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TARP OVERSIGHT: IS TARP WORKING FOR MAIN STREET?

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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TARP OVERSIGHT: IS TARP WORKING FOR MAIN STREET?

Wednesday, March 4, 2009

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 3:15 p.m., in room 2128, Rayburn House Office Building, Hon. Luis V. Gutierrez [chairman of the subcommittee] presiding.

Members present: Representatives Gutierrez, Maloney, Watt, Sherman, Moore of Kansas, Hinojosa, McCarthy, Baca, Green, Clay, Scott, Cleaver, Ellison, Klein, Wilson, Foster, Perlmutter; Hensarling, Castle, Capito, Neugebauer, Price, Marchant, Lee, Paulsen, and Lance.

Chairman GUTIERREZ. This hearing of the Subcommittee on Financial Institutions and Consumer Credit will come to order. Good afternoon and thanks to all of the witnesses for agreeing to appear before the subcommittee today.

Today's hearing is entitled, "TARP Oversight: Is TARP Working For Main Street?" We will examine whether the TARP has been successful in freeing up credit for American businesses, especially the small and medium-sized firms that are vital to the U.S. economy. We will be limiting opening statements to 10 minutes per side. But without objection, the record will be held open for all members' opening statements to be made a part of the record. I yield myself 5 minutes.

Last week in his first speech before a joint session of Congress, President Obama stated, "The concern is that if we do not restart lending in this country, our recovery will be choked off before it ever begins." I imagine that few will argue against the proposition that unfreezing the credit markets and reinvigorating lending to American businesses is how we find our way out of this recession.

Resuming the flow of credit to the businesses on Main Street so that those firms can retain existing employees and even create new jobs is exactly what this TARP oversight hearing is about. Specifically, we will focus on whether the TARP funds distributed through the Capital Purchase Program (CPP) have been successful in freeing up credit for American businesses, especially the small and medium-sized firms that are vital to the U.S. economy.

The impact of CPP funds on small banks, small businesses, and lending to Main Street deserves examination because small firms are the backbone of the American economy. Small businesses em-

ploy about half of the private sector employees in the United States and pay nearly 45 percent of the total U.S. private payroll.

In my home State of Illinois, more than 49 percent of the workforce is employed by small businesses. Since the mid-1990's, small businesses have created 60 to 80 percent of the new jobs in the United States and have traditionally led the Nation out of recession because small firms tend to recover faster.

I supported TARP and the Emergency Economic Stabilization Act that created it primarily because I felt it was necessary to unfreeze the credit markets and get capital flowing again. But under no circumstances do I want the money to be held in the vaults of Wall Street firms to be used for executive bonuses or to pay shareholder dividends or to be hoarded in case these institutions are threatened with insolvency.

When announcing the creation of the Capital Purchase Program, former Treasury Secretary Paulson stated, "Our purpose is to increase confidence in our banks and increase the confidence of our banks so that they will deploy not hoard their capital. And we expect them to do so, so increased confidence will lead to increased lending. This increased lending will benefit the U.S. economy and the American people."

Congress wasn't sure that TARP and CPP funds are being used in ways that are consistent the intent of those programs. If these programs, which could place a large financial burden on American taxpayers, are not working in ways that benefit U.S. businesses and consumers, then we should revisit the manner in which they are being implemented before the Treasury Department divides the second $350 billion in the same way they did the first.

Some critics of Congress' involvement in this area argue that we are setting out to force banks to lend or encouraging banks to make bad loans. This is a straw person argument. I am not interested in encouraging banks to made bad loans. I understand the support of the current environment of stricter lending standards because even under those strict standards there are thousands of businesses across the country that can qualify for loans.

Furthermore, I believe that those same strict standards should be applied to financial institutions. In other words, if banks will not lend to businesses that have made bad business or investment decisions, then likewise, Congress should not invest taxpayer dollars in financial institutions that have made bad investments and business decisions and which are quite frankly credit risks. Rather we should reward those institutions that have made sound investment decisions and stand ready to make loans in rural and urban areas all across our country.

It is time to shift our primary focus away from saving the Wall Street firms that got us into this mess and concentrate on the Main Street and community-oriented firms that know how to create jobs and grow the economy. Without a vibrant small business community, this recession will linger longer. Investing in small and medium-sized firms is one of the fastest routes we can take to economic recovery. I look forward to addressing these issues during this hearing.

I will yield the ranking member, Mr. Hensarling, 5 minutes for his opening statement.

Mr. HENSARLING. Thank you, Mr. Chairman. And thank you for holding what I believe is truly a very, very important hearing. People all across America have questions about the TARP program. The hearing is entitled, "Is TARP working for Main Street?" I think clearly most Members of Congress think that it ought to be, but whether or not it is, is frankly an open question.

Now, when we ask is TARP working for Main Street, we have to really take a look at what TARP was designed to do. And frankly, that is a difficult question to answer. Because if you look at the congressional, the enabling statute, TARP was told to, number one, protect taxpayers. It was told to provide financial stability to our financial markets. We were supposed to help struggling families in the law and help retirement security, stabilize communities, and the list goes on and on.

Now one can argue there were a lot of different competing goals in TARP and sometimes when you charge a statute with many things you charge it with nothing. Now if the purpose of TARP was to give large financial institutions a capital cushion at a time they vitally needed it, I suppose some people could argue maybe it worked. I don't know. Unlike the chairman, I did not support this statute. Although I think it is important that government act, I think there is a legitimate crisis, I think there is much pain within our society. And I am heartened to hear the comments of our chairman that a lot of the solution lies within our small businesses.

I believe many Members of Congress believe that ultimately the road to recovery does not lead through the halls of Congress. The road to recovery does not lead through Wall Street. The road to recovery leads through the small businesses of Main Street. And so again, as we question, is the program working for Main Street, I think we have to look how at, do we judge this? It is frankly difficult, and as a member of the Congressional Oversight Panel for TARP, there continues to be a regrettable lack of transparency within the program—very few metrics of success, very little accountability. And frankly, no articulated plan that the vast majority of Americans, much less the markets understand. Now I say that about both Administrations, the current Administration and the previous Administration.

So what we have in some respects is at least a second tranche of TARP was $350 billion in search of a program. Now we know that the President as of yesterday included $750 billion for son of TARP, grandson of TARP, whatever we call it now. Again we don't have an articulated program. Now I try not to read too much into 1-day swings in the stock market, but clearly, since this Administration has come to office, there has been a loss of approximately 15 percent in the DOW. And I think part of it is because the Administration has failed to articulate a plan, which is frankly the same mistake that the previous Administration made as well.

The best way again to get out of this economy is to help empower small businesses. Small businesses employ the majority of America. Three out of four new jobs are created by small businesses. But they need certainty in the market. There is so much capital sitting on the sidelines, but they are waiting to find out, is somebody going to bail me out, or are they gong to bail my competitor out, or bail

my customer out? We need some legislative and regulatory certainty. People need to know what the rules are.

We can't have a program also that is picking winners and losers, that is not going to help our small businesses. If TARP gets into the business of saying we want to help the auto industry, but we don't want to help the trucking industry, we don't want to help the software industry, that is picking winners and losers. Now people are concerned about throwing good money after bad. You know AIG is now in for their fourth involuntary contribution of taxpayer funds, Citi is in for their third, and Bank of America is in for their fourth. GM has now come back three different times. So we need a program that will help our small businesses, our struggling families, and where necessary, use Federal funds to close down failed financial institutions and launch new ones, but we need to do it in a way that doesn't send the bill to future generations and decrease their job opportunities and their homeownership opportunities.

Mr. Chairman, I appreciate again you calling this hearing. I yield back.

Chairman GUTIERREZ. Thank you so much, Mr. Hensarling. I look forward to working with you over the next 2 years.

Congresswoman Maloney for 3 minutes.

Mrs. MALONEY. Thank you, first of all. And welcome to all of the panelists. I congratulate Chairman Luis Gutierrez on his new chairmanship and Ranking Member Jeb Hensarling on his. And I look forward to working with both of you. We certainly have our work cut out for us.

What I have been hearing from my constituents is that our credit markets remain frozen, people are having trouble getting loans, and unemployment is rising. That is not to say that TARP has not had benefits. Its first step was to stabilize our banking system and to stabilize our economy and it was successful to a certain degree in that area.

I do want to note that a constituent of mine will be testifying, Robert Davenport. He is the president of the National Development Council, which is one of the oldest national nonprofit community and economic development organizations in the United States. Thank for your work and thank you for being here.

One of the concerns that the public has in having trust in the TARP system is transparency; they are saying they want to know where their dollars went before more dollars are allocated. I have asked Chairman Bernanke and he says this information is out there. Yet I would like to place in the record a letter from Professor Stiglitz, who points out that he cannot find this information, and a lawsuit filed by Bloomberg who say they likewise cannot find that information.

Chairman GUTIERREZ. Without objection, it is so ordered.

Mrs. MALONEY. And currently, if I could say this, I think it is important to note that the TARP data are presented in filings in over 25 different Federal agencies now, including filings with the Securities and Exchange Commission, Federal Reserve Registration Data, the FDIC, Over the Counter Trade, the Commodities Futures Trading Commission; the data sources required to perform transparency for the TARP initiative is not only housed in different agencies but incompatible systems and formats. It is impossible to

track this information. That is why I have introduced the TARP Accountability and Disclosure Act. This legislation would require the Secretary of the Treasury to develop a centralized database that will be the repository of how this money is spent after it has been provided to a financial institution so that we can track this information and know if it is being successful, not only in stabilizing our financial institutions, but in getting lending going, the wheel of our economy, of getting lending out into our communities and helping our economy go forward. I urge my colleagues to look at this legislation and hopefully join me in cosponsoring it.

And again, congratulations, Mr. Chairman. I look forward to working with you and the ranking member.

Chairman GUTIERREZ. The gentleman from Delaware is recognized for 2 minutes.

Mr. CASTLE. Thank you, Mr. Chairman. Let me just say I agree with all those who have spoken and I think that the words are well taken. And I believe very strongly that there is just not sufficient, and we keep using the word "transparency," but understanding of exactly what has happened here. I think most of us can track and follow those banking institutions, be they holding companies or banks directly, which have received money; we have charts to that effect. We can even look at some of their lending patterns which stay roughly the same if you look at the last 3 months of last year.

But it becomes very difficult to track exactly to whom those loans have gone and exactly how that money is being spent and accounted for, nor do I know if it is. I don't know if a banking institution has loaned an extra $50 million or to whom it has loaned it other than GM or somebody of that nature and exactly how it has been spent. I just don't think we have that information, which is one reason I look forward to this hearing today. I think it is vitally important that not only Members of Congress but the public understand this.

I watched the stock market just collapse here in the last several months. I think a lot of it is a lack of understanding of what is going on out there. And we need better information, better presented in terms of what is happening. You may make the argument that not only banking institutions but other institutions are raising money are in some way or other raising capital and for that reason are more stable than perhaps we think they are. But at this point, there is just a lot of doubt in the minds of a lot of people, even beyond the Congress of the United States who just aren't sure what is happening. I don't think anybody can make a conclusive argument that TARP is working or not working. So what you are going to present today and the answer to your questions is vitally important to all of us and I think we have an obligation to make sure that there is a public understanding of all of this. I am glad to see the Federal Reserve has started to move in that direction.

I yield back, Mr. Chairman.

Chairman GUTIERREZ. The gentleman yields back. Congressman Sherman from California for 2 minutes.

Mr. SHERMAN. Thank you. I usually focus on whether taxpayers are getting a good deal in TARP transactions or whether there has been undue generosity toward Wall Street. We have all been outraged by the dividends, the compensation and perks and the Con-

gressional Oversight Panel demonstrating being shortchanged by $78 billion in terms of receiving less preferred stock than we should have.

I have also been concerned about taxpayer money going to foreign entities as appears to be the case with the transfer of tens of billions of dollars to AIG counterparties, including what appears to be substantial transfers to foreign entities. Today we focus on helping Main Street and there are two ways that TARP can do that without going through Wall Street. One is the use of the TALF to have the Fed make loans. Now true, some of these may be generated originally by large banks, but they could also be from small banks and increasingly we could see Federal agencies making the loans themselves.

The second is to use community institutions. I look forward to seeing how we could better use community banks. And I want to comment about credit unions who want to make small business loans. They need capital and they are turning away deposits. They can't issue preferred or common stock because of their nature. They could be allowed to issue subordinated debt which is much like preferred stock. If they could, we in Congress authorized them to do so, they can sell the subordinated debt either to the TARP program or to the public, get the capital, accept deposits that their members want to make, and make small business loans.

The other thing we need to do is to explicitly authorize a greater amount of small business lending by credit unions. So I look forward to seeing community banks and credit unions get us out of a recession that they clearly did not put us into. I yield back.

Chairman GUTIERREZ. The gentleman yields back, Mr. Klein for a minute-and-a-half.

Mr. KLEIN. Thank you very much, Mr. Chairman. And thank you for holding this hearing. Last week, the Oversight and Investigations Subcommittee held a hearing on TARP oversight and this is an important follow-up to those proceedings.

Many of the witness here today will be discussing the need to improve lending to small businesses. And it is clear from today's testimony that we will hear that the TARP program, and I think from the experience we have had in speaking to our neighbors and friends back home is largely failing to unfreeze the credit markets and allow creditworthy businesses to assess credit on reasonable terms. And certainly nobody is asking anybody to make loans that are not credit worthy. But it is clear that the pendulum has swung wildly to the other side and has hit the wall and it is unfortunately lending itself to allowing these types of reasonable loans to take place.

I certainly agree with the recommendations to take concrete action with certainty to ensure businesses can obtain the credit that is essential in the successful operation of their enterprise. Small businesses tend to lose jobs faster as the country ends a recession, but they also tend to recover faster with a little more flexibility and adaptability in emerging from a recession. So it is even more essential that we find substantial ways to help these small businesses access the credit which is their life blood.

Elizabeth Warren, who is the chair of the Congressional Oversight Panel, testified last week, "If this TARP program is about

putting money into the hands of small businesses, then you make that part of the terms of receiving the money. And if someone doesn't want to do that with the money, then don't let them have the money. It's that straightforward."

It seems pretty simple to me, as well. I think her comments are absolutely correct, and I look forward to the testimony so we can work together to flesh out the ways of restoring the flow of credit to our small business community. Thank you very much, Mr. Chairman.

Chairman GUTIERREZ. Thank you Mr. Klein.

We are pleased to have before us today witnesses representing a small business, a community bank, a community development financial institution, two noted economists, and a financial consultant.

Testifying first is David Scharfstein, Ph.D., the Edmund Cogswell Converse Professor of Finance and Banking at the Harvard Business School. Next is Dean Baker, Ph.D., the co-director of the Center for Economic and Policy Research. Testifying third will be Robert Davenport, president of the National Development Council. Next is Rusty Cloutier, the president and CEO of MidSouth Bank Corp. located in Lafayette, Louisiana. Following him is Bert Ely, founder of Ely & Company, based in Alexandria, Virginia. Finally, we have Mr. Joseph Zucchero, who is the owner of Mr. Beef Deli in Chicago, Illinois.

Mr. Scharfstein, you may proceed with your testimony.

STATEMENT OF DAVID S. SCHARFSTEIN, PH.D., PROFESSOR OF FINANCE, HARVARD BUSINESS SCHOOL

Mr. SCHARFSTEIN. Good afternoon. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, thank you for inviting me to speak today. My name is David Scharfstein. I am a professor at Harvard Business School, and a research associate of the National Bureau of Economic Research. I am also a member of the Squam Lake Working Group on Financial Regulation, which is a nonpartisan, non-affiliated group of 15 academics who have come together to offer guidance on the reform of financial regulation, but I speak only for myself today.

I would like to make three main points. First, there has likely been a contraction in the supply of bank loans because of the poor financial condition of many large banks. This poses a challenge for most firms, but particularly for small firms which rely on bank loans for almost all of their financing. About half their loans come from large banks, and these banks appear to be cutting their lending more than our small banks. Thus it is important to find ways to ease the supply of credit to small firms.

Second, the Capital Purchase Program of TARP should be thought of as two distinct programs. One is a support program for large troubled financial institutions, some of which are systemically significant. The effect of this program on financial stability and credit availability is hard to measure since we cannot observe what would have happened in its absence.

The other part of the CPP program is targeted at small banks. This program is not a support program for troubled financial institutions, but rather, a program that provides capital to banks so

they can increase their supply of credit. The effect of this program will be somewhat easier to measure, but such measurement will inevitably be imperfect.

Third, and at the heart of my testimony, the government should consider expanding the Capital Purchase Program for small banks, perhaps even creating a separate program for them. The problems of the big banks have no easy solutions and it is highly uncertain how and when their problems will be resolved. In the meantime, small firms risk losing their primary source of funding. Many small banks are well-positioned to step into the breach, given their knowledge of local markets, and with an infusion of capital, could do so.

However, as with any government program, one must ask, why does the government need to be involved? In this case, one should ask, why can't banks with good lending opportunities raise capital on their own? The answer is that many can raise capital, but are reluctant to do so in the current financial environment. Given extreme investor uncertainty about the health of the banking sector, a bank that issues stock is likely to be perceived as one that is undercapitalized or has unrecognized losses on its loan portfolio. So it is natural that banks have been reluctant to issue stock on their own, given that doing so would likely drive down their stock price. In addition, most small banks are privately owned and cannot easily raise capital in illiquid markets. The government's commitment to purchase stock at a premium would entice small banks to participate in the program and raise capital as many have already done.

This program will attract more banks if it does not include the same sort of restrictions that are now imposed on TARP recipients, nor should it. This program would not be designed to put taxpayer dollars at significant risk. The program would be most effective if it targets small banks that are able to leverage the equity investment by expanding their deposits or borrowing. And it should target banks with expertise in business lending. Research I have done suggests that the existing TARP investments in small banks do appear to have gone to banks that do more business lending.

It would be tempting to require participating banks to reach a target level of new lending equal to some multiple of the government's investment. This temptation should be resisted. Mandates of this sort could result in a rash of bad loans and we do not want to turn healthy banks into unhealthy ones.

Moreover, we should probably not measure the success of the program purely on the basis of whether there is an increase in lending. It will be a success if the increased lending capacity of small banks increases competition and puts downward pressure on interest rate spreads which are now at high levels.

Of course, it is important to keep in mind the limitations of such a program. Some of the hardest hit communities may also have many troubled banks. Investment in these banks may help stabilize them, but that is not the sort of investment I have in mind. Moreover, while many small banks are relatively healthy now, their condition could worsen appreciably. In that case, the investments are unlikely to have the desired effects.

With these limitations in mind, I believe that the government should enhance its program of investment in small banks, targeting healthy banks that are well-positioned to increase lending at a time when large banks appear to be retrenching, this would better enable our financial system to meet the pressing needs of small enterprise.

Thank you for the opportunity to address you today. I look forward to answering any questions you may have.

[The prepared statement of Dr. Scharfstein can be found on page 74 of the appendix.]

Chairman GUTIERREZ. Thank you for so rigidly following the rule of the red light. Everybody has 5 minutes, so when you see the little yellow light, that means you have about 30 seconds to wrap it up.

Mr. Baker, please.

STATEMENT OF DEAN BAKER, PH.D., CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH

Mr. BAKER. Thank you, Chairman Gutierrez, and Ranking Member Hensarling, for inviting me to speak here. I want to make three main points in my comments here today. First off, agreeing with the chairman's opening remarks, I think there were two contradictory purposes or at least distinct purposes.

Chairman GUTIERREZ. Mr. Baker, could you pull the microphone closer?

Mr. BAKER. There were two distinct purposes or motivations behind the creation of TARP: One, the stabilizing of troubled banking institutions; and two, restoring the flow of credit. Those are two very distinct purposes. The second point I want to make, and perhaps I am out of line with some of the other witnesses here in some of the other comments, but I think the main cause of this downturn is we are misplacing it if we seeing it as being in the financial system. I think the main cause of the downturn is a loss of $8 trillion in housing wealth. I will make a couple of comments on that, but I think we would be misleading ourselves if we thought simply restoring the flow of credit would be sufficient to get the economy going again.

And then the third point, agreeing with many of the comments just made, is that the Treasury and the Fed should try to target TARP money to aid smaller financial institutions because many of those are best positioned to resume the flow of credit, which certainly will help with the recovery.

Now as far as the first point, just to recap the history that you all recall very well back in September and October, the pressing need, the urgency that the Treasury Secretary and the Federal Reserve Board Chairman came to Congress and said we needed TARP, the pressing need was that interbank lending had come to a halt, the LIBOR rate the spread between the interbank lending rate in London and the 90-day Treasury rate had expanded almost 5 percentage points at its peak. During normal times, it is typically between 15 and 30 basis points. So we basically had a freeze of interbank lending between the major banks simply because no one could trust that these banks would be in business 90 days out, we are only talking about 90-day loans. That, to my mind, was the ur-

gency, the main purpose of the TARP. And certainly I think Members of Congress have been right in pressing for more transparency. The taxpayers certainly have a right to know where their money is going.

On the other hand, getting the money to the banks to ensure that they did not collapse does not restore the flow of credit. And perhaps our best example here is simply the case of AIG, which is, of course, not a bank, but an insurance company, but the money that we funneled, the taxpayers have funneled into AIG is not about restoring the flow of credit, it is simply about keeping a systematically important institution from collapsing. And I think we do ourselves a disservice if we try to conflate the two. Getting money to AIG does not restore the flow of credit.

My second point is that the downturn is first and foremost due to the loss of wealth. We have lost on the order of $6 trillion of housing bubble wealth, and we are on our way to losing on the order of another $2 trillion. This explains the downturn almost in its entirety. The basic story, if you look at the housing industry itself, we have seen a contraction on the order of about $450 billion a year in annual demand due to direct housing construction, building in the housing sector and the residential sector. And then on top of that, the wealth effect that we would expect to see based on $8 trillion of housing wealth would imply an additional about $500 billion in annual consumption. That is sufficient to explain the downturn we are seeing.

The impact of the freezing-up of the credit system obviously magnifies that, but the basic story is that we had a very large bubble which led to a huge amount of, in effect, fictitious wealth, which has disappeared over the last 2 years. And that is the cause of the downturn.

Now, one item I like to cite as evidence that there isn't a problem or the problem is exaggerated of creditworthy customers being unable to get credit is the Mortgage Bankers Association mortgage applications index—if it were the case that creditworthy customers were having difficulty getting home mortgages, we would expect to see that index soaring as people had to apply for two, three or four mortgages just to get one. And of course, many people apply for two or three mortgages and are still not able to get one issued. In fact, this index has trailed downwards. It has followed wholesales downwards, indicating that creditworthy borrowers are not having much trouble at all getting mortgages. So I do not mean to say that businesses can never have trouble getting mortgages but the main factor here is simply the loss of wealth.

On the last point we know that we had many large banks that are severely troubled. One of the things that has been striking is many small banks have held up very well through this crisis, that is not true everywhere. Obviously, if you are in the middle of a bubble market, you will get hit hard. But if you look at the FDIC's data, you see that the category of banks with assets of $100 million to $300 million actually managed to increase their loans modestly in the fourth quarter, a period in which the economy was declining at a 6 percent annual rate. That suggests that those can be an engine that could move the economy out of the downturn and Con-

gress would be well-advised to try to get them the capital they need to sustain lending. Thank you.

[The prepared statement of Dr. Baker can be found on page 41 of the appendix.]

Chairman GUTIERREZ. Thank you very much.

Mr. Davenport.

STATEMENT OF ROBERT W. DAVENPORT, PRESIDENT, THE NATIONAL DEVELOPMENT COUNCIL

Mr. DAVENPORT. Mr. Chairman and members of the committee, I want to thank you for the opportunity to testify today regarding the effectiveness of TARP on Main Street. I am Bob Davenport, the president of the National Development Council in Washington, D.C., an organization that was created in 1968 after the tragic deaths of Dr. Martin Luther King and Robert F. Kennedy. Our mission is very simple: It is to end discrimination and create opportunity in low-income communities.

Fundamentally, we provide training and we provide technical assistance and we do financing in low-income communities. We finance affordable housing, we do small business lending, and we finance a whole variety of community facilities such as medical centers, libraries, educational facilities, and youth facilities.

We have lots of experience in business financing on Main Street. We are a CDFI and CDE as certified by the U.S. Treasury. We are also an SBLC with a license from the SBA. We financed about a half-billion dollars worth of affordable housing and we financed about a half-billion dollars of new markets transactions.

In SBA, we have loaned just under $100 million in financing to small businesses. Our average borrower is borrowing $300,000. All of our borrowers are on Main Street. It is clear the economic downturn is having a devastating impact on our low-income communities, but also on organizations such as ours which are involved in financing in low-income communities. And we do need another source of capital until the banks return to our market. We need TARP and TALF, we believe, not because we are doing poorly, but because we are doing well. We need to increase our liquidity and we need to replenish capital in order to meet the increasing demand that we are finding in our communities as the conventional banks pull back.

Here is how the pullback has affected us directly. First of all, I mentioned we are an SBLC, which means we are a small business lending company, we make SBA guaranteed loans, the SBA guarantees 75 percent of it. If we make a $400,000 loan, $300,000 of that loan is guaranteed by the SBA. We borrow that $300,000 from a conventional lender, they have a very secure loan, it is 100 percent guaranteed by the SBA.

