TARP and SBLF: Impact On Community Banks

Special Inspector General for the Troubled Asset Relief Program

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INTRODUCTION

This report provides an overview of the regional and community banks that participated in the most well-known TARP initiative, the Capital Purchase Program ("CPP"). This report also discusses recent actions that have allowed 137 banks to refinance out of the CPP program into another Government program outside TARP, the Small Business Lending Fund ("SBLF"), while still leaving hundreds more behind, many of them weaker than those that exited TARP through SBLF.

Beginning in late 2008, the U.S. Department of the Treasury ("Treasury") invested $204.9 billion of TARP money through CPP into 707 banks of all sizes, from global giants with assets of more than $1 trillion to local institutions with just one or two offices. In return, the banks agreed to give Treasury an ownership interest in the form of preferred stock and warrants to purchase more stock. They also agreed to pay Treasury quarterly dividends or interest, and to abide by other restrictions including rules on executive compensation. Those obligations were meant in part to encourage banks to repay the Government and exit CPP.

The largest banks have indeed exited CPP. However, as of March 31, 2012, 351 regional and community banks remained in CPP. That's in addition to 83 financial institutions in TARP's Community Development Capital Initiative ("CDCI"), for a total of 434 still in TARP. Their business models are very different from those of the mega-banks. So are the challenges they face. One paramount challenge is access to new capital to replace TARP funds.

Some smaller banks have been able to obtain capital to exit CPP through other federal programs, notably SBLF, which allowed qualifying institutions to refinance their TARP investments with Government money outside TARP. Treasury refinanced 137 CPP-recipient banks into SBLF, which closed to new entrants on September 27, 2011. The banks that exited TARP through SBLF were better capitalized and financially stronger than those that remained in TARP. After the 137 banks left CPP, 390 institutions remained in the program, most of them small community banks. The status of those banks is one of the major issues facing TARP nearly four years after the financial crisis. SBLF culled a large number of healthier community banks from TARP, leaving less-healthy banks in TARP that had less capital, had missed dividends, or in many cases, were subject to enforcement actions by their Federal banking regulators. In October 2011, SIGTARP issued recommendations calling for Treasury to work with Federal banking regulators to develop a clear TARP exit path to ensure that as many community banks as possible repay the TARP investment, and prepare to deal with the banks that cannot.

This report explains the structure of the remaining CPP banks as they relate to the structure of the banking industry as a whole, particularly the community banking sector. It examines the impact of TARP on community banks. It analyzes the TARP banks that exited TARP through SBLF versus banks that remain in TARP. It also examines the current status of TARP banks in the six months since SBLF closed to new entrants.

Separately, SIGTARP is conducting an audit of the process for refinancing TARP banks into SBLF, including whether Treasury and Federal banking regulators consistently evaluated SBLF applications from TARP institutions.[1]

THE U.S. BANKING INDUSTRY

Banking Sector Has Multiple Tiers

Through CPP, Treasury invested in 707 financial institutions of all sizes, or about 10% of the industry. Hundreds of institutions have exited the program, but those remaining in CPP are mostly small institutions that collect deposits from members of their communities and lend that money to local businesses, farmers, and consumers. They may be virtually unknown outside their immediate communities, but many of these small banks play a critical role in providing loans and cash management services to local employers as well as services such as checking accounts and auto loans to local residents. Among the smallest banks in CPP: Freeport State Bank with $23 million in assets and two offices in the wheat-growing plains of Kansas; Saigon National Bank with $59 million in assets and a bilingual staff catering to Vietnamese immigrants in southern California; and Crazy Woman Creek Bancorp, a bank holding company with $144 million in assets that took its memorable name from a tributary of Wyoming's Powder River.[2]

For more information on how banks left TARP, see SIGTARP's September 29, 2011, audit report, "Exiting TARP: Repayments by the Largest Financial Institutions."

The biggest U.S. banks – defined by the Federal Reserve Board ("FRB") as those holding $50 billion or more in assets – raised capital and met other Treasury conditions to exit CPP by the end of 2009. This group includes four banks that each have more than $1 trillion in assets and are household names: Bank of America Corp., Citigroup Inc., JP Morgan Chase & Co., and Wells Fargo & Company. Together, the four control just under half of all banking industry assets.[3]

Most institutions in the next industry tier, regional banks with assets of $10 billion to $50 billion, were also able to find new sources of capital and leave CPP in 2010 or 2011.[4] Eleven regional banks remained in the program on March 31, 2012: Cathay General Bancorp., First BanCorp., Flagstar Bancorp, Inc., International Bancshares Corporation, M&T Bank Corporation, New York Private Bank & Trust Corporation, Popular, Inc., PrivateBancorp, Inc., Regions Financial Corporation, Synovus Financial Corp., and Zions Bancorporation. Just after the end of the quarter, on April 4, 2012, Regions Financial Corporation, the largest institution that remained in CPP, paid back its $3.5 billion in TARP money, exiting TARP.[5] Most of the other regional banks have taken initial steps to issue new stock or debt, or are selling assets with plans to repay their CPP funding, according to company announcements and industry analysts.

The speed and manner in which banks and thrifts have exited CPP – or not – provides insights into the capital raising, regulatory, and competitive challenges faced by the nation's banking industry and especially its smallest institutions.

Some banks exited TARP only through other Federal Government programs. Last year, 137 banks qualified for a path out of CPP by refinancing taxpayer funds through SBLF, a separate non-TARP Government program. SBLF finished accepting participants on September 27, 2011. Another group of 28 banks exited CPP in 2010 by converting the Government's investment into another program within TARP, CDCI, which supports banks and credit unions that specialize in consumer banking services, credit counseling, and business planning for low-income borrowers.[6]

Only 43% of banks that have exited CPP have done so by fully repaying the Government. In 22 cases, banks exited TARP either by Treasury selling its investment in an institution at a loss, or by merging with other CPP banks. Sixteen banks left CPP the hard way – by failing.

But nearly half of all CPP recipients remained in the program on March 31, 2012, and those that are still in CPP will face a significant rise from 5% to 9% in dividend payments owed to the Government beginning in late 2013. The majority of those banks are smaller banks, often referred to as community banks because they serve customers within a compact geographical area.

