

# Size Matters



**How Federal TARP funds helped small Wisconsin banks succeed during the economic crisis**

**Jack Norman**  
with Jamal Hagler

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## Executive Summary

Wisconsin's small banks—with a little help from the federal government—have played a valuable role in helping stabilize the state economy during this deep recession. While Wisconsin's largest banks struggle for survival, its nearly three hundred community banks have increased lending while maintaining fiscal health.

It has been two years since the recession began and one year since enactment of the federal bank bailout, the Troubled Asset Relief Program (TARP). Twenty Wisconsin banks received TARP funds – three large corporate banks and 17 small community-based banks. Those smaller banks which received TARP money performed most successfully with increased lending and strong capital stability. Among the banks that did not take TARP money, it was the smaller—rather than the larger—banks that were most effective.

The performance of large banks without TARP funds trailed that of the smaller banks. And the three big Wisconsin banks which received the vast majority of federal aid are still in serious trouble. Those three large bank corporations —M&I Marshall & Ilsley, Associated and AnchorBank— received more than \$2.3 billion dollars in federal investment from the nation's TARP bank assistance program. Even with this massive support, these megabanks are still awash in losses, bad loans and continuing restructuring.<sup>1</sup>

On the other hand, the seventeen small Wisconsin banks received a modest \$163.5 million in federal TARP money. These local lenders used the federal funds to boost the number of loans provided, sustaining small business activity around the state.

It is widely understood that American financial giants were pivotal in creating the threat of global financial collapse and the worldwide recession. But small banks—those whose goal is to serve a limited geographic region within a state—don't deserve to be blamed for the economic disaster. Wisconsin's smaller banks did not cause the recession but have helped the state weather the resulting storm. TARP has been an effective tool for the Wisconsin community lenders who did accept the federal money. The government funds enabled them to maintain their capital stability and continue their expanded loan activities. This contrasts with the much larger and more overextended banks which cut lending dramatically.

The success of local TARP-assisted banks is an example of how government can help pave the way for business success. Wisconsin's long-time economic prosperity is based on a partnership among government, citizens and small business. The resilience and productivity of the small banking community demonstrate that proactive intervention by government directing the flow of money toward businesses and households is a critical tool for restoring Wisconsin's prosperity.

## Introduction

TARP—formally known as the Troubled Asset Relief Program—was designed to fulfill two goals. The first was to restore confidence in the nation’s banking system and ensure that the American finance system survives. The second goal was to make sure banks are strong enough to expand their lending in order to help move the economy out of recession. These twin goals are spelled out, for example, in the federal government’s most recent quarterly review of the program, co-written by the Treasury Department, Federal Reserve Board and Federal Deposit Insurance Corp. It states that TARP’s goals are “to **enhance market confidence** in the entire banking system, thereby **increasing the capacity of these institutions to lend** to U.S. businesses and consumers.”<sup>2</sup> (emphasis ours)

Twenty Wisconsin-based banks received federal TARP funds, ranging from \$1.7 billion at M&I Marshall & Ilsley Bank to \$1.5 million at Pigeon Falls State Bank. In Chart One, these banks are listed by the size of their TARP investment.<sup>3</sup>

### CHART ONE

<b>Bank</b>	<b>Community</b>	<b>TARP date</b>	<b>TARP amount</b>
M&I Marshall & Ilsley	Milwaukee	11/14/2008	\$1,700,000,000
Associated	Green Bay	11/21/2008	\$525,000,000
AnchorBank	Madison	1/30/2009	\$110,000,000
Park Bank	Madison	3/6/2009	\$23,200,000
Baraboo	Baraboo	1/16/2009	\$20,700,000
Nicolet	Green Bay	12/23/2008	\$15,000,000
River Valley	Wausau	6/12/2009	\$15,000,000
Horicon	Horicon	5/8/2009	\$13,600,000
Bank First National (repaid)	Manitowoc	1/16/2009	\$12,000,000
Ridgestone	Brookfield	2/27/2009	\$10,900,000
Blackhawk	Beloit	3/13/2009	\$10,000,000
Mid-Wisconsin	Medford	2/20/2009	\$10,000,000
Community First	Boscobel	5/15/2009	\$5,600,000
Sunset	Waukesha	6/26/2009	\$5,600,000
Legacy	Milwaukee	1/30/2009	\$5,500,000
Securant	Menomonee Falls	4/10/2009	\$5,100,000
First National Bank-Fox Valley	Neenah	2/13/2009	\$4,800,000
Deerfield	Deerfield	5/15/2009	\$2,600,000
Bank of Kaukauna	Kaukauna	5/15/2009	\$2,400,000
Pigeon Falls State Bank	Pigeon Falls	9/11/2009	\$1,500,000
<b>TOTAL</b>			<b>\$2,498,500,000</b>

source: FinancialStability.gov

It is clear from Chart One that the three biggest TARP recipients—M&I, Associated and AnchorBank—received substantially more federal investment funds than the 17 smaller recipients. Of nearly \$2.5 billion in total Wisconsin TARP investments, more than 93% went to those three big banks. The seventeen smaller banks shared \$163.5 million, or 6.5% of the total.

In this report, Wisconsin’s banks are divided into four groups, based on two characteristics: the first is whether or not it received TARP funds; the second is whether the bank is “big” or “not big.” The threshold between big and not-big banks is one billion dollars in assets, a standard industry dividing point.

There were 282 banks based in Wisconsin as of September 30, 2009, the most recent data available from the Federal Deposit Insurance Corp.<sup>4</sup> Of these, eleven were big banks, with assets over one billion dollars. The remaining 271, the small banks—often called “community banks”—each had assets under one billion dollars. To give a picture of how banks compare in terms of total assets, Chart Two lists the fifty biggest Wisconsin-based banks based on assets on Sept. 30, 2009.

