# IMPROVING RESPONSIBLE LENDING TO SMALL BUSINESSES

## FIELD HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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# IMPROVING RESPONSIBLE LENDING TO SMALL BUSINESSES

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**Monday, November 30, 2009**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 11 a.m., at Lawrence Technological University, 21000 West 10 Mile Road, Southfield, Michigan, Hon. Dennis Moore, [chairman of the subcommittee] presiding.

Members present: Representative Moore.

Also present: Representatives Peters, Dingell, and Schauer.

Chairman MOORE OF KANSAS. This hearing of the Subcommittee on Oversight and Investigations of the House Financial Services Committee will come to order.

Our field hearing today is entitled, "Improving Responsible Lending to Small Businesses," and I would encourage everybody, if you have a cell phone on you, please turn it off or a Blackberry or whatever you have, please turn it off so we can have this hearing.

I want to—this is our 8th Oversight and Investigations Subcommittee hearing this year and our 2nd field hearing. Our field hearing today is entitled, "Improving Responsible Lending to Small Businesses," which I think is of great concern to everybody in this room. Field hearings allow us to get out of Washington, D.C., and see and hear for ourselves the economic conditions that confront business owners in our country, the banks, and the credit unions.

Before we get started, I want to thank Congressman Gary Peters for inviting our subcommittee to the Detroit area for today's hearing. I also want to thank his staff for their hard work, and President Lewis Walker, the president of the Technological University, for hosting us today. Thanks, also, to Congressman John Dingell, a wonderful, long-term serving Member of Congress, and to Mark Schauer, Congressman Schauer, for being here today, as well.

We will begin with members' opening statements, and then we will hear testimony from our first panel of witnesses. Members will have up to 5 minutes to question our witnesses. We will repeat this for our other panels. The Chair advises members that I will be keeping everyone, including myself, to 5 minutes, as we want to keep things moving so we can wrap up no later than 1:50 this afternoon.

Keep in mind that unanswered or partially answered questions can also be followed up in writing for the record. We will get you information about that later. Also, if you don't have time to give all the information you want to, we would encourage you to make a written submission later. Without objection, all members' opening statements will be made a part of the record, and I now recognize myself for up to 5 minutes for an opening statement.

Just last week, we learned from the FDIC that lending by U.S. banks plunged by 3 percent in the third quarter, the largest drop since at least 1984 when this kind of information was first collected. This represents the 5th consecutive quarter in which banks have reduced lending. According to the report, banks reduced the amount of money extended to their customers by $210 billion between July and September, cutting back in almost every category from mortgage lending to business lending.

What is most frustrating, I think, to a lot of us about this report is that the largest banks, the ones that received tens of billions of taxpayer dollars, were responsible for a disproportionate amount, nearly 75 percent of the lending decline, and this is happening in a quarter when banks posted an aggregate profit of $2.8 billion. More than any other time, the banking industry needs to be reinvesting those profits in communities and local businesses in the Detroit area and throughout our country so we can turn around this economic decline.

Economists say small businesses account for up to 60 percent of new jobs. It's time to put people back to work and invest in the small businesses that can be an engine of economic growth. I look forward to hearing from the business community here in Michigan so we can have a better understanding of the obstacles small and mid-sized firms continue to face in finding credit.

We will also hear testimony from banks and credit unions on the challenges they face, and I know they face challenges, as well, in increasing prudent lending while remaining safe and sound. Finally, we will hear from regulators responsible for supervising these firms as they work hard to curb the rise in bank failures.

Improving responsible lending to small businesses, which is the title of today's hearing, is not an easy thing to do in the current economic environment, but I am hopeful this hearing will help Congress better appreciate the challenges and allow us to consider new ideas and solutions to address this problem.

In a joint statement released over a year ago, bank regulators warned, "If underwriting standards tighten excessively or banking organizations retreat from making sound credit decisions, it would lead to slower growth and potential damage to the economy."

FDIC Chairman Sheila Bair said recently, "We need to see banks making more loans to their business customers." I completely agree, and I hope this hearing will drive home a clear message to all stakeholders, banks, credit unions, regulators, and the business community. We are all in this together, and until we see more responsible lending out the door, I fear the economic recovery that we all want and our country desperately needs will take too long to happen. I look forward to taking the lessons we learn from today's hearing back to Washington, D.C., this afternoon and working with Republicans and Democrats on thoughtful, bipartisan solutions to this significant challenge. I yield back my time.

I now recognize, for an opening statement, Congressman Gary Peters for 5 minutes.

**STATEMENT OF THE HONORABLE GARY C. PETERS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN**

Mr. PETERS. Thank you, Chairman Moore, and thank you for traveling today to Michigan for this important hearing. I know all too well how little time you get to spend back home in Kansas with your family and with your constituents, and so I appreciate you traveling here this morning to hold the Oversight Subcommittee hearing here.

I would also like to thank two of my colleagues from Michigan, Chairman Dingell, and Mr. Schauer—my colleague from the west side of the State—for coming over here to join us in this very important hearing talking about the challenges of businesses here in our State. We deal with these issues on a global basis in Washington. It's important for us to focus on the unique challenges for us here in Michigan.

I would also like to thank our witnesses for taking time to testify to bring that first-person perspective to the challenges that we are facing, but I would also like to thank our host, Lawrence Technological University, for allowing us to use these facilities and for your hospitality.

It has now been a year since we entered the greatest economic decline since the Great Depression. Last fall, as the stock market rapidly deteriorated and the health of our entire financial sector was called into question, some institutions were deemed "too-big-to-fail," and the government acted very quickly to save them. Many of these large financial institutions have now returned to profitability and are repaying the TARP funds that have kept them solvent during this crisis; however, lending has continued to decline.

In fact, as Chairman Moore indicated in his comments, the FDIC recently reported that lending by U.S. banks declined by $210 billion in the third quarter of this year. This represents the largest drop in lending since 1984 and the 5th consecutive quarter in which banks have reduced lending.