Community Banks Play an Important Role in the Economy

There is no universally accepted definition of what constitutes a community bank. A group that lobbies on behalf of community banks, the Independent Community Bankers of America, shies away from defining a community bank by size and says its members range from institutions with a modest $3 million in assets to those with as much as $17 billion in assets.[7] The FRB, which supervises bank holding companies and member institutions of the Federal Reserve System, defines a community bank as one with assets up to $10 billion.[8] The Office of the Comptroller of the Currency ("OCC") has a lower threshold of up to $1 billion in assets for the nationally chartered community banks and thrifts it supervises.[9] (Credit unions, which include a number of institutions in CDCI, are regulated separately by the National Credit Union Association or under state law.)[10]

The Federal Deposit Insurance Corporation ("FDIC"), which regulates most of the country's small banks, has also used the $1 billion threshold as a cut-off point for community banks but is considering a more flexible definition. As part of a 2012 project analyzing community banks' business models and competitive pressures, FDIC researchers said they expanded the definition to include banks with more than $1 billion in assets if they meet certain criteria. Those exceptions include operating in fewer than four states and fewer than three major cities; maintaining a loan to assets ratio higher than 33% and a core deposits to assets ratio of at least 50%; and operating individual bank branches with deposits under $5 billion.[11] By that definition, 6,526 institutions were community banks or thrifts out of the total 7,658 U.S. financial institutions that existed on December 31, 2010, the FDIC researchers said.[12]

Despite the lack of agreement on defining community banks by asset size, there are other characteristics that distinguish community banks from global or regional banks. The best way to define community banks, argues a state banking regulators group, is by their customer relationships. "In community banking, both the borrower and the lender maintain a stake in the long-term outcome of the transaction. Community banks place a greater emphasis on long term customer relationships, incorporating soft information that is not easily quantifiable," the Conference of State Bank Supervisors said in a recent white paper.[13]

One especially important focus for community banks is small-business lending. Community banks provide nearly 40% of small-business loans made by U.S. banks even though they hold less than 11% of banking industry assets, according to the

FDIC.[14] Community bank lending is especially important to small businesses that have few or hard-to-value assets as collateral and lack audited financial statements. In those cases, a lending officer at a community bank might use his or her knowledge of the local economy, the borrower's business, the character and personality of the business owner, and credit scoring data to decide whether to approve a loan application.[15] "When I first arrived [at the bank], I found that one of the things they did was look at the neatness of the woodpile of the customer that we were lending to as one way to see whether or not they were a person who would pay us back," Dorothy Savarese, CEO and president of Cape Cod Five Cents Saving Bank, a non-TARP bank, said at a recent FDIC conference on the future of community banking.[16]

"Once a loan is made to a small business or consumer, a community bank typically holds onto it rather than securitizing or selling it," Timothy Koch, a professor of banking and finance at the University of South Carolina, said at that conference.[17] "Unlike big banks, community banks generate most of their earnings from net interest income on loans, and rely on core deposits by customers in the same community to fund lending," he said.

Community banks' lending to small businesses has decreased recently while large banks increased loans to small businesses. Small banks — those with assets under $1 billion — have steadily lost market share in small-business lending since 1995, according to an analysis of loan data by information provider SNL Financial LC ("SNL").[18] That group of banks now owns just 34% of commercial and industrial loans of less than $1 million that were secured by collateral other than real estate, down sharply from 51% in 1995, according to SNL. During that same period, bigger banks with more than $10 billion in assets doubled their market share of such loans, SNL reported.

Community Banks Have Limited Access to Capital

Banks of all sizes have felt regulatory pressure since the financial crisis to reduce risky loans and build stronger balance sheets able to absorb unexpected losses. Community banks need capital to pay off CPP investments, and raising that capital has been a significant challenge along with weakened loan portfolios and slow economic growth.

Industry experts say the amount of new capital needed by community banks nationwide is substantial. According to analysts with investment firms Raymond James and Barack Ferrazzano Financial Institutions Group, and consulting firm McGladrey & Pullen, LLP, it will take $23 billion in fresh capital for community banks to repay TARP or SBLF funds; to absorb credit losses and boost loan loss reserves; and to meet higher regulatory capital ratios.[19] A higher estimate of $90 billion in community bank capital needs came from StoneCastle Partners, an asset management and investment banking firm. It included $43 billion for healthy institutions to acquire weak and failing banks; $28 billion for banks to clean up their balance sheets; $12 billion to boost loan loss reserves; and $7 billion for internal growth.[20]

Ownership of the smallest community banks is often concentrated in the hands of a limited number of shareholders or family members. About 2,000 community banks are organized as Subchapter S corporations, which have fewer than 100 shareholders and are taxed at the shareholder level, rather than the corporate level.[21] About 1,000 community banks are publicly traded companies, raising capital through public offerings and private placements of their stock.[22] However, unlike the biggest U.S. banks with millions of shares traded daily on NASDAQ or the New York Stock Exchange, many community banks are thinly traded on over-the-counter markets. As of March 31, 2012, nearly half (169) of the remaining 351 CPP institutions were publicly traded community banks.

Banks with assets under $1.5 billion do not have access to capital from private equity firms, mutual funds, foundations, and other institutional investors, according to some who follow the industry. “Capital offerings for less than $20 million to $30 million are often too small for many institutional investors regardless of structure or investment thesis. Institutional investors have fixed costs to cover and deal size minimums. They simply cannot monitor an unlimited number of small investments, no matter how promising,” the Conference of State Bank Supervisors said in a recent white paper.[23] Institutional investors also want a bank to have a business plan that allows the investors to eventually realize gains through a stock offering or by selling the bank to a larger institution.

Small banks that are successful in raising new funds “often first pass the hat around the board room table,” industry experts told a capital-raising panel discussion held by the Federal Reserve Bank of St. Louis.[24] Money raised from insiders sends an important signal of confidence about the bank’s future to other potential investors. Another source of capital for small banks can be investments by local business owners and wealthy individuals who are among the bank’s customers.

Some industry experts predict a wave of mergers and consolidation among community banks over the next three to five years. “Size matters, and a rule of thumb used by many industry experts is that most banks eventually will need to be $1 billion in assets or greater in order to achieve the scale necessary to operate as an independent entity,” according to a white paper published this year by FJ Capital Management, LLC. “The typical merger can save 20% to 40% in operating costs, thereby creating significant earnings accretion for the combined entity.”[25] FJ Capital estimated 413 banks are potential merger candidates because they were trading below tangible book value, and had substandard capital levels and/or elevated asset quality issues.[26]

Subchapter S Corporations (“S corporations”): Corporate form that passes corporate income, losses, deductions, and credit through to shareholders for Federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are taxed at their individual income tax rates.

THE IMPACT OF TARP ON COMMUNITY BANKS

The 2008 financial crisis set off shock waves that rippled through the U.S. economy and onto the balance sheets of community banks. Faced with frozen credit markets and a deteriorating housing market, nearly 3,000 financial institutions, including many community banks and thrifts, applied for the TARP-funded CPP after it was unveiled on October 14, 2008.[27] Of those, 707 were accepted into CPP; 351 small-and medium-sized banks remain, along with 83 financial institutions in CDCI, for a total of 434. Treasury describes CPP as a program to provide emergency support to "viable" banks.[28] There are signs that some CPP banks face difficulty in exiting TARP. Despite the dramatic efforts to expedite the exit of the largest banks from TARP, there appears to be no corresponding plan for community banks' exit from TARP. The only exit strategy for smaller banks that has been announced has been SBLF, through which 137 banks exited TARP. A SIGTARP analysis of the 351 banks that remained in CPP on March 31, 2012, shows one-third had missed five or more dividend payments, and 32% faced formal enforcement actions by their regulators.

