposal that would allocate $10.6 million in TIF funds towards the purchase and construction of a warehouse on the site, and encourages the Mayor instead to pursue "the highest and best use" for the land. The letter estimates the cost of acquisition to be between $4 and $6 million, but Mr. Kelly seems less concerned about this sum than he is about the fact that Austin lacks a local high school, that the local YMCA is dilapidated, and that a potential community asset may go to waste.

How many publicly held banks, whose first priority must be profit margins, would make such a commitment? Will this commitment be honored by Park National Bank's successor? It seems highly unlikely. In 2008, the U.S. Bancorp Charitable Foundation gave $4.6 million towards education, *nationally.* Park National Bank was ready to match or surpass that sum in a *single Chicago community.* Will a nationally held bank with offices from coast to coast allocate nearly 100 percent of its educational donation budget to a single school in a single community? The answer must certainly be NO.

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[3] Poynton, Colleen. *Park National Bank: Community Leverage Overview.* 2009.
[4] Poynton, Colleen. *Park National Bank: Community Leverage Overview.* 2009.
[5] Ibid.

**FBOP Community Investment and Support: Coalition Experience**

Park National Bank's superlative record of community investment was not unique within FBOP Corp. FBOP itself was immensely supportive of local organizations and initiatives. FBOP's generosity to coalition member Christ the King College Preparatory School effectively dwarfs the charitable giving record of much larger financial institutions.

Christ the King is part of a national group of Jesuit schools operated by the Christo Rey Network. FBOP extended Christ the King a $20 million zero-interest loan for the construction of a new, state-of the art school.[6] In addition, FBOP agreed to $6 million in loan forgiveness for the school, and committed to supporting four student internship positions with the bank – collectively worth about $40 thousand per year.[7] The faith-based school is the first new Catholic school to be built on the West Side in 85 years.[8]

At the time of its seizure, FBOP had an asset base of $19.4 billion. In Comparison, U.S. Bank held $265 billion in assets[9]. Yet The U.S. Bancorp Foundation's total charitable giving for 2008 was only $20.7 million. The $6 million in loan forgiveness that FBOP promised Christ the King is nearly 30 percent of all of U.S. Bancorp's charitable giving *nationwide*. The school's grand opening was this past Monday. Now the community must ask whether the school will last out the year. Will U.S. Bank honor the zero-interest loan and millions in loan forgiveness promised by FBOP? The answer is unclear.

When school founders originally approached U.S. Bank and other local institutions about supporting several student interns at-cost, the bank declined. This story exemplifies the difference between a community-based bank and a bank that simply operates in a community. It is not a fictional difference that we have imagined; it is a difference we have experienced.

**The Bigger Picture: Community Banks at Risk**

These stories may be local in nature, but they are national in significance. In 2009 alone, 140 of the nation's 8,000[10] local banks failed, and at this moment more and more are struggling to stay afloat as the FDIC issues demands for banks to raise capital reserves above standard thresholds.[11] In Illinois seven community-based banks are at serious risk, including Shore Bank, Highland Community Bank, and Second Federal Savings and Loan.[12]

Meanwhile, financially healthy community banks are falling under increased pressure from the FDIC. Bank of Shorewood and America's Heartland are recent subjects of consent orders, which force them to either raise additional capital or shrink themselves in order to boost capital reserves

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[6] Poynton, Colleen. *Park National Bank: Community Leverage Overview*. 2009.
[7] Ibid.
[8] Dean, Terry. "Christ the King Opens in Austin." *Austin Weekly News*. Vol. 26:16. Jan 7, 2010.
[9] Yerek, Becky. "FDIC Seizes 9 Banks Operated by FBOP." *Chicago Tribune*, Oct. 31, 2009.
[10] Federal Deposit Insurance Corporation. *Failed Bank List*. Jan. 14, 2010. http://www.fdic.gov/bank/individual/failed/banklist.html (accessed Jan.15 2010)
[11] Daniels, Steve. "Bank regulators start focusing on healthier lenders," *Crain's Chicago Business*, Dec. 4, 2009. http://www.chicagobusiness.com/cgi-bin/news.pl?id=36344&seenIt=1 (accessed Jan. 9, 2010).
[12] Woodstock Institute. *Troubled Banks List*. November, 2010.

above normally acceptable levels. The necessity of these demands is unclear, as Shorewood's delinquent loans make up less than 3% of its $106 million portfolio, with American Heartland's share of delinquent loans only slightly higher at 5% of its total portfolio.[13]

Our communities and our nation cannot afford to stand by as local financial institutions die out. They are the economic lifeblood of neighborhoods, and will be pivotal credit pipelines for sustainable economic recovery. Community-based banks are where Americans turn when the local boy scouts troop needs a sponsor, when the high school football team needs new uniforms, or when a local non-profit wants to offer job readiness training. *Simply having a bank in the community is not the same as having a community-based bank.*

We know there is a difference between national and community-based banks because our experience has taught us so. National banks and community-based banks operate differently. They are beholden to different constituencies. Publicly held, national banks are beholden to their shareholders, whose primary concern is profit. In contrast, community-based banks are frequently privately held, just as PNB was. This enables community-based banks to place a premium on local reinvestment that would otherwise be infeasible.

Thus, community-based banks can loan to different groups at different rates and on different terms. They can give back to and invest in their communities at different levels. And finally, community-based banks can respond to the needs, challenges, and economic hardships of their customers in a different manner. Park National Bank's response to the foreclosure crisis, as well as its exemplary lending record illustrates these differences.

## Park National Bank: Foreclosure Response

In 2008, the city of Chicago posted 36.2 foreclosures per 1,000 mortgageable properties.[14]The communities of Austin, West Garfield Park, and East Garfield had much higher foreclosure levels than the city overall.[15] However, suburban communities such as Maywood have also been hit hard by foreclosures. The foreclosure crisis must be addressed across all communities, or it will continue to impede economic recovery.

Banks must adopt aggressive measures to work with residents and community organizations to mitigate home loss and foreclosure. Community-based banks know their customers. They are willing and able to work with borrowers to modify mortgage loans and use creative strategies to keep borrowers in their homes. Their immediate economic self-interest is closely tied to the long-term health and economic vitality of the communities they serve. Unlike large national banks, CBBs can't afford to see a neighborhood boarded up. CBBs are the partner communities need to address the foreclosure crisis.

Park National Bank has demonstrated outstanding leadership in responding to the foreclosure crisis in our communities. In a review of foreclosure filings across the Chicago region, PNB's

[13] Daniels, Steve "Bank regulators start focusing on healthier lenders," *Crain's Chicago Business*, Dec. 4, 2009. http://www.chicagobusiness.com/cgi-bin/news.pl?id=36344&seenIt=1 (accessed Jan. 9, 2010).
[14] Woodstock Institute.U.S. *Bank- Park National Bank Mortgage Lending and Foreclosure Activity.* November, 2009.
[15] Ibid.

name is conspicuously absent. For example, data collected by Housing Helpers indicates that PNB did not have a single foreclosure case filed or active against a Maywood property in all of 2008 and 2009.[16] In comparison, U.S. Bank was listed as the plaintiff in 18% of foreclosure filings in Maywood (59 cases) in 2008 alone.[17]

Park National Bank not only worked to avoid foreclosing on the mortgages it originated, it also sought to proactively purchase and modify mortgage loans it *did not* originate in order to help mitigate the crisis. At the time of its seizure, PNB was in discussions with Bethel New Life founder Mary Nelson, the City of Chicago, and the state of Illinois around a plan to buy up millions of dollars worth souring mortgage loans for modification. PNB would then come up with "creative loan products" to help keep people in their homes and stabilize faltering neighborhoods. While some portion of Park National Bank's investment would likely have been guaranteed by state money, there is no question that PNB's plans were motivated by its unique corporate values, its mission, and its community commitment- not by profit.

## Park National Bank: Minority Lending Record

As the previous example suggests, Park National Bank did not approach lending simply as a source of profit, but as a means to empower and support residents of underserved communities. This meant lending to individuals who would frequently be classified as "higher-risk"- that is, low to moderate income minorities, perhaps with imperfect credit, residing in economically disadvantaged neighborhoods

An FDIC survey of 685 banks found that reaching out to "underbanked" communities was a business priority for less than 18 percent of those surveyed.[18] Only one in five had established new branches in low-income areas.[19] This statistic is of serious concern, as the number of underbanked and unbanked households in America is large and increasing, and will undermine future economic growth and stability.

In January of 2009, the Census Bureau conducted a survey for the FDIC on American Households' access to traditional banking services. The *Economic Inclusion* survey revealed that a large segment of American society is severely underserved by traditional financial institutions. Thirty million households have little or no access to basic banking services such as savings accounts. Overall, 25.6 percent of U.S. households either lack bank accounts or use payday loans, check-cashing services and other costly alternatives to traditional banks. Low-income, minority, and immigrant households make up a disproportionately large share of unbanked and underbanked households. For example, seventy-one percent of unbanked households earn less than $30,000 a year. Fifty-four percent of black households, 44.5 percent of American

[16] Housing Helpers. Maywood Foreclosure Data, 2008-2009. December, 2009.
[17] Ibid.
[18] Wagner, Daniel. "FDIC: 25% of U.S. Households Have Limited Access to Banks, Minorities Hardest Hit By Disparity." *Huffington Post*, Dec. 2, 2009. http://www.huffingtonpost.com/2009/12/02/fdic-25-of-us-households_n_376811.html (accessed Jan. 2010).
[19] ibid.

Indian/Alaskan households and 43.3 percent of Hispanic households have limited access to banking.[20]

In the Chicago-Naperville-Juliet Metropolitan Statistical Area (MSA), a staggering 53.1% of black households are either unbanked (at 25.5%) or use payday loans, check-cashing services, or other costly alternatives to traditional banks (at 27.6%). This figure is more than twice the overall composit figure of 21.2% reflecting unbanked and underbanked households in the MSA generally. The percentage of unbanked or underbanked Hispanic households is likewise elevated at 30.1%.[21]

Outreach to the underserved lay at the core of Park National Bank's mission. PNB is distinguished from its successor by both its presence in LMI communities *and* its outstanding rate of lending to minority residents within those communities. The Woodstock Insititute's analysis of market shares and lending practices for Park National Bank and U.S. Bank produced the following figures:

- In 2008,U.S. Bank was the ninth largest lender in the Chicago MSA in terms of market share, with 2.5 percent of mortgages. Park National Bank was the 48th largest lender, with a market share of 0.3 percent.

- In 2008,U.S. Bank's market share in white communities was significantly higher than its market share in predominately African American communities in the Chicago MSA. In highly African American communities, where 80 percent of more of the population was African American according to the 2000 census, U.S. Bank was the 24th largest lender with a market share of 0.9 percent. In predominately white communities, U.S. Bank was the 12th largest lender with a market share of 2.4 percent.

- In 2008, Park National Bank's market share in African American communities was significantly higher than its market share in predominately white communities in the Chicago MSA. In highly African American communities, Park National Bank was the 43rd largest lender with a market share of 0.6 percent. In predominately white communities, Park National Bank was the 68th largest lender with a market share of 0.2 percent.

