DATE: April 25, 2010

TO: Congressional Oversight Panel for TARP
Elizabeth Warren – Chair

FROM: Lynne B. Herndon
Phoenix City President of BBVA Compass

RE: Testimony on the Impact of the Recession on Small Business Loan Demand

I. BBVA Compass Bank Profile

BBVA Compass began its banking operations in the United States as Compass Bank. Compass was founded in 1964 and headquartered in Birmingham, Alabama. At inception, Compass was primarily a Southeastern regional bank but later expanded into Texas and further west into Arizona with operations across the "Sunbelt" states. BBVA, headquartered in Madrid, Spain, acquired Compass Bank in 2008. Having already owned smaller banks in the United States, these BBVA bank operations were merged into BBVA Compass. BBVA, our parent company, has over $750 Billion in assets and is the 7th largest bank in the world by market capitalization.

BBVA Compass in the United States has approximately $85 Billion in assets today. Our Tier I Capital ratio is 10.86% and our Leverage ratio is 8.20%. While our non-performing and charge-off trends are higher than historical numbers, we are below our peer group. This performance coupled with capital injections from our parent has enabled BBVA Compass to continue to loan money to business owners throughout 2008, 2009 and 1st quarter 2010.

Retail, Wealth Management and Commercial Lending operations all contribute to the total bank results for Phoenix. As of 3/31/2010, Total Loans for all three business segments in Phoenix, Arizona totaled $1.6 Billion and Total Deposits totaled $1.8 Billion. BBVA Compass ranks 6th in deposit share with 2.54% share in Phoenix. It should be noted that almost 70% of the deposit market share is held by Bank of America, Wells Fargo and Chase. BBVA Compass has 49 branches or 5.11% market share in Phoenix.

BBVA Compass also has bank operations in Tucson, Flagstaff, Prescott and Payson. Branches in these cities coupled with branches in Phoenix give BBVA Compass a total of 77 branches in Arizona. Total Loans from these cities aggregate over $700 Million.

Currently, the Commercial and Industrial portfolio in Phoenix has 2,394 loans totaling $647Million: Loans less than $250,000 - 1,879 loans totaling $78 Million; Loans greater than $250,000 – 515 loans totaling $569 Million.

II. Market Conditions / Loan Demand

BBVA Compass has a commercial bank focus. Market entry is determined by cities with strong population and business growth. As one looks across our footprint, targeted cities were Phoenix, Denver, Dallas, Houston, Birmingham and Jacksonville, all due to favorable population and business trends. BBVA Compass is a preferred SBA Lender and has had strong business loan growth with the SBA programs.

BBVA Compass offers working capital lines of credit, equipment loans and owner occupied real estate loans to businesses. In addition, BBVA Compass looks to offer banking products to owners, officers and employees of these businesses. We are traditionally a recourse bank and utilize the SBA to enhance loans requests to under-capitalized or start-up companies.

Clearly, the demand for loans was greater in 2005, 2006 and 2007. The escalation of the real estate market in Phoenix brought tremendous growth to feeder businesses in the construction industry. Existing businesses grew and newly formed businesses emerged. As a result, competition among the banks increased with structure and pricing becoming more aggressive. Phoenix experienced unprecedented real estate appreciation, and businesses experienced unprecedented profitability. Unfortunately, both of these trends could not be sustained long-term.

In the 4^{th} Quarter of 2008, business owners experienced a dramatic halt in revenues. During this quarter and in 2009, business owners struggled to reset the expense structures of their companies in response to the 50 - 75% reduction in top line revenues. Liquidity and capital were drained as businesses needed excess reserves to fund losses. Companies put expansion plans on hold and tried to curb borrowing where possible. Loan demand dropped dramatically during this period.

BBVA Compass continued to make business loans during 2008 and 2009 and is doing so currently. While the bank's structure and terms were similar to previous years, it was and is challenging to underwrite borrowers in the current economic environment. Most companies recorded a loss in 2009 and some in 2008. 2010 looks to be breakeven at best for many companies. These profitability trends are challenging for banks given that we have to maintain higher levels of capital in order to carry watchlist loans. In other words, banks must have higher levels of capital in order to continue to bank existing credits that have had poor performance or in order to entertain new loans to companies coming off of poor performance.

In order to compensate for poor performance in previous years, BBVA Compass is placing more emphasis on strong sponsorship, higher levels of equity in real estate or excess availability in borrowing bases. Underwriting the economic risk is more difficult and access to liquidity is important. Companies still in business in 2010 have probably weathered the worst and should be survivors. These borrowers are most likely creditworthy. Banks are now able to obtain appropriate pricing for market risk in deals.

While other parts of the country have experienced harsh economic conditions, Phoenix may be among the cities most impacted. Phoenix has to find a way to replace thousands of jobs lost due to the downturn in the real estate industry. Quite frankly, we need to bring new industry to Phoenix in order to propel job growth forward once again. The deficit state budget issues are further complicating, though, since we need to make business relocation to Phoenix more attractive.

III. Impact of TARP and the Current Regulatory Environment

BBVA Compass did not take TARP monies nor has our parent company taken any government assistance in Spain. BBVA Compass has received capital injected from our parent company which has enabled us to properly reserve while maintaining better than guidelines Tier I and Leverage ratios.

BBVA Compass and other banks need to continue the business of lending. We are beginning to see loan demand rise. Although it will not return to the high demand level of 2006 and 2007, it is beginning to rise as business owners are seeing slight economic improvement or least perceive that we have hit bottom in Phoenix. Requests for replacement equipment or owner occupied real estate given that values have been reset to more realistic levels are being made by borrowers. This is a good sign.

Therefore, we do need large, mid-size and community banks able to loan money. While I firmly believe that regulation is necessary and positive for banks, businesses and consumers, I also believe that in these unprecedented times, we need the ability to avoid the pitfalls of the past but manage out of where we are today. It is countercyclical and self-defeating to require additional capital when economic times are bad and less capital when economic times are good. Further, if bank's are properly reserved, this should be a full credit to the bank's capital soundness. In short, continued requirements for more capital will prevent many banks from loaning money to creditworthy businesses.

While this hearing is not about commercial real estate, the impact of commercial real estate in Phoenix and for Phoenix banks is critical to the ability of bank's to loan money to business owners. Many banks in Phoenix are beyond the current capital guidelines for commercial real estate and so much so that the ability to make business loans is impacted. Many banks are shrinking their overall balance sheets in order to come closer to the guidance. Unfortunately, in many cases, this means asking creditworthy borrowers to leave as these are the loans most easily placed at another bank. Also, if a bank has chosen to charge off a portion of a loan, in effect right size it to the income stream from the property, the remaining loan is classified and requires additional capital. If, however, a bank were able to treat the loan as restructured as a pass credit, capital requirements would be lower. All of these requirements serve to dampen lending in a time when we need to be expanding.

The non-regulated firms, ie mortgage brokers, investment firms etc., played a large role in the financial debacle we have experienced. On the other hand, banks for many years have functioned in a regulatory environment. Most banks have their own internal audit and review teams that are at work providing oversight year round even when the regulatory bodies are not at their institution. We need to ensure that all firms able to loan money are under equal regulatory governance as the banks have been for many years. More regulation is not the answer but rather regulation for all in the lending business is the key to future soundness.