While the largest banks are, again, posting profits and paying record bonuses, there have been 124 bank failures so far this year, and hundreds more banks around the country are at a high risk of insolvency. While there is no doubt that some of these institutions are paying the price for poor management and risky investments, many well-run banks are fighting to survive because of the economic environment. Nowhere is that more evident than right here in the State of Michigan.

Many banks in our State are struggling due to declining property values caused by the huge numbers of job losses that we have suffered, and as the unemployment rate in the City of Pontiac, in my district, has gone from 6.4 percent in 2000 to a staggering 35 percent today, the median home price has dropped from $104,000 to just $10,000.

For small banks operating under these economic conditions, new sources of capital are very hard to come by. While the worst of this economic crisis may now be behind us, American businesses across the country continue to struggle with unemployment, and businesses continue to suffer from a lack of lending. Real recovery will not come until job creation is back on track, and having a strong network of lenders in our communities is critical to achieving that.

I believe this hearing represents an important opportunity for businesses, financial institutions, and regulators to begin a dialogue and hopefully come up with a new solution to this intractable problem. I look forward to hearing today from our witnesses about their ideas to help promote business lending and increase capital assistance to these financial institutions.

Mr. Chairman, I yield back the balance of my time.

Chairman MOORE OF KANSAS. Thank you, sir, and the Chair now recognizes the Honorable John Dingell, Congressman John Dingell.

**STATEMENT OF THE HONORABLE JOHN D. DINGELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN**

Mr. DINGELL. Mr. Chairman, I thank you for your courtesy, and I thank you very much for bringing the subcommittee here today. Your efforts in this regard are deeply appreciated by all of us here in Michigan, and I want to pay tribute to my colleague, Mr. Peters, for his leadership in arranging that this should occur today, and we're very proud of him and his service, and I want to thank my good friend, Mark Schauer, an outstanding Member, for being here today and to say how proud I am to have these two fine Members as my neighbors.

I want to also thank Lawrence Tech for making this opportunity available to us by hosting us in their fine facilities. It's a great educational institution, Mr. Chairman, and we're very proud of them and their leadership in keeping Michigan a great and strong industrial State.

Mr. Chairman, thanks again for convening this hearing. It's very, very important to our small businesses, particularly around Michigan. The present recession, which erupted last year nationwide and worldwide, has created enormously difficult conditions for Michigan, some of which were caused by irresponsible lending practices, irresponsible risk-taking by members of the financial industry.

In 1999 and for decades before, I fought to keep the Glass-Steagall Act in place and to prevent the kind of rascality that contributed so heavily to the misfortunes of the country today. Unfortunately, due to the repeal of that protection, we face now a situation where failed banks and other banks are creating a virtual credit market freeze.

There now exists no mean degree of hesitation among banks to continue lending, especially due to tight credit markets and ever growing public scrutiny of their activities, but this hesitation must not be allowed to persist as a hindrance to broader national recovery, and particularly to our people here in Michigan. I hear regularly from small businesses in my district not far from here in Southfield, as I'm sure you do and my other two colleagues here do, that cannot get access to credit to keep their doors open and their employees on the payroll.

Responsible lending is a vital component in our efforts to facilitate the economic recovery of the Nation and must be encouraged while, at the same time, Congress must impose adequate and fair oversight mechanisms to ensure that the rascality that caused us the current financial crisis never again occurs, and that's one of the reasons that your presence here, Mr. Chairman, is so important. I hope our discussion today will prompt the development and implementation of the policy initiatives, it will help deserving small businesses get the loans that they so desperately need to provide jobs and opportunities to our people, and I look forward to the witnesses who are here today and thank them for their presence. Your presence here, gentlemen and ladies, is extremely important to the recovery of our State and the Nation, and I thank you for your being here today.

Chairman MOORE OF KANSAS. Thank you, Congressman Dingell.

And the Chair next recognizes Congressman Mark Schauer for 5 minutes.

**STATEMENT OF THE HONORABLE MARK H. SCHAUER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN**

Mr. SCHAUER. Thank you, Chairman Moore, Representative Peters, thank you for hosting us for all of you coming to testify today, and certainly to our host, Lawrence Tech. I serve as—well, first of all, I live in Battle Creek. I represent seven counties that extend as far east to the Washtenaw/Wayne County line.

The story of businesses in my district is the story of businesses in Michigan and certainly in the industrial Midwest. I serve on the Transportation and Infrastructure Committee and the Agriculture Committee. It's an honor, Mr. Chairman, to be able to participate in this subcommittee hearing today. I'm here because we face in Michigan the deepest economic crisis of any State in our country, and I have counties in my district with unemployment rates close to 20 percent.

Quite candidly, we have an intractable problem here in Michigan that needs to be solved. Whether we use terms like red-lining or not, we are seeing industries in this State that absolutely cannot get credit. Mr. Chairman, I actually told the President directly that our recovery in Michigan has one hand tied behind its back. We have industries throughout this State that have survived that are attempting to diversify from automotive to military to clean energy jobs to automotive, aviation, aerospace.

These are stories I hear within my district from businesses every day, and the common theme is these businesses are being starved for credit, and it is unsatisfactory to me to hear anyone else suggest that we need to continue to winnow within this economy. In Michigan, we have winnowed enough. It is time to start rebuilding, not just our industrial sector but rebuilding small business.

While I appreciate the opportunity to be here today, I will not be satisfied, Mr. Chairman, unless we collectively leave here today with answers and leave here with real solutions. This is a problem that we can solve, and it is a problem that we must solve. No State more than Michigan knows the hardship of this recession, but no State is better positioned to create jobs and grow jobs simply by solving this problem. Thank you for the opportunity, and I reserve the balance of my time.

Chairman MOORE OF KANSAS. Thank you, Congressman.