Park National Bank's lending practices did not amount to bad business, or simple charity- far from it. *PNB lent wisely and with discretion, with trust built upon years of integration and participation in its community.* That cultivated trust and specialized knowledge explains why time and time again the bank financed the endeavors of individuals, organizations, churches, schools, and non-profits in our communities- despite imperfect credit scores, hard economic times, or foreseeable challenges. PNB was rewarded for its trust and respect, and it was

[20] Wagner, Daniel. "FDIC: 25% of U.S. Households Have Limited Access to Banks, Minorities Hardest Hit By Disparity." *Huffington Post.* Dec. 2, 2009. http://www.huffingtonpost.com/2009/12/02/fdic-25-of-us-households_n_376811.html (accessed Jan. 2010).
[21] Federal Deposit Insurance Corporation National Household Survey. *EconomicInclusion.gov,* 2009. http://www.economicinclusion.gov/household_survey.html (accessed Jan. 2010).

consistently paid back. This explains why at the time of its seizure and sale, Park National Bank was *a profitable institution.*

## The Bigger Picture: Economic Recovery

If economic recovery is to reach all Americans, then we must retain a network of local financial institutions that lend *wisely and well*; helping *where* others won't, *when* others won't. Already there is evidence that Federal Recovery dollars are not reaching communities of color in an equitable manner, and Federal Bailout funds are not being returned to Main Street

The Kirwan Institute for the study of Race and Ethnicity at Ohio State University found that as of Oct. 12 2009, only $1.6 billion of the $25 billion in federal funds distributed under the American Reinvestment and Recovery Act reached black, Hispanic, or women-owned businesses. While 5.2% of businesses are black-owned, only 1.3% of ARRA funds went to black-owned businesses, and while 7% of businesses are Hispanic owned, as of Oct. 12th Hispanic businesses received only 2% of ARRA funds.[22] This early analysis of federal contracts suggests that ARRA funds are not reaching some of the communities that have been hardest hit by the foreclosure crises and economic down turn.

Simultaneously, the billions of taxpayer dollars used to bail out Wall Street have been tightly guarded by the nation's largest banks. Lending rates fell 2.8% in the third quarter of 2008- the sharpest drop since 1984.[23] Rather than lend TARP resources to help stimulate local economies, large banks have instead posted large profits- on average $2.8 billion in the third quarter.[24]

Chairwoman of the FDIC Shelia Bair is on record as stating that banks must increase lending to spur economic recovery.[25] After urging the heads of the nation's largest banks to increase lending, President Obama has turned to community bankers with the same message.

Park National Bank served its communities equitably and dependably long before President Obama and Ms. Bair made their appeals. Furthermore, it did so profitably and successfully. Yet it was allowed to fail while Wall Street, which continues to resist the influence of Washington, was saved at the taxpayers' expense. Community-based banks may be the Federal Government's best ally in stimulating an economic recovery, but only if they are supported and sustained by rational and fair policies.

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[22] Kirwan Institute. "Federal Procurement." FairRecovery.org, 2009. http://www.fairrecovery.org/design.html (accessed Jan. 2010).
[23] Alppelbaum, Binyamin. "2.8% Drop in Lending is Largest Since 1984." *Washington Post,* Nov. 25, 2009. http://www.washingtonpost.com/wp-dyn/content/article/2009/11/24/AR2009112401604.html (accessed Jan. 2010).
[24] ibid
[25] ibid.

**Questioning the Wisdom and Equity of TARP**

The case of Park National Bank illustrates that the Troubled Asset Relief Program as it currently exists places smaller, community-based banks (CBBs) at a distinct disadvantage. In doing so, TARP blatantly undermines several of the FDIC's stated goals:

- Encourage institutions to increase lending throughout their communities;
- Increase the provision of financial services to minorities and the economically disadvantaged, effectively banking the "unbanked";
- Diversify and decentralize our financial sector by discouraging the formation of banks that are "too big to fail."

The "on the ground" experience of my organization and others fighting across the county for economic revitalization, proves that it is CBBs who keep credit flowing when times get tough; who keep rates down when their customers are hurting; who are financially prudent but also flexible, understanding, and trusting; and who reach out to blacks, Hispanics, and other "high risk" groups typically overlooked by mainstream finance. Our experience shows that however well-run and well intentioned U.S. Bancorp may be, it fails to measure up to Park National's record in any of these areas.

What then is the wisdom of a program that allows a model financial institution to die while saving banks that have ignored the call to increase lending and to bank the unbanked? Why was $180 billion worth of TARP funding allocated to only the 100 largest banks, while 661 banks with assets under 10 billion collectively received a mere $25 billion? [26] If we seek greater economic stability, then how does withholding crucial assistance from community-based banks advance the FDIC's goal of avoiding a future in which banks become "too big to fail"?

The facts just don't make sense. The FDIC's words and actions do not align. Rather than act in the interest of FBOP and our nation's CBBs, the FDIC further consolidated the banking industry by forcing the sale of FBOP Corp. and its nine local banks to U.S. Bancorp. We demand to know why.

The following details tell the story of only one bank, but without action and reform they will be repeated across the United States.

**Details of the Seizure**

On October 30, 2009, the FDIC seized the assets of FBOP Corp. and its Chicago Metro-area banking facilities, operated by Park National Bank. Invoking the cross-guarantee authority, a mechanism used by the FDIC only six times in twenty years, the agency seized Park National Bank along with its sister banks under FBOP Corp.[27] Despite the fact that PNB was profitable and well-capitalized, it was unable to compensate for the heavy losses suffered by FBOP and

[26] Hopkins, Cheyenne. "Huge Gains for Small Banks in the Public Eye and Washington." *American Banker*, Jan. 12, 2010. http://www.financial-planning.com/news/ICBA-Obama-Menzies-2665369-1.html (accessed Jan. 14, 2010).
[27] Sidel, Robin "When Bad Banks Sink Good Ones." *The Wall Street Journal*, Nov. 3, 2009. http://online.wsj.com/article/SB125720151735123867.html (accessed Jan. 2010).

several of its institutions in the South and West, which were particularly hard hit by the mortgage crisis. As a result, PNB was sold to U.S. Bancorp along with FBOP's eight other banks, at a cost to the FDIC of $2.5 billion.[28] A pillar of our community and an exemplary bank was lost.

The FDIC maintains that the seizure and sale was "the least costly" option on the table,[29] but the facts suggest otherwise. There is significant evidence that the seizure and sale was not only misguided, but unjustifiable and unnecessary.

The seizure occurred only hours after the United States Secretary of the Treasury, Timothy Geithner personally awarded $50 million in tax credits to Park National Bank-an indication of confidence in the bank's stability, and an acknowledgement of its vital role in community reinvestment and economic recovery. Furthermore, the FDIC inexplicably disregarded FBOP Corp.'s request for a one-week grace period following the seizure to formalize the acquisition of $600 million in private equity, which FBOP had secured to help stabilize its struggling banks.[30]

The cause of FBOP's trouble was largely traceable to its $896 million portfolio of Fannie Mae and Freddie Mac preferred stock, $855 million of which had to be written down as losses following the federal takeover of the mortgage giants.[31] Far from being risky investments, preferred holdings in Fannie and Freddie was cast as one of the safest bets a bank could buy. The preferred stock was rated AA by the S&P and had a risk rating of 20%- the same risk rating as U.S. Agency bonds or "cash in bank."[32] Banks were allowed by a *special regulatory exception* to purchase preferred holdings in both Fannie and Freddie, and the FDIC lifted all limits to the amount banks could invest in these Government Sponsored Enterprises (GSEs)- up to 100% of their tier 1 capital if they chose.[33]

As late as August 2008, all three major rating agencies classified these GSE's ability to meet financial obligations as "strong." The FDIC and other regulatory agencies never alluded to the amount of GSE securities a bank was holding, or to whether such assets were concentrated. Hence, the day before the securities were declared worthless there was no effort to alert banks that the value of this preferred stock was going to zero.[34]

While TARP was created expressly to assist banks hit by GSE write downs, it had the affect of inhibiting bank holding companies such as FBOP from raising private capital. Initially assured that it would receive TARP funds, FBOP went through an extended period of deferrals and delays, as guidelines were rewritten and policies changed. Its ability to raise capital was inhibited all the while by a lingering assumption that TARP funds were forthcoming. Ultimately, the FDIC

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[28] Sidel, Robin. "When Bad Banks Sink Good Ones." *The Wall Street Journal,* Nov. 3, 2009. http://online.wsj.com/article/SB125720151735123867.html (accessed Jan. 2010).
[29] Ibid.
[30] Yerak, Becky. "Regulators Seize FBOP Banks." *Chicago Tribune*, Oct. 30, 2009. http://archives.chicagotribune.com/2009/oct/30/business/chi-fbop-seize-oct30 (accessed Jan. 2010).
[31] O'Hara, Carolyn. "Chicago Community Morns Loss of Local Bank." *PBS News Hour*. Dec. 23, 2009. http://www.pbs.org/newshour/updates/business/july-dec09/parkbank_12-22.html (Accessed Jan. 14, 2010).
[32] Martin, Noll. *Statement on GSEs*. Jan. 14, 2010.
[33] Ibid.
[34] Ibid.

denied FBOP's request for $500 million in TARP funds to salvage its balance sheets.[35] The reason? It lacked the necessary matching equity infusion.

Still, the reputation of FBOP was such that upon finally receiving a clear denial, the bank was able to raise $600 million in private capital investment. But the FDIC had already made up its mind; it was already reviewing bids for FBOP. Unbelievably, as the FDIC acted on October 30th, legislation that could have prevented FBOP's seizure was sitting on President Obama's desk, waiting to be signed into law.

The Worker, Homeownership, and Business Assistance Act of 2009 was signed by the President on November 6, one week after the seizure and sale of FBOP Corp. The Act extends the Net Operating Loss (NOL) carryback period for businesses from two years up to five, and applies to any NOL arising in years ending after Dec. 31st, 2007 and beginning before January 1st, 2010.[36] The law effectively allows business to spread their losses for a single fiscal year in this interval over the preceding five years.[37] If FBOP had been able to exercise this option, it could have spread its $855 million in losses from GSE preferred stock holdings appropriately over the preceding five years, and forwards as necessary into the succeeding twenty years. The ability to do so would have infused approximately $200 million into FBOP subsidiary banks and only enhanced FBOP's ability to raise private capital. Just one week would have saved FBOP, and ergo Park National Bank, from seizure.

We have come here today to ask, WHY? To the residents of communities served by PNB, this seizure and sale are incomprehensible. Why was a financially successful, model community-based bank not only allowed to die, but prevented from saving itself? Why was the FDIC so inflexible that it would not grant the seven days needed to save FBOP? Why were TARP funds withheld from smaller financial institutions, and why is there *still no relief* for our community-based banks?

The FDIC has made a profound error. At every turn it's policies and decisions not only disadvantaged FBOP, but effectively blocked it from saving itself. Our coalition has worked tirelessly over the last three months to bring this issue to the attention of our municipal, state, and federal representatives. Both the City Council of Chicago and the State of Illinois have supported our efforts and have issued resolutions urging investigation into the seizure. They have done everything in their power to aid and assist us.

We presumed, we hoped, that the buck stops here with the United States Congress- the voice of the people of the United States. Imagine our frustration when we learned that in fact, the buck does not stop here; that there was nothing our congressional representatives could do to alter the FDIC's decision. If the FDIC cannot be held accountable by our congressional representatives, then by whom? By what power? Who is regulating the regulators?

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[35] Yerak, Becky "FBOP Owner Was Told It Would Get TARP Funds." *Chicago Tribune*, Nov. 3, 2009. http://archives.chicagotribune.com/2009/nov/03/business/chi-tue-fbop-nov03 (accessed Jan. 2010).
[36] Curtis, "New Law Signed by President Obama Extends the Net Operating Loss Carryback Period for All Businesses." *Tax Group Client Alert*. Nov, 2009.
[37] Ibid.

