The Washington Post

Wednesday, April 1, 2009

NATIONAL

Economy & Business

Four Banks Are First to Return U.S. Aid

Early Repayments Could Hurt Lending

By Binyamin Appelbaum
Washington Post Staff Writer

522 companies have received . . . **$198.6 billion** in public aid.

4 of those firms have repaid . . . **$338 million** to the Treasury Department.

Four regional banks from around the country yesterday became the first firms to repay emergency aid from the government, but the show of strength also underscored concerns about the health of a key element of the federal economic recovery program.

The Treasury Department has invested almost $200 billion in more than 500 banks to support new lending to consumers and businesses, but the growing clamor among recipients to repay the aid earlier than planned threatens to diminish the impact.

The largest bank to exit, Signature Bank of New York, which returned $120 million, said it was acting to avoid the effects of congressional restrictions on aid recipients, including limits on pay that could drive away its most productive employees. Chief executive Joseph J. DePaolo also said that the aid had become an undeserved scarlet letter because of public perception that the program was being used to save troubled banks, rather than buttressing healthy firms.

"We didn't want to be subject to taxpayer and lawmaker outrage," DePaolo said.

Other returns included $100 million from Old National Bancorp of Indiana, $90 million from IberiaBank of Louisiana and $28 million from California's Bank of Marin Bancorp.

The repayments are the latest challenge for the investment program, which was introduced in November with the stated goal of investing $250 billion in thousands of banks. The Treasury immediately put half the money in the largest banks but since has distributed less than 60 percent of the remaining funds.

Most of the money has gone to the nation's 25 largest banks, which did not increase lending. Lending by the five largest banks fell at an annualized rate of 16 percent in the fourth quarter, Federal Reserve Governor Elizabeth Duke said in a speech Monday. Lending by the next 20 largest banks fell at an annual rate of 4.25 percent, Duke said.

Officials have said that the investments prevented an even larger decline. "We're pleased with the success of this voluntary program, which has helped bank lending remain resilient in the face of a severe economic downturn," a Treasury spokesman said yesterday.

The concern now is that repayments by healthier banks will pressure less healthy banks to follow suit when they should conserve resources and that it will damage confidence in banks that cannot repay the money.

The departures reflect changes in the original program. The Bush administration imposed few restrictions on recipients. But Congress grew increasingly convinced that the terms were too lenient, in part because aid flowed disproportionately to troubled banks.

In February, Congress imposed tighter pay limits on aid recipients. At the same time, it eliminated a requirement that companies raise money from private investors to replace the government funds, basically opening the exits for healthier banks. Companies still must secure permission from the Treasury, which is advised by the banks' primary regulator.

So far, only smaller banks have announced repayment applications. The largest, TCF Financial of Minnesota, is less than 1 percent the size of Bank of America. Several larger banks, including Goldman Sachs and Northern Trust, have expressed interest, but have not announced applications.

The Treasury has estimated that banks may return as much as $25 billion in the near term, about 13 percent of the money invested so far. The government still is reviewing hundreds of applications for federal aid, and a Treasury spokesman said it will continue making new investments.

President Obama told chief executives of the nation's largest banks last week that the administration would allow repayment only if a bank's lending capacity was unaffected. A Treasury spokesman yesterday declined to comment on whether that standard applied to smaller banks.

The strict application of such a standard would require a bank to raise replacement funds from investors. But yesterday's repayments make clear that the Treasury is applying a looser definition. The Bank of Marin, for example, said it borrowed the money it used to repay the government instead of raising capital to do so.

Banks seeking permission to repay the Treasury, however, argue that compensation restrictions are the real threat to lending. Neil M. Barofsky, the special inspector general who oversees the investment program, testified before Congress yesterday that a survey of nearly 400 aid recipients found widespread concern that limits on pay will hamper retention of top employees, putting aid recipients at a competitive disadvantage.

Investors in the four banks that returned money yesterday cheered the decision. Shares of Old National Bank climbed 8 percent yesterday. Signature Bank and IberiaBank were up 6 percent. Bank of Marin Bancorp was up 2 percent.

Staff writers David Cho and Amit R. Paley contributed to this report.