**CHART TWO**

<b>Name</b>	<b>Community</b>	<b>Total assets (Sept. 30, 2009)</b>
M&I Marshall and Ilsley Bank	Milwaukee	\$51,571,329,000
Associated Bank	Green Bay	\$22,471,845,000
Johnson Bank	Racine	\$5,618,582,000
AnchorBank	Madison	\$4,639,906,000
Bank Mutual	Brown Deer	\$3,558,907,000
FPC Financial	Madison	\$2,074,841,000
WaterStone Bank	Wauwatosa	\$1,900,933,000
North Shore Bank	Brookfield	\$1,822,610,000
Guaranty Bank	Milwaukee	\$1,366,152,000
National Exchange Bank and Trust	Fond Du Lac	\$1,230,580,000
Baylake Bank	Sturgeon Bay	\$1,046,305,000
First Banking Center	Burlington	\$941,108,000
First Business Bank	Madison	\$919,287,000
River Valley Bank	Wausau	\$917,439,000
Park Bank	Milwaukee	\$804,164,000
Park Bank	Madison	\$803,911,000
Tri City National Bank	Oak Creek	\$790,130,000
Bank First National	Manitowoc	\$783,411,000
The Baraboo National Bank	Baraboo	\$774,166,000
Waukesha State Bank	Waukesha	\$758,188,000
State Bank of Cross Plains	Cross Plains	\$710,462,000
First National Bank	Waupaca	\$704,427,000
Town Bank	Hartland	\$681,331,000
First Bank Financial Centre	Oconomowoc	\$667,789,000
Investors Community Bank	Manitowoc	\$661,224,000
Bremer Bank, National Association	Menomonie	\$659,741,000
Westbury Bank	West Bend	\$654,590,000
The First National Bank and Trust Company	Beloit	\$642,219,000
Citizens Bank of Mukwonago	Mukwonago	\$625,019,000
Community Bank & Trust	Sheboygan	\$624,242,000
Peoples State Bank	Wausau	\$586,306,000
Nicolet National Bank	Green Bay	\$584,174,000
Great Midwest Bank	Brookfield	\$583,434,000
Citizens Community Federal	Eau Claire	\$575,359,000
National Bank of Commerce	Superior	\$572,885,000
RidgeStone Bank	Brookfield	\$572,663,000

Thrivent Financial Bank	Appleton	\$560,022,000
Time Federal Savings Bank	Medford	\$550,815,000
Charter Bank Eau Claire	Eau Claire	\$546,293,000
Horicon Bank	Horicon	\$536,711,000
PyraMax Bank	Greenfield	\$531,158,000
Blackhawk State Bank	Beloit	\$524,137,000
The Equitable Bank	Wauwatosa	\$493,979,000
Mid-Wisconsin Bank	Medford	\$493,312,000
Southport Bank	Kenosha	\$465,725,000
West Pointe Bank	Oshkosh	\$458,583,000
Dairy State Bank	Rice Lake	\$439,407,000
Wisconsin Community Bank	Madison	\$433,900,000
Bankers' Bank	Madison	\$420,241,000
ISB Community Bank	Ixonia	\$406,061,000

source: Federal Deposit Insurance Corp.

Wisconsin-based banks are not the only ones doing business in the state. Several bank systems based outside Wisconsin are among the most active financial institutions in the state. These include US Bank, JPMorgan Chase, Wells Fargo and National City. These non-Wisconsin banks are not analyzed in this report as it is not possible to find current data for these institutions on lending in Wisconsin. For this reason, this report will look exclusively at Wisconsin-based banks.

## Core measures of bank performance

### 1. Lending

One of the primary objectives of the TARP program was to expand bank lending in order to help move the economy out of recession. Because TARP began during the fourth quarter of 2008, evaluating its impact in Wisconsin means examining loan trends over the past twelve months, from Sept. 30, 2008 to Sept. 30, 2009.<sup>5</sup>

This report generally examines percentages of change rather than absolute numbers. This is so banks of hugely different sizes can be compared with one another. M&I is nearly one hundred times larger than Pigeon Falls State, so comparing a total change in lending volume makes no sense; a \$100,000 change in lending means something radically different at the two banks. But comparing percent changes—such as a 2% increase in lending compared with an 8% increase—does make sense.

Chart Three shows changes in the volume of bank loans during the past twelve months during which TARP has been in operation.