Chairwoman of the FDIC Shelia Bair is on record as supporting the need for increased checks and balances on the regulatory system. She has said, "I think there is too much power concentrated, frankly, with institutions and within the regulatory system, in a way that is not helpful."[38] Ms. Bair has said publicly that a concentration of power in any regulatory agency is undesirable:

> *"We don't want all the concentration of power in one place... If that single monolithic agency makes the right decisions, then maybe you've got a really efficient regulatory system. But if that single monolithic agency makes the wrong decisions, if it becomes captive of these big institutions that it regulates...we're in real trouble, because there's nobody else that can raise a hand and say, you know what? You're wrong."*[39]

Respected members of Congress, today we are raising our hand. We are saying that the Federal Deposit Insurance Corporation was wrong. It was wrong to seize FBOP Corp. without considering the ramifications to numerous communities; it was wrong to deny FBOP access to TARP funds; and it was wrong to deny FBOP the mere seven days needed to save itself and to preserve Park National Bank.

**Conclusion**

We believe that it is not too late to save our bank, that the injustice done to the superlative institution that was Park National Bank can be undone. We ask this Subcommittee to urge the FDCI to re-assess and reverse their actions regarding FBOP. We ask that Congress exercise its full power to ensure that other community-based banks across our nation do not meet a similar fate to that of PNB. Financial reform legislation is still pending in the U.S. Senate, and will come before you again for reconciliation. Use that opportunity to create a level playing field for community-based banks and to increase the access of *all* communities to the banking services and credit they need to recover from the Great Recession.

We have ridden for fourteen hours on a bus to be here, and tonight will make the fourteen-hour trip back home because many among us cannot afford overnight accommodations. That is how important this issue is to our communities.

We have not come in self interest, but in the interest of justice and fairness. We have not come simply on behalf of our community, but on behalf of communities across the nation. We do not represent a single political allegiance, ethnic group, or socioeconomic class. We are a coalition as diverse as America, and we have come here as Americans who demand a say in our economic future. We are asking that you, our elected representatives, exercise your power to reform misguided policies and to hold regulatory agencies accountable for their actions.

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[38] "FDIC's Bair: Bank Bailouts were 'Not a Good Idea.'" *PBS News Hour*. Int: Solman, Paul. Nov. 13' 2009. http://www.pbs.org/newshour/bb/business/july-dec09/fdic_11-13.html (accessed Jan 2010)
[39] Ibid

I am grateful to have had the opportunity to testify here today on behalf of my organization and my community. I hope that I have alerted you to the vital importance of our nation's community-based banks. On behalf of my community and concerned citizens everywhere, I urge you take immediate legislative action to foster and support the role of community-based banks in the American economy.

**Policy Recommendations: Community-based Banks and Banking**

Congress is currently in the process of passing financial reform legislation. When the final reform bill returns to the House of Representatives, we strongly urge you to support or incorporate the following recommendations:

1. Community Banking Departments:
   (a) Each bank operating one or more branches in a metropolitan (or other designated geographical area) should be required to establish a Community Banking Department (CBD). The CBD would develop programs that are specific to the areas the bank serves and that recognize and respond to the different needs of such areas.

   (b) Federal bank regulators (e.g., FDIC, OCC, the Federal Reserve System and Department of the Treasury) should also establish Community Banking Departments. These CBDs would work with those created by banks in developing and assessing the effectiveness of the various programs implemented by the CBDs.

2. A TARP II should be established using the unspent and repaid TARP funds. Unlike TARP I, TARP II funds should be directed to community-based banks and used for lending to small and medium sized businesses in these banks' geographical areas of operation.

3. Community-based banks receiving funds under TARP II should develop lending programs in consultation with an advisory committee drawn from community organizations. These programs should focus on pursuing partnerships with Community Development Corporations in the geographical area served by the bank.

4. Community Reinvestment Act (CRA)
   (a) Modernize the Community Reinvestment Act (CRA) to increase transparency, accountability and stability in the financial system by addressing historical imperfections in the execution of the law. Specifically:
      (i) Make CRA cover all lending;
      (ii) Institute a meaningful grading system, with real consequences for banks;
      (iii) Require public hearings and appeals on bank examinations and grading.

   (b) In selecting a purchaser for an FDIC-closed bank, the FDIC should assess the community service history of the acquiring bank, and preference banks with a strong record of local service over other bidders. This assessment of community service should be based on the metrics contained in the proposed Community Reinvestment Act reform legislation embodied in HR 1479 and HR 767.

5. In determining which banks should purchase an FDIC-closed bank, the FDIC should seek to reduce concentration in banking and encourage diffusion of assets among medium and small sized banks.

6. We recognize the real costs of regulation. However, we believe that the regulatory structure should not facilitate regulatory "shopping" by banks. Therefore, we believe that legislation proposing the creation of a Consumer Financial Protection Agency (CFPA) should be amended to reinstate the role of the CFPA as a regulator of small banks. At the same time, the costs of regulation should be adjusted to represent risk levels rather than size based economies of scale. Thus, the regulatory costs for community-based banks should be, in part, underwritten by the charges to banks with lower community service scores and/or with a higher risk asset base.

7. Congress should develop legislation similar to the Glass-Steagall Act. This legislation should reinstate the distinction between commercial and investment banking and require financial institutions to choose which of these activities they will pursue.

8. Congress should pass the "Too Big to Fail, Too Big to Exist" legislation proposed by Vermont Senator Sanders (or similar legislation).

9. We also support the provisions of the Consumer Financial Protection Agency Act that would limit fees, particularly overdraft fees, charged by banks. These fees, often embedded in account opening procedures, are a significant drain on the finances of low-income communities.

**Written Testimony of David N. Miller**
**Acting Chief Investment Officer, Office of Financial Stability**
**House Financial Services Subcommittee on Financial Institutions and Consumer Credit**
**January 21, 2010**

Chairman Gutierrez, Ranking Member Hensarling, and Members of the Subcommittee, thank you for the opportunity to testify today regarding the participation of small banks in the Troubled Asset Relief Program (TARP) under the Emergency Economic Stabilization Act of 2008 (EESA).

Small and medium-sized banks play a vital role in the economic fabric of our society, and the health of these institutions is essential to any continued economic recovery and the long-term success of the economy as a whole.

***Targeting Participation of Small Financial Institutions***

At every stage of the implementation of TARP, Treasury has sought to fulfill the dual purposes of stabilizing the financial system and protecting taxpayer interests. Understanding the critical role that small financial institutions play in supporting and strengthening communities, the Administration has strived to recognize the importance of, and protect the health of, smaller financial institutions throughout the implementation of TARP. EESA directed Treasury to ensure "[t]hat all financial institutions are eligible to participate in the program, without discrimination based on size, geography, form of organization..." The very first, and largest, program implemented under TARP, the Capital Purchase Program (CPP), was designed to provide capital to financial institutions of all sizes, with equal treatment on economic terms.

Smaller financial institutions make up the vast majority of participants in the CPP. Importantly, this participation rate is consistent with the fact that smaller financial institutions make up the majority of financial institutions in the country. Of the 707 CPP applications approved and funded by Treasury through the CPP by its close date of December 31, 2009, 473 or 67 percent were institutions with less than $1 billion in assets.

| CPP Initial Portfolio Profile ($ in billions) | | | | |
|---|---|---|---|---|
| | CPP Participants | | Investment | |
| Asset Range* | Number | Percent | Amount | Percent |
| <$1bn | 473 | 66.9% | 3.8 | 1.9% |
| $1bn - $10bn | 177 | 25.0% | 10.0 | 4.9% |
| >$10bn | 57 | 8.1% | 191.1 | 93.3% |
| **Total** | **707** | **100.0%** | **$ 204.89** | **100.0%** |

*Institutions with less than $10 billion in assets are considered small or medium-sized.

Throughout its efforts to stabilize the financial system, Treasury has continued to focus on ensuring that smaller financial institutions have access to critical capital. When, in May 2009, many larger institutions were able to start raising capital from the debt and equity markets, it was apparent that smaller institutions did not have the same available

access to the capital markets as larger institutions. Therefore, on May 21, 2009, the Administration re-opened the application window for participation in CPP only to institutions with less than $500 million in assets, extending the application deadline to November 21, 2009. The funding deadline for all CPP applications was December 31, 2009.

Further, to ensure adequate funding levels, Treasury also increased the amount of capital these institutions could receive under the program. Initially, institutions were eligible for a capital amount that represented up to three percent of risk-weighted assets. Upon re-opening the CPP for smaller institutions, Treasury raised the amount of funds available to five percent of risk-weighted assets, and did not require additional warrants in the institution for an investment over three percent of risk-weighted assets.

Treasury also recognized that for small institutions to participate in CPP, the program would need to accommodate their particular structures. To that end, Treasury prepared CPP transactional documents and applications for private institutions, mutual holding companies, Community Development Financial Institutions ("CDFIs") and S Corporations. These documents addressed the structural complexity of these types of institutions in a way best suited for each.

***Program Eligibility and Application Process***

I want to take this opportunity to provide additional information regarding the eligibility requirements for participation in CPP, and the process for reviewing and approving applications.

In designing CPP, one of the central questions facing the previous Administration was how to structure an investment program that would comply with the stated goals of EESA to promote financial stability and also protect the taxpayer. It was decided by the prior Administration in October 2008, after consultation with financial market participants and economic experts, that injecting capital into viable financial institutions would maximize program effectiveness in helping stem the tide of panic and credit constriction that was threatening to engulf the country.

Therefore, the program was designed to make investments in financial institutions that meet the regulatory viability standard. The CPP application process worked as follows: an institution wishing to participate in the program applied to its primary banking regulator – the Federal Reserve, Office of the Comptroller of the Currency, the Office of Thrift Supervision, or the Federal Deposit Insurance Corporation. The primary regulator then made a viability assessment for the financial institution. Viability is determined with a consistent standard utilized by the four primary financial regulators, and is based on whether an institution is viable without TARP funds. The regulators are in the best possible position to make this determination since they conduct regular reviews and analyses of the individual institutions in conjunction with their oversight responsibilities.

Then, if a financial institution is deemed viable by its primary regulator, the regulator forwarded the application it recommended for funding to the Treasury's Office of Financial Stability (OFS) for further review. For cases that met certain supervisory criteria, applications were first forwarded to a council made up of the four federal banking regulators for review prior to submission to Treasury. Once an application was received by Treasury, experienced examiners from the various federal banking regulators, on-site at Treasury, assisted Treasury personnel in reviewing the application for completeness and summarizing key points. Treasury staff and the experienced examiners then presented the application to an internal Treasury investment committee consisting of high-level officials who reviewed the application in its entirety, and recommended an action to the Assistant Secretary for Financial Stability.

Treasury has not approved any application for funding without a determination of viability from the primary regulator. This approach ensures program consistency and fairness to institutions, regardless of their size. Treasury has worked to provide responses to institutions that have applied for CPP funds as quickly as possible, based on our available resources, recognizing how important these applications can be, especially to smaller institutions.

Further, this consistency is applied to program exit as well. In order for an institution to repay TARP funds, it must secure the approval of its primary regulator. Treasury employs this framework for all institutions participating in CPP, regardless of size.

***Continuing Efforts to Make Capital Available to Small Financial Institutions***

Treasury has invested in 650 small and medium-sized financial institutions through the CPP. The Administration believes that more can be done to build upon these important efforts.

One of the reasons smaller institutions are so critical to our economic recovery is the role they play in our local communities, particularly in supporting small businesses. Most small banks extend the majority of their business loans to small businesses, compared to their larger bank counterparts. For instance, banks under $1 billion in assets do 56 percent of their business lending to small businesses, compared to only 21 percent for larger banks. In addition, small businesses may have few other options for financing outside of bank loans, so small and medium-sized banks are that much more critical to the future of these businesses.