One of our conventional lenders is a large money center bank that received TARP funds last fall. We had a longstanding relationship with that bank going back to the 1990's. This bank had a $5 million credit facility to us. Starting last December, however, they took a series of actions that forced us to pay the loan back. First of all, they raised the rates, which we felt was unwarranted because we had just completed a superlative safety and soundness exam by the Farm Credit Administration. And the SBA's overall

risk rating for our SBLC was 1, which places us at the highest grade, lowest risk rating possible.

Second, they asked for a direct security interest in the loans that we made. SBA has that security interest and we would be in violation of our SBA license if we were to give it to that bank. Finally, they said that they demanded that we agreed to pay them on any defaulted loan before the SBA pays us.

They said they assumed all of our small businesses loans would go bad in the communities in which we are working. They wanted to be paid in a timely fashion and would not wait for the SBA. Well, the only way we could meet that condition was by us borrowing from them and not lending the money out to have the money to pay it back if anything went bad.

Since we couldn't comply with the conditions, we had to agree to repay them. From their perspective, they didn't turn us down for credit, they believe they offered us credit. We just couldn't meet the terms that they demanded. And as a result, we are paying that loan back. And this all happened after the bank received TARP funds.

We have made several recommendations in our written testimony. I won't go into them, let me just say, if TARP and TALF were available to the 4,000 or 5,000 institutions that are out there, from the smaller community banks that you will hear from to alternative financial institutions such as us, to community development financial institutions, etc., if it was offered to those financial institutions to replenish their liquidity and to increase their capital because they have made loans and they will continue to make loans, they don't need the TARP funds because they might make loans, they are making loans. These mission-driven institutions have no desire to hoard their TARP funds. They will use the TARP funds to make loans, and they will use it responsibly. Thank you.

[The prepared statement of Mr. Davenport can be found on page 54 of the appendix.]

Chairman GUTIERREZ. Thank you.

Mr. Cloutier.

STATEMENT OF C.R. CLOUTIER, PRESIDENT AND CEO, MIDSOUTH BANK CORPORATION, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. CLOUTIER. Chairman Gutierrez, Representative Hensarling, and members of the committee, my name is Rusty Cloutier. I am president and CEO of MidSouth Bank Corp., which is a bank holding company located and headquartered in Lafayette, Louisiana, with total assets of approximately $940 million. Through our wholly owned bank subsidiary, MidSouth offers complete banking services to commercial and retail customers in both south Louisiana and the entirety of southeast Texas.

MidSouth Bank, like the vast majority of community banks, did not engage in the subprime lending practices that are at the heart of the current crisis. As a result, MidSouth bank is healthy and well capitalized and is in a strong position to help this economy recover. MidSouth Bank lived through the deep recession, or as I call it, depression, that ravaged the economies of Louisiana and Texas in the 1980's. We are terribly experienced in helping to revitalize

an economy when the large financial institutions have failed. It is important to distinguish the Capital Purchase Program available to community banks from other TARP programs. The Capital Purchase Program funds are only given to healthy community banks. On the other hand, too big to fail institutions do not have to be healthy to receive TARP money. In most instances, they receive it because they are not healthy.

The CPP program is not a bailout for community banks. MidSouth must pay an annual dividend of 5 percent on the $20 million in preferred shares we purchase from the Treasury along with a grand of stock 1s. Community banks participating in the program relend the money in order to cover the costs of this capital. MidSouth heeded the call by Treasury and banking regulators to participate in the TARP Capital Purchase Program because we believed it was our patriotic duty to participate in CPP to help stimulate the economy.

When MidSouth accepted the $20 million in CPP funds in January, we viewed the government's investment as a public, private partnership that President Obama has talked about to promote lending. We began to actively promote the availability of $250 million in loan opportunities to small businesses and community leaders through town hall meetings in 18 communities in south Louisiana and southeast Texas. We focused on small businesses because they drive the economy and create new jobs in our communities.

In addition to the general business community, we are also reaching out to the minority business community through town hall meetings with the Black chambers of commerce in Baton Rouge in southwest Louisiana and the group of 100 Black Men. We will also have a billboard campaign underway throughout our markets aimed at small businesses and the general public letting them know we have $250 million to lend.

While attendance at these meetings has been good, there seems to be a reluctance to take on a significant amount of new debt. This is true despite small business loan rates at least 2 percent lower than a year ago. The reluctance of the borrower is probably due to an uneasiness about the general economy and due to the drop of the price of oil, which is an important driver of the economies of southwest Louisiana and southeast Texas. Given the state of the economy and the tough regulatory environment we live with, it is harder for community banks to find borrowers who are currently creditworthy.

Despite the challenge, we believe our outreach efforts have paid off. Our level of lending for consumers and businesses remains about the same about this time last year. We believe that is quite an accomplishment in the midst of a most serious recession. Since receiving the CPC capital infusion in January, we have made approximately $13 million in new consumer and commercial loans and $7 million in mortgages. We are especially proud of 2 new small business loans made by MidSouth since receiving the CPP fund. These loans to 2 small oil field service business will create over 50 new jobs in south Louisiana and southeast Texas.

As MidSouth Bank has shown, community banks have the know-how and the desire to use the CPP funds to support economic re-

covery in the communities throughout the Nation. MidSouth Bank does not engage in compensation practices found at some of the larger TARP recipients, which have understandably created a public furor. We are frustrated at being tarred with the same brush as these large institutions. ICBA believes compensation restrictions and new corporate governance regulations should be focused on the larger TARP recipients that have undermined the public competence in the Treasury's recovery efforts.

If the government changes its agreement with MidSouth by adding new burdensome conditions, MidSouth will have to reevaluate its continuing participation in the CPP program as our hometown competitor, Iberia Bank, did when it paid back its CPP funds this week. It would be a shame if new burdened conditions forced MidSouth to withdraw from the program, because MidSouth has proven itself to be a responsible partner in the effort to revitalize the economy. I would be very happy to take your questions.

[The prepared statement of Mr. Cloutier can be found on page 46 of the appendix.]

Chairman GUTIERREZ. Thank you.

Mr. Ely, please.

STATEMENT OF BERT ELY, PRINCIPAL, ELY & COMPANY

Mr. ELY. Mr. Chairman, Ranking Member Hensarling, and members of the committee, I very much appreciate the opportunity to testify today about TARP and whether it is working for Main Street. I have appended to my written testimony the answers to 8 questions posed in the letter of invitation to testify. As will be readily evident from the answers, I am not a great fan of the TARP. Further, I greatly fear that the TARP will become a vehicle by which Congress will impose credit allocation policies on TARP investees. Such policies will be very destructive to the American economy.

My early consulting experience is especially relevant to the subject of this hearing as for over a decade, I consulted with small and medium-sized businesses on a broad range of financial matters including obtaining bank credit. I also worked with business insolvencies. Those experiences brought home to me the importance to small businesses of having sufficient equity capital which is safely leveraged bank credit.

Lending standards clearly are returning to earlier prudent standards after the excessive laxness of recent years. That return to prudent standards is crucial, both for the recovery from the current recession, as well as for the longer term health of the American economy. This is absolutely the wrong time for Congress to force banks, whether through TARP rules or otherwise, to launch a new round of imprudent lending whether to small businesses or homeowners or whomever.

With regard to lending to small businesses, it is important to realize the primary reason that a business cannot obtain credit it believes it needs is that it lacks sufficient equity capital and/or it cannot demonstrate to the lender that it can properly employ the credit being sought.

It is vitally important to realize that credit is not a substitute for equity capital, rather credit can only be reasonably leveraged of a

sufficiently strong equity capital base. In this regard, non financial businesses are no different than banks except that for good reason, non-financial businesses cannot operate with as much leverage as banks and other financial intermediaries.

Because lending centers are returning to normalcy, businesses of all types cannot operate with as much leverage as they could a few years ago, nor should they try. The underlying cause of insufficient credit for businesses, including small businesses, is inadequate equity capital as mentioned. Rather than beating on banks to lend more, Congress should address the tax incentive working against equity capital accumulation within businesses. To put this another way, the Internal Revenue Code is the principal underlying cause for the current financial crisis.

I address the tax laws and 10 other public policy causes of the crisis in an article which will appear shortly in the Cato Journal. I would be glad to submit that article for the record when it appears in print later this month.

While there are many aspects of the tax laws which fueled the housing bubble and gross overleveraging of the American economy, working together, they encourage businesses and individuals to overleverage by incenting overspending and undersaving, thereby discouraging an accumulation of capital denominated as equity. This is rather than encouraging saving, which builds equity on a balance sheet that tax laws actively discourage savings and equity capital accumulation through the relatively heavy taxation for profits, for profits represent the generation of equity capital.

At the same time, the tax deductibility of interest expense by businesses and homeowners encourages borrowing and therefore overleveraging.

When the pretax cost equity capital is easily 15 percent or more and the prime rate is 3¼ percent as it is today, it is an apparent no-brainer for a business to finance as much of its balance sheet as it can with that capital and as little as possible with equity capital. In addition to funding the portion of a business' bank balance sheet, the equity capital also serves as its loss cushion, the same role equity capital plays in a bank balance sheet. That lost cushion becomes vital to a businesses survival during a recession, for it is equity capital, not debt capital, which must absorb business losses and serve as a foundation on which where borrowing during tough times must be based.

Far too often, I have seen business owners seduced during good times by seemingly cheap debt only to suffer losses during the tough times that exhausted too-thin equity capital foundation. I will close this portion of my testimony by posing this thought experiment: What would be the condition of the American economy today and the availability of credit for businesses of all sizes if interest was not a tax deductible business expense and business profits were not taxed at a business level? I strongly suspect that America would not be in a recession and that it would enjoy a much more profitable or much leveraged business sector than it has today.

I will close by discussing a potential threat, threatened loss of bank capital and therefore reduction bank lending capacity. The 20-basis point deposit insurance special assessment that the FDIC

has proposed a levy on the Nation's banks and thrifts this coming September 30th. This assessment represents a $15 billion tax on bank capital and what occurs the government is trying to boost the banking industry's capital and lending capacity. As FDIC Chairman Sheila Bair has admitted, this assessment would be procyclical, yet she is determined to levy it. I recommend that the Financial Services Committee express its opposition in the strongest possible terms to this most untimely attack on bank lending capacity. With that, I thank you for your time.

[The prepared statement of Mr. Ely can be found on page 62 of the appendix.]

Chairman GUTIERREZ. I just want to say I have known Mr. Zucchero for over 20 years. I have been at his business in the summer, the winter, and the fall, and there is always a long line, many, many people. I just can't understand how a thriving business like that cannot really—there is so much demand at his place, any season of the years, anybody from Chicago knows, so all politics being local, I did invite a local business person, but he is so representative of what is wrong with our current banking system. Mr. Zucchero, please.

STATEMENT OF JOSEPH ZUCCHERO, OWNER, MR. BEEF DELI

Mr. ZUCCHERO. Good afternoon, Chairman Gutierrez, Ranking Member Hensarling, and members of the committee. On behalf of myself, my business partner, Michael Genovise, and my attorney, James DiChristofano, I thank the committee for inviting us to participate in this crucial hearing. I sincerely believe it is essential during this tumultuous time that the voices of small business owners are heard and those struggles are reported.

I am the owner of Mr. Beef on Orleans. We have been there in the City of Chicago for 30 years. We have built a reputable reputation and thriving business. In addition, I am the owner, along with Michael Genovise, of an apartment building and an Italian fine dining restaurant named Natalino's, also located in the City of Chicago. We opened that in March of 2008. Combined, both restaurants employ 50 hardworking people. We provide much of the needed sales tax receipts for the City of Chicago, Cook County, and the State of Illinois. We source all of our food and our products from small business purveyors. The economic downturn has had its impacts on my business due to loss of jobs and income from local residents who live and work near downtown Chicago.

Many small businesses are being starved of needed lines of credit or having their lines of credit not renewed upon maturity. Not only have I seen and heard this from a variety of small business owners, I personally lived out this nightmare. I have two relatively small loans that matured in October and November of last year. These loans have been paid every month and I continue to submit payments. I do not have the funds to give the entire loan amounts that are due. Midwest Bank, which received $85 million in TARP funds, will not renew or extend mature loans any further. This places my business and my properties in jeopardy.

Another bank will not refinance the two mature loans because the new bank would be placed in a third lien position, thus the banks want us to try to obtain funding to refinance all the loans

at Natalino's and Mr. Beef. This has hampered our nonstop efforts to find financing or a resolution to our problem. Small businesses do not have the capital to take on this loan. Again, big banks are not even the slightest bit interested in our using the TARP money to insulate their own revenues. We have actively been submitting loan packages to various banks and loan brokers in order to extract us from the situation.

Our current loans are approximately 55 to 60 percent loan-to-value based on recent appraisals. Our loans carry interest rates right now of 8½ to 9 percent. Current rates are around 6½ to 7 percent. Lowering our rates would provide a dramatic savings to our business, would prevent us from letting go of more employees, and would give us breathing room to ride out the economic turmoil. Midwest Bank frustrates me in that they received TARP money and are not willing to either extend our loans or lower our interest rate on the non-mature loans. They have been patient with us while we seek alternative banks to finance us, but in reality that means nothing. Many bankers seem to be paying us lip service and are not actually interested in providing financing but rather seek free publicity.

We have been dealing with one small bank for about 6 months, we have been giving them documents, we have paid for expensive appraisals and tried to accommodate every request they made. To this day, we have been constantly given optimistic outcomes that they have increased our hopes that an end is near to our situation, yet they have not approved or denied any loans.

My situation is just one example. I am fortunate to have a successful business in downtown Chicago. There are other business owners who are not that fortunate. At the end of the day, we are at the mercy of the banks who have no willingness or obligation to help us. I was approached by a local banker whom I knew, and he found out that I was coming here to testify in front of this committee. He strongly suggested that I should not appear, I should ride out the economic problems and wait until this all blows over. I politely asked him to give me the $84,000 a year that lower rates would save and he promptly walked out of my establishment.

I do fear backlash within the local banking industry for coming here today. I implore this honorable committee to set my mind at ease. I do not need a bailout from the taxpayers. I only want the banks to be fair and refinance our loans.

Congress needs to take action, Congress needs to know that small businesses drive the economy, that we are fighting every day to keep our doors open and our people employed. It is time that TARP funds come with requirements that the banks must actively seek out and help lower small businesses interest rates or extend the mature loans or the lines the credit that are performing. On behalf of myself, my partner, Michael Genovise, my attorney, Jim DiChristofano, and all of the small businesses that run the economy, I thank Chairman Gutierrez and the other members of the committee for the opportunity to come here today to tell our story. I welcome all questions from the committee.

[The prepared statement of Mr. Zucchero can be found on page 90 of the appendix.]

Chairman GUTIERREZ. Thank you very much, Mr. Zucchero.

I will open up with 5 minutes. First of all, Mr. Zucchero, I want to thank you for what I know is a difficult task, to come before the committee and tell your story, and for the courage that it takes. I know you are very fearful because of what the financial institutions and the kind of repercussions by complaining about them might cause you and your business.

Since you are here, I would like to make clear to everybody just what is going on so that we can see. So Midwest Bank holds how much in loans to your businesses? What is the total amount?

Mr. ZUCCHERO. $335,000.

Chairman GUTIERREZ. So, $335,000. And those loans have matured; is that correct?

Mr. ZUCCHERO. They have matured, yes.

Chairman GUTIERREZ. And they won't refinance those loans?

Mr. ZUCCHERO. We asked them to refinance, and they wouldn't.

Chairman GUTIERREZ. And they received $85 million in TARP money?

Mr. ZUCCHERO. Yes. They sent us a letter saying that they received $85 million in TARP money.

Chairman GUTIERREZ. Let me ask you something: Were you ever late on the loan during the time you had the loan with them?

Mr. ZUCCHERO. No. It just matured.

Chairman GUTIERREZ. Okay. And let me just ask you something. Even though they have said they are unwilling to renegotiate any new terms, have you continued to pay the loan?

Mr. ZUCCHERO. We continue to pay the loans in full amount.

Chairman GUTIERREZ. So you took out the loans with Midwest Bank. You paid it on time every month. The loan came to maturity. They refused to renegotiate the terms of the loan. You were never late, and you continue to this day to pay the loan and the amount of money owed as you try to renegotiate.

Mr. ZUCCHERO. Yes. We submit the payments on time.

Chairman GUTIERREZ. So let me ask you, what do you think the place on Orleans in downtown Chicago is worth? I mean, Mr. Beef is a nice—it is a nice, humble establishment, but it is what it is. But I just wonder, what does that land in such a critical part of the City—I mean, the real value there must be not the building but the land. What do you say?

Mr. ZUCCHERO. Our last appraisal, which was, I think, done in November of 2008, was about $3 million.

Chairman GUTIERREZ. $3 million. So that is where Mr. Beef sits, on a piece of land worth $3 million, and you owe them $300,000 on that loan that they refuse. And what is the value of the other property? Because there are two of them. There is the other restaurant. What is the other value?

Mr. ZUCCHERO. 1523 Chicago Avenue is, I want to say, about $3.1 million.

Chairman GUTIERREZ. So you have appraisals for $6.1 million; is that correct, Mr. Zucchero?

Mr. ZUCCHERO. I am sorry. It is about $5.3 million.

Chairman GUTIERREZ. $5.3 million.

Mr. ZUCCHERO. Both properties are combined.

Chairman GUTIERREZ. What is the total amount of money that you owe? This is everything, the $300,000 that won't be renegoti-

ated and the other permanent financing that you have. What is the total amount that you have?

Mr. ZUCCHERO. About $3.4-, $3.5 million.

Chairman GUTIERREZ. So we see that he isn't overleveraged. He has appraisals for $5.3 million in an economy where real estate is losing value every day. He owes $3.4 million or thereabouts in total amount. And we gave somebody $85 million in TARP dollars, and they won't renegotiate. And it isn't as though—or what is the interest rate you are paying to Midwest?

Mr. ZUCCHERO. 8½ to 9 percent. We also threw in private homes on that.

Chairman GUTIERREZ. Of course, you also secured this with your own private homes and the private homes of your own business partners in addition to what the appraisals are. And 8 and 9 percent. I mean, just so that we understand, that is what he is paying. He has paid it faithfully. I think that is what we need to understand. It isn't giving small businesses loans so that they won't be repaid to the financial institutions.

We hear this story day in and day out in my office, and I know in offices across the United States of America, that people who have thriving businesses, the choking of the lines of credit is such that it is causing our economy harm. Even if you have a business that makes money, they will not extend to you the credit, unless, of course, you go outside the regular banking system to even more onerous interest rates in order to get this done. I don't think that is where we want to take America in terms of where our small business is.

I just want to thank you again, Mr. Zucchero, for coming and testifying before this committee and telling your story. I have other questions for other members of the panel, but now I will go to Mr. Hensarling for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

And, Mr. Cloutier, maybe we have a new customer for you here. I don't know. It is against House ethics rules for us to take a commission. So it will just be a public service. Maybe you two can all meet after this hearing.

I am not a banker. My background is not in banking. Not unlike Mr. Zucchero, I was a small businessman for 10 years before I ran for the House of Representatives. At the recommendation of our chairman, Mr. Zucchero, I certainly look forward, one day when I am in the Windy City, to going to your restaurant. If that doesn't violate House rules, then I would be happy to have you buy the Italian sausage.

Frankly, I have no idea, Mr. Zucchero, whether you are the greatest credit risk in America or the worst credit risk in America. I have no idea. It is not my area of expertise. The gentleman sitting two seats to your right, it probably is his area of expertise. But before I ask my questions, I think there is a very important point to be made for myself and for a number of Members of Congress, and that is, we want to empower banks to lend credit to creditworthy individuals. We do not wish to cajole, browbeat, or mandate. With all due respect to all of my colleagues, with few exceptions, I don't think there are many people here who probably know how to run a bank. Just like when we were in our hearing with

the CEOs of the three auto manufacturers—I must admit I was a little amused at how many of my colleagues wished to tell them how to make cars. We don't know how to make cars. We don't know how to do this. We need to empower you to do your job.

Now, Mr. Cloutier, the question for you—I believe in your testimony you said essentially that if certain provisions of TARP were changed in the funding agreement under the Capital Purchase Program, that your bank would rethink its participation.

Previously the House passed a bill—the Senate did not take it up—that would have defined provisions with respect to the second tranche of the $350 billion. Included in that House-passed bill was a provision that allowed the Federal Government to put an observer into your boardroom, and all those who indirectly benefited from the TARP money, which ostensibly would be your customers as well, if that passed the Senate and became law, would that be a troublesome provision to you?

Mr. CLOUTIER. If that became law, I think you would have basically all 400 community banks returning the money. Most community banks most probably are thinking about it very seriously. When the Treasury came with the program—you remember the CPP program, which came by Mr. Paulson, after he realized he didn't have enough money to buy toxic assets, he came up with this idea of putting money into healthy banks to try to help regenerate the economy. They were counting on 2,000 community banks taking the money. It is now down to 400, and those banks are starting to return the money.

So, the answer to your question is yes, I would anticipate that we would return the money, and most community banks would.

Mr. HENSARLING. Mr. Ely, in your testimony you state that you have a fear that TARP could become a vehicle by which Congress could impose, "credit allocation policies," which I guess I read as lending mandates. Could you tell me in your long-standing history within the industry, what are your fears; what historic precedent are they based upon? And what would you see as the consequences of such actions on the part of Congress?

Mr. ELY. Well, first of all, there is, I think, a mistaken idea that the banks are being given TARP money. They are not being given TARP money. The government is making an investment in the banks. It expects to be repaid on that with what effectively is interest in the form of dividends, and hopefully the taxpayer will not end up losing any money. So I think it is very important to realize that there is not a present here.

Second of all, banks lend very little in the way of capital. Their capital serves primarily as a loss cushion. Most of the money that banks lend is actually the deposits that they bring in, and they are borrowing from institutions like the Federal Home Loan Banks. So I think it is a mistake to somehow equate a TARP capital investment, which is there to strengthen the bank's loss cushion, with its lending activities.

But there seems to be a lot of talk about that, and that we might end up with some kind of lending mandates being imposed on banks. There certainly has been that discussion, which I find unfortunate because it leaves out the fact that banks have been increasing their lending. The Federal Reserve data on this are very clear

that banks have been increasing their lending even though we are now in a recession and many potential borrowers are actually cutting back on their borrowing.

So, in my opinion, the banking industry has been performing as a whole exceptionally well and increasing its lending at a time of economic distress. And I would think that if lending mandates are in place, to follow up on what Mr. Cloutier said, that you will find a lot of banks are saying, you know, this just isn't worth it. We are out of here. We are going to buy back that preferred stock we sold to the Treasury Department.

Mr. HENSARLING. Thank you.

Chairman GUTIERREZ. Thank you.

Mr. Moore for 5 minutes.

Mr. MOORE. Thank you, Mr. Chairman.

The TARP program set up by the Treasury Department and the Federal Reserve to provide liquidity and stability in the financial marketplace, are there additional steps or changes in any of the current programs that the Federal Government should consider to ensure credit is flowing to our small businesses? Mr. Ely, do you have any comments on that?

Mr. ELY. Well, I think that in the short term, there are a lot of small businesses that are going to have to hunker down in this time and live with the fact that credit standards have tightened, that things did get too loose. And what the small businesses have to focus on is trying to raise equity capital so as to improve their creditworthiness. I realize that this is a very difficult environment to do that.

But I also don't think it is wise in this economy to encourage banks or to force banks to make risky loans, and that is, of course, the real concern that flows from the notion of lending mandates, that banks are going to be forced to make loans that they otherwise would not, keeping in mind that banks are in the business of lending, this is how they make money. We shouldn't assume that banks are just sitting on the TARP money and not looking for lending opportunities. They are, but in this environment they want to understandably make good loans.

And I have one additional point. What I hear from bankers across the country is that they are getting a lot of criticism from their bank examiners, the folks out in the field, about the riskiness of their loan books. So there is a lot of pressure coming from that element of the bank supervision establishment to actually cut back on the riskiness of their lending. And that may be the situation at Midwest Bank. I don't know.

Mr. MOORE. Mr. Cloutier, do you have any different thoughts?

Mr. CLOUTIER. I will tell you that I have a good friend in Louisiana who says, "The big banks get the gain, and we get the pain." Let me be honest, the "Miserable Eight"—as I have nicknamed them—who appeared before you here, most of them are insolvent now. We went through this in Texas and Louisiana in the 1980's. You have to deal with the insolvent institutions. The regulators in Congress have been very slow to do that. The pain is going to take a much longer period of time.

And I would tell you, there are two things you learn in the banking business very early on. One is that concentration is a bad

thing. And what we have done is we have concentrated all the assets in this country in deposits into eight hands to about the tune of about 64 percent, and that goes back to the late 1990's when I testified in this room in front of Congressman Baker's subcommittee in this exact committee room, and we brought that up when it was getting out of hand, and they were well aware of it.

The second thing is in the banking business you learn very early that your best loss is your first loss. To keep pumping money into these big banks is causing a lot of problems. And I will just tell you, the community banks out there, we are second-class citizens. We know it. Mr. Tim Geithner said it the other day when he testified before the Senate under questioning from Senator Kay Bailey Hutchison. He said point blank, "We are going to take care of the Big Eight. The community bankers have to take care of themselves."

Mr. MOORE. Sir, let me stop you for just a minute. I will ask both of you if we have time. Are there additional steps or changes in any of the current programs that Congress has set up now that the Federal Government should consider to ensure credit is flowing to our small businesses? What can we do to make this credit flow so we can get this economy revived and moving again?

Mr. CLOUTIER. Let me give you one example. Mr. Ely just talked about it. I woke up last week and found out that my second quarter profits are totally gone. They are going to the FDIC. I am going to have to pay a premium of 20 cents, which is about $1.6 million in my bank. My FDIC premium is up 480 percent since last year because I have to pay the losses that the big banks have gotten.