TARP Provided Lifeline to Community Banks

Treasury created CPP in 2008 with a stated goal of injecting capital into viable financial institutions of all sizes with the expectation they would make new loans to consumers and businesses and help support the economy.[29] "This program is designed to attract broad participation by healthy institutions and to do so in a way that attracts private capital to them as well. Our purpose is to increase confidence in our banks and increase the confidence of our banks, so that they will deploy, not hoard, their capital," Treasury Secretary Henry Paulson, Jr. said at that time.[30] After receiving TARP money, small banks with assets under $2.5 billion "significantly decreased" risky new commercial loans compared with their non-TARP peers, according to FRB researchers who studied risk ratings of loans made from November 2007 through August 2010.[31] "This is the first evidence that the TARP capital infusions may have reduced risk-taking among the small banks," the researchers wrote in a recent discussion paper, adding that their overall level of commercial loans remained about the same as that of non-TARP small banks. Larger TARP banks, on the other hand, increased the riskiness of their loans without actually increasing lending, they found.

Under CPP, a community bank would give senior preferred stock and related warrants to Treasury and use TARP money to boost its Tier 1 capital, a high-quality form of capital that can be used to absorb losses. Each dollar of additional Tier 1 capital, in theory, gave a healthy bank the leverage to issue $10 in new loans and remain adequately capitalized under Federal banking regulations.[32] The smallest banks with assets up to $500 million were allowed to apply for a maximum of 5% of their risk-weighted assets. Larger banks could apply for up to 3% of their risk-weighted assets.[33]

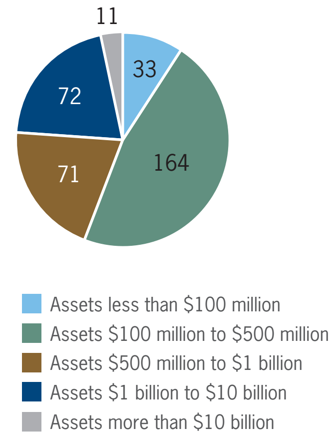
By the time CPP stopped investing in banks and thrifts, the program had handed out capital lifelines totaling nearly $205 billion to 707 financial institutions

of all sizes.[34] In return, each was to pay a 5% annual dividend to Treasury until it was able to repurchase its stock and warrants from the Government. In addition to paying the Government a quarterly dividend or interest payment, CPP banks and thrifts had to agree to limits on executive compensation, dividend payments to other shareholders, and stock repurchases.[35] As an incentive to exit the program, the dividend rate was scheduled to almost double to 9% five years after a bank entered the program, beginning in late 2013.

As of March 31, 2012, only 11 of the 351 institutions remaining in CPP had assets of more than $10 billion, the FRB's asset definition for regional banks. On April 4, 2012, Regions Financial Corporation, the largest of those 11 banks, exited TARP, leaving only 10 regional banks. Virtually all others were community banks. Significantly, more than half of the remaining TARP banks were small banks and thrifts holding less than $500 million in assets. Figure 3.1 shows remaining CPP institutions by asset size.

FIGURE 3.1

CPP BANKS BY ASSET SIZE, AS OF 3/31/2012



Source: SIGTARP analysis of SNL Financial data. Assets are from GAAP financials. If unavailable, regulatory filings were used. Financial information of subsidiary or subsidiaries was used if consolidated financials for holding company were unavailable.

In the Aftermath of the Crisis, Despite Some Positive Signs, Challenges Abound for Community Banks

While federal regulators now point to signs of improving health in the U.S. banking industry, the financial crisis and economic recession "have taken a serious toll" on community banks, Martin Gruenberg, acting FDIC chairman, said in a 2011 speech about the condition of the banking system.[36] Of the 396 FDIC-insured institutions that failed between January 1, 2008, and September 30, 2011, more than 300 were community banks, he said.[37] For comparison, a total of just 27 banks failed in the preceding eight years.[38] In response, the FDIC is studying how community banks and their business models have changed during the past two decades.[39] SIGTARP's tally of failed banks as of March 31, 2012, includes 16 community banks that received CPP funding before they were shut down.[40]

Despite a sluggish economy, banking experts see some positive signs for community banks. "Although the ratios of nonperforming assets remain high in many cases, asset quality appears to be stabilizing, and bank provisions for loan losses are decreasing. In addition, capital ratios are steadily improving at community banks, in part due to increases in retained earnings and a greater ability to raise new capital," FRB Chairman Ben Bernanke told a conference on community banking earlier this year.[41] An analysis of U.S. community banks' business loans under $1 million showed that the contraction in their commercial and industrial business portfolios since the 2008 financial crisis has "virtually stabilized," according to an October 2011 report by researchers at the Federal Reserve Bank of San Francisco.[42] However, that was not true of their small-business loans to commercial real estate developers.

Even though the worst days of the financial crisis have passed, community banks still face challenges. Many small banks were hit especially hard by the collapse in the commercial real estate market that was precipitated by the crisis and deepened in the recession that followed. Some had bulked up on commercial real estate loans ("CRE") in the decade before 2008 as they lost business to bigger

banks in other traditional products such as auto loans, home mortgages, and credit cards. A lending portfolio with a high concentration of CRE was especially vulnerable if the bank had failed to carefully monitor appraisal values and its total risk exposure to large borrowers with multiple loans. Analyses of failed banks suggest that a CRE concentration "proved disastrous for many community banks during the economic downturn," according to the senior bank examiner with the St. Louis Federal Reserve Bank.[43]

In 2010, the Office of the FDIC Inspector General issued a report that examined bank failures that occurred in 2009. That report found that FDIC examiners had not fully considered risky behaviors such as a bank's aggressive growth in CRE loans and in acquisition, development, and construction ("ADC") loans when assigning ratings of bank strength.[44] Ratings often focused on a bank's traditional financial data and failed to also take into account an excessive concentration of assets, ineffective executives or board members, lack of risk mitigation controls, and compensation that was tied to quantity of loans rather than quality. "Concentrations in CRE and ADC loans, coupled with inadequate risk management practices, have played a role in practically every failure that was the subject of an MLR [material loss review]," according to the report.[45]

Acquisition, development, and construction loans: Short-term loans used by real estate developers to buy land, add infrastructure, and construct buildings.