On October 21, 2009, the President outlined a new program designed to provide lower-cost funds to viable small banks, with the goal of increasing lending to small businesses. As President Obama explained: "[t]o spur lending to small businesses, it's essential that we make more credit available to the smaller banks and community financial institutions that these businesses depend on. These are the community banks who know their borrowers; who gave them their first loan; who've watched them grow from down the street…"

Since the October announcement, officials across the Administration have been working diligently to design a program that will provide the maximum benefit to small businesses, while simultaneously providing taxpayer protection and encouraging credit markets. We plan to provide the details of this program soon.

In addition to the small business lending initiative, Treasury is also developing a program that will make low-cost capital available to CDFIs, which conduct more than 60 percent of their lending and economic development in low-income and underserved communities.

We look forward to finalizing these programs in the near future and hope to encourage robust participation across the country. Previous TARP programs may have seen reduced participation as a result of a several factors, including perception concerns and certain statutory restrictions. Smaller institutions, in particular, have struggled with the executive compensation restrictions that are nearly the same for all institutions, regardless of size. This creates a situation where, for example, a small community bank might not be permitted to make severance payments to a bank teller or secretary. While the imposition of restrictions by Congress on institutions receiving assistance under EESA was entirely appropriate, the uniform application of such restrictions has presented challenges for program implementation.

In closing, let me restate Treasury's firm commitment to supporting small and medium-sized financial institutions. They are a critical link to small businesses, which are vital to our continued economic recovery and the long-term success of the economy as a whole. Treasury has been focused on making capital available to smaller financial institutions, and will continue to do so. There are always challenges in implementing any program of this kind, but we look forward to working with you to meet those challenges and help our businesses and communities flourish.

Thank you.

Questions from Chairman Gutierrez for Jeff Austin, III

1. How many of your Member Banks received TARP funds or other governmental assistance in the last 3 years? **30. See chart below.**

| | | |
|---|---|---|
| Central Community Corporation | Temple | TX |
| First State Bank of Mobeetie | Mobeetie | TX |
| Central Bancorp, Inc. | Garland | TX |
| First Texas BHC, Inc. | Fort Worth | TX |
| Farmers & Merchants Bancshares, Inc. | Houston | TX |
| BOH Holdings, Inc. | Houston | TX |
| Sovereign Bancshares, Inc. | Dallas | TX |
| MS Financial, Inc. | Kingwood | TX |
| IBT Bancorp, Inc. | Irving | TX |
| Vision Bank - Texas | Richardson | TX |
| Frontier Bancshares, Inc. | Austin | TX |
| OSB Financial Services, Inc. | Orange | TX |
| Fidelity Resources Company | Plano | TX |
| FC Holdings, Inc. | Houston | TX |
| Signature Bancshares, Inc. | Dallas | TX |
| The ANB Corporation | Terrell | TX |
| Liberty Bancshares, Inc. | Fort Worth | TX |
| Comerica Inc. | Dallas | TX |
| Encore Bancshares Inc. | Houston | TX |
| Sterling Bancshares, Inc. | Houston | TX |
| Plains Capital Corporation | Dallas | TX |
| Patriot Bancshares, Inc. | Houston | TX |
| International Bancshares Corporation | Laredo | TX |
| Texas National Bancorporation | Jacksonville | TX |
| Texas Capital Bancshares, Inc. | Dallas | TX |
| MetroCorp Bancshares, Inc. | Houston | TX |
| TCB Holding Company, Texas Community Bank | The Woodlands | TX |
| Treaty Oak Bancorp, Inc. | Austin | TX |
| Central Bancshares, Inc. | Houston | TX |
| Lone Star Bank | Houston | TX |

2. Which of your affiliated banks attempted to purchase a Texan subsidiary of FBOP? **First State Bank, Athens, Texas.**

3. How many Member Banks of the Texas Bankers Association were potential buyers of the FBOP subsidiary banks? **That information is confidential with the FDIC and we do not have any means of determining this information. Many banks may receive notices from the FDIC only if they have requested to receive them and if they meet certain (undisclosed) qualifications by the FDIC.**

4. Did the FDIC refuse to sell the subsidiary, or did the purchasing bank simply dislike the terms of the sale? **Our bank inquired about the possibility of selling one specific bank. The response from the FDIC was that they were trying to sell all the banks in the Holding Company as one package to a single purchaser and not break them up yet.**

**Response to questions from**
**the Honorable Luis V. Gutierrez**
**from the Federal Deposit Insurance Corporation**

**Q1: What factors of the purchasing bank does the FDIC take into account when approving the sale of an insolvent institution?**

**A1:** The FDIC is responsible for pre-approving potential bidders for failing institutions and for assessing the risk to the deposit insurance fund posed by potential resolution transactions. The process and factors are as follows:

I. Preparation of Bidders List

The FDIC considers the following factors in developing a bidders list: (1) geography, (2) overall financial condition, (3) asset size, (4) capital, (5) management, (6) Community Reinvestment Act (CRA) performance, (7) supervisory ratings, (8) Anti-Money Laundering/Bank Secrecy Act performance, and (9) minority depository institution status.

In those cases in which a proposed institution is seeking deposit insurance for the purpose of acquiring failed institutions, the FDIC considers the seven statutory factors enumerated in Section 6 of the Federal Deposit Insurance Act (FDI Act), which include: (1) the depository institution's financial history and condition, (2) adequacy of the capital structure, (3) future earnings prospects, (4) general character and fitness of management, (5) risk presented to the DIF, (6) convenience and needs of the community to be served, and (7) whether the institution's corporate powers are consistent with the purposes of the FDI Act.

II. Risk to the Fund Determination

The winning bid would generally be the one that poses the least cost to the Deposit Insurance Fund (DIF). The proposed purchase and assumption transaction is also evaluated in terms of the resultant risk to the DIF, considering (1) the type of transaction proposed (e.g., whole bank purchase and assumption, insured deposit purchase and assumption, insured deposit transfer, or asset pool/loan sale); (2) the acquiring institution's supervisory ratings, including the assigned safety and soundness, compliance, and CRA ratings, among other criteria; (3) affiliations of the acquirer; (4) an assessment of proposed management's competence, capabilities, and experience; (5) initial level of capitalization; (6) impact of acquired assets on the asset quality of the resultant institution; (7) an analysis of competitive factors; (8) whether the acquiring institution or the target institution qualifies for designation as a minority depository institution; (9) the opinion of the other relevant banking agencies, and (10) a conclusion as to whether the proposed transaction presents undue risk to the DIF.

For deposit insurance applications in which a proposed institution is being organized for the purpose of acquiring the failed institution, the foregoing considerations are captured within the assessment of the seven statutory factors enumerated in Section 6 of the FDI Act, listed above.

**Q2: Would you need Congressional approval to take into account, say, a bank's involvement in the community above and beyond the nominal CRA rating already included in your assessments?**

**A2:** The FDIC would not need Congressional action to take into account a bank's involvement in the community, either in lieu of, or in addition to the banks' CRA rating, to determine if a bank would be considered an eligible bidder. However, the FDIC is required by statute to accept the least costly bid that is submitted by an eligible bidder. Under current law, community involvement is not a factor that can be weighed in deciding whether a bank's bid meets the statutory least cost test.

**Q3: Mr. Glassman, you state in your testimony that each of the banks involved, including Park National, had deteriorating capital and even the healthiest of the FBOP banks wouldn't remain that healthy for long. Can you please go into further detail? What exactly in the bank's assets were deteriorating?**

**A3:** As of June 30, 2008, Park National held $116 million in FNMA and FHLMC preferred stock, $157 million in private label mortgage-backed securities, and $137 million in corporate bonds, and the loan portfolio was concentrated in commercial real estate (CRE) loans. Deterioration in asset quality was noted at the OCC's September 2008 examination. Poor selection of risk, the Bank's concentration in CRE loans, and the downturn in real estate markets contributed to asset quality problems. In addition, the Bank had significant holdings of sub-investment grade private-label mortgage-backed securities and corporate debt securities. By December 31, 2008, the Bank recognized $143 million in losses or impairment on its investment portfolio and $28.5 million in loan loss provision expenses, depleting earnings and eroding capital. As seen in the table below, Park National's capital ratios had been on a declining trend since 2006 and, based on the CRE concentration and commonality of the balance sheet with other FBOP banks, significant additional losses were expected.

| **FINANCIAL INFORMATION** | | | | |
|---|---|---|---|---|
| **Financial Data ($000s)** | **9/30/2009** | **12/31/2008** | **12/31/2007** | **12/31/2006** |
| Total Assets | 4,680,881 | 4,891,752 | 4,245,338 | 3,661,885 |
| Total Loans | 3,758,104 | 4,100,196 | 3,466,437 | 3,098,783 |
| Total Deposits | 3,716,626 | 2,989,491 | 3,173,830 | 2,976,143 |
| Return on Average Assets | (0.74%) | (0.88%) | 1.38% | 2.13% |
| Net Interest Margin | 3.60% | 3.96% | 4.06% | 5.09% |
| Non-current Loans/Gross Loans | 5.09% | 2.12% | 0.50% | 0.21% |
| Other Real Estate Owned | 202,892 | 63,280 | 15,103 | 5,433 |
| ADC Loans/Total Capital | 232% | 226% | 160% | 139% |
| CRE Loans/Total Capital | 660% | 643% | 487% | NA |
| Tier 1 Leverage Capital Ratio | 6.61% | 8.07% | 10.84% | 12.04% |
| Total Risk-Based Capital Ratio | 9.03% | 9.15% | 10.61% | 12.10% |

Park National's asset quality deteriorated further in 2009, resulting in additional loan- and investment-related losses. Park National incurred a net loss of $27.9 million through the first

nine months of 2009, primarily due to loan loss provisions of $95.1 million. As of September 30, 2009, non-current loans (those past due 90 days or more) represented 5.09 percent of the loan portfolio. In addition, the volume of Other Real Estate Owned (foreclosed properties) had grown to $202.9 million and represented 4.34 percent of Total Assets.

FBOP sold significant loan participations between its banks, for the most part, involving large CRE credits. In addition, a Park National subsidiary performed due diligence on CRE loan pools purchased from third parties by FBOP banks. Park National serviced the CRE loan pools for all of the FBOP banks. Approximately 40 percent of Park National's loan portfolio consisted of participations purchased from other FBOP banks and purchased CRE loan pools shared among FBOP banks. Investment decisions also were centralized, and the FBOP banks' investment portfolios contained similar or identical securities that had been downgraded to sub-investment quality.

Park National's capital ratios were overstated on its September 30, 2009 Call Report. First on October 13, 2009, the OCC informed Park National that a $6.5 million capital injection from FBOP on September 30, 2008, was ineligible because it was indirectly funded by simultaneous loans from sister banks. The ineligible capital needed to be deducted from regulatory capital. Second, the 2009 examinations of the other FBOP banks had resulted in the need for additional loan loss provisions, and Park National did not appear to be an exception. The OCC started an examination of Park National in October 2009. Based on off-site analysis using various methodologies, trend analysis, and comparisons to other FBOP banks recently examined, Park National's loan loss reserve appeared to be significantly underfunded. Third, as of September 30, 2009, Park National's deferred tax asset was $113 million and should have been disallowed from regulatory capital. Any tax benefit available to carry back to previous years was a receivable from FBOP as prior years' returns were filed on a consolidated basis. FBOP did not have the capacity to refund taxes up-streamed from Park National in previous years. Park National's ability to recognize a tax benefit in the near future was doubtful. Park National reported negative taxable income for the nine months ended September 30, 2009, and the trend was adverse. The net interest margin was shrinking, overhead was increasing, and loan and ORE losses were accelerating. Therefore, it was reasonable to assert that Park National would not generate positive taxable income in the following 12 months to recognize a tax benefit from the deferred tax asset – as required by Generally Accepted Accounting Practices.