I mean, you know, to feel like we feel, like a second-class citizen, is an understatement. And, you know, I didn't fly up here on a private jet, and I don't live that way. But I think the first thing Congress could do is drag the regulators in here, the Treasury and the Secretary of the Treasury, and say, "What are you going to do for the community banks? We are tired about hearing about saving the Big Eight. What are you going to do for Main Street? What are you going to do for the people who live in Mr. Gutierrez's district, Mr. Hensarling's district, your district? What are we going to do to help those on Main Street?" That is the real problem. And until that message gets to the regulators, we will continue to feel the pain, and they will continue to get the gain.

Mr. MOORE. Mr. Ely, did you have any different comments?

Mr. ELY. My comment would be that Congress should resist the temptation to put more restrictions and obligations on the banks that have accepted TARP funds so as not to drive those banks out of the program that are in it now, keeping in mind that there are many banks that have purposely chosen not to get involved with TARP in the first place because they don't want these lending restrictions and mandates.

Mr. MOORE. Anybody else on the panel have any thoughts, or are we out of time?

Chairman GUTIERREZ. We are out of time.

Mr. MOORE. Thank you, Mr. Chairman.

Chairman GUTIERREZ. Mr. Lee of New York for 5 minutes.

Mr. LEE. Thank you.

I may want to take this in just a slightly different direction, but what Mr. Hensarling started out with I thought was right on the mark. And I think we keep on picking on Mr. Ely here, but I liked one of the comments that I read in your testimony, and that was the comment, "Don't push banks to make bad loans." It is a pretty simple premise, but I believe over the years in Congress we have helped initiate some of the problems that we now see today.

And one thing that I have just learned over the years in business—and unfortunately, I think in Congress we keep trying to think that there is a magic pill that is going to get us out of these problems that we face. I am proud of the fact that I have many community banks in my district who have had sound lending practices. They haven't had their hands out. And they are the ones who still are making loans in my district to, for example, farmers who need cash to keep their operations running. So I agree with you that the TARP funds unfortunately, I think, in some cases have been misplaced.

In getting back to that point on regulation, I am deeply concerned, because unless there is a known bottom to this market, you have a lot of people sitting on the sidelines and not knowing what the rules are. And that applies to banks as well. I will start this out with Mr. Ely, and somebody else may also chime in, but right now we are toying with legislation on something called a cramdown. Are you familiar with that?

Mr. ELY. Yes, I am.

Mr. LEE. My personal concern is that the idea was to have good intentions; in fact, it will have the exact opposite. I believe that by allowing bankruptcy judges to have the power to rewrite or modify your primary mortgage, it would be very detrimental to the market and to banks. My concern is that I think it would raise interest rates, and it will further eliminate the flow of capital. I would like to hear your thoughts on that.

Mr. ELY. Well, I have those same reservations about cramdown. The essence of the cramdown provision would be to empower the bankruptcy courts to modify mortgage terms on the primary residence, and what that would do is increase the uncertainty in lending on mortgages, and banks and other lenders would have to take this into consideration in their loan pricing going forward. The talk is that the cramdown would only apply to loans that were made by a certain date. Once Congress did that, then it would be reasonable for lenders to assume that in the future you might have a similar provision. And so it would be actually unwise of them not to assume that as a new risk in lending. What this would do would be to hurt those who are the most credit constrained in borrowing, and it would have the effect of pushing up or pushing down minimum loan-to-value ratios on loans, requiring higher credit scores, and making it harder for the credit constrained to borrow.

I also have another concern that goes back to my years of doing bankruptcy work, and that is we have several hundred bankruptcy judges in the country spread across many district courts, 12 or 13 appellate circuits. It would take a long time for case law to develop through the courts as to what was an appropriate mortgage modification, and what was not. What I would be concerned about is during that time, which could be for many years, that you would

have great uncertainty across the judicial circuits as to what was appropriate or not appropriate in a cramdown, and that would add even more uncertainty in the—

Mr. LEE. I think we have opened up Pandora's box in doing so.

Mr. ELY. Absolutely.

Mr. LEE. One more question for Mr. Cloutier. I apologize, gentlemen. We are not trying to pick on these two gentlemen. But if we set TARP aside, is there anything else that we can be doing here legislatively here that would help your bank?

Mr. CLOUTIER. I think the number one thing you can do to help my bank and to help all the community banks in America is to separate it into two categories, large financial conglomerate institutions and banks. The people in New York are not banks. You know, I mean, I know they give them titles, Goldman Sachs and Morgan Stanley. They are in a different league from me. As I like to tell people, they are playing in the NFL, and in the communities I service, I am down at the junior high school level, and that is the difference.

I think when you lump them all together, when Congress says, well, the banks did this, the banks did that, it is just not the people in your district, Mr. Lee. I know your district. We have a future chairman coming out of New York, and, you know, he runs a little $80 million bank up there. He is not the same as the boys at Goldman Sachs and Morgan Stanley.

If we look at different regulations for the size of the institution and the complexity and realize that when you talk, it is Congress I am talking about, not you individually, I think we would make a huge difference.

Chairman GUTIERREZ. The time of the gentleman has expired, Thank you, Mr. Cloutier.

Mr. CLOUTIER. Thank you.

Chairman GUTIERREZ. Mr. Baker, I want to thank you, since I know we promised you we would get you out of here by 4:30. Unfortunately there were a few votes that delayed us. We thank you. Whenever you have to leave, please feel free to leave. And we thank you for your testimony. We look forward to speaking to you again soon.

Mr. BAKER. Okay. I appreciate that very, very much.

Chairman GUTIERREZ. You are very welcome.

And next, we have Mr. Sherman from California for 5 minutes.

Mr. SHERMAN. Thank you.

Let me just respond to Mr. Ely for a second. To think that if we pass a bankruptcy law in 2009 applicable to mortgages written in 2008 that somebody in 2015 is not going to make a mortgage loan because they wonder what Congress will do if there is a national financial panic in 2020 means that apparently nobody in the lending business knows much about politics or government.

How we respond to the economic panic of 2025 has almost nothing to do with what Congress does in 2009. I don't know what the politics will be. I don't know if the Democratic Party or Republican Party will be in existence. So if somebody wants to make loans in 2020, assuming that they know what the law is going to be in 2025, I don't think reading the history books of 2009 is going to tell them much. I do realize it would be unprecedented, but I, for one,

can't tell you what the law is going to be in 2025 with regard to cramdowns or how Congress is going to react in—

Mr. ELY. May I respond? I think the concern is not what happens in 2015 or 2020, but what happens in 2009, 2010, and 2011.

Mr. SHERMAN. Well, if somebody makes a loan in 2010, they are not going to be doing the same subprime they used to. But if we pass a law in 2009 designed to deal with the abusive lending of 2008, and somebody makes a legitimate loan in 2010, I will tell you I do know enough about politics. We are probably not going to pass a cramdown law in 2011 applicable to mortgages written in 2010. I am not going to ask for your response because you are the expert, except when it comes to predicting Congress. Then we don't really need to bring in outside experts to give us advice.

Mr. BAKER. Excuse me, Representative Sherman. If I could just comment on that very briefly. I think actually the effect that was referred to here by Mr. Ely is exactly what you would want; that in the event we saw a sort of crazed period of lending as we actually had in 2004, 2005, and 2006, we would precisely want the banks to be worried that Congress might take action to make it more difficult to collect those loans. That was what we want. It would be great if they had that concern.

Mr. SHERMAN. I am not looking for that particular fear. And I certainly don't want them to not make a good loan because they are worried that 2 or 3 percent of the good loans they make are going to go bad, and then there is going to be cramdown for those. I would hope the cramdown would exist only for laws prior to enactment, and that is what the statute before the Congress would provide. Yes, it takes the unprecedented and makes it precedented, but it certainly provides only the slightest bit of guidance as to how Congress is going to legislate with regard to mortgages issued in future years.

The focus of a lot of attention is, why aren't the banks lending? And there are a few benign reasons for that. First, I remember the good times, 2 or 3 years ago, constituents would always be coming to me, telling me their dreams are being crushed because nobody will make them the loan they want. So we start with a background base of people who would be disappointed even in the best of times. We then have the fact that up until very recently, lending standards were way too loose, so a lot of people were getting loans they shouldn't have. Then everyone is a worse credit risk now than they were a year ago. And finally, the banks themselves, or the big banks at least, are somewhere between insolvent and undercapitalized. So the big banks are still lending more money than they are getting from TARP. They are lending less money than they used to. And I have no way of calculating whether they are lending more money than they would have had there not been a TARP.

But the bigger issue is not are they lending more than they would have if we hadn't have adopted the program, but, rather, how do we configure a program that dollar for dollar imposed on the taxpayer gets you the most in lending into the economy?

Mr. Baker, how would you compare taking the next $100-, $200 billion of TARP money and giving it to the big banks in one form or another versus going to Chairman Bernanke, who has basically

said he will do TALF-type programs? We put up $10 billion, he will go out there and lend $100 billion, which provides the most—

Chairman GUTIERREZ. The gentleman's time has expired.

Mr. SHERMAN. I would ask that the witness be able to respond.

Chairman GUTIERREZ. Sure.

Mr. BAKER. I will just be very quick. I would follow-up from Mr. Scharfstein's testimony that I think you wanted to distinguish between money that is going to keep essentially insolvent institutions alive for systematic purposes versus lending. Your priority, I think very reasonably, is on lending. And we obviously have to deal with systematically important institutions, but that is a totally separate issue.

Chairman GUTIERREZ. Congressman Marchant for 5 minutes.

Mr. MARCHANT. Thank you, Mr. Chairman.

My question has to do with the distribution of the TARP funds among the large banks and the small banks. And I had some information that I had reviewed before I came to the committee that gave a list of all the banks in America, all the financial institutions that had received the money and the amounts. I am reading with great interest this trend, Northern Trust and bankers that are coming into my office, and in the testimony we are hearing that the small banks and many of the banks are going—the healthy banks are really going to give the TARP money back at their earliest opportunity because they don't like the restrictions that are involved with it.

I guess this may be more a philosophical question, if the TARP money was distributed across America to financial institutions basically not necessarily according to their need and their risk factor, but so that it would be distributed pretty well to affect lending across America, if you begin to have the healthiest banks and the small banks and the healthiest institutions give the TARP money back—and the way I understand the legislation, if the money is repaid, I don't think it goes into the Treasury and then pays the debt down. I think the money comes back into the system, into the TARP system, and then the TARP system then gives the money back out, so that you could have a situation where the healthiest institutions give the money back into TARP, and then it begins to be distributed then to the least healthy institutions, and in a matter of time there is no need for new injections of TARP. But all of the money flows and gets concentrated in the institutions that are the least able and the least likely to then lend. I would like some reaction to that.

Mr. ELY. I will take a shot at it. First of all, the Administration, at least initially, did set some minimums as to who they would invest TARP funds in. Basically it was a function—a belief, and I think an understandable one, that TARP funds should not go into really weak institutions that might be on the verge of failure; that instead those institutions ought to be merged into stronger institutions. Although there has been a lot of criticism, I think that is essentially what drove the PNC acquisition of National City. But as I understand how TARP would work, and given what the limit is in the ESA legislation, if moneys are paid back into the Treasury, from, let's say, the Northern Trusts of the world, that is money that could be reinvested in other banks, but with the proviso that

it wouldn't go into really weak banks. So possibly you might find that at the end of the day, not all TARP funds would be invested, or they would be available for investment outside of the banking industry.

Mr. SCHARFSTEIN. I think it is extremely unfortunate that the TARP program, as Mr. Cloutier was saying, was set up as a—there is a part of it that is a big bank bailout, if you will, a subsidy of the banks that are systemically significant, and we don't want those to go under. And then you have a set of healthy banks that have also received capital. I think it is important to separate these programs, and I think the problem is that putting lots of restrictions on the smaller banks, I am agreeing completely with Mr. Cloutier, I think that is a real problem. And I don't think the subsidy to the small banks is a big one. I think that they are basically sound institutions, and the kind of transfer that is occurring from taxpayers to large institutions is a much bigger transfer than anything that is going to the small banks.

So I don't think it is appropriate to have the same level of restrictions on the small banks. In fact, you know, there is an FDIC program that guarantees the debt that is issued by banks. The small banks haven't opted into that. And I think it would be a good thing if they could opt into a program where they could get the equity from the government in, I think, a newly designed CPP program for small banks and then leverage that equity by borrowing potentially with government-guaranteed debt.

So I think it is important to be able to invest in healthy banks that have the capability to leverage that capital and then also to have experience and exposure with business lending.

Mr. MARCHANT. Thank you, Mr. Chairman.

Chairman GUTIERREZ. Thank you. Your time has expired.

The gentlelady from New York, Mrs. McCarthy, please, for 5 minutes.

Mrs. MCCARTHY. Thank you, Mr. Chairman. Thank you for having this hearing.

Let me first say that in the bankruptcy bill that is going out, the cramdown, all of the language has been changed so that basically it is going to be out at last resort, because many of us were very nervous last week about how that language was, and we changed the language. That is why the bill was actually pulled last week.

And as far as the TARP money goes, if a bank refuses to take the TARP money, it goes back into the Treasury. Now the Treasury's business is to lend money to banks if they need it. So it actually is coming back into the system and not going—wasting taxpayers' money.

But, Mr. Davenport, it is basically you that I wanted to ask. I understand from your testimony that nonprofit organizations cannot presently participate in TARP through the Capital Purchase Program because they are not structured to issue warrants or accept equal investments, as required under CPP. It seems to me, however, that the community financial institutions, like yours, can make sound and efficient use of TARP funds. How can we work with the Treasury Department and the Federal Reserve to allow community financial institutions to participate on terms and conditions that make sense within the nonprofit structure?

Mr. DAVENPORT. Well, it is actually very simple because we are a nonprofit. We cannot issue shares of stock or warrants. But, in fact, we issue debt every day of the week. The large money center banks that do finance us—and we at any point in time have approximately $15 million of lines outstanding to them—it is all in the form of debt. We have debentures of various terms and maturities, and I think that the type of debenture that we are able to issue as a nonprofit entity is completely consistent with CPP or TARP in terms of the terms and conditions that would ensure that the debt was paid back, that it had an interest rate attendant to it, that we were willing to live with the conditions that were imposed upon it.

Mrs. MCCARTHY. You know, one of the things, I am listening to everybody's testimony and certainly listening to Mr. Zucchero. We go home and the stories that we, the Members of Congress, are hearing, that people can't get loans, and that is with our small community banks. That is why, you know, many of us sit here very puzzled on hearing that the small community banks are lending out there. But yet when Mr. Zucchero was giving his testimony, I noticed that Mr. Baker, who left, unfortunately, and Mr. Scharfstein were watching and listening very carefully. And I was just wondering if you had any input on the testimony that you heard from him on what is going on out on Main Street.

Mr. SCHARFSTEIN. I think if you look at the data, the data indicate that small-bank lending has maintained its level. Large banks are a different story. The large banks saw a big increase in their lending right after the Lehman Brothers failure, but that was largely involuntary lending as a number of very large companies drew down on their existing revolving credit facilities. This was GM, Tribune Company which later went bankrupt. So there was a big bump up in large-bank lending, but then it has come down dramatically in the ensuing 4 months.

So, you know, I don't know the specifics of Mr. Zucchero, what exactly is happening there, but if you look at the data, it seems that small-bank lending has maintained its level, and it is really the large banks, and there is a whole problem with the large banks of syndicated lending for large companies. It is sort of a separate issue.

Mrs. MCCARTHY. Last week, we had the large banks here, and they were saying they were lending billions and billions of dollars out. So if they are lending billions and billions of dollars out, and our small community banks are lending money out, then what is going on with our economy? Because it sounds like, as far as the large banks and the small banks, they say they are lending, they are putting billions of dollars out, and yet we are hearing that we can't get any money into the system.

Mr. ELY. If I could address that, Madam. The Federal Reserve data on commercial bank lending show that bank lending, commercial bank lending, has been increasing over the last year. And even though there has been some recent downtick in it, it is nowhere near as great as the decline in economic activity. Where the problem really lies as much as anything else is out in the shadow banking world, and specifically with asset securitization, and that is what the TALF is supposed to get going. So that is where the

greater weakness is is over at shadow banking versus in depository institutions.

Mrs. MCCARTHY. Thank you. I yield back.

Chairman GUTIERREZ. I thank the gentlelady.

Mr. Paulsen for 5 minutes.

Mr. PAULSEN. Thank you, Mr. Chairman. And I want to also commend you for holding this hearing today, especially focusing on the small business community in particular with the mainstream banks.

Mr. Cloutier, it was mentioned—I certainly believe it is the small business sector that is going to help lead our economy out of this current economic turmoil that we are in. Do you believe that the community banks have the liquid capital to help meet the needs of most small businesses in their community? And would receiving TARP funds significantly help that problem for community banks?

Mr. CLOUTIER. I think 30 days ago, that would have been a correct statement, but I think today, it is most probably not. Two major things have happened. First of all, I think all community banks have lost confidence in the Federal Government's ability to negotiate with them. We have all been told, those of us who took the TARP funds, that they are going to do the same thing to us that they did in the 1980's to the people who did business with the Federal Government, and then the government reneged on their commitments and ended up being sued. And that is why they put 5(c) in there to make sure they could change the rules. Most people took the TARP money, believing that the government wouldn't do that, that they had a serious economic crisis. It seems like the government has just ignored that.

The second thing is this FDIC premium is hitting all the banks. I talked to many community banks today. As one of them told me, I am going into a foxhole right now. I am never going to be criticized by my examiners for not lending, for not expanding my bank, and, you know, if the government—the FDIC made a decision this week that the capital in all the banks, the community banks in America, now are for the use of the FDIC to take care of the losses that are going to be entitled that are coming, and that scares the hell out of bankers. So there is no more strategic planning. There is no more long-term focus in banking because you can't. It is just impossible when things change that fast.

Mr. PAULSEN. Well, and it was touched on earlier about the concern that the FDIC's proposed premium increase was going to really hit community banks pretty hard, and that was going to be a significant challenge. Is that a significant challenge for our community banks right now, as a resistant fact in terms of respect to lending?

Mr. CLOUTIER. Absolutely. What happened was they took all the earnings out of banks, so you did away with the safety net. If you have any loan losses, now it is coming out of your capital. It makes it a very difficult situation. When community banks hear, you know, we are going to bail out the big banks, but we are not putting any money in to bail out the FDIC fund, I will tell you, the money is going to return to the TARP program, I think, in great numbers, and I guess the money will be available to go to the Big Eight because you are not going to get any community banks show-

ing up to borrow, and I think they are going to be very worried about adopting any of these other programs.

You know, I will just tell you, I think the community bankers and I think small businesses in America feel like they are left out of the conversations, be it at the White House, be it at the Treasury, or be it at the Congress. I will tell you right now, in my 18 meetings I have had around Louisiana and Texas, I can tell you they feel left out because every time they look at a picture, it is all the Wall Street people and it is all the New York people showing up at all the meetings, making all the conversations. And when they look at the President's economic panel, it is made up of G.E. and everybody else, and no people from Iowa, Nebraska, Texas, or anywhere else. I think they feel left out. I think they are hunkering down. And I am very concerned, I am going to be honest with you.

Mr. PAULSEN. Well, I certainly heard from many banks in my community, Mr. Chairman, that are concerned about paying the millions and millions of dollars of unexpected costs from these premium increases. And that is not going to restore the confidence of Main Street, Minnesota, or across the United States for that matter. And that is where we really do need to focus, I think, to make sure we come out of this economic crisis.

I will just ask one final question. It is not just capital that is going to be potentially lent out from banks in terms of liquidity. But how are our deposits right now? Have deposits increased? Have consumers hunkered down? Are they increasing their deposits at your banks?

Mr. CLOUTIER. I will tell you what worries me a lot. I spent an hour on the phone yesterday with a customer who wanted to take out some serious money, and I thought he was taking it to another bank. His concern was, how good is the health of the FDIC? What is inflation going to look like?

There are a lot of concerns out there. I go from one crisis to the other pretty much on an ongoing basis. I know many of your bankers in your State of Minnesota—I have spent a lot of time up there. It is a great State. And I will tell you, they are very concerned up there also.

Mr. PAULSEN. Thank you, Mr. Chairman. I yield back.

Chairman GUTIERREZ. Thank you.

Mr. Cloutier, that is why we are here.

Mr. CLOUTIER. I understand, and I greatly appreciate the invitation.

Chairman GUTIERREZ. We appreciate small banks. We think you are important.

I just want to go quickly out of order for 30 seconds. Mr. Scharfstein, Mr. Ely says they are lending, the big banks are lending. And your point is—

Mr. SCHARFSTEIN. Well, if you look at the data, I mean, it really does look like the large banks had an initial bump-up in kind of involuntary lending, but it is coming down. The data is very hard to track in some ways because a lot of the lending that—most lending that banks make is actually in the form of extending lines of credit, which are not well-reported in the Fed data. And I think a reporting change would actually allow us to better measure the ac-

tual extension of credit so we could see it. And if you look at the data, it looks like it is actually coming down.

Chairman GUTIERREZ. Thank you.

Mr. Scott for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman. This is a very good hearing. And it really gets right to the meat of the issue as far as I am concerned, because I have always felt that we rushed to try to get the right answer without having the right problem presented before us in the very beginning. And sometimes you can figure out—you need to try to figure out how you got into a problem in order to get out of it. And I think we got into this—if you look at—we went in with a TARP program, a Troubled Assets Recovery Program, that was designed to free-up the credit. And somewhere along the line 2 weeks later, after we left Washington, we had come up with another program that we had nothing to do with here in Washington, we voted on, called the CPP program. I didn't know what that was. All of a sudden, TARP morphed into a Capital Purchase Program. And the next thing you know, nearly $300 billion of that has already gone as direct infusions into banks, and what little guidelines we were able to put on the TARP were applicable to TARP, not to a Capital Purchase Program. Those big banks did what they saw fit with it. So is it any wonder you come back with them having thrown up $18 billion to themselves in bonuses?

About that time the auto companies come to us, we never thought of that in the TARP program. Now we are bailing out the auto companies. The reason we are bailing out the auto companies is they came before us and said they can't get loans from the banks after we have given them $290 billion. And as a result of all of this, the question comes down to now, how do we make sure the $700 billion or what is left of it—and that is one thing I would like to ask you all from your own understanding of this, how much is left of this? How much are we talking about that is available now? Seventy-five billion dollars is certainly being set aside for housing. You have the $290 billion gone. So much has gone to the autos, another $50 billion went to Citicorp, and another $45 billion went to AIG. So when you look at all of this, I think it would do us well to try to get an accounting of what we do have left here to work with.

And if we are going to bring in the real people on Main Street, that little bank sitting there on Main Street in my district, that is where the auto dealer goes to to get his loan. That is where the person who is going to open up a beauty parlor or any other small business, which makes up about 70 percent of our labor force, that is where they go.

I want to ask you, Mr. Cloutier, what is it—and can you identify in order of priority the challenges that community banks are faced with right now with respect to lending? And then secondly, is there anything that we here in Washington can do, the Treasury Department, whatever moves we can make to see to it that whatever we have left of this TARP money, whenever somebody can get their hands around what we do have left, to see how we can channel and more directly get this down to the small community independent banks that, in my estimation, will be the saving grace of our economy and our financial system.

Mr. CLOUTIER. Well, I agree with you, Mr. Scott. Of course, I am a little prejudiced since I run a community bank. But I will just tell you that, you know, I think you talk to the regulators, tell them that the community banks are the backbone of America. And I want to make it clear again—and I want to thank this committee so much for letting us, the small banks, have a voice today—it is not my opinion that we are not being heard. It is the opinion of the American people that when they turn on the television, that is all they see is the automobile execs and the big bankers and whatever. But I think it is to continue to have a vocal dialogue with the community bankers of America, to continue to be engaged with them, to continue to be engaged with small business people like Mr. Zucchero, to listen to what is going on out there and certainly work. And I gave Mr. Zucchero my card before I sat down, and I told him I would try to help him and go to Chicago. I love the Cubs.

Chairman GUTIERREZ. That is very good. Thank you very much. The time of the gentleman has expired.

We are going to go to Mr. Ellison, who has patiently been waiting, and then we will finish up with my friend, Mr. Green.

Mr. Ellison for 5 minutes.

Mr. ELLISON. I will yield to the gentleman from Georgia 30 seconds.

Mr. SCOTT. I did want to try to get an assessment as to how much money do you think is left, just from your cursory following of the news and the allocation? Where would you say we are in terms of $700 billion?

Mr. CLOUTIER. Mr. Scott, I wish I could answer that, but they throw around billions so fast, that even Everett Dirksen couldn't keep track of it anymore.

Mr. SCOTT. Just to answer the other part of my question, what I am after here is, I am after, what can we do in terms of the restrictions that we could lift or add? If I may, just one.

Mr. ELLISON. It is coming out of my—I gave you 30 seconds, man.

Mr. SCOTT. You did good. Thank you. I appreciate it.

Chairman GUTIERREZ. The gentleman wants his time back, Mr. Scott.

Mr. Ellison, please.

Mr. ELLISON. Man.

Mr. SCOTT. Thank you, Mr. Ellison.

Mr. ELLISON. Give him a rope, he wants to be a cowboy.

Anyway, I want to thank everyone for coming today. I want to also thank the chairman. This is a phenomenal hearing, and it is a long time coming.