**CHART THREE**

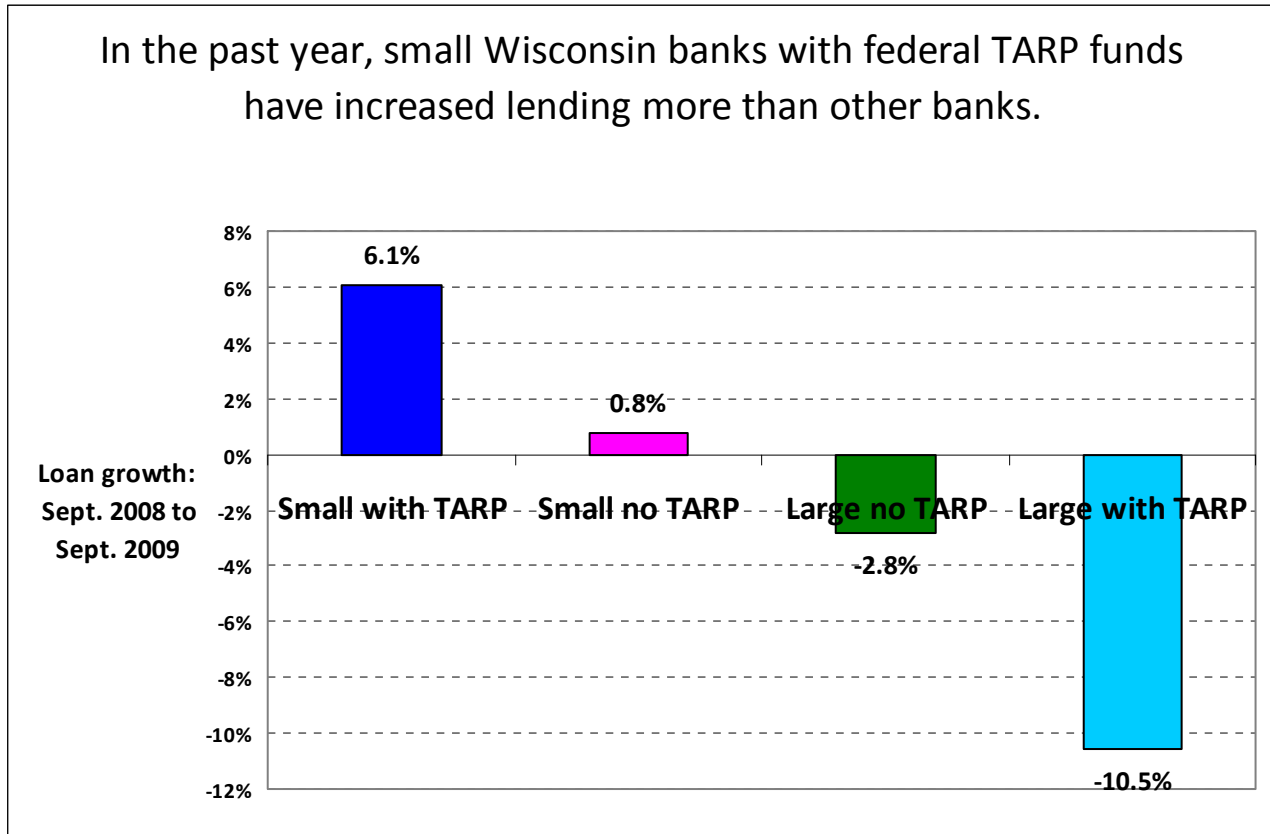


Chart Three shows that small banks with TARP funds had the largest growth in lending: an increase of 6.1%. Small banks without TARP money also had modest loan growth, despite the recession, edging up 0.8%. Large banks, by contrast, shrank their loan portfolios. At the big banks without TARP, loans were down 2.8%. At the three big TARP banks, lending was down 10.5%.

Though TARP has been in operation nearly a year, the participating banks all have different dates on which they received the federal money, as shown in Chart One. The most accurate comparison of lending would take into account changes only since the quarter in which TARP funds were actually received. When this is done, the results are qualitatively the same: the best performance is by small banks with TARP funds; next best is the remaining small banks; next are large banks without TARP; and worst are big TARP banks.

Chart Four shows the percentage change in lending for each group, using as starting dates not only September 30, 2008 but also December 31, 2008; March 31, 2009 and June 30, 2009. This gives a more detailed look at loan trends, recognizing that most TARP banks have had the federal money for less than a full year.

**CHART FOUR**

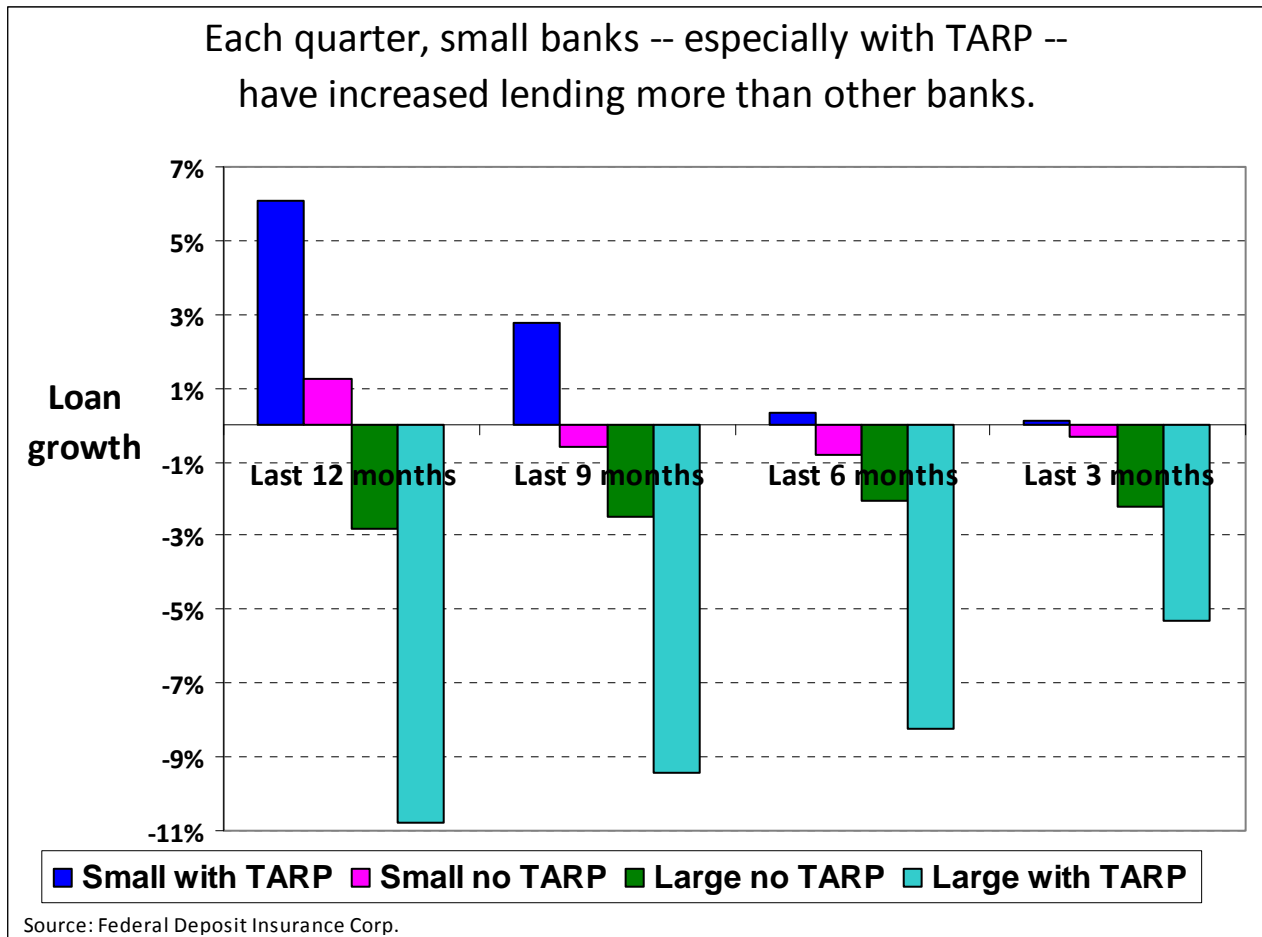


Chart Four shows that whatever time period is used during the lifespan of TARP, the small TARP banks have increased their total loans and far outpaced the performance of large banks, with or without TARP. Also, non-TARP small banks have also clearly outperformed large banks.