After deducting the estimated loan loss provision, the $6.5 million in ineligible capital, and the $113 million in the disallowed deferred tax asset, Park National's tier 1 leverage capital ratio was estimated at 3.88 percent, causing their PCA category to fall to "Significantly Undercapitalized." In addition, after these adjustments, Park National's CRE concentration would exceed 1,000 percent of total capital; therefore, continued losses and capital erosion was expected.

**Q4: How many times before this has the FDIC used the cross-guaranty provisions?**

**A4:** The FDIC issued cross-guaranty liability assessments related to eight bank failures from 1989 – 1994 with none again until FBOP. Between 1994 and 2008, there were 52 bank failures. The absence of cross-guaranty assessments was a function of the low number of failures coupled with the lack of situations where a cross-guaranty assessment would have reduced the loss suffered by the FDIC.

**Response of Mr. Steven McCullough to Questions Submitted for the Committee Record by Chairman Luis Gutierrez**

**FI Subcommittee Hearing on January 21, 2010**

February 26, 2010

1. *Since U.S. Bank's acquisition of Park National, has there been a change in Park National's relationship to the community?*

Since U.S. Bank acquired Park National Bank (PNB), there has been a clear change in its relationship to the community. The most obvious manifestation of this change is U.S. Bank's recent decision to cut between 650 and 700 jobs from PNB branches across Chicago. In addition, retained employees have experienced a 10 to 40% cut in salaries and benefits. Despite assurances from U.S. Bank that it did not intend to shutter a single branch unless it was "within eyesight" of another, these cuts are comparable in impact to closing multiple branches.

The terms on which Park National Bank does business with the community have also changed. PNB offered reasonable rates of return for small savers – regular individuals who didn't want to play the stock market, but still wanted to see their investments and savings grow. Following the acquisition, consumer deposit rates at PNB immediately fell. For example, interest rates on a regular 12-month CD fell from a reasonable 2.3% to a meager 0.25%. Additionally, there is evidence that the rates of loans originated prior to the acquisition are being reevaluated.

Several education institutions that had received zero-interest loans from PNB, including Catalyst Charter Schools and Christ the King Jesuit College Prep, are currently in productive negotiations with U.S. Bank. They expect to resolve the status of these loans in a timely and beneficial manner. Unfortunately, this has not been the universal experience of organizations in our community.

Prior to the seizure, Faith Community Church was working with PNB to refinance its mortgage. Since U.S. Bank's acquisition of PNB, Faith Community Church has not been able to make any progress towards successfully refinancing. Despite a verbal guarantee in January, 2010 from Executive Vice President Steven SaLoutos that U.S. Bank would work with the church to resolve the issue in a timely fashion, the church has made no progress towards refinancing as of March 13, 2010. Rather, U.S. Bank has demanded a full reappraisal of the property, at a cost to the church of roughly $3,000, before moving forward.

The experience of the Maywood Fine Arts Alliance has been similar. The group was in negotiations with PNB to receive a loan needed to relocate to a larger facility. Since taking over these negotiations, U.S. Bank has declined to extend the loan unless the Alliance Director offers up her home as collateral. Beth Harvey, owner of Harvey House Bed and Breakfast in Oak Park, has also met with new obstacles or demands

since taking up negotiations with U.S. Bank. Under Michael Kelly, PNB was supportive of Ms. Harvey's vision to expand her business and receptive to her need for credit. Yet U.S. Bank has been unwilling to extend her line of credit, except in the form of a high-interest credit card.

Even local municipal government has experienced a change in its relationship with Park National Bank. While the Village of Oak Park CFO could once speak directly to PNB President Mike Kelly about financial matters, he must now make a series of phone calls to Minneapolis, simply to identify an appropriate contact person. The difficulty of maintaining a productive relationship with PNB since its sale has inspired the Village government to look elsewhere for banking services.

As these antidotes illustrate, Park National Bank's business model and approach to valued community relationships appears to have fundamentally changed since its acquisition by U.S. Bank.

2. *What community needs were best satisfied by Park National that were not being meet by other banks in the area?*

Park National Bank offered financial products and services with fair rates and terms in a community traditionally underserved by mainstream financial institutions. In Chicago, 40% of Park National's branches are located in low and moderate income census tracts. With the exception of PNB branches, the financial landscape of the West Side is dominated by payday lenders and check-cashing services. In many of the neighborhoods Bethel serves, PNB was not just an active bank, it was the only bank. Park National Bank not only had a larger presence in minority and underserved communities, its lending rates and market share ratios demonstrated that it *served* those communities to a greater extent than its competitors.

In predominately African American communities in the Chicago Metropolitan Statistical Area (MSA), Park National Bank had a market share of 0.6%, which was three times higher than its market share of 0.2% in predominately white communities. It ranked as the 43rd largest lender in predominately African American communities, but as the 48th largest lender in the Chicago MSA overall- illustrating that it did a larger proportion of its lending in underserved communities than in the Chicago market as a whole. In comparison, U.S. Bank had a market share of 2.4% in predominately white communities, but only 0.9% in predominately African American communities.

Additionally, Park National Bank supported and partnered with local organizations to an unparalleled degree. For example, Park National and FBOP Corp. partnered with Bethel New Life in operating the Community Savings Center, a nationally recognized institution that offers accessible banking product to very low-income residents. Park National also is a partner in our Individual Deposit Account matched savings program, Smart Savers 2. In that initiative alone the bank provided over $150,000 in in-kind services.

Park Bank Initiatives (PBI), the not-for-profit subsidiary of Park National Bank, was actively engaged in neighborhood revitalization projects in low-income communities throughout Chicago. Some examples of PBI projects include the redevelopment of 200-acres of vacant industrial land in Pullman for retail, affordable housing, and recreational facilities; the new construction of affordable homes in Englewood and Roseland; and the rehabilitation of vacant, foreclosed homes in Maywood and Pullman.

PBI was an especially unique resource in Maywood. No other organization was active in home purchase and revitalization in this community. At this point, the future of PBI in Maywood remains unclear. There has been no clarification from U.S. Bank as to whether the successor of PBI, Chicago Neighborhood Initiatives, will have the resources to complete the four-home rehabilitation project initiated by PBI and currently underway in Maywood. It is also unclear whether the Maywood organization Housing Helpers will receive funding support from U.S. Bank to continue the homeowner seminars formerly funded by Park National Bank. In these economic times, the public funding resources needed to fill these gaps do not exist. Unfortunately, there is little evidence that U.S. Bank intends to fill this void.

Finally, Park National Bank extended low-interest and zero interest loans to local schools, churches and non-profits including a $20 million dollar zero-interest loan to Christ the King Jesuit College Prep and zero-interest loans to Catalyst Charter School and Chicago Jesuit Academy. Park National's community commitment reflected that of its parent company, FBOP Corp. In 2007 and 2008, FBOP Corp. banks made community donations totaling $55 million, or 28% of FBOP's profits from those years. No other local financial institution has even approached a comparable level of community reinvestment and support.

3. *Does Bethel New Life work with other banks in the same capacity as it did with Park National?*

Although Bethel New Life does have relationships with other financial institutions, none are comparable to that which we had with Park National Bank.

The Coalition to Save Community Banking, of which Bethel New Life is a member, is currently in negotiations with U.S. Bank over a Community Benefits Agreement that is intended to be the foundation of a productive working relationship with the Bank. We hope for a timely and productive conclusion to these negotiations that will demonstrate U.S. Bank's commitment to meeting the exemplary standard set by Park National Bank.

**Subcommittee on Financial Institutions and Consumer Credit**
**"The Condition of the Financial Institutions:**
**Examining the Failure and Seizure of an American Bank"**
**Questions for the Record**
**David Miller**
**January 21, 2010**

**Questions from Chairman Gutierrez**

**1. Could you explain what involvement Treasury had, if any, in FBOP's application for TARP funds?**

The FBOP application was filed with the Office of the Comptroller of the Currency (OCC), which then submitted the application to Treasury in accordance with the Capital Purchase Program (CPP) application processing guidelines but prior to the existence of a term sheet for private institutions. While Treasury had outlined terms for investing in publicly held firms, the term sheets for private institutions had not been completed. Before Treasury acted on FBOP's application, the OCC requested that the application be reviewed by the CPP Council, which is a council of representatives from the four federal banking agencies. In accordance with the CPP application processing guidelines, Treasury deferred action on the application pending review by, and a recommendation from, the CPP Council. The application was never resubmitted by the OCC or the CPP Council to Treasury for consideration once a term sheet for private institutions became available.

**2. I spoke with Secretary Geithner last month about the importance of Treasury's not-yet-unveiled plan to make low-cost capital available to CDFIs. I impressed upon him the importance of implementing this program as soon as possible and making it as broad as possible to worthy and qualified CDFIs, of course, as CDFIs are of vital importance to our communities, especially low-income and minority communities. When will this program be finally announced and implemented? And can you explain what the program will consist of?**

The Community Development Capital Initiative (CDCI) was announced on February 3, 2010. CDFI banks, thrifts, holding companies, and credit unions are eligible to receive investments of capital with an initial dividend or interest rate of 2 percent, compared to the 5 percent rate offered under the Capital Purchase Program (CPP). CDFIs may apply to receive a capital investment in an amount up to 5 percent of risk-weighted assets or, if the CDFI is a credit union, up to 3.5 percent of total assets. To encourage repayment while recognizing the unique circumstances facing CDFIs, the dividend rate will increase to 9 percent after eight years, compared to five years under the Capital Purchase Program (CPP). Eligible institutions may apply to participate in the CDCI through April 2, 2010.

In cases where an institution might not otherwise be approved by its regulator, it may be eligible to participate so long as it can raise sufficient private capital that - when matched with Treasury capital up to 5 percent of risk-weighted assets or 3.5 percent of total assets for credit unions - it can reach viability. The private capital must be junior to Treasury's investment and the CDFI must be in compliance with any other regulatory mandates. CDFIs that participated in CPP and are in good standing will be eligible to exchange those investments into this program. Consistent with the exception under the Emergency Economic Stabilization Act of 2008 for de minimis investments, CDFIs will not be required to issue warrants.

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## Failed banker called local hero

**Supporters decry government double standard that led to takeover of FBOP, owned by Mike Kelly, who was named Oak Park's "Villager of the Year."**

By Michael Oneal, Tribune reporter

January 20, 2010

If you knew Mike Kelly only as the secretive billionaire who lost his Oak Park-based banking empire, you might easily lump him in with all the other failed financial wizards now blamed for wrecking the American economy.

But that wouldn't explain the hue and cry that has erupted on Chicago's West Side among people from all walks of life — white, black, rich, poor — since regulators seized his nine banks Oct. 30 and handed them over to U.S. Bank in Minneapolis.

Impassioned testimonials in Oak Park's local paper have called him a hero, the rare financier who funded new schools, low-income housing and countless small businesses in downtrodden places such as Austin and West Garfield through his Park National Bank. The paper itself decried the takeover, naming him "Villager of the Year."

The uproar has led to hearings scheduled for Thursday in Washington chaired by Illinois Rep. Luis Gutierrez, where Kelly and regulatory officials will testify about what happened.

The reasons behind the seizure were complex and it's clear Kelly made some key mistakes. But the anger around Chicago is about a perceived government double standard that ignored the good his banks were doing. Kelly didn't traffic in the "toxic" subprime loans or derivatives that toppled the "too-big-to-fail" banks at the heart of the financial meltdown. Yet while the government coddled the big banks with billions in bailouts, Kelly got caught in a thicket of rules and procedures.