Mr. Scharfstein, I have a question for you. You have recommended that we infuse, invest more in our community banks. I think that is a good idea, for a lot of reasons. But I wonder if you could flesh your thinking out a little bit more. What do you think is an appropriate level of capital investment in community banks for the government to make? And do you think it should be under the TARP program, or do you have another kind of program in mind?

Mr. SCHARFSTEIN. Well, in terms of how the government allocates the budget, I don't know. I do think it should be a conceptually separate program. The idea that I am sort of pushing is this notion that if the large banks are under financial stress, in difficulty, potentially insolvent, you know, it stands to reason they are going to be cutting back on their lending.

About half of small business lending comes from large banks. And so my thought is that if we can encourage small banks to take the space that is left open by the large banks, by the retrenchment of the large banks, that would actually help our economy, help small firms.

About 23 percent, 25 percent of the assets in small banks, let's say banks under $5 billion, have received TARP money, okay. I think that there is potential to expand that. But I think the way to expand it is that we have to recognize that it is not a major subsidy, that it is not the same kind of thing that is going on with the investments in the Wall Street firms, with the big banks, and therefore it should not be associated with sort of onerous measures. And I think that is the way to get more banks involved.

Mr. ELLISON. Well, one difference is that the program you are proposing is really to help small business lending and help consumer purchases and help small community banks do that, whereas the other bank program was a salvage program.

Mr. SCHARFSTEIN. The other program was—you know, had two goals allegedly. One was to sort of help out the systemically significant banks. It was to sort of keep them stable. The other goal was to promote lending. But if that had been the goal, we wouldn't have put the money in the bank holding companies, but rather in the actual subsidiary banks to promote lending.

Mr. ELLISON. Mr. Cloutier, could you kind of react to what you think about Mr. Scharfstein's proposal?

Mr. CLOUTIER. Well, you know, I think there are a lot of good things he is absolutely correct about. I agree with his testimony completely.

I will tell you one great thing that the Congress did do was expand the SBA program. I can tell you that has helped a lot of my customers. It has helped some people get into business. That is a very good program that is working right now, helping to increase lending.

So the problem is going to be to get the community banks again to have faith in Congress that you offer them some money and they take it. I can tell you right now, most of them are just very nervous about getting into any capital arrangements with the government at this moment.

Mr. ELLISON. I see.

I will yield back. If I have some more time, the gentleman from Georgia can have it.

Mr. SCOTT. Well, I am ready. I certainly will ask this. It is my final question I want to ask you. I want to ask you this because I think it is very important, Mr. Cloutier.

Can you tell me what impact the FDIC's recent proposed premium increase and surcharge will have on community banks and lending by community banks?

Mr. CLOUTIER. Most of them will give up a great deal of income this year. In my bank, it is about 50 percent. And I can tell you, it is going to make the community banks across America retrench, you know, because you have given up the safety net of earnings. And I know Ms. Bass says that earnings are not going to be part of the CAMEL ratings, but I don't think anybody really believes that in the bottom of their heart. So it is going to cause banks to really retrench.

Mr. SCOTT. I agree with you.

Chairman GUTIERREZ. The time of the gentleman has expired.

Mr. Green, for our final 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I thank you and the ranking member, both of whom are my friends. And I think that this is a timely hearing.

Mr. Chairman, I do believe that if you know the truth, it will set you free, and I also believe that the truth can free capital. So for just a moment, I would like to take the axe of truth and slam it into the tree of circumstance and let the chips fall where they may.

Let's talk for just a moment about the CPP program, which was a $250 billion purchase program of nonvoting senior preferred shares. I assume that everybody agrees with this. And senior preferred shares were issued such that they qualify as tier one capital. Everybody agrees with this, I am sure, tier one capital.

Now, it is important to know what tier one capital is. Tier one capital, generally speaking, is used to protect against unexpected losses; tier one capital, unexpected losses. Tier one capital, generally speaking, is not money that a bank lends. Banks make loans from deposits and from money that they can borrow. Some would say they borrow cheap. They borrow from the government and then they lend that money. So if you have tier one capital that generally speaking you cannot lend, larger institutions were in a position wherein they had a problem with reference to unexpected losses that had become expected because we know that there were runs on banks, and given that there were runs on banks when they received this tier one capital, it was used to help cause them to become well capitalized. To be well capitalized, a bank has to have a certain amount of what I am going to call tier one moneys in reserve so that they can make loans. The truth is that many of these banks can't make loans because they need to be well capitalized, and they are using TARP moneys, which were given to them as tier one moneys to be well capitalized.

Now, I just want to deal in truth, because if we are going to fix it, we have to know what we are going to fix. So the notion that we should have lent the TARP money is a notion that in some ways is flawed, because the way it was received put banks in a position where they couldn't lend the TARP moneys.

Now, Mr. "Banker," you help us with this truth, this search for truth, if you would.

Mr. CLOUTIER. Certainly. And, Congressman, it is so good to see you again. I always remember when I testified after the Katrina hearings, and you and I had a good exchange about what was happening during Katrina, and I have always appreciated that.

Let me tell you, and in my testimony, if you had noticed, I said we started a campaign the minute after we got the $20 million in

TARP money to loan $250 million. Our goal was to bring in deposits and to make loans. But what has happened pretty much in the regulatory environment is that now they have increased the capital requirements on banks. They are now out there, rather than saying 8 percent is well capitalized in community banks, they are now talking about 10, 12 percent. That is what the FDIC did. There is a premium—

Mr. GREEN. For people who don't know, Mr. "Banker," that is 8 percent of—

Mr. CLOUTIER. Of the assets of the bank.

Mr. GREEN. —of the assets of the bank. That is important for people to understand.

Mr. CLOUTIER. Right. Assets of the bank.

So what they have said now is now rather than 8 percent, it has to be 10 percent, so nobody can make loans because they have to keep it all for capital. You are absolutely right, Congressman Green. They have changed the rules of the game. The regulators have said, we want more capital, bigger safety net. And now the FDIC—

Mr. GREEN. Let me do this quickly because I have to move on. I wanted to bring this out not to defend any position, not to really stake out a position, but so that we can understand what is happening such that we can lend money at some point. But you have to understand what the problem is before you can solve a problem, generally speaking.

Now I have to move to something else quickly. I would like to say more about this, and I have a lot more that I could say. But I do want to talk about now something that is near and dear to me called the LaTourette-Green amendment. That is "Green," as in Al Green. And I am concerned about it because this is an amendment that allows us to have that transparency with reference to how the moneys are being utilized. Is there anyone who would oppose banks giving us intelligence about new lending based on TARP moneys received, anyone see a problem with that?

Chairman GUTIERREZ. One person can answer that question.

Mr. GREEN. Thank you, Mr. Chairman.

Chairman GUTIERREZ. Does anybody care to answer? Mr. Scharfstein?

Mr. ELY. I would like to because I addressed it in my written testimony.

You cannot track the flow. The capital comes in on the right side of the balance sheet. It comes in as cash. Cash is fungible on the bank balance sheet. You are not going to be able to track TARP funds into specific loans.

Chairman GUTIERREZ. Thank you.

Mr. GREEN. Mr. Chairman, could I ask unanimous consent for 10 seconds?

Chairman GUTIERREZ. Sure. For 10 seconds, I won't object.

Mr. GREEN. What about tracking simply the amount of increase in new lending? Can that be done?

Mr. ELY. What you can track through the call reports and through the data filed with the Fed are changes in the total amount that a bank has lent at any particular time.

Chairman GUTIERREZ. The time of the gentleman has expired.

Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman. I always feel the need to let the panelists know that when people are going in and out, it is not because they are bored. Most of us are on two committees. And Mr. Green and I are just running back from Homeland Security, a very important meeting on immigration. So I apologize. And because of that, I will be brief.

First of all, I think we have damaged the credibility of the Congress because most people think we voted for Secretary Paulson to give the money to the banks, and as you know, there was never a congressional vote for that. They did that, Mr. Paulson and the Administration. So we are trying to at least create some truth to what happened.

I am interested, particularly Mr. Cloutier, community banks seem to be doing so much better than the banks that we have labeled too big to fail. So do you think that maybe what we ought to do is to encourage more community banks to participate in TARP so that they will make loans to the small businesses that I think both sides are interested in? Because it seems that when we are putting money in the giants, we lose. The taxpayers lose and certainly the small businesses lose. I mean, this is a kind of a self-rewarding question, but I need to get a response on it anyway.

Mr. CLOUTIER. You know, I was thinking about Congressman Scott's question, too, and yours is almost identical. I would tell you that regulatory reform is going to be something coming up in Congress. I think one thing that I learned in Texas and in Louisiana and Oklahoma in the 1980's is that Congress has to come up with the plan of how to rebuild the banking system. The big bank model didn't work. They sold it to Congress. It was well sold. It was told that if you all go along with this, life is going to be great. Life hasn't been great. It is obvious now. And I think, you know, you have to go back to the model and look at breaking them up. I mean, as an example, Citicorp today, they wanted to sell their branches. I know Don Adams would buy them all and put the money up in the morning. So you have to relook at the models.

So when they come with regulatory relief or regulatory rewrites, I would encourage Congress to very much look at going back to the models of increasing community banks around America, increasing the banks in the States. And I would ask you please to come study what has happened in Louisiana, Texas, and Oklahoma. We lived through this in the 1980's. Congressman Hensarling will tell you that the banks in Texas were destroyed in the 1980's, and we rebuilt a very solid banking system through community banks in that State.

Mr. CLEAVER. One final question. Do you think—or maybe this is for any of you: Has there been any kind of detectable change since the FDIC insurance was increased from $100,000 to $250,000?

Mr. CLOUTIER. Absolutely. I will tell you that, you know, absolutely. It was amazing how many people fought that change for years, and then we did it in a matter of a week. But it has made a big change. It has given people a lot of confidence. It has helped keep deposits in the banking system. And people are looking for a home today that they feel is safe, and we are just trying to get

them to keep it in the banks right now and not put it in their back yard because they are very nervous. All of a sudden, as I tell my people at the bank, we have this new product called a CD that pays 2 percent, but at least you get your money back. People are pretty happy with that today.

Mr. CLEAVER. Two percent is big now.

Mr. CLOUTIER. Yes. I wish I had some of my money back that I lost, I will be honest.

Mr. CLEAVER. Thank you very kindly.

Chairman GUTIERREZ. Thank you so much. I want to thank the witnesses and the members for their participation in this hearing. The Chair notes that some members may have additional questions for the witnesses which they may wish to submit in writing. Therefore, without objection, the hearing record will remain open for 30 days for the members to submit written questions to the witnesses and to place their responses in the record.

I think there is a new bipartisan truth. Small business is important and vital to our economic prosperity and survival, and that we need to work to encourage those kinds of dollars. We need to reexamine TARP. We need to look at the new FDIC insurance requirements and the impact that they are going to have. And we need to ensure that we are getting correct data and information in terms of just who is lending and how much they are lending.

Mr. Zucchero, I hope you can say stay. I and my staff want to sit down and talk to you a minute, too. Mr. Cloutier has been very kind to extend a warm hand of help to you. We want to do the same right after this hearing.

Thank you all so much. Without objection, this hearing is adjourned.

[Whereupon, at 5:15 p.m., the hearing was adjourned.]

A P P E N D I X

March 4, 2009

Thank you, Chairman Gutierrez, for holding this hearing. Last week, the Oversight and Investigations subcommittee held a hearing on TARP oversight, and this is an important follow-up to those proceedings. Many of the witnesses here today have discussed the need to improve lending to small businesses, and it is clear from today's testimony that the TARP program is (in large part) failing to unfreeze the credit markets and allow creditworthy businesses to access credit on reasonable terms.

I couldn't agree more with the recommendations to take concrete action to ensure that businesses can obtain the credit that is essential to the successful operations of their enterprises. Small businesses tend to lose jobs faster as the country enters a recession, but they also tend to recover faster than larger businesses from a recession. If we can find a way to provide substantial help to small businesses, it is more likely that we can recover from this recession in a more timely fashion.

For example, Uniweld Products in my district is a family-run manufacturing business that has been operating in Ft. Lauderdale since 1949. It is owned and operated by WWII veteran David S. Pearl and his sons, David and Douglas. Uniweld is an example of a local business fighting to stay afloat in these difficult economic times. The Pearl family employed 275 people Ft. Lauderdale, but because of the recent credit squeeze and related market conditions, they have been forced to reduce their workforce to 190. We have to start using TARP funds or some other mechanism to ensure that businesses such as Mr. Pearl's can continue to operate.

Large banks such as Citigroup and Bank of America are important to the health of the American economy, and the uncontrolled failure of these institutions would have a significant negative impact on credit availability and the successful operation of the financial system. But, it is essential that taxpayers dollars are not spent propping up insolvent institutions. In his written testimony, Dr. Baker asserted that some of the large financial institutions are likely insolvent, and we need to closely examine the benefits of continued capital injections into these firms. However Congress decides to handle the solvency and liquidity issues of the large banks, we must ensure that TARP funds are spent in ways that will maximize the availability of credit.

Elizabeth Warren, who is the chair of the Congressional Oversight Panel, testified last week that, "If this [the TARP program] is about putting money into the hands of small businesses…then you make that part of the terms of taking the money, and if someone doesn't want to do that with the money then don't let them have the money. It's that straightforward." I think her comments are right on target, and I look forward to the testimony today so we can flush out the best solutions to restoring the flow of credit to businesses in South Florida and communities across the nation.

Testimony of Dean Baker
Before the House Financial Institutions Subcommittee
of the Financial Services Committee
March 4, 2009

Thank you, Chairman Gutierrez for inviting me to share my views on the success of the TARP to date and its impact on the broader economy. My name is Dean Baker and I am the co-director of the Center for Economic and Policy Research (CEPR). I am an economist and I have been writing about issues related to finance since 1992.

I will make three main points in my testimony:

1) There are two separate issues ostensibly addressed by TARP and subsequent measures by Treasury and Federal Reserve Board. First, government involvement is needed to arrange an orderly reorganization of insolvent institutions; and second, actions are necessary to maintain the flow of credit.
2) The primary cause of the downturn is the loss of wealth as a result of the collapse of the housing bubble and the subsequent loss of value in the stock market. Credit is a secondary issue.
3) The government can help to promote a better flow of credit in this downturn by ensuring that smaller financial institutions that are in reasonably good financial health have fuller access to funds.

I'll address each of these in turn.

The Insolvency of the Major Banks

The immediate cause of the financial crisis that prompted the drive for the TARP in mid-September was the concern that several of the major money center banks were insolvent. As a result of these concerns, the major banks had largely stopped lending to each other. This was demonstrated most clearly by the "Ted Spread," the gap between the interest rate charged on interbank dollar loans in the London market and Treasury notes of the same maturity. This spread increased to almost 5.0 percentage points on 90-day loans at its peak in early October. In more normal times, it hovers in the range of 0.15 to 0.3 percentage points. This extraordinary gap implied that banks were seriously concerned that the failure of other major banks was imminent, otherwise there would be no reason not to take advantage of the much higher interest rates available on interbank loans than on Treasury bills.

The banks had good reason for this concern. The major money center banks have massive quantities of bad assets on their books. Several of them would undoubtedly already be

insolvent if they were forced to write down bad assets. There have been several credible estimates that place the losses of the banks at more than $2 trillion.[1] The FDIC put the capital of the commercial banking system at less than $1.2 trillion at the end of 2008. Of this, $400 billion was goodwill, the value of which would largely disappear as banks become insolvent. In short, it is very plausible that the liabilities of the banking system as a whole considerably exceed its assets. And, many of the largest banks are among those in the worst position.

The TARP effectively tossed these banks a lifeline, providing capital at below market rates to banks that were essentially insolvent. The additional capital provided by the TARP, along with the more generous guarantees of deposits, eased the immediate stress on the banking system. Interbank lending resumed and the TED spread fell back closer to its normal range. (It is currently near 1 percentage point).

However, these banks still must deal with the basic problem that they are insolvent. When their assets are properly valued, many of the largest banks in the country will not be able to meet all of their liabilities. At some point this situation will have to be resolved with the government determining which of the banks' liabilities it will cover.

The TARP was successful in putting off a day of reckoning for the insolvent banks. Without the TARP, several major banks likely would have failed last fall. This would have led to some sort of receivership arrangement comparable to the situation of Fannie Mae, Freddie Mac, and AIG. Many of the major banks will likely still end up in a receivership type arrangement, but the TARP did buy the government time so that in principle it can carry through a bankruptcy-like procedure in an orderly manner.

It was unrealistic to expect that TARP would have led to a surge of new lending by the banks that received TARP money. In fact, the FDIC reported that the volume of outstanding loans at the 84 institutions with assets of more than $10 billion fell at an 8.8 percent annual rate between the end of the third quarter and the end of the fourth quarter of last year. While most of this decline was associated with real estate loans, loans to businesses fell at a 3.4 percent annual rate over this period.

These large banks desperately need to shore up their capital position to protect against further write-downs that they know are coming. In fact, it would be irresponsible for the management of banks that are at the edge of insolvency to making large volumes of new loans, which will inevitably carry considerable risk in the current environment. In short, it was unreasonable to believe that the TARP would lead to a large volume of new lending from the recipients of TARP funds.

Even if banks could not easily lend much of the money they received under the TARP, they could have taken other measures to better husband their capital, most obviously by slashing dividends and cutting executive pay. While such conditions could have been imposed as a requirement for receiving TARP funds, in the rush to pass legislation,

[1] New York University professor Nouriel Roubini and Goldman Sachs have both estimated likely bank loan losses at more than $2 trillion.

Congress did not take the time to insert language that effectively imposed these sorts of restrictions.[2]

As a result, in the months immediately following the TARP, the banks receiving money continued to act largely as they had previously, paying out executive bonuses and meeting their regular dividend schedule. In response to public pressure and pressure from Congress, and more recently pressure from the Obama administration, banks have begun to curtail executive compensation. Many have also reduced or eliminated dividends. The restrictions on executive compensation that were included in the American Recovery and Reinvestment Act of 2009 will also help to restrain pay at the banks receiving TARP money.

Restrictions on pay and dividends at these banks are important for two reasons. First, excessive executive pay and dividends are pulling money away from the purpose of the TARP, which is to restore the banks' capital. Every dollar that is paid out as excessive compensation or to shareholders as dividends is a dollar that could have bolstered the banks' capital.

The second reason why Congress should be concerned about excessive executive pay and shareholder dividends is a simple question of fairness. The TARP money is coming from taxpayers as a group. It can be justified by the public interest in keeping the financial system operating. If several major banks were to fail, it would severely damage the normal flow of credit in the economy. Also, the creditors of these banks (many of whom are public and private insurance funds, as well as mutual funds in individual retirement accounts) would find themselves in an uncertain situation until a bankruptcy could determine the portion of the assets that can be recovered. This would further depress economic activity.

However, there is no public interest in using taxpayer dollars to compensate bank shareholders, who presumably understood the risk in owning stock when they purchased it. There is also no public interest in sustaining the compensation packages of bank executives, who are among the highest paid people in the country. For this reason, Congress is entirely justified in imposing stringent conditions on the recipients of TARP money. After all, the banks don't' have to take the money.

The Credit Squeeze and the Economy

[2] In this respect, it is worth noting the peculiar decision by Federal Reserve Board Chairman Ben Bernanke to wait until after Congress passed the TARP to announce that the Fed would begin buying the commercial paper of non-financial corporations. Prior to the passage of the TARP, Chairman Bernanke had identified the freezing up of the commercial paper market as one of the main reasons for a quick passage of the TARP. It is likely that many members of Congress did not know that the Fed already had the ability to direct lend in the commercial paper market prior to the vote on the TARP.

While many businesses and individuals are finding it considerably more difficult than usual to get credit, this is not the cause of the recession. The cause was the collapse of an $8 trillion dollar housing bubble. The collapse of the bubble has directly harmed the economy most immediately by sending residential construction plummeting. This sector accounted for 6.2 percent of GDP at its peak in 2005. It currently accounts for less than 3 percent of GDP. This implies a loss in annual demand of more than $450 billion.

In addition, the lost wealth in housing has caused consumption to plunge. Homeowners had eagerly spent based on the run-up in wealth in their homes during the boom years. In some cases they borrowed directly against the equity in their homes, in other cases, they opted not to save for retirement because their rising home equity was providing all the saving they felt they needed.

With the decline in house prices to date having destroyed approximately $6 trillion in housing wealth, consumers have radically changed their behavior. By some measures, the saving rate has increased by more than 4 percentage points, implying a further loss in annual demand equal to approximately $400 billion. (The collapse of the stock market, resulting in the loss of approximately $8 trillion in wealth, is also depressing consumption.)

The huge falloff in residential construction coupled with the fall in consumption driven by the collapse of the bubble, are the primary causes of the downturn. The massive loss of wealth in the housing and stock market has made potential borrowers far less creditworthy than they were one or two years ago. Concretely, a homeowner with substantial equity poses much less default risk to a bank when he or she seeks a credit card, car loan, or even small business loan than a homeowner with little or no equity. As a result of the sharp decline in house prices over the last two and half years, tens of millions of homeowners now have little or no equity in their home. These people would find it much more difficult to obtain credit regardless of the finances of the banking system.

Similarly, the sharp decline in consumption has made many formerly creditworthy businesses much greater risks. Businesses of all types have seen declines in demand of 20-30 percent, squeezing profits and jeopardizing their survival. Banks would be far more reluctant to lend to these businesses in current circumstances regardless of the strength of their balance sheets.

One piece of evidence that would seem to refute the claim of a credit squeeze – credit worthy borrowers unable to get loans – is the decline in the Mortgage Bankers Association, mortgage applications index. If there credit squeeze story was accurate then the mortgage applications index should be rising rapidly, since potential homebuyers might have to make two or three applications to get a mortgage and some would-be buyers might make several applications and still not get a mortgage. In fact, the mortgage applications index has trended downward in step with home sales.[3] This index provides

[3] The purchase applications index for the week ending February 21, 2009 was 250. It had often been over 500 during the peak years of the bubble. House sales are still at more than half their peak bubble levels.

no evidence that homebuyers or potential homebuyers are having any special difficulty getting loans.

There are undoubtedly cases where individuals and businesses who are in fact good credit risks are unable to get loans in the current environment because they have limited collateral and banks are being overly cautious. However, there is little clear evidence that there is a generalized problem of lack of credit beyond what would be expected given the severity of the downturn and the massive loss of wealth over the last two years.

Restructuring the Nation's Banking System

While the lack of credit may not explain the downturn, it will be important to ensure that individuals have access to adequate credit to ensure a sustained recovery. In almost any scenario most of the country's major banks are likely to be seriously impaired for at least next several years. This provides an opportunity for many smaller banks to fill a void in meeting credit needs.

There is of course a wide range of divergence in the financial condition of smaller banks. As a general rule, they did not engage in the sort of reckless lending that has jeopardized the survival of the largest banks. Nonetheless, few banks could escape the impact of this downturn altogether. In areas where house prices have plummeted with the collapse of the housing bubble, loans that may have seemed very prudent based on bubble-inflated house prices may now be underwater and in danger of default. Lending institutions in these former bubble markets are therefore likely to be seriously stressed even if they had acted cautiously during the bubble years.

However, where these banks have managed to stay relatively sound, the Treasury should seek to ensure that they have adequate access to capital to help rebuild the economy. By bank size, it is worth noting that institutions with between $100 million and $300 million in assets actually increased their lending at a 3.2 percent annual rate from the end of the third quarter to the end of the fourth quarter, according to FDIC data. This was not true for either smaller banks as a group, nor larger banks.These relatively small banks can be expected to have a much larger role in the post-recovery economy than they did prior to the recession, due to the collapse or crippling of the major money center banks.

Therefore, it is entirely appropriate that Congress encourage the Treasury to use TARP funds to ensure that smaller banks have access to capital. There is no way that the country can simply abandon the large banks, because their unchecked collapse would lead to massive losses at pension funds, mutual funds, and insurance companies and likely lead to destruction of our whole financial system. However, there can be no doubt that smaller banks will play an important role in the economy in the future and the Treasury should act to ensure that they are prepared to play this role. The nation's smaller banks should not be penalized for having made the right decisions during the bubble years.

Testimony of
Mr. C. R. Cloutier
President and CEO, MidSouth Bank, NA

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services

Hearing on

"TARP Oversight: Is TARP Working for Main Street?"

March 4, 2009
Washington, DC

Chairman Gutierrez, Representative Hensarling and members of the Committee, my name is Rusty Cloutier. I am the President and CEO of MidSouth Bancorp, Inc. MidSouth is a bank holding company located in Lafayette, LA, with total assets of $936.8 million as of December 31, 2008. Through our wholly-owned subsidiary, MidSouth Bank, NA, MidSouth offers complete banking services to commercial and retail customers in south Louisiana and southeast Texas. We have 34 locations in Louisiana and Texas. We are community oriented and focus primarily on offering commercial and consumer loan and deposit services to individuals, and small and middle market businesses. I am member and a former Chairman of the Independent Community Bankers of America. I am pleased to represent community bankers and ICBA's 5,000 members at this important hearing on "TARP Oversight: Is TARP Working for Main Street?"

Community Banks and the Capital Purchase Program

MidSouth, like the vast majority of community banks, did not engage in the irresponsible subprime lending practices that are at the heart of the current economic crisis. Moreover, MidSouth and the majority of community banks do not employ the compensation practices of the mega banks, which led to excessive and careless risk taking in these larger institutions, and that rewarded executives for abject and costly failure.