And I am now pleased to introduce our first panel of witnesses. First, we will hear from Ms. Tammy Carnrike, chief operating officer for the Detroit Regional Chamber of Commerce. Next, will be Mr. Dave Andrea, vice president of industry analysis and economics for the Original Equipment Suppliers Association, testifying on behalf of the Motor and Equipment Manufacturers Association.

Third, we will hear from testimony from Mr. Thomas Anderson, senior director for Automation Alley. After him, will be Mr. Ned Staebler, vice president of capital access and business acceleration for the Michigan Economic Development Corporation. Finally, we have Mr. Herbert Trute, president of T & W Tool & Die Corporation, who is also the chairman of the Tooling Manufacturing & Technologies Association. Without objection, your written statements will be made a part of the record.

Ms. Carnrike, you are recognized for 5 minutes to provide a summary of your statement, and again, I thank all of our witnesses for coming today. Ms. Carnrike?

## STATEMENT OF TAMMY CARNRIKE, CHIEF OPERATING OFFICER, DETROIT REGIONAL CHAMBER

Ms. CARNRIKE. Thank you very much, and I would like to take the opportunity, Chairman Moore, to say thank you—

Chairman MOORE OF KANSAS. Sure.

Ms. CARNRIKE. —and welcome to Michigan on behalf of all of us in the room—

Chairman MOORE OF KANSAS. Thank you. I am glad to be here.

Ms. CARNRIKE. —and to thank Congressman Peters for arranging this. This is a very critical and timely issue for discussion, and I'm also recognizing that Lawrence Tech is more than just a fine educational institution; it is a partner in entrepreneurship and small business development. So thank you very much, Mr. Chairman, members of the committee, and our honorable Members of the Michigan delegation for the opportunity to testify regarding the concerns of small business today and getting access to capital. I am Tammy Carnrike, the chief operating officer of the Detroit Regional Chamber.

With over 20,000 members, the Detroit Regional Chamber is the largest Chamber of Commerce in the country. The Chamber's mission is to power the economy of southeast Michigan, and it's carried out through business attraction efforts, advocacy, strategic partnerships, and valuable benefits and services to our members.

Our members range in size and scope and sector, and they contribute significantly to the vitality of our region. Approximately 75 percent of our member firms are small businesses with 50 employees or less. Recognizing the impact of staying connected with that small business sector and its needs, we maintain a small business advisory committee made up of members who volunteer their time to make sure we're kept abreast of the issues impacting small business.

We have received a very clear message through focus groups, small business representatives who have shared their experiences that the credit crunch and cash flow challenges have placed increased stress on their daily operations. Access to capital has been a strategy on our small business agenda for over 5 years. This has been a long-standing issue, and it has been compounded by the financial crisis that struck the State of Michigan and the entire Nation over the past year.

Without question, the economic crisis we are in is stunning. Increased availability of capital to small business can support retaining jobs and also provide opportunity for job growth, as well as expansion.

Our country is in the midst of the largest entrepreneurial surge ever witnessed. Considering the Small Business Administration projections of more than 1.3 million new companies with employers started in just the last 2 years, this represents one of the largest growth rates in our history, even outpacing the height of the dot-com craze.

When it comes to the vitality and economic prosperity of our country, there is nothing small about small business. The pace of change in the banking industry is being matched by the unprecedented growth of small business, and we find ourselves in a situation that requires attention.

As of August, there were 80 bank closures nationally, and analysts are predicting more than 300 bank failures over the next couple of years. Yet, we believe that this crisis does present an opportunity.

Today we're here to discuss southeast Michigan's small business community and their need for access to capital, but we also want to recognize that there are many supportive lending institutions that contribute regularly to small business success in this region. Besides their programs and services, these institutions also provide support and resources to our small business programs. They serve on committees, boards, they're engaged in economic and community development activities and focus on our region's needs for the appropriate diversification of the automotive supplier industry. We need both our small business sector, as well as our banking industry, to be successful in order to strengthen our economy and to create jobs, create an opportunity for solid working relationships between both sectors, and organizations like ours to commit to be there to provide similar end connection to resources.

The Detroit region is more economically stressed than many other areas of the Nation. Just look at our high unemployment rates and the staggering loss of jobs. Regardless of where the job loss occurs, it ultimately impacts our small business community. Michigan lost more private sector jobs just since the year 2000 than any other State, nearly half of all private sector jobs lost in the United States during this time.

The Detroit Regional Chamber, along with many other business organizations, are focused on a need for transformation of our economy, and this will happen through new targeted sectors for growth and for helping small businesses to diversify their business and support these new sectors. Additional resources for supplier diversification would have a significant impact and help expedite economic transformation efforts. Small businesses can and will create jobs with available resources.

We recently reached out to a targeted segment of our leadership. Based on sur—

Chairman MOORE OF KANSAS. I'm sorry, but I'm going to have to ask you to wind up. We have kind of a set time here. If you would wind up—

Ms. CARNRIKE. Sure.

Chairman MOORE OF KANSAS. —and I would remind each of the witnesses, as well, that your written statements will be made a part of the record. So if you would, please, Ms. Carnrike, thank you.

Ms. CARNRIKE. Probably importantly from the survey is that over 70 percent of these small businesses will be accessing and will need capital and credit in the coming 12 months. It's very important, and so at this time, we must say that this is where it becomes very important for America and Detroit, and it has always been a time of crisis and challenge, this is one of them, but it offers us an opportunity for change, innovation, and to ultimately make a difference. Thank you.

[The prepared statement of Ms. Carnrike can be found on page 191 of the appendix.]

Chairman MOORE OF KANSAS. Thank you very, very much for your testimony.

Mr. Andrea, you are recognized, sir, for 5 minutes.

Mr. ANDREA. Good morning, Mr. Chairman.

Chairman MOORE OF KANSAS. Good morning, sir.

