TO: **Congressional Oversight Panel for Troubled Asset Relief Program (TARP) – Elizabeth Warren, Chair**

FROM: **James H. Lundy, President/CEO of Alliance Bank of Arizona (Alliance Bank)**

RE: **A community banker perspective on the impact of the economic recession on small business loan demand and credit availability in Arizona and the efficacy of current and proposed TARP initiatives on encouraging small business lending.**

DATE: **April 27, 2010**

I. Alliance Bank Profile

Alliance Bank is a state-chartered bank which opened for business in February 2003. As of 3/31/10, Alliance had $1.370 billion in total assets, $1.237 billion in deposits and $783 million in loans. It operates out of ten offices and serves Arizona's two primary population areas (Greater Phoenix and Tucson), as well as the northern Arizona communities of Flagstaff, Sedona and Village of Oak Creek. Alliance is primarily focused on delivering commercial banking products to Arizona based businesses as well as retail banking services to the owners and employees of its business customers and other individuals seeking a personalized banking relationship. With $984 million in deposits at year end 2009, Alliance controlled approximately 1.3% of Arizona's deposits, placing it third among Arizona-based banks in deposit share and 11th overall out of some 80 banking institutions operating in Arizona. (In Arizona, three large national banks, JP Morgan Chase, Wells Fargo and Bank of America, control approximately 70% of all deposits.)

Alliance Bank is a wholly owned subsidiary of Western Alliance Bancorporation, a five bank western regional banking holding company with headquarters in Las Vegas, Nevada. As of 12/31/09, Western Alliance had total assets of $5.8 billion, deposits of $4.7 billion and loans of $4.1 billion, ranking it 88th in size out of 520 publicly held banking companies in the United States.

II. Description of Alliance Bank's loan composition.

A. Alliance Bank focuses its lending efforts almost entirely within the state of Arizona, responding to the commercial and industrial (C&I) and commercial real estate borrowing needs of local business owners and professionals. As of December 31, 2009, the Bank's loan portfolio was composed as follows:

	$ in million Outstandings
C & I Loans & Leases	190
Commercial Real Estate (owner occupied)	209
Commercial Real Estate (construction & land)	104
Commercial Real Estate (investor term loans)	138
Residential RE & Consumer, all types	104
Total	$ 745

Total # of loan customers 1,363
Average loan size $547,000

B. Meeting the needs of the local community (CRA Statistics):

The table below displays a distribution of the Bank's loans made from January 2007 through December 31, 2009 which meet the definition of "small business loans" for purposes of CRA assessment.

	Number of Loans				Loan Amount (in 000's)				
	Inside primary service area		Outside primary service area		Inside primary service area		Outside primary service area		Total
	#	%	#	%	$	%	$	%	$
2007	387	97	11	3	96,585	96	4,168	4	100,753
2008	380	97	12	3	98,856	93	7,271	7	106,127
2009	375	97	13	3	90,283	95	4,364	5	94,647
Total	1,142	97	36	3	285,724	95	15,803	5	301,527

Additionally, as shown in the table below, Alliance Bank has made over $35 million in loans over the past three years which were $1 million or more and met the definition of "Community Development Loans" for CRA purposes.

Community Development Loans:

Year	Dollar	Number
2007	$10,868,000	6
2008	$11,198,500	6
2009	$13,165,090	11
Total	**$35,231,590**	**23**

C. Loan Quality comparisons to national, regional and Arizona peers.

Alliance Bank has generated significant loan growth during its seven year history. Even so, the Bank's loan quality and performance statistics compare favorably with peers given the severity of the recession in Arizona.

	% of (NPAs + 90 Past Due) to Total Assets	% of Net Charge-offs to Average Loans	Texas Ratio*
All US Banks	3.1%	1.8%	27.0%
All Western Banks	4.7%	5.6%	38.9%
All Arizona Based Banks	5.8%	3.7%	55.0%
Alliance Bank	**2.4%**	**2.1%**	**31.0%**

* The **Texas Ratio** is commonly used to measure the severity of a bank's credit problems in relation to its capital. It is calculated by dividing non-performing assets and loans 90 days or more past due by its common equity capital and loan loss reserve. The lower the number the better. Historically, a Texas ratio

above 100% has been a warning sign. For example, the average Texas ratio for the 6 Arizona banks which have failed since 2008 was 233% in the quarter before they were closed.