As a result of prudent lending practices and other prudent business practices, MidSouth, and the majority of community banks, have remained strongly capitalized and ready to do their part to aid economic recovery. When MidSouth

Bank elected to participate in the Treasury's Capital Purchase Program, we were convinced that we could put the funds to good use in our service area in Louisiana and Texas through loans to small and mid-sized businesses and consumers.

It is important to distinguish the Capital Purchase Program available to community banks and the other Troubled Asset Relief Program investments that have been used in connection with some of the largest institutions, particularly the systemically important institutions. CPP funds are only given to healthy community banks like MidSouth. Simply put, so-called systemically important institutions do not have to be healthy to receive TARP money.

MidSouth Participates in the CPP

The CPP is not a bail-out for community banks. MidSouth must pay an annual dividend of five percent on the $20 million in preferred shares purchased by Treasury, along with the grant of stock warrants. If MidSouth does not repay the principal in 5 years, the dividend increases to nine percent annually. The cost of this CPP capital is not inexpensive for community banks, at some 7.5% tax effective rate in the first five years with additional warrant-related costs on top. Community banks participating in the program have to relend the money in order to cover the costs of the capital.

When MidSouth accepted CPP funds in early January, we viewed the government's investment as a public-private partnership to promote lending to stimulate the economy. The $20 million infusion of capital would also provide a substantial capital cushion in case credit conditions deteriorated further.

MidSouth Promotes Availability of Funds

We saw the CPP as an opportunity to encourage and support economic expansion in every market we serve during a national recession that could last, at least, another 12 to 18 months. After completing the CPP transaction on January 9, 2009, we began to actively promote the availability of $250 million in loan opportunities to small businesses and community leaders throughout our service area. MidSouth conducted town hall meetings in 14 communities in south Louisiana and southeast Texas from the end of January through February 19th. We focused on small businesses because small businesses drive the economy and create new jobs in our communities.

In addition to the general business community, we are also reaching out to the minority business community, through town hall meetings with the Black Chambers of Commerce of Baton Rouge and Southwest Louisiana and the Group of 100 Black Men, another African-American business organization. Our efforts to publicize the lending program continue with more meetings scheduled with homebuilders, industrial companies and other business groups.

We have also directed an ad campaign at consumers and the general public. We have placed billboards in every market in our service area advertising the availability of $250 million in loans.

Public Response to Outreach Efforts

While attendance at these meetings was good, there seemed to be a reluctance among audience members to take on significant amounts of new debt. This is true despite small business loan rates at least two percentage points lower than a year ago. I believe that some of the reluctance in our market is due to the drop in the price of oil, which is an important driver for the economies of southwest Louisiana and southeast Texas. But, I also attribute it to unease about the general economy. Given the state of the economy, it is harder for community banks to find borrowers who are creditworthy. Lending to creditworthy borrowers is a sound banking principle that the federal banking regulators emphasized in their Interagency Statement on Meeting the Needs of Creditworthy Borrowers. Actions of bank examiners in the field are putting further restraints on lending standards through such actions as requiring write downs of performing loans – a subject the Financial Services Committee will take up on March 10, 2009.

Despite the reluctance of some in the business community to take on new debt and the challenging lending environment, we believe that our outreach efforts have paid off. Our level of lending, for consumers and businesses, remains

about the same as this time last year. We believe that this is quite an accomplishment in the midst of the current serious recession.

Since receiving the CPP capital infusion in January, we have made approximately $13 million in new consumer and commercial loans. The lending include $1.7 million in new car loans, lending support to not only our local consumers and car dealer community, but also indirectly auto manufacturing. Included in our new loans are $8.53 million in small business loans and $3.4 million in real estate loans. Also, within MidSouth Bancorp, we have generated over $7 million in new mortgages since the first of the year. We are especially proud of two new small business loans made since MidSouth received the CPP funds. These loans to two small oil services businesses will create 50 new jobs in south Louisiana and Texas. As MidSouth Bank has shown, community banks have the know-how and desire to use the CPP to support economic recovery in communities throughout the nation.

Mutual Term Sheet

Allowing all community banks to participate in the TARP CPP will help boost lending to families and small businesses. No CPP term sheet exists yet for mutual institutions. Mutual institutions are important providers of credit, particularly small business and housing credit, in many areas of the country. In New England, mutual institutions are a primary source of loans for small businesses. We urge the Treasury to complete work on the mutual term sheet.

MidSouth Keeping Options Open on CPP

Public anger over $50 million private jets and multi-million dollar bonuses and golden parachutes for CEOs who led their companies into insolvency, or near insolvency, is understandable. In response to this anger, Congress recently enacted executive compensation and corporate governance limits for TARP recipients. The new statutory restrictions in some cases went beyond restrictions put in place by the Obama Administration and took away Treasury's discretion to focus these remedies where the problems actually occurred – in some large TARP recipient institutions.

As noted above, MidSouth Bank does not engage in the compensation practices that have created the public ire. While we appreciate congressional amendments that diminished the impact of these limits on community banks, we are frustrated by being tarred by the same brush used on the large financial institutions that caused the current economic crisis and that have undermined public confidence in programs to restore the credit markets and shore up the banking system. MidSouth Bank is a solid, healthy community-minded financial institution and should be treated as a responsible partner in the effort to revitalize the economy.

MidSouth entered into an agreement with the government on January 9th, which, as we have described above, carries significant monetary and other obligations.

If the government changes that agreement and adds new burdensome conditions, MidSouth will have to reevaluate its continued participation in the CPP. We are pleased Chairman Frank's idea to allow TARP participants to repay TARP funds early without penalty was included in the economic recovery bill. The provision allows MidSouth and other community banks to keep their options open.

But it would be a shame if new conditions forced us to withdraw from the program. MidSouth has taken the purpose of the CPP seriously by aggressively marketing the credit opportunities afforded by Treasury's investment in the bank. Policymakers should be encouraging the participation of more community banks like MidSouth bank who are willing and ready to be active leaders in our economic recovery.

Conclusion

ICBA appreciates this opportunity to testify on these critical issues. We look forward to working with the Subcommittee and Congress on these and other steps that will help us emerge from this current crisis and improve our financial system for the long run.

NATIONAL DEVELOPMENT COUNCIL
Partners in Community Development Since 1969

Testimony of Robert W. Davenport, President of the National Development Council
Before the
House Financial Services Subcommittee on Financial Institutions and Consumer Credit

March 4, 2009

Mr. Chairman, my name is Bob Davenport and I am the President of the National Development Council based in New York City. I am pleased to be here today, and appreciate the invitation to testify before the distinguished House Financial Services Subcommittee on Financial Institutions and Consumer Credit.

Background on NDC

The National Development Council (NDC) is a 501(c)(3) nonprofit organized in 1968 after the tragic deaths of Dr. Martin Luther King, and Robert F. Kennedy to eliminate discrimination and create economic opportunity in disadvantaged areas. We remain one of the oldest national non-profit community development organizations in the country. Over the last 40 years we have worked to bring financial and technical assistance including professional training, investment in affordable housing, small business credit and direct developer services to communities across the country. Each year NDC trains more than 3,000 economic development and housing development practitioners. We have worked in all 50 states and have experience using a number of housing and small business programs. Because we are a non-profit, we do not raise our lending capital from shareholders, rather private sector lenders make lines of credit or other funding available to us at interest rates we can afford, and we in turn use those funding sources to make loans to our borrowers.

NDC is a certified Community Development Financial Institution (CDFI) and Community Development Entity (CDE) as certified by the Treasury Department and a Small Business Lending Company (SBLC) certified by the Small Business Administration. We received our SBLC license in 1992, our CDFI certification in the late 1990s, and CDE certification in 2003.

History of Business Lending

Recently, NDC has financed New Markets Tax Credit projects totaling $640 million, loaned over $90 million to small businesses for projects with investments of $150 million, invested $350 million in equity for affordable housing or historic preservation projects (leveraging an additional $280 million), and financed and developed $1.1 billion in public and community facilities.

The reason I am testifying here today is because the downturn in the financial marketplace is having a devastating impact on our ability to continue our lending to the businesses we serve, and NDC is now operating in a drastically changed environment in which its traditional sources of capital are pulling back, which means we cannot meet client needs for a range of community development financing products. The sources of capital we have used in the past to provide debt to small businesses, as well as the equity our borrowers have counted on for affordable housing and community development projects is drying up, which leads to serious financing gaps that stall projects or destroy their viability, sacrifice quality, and constrain the ability of mission-driven organizations to meet the nation's housing and community development needs. Notwithstanding the size of our loans and our borrowers, we have an excellent record of success and few defaults.

NDC makes loans to borrowers in difficult lending markets, with smaller average loans or investments and with more complex transactions. Given the low and moderate income communities in which we work, it is simply not feasible, from a business standpoint, for us to pass on to customers the capital costs that are being proposed of late by mainstream money center banks. And our customers have few options to find a lender besides us and other community oriented lenders like us. According to an October 2008 Senior Loan Officer Opinion Survey released by the Federal Reserve Board, nearly 75% of lenders say they have tightened their credit standards for approving applications for commercial and industrial loans to small businesses. This pull back has had the curious result of our receiving even more applications for loans, from very credit-worthy businesses that are being turned down by their regular banks. Accordingly, at a time when our own customers need us, we are being asked to serve new customers, and with the credit freeze, we find it difficult to do either.

I am here today because NDC wants to continue to provide debt financing for its borrowers and to do that, we need to find another source of lending capital until the banks return to this market. We believe the only source for such capital is the federal government.
My testimony today outlines our recommendations for ways to strengthen the Troubled Asset Relief Program (TARP) and the Term Asset-Backed Securities Lending Facility (TALF) to increase liquidity of community financial institutions so they can continue to lend and keep pace with demand, and to use TARP and TALF as a secondary market to acquire federal business loans and those guaranteed by various federal agencies (including Treasury, Housing and Urban Development, Small Business Administration, Economic Development Administration and US Department of Agriculture). This would allow access to Treasury-rate financing for businesses. We recommend this new mechanism for business financing be implemented through proven local delivery system of community financial institutions in cities and states, both urban and rural, and that existing federal regulations for this lending be streamlined to ensure timely impact.

An NDC Lending Model

We have a lending unit called Grow America Fund (GAF) that is a wholly owned subsidiary of NDC. GAF's mission is to stimulate investment in low income communities, to create jobs for the unemployed, and to spur entrepreneurship, especially among women and minority owned businesses.

Over our history, GAF has made nearly $100 million of loans. We are a small lender, averaging $10 million of loans annually. Our typical loan is under $300,000. Half of our borrowers are businesses owned by minority or women entrepreneurs. Because our mission is to build entrepreneurship, we make fewer loans and work closely with our borrowers to build their capacity to succeed as a business. Our loan loss rates average six tenths of one percent, which is extremely low given the fact that more than half of all small businesses fail within five years of start-up.

Because banks are not lending on the terms or at the rates of the past, loan applications to GAF have burgeoned. One business we helped finance just last month is a furniture manufacturer located in Brooklyn, New York.

In 1986 a woman started her own company making custom furniture products. She formed the business to facilitate the manufacturing and sale of the pieces of furniture and accessories she created. Today, her hand made products range from chandeliers, lamps and other ornamental pieces to bedroom sets. The owner works with interior designers, decorators and architects to produce custom pieces in addition to those made for sale in her retail boutique.

In 2004 the owner formed a retailing arm of her business in New York City. The company leases a 600 sq. ft. space where her pieces are for display only. A catalog is available at the store from which orders may be placed. The $488,000 GAF loan proceeds were used to refinance short-term working capital loans in the amount of $339,000 and provide $125,000 in permanent working capital to support the company's expansion through additional showrooms and $23,897 to finance project related soft and closing costs. The company employs fourteen people and is expected to add two full time jobs as a result of this 10-year, 5% loan.

GAF closed this loan in January, 2009. Recently, however, market conditions have changed.

How Bank Pullback has Affected Our Lending

Last fall, a money-center bank with which NDC had a long standing borrowing relationship received TARP funds. Recently, that same bank raised our borrowing rates. In addition, the bank imposed lending conditions with which we could not legally or operationally comply. These actions forced us to terminate this relationship at a time when we needed the money.

As an SBLC or "non-bank lender" GAF is authorized to make Small Business Administration (SBA) guaranteed loans nationwide. We are regulated by the SBA and audited for safety and soundness by the Farm Credit Administration. We have always received laudatory audits from Farm Credit Administration for safety and soundness and the policies and procedures we employ to carry out our mission. The SBA's Overall Lender Risk Ranking for GAF is 1, the best possible rating, evidencing the lowest risk ranking in the nation.

Our relationship with a particular Bank goes back more than 10 years. The Bank financed the 75% guaranteed portion of the loans made by GAF in the Bank's CRA assessment areas. By financing only the guaranteed portions of GAF's loans, they in essence have a 100% guarantee from the SBA on their loans to GAF. Because of the low risk and CRA credit they received, they loaned to GAF at LIBOR plus 25 basis points. They have never suffered a loss or a late payment from GAF and have always indicated to us that our relationship was very satisfactory to the Bank.

In late 2008, without prior warning, the Bank raised its interest rate to GAF by 1% to LIBOR plus 1.25. No reason was given for the rate increase. We had just completed our best ever audit with Farm Credit Administration and showed a continued Overall Risk Rating of 1 from the SBA. If anything, we were expecting a decrease in the rate for the successful management of this business. We nonetheless accepted the increase, to enable us to continue our lending.

Then, in January 2009 the Bank imposed two new conditions, which they were unwilling to put into writing. First, the Bank demanded a direct security interest either in the loans we made or in the SBA guarantee of the loans we made. To accommodate this request would have been a violation of SBA regulations and would lead to GAF losing its SBA license.

In addition, the Bank demanded that if any GAF loan financed under the Bank's line defaulted, GAF must pay the Bank prior to collection of the guaranteed portion from the SBA. No explanation was given for the demand beyond saying that they assumed all our loans would default and they wanted to be paid in a timely fashion.

This condition was both unreasonable – the Bank in essence would not wait for its money even though it was guaranteed by the US Government – and it could not be met because we would have had to maintain idle cash balances in an amount equal to their loan to GAF. In essence, they would loan GAF money, but only if GAF kept it in cash, and did not use it to make loans. Moreover, in light of our continuing good track record of very low loan losses, we feel penalized because we have continued to serve our customers instead of sitting on our cash.

As a result, we have been forced to terminate our borrowing relationship with that particular

Bank, and are retiring their loan to us. The Bank claims they did not deny GAF credit. They claim GAF simply could not meet the conditions of their offer. The fact that they were demanding conditions we could not legally meet, or which made it a loan in name only seems irrelevant to them. The Bank in question changed its terms for us after it received TARP money.

Recommendations

Utilize the Troubled Asset Relief Program (TARP) and the Term Asset-Backed Securities Lending Facility (TALF) to Enhance Lending

Congress must ensure that community based lenders have the same support from Treasury's TARP program, and the Federal Reserve's TALF program as regulated depository institutions do. As evidenced in my example above, community lenders cannot rely on a TARP funding trickle down effect from money center banks. There is a need for TARP funds to increase liquidity of community financial institutions like GAF to expand their lending capacity to meet increasing loan demand and fill financing gaps resulting from banks' retrenchment. There is also a need for TALF so Treasury and the Federal Reserve can set up a facility to acquire guaranteed federal business loans. Here are ways that TARP and TALF might be used for this purpose.

TARP:
Congress passed the Emergency Economic Stabilization Act in October, 2008. The purpose of EESA was "to immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States." (Section 2. Purposes). EESA authorizes the Secretary to establish a Troubled Asset Relief Program ("TARP") in Section 101.

Troubled assets are defined as including both mortgages as well as "any securities, obligations, or other instruments that are based on or related to such mortgages" and, "any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability… ." (Section 3(9)(A-B)).

Treasury has created a Capital Purchase Program (CPP) through which it is purchasing securities from financial institutions, in order to provide them more capital in the expectation of promoting financial system stability. Thus far, publicly held regulated financial institutions, privately-held C corporations, and most recently, Subchapter S corporations have been able to apply. Treasury has indicated it is working on a program for mutual associations.

Treasury can similarly create a version of the CPP suitable for the 3,000 to 4,000 seasoned non-profit community oriented lenders such as the National Development Council, who have a demonstrated track record of successful lending. These lenders include Community Development Corporations, CDFIs, non-profit low income credit unions and government-sponsored community lenders. In keeping with the purpose of the CPP, these investments would be just that, a source of capital from the taxpayers which would be paid back. We believe that investments in organizations like ours are consistent with the purposes of the TARP legislation. In Section 103 the legislation states,

> In exercising the authorities granted in this Act, the Secretary shall take into consideration—
> (1) protecting the interests of taxpayers by maximizing overall returns and minimizing the impact on the national debt;
> (2) providing stability and preventing disruption to financial markets in order to limit the impact on the economy and protect American jobs, savings, and retirement security;
> (3) the need to help families keep their homes and to stabilize communities;
> (4) in determining whether to engage in a direct purchase from an individual financial institution, the long term viability of the financial institution in determining whether the purchase represents the most efficient use of funds under this Act;
> (5) <u>ensuring that all financial institutions are eligible to participate in the program, without discrimination based on size, geography, form of organization, or the size, type, and number of assets eligible for purchase under this Act</u>

We recommend the terms of the CPP for community lenders be adjusted, given our much smaller size, and the fact that we are committed to lending and providing technical assistance to our borrowers. Rather than basing the amount of assistance on risk-weighted assets, we believe that the amount of assistance should be based on a percentage of the weighted average lending activity in which the institution has been engaged over the last 5 years. We suggest that a percentage of average annual lending or investing activity over the last three years be used to size the subordinated debt.

We propose that the subordinated debentures bear interest at a rate equal to no more than the 10-Year Treasury rate at the time of issuance, with the Secretary having the authority to set the rate at as little as 1%, payable in similar fashion to other classes of CPP investments.

No one knows how long the current economic conditions and credit freeze in the private markets will persist. In its term sheet for Subchapter S corporations, Treasury proposed a

maturity of 30 years, which we suggest be used for community lenders as well, with Treasury having the ability to redeem starting at the end of 7 years from the date of their issuance, which is 4 years longer than the inception of the redemption period for Subchapter S financial institutions. We believe this additional period is justified in light of the greater difficulties community financial institutions like NDC will have replacing the capital at redemption than traditional financial institutions may experience.

We would agree to the other standard provisions that Treasury is using, including the executive compensation provisions, and would work with them to identify appropriate measures to determine the financial health attributes for community lenders to participate.

We suggest a term that does not currently exist in the CPP agreements with regulated depository institutions, and that is that in return for this debt, we will agree to make loans and provide technical assistance to our borrowers.

TALF:
The TALF combines capital provided by the TARP with funding from the Federal Reserve in order to promote lending by increasing investor demand for securitized loans. As Treasury and the Federal Reserve continue to work on the TALF program we want to ensure that community financial institutions are given full consideration and a means to participate.

On February 10, 2009 Treasury Secretary Geithner announced an expansion of the Term Asset-Backed Securities Lending Facility (TALF) as part of the Administration's Financial Stability Plan. The purpose of this expansion, Secretary Geithner announced, is to "kickstart the secondary lending markets, to bring down borrowing costs, and to help get credit flowing again." He went on to say,

"In our financial system, 40% of consumer lending has historically been available because people buy loans, put them together and sell them. Because this vital source of lending has frozen up, no financial recovery plan will be successful unless it helps restart securitization markets for sound loans made to consumers and businesses – large and small.

We have agreed to expand this program to target the markets for small business lending, student loans, consumer and auto finance, and commercial mortgages.

And because small businesses are so important to our economy, we're going to take additional steps to make it easier for them to get credit from community banks and large banks. By increasing the federally guaranteed portion of SBA loans, and giving more power to the SBA to

expedite loan approvals, we believe we can turn around the dramatic decline in SBA lending we have seen in recent months."

In keeping with Secretary Geithner's proposal to increase guarantees, we recommend that all federal business guarantees be increased on the following scale until the economy recovers:

- 95% guarantee on loans less than $150,000;
- 90% guarantee on loans less than $500,000 and greater than $150,000;
- 85% guarantee on loans less than $2 million and greater than $500,000;
- 80% guarantee on loans up to $5 million and greater than $2 million; and
- Permit SBA to guarantee loans up to $5 million

In addition to raising the amount of federal guarantees, we recommend that Treasury and the Federal Reserve permit community financial institutions to sell their direct loans to TARP or TALF to recapitalize and enhance the liquidity of these lenders who have not stopped lending to businesses. We also recommend that Treasury and the Federal Reserve permit lenders to sell their guaranteed loans at low rates to TARP or through TALF if the established secondary market will not buy the loans because of the concessionary rate.

We believe that just as the Treasury Department is purchasing Fannie Mae and Freddie Mac mortgage-backed securities to promote stability and liquidity in the marketplace, TARP and TALF can and should serve as a secondary market for federal business loan guarantees for the same reason.

Thank you for your consideration of these recommendations. I would be happy to answer any questions that you might have for me. Again, I appreciate the opportunity to testify here today on such an important topic.

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Testimony by Bert Ely
to the
House Financial Institutions Subcommittee
at a hearing entitled
TARP Oversight: Is TARP Working for Main Street?
March 4, 2009

Mr. Chairman Gutierrez, Ranking Member Hensarling, and members of the subcommittee, I very much appreciate the opportunity to testify today about TARP and whether it is working for Main Street.

I have appended to this testimony two recent Wall Street Journal op-eds of mine pertaining to bank lending, headlined "Banks Don't Need to be Forced to Lend" and "Don't Push Banks to Make Bad Loans" as well as my resume. I also have appended to this testimony my answers to the eight questions posed in the letter of invitation to testify today. As will be readily evident from my answers, I am not a great fan of the TARP. Further, I greatly fear that the TARP will become a vehicle by which Congress will impose credit-allocation policies on TARP investees. Such policies would be very destructive to the American economy.

Harking back to resume, my early consulting experience is especially relevant to the subject of this hearing as for over a decade I consulted to small and medium-sized businesses on a broad range of financial matters, including obtaining bank credit. I often worked with business insolvencies, including serving as the operating trustee of a company in Chapter 11 bankruptcy, as a consultant to companies in Chapter 11, and as a bankruptcy examiner. Those experiences brought home to me the importance to small businesses of having sufficient equity capital on which to safely leverage bank credit.

As I discussed in my Wall Street Journal op-eds, lending standards clearly are returning to earlier, prudent standards from the excessive laxness of recent years. That return to prudent standards is crucial, both for the recovery from the current recession as well as for the longer-term health of the American economy. This is absolutely the wrong time for Congress to force banks, whether through TARP rules or otherwise, to launch a new round of imprudent lending, whether to small businesses or homeowners or whomever.

With regard to lending to small businesses it is important to realize that the primary reason why a business cannot obtain the credit it believes it needs is that it lacks sufficient equity capital and/or it cannot demonstrate to a lender that it can profitably employ the credit being sought. It is vitally important to realize that credit is not a substitute for equity capital. Rather, credit can only be reasonably leveraged off a sufficiently strong equity-capital base. In this regard, non-financial businesses are no different than banks, except that for good reason non-financial businesses cannot operate with as much leverage as banks and other financial intermediaries. Because lending standards are returning to normalcy, businesses of all types cannot operate with as much leverage as they could a few years ago, nor should they try.

The underlying cause of insufficient credit for businesses, including small businesses, is inadequate equity capital. Rather than beating on banks to lend more, Congress should address the

tax disincentives working against equity-capital accumulation within businesses. To put this another way, the Internal Revenue Code is the principal underlying cause of the current financial crisis. I address the tax laws and ten other public-policy causes of the crisis in an article which will appear shortly in the Cato Journal. I would be glad to submit that article for the record when it appears in print later this month.

While there are many aspects of the tax laws which fueled the housing bubble and the gross overleveraging of the American economy, working together they encouraged businesses and individuals to overleverage by incenting overspending and undersaving, thereby discouraging the accumulation of capital denominated as equity. That is, rather than encourage saving, which builds equity capital on a balance sheet, the tax laws actively discourage savings and equity-capital accumulation through the relatively heavy taxation of profits, for profits represent the generation of equity capital. At the same time, the tax deductibility of interest expense by businesses and homeowners encourages borrowing, and therefore overleveraging.

When the pre-tax cost of equity capital is easily 15% or more and the Prime Rate is 3.25%, as it is today, it is an apparent no-brainer for a business to finance as much of its balance sheet as it can with debt capital and as little as possible with equity capital. In addition to funding a portion of a business's balance sheet, equity capital also serves as its loss cushion, the same role equity capital plays in bank balance sheets. That loss cushion becomes vital to a business's survival during a recession, for it is equity capital, not debt capital, which must absorb any business losses and serve as the foundation on which borrowing during tough times must be based. Far too often, I have seen business owners seduced during good times by seemingly cheap debt, only to suffer losses during the tough times that exhaust their too-thin equity-capital foundation.

I will close this portion of my testimony by posing this thought experiment. What would be the condition of the American economy today, and the availability of credit for businesses of all sizes, if interest was not a tax-deductible business expense and business profits were not taxed at a business level? I strongly suspect that America would not be in recession and that it would enjoy a much more profitable and much less leveraged business sector than it has today.