Banks Continue to Rely on TARP Funds

A key issue raised by SIGTARP early in the program was tracking the way CPP recipients used the taxpayer money they received, and how much of it was used to boost lending as intended when the program was created. When Treasury initially refused to require CPP institutions to report on their use of TARP funds, SIGTARP launched its own survey of 360 recipients early in 2009 and brought significant transparency, issuing a report that found the capital injections were primarily used by banks for lending, capital reserves, and investments. Most of the respondents — 309 banks — had assets under $10 billion.[46] SIGTARP reported, "The results of the survey demonstrate that, despite the inherent fungibility of money, financial institutions are capable of providing at least basic narrative descriptions of how they used TARP funds. Although most banks reported that they did not segregate or track TARP fund usage on a dollar-for-dollar basis, they were able to provide insights into their actual or planned use of TARP funds; indeed, more than 98% of survey recipients reported their actual uses of TARP funds. Moreover, the results show that institutions commonly have used TARP funds in ways that will not immediately or directly register on a bank's lending report."[47] Table 1.1 shows the findings of that survey by use of funds and institution size.

TABLE 1.1

RESULTS OF SIGTARP'S 2009 SURVEY ON CPP USE OF FUNDS, BY INSTITUTION ASSET SIZE

	Assets Less Than $100 Million	Assets $100 Million to $1 Billion	Assets $1 to $10 Billion	Assets More Than $10 Billion
Lending	54	87	113	46
Investment	12	31	40	27
Debt Payoff	11	10	26	5
Acquisition	1	1	8	5
Capital Cushion or Reserves	32	48	55	21
Total	**110**	**177**	**242**	**104**

Note: Many respondents reported multiple uses of funds.

Source: SIGTARP Survey of Initial CPP recipients, July 20, 2009.

In December 2008, SIGTARP recommended that Treasury require all TARP recipients to report on the actual use of TARP funds. After one year, in December 2009, Treasury finally agreed to implement SIGTARP's recommendation. Treasury also launched an annual survey in 2010 that asks each CPP recipient for a detailed, narrative description of what it is doing with capital received under the program.[48] Treasury publishes a monthly lending report that aggregates all CPP recipients' average outstanding balance for consumer loans and commercial loans.[49]

The latest annual survey results available from Treasury, for calendar year 2010, showed 82% of respondents said they had used TARP funds either to increase lending or to "reduce lending less than otherwise would have occurred."[50] Nearly half of the group said they used TARP funds to boost reserves for non-performing loans, and 45% said they applied the money toward their overall capital level. Meanwhile, 10% said they used TARP funds in 2010 to purchase another financial institution or assets from an institution.

One bank described how TARP funds allowed it to be aggressive in writing down problem loans in 2010. "Without CPP funds, there would have been a strain on capital that would potentially put the Company in a capital preservation mode and minimize the opportunity to seek new loans. We remained in a well-capitalized capital position with all of the regulatory benchmarks and without the infusion could have slipped into an adequately capitalized position, rather than well-capitalized," Georgia-based Colony Bankcorp, Inc. said on its use of funds survey form. The bank received $28 million and remains in TARP.[51]

Another Georgia bank, Ameris Bancorp, said it used TARP funds to participate in acquiring the assets of six failed banks from the FDIC. "If we had not taken the CPP funds, we would not be doing that or anything else to leverage capital. We had enough capital to maintain a cushion and an excess throughout this cycle otherwise, but the TARP funds allowed us to be more offensive and growth oriented," Ameris said on its 2010 use of funds survey.[52] It received $52 million in CPP capital and remains in TARP.

Community Banks Need New Capital to Exit TARP

To exit TARP, banks must obtain the approval of their primary Federal banking regulator, which determines if an institution is strong enough to maintain adequate capitalization after repaying the CPP funds. The regulator also weighs the impact on an institution's ability to lend and examines its internal capital assessment process.[53] The banks that have exited TARP so far have used capital from a variety of sources to pay back the Government, including selling assets, selling new common stock, selling debt securities, or accepting funds from other Government programs.

To exit TARP, in addition to paying Treasury to buy back the TARP preferred shares, bank holding companies must make up any dividend payments they missed.[54] However, banks that were not subsidiaries of holding companies issued non-cumulative preferred shares to Treasury and have no legal obligation to pay dividends to Treasury unless the institution declares a dividend to shareholders. These institutions do not have to repay skipped dividends or interest to exit TARP.[55]

Instead of a lump sum repayment, some publicly-traded banks have repaid Treasury's capital injection in installments, taking additional time to purchase the warrants, which Treasury is required to sell at a fair market value. In cases when Treasury and a publicly-traded bank were unable to negotiate a price for warrants, Treasury has held an auction to sell the warrants.[56]

TARP banks have also asked Treasury to restructure or exchange its investment. Treasury has said it is willing to consider restructuring proposals because it believes inaction may lead to a bank failing, which would mean a total loss for the taxpayer.[57] Treasury has agreed to more than two dozen restructurings and exchanges with CPP banks of all sizes since 2008. At least one of those banks, Midwest Banc Holdings Inc., failed after a restructuring in which Treasury exchanged $84.8 million in preferred shares for $89.4 million of mandatorily convertible preferred stock.[58] In weighing a restructuring request, Treasury told SIGTARP that it considers the effect restructuring would have on the bank's capital, and the overall impact on the taxpayer investment.[59] Terms of restructuring agreements often involve Treasury exchanging its CPP preferred shares for more junior forms of equity such as common stock, sometimes at a discount or loss.

SBLF AS AN EXIT STRATEGY FROM TARP FOR COMMUNITY BANKS

SBLF was created by the Small Business Jobs Act of 2010, with the stated intent of allowing Treasury to make capital investments in community banks in order to increase the availability of credit for small businesses.[60] Many community banks in CPP looked to SBLF as a way to refinance and exit TARP. Treasury received 935 applications to the program, of which 320 were from TARP banks (315 from CPP participants and five from CDCI participants).[61] Treasury gave SBLF funding to 332 institutions and invested $4 billion in those institutions.[62] Those included 137 community banks that refinanced from CPP into SBLF.[63] None of the CDCI institutions that applied received funding.[64] The 137 CPP banks received two-thirds of the total SBLF funding ($2.7 billion), while non-CPP institutions received one-third of the funding ($1.3 billion). Table 1.2 shows the 10 banks with the largest CPP investments that refinanced into SBLF. Nine of the 10 largest TARP banks that refinanced into SBLF also immediately repurchased TARP warrants from Treasury. Some may have used SBLF funds for their warrant repurchases.