**STATEMENT OF DAVE ANDREA, VICE PRESIDENT, INDUSTRY ANALYSIS & ECONOMICS, ORIGINAL EQUIPMENT SUPPLIERS ASSOCIATION**

Mr. ANDREA. Thank you for the opportunity to testify in front of the subcommittee. My name is Dave Andrea, and I am the vice president of Industry Analysis and Economics for the Original Equipment Suppliers Association, an affiliate of the Motor and Equipment Manufacturers Association, and I'm testifying today on behalf of each association.

Motor vehicle parts suppliers are the Nation's largest manufacturing sector, directly employing over 685,000 workers and contributing to over 3.2 million jobs across the country. Suppliers are responsible for over two-thirds of the value of the vehicle today and nearly 30 percent of the $16.6 billion in automotive research and development investment. Over the past year, unprecedented government and industry actions prevented a collapse of the U.S. auto industry, a collapse that would have affected all vehicle manufacturers and suppliers and all related capital equipment and service providers. Without a doubt, the actions taken in the General Motors, Chrysler and numerous supplier bankruptcies, the selective restoration of credit, and the improving economy have stabilized the industry.

However, continued progress to restore credit availability and to incentivize technology and development throughout the entire supply chain is essential to ensure the financial viability and economic contribution the suppliers—of the supplier sector, as well as commercialization of advanced fuel economy and emission control technologies. To weather the production volume reductions of 40 to 60 percent this year, a majority of our members instituted mandatory shutdowns, furloughs, and reduction in work weeks, as well as reduced salaries and—and reduced employer matches of 401(k) contributions.

In addition, OESA has identified 48 U.S. suppliers that have filed for bankruptcy in 2009; although, we know that there are hundreds of other suppliers who have filed but were not reported in the press, were simply liquidated saving the cost of going through bankruptcy. It appears that credit is selectively becoming available to suppliers. However, I want to emphasize it is selectively becoming available. Credit availability, terms, and costs remain a significant and serious issue, particularly for smaller suppliers.

According to the OESA September Automotive Supplier Barometer Survey, smaller suppliers have actually experienced tighter lending terms, and conversations as current as last week with members indicate difficulty in securing capital to invest in new tooling for new vehicle programs. Simply put, the auto supply base continues to face significant headwinds as it ramps up for higher production levels and launches essential new products and technologies. The supply base needs collective action that will deepen the industry's human, financial, and intellectual capital base.

Governmental efforts to date from the U.S. Treasury Supplier Support Program to the U.S. Department of Energy Advanced Technology Vehicle Manufacturing Loan Program have primarily focused on the vehicle manufacturers and the largest suppliers. We encourage Congress and the Administration to broaden their attention through the entire supply chain, particularly with the smaller suppliers who have shown greater uncertainty over their ability to finance plant and equipment investment, merger and acquisitions for industry rationalization, and program consolidation actions.

Smaller suppliers—and given the scale that the industry operates on, we define small as being under $250 million in revenue—remain a critical source of new technology and cost competitive components for the industry, so MEMA and OESA recommends that the Congress and the Administration focus on two different issues.

First, for smaller suppliers, given the industry's significant capital requirements and the general mismatch of funding, a steady access to lines of capital and asset-backed loans is essential for the survival of the supply base, and second—and MEMA and OESA fully support the recent announcements by the Administration to expand existing SBA programs, and second, in technology funding, the supplier industry is working with customers to develop a wide range of new technologies that promote increased safety and improved fuel economy.

So here MEMA and OESA support additional programs such as S. 1617 and the IMPACT Act to help additional investment in the industry. Thank you.

[The prepared statement of Mr. Andrea can be found on page 68 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Andrea, and again, your remarks will be received in the record, your written remarks.

Mr. Anderson, you are recognized for 5 minutes.

**STATEMENT OF THOMAS E. ANDERSON, Ph.D., MBA, SENIOR DIRECTOR, AUTOMATION ALLEY**

Mr. ANDERSON. Thank you, Mr. Chairman. My name is Tom Anderson, and I am senior director and director of entrepreneurism at Automation Alley.

I want to express my sincere thanks to Congressman Peters for arranging this morning to talk about the severe issue of credit for small and emerging technology companies. Automation Alley acts as a catalyst to enhance the image and growth in southeast Michigan's technology driven economy, and since our founding in 1999, our membership has expanded to include over 1,000 businesses, educational institutions, and government entities from the City of Detroit and the surrounding eight counties. We promote regional prosperity through entrepreneurial and exporting assistance, workforce development, and technology commercialization assistance.

It's a pleasure to offer testimony this morning specifically focusing on our business accelerator and seed investment program. To date, we have made 25 investments from our 3 seed investment funds totaling just under $5 million. In addition, those companies have attracted venture capital and other private investment exceeding $38 million, and employment is just over 150 currently.

We are an active investor. We stay in touch with our companies. I serve on the board of several of those companies and other members of our investment committee are on the board. We also have a small business technology development centers counselor at our facility who works with those companies, and occasionally, we engage with those companies with repurposing discussions on strategy and approach to market because things don't always go as you originally plan. I have profiled a number of those companies in the written testimony, and I want to highlight just a few that target today's question, access to capital.

ElectroJet is a small company based in Brighton that has received funding from the MEDC's 21st Century Jobs Fund, as well as from our seed fund, and they have successfully taken a product to market and developed customers in China for an export product.

The problem has been finding funds to fulfill those purchase orders, getting the working capital they need to build the product to deliver it in a timely fashion. As a result, they have had to go to the capital markets to raise those funds rather than the banks, selling a portion of the company in the process.

Limo-Reid Technologies has developed a novel hydraulic hybrid technology for the drive train of medium-duty and heavy-duty trucks. They have received funding from us and they have also received funding from the 21st Century Jobs Fund and from private venture capital. They are currently well-funded as they move through the development phase, but they are moving to a stage where they will need to begin to manufacture product and could anticipate difficulty in funding.