While not every small TARP bank has increased lending, the overall performance of the group of seventeen is strikingly better than that of the other groups. Getting a TARP investment required both a bank willing to accept the requirements attached to the money and also a federal regulator willing to invest in that particular bank. It appears that the match between regulator and bank willingness led to a successful round of small-bank TARP investments in Wisconsin.

The data clearly show that small banks showed the best loan performance during this past recession year, with small TARP banks doing best of all. Was this simply a continuation of a long-standing trend? Or is it unique to the past year? The answer is that this superior performance by small banks is a break from the recent past. This is clear from Chart Five, which displays changes in loan volumes using September 30, 2005, as a starting point.

CHART FIVE

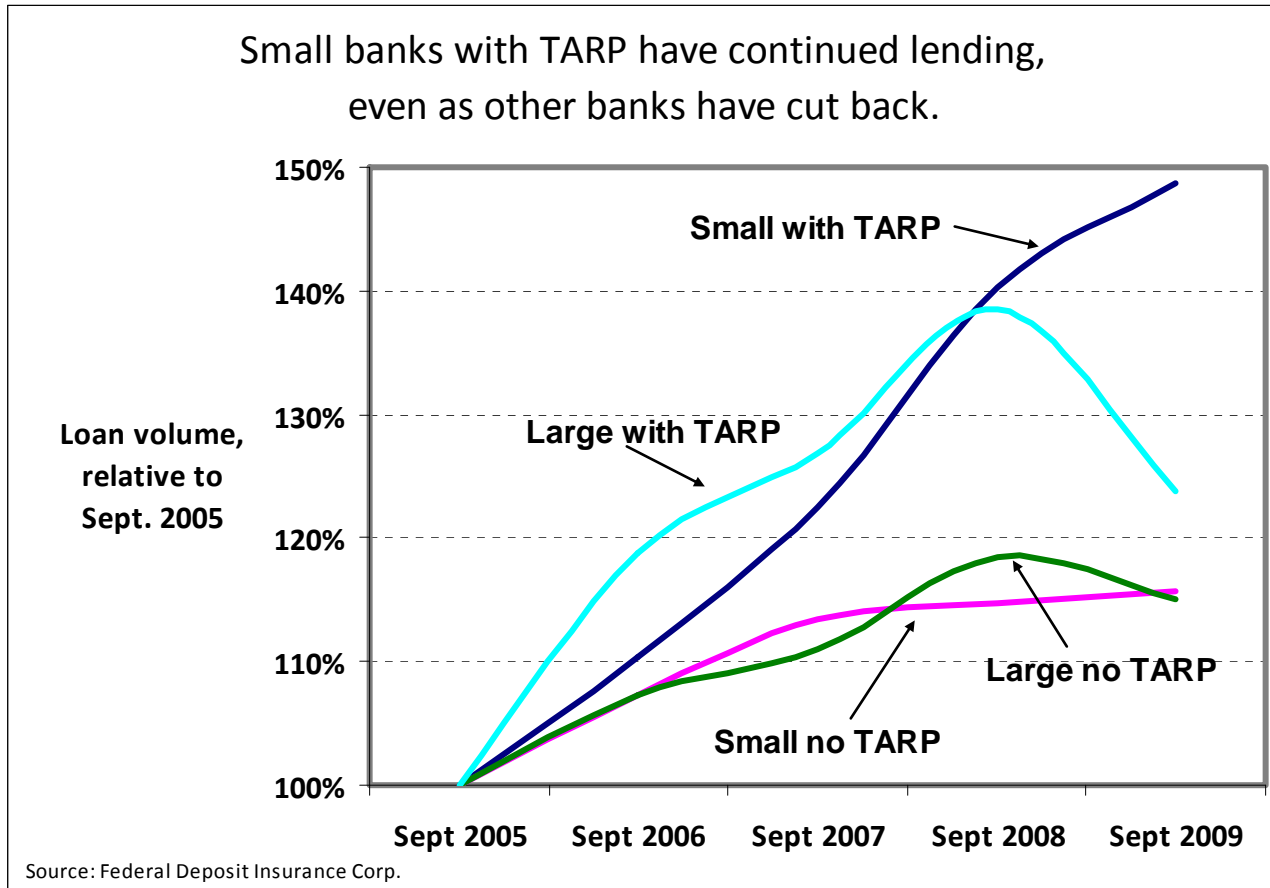


Chart Five shows that in the two years leading up to the recession—2005 to 2007—the three big TARP banks were the most aggressive in their lending expansion. The big three’s loan volumes grew 19% from 2005 to 2006 (third-quarter each year) and another 7% from 2006 to 2007. Loan volumes grew substantially even during the first year of recession, before plunging dramatically over the past twelve months. These banks were being extremely aggressive for several years, before reversing course as the extent of their bad loans was revealed.

During the same period, the 17 small TARP banks were also lending at a growing rate through the first year of the recession. Between September 2005 and 2008, both big TARP banks and small TARP banks grew their portfolios about 40%. But from 2008 to 2009 the lending patterns of the large and small TARP banks diverged significantly. While lending by the big TARP banks plunged, the small TARP banks continued to expand their loan portfolio.

Meanwhile, banks which did not take TARP funds lagged in loan growth leading up to the recession and since. While TARP bank portfolios grew about 40% from 2005 through 2008, lending by the big non-TARP banks grew only 18%, before sinking in 2008. During the same pre-recession period, small non-TARP banks grew 15%, but unlike the larger non-TARP banks, they continued to grow from 2008 to 2009.

What Chart Five shows is that the TARP banks, both big and small, had been expanding their loan volume more than the non-TARP banks up until September 30, 2008. For the big three TARP banks, this led to

disaster as bad loans began to unravel. These large banks, trying to compete with the huge national mega-corporations, grew too aggressively until forced to retrench.

The small TARP banks, by contrast, while growing rapidly leading up the recession, have been able to continue that growth since then. For these institutions, TARP money was used to maintain loan activity to businesses and consumers.