TABLE 1.2

BANKS WITH THE 10 LARGEST TARP INVESTMENTS THAT WERE REFINANCED INTO SBLF ($ MILLIONS)

Institution	TARP Principal Investment	TARP Warrant Disposition Proceeds	SBLF Principal Investment
Western Alliance Bancorporation	$140.0	$0.4	$141.0
W.T.B. Financial Corporation	110.0	5.5	89.1
First Busey Corporation	100.0	0.1	72.6
Plains Capital Corporation	87.6	4.4	114.1
Heartland Financial USA, Inc.	81.7	1.8	81.7
TowneBank	76.5	—	76.5
First Merchants Corporation	69.6	0.4	90.8
First Bancorp	65.0	0.9	63.5
CoBiz Financial Inc.	64.5	0.1	57.4
Great Southern Bancorp	58.0	6.4	57.9

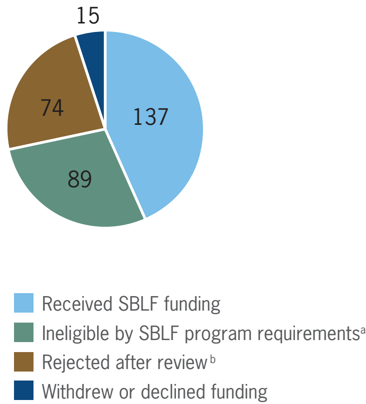
Notes: Numbers may be affected by rounding. Warrant disposition proceeds as of 3/31/2012.

Sources: Treasury, "*SBLF Transactions Report*," 9/28/2011, www.treasury.gov/resource-center/sb-programs/Pages/sblf_transactions.aspx, accessed 2/29/2012; Treasury, *Transactions Report*, 4/2/2012.

While the SBLF program provided an exit path from TARP for the 137 banks that took part, 390 banks remained in CPP as of the September 27, 2011, closing date of SBLF investing authority. Of those 390 banks, nearly half — 178 banks — had applied to the SBLF program, but did not receive funding.[65] The sheer number of CPP banks that applied indicates that SBLF was a key potential exit strategy for more than half of the community banks in CPP. The exit of 137 banks dwarfs the 28 banks that exited CPP to CDCI, another TARP program.[66]

FIGURE 3.2

RESULTS OF CPP BANK APPLICATIONS TO EXIT TARP THROUGH SBLF



Received SBLF funding
Ineligible by SBLF program requirements[a]
Rejected after review[b]
Withdrew or declined funding

Notes: This figure shows the disposition of the 315 applications of CPP banks to refinance through SBLF.

[a] Includes banks that were not current on dividends and interest (79), banks that had ever missed two TARP payments (3), and banks that were otherwise ineligible by statute (7).

[b] Includes banks that were rejected after review of the Application Review Committee (51), Investment Committee (17), Deputy Assistant Secretary (2), or by the bank's Federal banking authority (4).

Source: Treasury, "TARP Participants that Applied to SBLF," list provided to SIGTARP on 12/29/2011.

Seventy-nine CPP banks that applied to SBLF were not eligible to participate in SBLF because they were not current on TARP dividends or interest payments (in some cases because their federal or state regulators restricted their ability to pay dividends).[67] Other TARP banks were eliminated at various steps of the SBLF review process: four were rejected after review by their Federal banking regulator, 51 after first-level review by the application review committee, 17 after review by the investment committee, and two after review of the Treasury official overseeing the program.[68] Banks typically withdrew their application when they were informed they were ineligible or otherwise rejected for funding. Figure 3.2 shows the disposition of CPP bank applications to the SBLF program.

TARP Banks Received Larger SBLF Investments Than Other Banks

TARP banks received larger SBLF investments than non-TARP banks; 61% of TARP banks received investments of more than $10 million, compared with 22% of non-TARP banks that received more than $10 million.[69] The size of SBLF investment in TARP banks varied dramatically — from the smallest investment in a TARP bank of $700,000 to Farmers State Bankshares, Inc., to the largest investment in a TARP bank of $141 million to Western Alliance Bancorporation.[70]

Non-TARP banks that got SBLF funding tended to be smaller in size than TARP banks that exited TARP through SBLF. The size of the bank affected the amount of funding a bank could receive under SBLF. The average SBLF investment in TARP banks was nearly three times the size of the average non-TARP bank investment. The average TARP bank SBLF investment was $19.6 million, with a median investment of $12.6 million, compared with the average non-TARP bank SBLF investment of $6.9 million, with a median investment of $4.6 million.[71] Table 1.3 shows the size of SBLF investments for TARP and non-TARP community banks.

TABLE 1.3

BANKS IN SBLF, BY SBLF FUNDING AMOUNT

	Less than $10 Million	$10 to $20 Million	$20 to $30 Million	$30 to $50 Million	$50 Million or More
TARP Banks	53	37	26	9	12
Percent	*39%*	*27%*	*19%*	*7%*	*9%*
Non-TARP Banks	152	30	8	5	0
Percent	*78%*	*15%*	*4%*	*3%*	*0%*

Note: Numbers may be affected by rounding.

Sources: Treasury, *SBLF Transactions Report*, 9/28/2011, www.treasury.gov/resource-center/sb-programs/Pages/sblf_transactions.aspx, accessed 2/29/2012.

SBLF gave 124 of 137 TARP banks the full funding they needed to pay off TARP and gave 107 of those banks additional funds.[72] Thirteen banks combined SBLF funds and funds from other sources to exit TARP. Fifty-three TARP banks received an SBLF investment 50% or more larger than the TARP investment,

including 26 TARP banks that received an SBLF investment of double or more the TARP investment and two banks that received more than triple the TARP investment: Centrix Bank & Trust ($7.5 million in TARP funds compared to $24.5 million in SBLF funds) and Banner County Ban Corporation ($795,000 in TARP funds compared to $2.4 million in SBLF funds).[73] Eighteen TARP banks received at least $10 million more in SBLF funding than they had received in CPP investment, including three banks that received over $20 million more in SBLF funding.[74] Table 1.4 lists the 10 largest dollar increases in investment from TARP to SBLF.

TABLE 1.4

BANKS WITH THE 10 LARGEST INCREASES IN GOVERNMENT INVESTMENT FROM TARP TO SBLF ($ MILLIONS)

Institution	TARP Investment	SBLF Investment	Increase in Investment	% Increase
Plains Capital Corporation	$87.6	$114.1	$26.4	30%
Community Trust Financial Corporation	24.0	48.3	24.3	101%
First NBC Bank Holding Company	17.8	37.9	20.1	113%
First Guaranty Bancshares, Inc.	20.7	39.4	18.7	91%
Eagle Bancorp, Inc.	38.2	56.6	18.4	48%
Centrix Bank & Trust	7.5	24.5	17.0	227%
The ANB Corporation	20.0	37.0	17.0	85%
First Texas BHC, Inc.	13.5	29.8	16.3	120%
BOH Holdings, Inc.	10.0	23.9	13.9	139%
Northway Financial, Inc.	10.0	23.6	13.6	136%

Note: Numbers may be affected by rounding.

Sources: Treasury, *SBLF Transactions Report*, 9/28/2011, www.treasury.gov/resource-center/sb-programs/Pages/sblf_transactions.aspx, accessed 2/29/2012; Treasury, *Transactions Report*, 4/2/2012.