"This was a bank that knows, understands and trusts the community," said Oak Park Village Manager Tom Barwin. "It was there as a backstop. So they could bail out Citigroup and Bank of America but couldn't find a way to help a relatively modest organization get over the hump? The gap between what's happening on Main Street and what's happening in Washington, D.C., is wide and growing."

If you've never heard of Mike Kelly, you're not alone. Although he spent three decades building a holding company called FBOP Corp. into a $19 billion powerhouse with banks in Illinois, California, Arizona and Texas, the media-averse, 64-year-old executive went to great lengths to insulate himself behind what one of his lieutenants jokingly refers to as "the Mike Kelly cone of silence."

His sole ownership of FBOP made it the nation's largest privately owned banking company and gave him a net worth in the billions. But Kelly has been invisible to much of Chicago, even among his peers.

"Most of the city's bankers wouldn't recognize him if he walked in the room," said a rival lender.

It was always different in neighborhoods where Park National did the kind of lending other banks ignored. There, Kelly is viewed as an irreplaceable resource whose bank might quietly assist the Village of Maywood with payroll or help the Oak Park library avoid missing a bond payment.

It has already become West Side lore that the very day the Federal Deposit Insurance Corp. was closing in on FBOP, Treasury Secretary Timothy Geithner was in Chicago granting an arm of Park National $50 million in tax credits it could use to fund schools, health care facilities and new retailers.

For reasons nobody but Kelly can explain, he is deeply uncomfortable with public acknowledgment and declined interview requests. But he's hardly shy. Associates describe him as a tough-nosed banker first, community builder second. He built FBOP by swooping in on hobbled banks, buying them on the cheap and turning them around.

He launched his banking career in Minneapolis, landing in Chicago in 1981 after organizing a group to buy a tiny bank called First Bank of Oak Park.

At the time, said community organizer Sherlynn Reid, Oak Park was in the middle of a groundbreaking effort to prevent white flight, having passed the nation's first fair housing law.

Shortly after Kelly arrived, Reid visited him and saw he was already enthusiastic about using loans to bolster businesses and stabilize the area. She credits Kelly and Park National with helping make Oak Park one of America's most integrated communities.

"He saw that it was positive for the bank and the community," she said.

Over the years, Kelly became increasingly involved in community development efforts. Several years ago, when he saw that 14,000 high-school-age students in Austin were fighting over just 7,000 public school seats, he had Park National extend a $22 million no-interest loan to build Christ the King Jesuit College Preparatory school, using the Christo Rey system pioneered in Pilsen in which students earn their tuition by working for local businesses.

Another Kelly project, said Steven McCullough, president of Bethel New Life in Austin, was a joint venture to open a bank branch near the "L" stop at Pulaski and Lake.

In a neighborhood preyed upon by payday lenders with sky-high rates, the branch lends to customers with low scores or no credit history and provides incentives for building savings accounts. Borrowers have to agree to a course in financial education, which builds financial literacy and devoted customers.

Although such activities are vital to communities, said Dan Watts, Park National's former president, bread-and-butter lending is also crucial. Banking experts note that although national banks rely on lending formulas, community banks are more willing to take personal guarantees and unconventional collateral. Managing that sort of risk relies on local knowledge of people and markets.

Kelly's team also made plenty of big loans and prided itself on the ability to turn around troubled banks. So in the 1990s when opportunities arose to buy bargain banks in high growth Western markets, Kelly

pounced. The regulators were more than happy to oblige. "Whenever they had an institution in trouble, we were called in," Watts said.

Rudolf Guenzel, the former CEO of People's Bank of California, which eventually became part of FBOP's California National Bank in Los Angeles, said Kelly could be brutally opportunistic. The Chicago banker appeared from nowhere one day in late 2000 when Guenzel was trying to sell the bank to somebody else. Unbeknownst to Guenzel, Kelly had persuaded the bank's two major shareholders to sell their stakes so he could assemble a controlling interest that would trump any other buyer.

"I was working on a deal with another institution," Guenzel said. "But once they became aware of Kelly they backed off. They didn't want to get into a bidding war."

FBOP's banks had above-average concentrations in commercial real estate. But as economic storm clouds gathered in 2008, delinquency rates were low and capital ratios strong.

The bargain hunter in Kelly sensed opportunity in the downturn, a source said, and with Treasury yields low, he had stashed $896 million in the preferred stock of government sponsored mortgage lenders Fannie Mae and Freddie Mac, partly to fund acquisitions.

This would be the biggest mistake of Kelly's career.

At the time, regulators had created numerous incentives encouraging banks to invest in the so-called GSEs. They were deemed about as risky as government bonds and were treated favorably when it came to evaluating a bank's capital.

Kelly, however, was ignoring a golden rule of risk management: avoid concentration. And he had few independent voices around him to send up red flags, said Murray Galinson, who sold Kelly his San Diego National Bank and then sat as board chairman.

When the government took over Fannie and Freddie in September 2008, it wiped out the value of the companies' equity overnight. FBOP suffered an $885 million loss, blowing a gaping hole in its banks' capital reserves.

Kelly applied for more than $500 million in TARP money as soon as Congress approved the program and was initially told he would get it, Watts said. The Treasury balked, though, when it realized it had no rules for "investing" in private firms. When Geithner took over, tough new rules required Kelly to match any government aid with private capital.

Kelly spent the next seven months scouring for willing investors. From the beginning, sources said, how much control he would be willing to give up became a sticking point. He found a group including Chicago's Madison Dearborn Partners and Paramax Capital Partners in Connecticut. But as Kelly became more willing to cede control, the economy began to drag down his loan portfolio, creating disputes about future loss estimates, sources said. One issue: Kelly's relationship-based lending was hard for outsiders to evaluate.

Two days before an Oct. 30 deadline, Kelly and his investors presented FDIC officials with a complex compromise deal. Sources said it erased Kelly's stake in the company while injecting $600 million from the private equity group. But the FDIC would have to agree to contribute a similar amount of cash and share losses. Sources said FDIC officials told the group the deal might have worked had it come earlier. But time had run out.

An FDIC spokesman wouldn't comment.

Whether the government could have done more is an open question. Matthew Anderson at Foresight Analytics points out that the delinquency rates for FBOP's banks were rising sharply by the end and it was highly exposed to some of the nation's worst real estate markets. With a deal still tentative, officials might have assumed it was safer to go with U.S. Bank, which had enthusiastically answered the FDIC's September call for rescue bids.

"We all wanted it to work," said one source, "but its not that simple. There are rules and regulations and everybody has somebody to answer to."

Still, Kelly supporters raise several issues.

First, FBOP would likely have survived were it not for the CSE debacle. Had the government found a way early on to extend $600 million in TARP funds, it might have avoided the $2.5 billion in write-downs that the FDIC has taken in the U.S. Bank deal.

Second, other banks in much worse shape, such as Chicago's Corus Bankshares, were granted extensions to enforcement deadlines simply because no acceptable buyer like U.S. Bank would readily step forward to take them on.

Finally, and most frustratingly, a week after FBOP lost its banks, President Barack Obama signed into law a bill that eased rules on how Fannie/Freddie losses must be realized. That would have dramatically reduced the amount of money Kelly would have had to raise, possibly making it easier.

For Kelly supporters, what's left is to wonder if U.S. Bank will be willing to fill the void. A company spokesman said officials are evaluating the organizations FBOP supported with hope of maintaining ties.

But many still feel let down.

"Did the dire need for relationships and resources ever get considered in this decision," said the Rev. Marshall Hatch, pastor at the New Mount Pilgrim Missionary Baptist Church of West Garfield. "That's the question from the grass roots: Does any of that matter?"

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January 19, 2010

The Honorable Luis Gutierrez
Chairman, Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee

The Honorable Jeb Hensarling
Ranking Member, Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee

Dear Chairman Gutierrez, Ranking Member Hensarling, and Members of the Subcommittee on Financial Services and Consumer Credit,

Thank you for the opportunity to provide testimony regarding this important topic.

I am submitting this testimony on behalf of the 53,000 residents of Oak Park, IL whom I am honored to represent as their twice elected Village President (chief elected officer equivalent to that of Mayor). I am also a member not only of the leadership group of the Metropolitan Mayors Caucus for Northern Illinois but also of the leadership of the United States Conference of Mayors.

I am here today to address what amounts to the largest bank robbery in the history of the United States. On October 30, 2009, the FDIC took over a very profitable Main Street bank (with operating profits of $250,000,000 annually), and handed it over to one of the nation's largest Wall Street banks at a dramatic discount – including a direct check from the FDIC. I am asking the leadership and the members of this subcommittee to, in your appropriate oversight role, reverse and overturn this profoundly ill-advised action. In so doing you have an opportunity here to demonstrate your commitment to accountability, financial responsibility, and community well-being.

Again, it can't be overstated that First Bank of Oak Park was, is, and will continue to be, profitable. Which re-emphasizes the question, "then why are we all here?"

We are here today because of a set of circumstances that culminated in a series of profoundly bad decisions by the FDIC and the Treasury Department. As a direct consequence, the federal government has wasted more than $2.5 billion in federal funds, unnecessarily seizing this profitable bank.

Further, by their actions (not only in this case but in numerous examples) these agencies have clearly designated Wall Street banks and their management teams as friends. Even more

importantly however, they just as clearly have identified Main Street banks, as well as their customers and the neighborhoods and small businesses that depend on them, as enemies.

Understand, there is no allegation of any illegality on the part of these federal agencies. There is, instead, incontrovertible evidence of poor judgment and mismanagement including:

- **Poor financial judgment in ignoring "lowest cost" resolution opportunities and instead proceeding with a higher cost alternative** resulting in a waste of federal resources by the FDIC's own admission of two and a half billion dollars (an accounting of which must be pursued by this oversight body).

- **If FDIC had simply accommodated FBOP's request for a one week extension** (the very type of extension which it has routinely granted in numerous instances over the course of the past 12 months), two things would have happened:
    - **First, Such an extension would have allowed FBOP to finalize its impending private equity infusion** which would have **thereby eliminated the need for any FDIC writedown at all** of FBOP's assets.
    - **Second, President Obama's signing**, one week later (on November 6th), **of the Worker, Homeowner, and Business Assistance Act** (WHBAA) of 2009, **would have translated into at least a $150 million improvement in FBOP's balance sheet**, further strengthening the capital position of the bank and ensuring its "well-capitalized status, and **placing it well beyond the level at which FDIC could legally seize FBOP and its assets**. The effect of this legislation on FBOP's status was not lost on the FDIC.

- **Identifying 23 "second tier" banks as qualifying to receive TARP funds, formally notifying them that they would receive such funds, and then reneging on that commitment to only one of these banks (FBOP)** simply because it was the only privately held institution among the 23 (demonstrating the clear federal bias that exists against privately held banking institutions). If such a reversal occurred in the private sector, it would constitute fraud.

- **Lack of understanding of, much less support for, the critical role occupied by community banks in our society,** particularly in the economic recovery of low-to-moderate income communities that are historically "unbanked" or under-banked;

- **Interagency mistrust and animus resulting in lack of communication, lack of coordination, and disagreement regarding federal objectives and methods to achieve them.** This lack of coordination helps to explain Treasury's granting of $50 Million in tax credits to FBOP on the very morning of the day that the FDIC subsequently seized the bank. It also helps explain the takeover of one of the nation's most fiscally responsible, respected, and community-minded banks – a bank that the OCC had used as a model for others – and its subsequent handover to one of the nations most profit-oriented but least community minded banks.