How much in additional lending can be attributed to the investment of TARP funds in the seventeen small banks? During the past year, the 6.1% growth in the small TARP banks' portfolios amounted to an additional \$290 million in loans to Wisconsin businesses and consumers. Not all of this increase is the result of the TARP investments since much of that money only came after the beginning of the year. Among the 17 small TARP banks, the average length of time with federal money—as of September 30, 2009—was 181 days or about half a year. If half of the additional \$290 million in loans are attributable to TARP, this means a TARP 'lending boost' of \$145 million. It seems clear that small banks did use the federal investment as intended—to increase lending in their communities.

By contrast, while the three big TARP banks took \$2.3 billion in federal money, their banks showed a \$6.8 billion drop in loan portfolios. This includes a reduction in lending of \$4.5 billion in M&I's total loans; \$1.8 billion in Associated's lending; and \$0.5 billion at AnchorBank.

Ultimately, TARP funds are supposed to be repaid to the US government. The money was an investment rather than a gift. One small TARP bank—Bank First National—has already repaid the government. If the other small TARP banks are able to repay the federal government, it would mean that the government intervention in their business ultimately cost taxpayers nothing while helping those banks to increase investment activity for homes and businesses in their communities.

## **2. Bank capital stability**

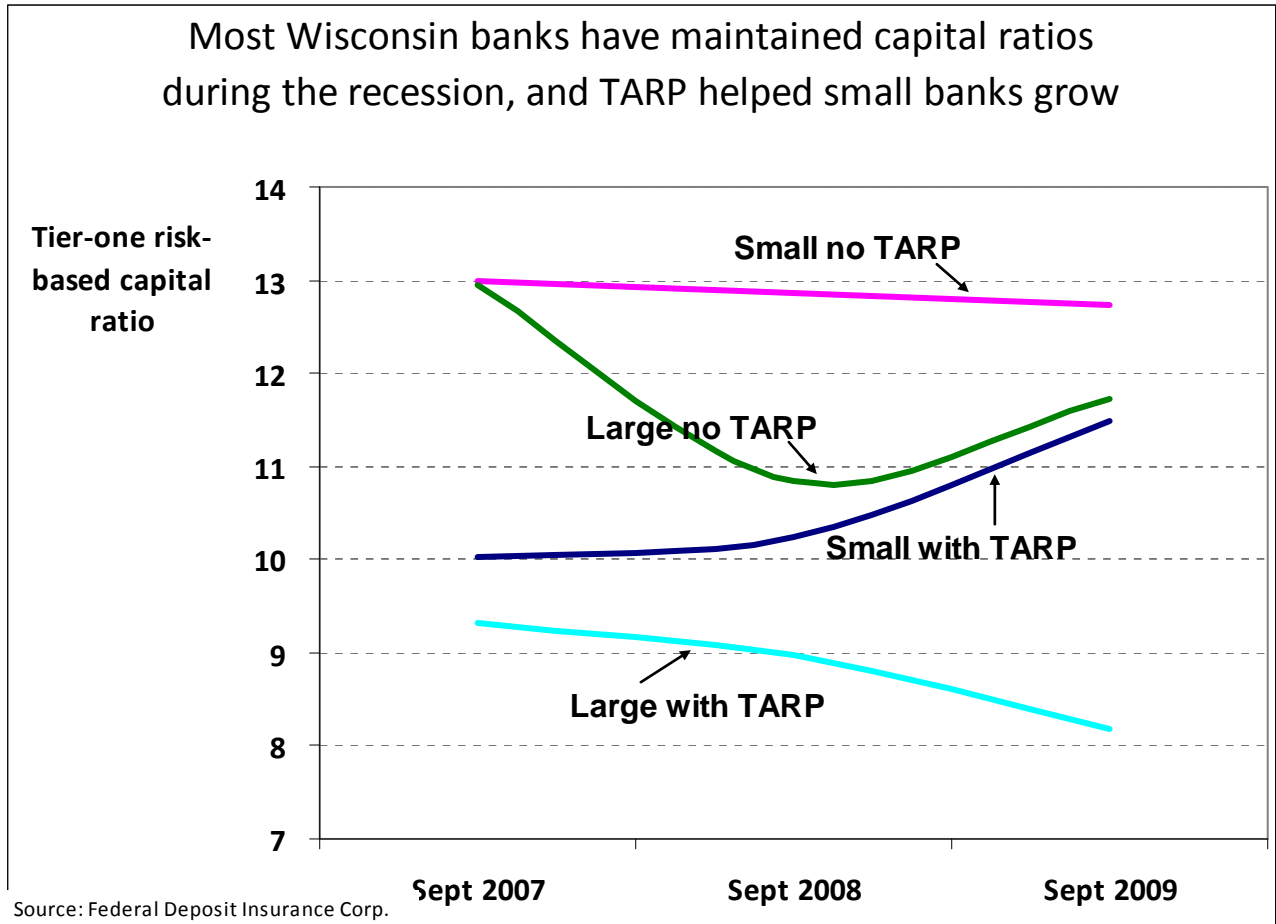
As stated earlier, the goal of TARP was “to enhance market confidence in the entire banking system, thereby increasing the capacity of these institutions to lend to U.S. businesses and consumers.” What constitutes ‘enhanced confidence?’

In the banking world, everything is quantifiable. “Market confidence” is quantified in terms of a bank's capital strength: how much money the bank has in solid funds to support its loans. A low capital ratio means that the bank has a small amount of capital compared with the size of its loan portfolio. Banks that are rapidly growing their lending often have declining capital ratios as the volume of their loans grows faster than the underlying capital.

TARP's strategy was for the federal government to inject funds directly into a bank's capital base—by purchasing preferred stock—thereby increasing its ratio of capital to loans.

Chart Six shows how the four bank groups fared since the recession began in one of the key capital ratios: “Tier One Risk-Based Capital Ratio.” Other measures of capital show similar results. Chart Six shows the median capital ratio within each group.

CHART SIX



It's clear from Chart Six that the big TARP banks started the recession with the lowest capital ratios and that those ratios have continued to decline. These are the banks that are still in trouble.

