AMERICAN BANKERS ASSOCIATION ®

CEO Alert

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TO: Bank CEOs

FROM: Ed Yingling, President
Diane Casey-Landry, COO

RE: Treasury's Capital Purchase Program

Thousands of well capitalized banks throughout the country that are making solid loans and serving their communities are justifiably angry because the word "bank" is being used to describe failed financial institutions that are not, in fact, banks. Adding to the anger is concern about the public perception of the steps being taken by Congress to address the crisis and the implications of banks' participation.

Since the announcement by Treasury of its Capital Purchase Program (CPP) under the emergency legislation recently passed by Congress, we've talked to — and heard from — many of you. You've shared your many questions, concerns and opinions about the Treasury program. Some of the questions have clear answers; others do not.

The Nov. 14 deadline for deciding whether to participate in the Treasury CPP is fast approaching. Yesterday, we sent a letter to Treasury asking for an extension of this deadline and for the terms under which mutual institutions, Sub S banks and some non-publicly traded banks could participate to be announced. After meeting with Treasury staff, we are optimistic that they are open to our suggestions on how to make the CPP work for all types of banks. We believe they will extend the deadline for Sub S, non-publicly traded and mutual institutions, but so far they're not inclined to extend the deadline for publicly traded banks that qualify now. It's a complicated plan, with many potential ramifications. To help those of you who have to make a decision, here are some factors to consider:

How Would You Use the Capital? As we reminded Treasury and the media, the vast majority of the banking industry today is highly capitalized. Nevertheless, many banks would like to raise additional capital if they can do so on reasonable terms. Treasury has emphasized that they hope that banks would use the capital to expand lending and other financial services. Some banks may need more capital to sustain activities to meet community credit needs and others may want to take advantage of additional lending opportunities.

Treasury also believes that additional capital can assist in the acquisition of weakened banks by stronger institutions. We are extremely troubled that, under today's accounting practices, such an acquisition can seriously dilute the capital of the acquiring bank by forcing a mark-to-market of all of the assets of the acquired bank. For that reason alone, it's no surprise that few such mergers are taking place.

There are other banks that, due to hits on their Fannie Mae and Freddie Mac preferred stock, have seen their capital dip below the 10 percent divide between "adequately capitalized" and "well capitalized" status. A shot in the arm of capital could help these banks become stronger participants in economic expansion in their communities.

We believe Treasury will approve applications in the above cases. However, Treasury has repeatedly made it clear that it does not envision the CPP being available for troubled banks, except perhaps as a catalyst for significant additional private capital investment.

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We are very concerned about cases in which regulators appear to be pushing hard for banks that are well capitalized and do not want to use the CPP to participate anyway. We told Treasury of our concern about the possible stigma attached to banks' decisions to participate (or not participate) and misperceptions about their health. **If you have experienced such pressure, please let us know, as it will strengthen the case we're making with Treasury.**

How Much Will It Cost? This is not an easy question to answer. Here are some of the factors going into that calculation. There is the nominal price — the initial 5 percent dividend on the preferred shares to be issued to the Treasury, which rises to 9 percent after five years. **Tax experts caution that this 5 percent (and later 9 percent) dividend would likely be paid on an after-tax basis; that is, these payments would not be tax deductible. That could significantly add to the cost of the dividend.** Added to this is the potential cost of the warrants on common shares that also must be issued to Treasury, equal to 15 percent of the Treasury investment. There are also the limitations on executive compensation and related tax treatment.

We share bankers' concern about strings that may be attached to taking public money. Examiners will be checking to see if loans have been made. Suggestions have been raised that banks that receive capital investments should engage in foreclosure forbearance or restrict lobbying activities. **We will fight on every front in Congress to make sure that banks that didn't have anything to do with the problem don't find themselves buried in regulations more appropriately aimed at others.**

What Will My Customers Think? If a bank receives a capital investment from Treasury, will its customers call it a bailout? This is an enormous concern that we've raised with Secretary Paulson. Perception is still reality, and in the eyes of many customers and the media, it's a bailout, no matter how many times Treasury says that the capital is for healthy institutions. Most banks have never made a single subprime loan. They've watched Wall Street boom and bust and receive handouts. Many banks will not participate in the CPP if it continues to be perceived by their customers as a bailout for troubled institutions. Yet it's also possible that if a banker doesn't participate and competitors do, customers or the media might think they were turned down.

This is a voluntary program, and there are good business reasons why a bank may choose to participate. This is a message we'll be hammering in the media, just as we are pressing Treasury and the regulators to do.

Regardless of what you decide, it's important that you have a good feel for the outcome before you apply. Make informal inquiries first with your federal and state regulators to discuss your situation, conditions and concerns. (Rejections won't be made public, and we expect the regulators to tell banks if they're likely to be turned down.) Discuss the program with your board. The regulators will be analyzing all applications before they go to Treasury for final action.

We will continue to provide details on our Web site — www.aba.com — as we learn them in our discussions with Treasury and the regulators. Our comprehensive staff resources are also available to field questions and provide information as you make your decision.

Next Monday at 2 p.m. Eastern time, we'll be hosting a free, members-only call to discuss participation in the CPP by non-exchange traded public companies and privately held companies, including Sub S corps and mutuals. The main purpose of the call is for members to identify issues that will need to be resolved in order for them to participate in the CPP, although other issues of general applicability (like the executive compensation restrictions) may be discussed as well. ABA staff will forward the issues to Treasury for their consideration as they prepare term sheets for each type of institution. While members are welcome to dial in for the entire call, you can also choose to participate in only that portion that will apply to your institution. We'll spend 15-20 minutes on each of the following institutions, in the following order: (1) publicly traded institutions whose stock is not traded on an exchange; (2) privately held institutions; (3) S corps; and (4) mutuals. To register, go to http://www.aba.com/Members+Only/CPP110308.htm.

We want to hear your views. Please continue to contact us and to use ABA staff to increase your understanding of this program. We're here to help you in any way we can.