III. Impact of TARP on Alliance Bank's access to capital during 2008 and 2009 and the corollary impact of TARP on the ability of Alliance Bank to fund loans to Arizona based businesses.

Alliance Bank's parent, Western Alliance Bancorporation (WAL), raised significant new capital during 2008 & 2009, as follows:

	Amount (in $ MM)	Source
2nd Quarter 2008	$30 MM	Private Equity Offering
3rd Quarter 2008	$50 MM	Private Equity Offering
4th Quarter 2008	$140 MM	TARP Funds
2nd Quarter 2009	$200 MM	Public Stock Offering

Total Capital Raised = $420 million
% of Total from TARP = 35%

WAL, in turn, has made $35.5 million in capital injections into Alliance Bank from 1/1/08 until 3/31/10, so $12 million or 35% of the capital Alliance has received over the past 2 ½ years had its source in TARP. Alliance Bank has maintained its leverage capital ratio at 6% or higher which is 1% above the threshold required to be considered "well capitalized" by federal banking regulations. This capital position, coupled with asset quality statistics that are above market peer, have supported the Bank's ability to continue to generate loan growth in an extremely difficult environment, as is illustrated below:

	12/31/07	12/31/08	12/31/09	03/31/10
Loan Outstandings	$584MM	$678 MM	$745MM	$783MM
$ and % Growth		$94MM – 16%	$67MM – 10%	$38MM – 20%

BY CONTRAST, THE TOTAL LOANS OUTSTANDING FROM ALL ARIZONA BASED BANKS DROPPED BY $52 MILLION BETWEEN 12/31/08 AND 12/31/09.

While Alliance Bank of Arizona is running against industry norms and adding net loan growth when many banks are not, I don't want to leave the impression that this is not an extremely difficult lending environment. The recession has sharply decreased loan demand from many Arizona businesses. Every bank portfolio experiences normal runoff, and, in this environment, a higher level of charge-offs than normal. Thus, increasing loan outstandings in the current environment is quite challenging. Considered in combination with requests from regulators for more capital and the heavy emphasis on rapidly reducing real estate concentrations it is no surprise that loan totals are shrinking at many banks.

IV. Suggestions for encouraging increased lending to small business by banks doing business in Arizona.

A. Phase-In Increased Capital Requirements:

Through formal and informal enforcement actions, regulators have effectively increased the capital requirements for banks. These actions are pro-cyclical and, in the current climate, have the effect of discouraging lending. Increased capital requirements for the banking industry may make sense, particularly for banks with higher risk profiles. However, increased capital requirements should be phased in, perhaps over a two to four year period, allowing the industry to deal with capital issues more strategically. (This need not interfere with appropriate actions related to capital shortfall at banks facing imminent failure in the absence of additional capital.) Additionally, another comment on capital is appropriate. Tier I risk based capital, which incorporates a portion of the Bank's loan loss reserve within its calculation, was designed to give banks some "capital credit" for

adequately planning for future loan losses. In the current environment, Tier I risk based capital levels seem to carry less weight with regulators. Moreover, with loan loss reserves nationally running over 2%, banks have taken the hit to earnings and capital through "beefed up" reserves but receive limited credit for these increased reserves in their capital calculations. The regulatory community appears to be paying less attention to this specific view of capital as an analytical tool in the current environment when, in fact, this method of looking at capital was envisioned as an appropriate measure to analyze bank health in a stressed credit cycle.

B. Build more flexibility into the regulatory playbook.

The swiftness and depth of the financial crisis caught everyone off guard and it is not surprising that bank regulators are under strong pressure to enhance their oversight activities. Regulatory resources might be better utilized to focus more attention on banks with high levels of non-performing assets and other danger metrics. Despite the number of bank closures during the past 30 months (215 as of 4/16/10), more than 700 banks remain on the FDIC "problem" bank list. My colleague, Candace Wiest, President/CEO of West Valley National Bank, can speak eloquently as to the level of scrutiny and manpower expanded on her very small bank during this past year by her bank's regulators. A new playbook which encourages the banks' regulators to do more frequent "short reviews" with banks with better asset quality and liquidity metrics and expend more of their resources on banks which are most likely to fail might bring about faster resolution of problem institutions. Regulators are stretched very thin but seem to have too little flexibility in their examination procedures and process which exacerbates their resource shortage.