Ventech is a third company that has developed a novel heating technology approach for school buses. They have in hand over 40,000-unit purchase orders and are having a difficult time finding funding for the working capital to buy the raw materials to manufacture the heaters to sell them to the industry.

So there's a theme, and the theme is that it's particularly difficult for companies that are manufacturing a product to find the working capital for work in progress in order to fulfill purchase orders that they can achieve. Automation Alley supports the Obama Administration's proposal to support further economic recovery and job creation by ensuring that credit is available for small businesses, and of particular interest are the measures that would raise lending limits on the SBA 7(a) and 504 programs from $2 million to $5 million, raise the manufacturing company limit to $5.5 million, and raise the lending limits on the microloan program from $35,000 to $50,000.

For companies that are looking to diversify, the value of the existing plant and equipment has fallen, and is often inadequate to support the credit lines needed to move into new markets. Supplier diversification funding from the Federal Government has enabled a way to guarantee that gap, and move funds to those companies. Many new economy companies also need some support of that gap, and I would suggest that perhaps an expansion of that loan guarantee to include startup technology companies might be helpful, as well. The capital needed to move from seed stage to venture capital or bootstrap capable funding is scarce, and perhaps a subordinated debt fund would also meet that gap.

In conclusion, we find for our companies, the largest gap is in the funding continuum moving from seed stage to venture funds or to operating the business. The State has done an admirable job of expanding the pool of pre-seed capital and of venture capital, but it's that gap in between, the $500,000 to a $1.5 million that is really difficult to obtain. Companies that are beginning to generate revenue but are not yet profitable and who may never be a good candidate for venture capital because they're a good solid $500,000 to a $1.5 million business.

In conclusion, we're very appreciative of the attention received by Congress and Federal agencies during this time and in our State and believe that a continuum of local funding and support for technology entrepreneurs is a vital piece in the economic development puzzle. Thank you.

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

Chairman MOORE OF KANSAS. Thank you, Mr. Anderson.

And the Chair next recognizes Mr. Staebler for 5 minutes, sir.

**STATEMENT OF NED STAEBLER, VICE PRESIDENT, CAPITAL ACCESS AND BUSINESS ACCELERATION, MICHIGAN ECONOMIC DEVELOPMENT CORPORATION**

Mr. STAEBLER. Good morning, Mr. Chairman, and distinguished Members of Congress. My name is Ned Staebler, and I am the vice president of capital access and business acceleration at the Michigan Economic Development Corporation, the State's economic development agency. I sincerely appreciate the opportunity to testify today on this important subject. Thank you very much for coming here. This is really a critical juncture in our State and also in our Nation.

Manufacturers in the United States face considerable uncertainty. While some firms are cautiously optimistic about the overall economic recovery, the persistent lag in credit markets continues to pose a serious and permanent threat to manufacturers and to our country's industrial capacity as a whole. While there was an uptick reported in manufacturing output over the summer months, recent data has shown that this has largely disappeared in September and October, and while conditions are somewhat improved from the lows seen in the first quarter of 2009, U.S. manufacturing output is still very weak compared to historical levels, and utilized capacity remains at or very near all-time lows. And the corollary, of course, is that excess capacity is at or very near all-time highs.

In Michigan, and from our view at the MEDC, the State of the market is clear. Unemployment in the State is over 15 percent. A recent University of Michigan report projected the State will have lost nearly a million jobs by the time we reach bottom. Over half of those losses are coming in the manufacturing sector alone. A.T. Kearney estimates that 50 percent of tier 1 automotive suppliers are still at risk of bankruptcy. Perhaps most troubling is that the automotive industry has one of the largest economic multipliers of any sector in the U.S. economy, a reminder that other non-auto jobs are tightly linked to the success or failure in manufacturing.

Even with the interventions of TARP, which was designed to improve the health of the banking sector and, thereby, increase available capital to businesses, commercial and industrial lending across the United States has fallen 15.4 percent year over year in the last 12 months. Clearly, the recovery plan has not done enough to increase the flow of credit from private lenders.

This juncture is critical for three reasons: One, manufacturers need capital to reorganize and consolidate efficiently and in an orderly fashion; two, those manufacturers who have right-sized and are now seeking to fill new orders are finding that with their reduced borrowing bases, it is difficult to access capital to scale back up; and three, those manufacturers seeking to utilize their core competencies in other non-traditional verticals like wind, solar, medical device, or homeland defense are increasingly unable to finance this transition. We applaud many of the efforts of Congress and the Obama Administration to address these issues. Increasing access to, cost of, and timeliness for capital to manufacturers will be an essential part of our Nation's economic recovery.

Increasing SBA guarantee levels, reducing fees, and reducing administrative hurdles and bureaucracy should continue to be congressional and Administration goals. We urge this committee to continue to support them. However, we feel that these measures overlook the deep interdependence between the health of banks and the health of borrowers.

TARP and many of the SBA adjustments I have discussed fail to fully address the problem; they only focus on the health of banks. We agree that banks need to be healthier, and access to cheaper capital certainly helps, but to grow our deflated manufacturing sector, borrowers must be made healthier, as well. We're not suggesting that underwriting standards be lowered at all, quite the contrary.

Rather, the best way to widen the scope of lenders to include manufacturers and other historically healthy firms in this difficult environment is to enhance borrowers' financial qualifications from a commercial loan underwriter's perspective. This requires mechanisms targeted specifically at borrowers' shortcomings, namely, cash flow and collateral.

In recognition of this fact, the MEDC created the Michigan Supplier Diversification Fund, which has been very successful in inducing new loans that were otherwise unqualified from the bank's perspective, many of which provided funds for diversification into emerging green technologies. Crucial is that this program targets the support of both banks and the borrowers at the individual loan request level. This ensures that projects move forward at the time of the deployment of funds. In essence, the program self-regulates by ensuring that the lending activity happens right away in contrast with TARP, where following lending has severely lagged.