Chart Six also shows that the small TARP banks began the recession with a capital ratio just a bit larger than the big TARP banks, and considerably lower than the non-TARP banks big and small. This is consistent with the observation earlier that the banks that ultimately got TARP funds had been more aggressive lenders before the recession, and hence had lower capital ratios. But while the capital ratio for large TARP banks continued to deteriorate, the small TARP banks managed to grow their capital ratios (using TARP money) while significantly increasing their lending. These small banks have generally been stable and consistent lenders. Finally, Chart Six confirms that small banks that did not take TARP funds have consistently had the highest ratios of all, indicating continuing capital strength while lending has continued to grow modestly.

What Charts Five and Six together tell us is that the banks that ultimately took TARP funds, both large and small, were among the state's most aggressive lenders leading into the recession. But for the big banks, taking TARP funds was an act of desperation, an effort at survival whose ultimate outcome is still uncertain. For small banks, taking TARP funds was more a calculated business decision, a way to become both stronger and more active lenders.

Increased lending depends first on enhanced confidence in the banks—on healthy capital ratios. The big TARP banks have not restored healthy ratios and have not been able to expand lending. The small TARP banks have healthier ratios, enabling them to increase their lending. And the small banks without TARP funds maintain healthy ratios which supports their continued modest growth in lending.

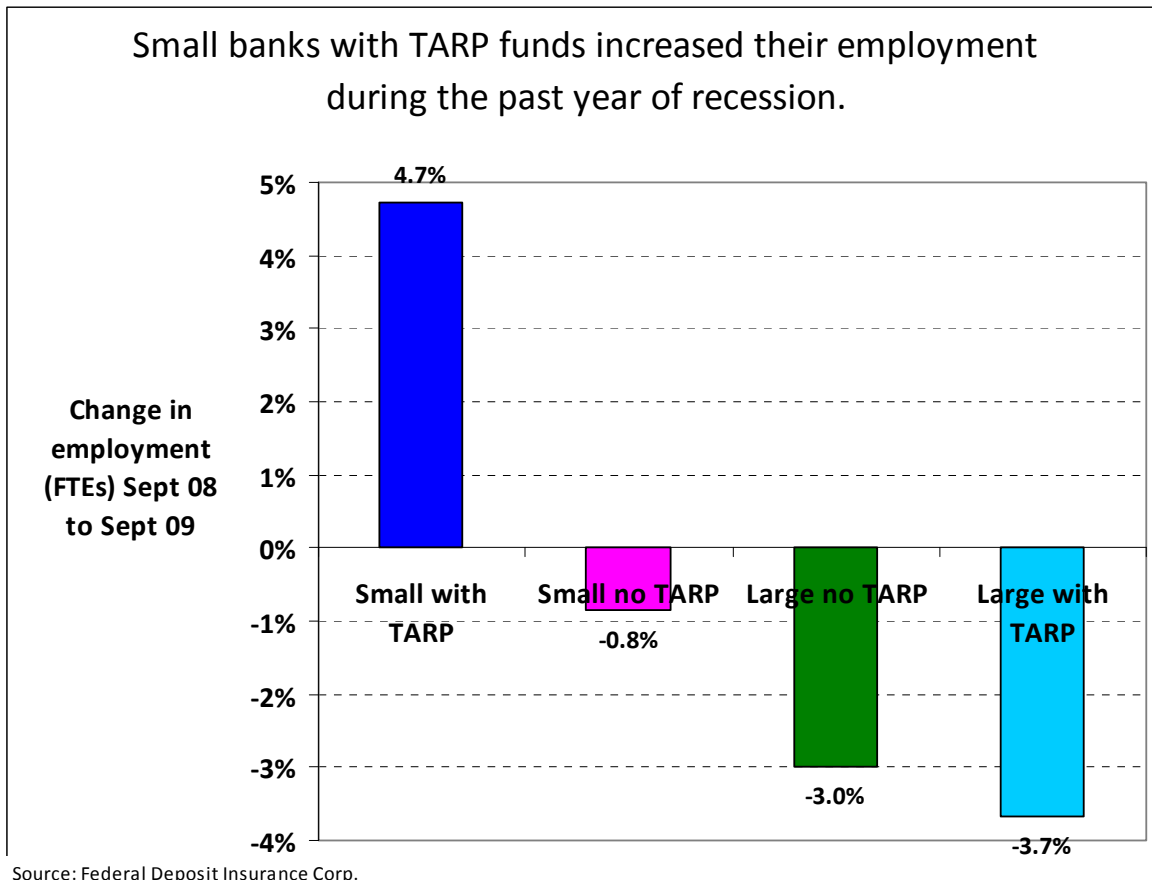
## Assessing other aspects of bank operations

### 1. Employment

Ultimately, a recession is about job loss. Banks are a critical part of the job base, located as they are in communities all over Wisconsin. Banking has remained a relatively strong part of Wisconsin’s job picture during the recession. Over thirty thousand people in Wisconsin are employed by local banks (and thousands more by the large out-of-state banks also doing business here). In the past twelve months (September 30, 2008 to September 30 2009), Wisconsin-based banks lost 634 full-time-equivalent positions, or 2.1%.

As in the other indicators of bank performance, small banks with TARP investments are the employment stars of the industry. Over the past twelve months, those seventeen small TARP banks **added** 75 jobs, an increase of 4.7%. The other groups of banks all lost jobs, with the big TARP banks losing both the largest number (456 FTEs) and the greatest percentage (3.7%). Chart Seven shows the percent change in full-time-equivalent jobs for the four bank groups during the past twelve months, the deepest part of the recession.