- **Seeming inability to grasp the concept of "total economic impact" in evaluating alternatives and, in addition to operational performance, of ignoring bank track records** and prospective performance **regarding community impacts** such as:
  - philanthropic contributions;
  - community investments;
  - employment levels;
  - service offerings;
  - local reinvestment of profits and resulting neighborhood economic multiplier effects;
  - advancement of CRA lending levels;

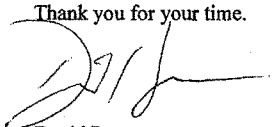
Ultimately, federal departments and the federal regulatory agencies have taken steps that have supported, perpetuated and promoted a dramatically unfair and unlevel playing field. This unlevel playing field has been the direct cause of the handover of this vitally important and profitable bank, to a much larger bank which has instead found favor with the FDIC.

During this profoundly challenging economic time, the FDIC has been functioning with virtually no oversight – or at least no oversight that is apparent to anyone "outside the Beltway". Unfortunately, and as this case clearly demonstrates, when oversight breaks down, bad things happen.

We can't only have Mayors caring about Main Street. We need our Congressional Representatives to care about Main Street. We need our President to care about Main Street.

We had a bank that cared, truly cared, about Main Street; about our shops, about our neighborhoods, about our schools, about our parents and our children, and about us. The FDIC has taken that away from us. We hope that you will help to give it back.

Thank you for your time.



David Pope

President
Village of Oak Park
Oak Park, IL

**Response to Questions from**
**the Honorable Tom Price, M.D.**
**from the Federal Deposit Insurance Corporation**

**Q1: While bank regulators use financial statements based on U.S. Generally Accepted Accounting Principles (GAAP) as a reference point for determining a financial institution's capital needs, do these standards dictate regulatory capital requirements?**

**A1:** Regulatory reports prepared under GAAP are the starting point for determining regulatory capital. Although Section 37 of the Federal Deposit Insurance Act (12 U.S.C. 1831n) generally requires that accounting principles applicable to depository institutions for regulatory reporting purposes (e.g., the Consolidated Reports of Condition and Income, also known as the Call Report) must be consistent with or no less stringent than GAAP, the FDIC believes that the requirements of Section 37 do not extend to the federal banking agencies' definitions of regulatory capital. Therefore, as the Financial Accounting Standards Board changes GAAP, these changes may affect the starting point for regulatory capital and the banking agencies must evaluate whether there is a compelling supervisory need to revise their regulatory capital rules in response to the accounting changes.

For prudential purposes, the agencies' regulatory capital rules adjust GAAP equity to develop a better measure of capital. Equity adjustments that are commonplace include, for example, deductions of deferred tax assets above certain limits and goodwill. Additions to equity, subject to limits, include certain subordinated notes and debentures, which are accounted for as debt under GAAP, and the allowance for loan and lease losses, which GAAP treats as a valuation allowance for the held-for-investment loan and lease portfolio. GAAP equity includes certain unrealized gains and losses that are reported in accumulated other comprehensive income, which are generally disregarded in determining regulatory capital.

**Q2: Does the OCC and the FDIC have the authority to decouple or delink GAAP and bank regulations to both preserve the integrity of fair-value accounting and provide regulators with more leeway for adjusting capital requirements?**

**A2:** As indicated in the previous answer, the FDIC does not believe that the agencies' regulatory capital requirements are completely tied to GAAP. As a consequence, the agencies have the authority to preserve the integrity of fair-value accounting for regulatory reporting purposes, while at the same time adjusting the results of fair-value accounting for regulatory capital requirements.

**Q3. Has this authority been used? If not, why?**

**A3:** Yes, this authority has been used. Since 1994, available-for-sale debt securities have been reported at fair value on the balance sheet, with unrealized gains and losses arising from changes in the fair value of these securities reported in the accumulated other comprehensive income component of equity. In contrast, the agencies exclude these unrealized gains and losses from regulatory capital.

More recently, GAAP introduced a fair value option that allows banks and other entities to elect to report certain financial assets and liabilities at fair value with the changes in fair value included in earnings. However, for a liability that is measured at fair value, an entity must consider the effect of a change in its own creditworthiness on the fair value of the liability. When an entity's credit condition worsens, the fair values of liabilities accounted for at fair value through earnings decrease, which has the contrary effect of increasing the entity's earnings and its equity at the same time that its financial condition is deteriorating. This counterintuitive accounting outcome is regarded as inappropriate from a safety and soundness perspective. Therefore, the banking agencies determined that banks should exclude from regulatory capital the cumulative change in the fair value of liabilities accounted for under a fair value option that is attributable to changes in the bank's own creditworthiness and included in equity.

**Q4. How could implementing such a change impact the reserves a bank has to hold to remain well or adequately capitalized?**

**A4:** As stated previously, the agencies control the determination of regulatory capital, which already gives them the authority to preserve the integrity of fair-value accounting for regulatory reporting purposes, while at the same time adjusting the results of fair-value accounting for regulatory capital requirements if and when appropriate. Under longstanding agency policies, losses recognized in earnings under the accounting standards currently in effect, whether due to fair value changes or other causes, are reflected in regulatory capital with the recent exception of the "own-credit-risk" adjustment for fair value option liabilities. Revising the agencies' capital requirements to permit depository institutions to exclude from regulatory capital other types of losses that are reported in earnings for regulatory reporting purposes under GAAP would not be consistent with safety and soundness, including the objectives of prompt corrective action. Deferring losses for regulatory capital purposes that are recognized in earnings for accounting purposes would reduce the credibility of regulatory capital measurements when institutions are nominally well or adequately capitalized, but have GAAP equity that has fallen to a nominal level.

**Q5: Would this change result in fewer bank failures?**

**A5:** Credit losses on loans typically are the cause of bank failures. Under GAAP, the loans that banks hold for investment (rather than for sale or trading) are accounted for at amortized cost less an allowance for loan and lease losses, not at fair value. Nevertheless, loan loss allowances for impaired collateral dependent real estate loans are measured based on the fair value of the collateral. Foreclosed real estate is initially booked based on its fair value and its ongoing measurement considers any declines in fair value. Ignoring accounting losses that run through earnings when calculating regulatory capital would mean that reported regulatory capital levels do not reflect the economic condition of the institution, raising moral hazard concerns. While this may delay bank failures, it would not likely result in fewer failures; but delays in closing institutions that are no longer viable increases the cost to the Deposit Insurance Fund and, hence, to the banking industry.

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The Honorable Tom Price
United States House of Representatives
506 Cannon House Office Building
Washington, DC 20515

SUBJECT: Regulatory Environment and Bank Failures

Dear Congressman Price:

Community Bankers Association of Georgia (CBA) and the community bankers in Georgia want to thank you for the opportunity to comment regarding the current regulatory environment for community banks and the large number of community bank failures in Georgia. The CBA represents community banks from all areas of Georgia, so the feedback we receive provides a good cross section of the views of bankers in rural, metropolitan and suburban areas. Right now, the view is pretty universal across the state that the regulatory environment is extremely tough.

As you will recall, I was a regulator with the Georgia Department of Banking and Finance for almost thirty years before retiring as Commissioner, and have been with the CBA for the last eight years. Without a doubt, the regulatory environment in Georgia for the past twenty-four months has been the most harsh regulatory environment that I have ever seen in my roughly thirty six years in this business. Perhaps that is somewhat understandable and even necessary given the fact that we have been in the midst of the worst economic environment since the Great Depression. It is also a fact that many Georgia community banks held concentrations in real estate loans when this downturn began; and real estate is the sector that most would agree has taken the worst beating during the downturn.

Regulators have always been tough when the financial condition of a bank significantly deteriorates; they have to be in order to do their jobs. However, in the past, when a bank developed problems, it seemed that the regulators, state and federal, were there trying to help the bank correct its deficiencies, improve its condition and survive. That no longer seems to be the case, especially with the federal regulators. While there may be rhetoric regarding trying to help, community bankers indicate there is no tangible evidence that is the case. There seems to be an attitude intent on punishing the bankers for the err in their ways, rather than trying to help. Based upon the latest information available to us, over 45% of the community banks in the state of Georgia are under some form of formal administrative action, most commonly consent orders. Additional orders are in process and many additional community banks are under various informal regulatory actions. Based upon feedback from community bankers, the orders imposed on community banks today are so tight and so prescriptive that they severely limit the flexibility of bank management to manage their way through the bank's problems and improve the bank's condition. Many have said that when they do what the orders require them to do, it makes their situation and their financial condition even worse.

We would like to mention three areas that are perhaps of the greatest concern by the majority of community bankers in our state:

**Fair Value Accounting for Real Estate and Related Appraisal Issues**: The very strict application of fair value accounting for real estate by the federal regulators has directly resulted in most of the bank failures we have had in Georgia and is the primary reason for the weakened financial condition of many more community banks that are still struggling to survive. To be sure, many of the community banks that have failed were so heavily concentrated in real estate construction and development loans, failure may have been inevitable. However, the regulatory application of fair value accounting for real estate (i.e. mark to market) gave these institutions virtually no opportunity to work through their problems. New appraisals on real estate are being required by regulators, sometimes when an existing "new" appraisal is less than 90 to 120 days old, and the banks are being required to write down the value of the loan or other real estate (or at least set aside a specific reserve; NOTE: There is considerable inconsistency from examiner to examiner on this point) to the new appraised value with no regard to prospects for a rebound of the property value somewhere down the road. As one community banker put it, "We are being required to write down theoretical losses using real capital." It is also noteworthy that once a bank charges down other real estate, the only way it can get that value and in turn the capital back is to sell the real estate. Even if the real estate markets were to rebound and a higher appraisal could be obtained, the bank can only recover the lost capital on its books by selling the property.

It is true that there is little market for many of these properties today, so naturally the "new" appraisals are reflecting significant losses related to the book value of the loans and property. However, the fact is there has been no rational market for most real estate in Georgia for at least the last eighteen months. There are no willing buyers in this market, so how can appraisers possibly establish a "realistic" value for these properties? The irrationality of the market is perhaps best illustrated by a fact that one community banker shared that he actually received an appraised value of "zero" for two building lots in a suburban area around Atlanta. The very fact that appraisers are being asked to re-appraise properties so frequently is likely driving appraised values downward. The appraisers are concerned about their liability, particularly when they are an institution-affiliated party of a federally insured financial institution. The appraiser knows when a regulator has required a new appraisal; the regulator did not require the new appraisal expecting the value to go up. Further, the FDIC itself has been a major contributor to the downward spiral in real estate values in many of the submarkets in Georgia due to their "dumping" real estate and real estate related loans on the market at "fire sale prices." See additional comments below on this subject.

The federal regulators take the position that their strict application of fair value accounting is required by generally accepted accounting principles (GAAP) under FAS 5 and FAS 114. Many bank accountants will privately tell you that the regulators have been considerably more aggressive about requiring the mark to market of real estate than GAAP would mandate, especially in regard to requiring the charge off of loans. They say that GAAP provides greater flexibility and discretion than the regulators have allowed. However, understandably so, the accountants are reticent to challenge the regulators, especially in view of their potential liability as an institution-affiliated party to a federally insured financial institution.

This regulatory environment has created a continuous downward spiral in the local economies of many of the communities in Georgia. There is little incentive for a banker to work with a borrower in this environment. They have already been required to take the hit to their capital anyway, so there is no incentive for them not to foreclose and try to sell the property. This has especially been the case with many of the regional banks that received TARP money. These banks have often been quick to foreclose, dumping additional properties on the market at "fire sale prices," further exacerbating the real estate markets and the situations of the community banks in those markets. This never ending downward spiral in real estate values plus the failure of some community banks has been devastating to some local economies in Georgia.