I will close by discussing a threatened loss of bank capital, and therefore a reduction in bank lending capacity – the 20-basis-point deposit insurance special assessment that the FDIC has proposed to levy on the nation's banks and thrifts this coming September 30. This assessment represents a $15 billion tax on bank capital and would occur as the government is trying to boost the banking industry's capital and lending capacity. As FDIC chairman Sheila Bair has admitted, this assessment would be procyclical, yet she is determined to levy it. I recommend that the Financial Services Committee express its opposition, in the strongest possible terms, to this most untimely attack on bank lending capacity. As the banking industry demonstrated in the 1991-96 period, it has the capacity to rebuild the Deposit Insurance Fund back to its statutory minimum, but that rebuilding process should wait until the economy and the banking industry have begun to recover.

Mr. Chairman, I thank the Subcommittee for its time this afternoon. I welcome your questions.

Responses to questions posed in the Subcommittee's Letter of Invitation

1 – In general, have TALP and TALF funds/actions had measurable positive effects on the credit markets? If so, to what extent? If not, or if the positive effects have been *de minimis*, to what factors do you attribute these shortcomings?

It is not possible to specify the effect of TARP on the credit markets, for two reasons. First, TARP investments represent an addition to bank and thrift capital, as shown in the lower right hand corner of the accompanying illustration of a typical bank balance sheet. Because of the leveraged nature of bank and thrift balance sheets, capital is not a major source of bank funding – deposits and borrowings provide most of the funding with which banks and thrifts make loans and investments. According to FDIC data, bank equity capital (common and preferred) accounted for just 9.4% of total bank and thrift funding at December 31, 2008, while deposits provided 65.2% of bank and thrift funding and borrowings provided another 19.9% of that funding.

Second, because cash is fungible, the cash a bank or thrift receives when Treasury makes a TARP investment in the institution (not a gift, but an investment), it is impossible to trace the flow of the TARP investment into specific loans or investments or other bank assets. Therefore, it is impossible to draw a direct link between TARP investments and changes in bank and thrift lending to any class of borrower.

It is important to recognize that the primary purpose of bank and thrift capital, including TARP investments, is to serve as a loss cushion, to protect bank liabilities, and notably deposits, from losses. Therefore, TARP investments potentially enhance the credit markets, and specifically bank and thrift lending, by increasing the capacity of banks and thrifts to lend to all classes of borrowers.

2 – Generally, have the TARP recipients used the funds in responsible ways and consistent with Congressional intent? (Assuming that Congressional intent was to unfreeze the credit markets, freeing-up capital for lending.)

Banks and thrifts have used TARP investments responsibly as these investments have strengthened their capacity to lend, and lend they have in the face of an economy sliding into a potentially long and severe recession and declining loan demand because of that recession.

As the accompanying page from the most recent Federal Reserve compilation of commercial bank assets and liabilities shows, bank lending to the non-financial sector of the U.S. economy (line 5 minus line 15) has held up amazingly well. The amount of these loans actually rose 1.8% from its September 2008 average to February 18, 2009, and has declined only 1.2% from the December 2008 average to February 18. During the first year of the present recession (January 2008 to January 2009), bank lending to the non-financial economy increased quite robustly, by 3.9%. It is patently not the case that banks have stopped lending – not only are they lending, but the ratio of their loans to GDP has steadily increased since the recession began.

It also is important to note that the bank lending reported by the Fed is net of loan-loss reserves, as footnote 4 to this Federal Reserve report states. That is, the amount of loans actually outstanding has been reduced by the amount the banks have reserved for losses on those loans. Banks and thrifts have dramatically increased their loss reserves in recent months; for Fed reporting purposes, those increases offset loans, leading to an understatement of bank loan growth. For example, during the fourth quarter of 2008, banks and thrifts increased their loan-loss reserves by $16.5 billion; during all of 2008, they boosted their loan-loss reserves by $70.5 billion.

3 – Have TARP recipients increased business lending? Small business lending? If so, to what extent?. If not, what are the obstacles to lending (e.g., decreased demand, regulatory and capital requirements, inability to leverage, bank mismanagement)?

Business borrowing demand will decrease during a recession as business working capital needs (principally accounts receivable and inventories) shrink, due to lower sales volumes, and as capital outlays (new equipment, building expansions, etc.) are trimmed or postponed. Despite an expected drop-off in business loan demand, due to the recession, the accompanying Federal Reserve data show that bank lending to businesses (commercial and industrial loans, line 6) increased $111 billion, or 7.7%, from January 2008 to February 18 of this year.

Unfortunately, data on bank and thrift lending to small businesses is collected just once a year, on the June 30 Bank Call Reports and Thrift Financial Reports. That data will not be available until early August. It will be most interesting to see what changes in the volume of bank lending to small businesses will have occurred between June 30, 2008, and June 30, 2009.

4 – In order to increase business lending, especially small business lending, should the Treasury Department funnel more funds into the larger banks or should TARP funds be directed to smaller regional and community banks and Community Development Financial Institutions? Which would seem more effective?

As explained above, it is impossible to link any type of bank and thrift lending to TARP investments.

5 – Could you suggest a way to accurately measure whether or not banks have increased lending as a result of accepting TARP funds?

No, I cannot nor can anyone offer a credible way to measure a link between an institution's receipt of a TARP investment and the institution's lending.

It is extremely important to note that bank lending absolutely cannot be measured by the amount of new loans extended by a bank or thrift as much of that lending is merely a rolling over of previous loans. For example, a mortgage refinance for the same amount as the old mortgage does not increase the aggregate amount of mortgage credit outstanding.

Likewise, a business which draws $200,000 under a bank line of credit and then pays down that line of credit nine days later when it receives a payment from a large customer has not changed the amount it has borrowed from its bank even though the $200,000 draw on its line of credit technically would count0 as a new loan. The amount of credit that a bank, or the banking industry overall, has supplied to the economy, can only be measured by the amount of credit outstanding at any one time.

6 – Did the Treasury Department makes its initial TARP investments in the large banks in a manner that was likely to motivate the fund recipients to lend? If not, how should those investments have been made and what can be done to correct past errors?

As noted above, no linkage can credibly be drawn between a TARP investment in a large bank and its lending. Additionally, large banks, like all banks, are in the lending business, for extending credit is the principal way that banks earn profits.

Because of subsequent changes in the rules governing the recipients of TARP investments, notably executive compensation limits, and the prospect of future rules, specifically lending mandates, TARP investments are becoming increasingly unattractive to banks. Not surprisingly, more and more banks which accepted a TARP investment are now preparing to buy back the preferred stock they issued to the government when they received a TARP investment. Right from the beginning, I have strongly recommended to banks and thrifts that they not seek a TARP investment because I could foresee that the rules would make a TARP investment increasingly unattractive. My prophesy unfortunately has come true.

7 – Do you believe some of the large bank TARP recipients are insolvent? If so, how should the regulators deal with those institutions?

Any good accountant should be able to demonstrate that (1) all the large banks are insolvent or (2) all of them are solvent – it is just a matter of the assumptions the accountant makes. This is especially the case with determining the value accorded to investment securities under the fair-value accounting rules.

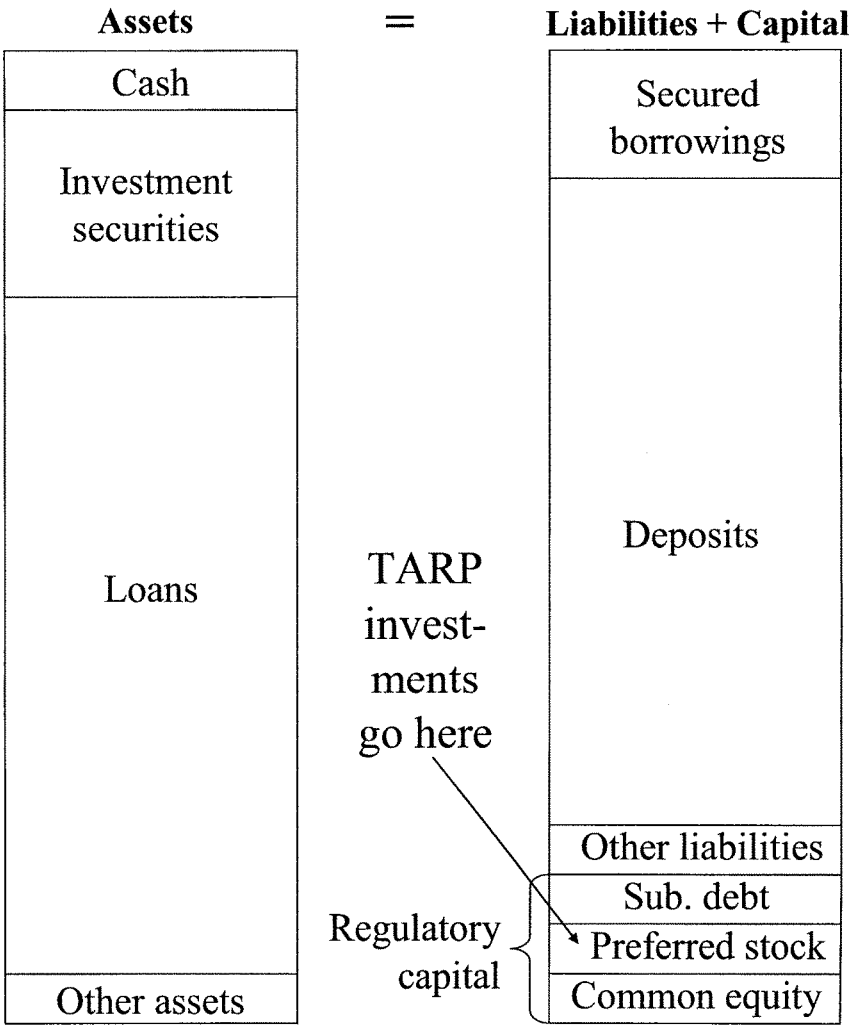
There also is a second question which must be addressed: Is the solvency test aimed at the holding company which owns the large bank or the large bank itself. Given the existence of "double leverage" (holding company debt invested in the subsidiary bank as equity capital), it is conceivable that a large bank holding company is insolvent, but that its subsidiary bank, which has more book equity capital than its parent holding company, is not insolvent.

8 – If the Treasury Department's proposed stress tests reveal that banks are undercapitalized, should those banks receive more TARP funds or would TARP funds be better spend on stronger banks?

As an accountant, I can produce whatever outcome is desired from the proposed stress tests – it is simply a matter of the assumptions that I make. That said, the Treasury Department and the regulators must make judgments about which banks cannot survive on their own. Weak banks should be encouraged to merge with stronger banks while clearly insolvent banks should be taken over by the FDIC under its well-established procedures for dealing with failed banks.

Typical bank balance sheet

(not to scale)



Assets and Liabilities of Commercial Banks in the United States[1]

Not seasonally adjusted, billions of dollars

February 27, 2009

	Account	2008 Jan	2008 Jul	2008 Aug	2008 Sep	2008 Oct	2008 Nov	2008 Dec	2009 Jan	Week ending Jan 28	Week ending Feb 4	Week ending Feb 11	Week ending Feb 18
	ASSETS												
1	Bank credit	9,352.2	9,377.4	9,400.5	9,596.6	9,995.0	9,972.3	9,998.0	9,859.2	9,814.7	9,830.4	9,811.1	9,762.7
2	Securities in bank credit	2,427.6	2,468.4	2,477.3	2,525.5	2,709.6	2,740.0	2,769.1	2,721.5	2,704.5	2,661.1	2,643.4	2,664.9
3	Treasury and Agency securities[2]	1,091.0	1,126.3	1,139.9	1,152.0	1,217.6	1,260.6	1,238.5	1,261.5	1,263.9	1,260.7	1,240.9	1,264.0
4	Other securities[3]	1,336.6	1,362.1	1,337.5	1,373.5	1,492.0	1,479.1	1,530.6	1,460.0	1,440.5	1,400.4	1,402.5	1,400.9
5	Loans and leases in bank credit[4]	6,924.6	6,868.9	6,923.2	7,071.2	7,285.4	7,232.3	7,228.9	7,137.7	7,110.3	7,169.3	7,167.6	7,097.9
6	Commercial and industrial	1,453.0	1,505.7	1,511.6	1,544.3	1,611.1	1,607.6	1,590.6	1,574.6	1,574.5	1,578.7	1,565.6	1,564.2
7	Real estate	3,621.7	3,623.2	3,627.3	3,669.6	3,831.0	3,833.6	3,823.6	3,797.2	3,797.6	3,816.4	3,826.1	3,804.5
8	Revolving home equity	491.0	522.6	527.3	541.6	561.5	566.2	592.0	595.3	595.2	595.0	595.6	595.6
9	Other residential	1,515.6	1,427.9	1,423.7	1,438.5	1,516.3	1,511.4	1,496.1	1,477.0	1,477.5	1,499.2	1,507.9	1,487.6
10	Commercial	1,615.2	1,672.5	1,676.3	1,689.7	1,733.2	1,736.1	1,735.6	1,725.0	1,724.9	1,722.2	1,722.6	1,720.9
11	Consumer	928.4	833.7	844.8	854.8	866.5	877.0	891.6	912.9	919.6	911.7	907.7	910.4
12	Credit cards and other revolving plans	361.9	348.4	356.6	364.2	378.4	390.1	403.1	411.0	410.3	401.4	398.9	405.1
13	Other	466.5	485.3	488.0	490.6	488.1	486.9	488.7	501.9	509.3	510.3	508.8	505.3
14	Security[5]	268.8	275.5	268.7	323.3	302.2	270.8	256.4	224.0	202.9	244.3	254.7	200.2
15	Fed funds and RPs with brokers	229.0	225.1	237.2	260.3	238.9	219.1	211.5	182.3	162.2	205.3	216.0	161.7
16	Other	59.8	50.4	51.5	63.0	63.3	51.7	44.9	41.6	40.7	39.0	38.7	38.5
17	Other loans and leases	732.6	650.8	650.7	679.0	674.6	643.1	666.3	629.0	615.7	618.2	613.6	618.5
18	Interbank loans	446.0	426.8	428.5	463.2	445.6	355.3	375.0	441.4	458.7	438.5	441.1	445.3
19	Fed funds and RPs with banks[5]	366.7	350.4	352.4	391.2	366.0	277.9	309.9	377.4	393.6	376.2	379.4	384.2
20	Other	81.3	76.4	76.1	72.0	79.6	77.4	65.0	63.9	65.1	62.3	61.7	61.1
21	Cash assets[7]	313.6	296.9	290.5	371.7	565.9	890.5	1,041.6	1,019.1	936.3	847.2	790.4	900.6
22	Other assets[8]	968.4	1,013.5	1,010.4	1,047.5	1,096.4	1,129.0	1,141.6	1,104.3	1,101.6	1,108.5	1,122.7	1,096.1
23	TOTAL ASSETS[9]	**11,000.3**	**11,003.2**	**11,015.9**	**11,359.6**	**11,954.3**	**12,215.4**	**12,422.9**	**12,283.6**	**12,172.7**	**12,080.2**	**12,021.6**	**12,061.4**
	LIABILITIES												
24	Deposits	6,714.1	6,857.6	6,869.5	7,072.4	7,161.4	7,132.9	7,343.7	7,364.9	7,297.1	7,350.6	7,320.6	7,322.4
25	Transaction	627.2	602.5	565.2	624.3	660.2	701.0	901.9	719.4	732.2	670.8	642.3	676.1
26	Nontransaction	6,086.9	6,255.2	6,264.3	6,448.1	6,501.2	6,431.9	6,541.8	6,645.5	6,565.0	6,680.0	6,678.4	6,646.4
27	Large time	2,050.4	2,097.0	2,105.5	2,150.2	2,074.6	1,952.8	1,989.9	1,999.1	1,983.3	1,970.1	1,954.1	1,936.0
28	Other	4,036.5	4,158.2	4,173.9	4,297.9	4,426.6	4,479.2	4,551.9	4,646.4	4,581.7	4,709.9	4,724.4	4,710.4
29	Borrowings	2,261.6	2,332.1	2,373.3	2,447.2	2,653.6	2,637.5	2,495.2	2,423.1	2,445.7	2,425.7	2,421.6	2,443.7
30	From banks in the U.S.	467.5	466.6	470.1	479.2	453.1	404.5	364.7	435.2	443.0	423.1	415.6	432.6
31	From others	1,794.3	1,865.5	1,903.2	1,968.0	2,200.5	2,232.9	2,110.5	1,987.8	2,002.8	2,002.7	2,006.2	2,010.9
32	Net due to related foreign offices	122.9	-26.3	-77.2	-65.6	161.6	399.5	460.7	447.3	390.5	341.5	273.0	295.1
33	Other liabilities	700.5	661.1	666.5	707.6	806.9	860.5	932.9	857.8	843.2	764.5	793.6	777.4
34	TOTAL LIABILITIES	**9,819.3**	**9,824.6**	**9,832.1**	**10,161.8**	**10,803.5**	**11,030.4**	**11,232.5**	**11,093.1**	**10,976.5**	**10,882.6**	**10,809.2**	**10,838.6**
35	Residual (assets less liabilities)[10]	1,181.0	1,178.6	1,183.8	1,197.8	1,150.8	1,185.0	1,190.3	1,190.5	1,196.2	1,197.6	1,212.4	1,222.8

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OPINION

JANUARY 6, 2009

Banks Don't Need to Be Forced to Lend

The last thing we need is Congress setting business models.

By Bert Ely

Tomorrow, the House Financial Services Committee will hold a hearing to "discuss priorities" for the Obama administration's use of Troubled Asset Relief Program (TARP) funds. Those priorities could include lending and other directives to financial institutions receiving TARP investments. These directives could be disastrous for taxpayers and the economy if they force banks to engage in unwise lending, or keep weak, troubled banks from being absorbed by stronger banks.

TARP has two major shortcomings. The first is a lack of political support. Congress did not explicitly authorize capital investments in financial institutions when it created the $700 billion program three months ago. The Treasury originally was supposed to buy troubled assets of banks and other financial institutions. It quickly realized that this was unworkable due to challenges in determining asset prices. It then decided to invest TARP funds in the institutions, to increase their capital. But the lack of congressional consent for these investments has understandably stoked controversy about their purpose.

Second, there is widespread confusion about the role capital plays in bank balance sheets, which has exacerbated this controversy. That confusion is evident in comments such as "banks should be forced to lend the TARP monies the government has given them."

Treasury invests TARP funds by purchasing preferred stock in a bank, which adds to the bank's capital. Bank capital, which also includes common stock and retained earnings, serves as a cushion to absorb losses from loans and other bank activities; it is not loaned out directly. Most bank lending is funded by customer deposits and borrowings from third parties (such as the Federal Home Loan Banks).

Potentially, a bank could use its increased capital from TARP to absorb losses from loans and investments already on its books, to acquire banks too weak to remain independent, or to increase its lending. The higher capital boosts a bank's lending capacity because it enables the bank to safely increase its deposits -- and thus its loans -- without increasing its risk of insolvency.

Unfortunately, Treasury has poorly explained the legitimacy of those uses. Congressional debate about TARP may further muddy the waters. A review of these uses show why none should be mandated or barred.

First, even well-managed banks are suffering loan losses as collateral values shrink and the recession deepens. In normal times, a bank would raise new capital to offset those losses. However, the capital markets are not functioning normally, with many sound banks now unable to raise fresh capital.

TARP investments, which increase a bank's capital, therefore serve as a bridge to when normality returns to the capital markets. Because of restrictions accompanying TARP investments, and a jump in the TARP dividend rate after five years to 9% from 5%, banks will have an incentive to raise private capital to finance a buyback of their TARP preferred stock. Taxpayers will profit from these TARP investments because of the dividends paid by the banks on the preferred shares the Treasury purchased.

Second, weak banks need to be acquired by well-managed banks rather than being propped up by TARP investments, for weak banks are not good lenders. The continued existence of weak banks will impede the economic recovery.

However, an acquirer needs to realistically account for losses buried in the other bank's balance sheet even though this accounting will reduce its own capital. The TARP investment should therefore ensure that the merged bank is well capitalized. Eventually, that bank would raise capital to retire its TARP stock.

Third, while a TARP investment increases a bank's lending capacity, lending mandates -- such as that a bank must increase its outstanding loans by some multiple of its TARP investment -- could force banks to make new bad loans.

Unfortunately, banks accepting TARP investments must, under the contract governing Treasury's investment in the bank, agree that Treasury can "unilaterally amend" the agreement "to comply with any changes . . . in applicable federal statutes." Through this provision the new Congress can impose on banks with TARP investments lending mandates or other obligations and restrictions, such as barring the use of TARP funds to acquire weak banks. Even worse, Congress may legislate credit allocation, such as directing that a certain percentage of a mandated lending increase must go to a favored class of borrowers.

Banks are in the lending business: They do not need to be forced to lend. And contrary to popular and political opinion, banks have not stopped lending. Despite the recent financial market turmoil, a declining GDP, and an increase in loan-loss reserves, commercial bank lending actually grew $336 billion, or 4.9%, from August to Dec. 24, according to Federal Reserve data. While lending dictates or other restrictions may be tempting, the Obama administration must discourage Congress from imposing them on recipients of TARP investments.

Mr. Ely, the principal in Ely & Co., Inc., is a financial institutions and monetary policy consultant.

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OPINION

FEBRUARY 2, 2009

Don't Push Banks to Make Bad Loans

Contrary to myth, commercial bank lending is up. So are standards.

By BERT ELY

There is a widespread belief that banks are now refusing to lend as much as they should, and that Congress should pressure them to extend more credit to consumers and businesses.

In reality, banks as a whole increased their lending during 2008 -- the notion they haven't is based on a misunderstanding of U.S. credit markets. Pressuring banks to lend more could backfire.

Lost in too many discussions of the financial sector is that banks and other depository institutions account for only 22% of the credit supplied to the U.S. economy (down from 40% in 1982). "Shadow banking" -- notably asset securitization and money-market mutual funds -- now supplies 33% (up from 14%). Insurance companies, other financial intermediaries, non-financial firms and the rest of the world provide the balance.

As far as commercial banks go, Federal Reserve data released last week show that their lending increased 2.36% during the last quarter of 2008. For all of 2008, commercial-bank lending rose by $386 billion, or 5.63%, even as the economy slid into recession. Over that 12-month period, business lending jumped $152 billion, or 10.6%, real-estate loans were up $213 billion, or 5.9%, and consumer lending rose $73.5 billion, or 9%. Other categories of bank lending such as loans to farmers, broker-dealers and governments, declined $53.2 billion, or 5.4%.

Fed data also show that during the first three quarters of 2008, the total amount of credit supplied to the economy increased $1.91 trillion, or 3.8%, with $540 billion of that amount coming from foreign lenders.

Nevertheless, Treasury recently demanded that the 20 largest recipients of government capital investments start providing detailed monthly reports about their lending and investment activities. This new requirement could lead to government lending mandates. That would not be a good idea.

In the first place, the drop in stock-market and house prices has made millions of families feel poorer and led them to save more than in recent years. It has also encouraged them (especially Baby Boomers approaching retirement) to pay off debt. They don't need more debt.

More broadly, many of the most creditworthy neither need to nor want to borrow right now. Richard Davis, CEO of U.S. Bancorp, recently said that he is seeing the demand for loans diminish at his and other banks "from people and businesses spending less and traveling less and watching their nickels and dimes."

Lenders moreover have tightened lending standards, correcting an excessive laxness that contributed to our financial mess. Zero or very low down-payment mortgages are out, as are "covenant light" corporate loans. Likewise, lenders have trimmed credit-card limits and cut the amount of money available under home equity lines of credit as home values have declined.

And contrary to the "lend more" message broadcast from inside the Washington Beltway, bank examiners are criticizing weak loans and forcing banks to tighten lending standards. Bankers are caught in a vise between politicians and examiners.

A lot of the credit tightness is a reflection of the near-collapse of loan securitization. Recent Fed plans to buy asset-backed securities may help revive asset securitization, but bankers have no control over the fate of that initiative.

The economy is in recession and working off the consequences of a housing bubble fed by excessive mortgage credit. Given that loan demand typically falls during a recession, it's amazing that bank lending increased as much as it did last year. It was essentially flat during the 2001 recession.

Bankers should always lend prudently, as they are now doing. If they are jawboned or worse by Washington into reckless lending, the U.S. will set itself up for another debt crisis, even before the present mess has been cleaned up.

Mr. Ely, the principal in Ely & Co. Inc., is a financial institutions and monetary policy consultant.

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Biographical sketch for Bert Ely

Bert Ely has consulted on deposit insurance and banking structure issues since 1981. In 1986, he became an early predictor of the S&L crisis and a taxpayer bailout of the FSLIC. In 1991, he was the first person to correctly predict the non-crisis in commercial banking.

Bert continuously monitors conditions in the banking industry as well as monetary policy. In recent years, he has focused increased attention on the GSEs, notably Fannie Mae, Freddie Mac, and the Farm Credit System. He has co-authored a monograph on how to privatize the three housing-finance GSEs. Currently, Bert is focusing his attention on banking problems, the crisis in housing and housing finance and the entire U.S. financial system, and the resolution of the Fannie and Freddie conservatorships.

Bert has testified on numerous occasions before congressional committees on banking issues and he often speaks on these matters to bankers and others. He is interviewed by the media on a regular basis about banking and other financial issues.

Bert first established his consulting practice in 1972. Before that, he was the chief financial officer of a public company, a consultant with Touche, Ross & Company, and an auditor with Ernst & Ernst. He received his MBA from the Harvard Business School in 1968 and his Bachelor's degree in economics in 1964 from Case Western Reserve University.

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Testimony of
DAVID S. SCHARFSTEIN
PROFESSOR OF FINANCE
HARVARD BUSINESS SCHOOL

on
TARP OVERSIGHT: IS TARP WORKING FOR MAIN STREET?