HEALTHIER BANKS EXITED TARP THROUGH SBLF

SIGTARP's analysis of the 390 banks that remained in CPP after SBLF versus the 137 that exited TARP through SBLF reveals differences in total asset size and geographical location. Analysis of indicators of bank financial health, including capital ratios, missed TARP dividends, and formal regulatory enforcement actions, shows that healthier banks exited TARP through SBLF and many weaker banks remain in TARP.

Total Asset Size

SBLF was not a program intended for larger banks because it limited participation to banks with $10 billion in assets or less. The SBLF program was a more viable TARP exit strategy for small to mid-sized community banks than it was for very

small or larger CPP community banks. Almost half (47%) of the CPP banks that exited TARP through SBLF had assets of $300 million to $1 billion.[75] Of the banks that remained in CPP as of September 30, 2011, after SBLF, 34% had assets of $300 million to $1 billion.[76] Only 10% of the CPP banks that exited TARP through SBLF had assets of less than $150 million, compared with 19% of the banks that remained in CPP.[77] Of the institutions remaining in CPP, 11 of the very largest institutions were too big for SBLF.[78] Table 1.5 provides a comparison of TARP banks that exited TARP through SBLF and those that remained in CPP as of September 30, 2011, after SBLF.

TABLE 1.5

TARP BANKS THAT REFINANCED INTO SBLF AND BANKS REMAINING IN TARP, BY ASSETS, AS OF 9/30/2011

	Less than $150 Million	$150-$300 Million	$300 Million -$1 Billion	$1-$5 Billion	More than $5 Billion
TARP Banks that Refinanced into SBLF	14	28	64	29	2
Percent	*10%*	*20%*	*47%*	*21%*	*1%*
Remaining TARP Banks	75	77	131	88	19
Percent	*19%*	*20%*	*34%*	*23%*	*5%*

Note: This table compares the 137 banks that refinanced from TARP into SBLF to the 390 banks that remained in TARP as of 9/30/2011.

Source: SNL Financial data. Assets are from GAAP financials. If unavailable, regulatory filings were used. Financial information of subsidiary or subsidiaries was used if consolidated financials for holding company were unavailable.

Geographic Location

TARP banks in the Southeast and in the Midwest were not as successful as banks in other regions in securing SBLF funding to exit TARP. More than 50% of TARP banks that applied to SBLF in the Western region, Southwest/South Central region, Mountain West/Plains region, and Mid-Atlantic/Northeast region received SBLF funding.[79] In sharp contrast, only 16 of the 71 TARP banks (23%) in the Southeast that applied to SBLF were accepted.[80] Only 33 of the 88 TARP banks (38%) in the Midwest that applied to SBLF received SBLF funding.[81] As a result, the Southeast and Midwest regions are home to the largest population of banks remaining in TARP after SBLF investments were made. After SBLF, there were 98 Southeastern banks left in TARP and 116 Midwestern banks left in TARP.[82] Tables 3.6 through 3.12 show a breakdown by region and state of banks that were accepted into SBLF compared with the 390 that remained in CPP as of September 30, 2011. (Regions were defined to align with the definitions of regions that Treasury uses in its monthly report to Congress on the status of TARP.)

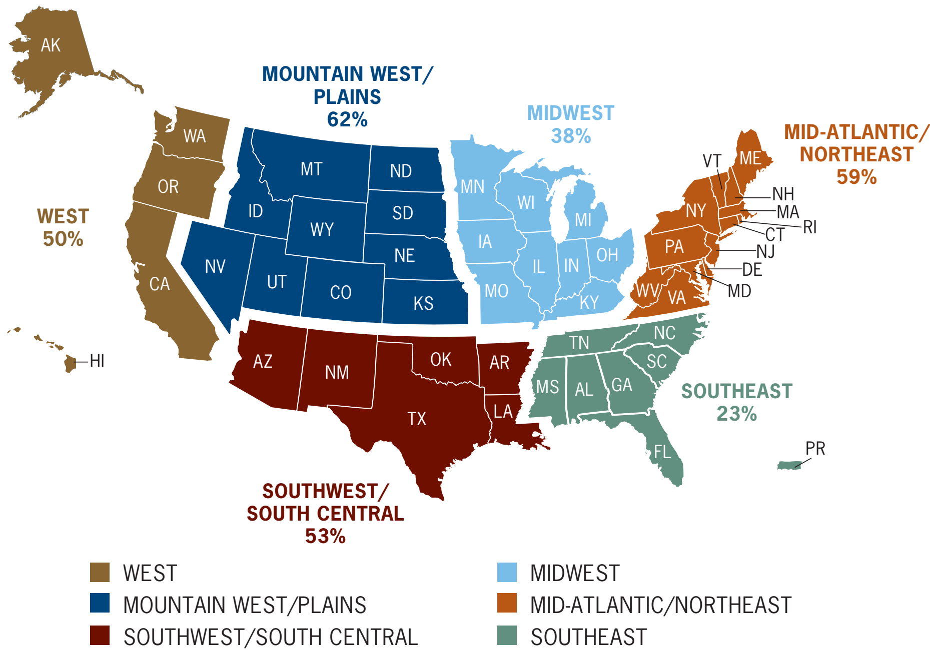
TABLE 1.6

TARP BANKS THAT REFINANCED INTO SBLF AND BANKS REMAINING IN TARP, BY REGION, AS OF 9/30/2011

	Applied to SBLF	Refinanced into SBLF	Percentage Funded	Remaining in TARP
West	36	18	50%	48
Mountain West/Plains	26	16	62%	32
Southwest/South Central	30	16	53%	33
Midwest	88	33	38%	116
Mid-Atlantic/Northeast	64	38	59%	63
Southeast	71	16	23%	98
Total	**315**	**137**	**43%**	**390**

Note: Numbers may be affected by rounding.

FIGURE 3.3 PERCENTAGE OF CPP APPLICANTS TO SBLF THAT RECEIVED SBLF FUNDING, BY REGION



West

TABLE 1.7

TARP BANKS THAT REFINANCED INTO SBLF AND BANKS REMAINING IN TARP, BY STATE, AS OF 9/30/2011

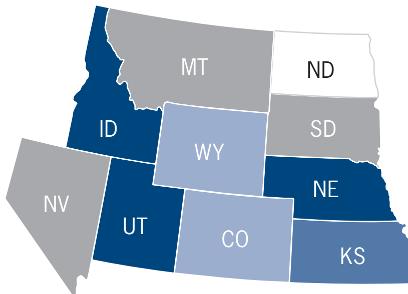
	Applied to SBLF	Refinanced into SBLF	Percentage Funded	Remaining in TARP
AK	1	0	0%	1
CA	27	15	56%	36
HI	0	0	—	1
OR	2	0	0%	3
WA	6	3	50%	7
Total	**36**	**18**	**50%**	**48**

Note: Numbers may be affected by rounding.