If some method could be found to allow the spreading of losses on real estate and real estate secured loans over a period of time (maybe five to ten years), that would give some community banks the opportunity to survive that may otherwise fail due to the mark to market/fair value accounting requirements of the regulators. If the banks had the

certainty of a write down over a period of years it would stabilize their situations, they could begin to lend again and the process of economic recovery could begin. The certainty this would bring would likely attract private equity back to the community banking sector, as well, and allow the real estate markets to find a bottom and recover quicker. With the beginning of a real estate market recovery and with community banks lending again, the local economies around Georgia should be pushed in the direction of recovery.

**FDIC Actions as Receiver of Failed Banks Have Contributed to the Decline in Real Estate Values:** As you are aware, unfortunately Georgia has experienced more bank failures than any other state since the current financial crisis began. As a result, the FDIC has acquired a very large volume of Georgia real estate loans and other real estate in connection with the thirty failures that have taken place. The FDIC has sold many of the real estate loans and other real estate at very low, "fire sale prices." Prices of less than thirty cents on the dollar have not been uncommon. Community bankers struggle with understanding how such sales can be in the best interest of the FDIC and the deposit insurance fund. Additionally, as mentioned above, such sales at extremely low prices have served to further depress the residential real estate market making the banking environment even tougher for the existing banks trying to survive. Further, such sales have contributed significantly to the devastation of many local economies around the state.

**Brokered Deposit Restrictions and Related National Deposit Rate Cap Rule**: When a community bank's capital drops below the threshold of "well capitalized," the bank can no longer obtain any new brokered deposits and may not renew existing brokered deposits without a waiver from the FDIC. While FDIC indicates they do grant waivers, community bankers indicate that waivers are rarely granted and when granted are only granted for a very short period of time; 90 days, for example. Further, any bank that is subject to a formal administrative action by their primary federal regulator is considered to be less than "well capitalized" for the purposes of this brokered deposit rule regardless of the bank's actual capital ratios. So, these community banks become subject to the brokered deposit restrictions, as well. While it is clear that some community banks have overused brokered deposits as a source of funding, many community banks have used brokered deposits in a responsible manner to assist with temporary funding needs and to avoid paying above market rates in their local markets. The availability of this funding source as a supplement to local deposit funding has provided community banks with significant flexibility to better manage liquidity and earnings. When used properly and in moderation this source of funding has actually enhanced the safety and soundness of many community banks. However, when a community bank loses access to the brokered deposits market, it loses any ability to continue to use this funding source to enhance the bank's safety and soundness. Further, the loss of one of the few remaining sources of funding available to community banks, other than local deposit funding, adds liquidity pressures to any community bank and in particular to any community bank with a significant volume of existing brokered deposits. The loss of this vital source of funding significantly reduces a community bank's flexibility to manage through the economic crisis and the many other problems it may have.

The FDIC has further complicated the situation with brokered deposits by adopting a deposit interest rate cap rule, which went into effect on January 1, 2010. Under the rule, any bank subject to brokered deposit restrictions is not allowed to pay more than 75 basis points over the national average rate for a like deposit account for local market deposits. Otherwise, the deposits gathered in the local market are considered to be brokered deposits and are subject to the waiver requirements for brokered deposits. A bank can request a waiver from the national rate cap restriction on the basis that the bank is located in a high rate market; however, the willingness of FDIC to grant an exemption from the rate cap is unclear at this point. This rate cap rule further increases liquidity pressures for community banks and significantly reduces flexibility in managing a community bank's earnings and liquidity at a time when community banks are already operating under considerable stress. It should also be noted that the method for calculating the national average rate and for calculating average rates for a bank's market area further exacerbates this issue. The calculation requires that the rate paid by each branch of a bank be added into the calculation of the average. This results in larger institutions with more branch locations being counted into the average multiple times, which has a tendency to skew

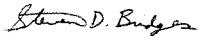
the average rates downward. A more accurate reflection of national and individual bank market average rates would be discerned by counting the rates of each institution only once in the calculation, regardless of the number of branches of that institution.

We are highly concerned that the brokered deposit and related national rate cap restrictions significantly decrease the flexibility of community bank management to effectively manage the bank's earnings and liquidity, thereby diminishing safety and soundness. We realize and understand FDIC's concern that failed banks with large volumes of brokered deposits are not as attractive to potential bidders and generally cost more to resolve than failed banks with mostly local core deposits. However, the flexibility to use a moderate volume of brokered deposits in a responsible manner in managing a community bank may actually enhance safety and soundness and hopefully increase chances for survival, rather than failure. For example, right now brokered deposits for longer term deposits, such as certificates of deposits with a three to five year term, are much cheaper in the brokered market than in most local markets in Georgia. So, the lack of access to the brokered deposit market increases the cost of funds for any bank needing longer term certificates of deposits.

Further, we are particularly puzzled by the FDIC's aversion to the renewal of brokered deposits that a bank already has when it becomes subject to brokered deposit restrictions. As long as only the renewal of existing brokered deposits is allowed the potential risk to the deposit insurance fund should not be increased, even if the bank ultimately fails. In addition, allowing a struggling bank with a volume of brokered deposits to renew existing brokered deposits, with a longer term brokered deposit reduction plan, should reduce liquidity pressures and add to bank management's flexibility to work through the bank's problems. We are concerned that the absence of this flexibility, especially combined with the restrictions of the national rate cap rule, may result in community banks failing more quickly due to liquidity issues. Restricting the ability of management to prudently manage a community bank through its problems would not appear to be in the best interest of FDIC, hence our puzzlement. Some community bankers are questioning whether these policy restrictions are designed to improve a troubled bank's condition or simply designed to prepare a bank for failure.

**Conclusion:** Congressman Price, we appreciate the opportunity to express the concerns of Georgia community bankers with the current regulatory environment. We are genuinely concerned that the harsh regulatory environment will result in additional community bank failures and further devastate our local economies around the state. If you have any questions regarding our comments or if we can assist in any way, please do not hesitate to call on us. I may be contacted through the CBA office at 770-541-4490 or by cell phone at 770-789-5605.

Sincerely,



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January 20, 2010

The Honorable Tom Price
424 Cannon House Office Building
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3730 Roswell Road, Suite 50
Marietta, GA 30062

Dear Congressman Price:

Community banks are more than mere money changers. Community banks are social organizations, extended families and the economic engines in the communities in which they operate. As a result, the boards of directors of community banks, as they work through the worst economic downturn since the Great Depression, feel like having their bank's fate in their hands is not merely an economic responsibility.

Lately, that responsibility has been made worse not because of increasing declines in property values or consumer confidence. In fact, the consensus seems to be that both of those and most other economic indicators are on the way back up or have at least reached bottom. Instead, these banks and their boards find themselves face to face with a regulatory process that is unreasonable, misguided and unwaveringly moving their banks to failure. This issue is creating an uneven playing field for the thousands of Main Street banks that are not "too big to fail."

Closing traditional community banks often makes no economic or policy sense and would be immeasurably damaging to the communities they serve. Many of the banks that have failed in the current economic cycle had flawed or nonexistent business plans, miniscule market shares, few core deposits and limited prospects of achieving their goals of being bought out by larger competitors in a relatively short time frame. There are many traditional community banks that are different. They have a long track record of serving their communities, core deposits and the proven ability to operate successfully and independently for an indefinite time. A "run" on these banks is often remote, particularly given the overwhelming preponderance of insured deposits, and a slow, steady recovery is probable if the banks are not closed and the economy gradually improves. While these banks may be sustaining losses, those losses are not materially increasing the risk to the Deposit Insurance Fund if they should subsequently fail.

Unfortunately, many of these banks may not have the opportunity to earn their way to back to health. Here are a few examples of what so many of our vital community banks are dealing with:

1. Examination Procedures and Enforcement Actions. Exams are intended to be a thorough and thoughtful analysis of a bank's operations and condition. After that exam, a report is written and a composite CAMEL rating is applied to the bank. Based on the exam and the ratings, in some instances, the regulators may seek an enforcement action to bind the bank to make certain changes or address certain issues. In normal times, cease and desist or consent orders are rare and imply that a bank is truly having a difficult time or has issues that need to be addressed.

In what must be perceived as an irrational overreaction to the Inspector General reports that have consistently said that examiners were too slow to recognize risks and too lax in addressing them, the regulators are coming into community banks with guns blazing. They are coming into community banks expecting to find flaws and to downgrade the bank. Reports of exam describe facts that in many instances are identical to the facts as they were just a year ago, although the facts now demonstrate a 4 or 5 rating in a particular category rather than a 2 or 3. Consent orders have become the enforcement tool of choice.

As a result, community banks' problems are being exacerbated by the bad publicly and other consequences of harsher ratings and enforcement actions, like the loss of funding sources and liquidity issues caused by the unnecessary concerns of depositors. It is obvious that among the many causes of where we are today is that the regulators were lax and did not do a good enough job in recent years identifying risky concentrations and business plans. To make matters worse, virtually any group of entrepreneurs could get a bank charter. Rather than learning from that and taking a more careful, measured approach to exams and enforcement actions, the regulators are overreacting to the detriment of this country's community banks and the country as a whole. If we wipe out all of the community-based lenders, what engine is going to drive local economies?

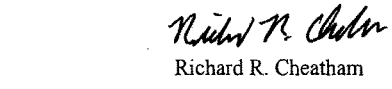
2. Capital and the Allowance for Loan Losses. While the banks that were too big to fail were forced to take the US Treasury's capital injections that they used to finance mammoth bonuses for executives, thousands of other community banks have been left out and are being criticized by their regulators for their inability to maintain extraordinary capital and allowance levels. Community banks are being asked to maintain capital ratios arbitrarily selected by their regulators that are 3 to 4% above "well-capitalized" minimums. This demand for high capital levels by the regulators comes at a time when capital is almost impossible to come by. As the trust preferred and other capital markets have dried up, most community banks have not had the benefit of a TARP investment and any capital raising efforts are in competition with the big banks that are selling securities essentially guaranteed by the US Government. In addition, community banks are being asked to maintain huge allowances for loan losses equal to 4% or more of total loans. A more realistic approach to capital and loss allowance has to be applied by the regulators if any community bank is going to be given the chance to earn its way out of the current crisis.

3. Rush to Close. Historically, when banks fail it is because of "runs." Depositors lose their confidence in the bank and all want their money now. There is no real threat of a run at many of this country's community banks unless a loss in confidence of their customers arises out of the public nature of the bank's battle to avoid closure. Instead, their fate often lies with whether it has enough capital to survive, a fate determined in large part by how its assets are valued.

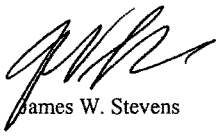
Congress reacted to the thrift crisis with a 90 day/2% leverage capital bright line test. In hindsight, it appears now to have been a mistake to adopt this bright line test for FDIC "resolution" decisions. That made some sense for thrifts which were destined to fail as a result of a flawed business model of borrowing short and lending long during a period of relative economic stability when "fair value" was determinable based on active, stable markets. It makes far less sense in the context of traditional banks with varying economic prospects when "fair value" is only determinable within gapingly wide ranges.

If we are going to get out of this crisis with some of our community banks and something left in the Deposit Insurance Fund, the FDIC must begin to look for some banks that actually may have a chance to work themselves out of very low capital positions. There are many community banks in this country that have the core deposit base that makes a run unlikely and that will not cause a great risk of loss to the fund if they are allowed 6 months to a year to keep trying to solve their problems. No one wins when the FDIC takes a loss equal to 20% or more of a bank's assets in connection with its failure.

Sincerely,



Richard R. Cheatham



James W. Stevens