CHART SEVEN



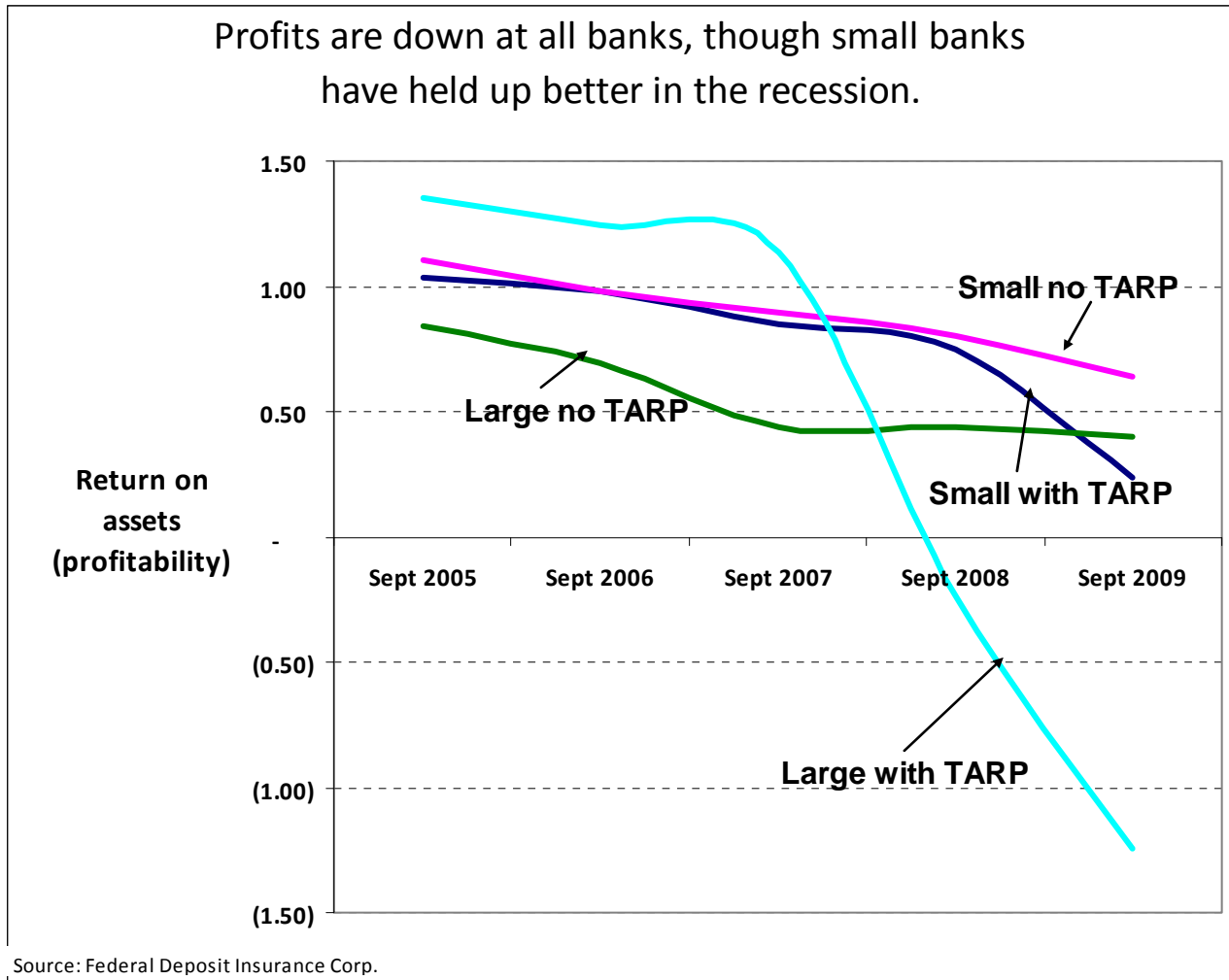
From a jobs perspective, the health of the three big TARP banks is especially important because of their role as large employers. As of September 30, 2009, those three have 11,933 full-time equivalent employees, or 40% of the total employment for Wisconsin-based banks.

## 2. Profit

The financial crisis has diminished profit at all Wisconsin-based banks. At the big three TARP banks, the profit drop has been devastating. At the smaller banks and the large non-TARP banks, profits have decreased but the operations are generally still profitable.

Bank profitability is commonly measured as “return on assets,” defined as profits as a percent of total assets. Chart Eight shows the median return on assets for the four bank categories.

**CHART EIGHT**



The collapse of profits at the big three TARP banks is dramatic. In just two years, they went from being the most profitable to the big money-losers. The other three categories all declined somewhat, but the drop is

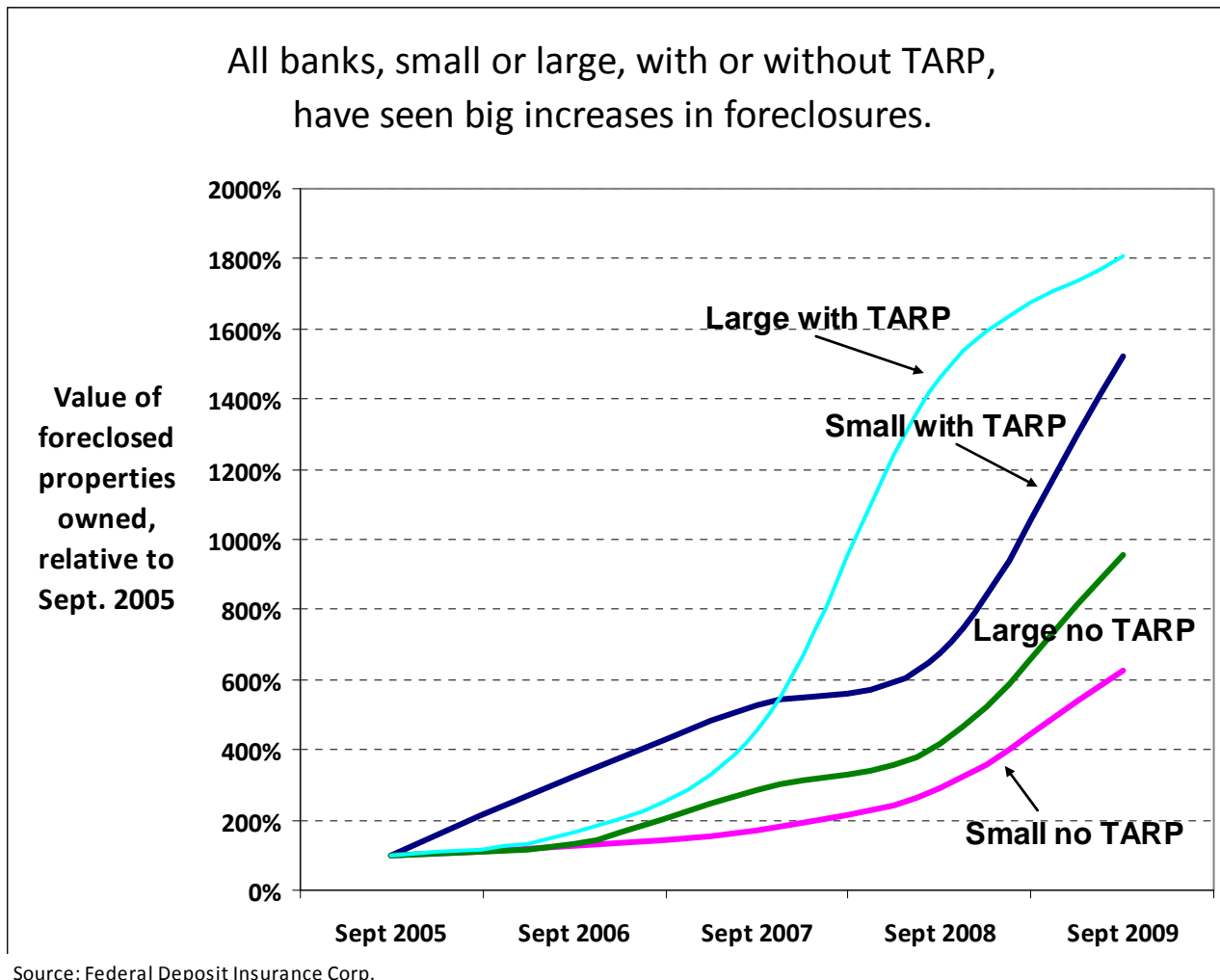
not substantial. It is important to note that as of September 30, 2009, the small non-TARP banks had become the most profitable banks in Wisconsin, measured by return on assets.