MSDF, or the Michigan Supplier Diversification Fund leverages the market expertise, prudent risk management practices, and financial capacity of private lenders who source, underwrite, lead, and service the deals while injecting public—targeted public dollars at the level of individual loan requests. So far, every $1 in public funds has leveraged more than $3 in private funds and helped create more than 2,000 jobs.

As evidenced by the 15 percent unemployment rate in Michigan, the transition of the American manufacturing base from traditional sectors to new high-tech verticals is a challenging one. However, the speed of this transition is crucial to the retention of an advanced manufacturing cluster in the United States. We urge this committee to continue to seek new models like the proposed National Manufacturing Diversification Fund and act expeditiously to get this money into the hands of those who need it the most, American businesses.

[The prepared statement of Mr. Staebler can be found on page 276 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Staebler.

Mr. Trute, you are recognized for 5 minutes, sir.

**STATEMENT OF HERBERT W. TRUTE, PRESIDENT & CEO, T & W TOOL & DIE CORPORATION; AND CHAIRMAN, TOOLING, MANUFACTURING & TECHNOLOGIES ASSOCIATION (TMTA)**

Mr. TRUTE. Thank you, Chairman Moore, and thank you, Congressman Peters, for hosting this important hearing on an issue so vital to small and mid-sized manufacturing. My name is Herb Trute, and I am the president of T & W Tool & Die Corporation of Oak Park, Michigan. I am also the chairman of the board of directors of the Tooling & Manufacturing Technologies Association. I am a 32-year veteran of the auto supply business, and I am surviving today with absolutely no thanks to the banking industry.

In my capacity as chairman of the TMTA, I have traveled to Washington, and I have had meetings with Senator Stabenow, Michigan Governor Granholm, and other Members of Congress during the automotive hearings. I was there for that. I was subsequently asked and also served as an adviser to the Obama transition team with respect to manufacturing, and I was very proud to do that.

I know the focus of this hearing is primarily on the banking industry and the ability of manufacturing to receive financing, but a business or an industry, for that matter, that is in crisis does not arrive at that point in a vacuum. There are always reasons. And very briefly, the main reason is that the American auto industry has outsourced the supply base virtually to the point of oblivion. This past year, faced with a dramatic slowdown, I did what everyone suggested, I right-sized, downsized, leaned, cut wages and benefits, and reorganized the business in such a way that we could survive. I was able to garner a fair amount of business, a sizable package on today's open market competing globally.

I have a 15-year relationship with Comerica Bank where I went to obtain financing for this work in process. The package that they offered me was inadequate, did not rely on adequate work-in-process financing. The guarantees and collateral requirements were such that the amount of money they offered me, I would never have been able to borrow. Faced with the prospect of having to turn the work back and close my business, I approached my customer, one of the Big Three.

They recognized the need that it was vital for American manufacturing to have a supply base locally. So in exchange for a discount, I received progressive payment terms from them. Another one of my customers chose to go the other route and continues to funnel American taxpayer money overseas for tooling. I would like to know where the outrage is in that. That should not be happening.

The question should not be, "Where was it purchased?" but "Where was it built?" The current bank crisis has provided a convenient reason for large multinationals to continue sourcing overseas. Now they're using it as a reason, as an excuse. These are American taxpayer dollars. My belief is that the outsourcing, coupled with other countries' predatory trading practices, have precipitated this. The unfair international playing field has exacerbated the situation making it almost impossible for small business to compete globally. Yes, credit is almost impossible to get, and yes, readily available credit will help, but if the Big Three and other large American corporations will not even try to buy American, there will be no recovery, and we will have lost our ability to manufacture anything.

The banks are unwilling to assume any risk with respect to lending to small manufacturers. We were offered a loan package totally inadequate to finance the large amount of work we have been awarded. The interest rates were steep, collateral requirements outrageous, and the amount offered would not have been enough. There's definite need, but that is not part of the equation for the banks. They will assume no risk.

My own belief is that the needs along with the benefits far outweigh the risks in lending to small businesses. Small business provides a shot in the arm to any local community. We found it possible to survive with little or no credit, but if financing were readily available, we would easily be able to double our employment. This would be even more dramatic for a business that has had to close due to lack of financing. Most small businesses create jobs in the local communities surrounding them.

The direct result would be reduction in unemployment and injection of dollars into local economies and, thereby, helping other businesses. Thank you very much for your time.

[The prepared statement of Mr. Trute can be found on page 283 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Trute.

I want to thank all of the witnesses for their testimony. I now recognize myself for 5 minutes for questions.

I am interested in exploring the challenges we have seen in the automobile industry during the past year or two and how that relates to this lending crisis. I represent Kansas City, Kansas, in my district where we have a GM plant that produces the Chevy Malibu and employs about 3,000 of my constituents. We also have a number of auto suppliers in my district supporting the auto plant. I worry about suppliers and other small businesses having their access to affordable credit cut off.

Mr. Andrea, is it more difficult to find credit if you own a business that's part of the auto industry? Do banks that might make a loan to any small business decide not to if the firm is related to the auto industry?

Mr. ANDREA. Currently, that's the case because—twofold. One is with production volumes so dramatically low and uncertain going into 2010, that adds systemic risk with the bankers. The other is just the low value of automotive assets to back up any of the loans. And we have a—and I can follow up with additional responses for you.

Chairman MOORE OF KANSAS. Thank you. Ms. Carnrike, what do you think?

Ms. CARNRIKE. I can speak directly to an example of a small business who is diversifying from the automotive industry, 7 years ago, 100 percent automotive reliant, now today, 10 percent reliant. Access to capital is critical to this growth. It will create hundreds of jobs over the next 3 years, and their main source they're looking at right now is an SBA 504 loan. It's very important to help companies diversify from the automotive industry to be successful in this region.