C. Differentiate real estate concentration issues depending on the date of loan origination.

There seems to be little differentiation for loans made in 2004, 2005 or 2006 when values were peaking as opposed to loans made in 2008 or later when values had declined sharply. Virtually every community bank in the Western U.S. has significant real estate concentrations. The message by regulators to reduce these concentrations is loud and clear. However, the failure to differentiate the risk associated with a real estate loan made in 2006 versus one made in 2009 from a concentration standpoint, works to discourage banks from making new real estate loans, particularly when combined with the request to raise more capital immediately, or failing that, to aggressively shrink bank balance sheets in order to raise capital percentages.

D. More balance in the compliance area.

The compliance aspect of examinations has become increasingly difficult for community banks. While Congress and the Administration debate how to better regulate Wall Street/investment banking activities and also discuss how to effectively include myriad "shadow banking" players within meaningful regulatory oversight, compliance exams at community banks have become much more difficult. Having been a community banker in Arizona for 25 years and having worked in a range of banks during that timeframe I can attest that most commercial banks take their compliance responsibilities very seriously. Banking regulations are complex and are constantly changing but we try very hard to get it right. Recently, compliance exams have an increasingly hard edge to them which, to the community banker, is frustrating because community banks in the aggregate, had very little to do with subprime lending or the various housing bubble excesses with which we are now all too familiar. When combined with all the other issues facing banks today (i.e. capital, loan quality problems, liquidity challenges, etc), the regulatory posture that somehow community banks are short changing consumers on the compliance front seems unwarranted and difficult to understand.

V. Specific comments on the potential of $30 billion of additional TARP funds proposed as a source of capital for community banks as a means to encourage lending to small businesses.

Over the past two years, through its parent, Alliance has benefited from $35.5 million in capital infusions, 35% which came from TARP. Alliance Bank has continued to expand its loans to small businesses when many banks have not. For example, Alliance Bank has funded $38MM in net loan growth in the first quarter of this year, accompanied by very strong deposit growth (over $200MM) attributable to a new relationship with an Arizona municipality. As noted above, we recently received a $5.5MM capital infusion from our parent which has enabled Alliance to continue to maintain a 6% capital level, 1% above the "well capitalized" threshold. Without this access to capital from our parent, about 1/3 of which can be attributed to TARP, it would have been more difficult to support this growth in our balance sheet.

Alliance's experience suggests, at least conceptually, that making an additional source of capital available to community banks has the potential to encourage them to do more lending. However, at this point in the cycle, there may be other measures, which could be implemented more easily. For example, the Small Business Administration (SBA) has a well developed program supporting community bank lending to small businesses. If a significant portion of the $30 billion were earmarked to expand support to the SBA, perhaps by permitting the 7(a) or 504 programs to include refinance of existing loans in appropriate circumstances, or increasing the guarantee levels to 90% from 75% for the next two years, or expanding the revenue and number of employee restrictions for SBA eligibility now in place….all of these suggestions might have a more immediate positive impact on local business lending rather than a new version of TARP.

VI. Conclusion:

Community banks play a critical role in supporting local businesses which are the key to any local economy. It is important that a healthy local banking sector survive the current financial crisis not only in Arizona but across the country. If additional TARP funds are to be made available to community banks it needs to be done soon. We are at a point in the cycle when prudent lending to small business needs to be encouraged and any program with a long lead time may arrive after the ship has left the dock. In the interim there are several steps that could be an immediate spur to increased small business lending by community banks:

- A "phased-in" approach to increased capital requirements
- More flexibility with regard to real estate concentration issues
- More regulatory focus on banks with high levels of non-performing assets with a goal of swifter resolution of "problem" banks
- More regulatory flexibility with respect to examination scope at relatively healthy banks
- Expansion of existing SBA programs
- More measured compliance examinations

I look forward to discussing these and other ideas with the committee.

Respectfully submitted,

James H. Lundy
President/CEO

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