Mountain West/Plains

TABLE 1.8

TARP BANKS THAT REFINANCED INTO SBLF AND BANKS REMAINING IN TARP, BY STATE, AS OF 9/30/2011



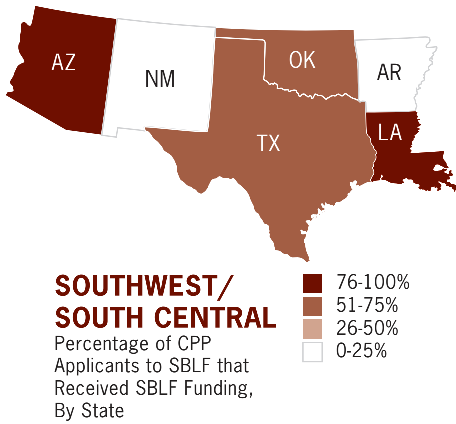
	Applied to SBLF	Refinanced into SBLF	Percentage Funded	Remaining in TARP
CO	6	3	50%	8
ID	1	1	100%	3
KS	9	6	67%	9
MT	0	0	—	0
ND	3	0	0%	3
NE	3	3	100%	5
NV	0	0	—	1
SD	0	0	—	0
UT	2	2	100%	2
WY	2	1	50%	1
Total	**26**	**16**	**62%**	**32**

Note: Numbers may be affected by rounding.

Southwest/South Central

TABLE 1.9

TARP BANKS THAT REFINANCED INTO SBLF AND BANKS REMAINING IN TARP, BY STATE, AS OF 9/30/2011



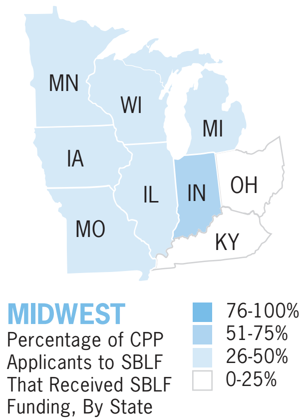
	Applied to SBLF	Refinanced into SBLF	Percentage Funded	Remaining in TARP
AR	7	1	14%	7
AZ	1	1	100%	3
LA	5	4	80%	4
NM	1	0	0%	3
OK	4	3	75%	2
TX	12	7	58%	14
Total	**30**	**16**	**53%**	**33**

Note: Numbers may be affected by rounding.

Midwest

TABLE 1.10

TARP BANKS THAT REFINANCED INTO SBLF AND BANKS REMAINING IN TARP, BY STATE, AS OF 9/30/2011



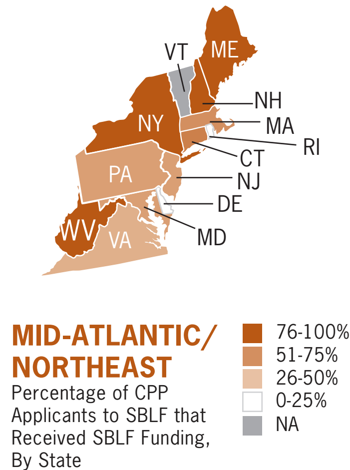
	Applied to SBLF	Refinanced into SBLF	Percentage Funded	Remaining in TARP
IA	4	2	50%	5
IL	22	7	32%	27
IN	8	5	63%	8
KY	6	1	17%	11
MI	5	2	40%	9
MN	7	3	43%	12
MO	18	8	44%	22
OH	6	0	0%	10
WI	12	5	42%	12
Total	**88**	**33**	**38%**	**116**

Note: Numbers may be affected by rounding.

Mid-Atlantic/Northeast

TABLE 1.11

TARP BANKS THAT REFINANCED INTO SBLF AND BANKS REMAINING IN TARP, BY STATE, AS OF 9/30/2011



MID-ATLANTIC/ NORTHEAST
Percentage of CPP Applicants to SBLF that Received SBLF Funding, By State

76-100%
51-75%
26-50%
0-25%
NA

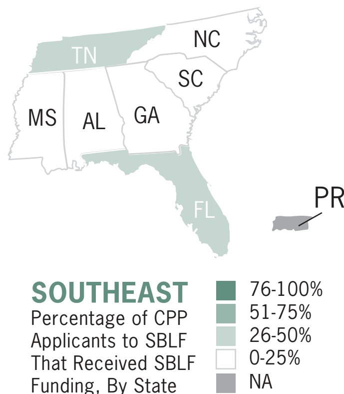
	Applied to SBLF	Refinanced into SBLF	Percentage Funded	Remaining in TARP
CT	4	3	75%	1
DE	1	0	0%	1
MA	3	2	67%	2
MD	8	4	50%	10
ME	1	1	100%	2
NH	5	5	100%	1
NJ	8	4	50%	9
NY	3	3	100%	5
PA	18	10	56%	14
RI	1	0	0%	1
VA	11	5	45%	16
VT	0	0	—	0
WV	1	1	100%	1
Total	**64**	**38**	**59%**	**63**

Note: Numbers may be affected by rounding.

Southeast

TABLE 1.12

TARP BANKS THAT REFINANCED INTO SBLF AND BANKS REMAINING IN TARP, BY STATE, AS OF 9/30/2011



SOUTHEAST
Percentage of CPP Applicants to SBLF That Received SBLF Funding, By State

76-100%
51-75%
26-50%
0-25%
NA

	Applied to SBLF	Refinanced into SBLF	Percentage Funded	Remaining in TARP
AL	5	1	20%	7
FL	6	2	33%	14
GA	11	0	0%	20
MS	4	1	25%	3
NC	16	4	25%	21
PR	0	0	—	2
TN	17	6	35%	15
SC	12	2	17%	16
Total	**71**	**16**	**23%**	**98**

Note: Numbers may be affected by rounding.

Financial Health

SBLF culled a large number of the healthier community banks from TARP, leaving less-healthy banks in TARP that had less capital, had missed dividends, or, in many cases, were subject to enforcement actions by their regulators. No banks received SBLF investments if they were delinquent on their TARP dividends and interest payments or were subject to enforcement actions by their regulators.