Chairman MOORE OF KANSAS. Thank you. Ms. Carnrike, what are you hearing from Detroit businesses that are having their lines of credit decreased or eliminated altogether? Do you have any sense whether banks are overly cautious on their own about making loans, particularly to any auto-related firm, or do you think these banks want to make the loans, but they're under pressure not to from the regulators?

Ms. CARNRIKE. I don't have specific examples of it being related directly to the automotive industry. We do have feedback from small business customers about their barriers to accessing capital. I can tell you that over half of a surveyed pool tells us that banks not lending is the biggest barrier to assess to capital, 56 percent, and that 38 percent have trouble getting nontraditional business models approved for financing.

Chairman MOORE OF KANSAS. Mr. Trute, do you have any thoughts about this?

Mr. TRUTE. Well, it would definitely help. We have been forced to turn business away due to inadequate financing. The business that we have kept is largely in part of our customer's recognition that we are vital to them.

Chairman MOORE OF KANSAS. Any other—thank you. Do any other witnesses care to comment on this question? Yes, sir, Mr. Andrea?

Mr. ANDREA. In the survey work that we have done of our members, approximately 20 percent of our members do say that you—describing their banking relationship with their banker that their banks are actively exiting the industry overall or particularly with their relationship.

Chairman MOORE OF KANSAS. Any other comments?

Mr. Staebler, as we consider various solutions at the Federal level, including the proposal put forward by the Obama Administration last month, what are States like Michigan doing to turn the local economy around? Are there ways that the Federal Government can partner up with States like Michigan to seek solutions to an economic downturn, and is the key to an economic recovery increasing lending to small and mid-sized businesses?

Mr. STAEBLER. I certainly think that's going to be a huge driver in our economic recovery, that is, small and mid-sized businesses have been the main engine for job growth in this country over the last 25 to 30 years, so I think that would be critical. In terms of ways that the Federal Government can partner with State government, we have put a proposal in place and in front of the Administration on a way to create a national version of our supplier diversification program, not just for auto suppliers, but for all manufacturers wishing to use their core competencies in new emerging technology sectors. We think it's one that maintains the fiduciary responsibility of banks but also provides access to credit for those small and mid-sized businesses that are so crucial.

Chairman MOORE OF KANSAS. Mr. Anderson, any comment?

Mr. ANDERSON. As I mentioned before, I would urge that a national fund such as Ned suggested for supplier diversification could well be expanded to also include startup businesses and technology space who have similar challenges in gaining access to capital, and that slight risk reduction might enable them to be a viable investment candidate—or loan candidate for a bank.

Chairman MOORE OF KANSAS. Thank you, sir. The Chair's time has expired.

Congressman Gary Peters, you are recognized for 5 minutes, sir.

Mr. PETERS. Thank you, Mr. Chairman.

Thank you for all of your testimony here. As you know, the hearing is organized in three ways. We have businesses talking about the difficulties, and we're going to hear from the bankers as to how they're trying to achieve and bring that money to you, and then regulators, and I know the banks have some concerns about what the regulators are doing, so it's about a dialogue together. But one thing I thought was interesting, and I want to get your response to, is that I have looked at some of the testimony that's going to come later from the bankers, as well as from regulators, and in the testimony, both of them quote the National Federation of Independent Businesses that talk about the fact that although credit is tight, it's really not the leading reasons why a lot of businesses are experiencing some difficulties.

Now I have heard something different from all of you through your discussions here and your testimony. Let me just read—this is, I think, from the FDIC or the bankers:

"The NFIB reports that in spite of the difficult economic environment, 33 percent of businesses reported regular borrowing in October, and that's compared to 9 percent of the reported problems that they had before. They noted that only 4 percent of business owners reported financing as their number one business problem, and this is extremely low compared to other recessions."

So some of the folks in the banking community think this is different than other—actually better than other recessions or that the credit isn't that big of a problem. How would you respond? Because we're going to have these other panelists who may be saying that later. How would you respond with your experience in business, particularly here in Michigan? And that's why I wanted to bring this field hearing here is because I think we have a whole different situation than the NFIB may on a national basis.

Would anybody like to start? Ms. Carnrike?

Ms. CARNRIKE. I can respond from our survey data that half of our respondents had applied for financing in the last 12 months. It goes from 41 percent, I'm saying about half, but 41 percent, to 70 percent anticipating needing financing in the coming 12 months. So that indicates there will be a rise for an increase in need of capital, and we also were able to secure from them that in looking at the sources for the future, they actually will look to increase their interest in SBA loan programs from 29 percent—to 29 percent from 14 percent in the past.

Mr. PETERS. Mr. Andrea?

Mr. ANDREA. My only suggestion would be to cut the data by size of company and by sector and to see if at the national level those national numbers hold up when you look at large to small and by industry sector. I think you'll find a difference.

Mr. PETERS. Okay.

Mr. ANDERSON. And in my experience, both with our startup companies and with some of our small businesses, it may well turn out because what I see is that their number one problem many times is getting purchase orders. So although funding and loans may still be an issue, if you're not getting purchase orders, that becomes your number one problem, so perhaps it's best to look at the top three issues of small businesses.

Mr. PETERS. They're all interrelated?

Mr. ANDERSON. They are interrelated.

Mr. PETERS. Right, right.

Mr. STAEBLER. Through the second quarter of 2009, the FDIC reported that commercial lending nationally was down 8.5 percent. At the end of the third quarter, it's down 15.4 percent. And it wasn't like the third quarter of 2008 was a banner time for commercial lending. So I think it's clear that things are not necessarily on the upswing, and I think Tom's right that they are interconnected, that demand certainly reduces the amount of borrowing, but certainly the availability of capital also reduces the amount of lending that's happening, so—

Mr. TRUTE. I would agree with Mr. Anderson. The problems began in the manufacturing sector, not through lack of financing, but lack of financing is definitely hampering any type of recovery.