### 3. Bad loans

Aggressive lending in the years leading up to the recession generally centered on escalating real estate loans. It was the crash of these real estate loans that set up the financial crisis and recession. Wisconsin's banks were no exception to the general rule. Because the state's TARP banks went into the recession as more aggressive lenders than the non-TARP banks, they showed significantly higher problems with their real estate loan portfolios.

Chart Nine measures change in the value of foreclosed property held by the bank, known formally as Other Real Estate Owned (OREO), using September 30, 2005 as the base. It shows explosive growth in OREO for both large and small TARP banks and rapid growth for the non-TARP banks as well.

Chart Nine:



These bad loans will continue to be a severe issue for banks.

## Summary and conclusion:

The Troubled Asset Relief Program (TARP) was a federal program to cope with the largest financial crisis the country has faced in over 70 years. By infusing money into banks across the United States, the Bush administration hoped to protect the American finance system. The twin goals were to restore public confidence in the banks and support increased loan activity to revive the faltering economy.

Twenty Wisconsin-based banks received \$2.5 billion in federal TARP funds. The three biggest TARP recipients—M&I, Associated and AnchorBank— received more than 93% of these funds. The 17 smaller banks shared \$163.5 million, or 6.5% of the total.

The report divided Wisconsin's nearly 300 banks into four groups based on two criteria: Is the bank large (over one billion dollars in assets) or small? Did the bank receive a TARP investment or not?

The data show that small banks in general were stronger during the past year of recession than were larger banks, and those small banks that received TARP funds did best of all as a group. They expanded their lending, retained their employees and managed to be profitable.

Small banks, like the small businesses they work with, are stable elements in Wisconsin's economy. Partnerships among local businesses, local governments and citizens built a prosperous Wisconsin. These partnerships are critical for sustaining a strong middle class.

Government plays a vital role in supporting economic growth. When Wall Street crashed, sending shockwaves nationwide, the federal government was the only safety net strong enough to protect the country from financial collapse. Historically, federal, state and local governments have paved the way for economic growth—literally and figuratively. Highways, railroads, telecommunications, public safety, legal systems and thousands of physical, social and organizational structures are the groundwork for successful businesses and communities.

President George W. Bush signed the TARP legislation in a time of financial near-panic. There are certainly flaws in it and Wisconsin has yet to see its largest TARP banks regain stability and increase lending. But federal intervention was needed. Government has the capacity and the responsibility to direct the flow of money in a way that sustains the public interest. When the TARP funding was injected into community banks and they increased lending, the funds served the common good. This is "best practice" for how government can affect the economy. Hopefully, this best practice can be expanded effectively to address other serious problems in the current recession.

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<sup>1</sup> Marshall & Ilsley Corp. lost \$2.0 billion in 2008 and lost another \$599 million through the first three quarters of 2009. Associated Banc-Corp has returned to profitability, but last month disclosed a "memorandum of understanding" with federal regulators requiring improved risk management and capital. Associated named a new CEO effective December 1, 2009. Anchor Banc Wisconsin lost \$218 million in 2008 and another \$134 million so far in 2009. In June it entered into a cease-and-desist order with federal regulators to increase capital and improve asset quality. On December 1, 2009, the company announced that 95% of its stock would be sold to a Chicago investor for sixty cents a share.

<sup>2</sup> *Quarterly Analysis of Institutions in the Capital Purchase Program: 2009 Q2*. Accessed at: [www.financialstability.gov/docs/PPP/QuarterlyPPPReportQ22009.pdf](http://www.financialstability.gov/docs/PPP/QuarterlyPPPReportQ22009.pdf).

<sup>3</sup> A good overview of the financial bailout and database of facts is on the ProPublica bailout web site: <http://bailout.propublica.org>.

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<sup>4</sup> Data for this report are from the Federal Deposit Insurance Corp.'s *Statistics on Depository Institutions*: <http://www2.fdic.gov/sdi/index.asp>.

<sup>5</sup> Because the most recent FDIC data are for the quarter ending September 30, 2009, going back in twelve-month intervals makes most sense, so third-quarter data from each year are used. Using third-quarter data is also convenient because it matches up with two key dates of interest: first, the start of the recession in December 2007; second, the onset of TARP in October 2008. In both cases, the last data snapshot before the onset of recession and before the creation of TARP was the third-quarter snapshot. Using third-quarter data gives us exactly one year's data since the beginning of TARP and exactly two years' data since the beginning of the recession.



INSTITUTE FOR WISCONSIN'S FUTURE  
*policy research in the public interest*

325 W Silver Spring Dr. 2<sup>nd</sup> Floor  
Glendale, WI 53217  
(414) 967-1682  
[www.wisconsinsfuture.org](http://www.wisconsinsfuture.org)