Before the
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES
2:30 p.m., March 4, 2009
Room 2128, Rayburn House Office Building

Good afternoon, Chairman Gutierrez, Ranking Member Hensarling, and Members of the Subcommittee. Thank you for inviting me to speak today. I am David Scharfstein, Professor of Finance at Harvard Business School and Research Associate of the National Bureau of Economic Research. I am also a member of the Squam Lake Working Group on Financial Regulation, a nonpartisan, nonaffiliated group of fifteen academics who have come together to offer guidance on the reform of financial regulation. I speak only for myself today.

I would like to make three main points.

First, there has likely been a contraction in the supply of bank loans because of the poor financial condition of many large banks. This poses a challenge for most firms, but particularly for small firms, which rely on bank loans for almost all of their financing. About half their loans come from large banks, and these banks appear to be cutting their lending more than small banks. Thus, it is important to find ways to ease the supply of credit to small firms.

Second, the Capital Purchase Program (CPP) of TARP should be thought of as two distinct programs. One is a support program for large, troubled financial institutions, some of which are systemically significant. The effect of this program on financial stability and credit availability is hard to measure since we cannot observe what would have happened in its absence. The other part of the CPP program is targeted at small banks. This program is not a support program for troubled financial institutions, but rather a program that provides capital to banks so that they can increase their supply of credit. The effect of this program will be somewhat easier to measure, but such measurement will inevitably be imperfect. Below, I will detail a proposal to improve measurement.

Third – and at the heart of my testimony – Treasury should consider expanding the Capital Purchase Program for small banks, perhaps even creating a separate program for them. The problems of the big banks have no easy solutions, and it is highly uncertain how and when their problems will be resolved. In the meantime, small firms risk losing their primary source of funding. Many small banks are well-positioned to step into the breach given their knowledge of local markets, and with an infusion of capital could do so. However, as with in any government program, one must ask: Why does the government need to be involved? In this case, one should ask: Why can't banks with good lending opportunities raise capital on their own? The answer is that many *can* raise capital, but are reluctant to do so in the current financial environment. Given extreme investor uncertainty about the health of the banking sector, a bank that issues stock is likely to be perceived by investors as one that is undercapitalized or has unrecognized losses in its loan portfolio. So it is natural that banks have been reluctant to issue stock on their own given that doing so would likely drive down their stock price. In addition, most small banks are privately owned and cannot easily raise capital in illiquid private markets. The government's commitment to purchase stock at a premium would entice small banks to participate in the program and raise capital, as many have already done.

This program will attract more banks if it does not include the same sort of restrictions that are now imposed on TARP recipients. Nor should it; this program would not be designed to put taxpayer dollars at significant risk. The program will also be more effective if it targets small banks that are able to leverage the equity investments by expanding their deposits or other borrowing. And it should target banks with expertise in business lending. The existing TARP investments in small banks do appear to have gone to banks that do more business lending.

It would be tempting to require participating banks to reach a target level of new lending equal to some multiple of the government's investment. This temptation should be resisted. Mandates of this sort could result in a rash of bad loans, and we do not want to turn healthy banks into unhealthy ones. Moreover, we should probably not measure the success of the program purely on the basis of whether there is an increase in lending. It will be a success if the increased lending capacity of small banks increases competition and puts downward pressure on interest rates spreads, which are now at high levels. This would benefit the many firms that are struggling to meet expenses and to keep their doors open.

Of course, it is important to keep in mind the limitations of such a program. Some of the hardest hit communities – the ones that need the most support – may also have many troubled small banks with large real estate exposures. Investments in these banks may help to stabilize them, but this is not the sort of investment I have in mind. Moreover, while many small banks are relatively healthy now, their condition could worsen appreciably. In that case, the investments are unlikely to have the desired effect.

With these limitations in mind, I believe that the government should enhance its program of investment in small banks, targeting healthy banks that are well-positioned to increase lending. At a time when large banks appear to be retrenching, this would better enable our financial system to meet the pressing needs of small enterprise.

I. Bank Lending During the Financial Crisis

There is no question that business lending has fallen. Some of this decline is to be expected: during a recession the demand for credit falls, as firms cut capital expenditures, reduce working capital, forgo acquisitions, and go out of business. But some of the decline in lending almost surely stems from a contraction in supply – banks and other lenders are less willing to extend credit. The contraction in the supply of bank loans is a feature of other recessions, even when banks are healthy.[1] Given that many of them are in bad financial shape – and some might even be insolvent – it is not hard to believe that there has been a contraction in supply and that it is affecting investment. Indeed, according to one study, which surveyed over 1,000 CFOs, 86% report that they are passing up valuable investment opportunities due to lack of funding.[2]

Measuring the level of bank lending is tricky, particularly lending during the current financial crisis. It is tempting to measure this as the change in the total outstanding amount of commercial and industrial (C&I) loans on banks' balance sheets. However, this amount can increase either because banks are extending new loans or because firms are drawing on their pre-existing revolving credit facilities. In fact, Figure 1A shows, during the first few weeks of the financial crisis – from the failure of Lehman Brothers to mid-October – C&I loans actually rose by roughly $100 billion. This is puzzling: Why would banks increase lending at the peak of the crisis, when many were near collapse? The answer is that C&I loans rose not because banks were voluntarily extending credit to new borrowers, but rather because firms were drawing down their revolving credit facilities – largely as a precautionary measure given turbulent financial markets. For example, on October 2, 2008, the automotive parts manufacturer, Dana Corporation, drew $200 million from its $650 million credit line. Their explanation of why they did so is typical of many firms that drew on their lines:

Drawing down these funds is a prudent liquidity measure. Ensuring access to our liquidity to the fullest extent possible at a time of ambiguity in the capital markets is in the best interest of our customers, suppliers, shareholders, and employees.

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[1] See Anil K. Kashyap and Jeremy C. Stein (1995), "The Impact of Monetary Policy on Bank Balance Sheets," Carnegie-Rochester Conference Series on Public Policy, vol. 42, pp. 151-95.
[2] Murillo Campello, John Graham and Campbell Harvey (2009), "The Real Effects of the Financial Crisis: Evidence from a Financial Crisis," working paper, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1318355

Table 1, reproduced from my research paper with Victoria Ivashina of Harvard Business School,[3] provides information on the firms that announced drawdowns. The total comes to $16 billion, a large fraction of the $100 billion increase in C&I loans after the Lehman failure.[4] Many of the firms had poor credit ratings -- one later went bankrupt (Tribune Company) and another is at risk of or going bankrupt (General Motors) – but the interest rates they paid were far lower than the rates they would have paid on newly issued loans. Importantly, these draw-downs for precautionary reasons may have forced banks to scale back their lending to other borrowers.

Figure 1A reveals that after the initial increase in C&I loans, the amount of outstanding C&I loans of large banks fell significantly over the ensuing four months. It is telling that the rise and subsequent fall is much more pronounced for large banks (Figure 1B) than it is for small banks (Figure 1C). Interestingly, this is the exact opposite of what happens in typical recessions: C&I lending of large banks usually falls less than that of small banks.[5] The current poor financial condition of the large banks may explain this reversal of the normal pattern.

A. Small Business Lending

The relative good health of small banks is good news for small firms since small banks – those with assets of less than $5 billion -- hold about 43% of small business loans (less than $1 million in size). The bad news is that big banks provide the rest of the credit to small firms. The recent bank-specific loan data do not break out loans to small business, so it is difficult to say whether large banks are specifically scaling back their loans to small firms. But if they are cutting lending across the board, then this would constitute a significant contraction in loan supply to small firms.

Such a contraction would present a significant challenge to small firms because, unlike large firms, they do not have access to other sources of credit such as commercial paper, public bonds, or private placements with institutional investors. It has been shown that when banks scaled back their supply of credit during the recessions of 1974-75 and 1981-82, small firms that could not issue public bonds were more adversely affected than large firms, who generally have access to other non-bank sources of capital.[6]

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[3] Victoria Ivashina and Scharfstein, David (2008) "Bank Lending during the Financial Crisis of 2008," Harvard Business School working paper. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1297337

[4] This is clearly only a portion of the firms that increased their drawdowns. Using data released by The Shared National Credit Program of the Federal Reserve, it is possible to show that the $100 billion increase in C&I loans would occur if firms drew an extra 15-20% of the unused portion of their credit facilities. It is not unlikely that they did this.

[5] See Anil K. Kashyap and Jeremy C. Stein (1995), "The Impact of Monetary Policy on Bank Balance Sheets," Carnegie-Rochester Conference Series on Public Policy, vol. 42, pp. 151-95.

[6] See Anil Kashyap, Owen Lamont and Jeremy Stein (1994), "Credit Conditions and the Cyclical Behavior of Inventories," *Quarterly Journal of Economics*, pp. 565-592. http://faculty.chicagobooth.edu/anil.kashyap/research/creditconditions.pdf

In addition to the decline in lending, there has almost surely been an increase in interest rate spreads (the difference between loan interest rates and safe government bonds). Some of this increase, of course, is related to the decline in credit quality, but some of it is likely related to the contraction in supply of credit. This added extra interest expense creates problems for all firms, particularly many small firms that are struggling to keep expenses down and their doors open.

B. Large Business Lending

Large borrowers also face significant challenges. Their bank loans are almost always organized through the loan syndication market, which has experienced major disruptions since the middle of 2007, leading to dramatic declines in bank loans to large borrowers.

Some background on this market is useful. Syndicated loans are "originated" by "lead" banks, which retain a share of the loan, and sell the remaining share to a syndicate of other lenders. This market started out in the mid-1980s with banks as the main participants (including investment banks), but grew to include numerous institutional investors including insurance companies, mutual funds, and hedge funds. Bank of America, Citigroup, and JPMorgan Chase are central to this market. Together, they originate over 60% of all syndicated loans, and are involved in 70% of all syndications. During the credit boom of 2002 to mid-2007, syndicated loans were often pooled together and packaged into collateralized debt obligations (CDOs), as was done with residential mortgages (including subprime). Funds raised from loan syndications were used for a variety of restructuring purposes including mergers and acquisitions (M&A), leveraged buyouts (LBOs), and share repurchases, as well as for the usual investments companies make in working capital and plant and equipment (real investment loans). At the peak of the credit boom, about half the loan syndications were restructuring loans (i.e. for M&A, LBOs and share repurchases).

In mid-2007, the world became aware of the problems in subprime lending, and began to recognize that AAA tranches of securities that used subprime loans as collateral were a lot riskier than their ratings implied. Because of those concerns, the market for all kinds of securitized products dried up, including the market for CDOs of loan syndications. Since many of the loans that went into the CDOs were below-investment-grade debt primarily used to fund leveraged buyouts (LBOs) and some mergers and acquisitions (M&A), this led to a huge drop in this market. But it also led to a significant fall in real investment loans.

Figure 2, which is based on my research with Victoria Ivashina of Harvard Business School, plots quarterly volumes of restructuring loans and real investment loans.[7] What this figure makes clear is that much of the reduction in lending to large borrowers pre-dates the crisis that erupted in September 2008; rather it began in mid-2007 with concerns about sub-prime lending.

The volume of loan syndication will likely not return to its peak -- nor should it. There was clearly too much credit then. And much of that credit was going to fund restructuring activities, which is arguably a less important source of economic growth than real investments. It is more important to make sure that large firms that want to fund valuable real investments can do so at reasonable cost. Unfortunately, it is harder to do this through loan syndications than it once was for two main reasons. First, the main lead banks – JPMorgan Chase, Citigroup, and Bank of America – are among the most troubled banks in the financial system. While they earned significant fees for arranging loan syndications, they still have to hold a share of their loan originations in their portfolio and they may be increasingly reluctant to do so given their own financial troubles. Second, many of the banks that were active syndicate members have retrenched significantly – particularly investment banks. This may be putting more pressure on the lead banks to hold a larger share of the loans and cooling their appetite for originating large loans.

The weakness of the loan syndication market is a problem for large borrowers but, as noted above, many of them have access to public bond markets and private placements. There is some weak evidence that some firms, particularly very large ones, are beginning to access the public bond markets. How effective firms will be at substituting away from large banks is an open question. If they can do so successfully, the negative implications of a weak banking sector will be muted.

II. The Allocation of TARP Funds and Measuring Their Effect on Lending

A. Allocation of TARP Funds

To date, Treasury has invested over $236 billion in the preferred stock and warrants of financial institutions as part of its Capital Purchase Program ($196 billion) and Targeted Investment Program ($40 billion). Not surprisingly, most of this money ($211 billion) has gone to large banks. But relative to their size, they have received about the same amount as small banks. Banks with assets of greater than $25 billion account for 92% of bank assets, and these

[7] Victoria Ivashina and Scharfstein, David (2008) "Bank Lending during the Financial Crisis of 2008," Harvard Business School working paper. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1297337

banks received 90% of the TARP money.[8] About 4.5% ($11 billion) of the TARP investments went to small banks with assets less than $5 billion, and they account for 3.5% of bank assets. The remaining 5.9% ($14 billion) went to medium sized banks with assets of $5-25 billion and they account for 4.8% of bank assets. This implies little about the cost of the programs since the premiums that were paid for the securities may have differed across size classes.

The investments in small banks and large banks should be thought of differently. Much of the money that was invested in large banks went to institutions that are in significant financial trouble and pose systemic risks. These investments were an attempt not just to increase lending, but also to promote financial stability. Whether this program enhances financial stability in a cost-effect manner is an open question, but if it does then the benefits are significant even if they cannot be measured in a specific bank's lending statistics.

The program of investment in small banks appears to be less about propping them up to promote financial stability and more about providing capital for them to lend. It is therefore useful to look in greater detail at the characteristics of small bank TARP recipients. The Exhibit below summarizes some key characteristics.

Characteristics of Small Bank TARP Recipients and Non-Recipients

	Small Bank Tarp Recipients	Small Bank Not TARP Recipients
Domestic Loans as % of Banks Assets	72.6%	65.7%
C&I Loans as % of Domestic Loans	18.3%	15.4%
Commercial Real Estate as % of Domestic Loans	29.4%	28.1%
% of Total Small Bank Assets	22.8%	77.2%
% of Total Small Bank C&I Loans	27.3%	72.7%
% of Total Small Bank Commercial Real Estate Loans	24.8%	75.2%

There are two main points that are worth noting:

1. Small bank TARP recipients are heavily involved in business lending. C&I loans and commercial real estate loans comprise 47.7% of their domestic loan portfolios. By contrast, these business loans comprise a smaller share of the loan portfolios of small banks that did not receive TARP funds (43.5%). Small bank TARP recipients also have a larger share of their assets in domestic loans. Though not shown in the exhibit, large banks have only 29% of their loan portfolios in C&I and commercial real estate

[8] The money was actually invested in bank holding companies, but we only measure the assets of the banks in the bank holding company and thus understate the assets of the bank holding company. In this respect, the large banks are likely to have received less of their pro-rata share.

combined. In addition, a much smaller percentage of their assets on a consolidated holding company basis is invested in domestic loans.

2. TARP money invested in small banks has been invested in banks that account for 22.8% of the assets of the small bank sector, 27.3% of the C&I loans of the small bank sector, and just under a quarter of the commercial real estate loans of the small bank sector. Not surprisingly, these percentages are much higher for medium and large banks. Medium size bank TARP recipients control 53.7% of bank assets in that size range, and large bank recipients control 91.1% of the assets of large banks. Whether desirable or not, this suggests that if there is additional TARP money that could go to many small banks that have not yet received any funding from TARP.

B. Measuring the Effect of TARP on Bank Lending

There is great interest in determining whether TARP investments have led to an increase in bank lending. This is understandable given the magnitude of taxpayer dollars at risk. Unfortunately, measuring the effect of Treasury's investments is difficult and – in the case of the large banks – probably impossible. Almost all large banks have received TARP funds so there are no meaningful non-recipients against which to compare recipients. We also cannot observe the counterfactual world in which large banks did not receive TARP funding as well as other significant support. While their lending does appear to have fallen after the capital infusion, as shown in Figure 1B, we do not know whether it would have fallen even more without the government's support.

There is somewhat more hope that we will be able to measure the effect of capital infusions on the lending of small and medium banks. As noted above, small bank TARP recipients make up about 23% of the assets controlled by small banks; the equivalent number is 53.7% for medium size banks. Therefore, there is a sizable set of non-recipients against which to compare the TARP recipients. However, it is important to keep in mind that TARP recipients are not randomly selected; those who applied for TARP funds, may have done so because they saw better lending opportunities. It is also possible that some TARP recipients applied for funds because they were having financial difficulties and had fewer lending opportunities. With these important caveats in mind, it may still prove useful to track lending by TARP recipients relative to banks that do not receive TARP funds.

Measuring bank lending would be facilitated by a small change in the way banks report loans and loan commitments. Currently, FDIC-insured banks report C&I loans outstanding in their Reports of Condition and Income (Call Reports) filed with the Federal Financial Institutions Examination Council. But they should also be required to report the outstanding amount of C&I

revolving credit facilities. Approximately 80% of all C&I loans originally start as credit facilities and are drawn from these facilities.[9] And as noted above, a big portion of the increase in C&I loans after Lehman Brothers failed was the result of precautionary credit facility drawdowns by credit-challenged borrowers rather than the result of lending to new borrowers. It would be useful to be able to track this more closely.

It would not take much to add this information to Call Reports or to report this information to regulators. Banks are already required to report outstanding credit card lines, commercial real estate commitments, and home equity lines.[10] C&I credit facilities, by contrast, are subsumed in a catchall reporting item called "Other Unused Commitments" that, for many banks, is largely made up of C&I commitments, but may include other types of commitments.[11]

During the fourth quarter of 2008, the three largest bank holding companies – JPMorgan Chase, Citigroup and Bank of America – had large drops in "Other Unused Commitments" totaling $173 billion, nearly 16% of the outstanding amount of these commitments. Was this large decline because firms were drawing down on existing C&I credit facilities, or because banks were cutting bank on new issues of C&I credit facilities?[12] Was this driven by other items including in this data item unrelated to C&I lending? Without more detailed information, it is impossible to know.

III. Increasing the Supply of Credit to Small Firms

What can be done to increase the supply of credit to small firms? One potential solution is to improve the health of big banks. While this would help – and it is important for the stability of the financial system and the overall economy – the road to their recovery is going to be bumpy, and has no clear end in sight. In the meantime, undercapitalized (or maybe even insolvent) banks will be under pressure to "deleverage" – to sell assets or curtail lending in order to pay down debt and improve their financial health.

While the big bank crisis is being worked out, we should consider making further equity investments in small banks, on top of the approximately $11 billion of TARP money that has already been invested in small banks. The goal of this program would be to increase the lending of small banks as an antidote to the reduction in lending by big banks. Ideally, banks would not

[9] Survey of Terms of Business Lending, Federal Reserve Statistical Release, http://www.federalreserve.gov/releases/E2/current/default.htm
[10] These items are reported on Schedule RC-L of the Call Reports.
[11] Kashyap, Rajan and Stein (2002) use item RCFD 3818, "Other Unused Commitments" as a measure of outstanding C&I credit facilities. This item also includes other commitments such as mortgages that have been committed to but have not yet closed.

just increase lending one-for-one, but rather would leverage the equity investment to increase lending. At historical ratios, each dollar of equity invested in a small bank leads to seven dollars of additional loans. Thus, for example, a $5 million investment might eventually increase loans by $35 million. Of this amount just under half – about $16 million -- would end up in C&I and commercial real estate loans. Of course, there is no guarantee that banks will increase lending – they have to be able to identify good loans. But the chances are increased if troubled large banks are indeed shedding small borrowers.

It is reasonable to ask why the government needs to step in to provide capital to small banks. After all, why can't these banks raise capital on their own, particularly if they are in good financial shape? The answer is that many *can* raise capital, but are reluctant to do so in the current financial environment. It has been shown that investors often interpret stock issues as a signal that the issuer thinks its stock is overvalued. Investors respond by driving down the stock price. Given extreme investor uncertainty about the health of the banking sector, investors are likely to respond to a bank that issues stock by lowering the price they are willing to pay So it is natural that banks have been reluctant to issue stock on their own given the adverse stock price consequences it is likely to have. The government's commitment to purchase stock at a premium may entice small banks to participate in the program, as many have already done.[13]

Unlike the TARP investments in big banks, these investments would not be a "bailout" of shareholders and creditors. Thus, it would not be necessary to cap compensation or restrict dividend payments. The idea is simply to subsidize the expansion of healthy small banks, akin to a host of other government subsidies (such as investment tax credits) used to encourage particular behavior.

It would be tempting to require participating banks to reach a target level of new lending equal to some multiple of the government's investment. This temptation should be resisted for two reasons. First, mandates of this sort could result in a rash of bad loans; we do not want to turn healthy banks into unhealthy ones. Second, we should probably not measure the success of the program purely on the basis of whether there is an increase in lending. It will be a success if the increased lending capacity of small banks increases competition and puts downward pressure on interest rates spreads, which are now at high levels. This would benefit the many firms that are now struggling to meet expenses and to keep their doors open.

There are at least two caveats to keep in mind. First, for this program to be successful, it is important that banks be able to leverage their equity investments. They can do this by borrowing from a variety of sources – from the Federal Home Loan Bank, by getting brokered deposits, or by trying to attract new retail deposits. Some banks may be more effective than

[13] The premium paid by Treasury has been documented in "Valuing Treasury's Acquisitions," February Oversight Report of the Congressional Oversight Panel, Feburary 6, 2009.

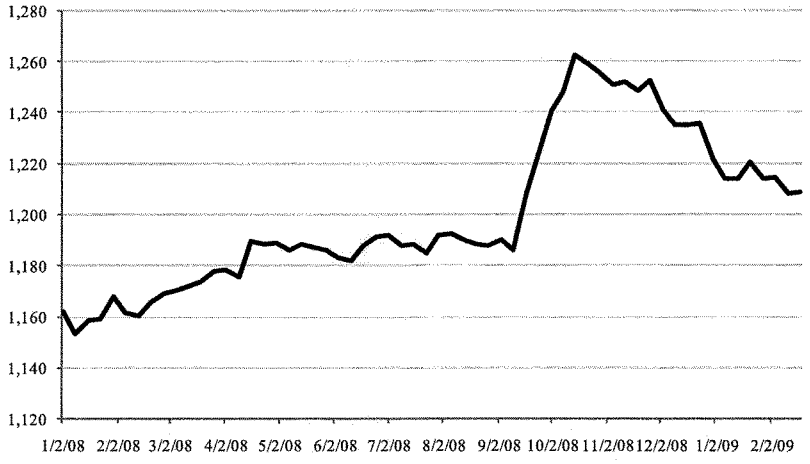
others in tapping these sources. For example, some banks may not currently have outstanding arrangements with the FHLB; others may have a hard time expanding retail deposits. To the extent possible, any additional investments should be in banks that have the capacity to leverage the investment.

A second problem is that some of the hardest hit communities – the ones that need the most support – may also have many troubled small banks with large real estate exposures (including construction loans and commercial real estate). Investment in these banks may help to stabilize them, but it is not the sort of investment I have in mind. Moreover, while many small banks are relatively healthy now, their condition could worsen appreciably in which case investments in them is unlikely to have the desired effect.

With these limitations in mind, I believe that the government should enhance its program of investment in small banks, targeting healthy banks that are well-positioned to increase lending. At a time when large banks appear to be retrenching, this would better enable our financial system to meet the pressing needs of small enterprise.

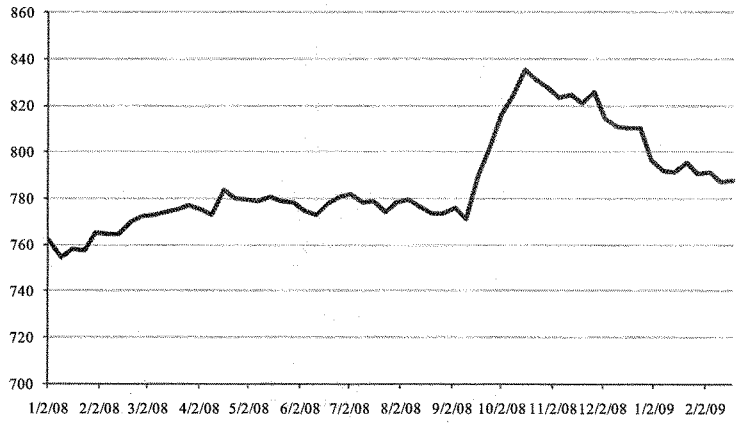
Thank you for the opportunity to address you today. I look forward to answering any questions you may have.

Figure 1A: C&I Loans by Domestically Chartered Commercial Banks (Billion USD)



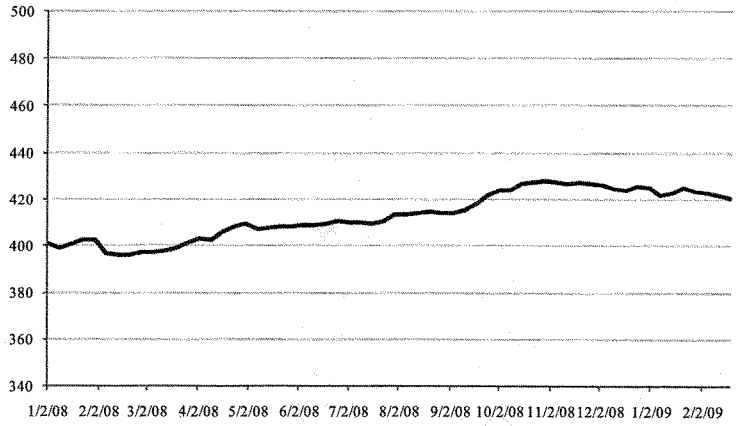
Source: Federal Reserve Board, Assets and Liabilities of Commercial Banks in the United States, (http://www.federalreserve.gov/releases/h8). Not seasonally adjusted, adjusted for mergers.