Capital Status

The banks that exited TARP through SBLF were better capitalized and financially stronger than those that remained in TARP. Capital ratios are one widely used measure of the health of a financial institution. One of the most closely followed is called a Tier-1 common risk-based capital ratio.[83] That ratio compares an institution's core equity capital to its risk weighted assets, excluding preferred shares and non-controlling interests. TARP investments are not considered equity in this calculation. The higher the ratio, the healthier the bank. As one benchmark, under the international banking capital standards known as Basel III, which are being phased in worldwide but have not been adopted in the United States, banks would effectively be required to maintain Tier 1 common risk-based capital ratios of 7%.[84] Among the 19 largest U.S. banks, that ratio on aggregate in the third quarter of 2011 was 10.1%, according to the Federal Reserve.[85]

The average Tier 1 common risk-based capital ratio in the third quarter of 2011 for TARP banks that refinanced into SBLF was 11.7%, with 59.6% with ratios over 11% and only 3.7% with ratios under 7%.[86] In contrast, for banks remaining in CPP as of September 30, 2011, the average Tier 1 common risk-based capital ratio was 10.25%, but 20.2% had ratios under 7%.[87]

Table 1.13 shows the Tier-1 common risk-based capital ratios for the community banks accepted into SBLF compared with the banks that remained in CPP as of September 30, 2011.

TABLE 1.13

TARP BANKS THAT REFINANCED INTO SBLF AND BANKS REMAINING IN TARP, BY TIER 1 COMMON RISK-BASED RATIO, AS OF 9/30/2011

	Less than 7%	7-8.9%	9-10.9%	11-12.9%	More than 13%
TARP Banks that Refinanced into SBLF	5	23	27	39	42
Percentage	*4%*	*17%*	*20%*	*29%*	*31%*
Remaining TARP Banks	78	61	71	84	92
Percent	*20%*	*16%*	*18%*	*22%*	*23%*

Notes: Percentages may not add to 100 due to rounding. This table compares the 137 banks that refinanced from TARP into SBLF to the 390 banks that remained in TARP as of 9/30/2011. Tier 1 common risk-based ratios were not available, and not included in this table, for four banks remaining in TARP (Blue River Bancshares, Inc.; First Financial Holdings, Inc.; Santa Lucia Bancorp; and Tennessee Commerce Bancorp.) and for one bank that refinanced into SBLF (MutualFirst Financial Inc.).

Source: SNL Financial data; if information was unavailable at the holding company level, data from largest banking subsidiary was used.

Missed TARP Dividend Payments

One sign of the squeeze facing community banks is the number that have missed CPP dividend or interest payments to the Government. Of the 351 banks remaining in TARP as of March 31, 2012, there were 163, or 46%, that were not current in making dividends and interest payments totaling $306 million.[88] (Other CPP banks have missed dividends and subsequently failed, filed for bankruptcy, or were sold or restructured, sometimes at a loss to Treasury). Of those 163 banks, 116 had missed five or more payments.[89] Ninety-five of those institutions had missed six or more payments, which gives Treasury the right to appoint directors to their boards. Treasury had appointed directors at only nine of those institutions as of March 31, 2012, but not the rest.[90] Table 1.14 lists institutions still in CPP that had missed payments as of March 31, 2012, by bank asset size.

TABLE 1.14

MISSED DIVIDEND OR INTEREST PAYMENTS, BY BANK SIZE, AS OF 3/31/2012

	Assets Less Than $100 Million	Assets $100 to $500 Million	Assets $500 Million to $1 Billion	Assets $1 to $10 Billion	Assets More Than $10 Billion	Total
1 or 2 missed payments	2	10	0	3	1	16
3 to 5 missed payments	6	24	10	12	0	52
6 to 9 missed payments	6	38	14	11	1	70
10 or more	1	13	6	5	0	25
Total	**15**	**85**	**30**	**31**	**2**	**163**
Percent	*9%*	*52%*	*18%*	*19%*	*1%*	

Notes: Numbers may be affected by rounding. Banks paid dividends on preferred shares held by Treasury. Mutual banks and savings institutions made interest payments on debt securities held by Treasury because they are not allowed to sell preferred shares.

Sources: Treasury, *Dividends and Interest Report*, 4/10/2012; SIGTARP analysis of SNL Financial data. Assets are from GAAP financials. If unavailable, regulatory filings were used. Financial information of subsidiary or subsidiaries was used if consolidated financials for holding company were unavailable.

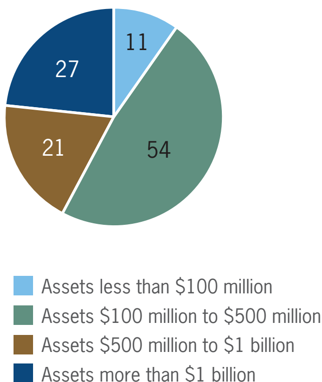
Regulatory Enforcement Orders

About one-third of the banks that remained in CPP on March 31, 2012, faced formal enforcement orders from their Federal regulators. Banking regulators have many informal and formal enforcement powers when a bank examination raises safety and soundness concerns. These actions range from informal written commitments to formal enforcement actions such as cease-and-desist orders, written agreements, and orders calling for "prompt corrective action."[91]

More than half of the pending formal enforcement orders against CPP banks involved smaller community banks, with assets less than $500 million; three-quarters involved banks with assets less than $1 billion.[92] The orders set deadlines spelling out specific steps that must be taken by bank executives, such as reducing CRE loan concentration, creating independent loan review procedures, or hiring a consultant to assess the performance of current management. Figure 3.4 shows formal enforcement actions outstanding against CPP institutions as of March 31, 2012.

FIGURE 3.4

FORMAL ENFORCEMENT ACTIONS AGAINST CPP BANKS BY ASSET SIZE, AS OF 3/31/2012



Assets less than $100 million
Assets $100 million to $500 million
Assets $500 million to $1 billion
Assets more than $1 billion

Note: Banks that had both a pending FRB Written Agreement and a Cease and Desist Order on 3/31/2012 were included only in the FRB category and not counted twice.

Source: FRB, OCC, FDIC, OTS enforcement databases.

RECENT DEVELOPMENTS

The number of banks in CPP has fallen from 390 on September 30, 2011, after SBLF, to 351 as of March 31, 2012:

- 27 banks have paid back CPP in full
- 8 banks have been sold at a loss
- 1 bank merged with another CPP bank
- 3 banks have failed

SBLF provided a way out of CPP for 137 TARP banks. How the banks that remain in TARP as of March 31, 2012, will leave TARP remains unclear. Those banks that remain in the program face a steep increase in their dividend rates next year, from 5% to 9%.

Because of the situation facing community banks in TARP, on October 11, 2011, two weeks after SBLF closed to new entrants, SIGTARP made two recommendations urging that Treasury must take action on community banks. One recommendation called for Treasury, working in consultation with Federal banking regulators, to "develop a clear TARP exit path to ensure that as many community banks as possible repay the TARP investment and prepare to deal with the banks that cannot." The second called for Treasury to "assess whether it should renegotiate the terms of its Capital Purchase Program contracts for those community banks that will not be able to exit TARP prior to the dividend rate increase in order to help preserve the value of taxpayers' investments." Getting these banks back on their feet without Government assistance must remain a high priority of Treasury and the Federal banking regulators.

For more on these recommendations regarding community banks, see SIGTARP's October 2011 Quarterly Report, pp. 7-8 and 167-169.

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