Figure 1B: C&I Loans by Large Domestically Chartered Commercial Banks (Billion USD)



Source: Federal Reserve Board, Assets and Liabilities of Commercial Banks in the United States, (http://www.federalreserve.gov/releases/h8). Not seasonally adjusted, adjusted for mergers.

Figure 1C: C&I Loans by Small Domestically Chartered Commercial Banks (Billion USD)



Source: Federal Reserve Board, Assets and Liabilities of Commercial Banks in the United States, (http://www.federalreserve.gov/releases/h8). Not seasonally adjusted, adjusted for mergers.

Figure 2: Real Investment Loans vs. Restructuring Loans (Billion USD)

Compiled from DealScan database of loan originations. Real Investment Loans are defined as those that are intended for general corporate purposes, capital expenditure or working capital. Restruturing Loans are defined as those that are intended for leveraged buyouts, mergers and acquisitions, or share repurchases.

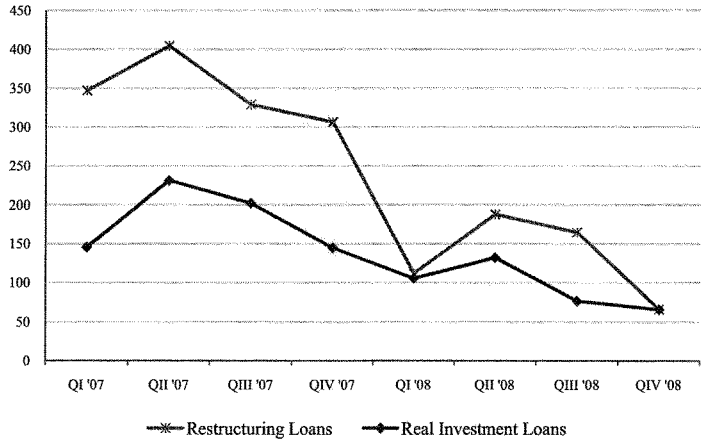


Table 1: Revolving Lines Drawdonws, US Corporate Loans (Billion USD)

Compiled from SEC filings and Reuters. Exposure to Lehman Brothers identifies loans with Lehman in the original lending syndicate.

Date drawn	Company	Current credit rating	Amount drawn ($MM)	Credit line ($MM)	Maturity	Spread (Undrawn/ Drawn)	Lead bank	Exposure to Lehman Brothers	Comment (SEC filings)
08/25/2008	Delta Air Lines	BB-/Ba2	1,000	1,000	2012	50/ L+200	JPM	Yes	Simply put, we have taken this action to increase our cash balance as we approach the closing of the merger. We believe this will provide us with the utmost in flexibility – at minimal cost – as we prepare for this critical transition.
09/15/2008	FairPoint Communications	BB+/Ba3	200	200	2014	37.5/ L+275	Lehman Brothers	Yes	The Company believes that these actions were necessary to preserve its availability to capital due to Lehman Brothers' level of participation in the Company's debt facilities and the uncertainty surrounding both that firm and the financial markets in general.
9/19/2008	Michaels Stores	B	120	1,000	2011	25/ L+150	Bank of America	No	The Company took this proactive step to ensure that it had adequate liquidity to meet its cash needs while there are disruptions in the debt markets.
9/22/2008	General Motors	B-/Caa3	3,400	4,100	2011	30/ L+205	Citigroup, JPM	No	The company said it was drawing down the credit in order to maintain a high level of financial flexibility in the face of uncertain credit markets.
9/26/2008	Goodyear Rubber & Tire Co.	BB+/ Baa3	600	1,500	2013	37.5/ L+125	JPM	No	Temporary delay in the company's ability to access $360 million currently invested with The Reserve Primary Fund, Goodyear said in a statement. The funds also will be used to support seasonal working capital needs and to enhance the company's liquidity position.
9/26/2008	AMR Corp	B-	255	225	2013	50/ L+425	GE Capital Corp.	No	Cash balance
9/30/2008	Duke Energy	A-/ Baa2	1,000	3,200	2012	9/ L+40	Wachovia, JPM	Yes	In light of the uncertain market environment, we made this proactive financial decision to increase our liquidity and cash position and to bridge our access to the debt capital markets. This improves our flexibility as we continue to execute our business plans.
10/1/2008	GameStop	BB+/Ba1	150	400	2012	25/ L+100	Bank of America	No	Acquisition
10/2/2008	Dana Corp	BB+/Ba3	200	650	2013	37.5/ L+200	Citibank	Yes	Drawing down these funds is a prudent liquidity measure. Ensuring access to our liquidity to the fullest extent possible at a time of ambiguity in the capital markets is in the best interest of our customers, suppliers, shareholders, and employees.
Oct-2008	Six Flags	B/B2	244	275	2013	50/ L+250	JPM	Yes	(W)e borrowed $244.2 million under the revolving facility portion of the Credit Facility to ensure we would have sufficient liquidity to fund our off-season expenditures given difficulties in the global credit markets.
Oct-2008	Saks	B+/B2	80.6	500	2011	25/L+100	Bank of America	No	Cash balance
Oct-2008	Monster Worldwide		247	250	2012	8/L+30	Bank of America	No	"We have always viewed our revolving credit as an insurance policy, and given the events in the market, we felt that it was appropriate to access that insurance," CFO Timothy Yates said in an Oct. 30 earnings call.

10/9/2008	CMS Energy	BB+/ Baa3	420	550	2012	20/ L+100	Citigroup	No	Cash balance
10/10/2008	American Electric Power	BBB/ Baa2	2,000	3,000	2012	9/ L+45	JPM, Barclays	No	AEP took this proactive step to increase its cash position while there are disruptions in the debt markets. The borrowings provide AEP flexibility and will act as a bridge until the capital markets improve.
10/15/2008	Lear Corp	BB/B1	400	1,000	2012	50/ L+200	Bank of America	No	Given the recent volatility in the financial markets, we believe it is also prudent to temporarily increase our cash on hand by borrowing under our revolving credit facility.
10/16/2008	Southwest Airlines	BBB+/ Baa1	400	1,200	2010	15/ L+75	JPM	No	Although our liquidity is healthy, we have made the prudent decision in today's unstable financial markets to access $400 million in additional cash through our bank revolving credit facility.
10/16/2008	Chesapeake Energy	BB/Ba2	460	3,000	2012	20/ L+100	Union Bank of California	Yes	Cash balance
10/16/2008	Ebay		1,000	1,840	2012	4/ L+24	Bank of America	Yes	Acquisition
10/20/2008	Tribune Co.	B/Caa1	250	750	2013	75/ L+300	JPM	Yes	Tribune is borrowing under the revolving credit facility to increase its cash position to preserve its financial flexibility in light of the current uncertainty in the credit markets.
10/23/2008	FreeScale Semiconductor	BB/B-	460	750	2012	50/ L+200	Citibank	Yes	We made this proactive financial decision to further enhance our liquidity and cash position. This improves the company's financial flexibility as we continue to execute our business plans.
10/24/2008	Idearc	BBB-/ Ba3	249	250	2011	37.5/ L+150	JPM	No	The company made this borrowing under the revolver to increase its cash position to preserve its financial flexibility in light of the current uncertainty in the credit markets.
11/13/2008	Genworth Financial	A/A2	930	1,700	2012	5/ L+20	Bank of America, JPM	Yes	The Company intends to use the borrowings along with other sources of liquidity for the repayment of outstanding holding company debt (including the Company's senior notes maturing in 2009) at maturity and/or the purchase and retirement of outstanding debt prior to maturity or for other general corporate purposes.
11/23/2008	Computer Sciences	A-/Baa1	1,500	1,500	2012	7/L+25	Citibank	No	The Company took the action due to the current instability of the commercial paper market and to ensure the Company's liquidity position in light of the ongoing credit market dislocation.
11/25/2008	NXP Semiconductors	B	400	600	2012	50/ L+275	Morgan Stanley	No	In view of the current global financial turmoil we are drawing USD 400 million under our revolving credit facility. This is a proactive financial decision in order to secure availability of this facility in a turbulent financial market environment.

Source: Victoria Ivashina and David Scharfstein, "Bank Lending During the Financial Crisis of 2008," Harvard Business School working paper. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1297337

STATEMENT OF JOSEPH ZUCCHERO TO THE U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

Good afternoon, Chairman Gutierrez and members of the Committee. On behalf of myself, my business partner Michael Genovise and my attorney Jim DiChristofano, I thank the Committee for inviting us to participate in this crucial hearing. I sincerely believe it is essential that during this tumultuous time, the voices of small business owners are heard and their struggles reported.

I am the owner and operator of Mr. Beef on Orleans in the City of Chicago. I began the restaurant in 1979 and over the past 30 years have built a reputable and thriving business. In addition, I am an owner along with Michael Genovise of an apartment building and an Italian fine dining restaurant named Natalino's also located in the City of Chicago. Natalino's was opened in March, 2008 after substantial remolding of the building.

Combined, both restaurants employ 50 hard-working people. We provide much needed sales tax receipts to the City, Cook County and the State of Illinois. We source our food and products from numerous small business owners.

The economic downturn has had impacts on my business due to the loss of jobs and income from the local residents that live and work near downtown Chicago.

Many small businesses are being starved of needed lines of credit or are having their lines of credit not renewed upon maturity. Not only have I seen and heard this from a variety of small businesses, but I have personally lived this nightmare.

I have two loans of comparatively small amounts that have matured in October and November of last year. The loans have been paid every month and I continue to submit payments. I do not have the funds to give the entire loan amounts due. Midwest Bank, which received approximately $85 million in TARP funds will not re-new or extend the matured loans further. This places my business in jeopardy.

Another bank will not refinance the two matured loans because the new bank would be placed in a third lien position. Thus, the banks want us to try and obtain funding to re-finance all the loans in Mr. Beef and Natalino's.

This has severely hampered our non-stop efforts to find financing or a resolution to the problem. Small banks do not have the capital to take on a large loan. Again,

big banks are not even the slightest bit interested and are using the TARP money to inflate their own revenues.

We have been actively submitting loan packages to various banks and loan brokers in order to extract us from this situation.

Our current loans are at an approximate 60% loan to value, based on recent appraisals. Our loans carry interest rates of 8 ½ % and 9%. Recent rates are around 6.5% to 7%. Just lowering our interest rates would provide a dramatic savings to our business, would prevent us from letting go of more employees, and would also give us breathing room to ride out the economic turmoil out.

Midwest Bank frustrates me in that they received TARP money and are not willing to either extend our loans or lower the interest rates on the non-matured loans. They have been patient with us while we seek alternative banks to finance us, but in reality that means they are doing nothing.

Many bankers seem to be paying us lip service and are not actually interested in providing financing, but rather seek free publicity.

We have been dealing with one small bank for six months. We keep giving them documents, we paid for expensive appraisals and tried to accommodate every request they make. To this day, we have been consistently given optimistic outcomes that have increased our hopes that an end is near to our situation. Yet, they have not approved or denied a loan. They have enjoyed the publicity.

My situation is just one example. I am fortunate to have a successful business in downtown Chicago. There are other business owners who are not so fortunate. At the end of the day, we are at the mercy of the banks, who have no willingness or obligation to help us.

I was approached by a local banker who found out I was coming here with my attorney to testify in front of this Committee, and he strongly suggested that we should not appear. He wanted us to "just lay low and let this situation blow over!" I politely asked him to give me the extra $84,000.00 a year that lower rates would save, and he promptly walked out of my establishment.

I do fear a backlash within the local banking industry for us coming here today. I implore this honorable Committee to set my mind at ease.

I do not need, nor want, a bailout from the taxpayers. I only want the banks to be fair.

Congress needs to take action. Congress needs to know that small businesses drive the economy, that we are fighting everyday to keep the doors open and people employed. It is time that TARP funds come with requirements that banks must actively seek out and help lower small businesses' interest rates or extend their matured loans or lines of credit that were performing.

On behalf of myself, Michael Genovise, Jim DiChristofano and all the small businesses that run this economy I thank Chairman Gutierrez and the members of this Committee for the opportunity to come here and tell our story.

I welcome any and all questions that the Committee may have at this time.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

BLOOMBERG L.P.,	:	
Plaintiff,	:	Case No.
- against -	:	COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,	:	
Defendant.	:	

INTRODUCTION

1. This is an action by a news organization, Bloomberg L.P. ("Bloomberg"), pursuant to the Freedom of Information Act ("FOIA"), 5 U.S.C. § 552, as amended, seeking to vindicate the public's right to obtain government records maintained by the Board of Governors of the Federal Reserve System (the "Fed"), an agency of the United States government, concerning the Fed's lending of public money to private financial institutions.

2. The government documents that Bloomberg seeks are central to understanding and assessing the government's response to the most cataclysmic financial crisis in America since the Great Depression. The effect of that crisis on the American public has been and will continue to be devastating. Hundreds of corporations are announcing layoffs in response to the crisis, and the economy was the top issue for many Americans in the recent elections.

3. In response to the crisis, the Fed has vastly expanded its lending programs to private financial institutions. To obtain access to this public money and to safeguard the taxpayers' interests, borrowers are required to post collateral. Despite the manifest public interest in such matters, however, none of the programs themselves make reference to any public disclosure of the posted collateral or of the Fed's methods in valuing it. Thus, while the

taxpayers are the ultimate counterparty for the collateral, they have not been given any information regarding the kind of collateral received, how it was valued, or by whom.

4. To discharge its obligation as the eyes and ears of the public, Bloomberg sought access to this information under FOIA. To date, the Fed has failed to produce the requested documents, or even formally to respond to Bloomberg's request. Consequently, Bloomberg brings this suit to compel the Fed to discharge its obligations under FOIA, so that the public can be informed of how the Fed is safeguarding the public's money.

JURISDICTION AND VENUE

5. This Court has jurisdiction over this action pursuant to 28 U.S.C. § 1331 because this action arises under the laws of the United States, in particular, 5 U.S.C. § 552. In addition, this Court has jurisdiction over this action pursuant to 5 U.S.C. § 552(a)(4)(B), under which, "the district court of the United States in the district in which the complainant resides, or has his principal place of business . . . has jurisdiction to enjoin the agency from withholding agency records and to order the production of any agency records improperly withheld from the complainant," because, among other things, Plaintiff Bloomberg maintains its principal place of business in this District.

6. Venue is proper in this District pursuant to 5 U.S.C. § 552(a)(4)(B) and 28 U.S.C. § 1391 because, among other things, Plaintiff Bloomberg's principal place of business is in this District.

PARTIES

7. Plaintiff Bloomberg is a limited partnership organized and existing under the laws of the State of Delaware, with its principal place of business at 731 Lexington Avenue, New York, New York. Bloomberg operates Bloomberg News, a 24-hour global news service with

more than 1,800 journalists in 108 bureaus around the world. Bloomberg supplies real-time business, financial, and legal news to more than 200,000 subscribers worldwide. As a wire service, Bloomberg provides news to more than 400 newspapers globally. Bloomberg provides radio and television programming throughout the world through its 750 radio affiliates and its eleven 24-hour news television stations. Bloomberg publishes two monthly magazines and more than 50 books each year. Bloomberg's website receives 3.5 million visits each month. In total, Bloomberg distributes news, information, and commentary to millions of readers and listeners each day, and has published over one hundred million stories.

8. Defendant Fed is an agency of the United States of America, and has possession and control of the records that Bloomberg seeks. According to the Fed, it is charged with supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers, and with providing financial services to depository institutions, the U.S. government, and foreign official institutions, including playing a major role in operating the nation's payments system.

FACTS

The Fed's Lending Facilities

9. The Fed uses a number of methods to regulate the banking and financial system in the United States. One method is the lending of money to private financial institutions.

10. As of August 2007, the Fed lent money to private financial institutions primarily through its discount window. The discount window allowed the Fed to lend money, on an overnight basis, to so-called "depository institutions," which are financial institutions that obtain their funds mainly through deposits from the public. Depository institutions include commercial banks, savings and loan associations, savings banks, and credit unions.

11. Starting in or around August 2007, to improve market functioning, the Fed expanded the lending from the discount window, by extending the loans from overnight to as long as 90 days. In addition, the Fed added three new lending facilities: the Primary Dealer Credit Facility, the Term Securities Lending Facility, and the Term Auction Facility.

12. The changes to the discount window lending, and the three new facilities, were designed to enhance the Fed's ability to lend to depository institutions, and also created the ability to lend to so-called "primary dealers," which are banks and securities broker-dealers that trade in U.S. Government securities with the Federal Reserve Bank of New York. During 2008, the Fed has included on its list of primary dealers Bear, Stearns & Co., Lehman Brothers Inc., Banc of America Securities LLC, Barclays Capital Inc., Goldman, Sachs & Co., HSBC Securities (USA) Inc., J. P. Morgan Securities Inc., Merrill Lynch Government Securities Inc., and Morgan Stanley & Co. Inc.

13. According to the Fed, the discount window for depository institutions and the Primary Dealer Credit Facility for primary dealers are effectively 'standing' facilities that provide daily access to funding for eligible institutions. Access to funds through these facilities occurs at the initiative of the borrowing institution, in an amount determined by the borrowing institution's needs and collateral. The Fed charges a fixed interest rate set at a premium to market rates on this kind of facility to discourage institutions from unnecessary use of Fed lending.

14. Also according to the Fed, the Term Auction Facility for depository institutions and the Term Securities Lending Facility for primary dealers constitute a second kind of facility in which a pre-determined amount of longer-term funding is made available at auction on pre-announced dates for settlement on a later date. These facilities are designed to improve overall

liquidity conditions in term and secured funding markets, rather than to satisfy the needs of a particular institution on a particular day. The interest rate and the distribution of the awards across institutions in this second kind of facility are determined by an auction.

15. Before these changes to the Fed's lending programs, during the week ending August 8, 2007, the Fed had average outstanding lending through the discount window of around $1 million. After these changes to the Fed's lending programs, during the week ending October 8, 2008, the Fed had average outstanding lending of over $400 billion.

16. Private institutions that seek to avail themselves of these lending facilities must post collateral to the Fed in exchange for the loans of government money. The amount of the loan corresponds with the value assigned to the collateral.

The Request

17. On May 20, 2008, Bloomberg reporter Mark Pittman submitted to the Fed, through the Fed's website at www.federalreserve.gov/generalinfo/foia/EFOIA/EFOIAForm.cfm, an electronic FOIA request (the "Request") seeking certain records (the "Requested Records").

18. The Request stated: "For all securities posted between April 4, 2008 and May 20, 2008 as collateral to the Primary Dealer Credit Facility, the discount window, the Term Securities Lending Facility, and the Term Auction Facility (the 'Relevant Securities'), we request copies of:

> "1. all forms and other documents submitted by the party posting the Relevant Securities as part of the application for the loan;
>
> "2. all receipts and other documents given to the party posting the Relevant Securities as part of the application for the loan;
>
> "3. records sufficient to show the names of the Relevant Securities;
>
> "4. records sufficient to show the dates that the Relevant Securities were accepted and the dates that the Relevant Securities were redeemed;

"5. records sufficient to show the amount of borrowing permitted as compared to the face value, also known as the 'haircut';

"6. records sufficient to describe whether valuations or 'haircuts' for the Relevant Securities changed over time;

"7. records sufficient to show the terms of the loans and the rates that the borrowers must pay;

"8. records sufficient to show the amount that the Federal Reserve has accepted of each of the Relevant Securities;

"9. records sufficient to show which, if any, Relevant Securities have been rejected as collateral and the reasons for the rejections;

"10. all databases and spreadsheets that list or summarize the Relevant Securities; and

"11. records, including contracts with outside entities, that show the employees or entities being used to price the Relevant Securities and to conduct the process the lending."

19. The public has a significant and legitimate interest in the Fed's conduct with respect to these four lending facilities because the Fed's assets are public assets. Taxpayers are entitled to understand and assess the decisions by the Fed on the valuation of the collateral it accepts as security for public money being lent to private institutions. The public's interest is particularly pronounced in light of the new expansive powers of the Fed, the new risks that the Fed is taking with public money, and the ongoing financial crisis and its effects on the American economy.

20. On information and belief, the Fed possesses the Requested Records.

21. The Fed is obligated to release the Requested Records under FOIA unless it can show that the records are exempt from disclosure.

To Date, The Fed Has Failed to Respond to the Request.

22. Under FOIA, the Fed was required to respond to the Request by June 18, 2008, which is 20 business days after the date on which Bloomberg submitted the Request.

23. One day after a response was due, in a letter dated June 19, 2008, the Fed acknowledged that it had received the Request, and invoked its right to extend its response time until July 3, 2008, 10 business days after June 19, 2008.

24. By telephone, on or around July 8, 2008, Alison Thro, Senior Counsel and FOIA Public Liaison of the Fed, informed Bloomberg that the Fed was processing the Request.

25. By telephone, on or around August 15, 2008, two Fed employees, Ms. Thro and Pam Wilson, informed Bloomberg that the Fed expected that it would provide a formal denial of the Request by the end of September 2008.

26. To date, more than five months after submitting the Request, Bloomberg has not received a response.

27. Bloomberg has exhausted its administrative remedies.

28. Bloomberg has a statutory right to the Requested Records.

FIRST CAUSE OF ACTION
(Request for declaratory judgment under 28 U.S.C. § 2201)

29. Bloomberg repeats, realleges, and incorporates the allegations in the foregoing paragraphs as though fully set forth herein.

30. FOIA mandates public disclosure by the Fed of the Requested Records.

31. The Fed has not provided the Requested Records to Bloomberg.

32. An actual and justiciable controversy exists as to whether the Fed has violated FOIA.

33. Bloomberg seeks declaratory judgment that FOIA entitles Bloomberg to the Requested Records and that the Fed should produce those records immediately.

SECOND CAUSE OF ACTION
(Request for records improperly withheld in violation of FOIA)

34. Bloomberg repeats, realleges, and incorporates the allegations in the foregoing paragraphs as though fully set forth herein.

35. Bloomberg seeks disclosure of, and access to, the Requested Records.

36. The Fed was required to respond to the Request no later than June 18, 2008 or July 3, 2008, but to date, has still failed to respond.

37. Bloomberg has exhausted its administrative remedies with respect to receiving a response to the Request.

38. FOIA mandates public disclosure by the Fed of the Requested Records.

39. The Fed's failure to make the Requested Records promptly available to Bloomberg violates 5 U.S.C. § 552(a)(3)(A).

40. Upon substantially prevailing, Bloomberg should be awarded its attorneys' fees under 5 U.S.C. § 552(a)(4)(E).

PRAYER FOR RELIEF

WHEREFORE, Bloomberg requests that this Court:

41. Declare that the Fed's constructive denial by failing to respond to the substance of the Request was unlawful;

42. Order the Fed to make the Requested Records immediately available to Bloomberg; and

43. Grant such other and further relief as this Court may deem just and proper.

Dated: New York, New York
November 7, 2008

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Joseph E. Stiglitz
University Professor

February 24, 2008

Dear Representative Maloney,

I have been trying to study the impact on the American economy of the bail-outs to AIG and to banks. One of the critical questions is where did the money that we gave them go? It is important to know this for several reasons. First, the claim was made that it was necessary to bail-out AIG in order to prevent systemic risk to the American economy. In order to evaluate this claim, we must know who the ultimate beneficiaries were of the money provided to AIG. If, for instance, the money went abroad, then it was unlikely that AIG's failure would have represented systemic risk to the US. If the money went to a large investment bank, then we can assess the impact on that bank. Perhaps without the bail-out the bank would have survived, though admittedly its shareholders would have been worse off.

Secondly, going forward, we have to devise clear rules about when we will bail-out institutions and when we will not. With our growing national debt, it is imperative that we spend taxpayer dollars wisely. If only a small percentage of the AIG money went to banks which were systemically important, it would have been far more efficient to assist directly those firms. The AIG bail-out provides a good case study within which to frame this important policy debate.

Unfortunately, the public does not seem to have access to this information. I realize that some claims may be made that releasing such information at the time of the bail-out might have exacerbated market turmoil. I am, however, a strong believer in market transparency. Many of our current problems can be traced to inadequate transparency. Whatever one's views on this, sufficient time has elapsed that these concerns are no longer relevant. American taxpayers have a right to know where their money is going, and it is imperative that Congress has this information in order to frame appropriate legislative responses.

Firms should play by the rules. The basic rule of capitalism is that firms should bear the consequences of their mistakes. If there are exceptions, they should be narrow and well defined. I am requesting that you make publicly available information about who received the money given by the Fed and the U.S. Government to AIG and about the derivative contracts under which this money was delivered. The information I am requesting should be of immense help in assisting Congress to undertake the essential analyses I have described.

It would also be useful to know the analyses that the Federal Reserve and Treasury undertook prior to the bail-out, which led them to the conclusion that the failure of AIG would lead to systemic risk, as well as the analyses that they undertook prior to the decision not to bail-out Lehman Brothers which led them to the conclusion that the failure of Lehman Brothers would not lead to systemic consequences. It is important that the government have appropriate analytic frameworks for addressing these questions, and it is apparent that, at least in the case of Lehman Brothers, the existing frameworks are deficient.

As the current crisis continues to grow, it is important to have this information as quickly as possible.

I look forward to your response.

Sincerely,

Joseph E. Stiglitz
University Professor
Columbia University