Mr. PETERS. Yes, as your businesses that you represent are going out and trying to get credit, and particularly small businesses, small businesses, as I think was mentioned, rely primarily on bank financing, or if they try to go to the capital markets, there are others, but it's bank financing, what differences have your members experienced by going to the large, multi—or the large money-centered banks that aren't headquartered here in Michigan versus community banks, or are there similar challenges, different challenges.

How would you respond to where your businesses are going to get money? We can start with anybody. Mr. Anderson?

Mr. ANDERSON. With my startup businesses, they have encountered, basically, the same problem at many institutions, and they have talked to pretty much anyone they can find, and the problem is providing sufficient mortgageable assets to support the loan.

Take the case of ElectroJet. Kyle benefited substantially by the devaluation of assets. He was able to purchase equipment for his shop at 10 to 20 cents on the dollar. It worked great during the startup phase. Now as he needs to get financing for working capital to build product, those same assets are still valued at 10 cents on the dollar, so it's not going to support the kind of loan value that he needs in order to fulfill the orders.

Chairman MOORE OF KANSAS. Thank you, sir.

Congressman Dingell, you're recognized, sir, for 5 minutes.

Mr. DINGELL. Mr. Chairman, with your permission, I would like to defer to Mr. Schauer.

Chairman MOORE OF KANSAS. Certainly.

Mr. SCHAUER. Thank you, Mr. Dingell.

Mr. Trute, thank you. I think you're providing us a reality check here today. I could have lined up this entire room with small businesses, particularly small manufacturers, that tell the exact same story. So you're representing Main Street here today. I appreciate that. And what I hope that we avoid today is—and this is sort of what I see, it's sort of like the scarecrow on the Wizard of Oz, everybody pointing different directions or pointing at each other, and we're not solving the problem. I look forward to hearing from the banks later today with a reduction in loan volume, that's—doesn't seem to me to be a sustainable trend for that industry, and we continue this downward spiral.

I'm going to ask some quick questions, and since I have about 4 minutes, ask for relatively brief answers. Mr. Staebler, I'm very familiar with the Michigan Supplier Diversity Fund. Thank you for that and the influence you're having on a national program. How can we help make that happen?

Mr. STAEBLER. We worked with some of my colleagues here on trying to figure out what demand there might be for this program, and in the State of Michigan alone, we anticipate that number over the next 2 to 3 years to be close to $2 billion. Nationally, we looked at it as close—at least $10 billion that would help small businesses transfer into new verticals. We managed to have about $13 million, with an "m," available at the State level to help that transition along, so obviously, creating a national program to allow manufacturers all over the country to access—

Mr. SCHAUER. How much money does that national fund need?

Mr. STAEBLER. I would say at least $10 billion.

Mr. SCHAUER. $10 billion? Has the focus been on TARP money to help capitalize that?

Mr. STAEBLER. Certainly, repayments to TARP, non—portions of TARP that haven't been expended yet, any avenue, really—

Mr. SCHAUER. And $10 billion will help create how many jobs?

Mr. STAEBLER. That number is in the $200,000 to $300,000 range. I have some data—

Mr. SCHAUER. Okay.

Mr. STAEBLER. —if you would like to see it later.

Mr. SCHAUER. Thank you. I think, Mr. Anderson, you talked—or maybe it was Mr. Andrea, about—at least my impression was you're talking about $5 billion from TARP that went to the Big Three autos, intended to go to tier 1 suppliers, and that was supposed to trickle down, and that really didn't happen, if I'm hearing you correctly, and only a portion of that was used. Is that part of a solution to use those dollars to get to smaller suppliers?

Mr. ANDREA. Without a doubt, the program served its purpose to stabilize the industry, but from the perspective of moving forward, an ongoing investment in plant and equipment from mergers and acquisitions to consolidate the industry, that's the capital that ran short, and it was not available through any public, private—

Mr. SCHAUER. If we would figure out how to loosen that up, that would be part of the solution; is that correct?

Mr. ANDREA. Absolutely, and MEMA and OESA have been very strong supporters of the MEDC program.

Mr. SCHAUER. My final question to the panel, I think it's my final one, is to talk a little bit more about SBA programs. We have, all of us here on this panel, have worked to increase limits on some of those, increase guarantees, including through the stimulus program and beyond that. Are lenders participating? My experience is no, not really. What will it take for lenders to participate in these enhanced SBA programs which I have heard a number of you suggest would be part of the solution? Any or all of you.

Mr. STAEBLER. I would say that, as I mentioned before, that's certainly a part of it. And I think there are—I hate to overgeneralize it, but there certainly are some lenders that are doing more SBA lending now than they were a year ago. Of course, many of them were lending to companies that a year ago didn't need to take an SBA loan, and now they are. But I still think that even with expanded SBA guarantees and reduced fees, you're not addressing the core issue, which is that the collateral and cash flow of the borrowers, themselves, is so damaged. As Tom talked about, when you have your assets valued at 10 or 20 cents on the dollar, it's very difficult to collateralize a loan, even with the SBA programs. It's just—it won't be bankable.

Mr. ANDERSON. I would agree and expand on that in many cases with our startup entrepreneurs, they have already mortgaged their house, mortgaged their 401(k) to put into the business to get started, so the ability to collateralize an SBA loan is severely impacted.

Mr. ANDREA. And then as we have surveyed our members, just the limits, the loan limits that hamper auto suppliers, even the smallest auto suppliers that you're talking about, a $100 million or $125 million supplier—

Mr. SCHAUER. The limits need to be—

Mr. ANDREA. —participating. When we did our survey work, it was $5 million would be a minimum limit, which is what has been proposed to move those up to in the 7(a) loan program to be of value.

Mr. SCHAUER. Okay, thank you, Mr. Chairman.

Chairman MOORE OF KANSAS. Thank you, sir, and Congressman Dingell, you're recognized, sir, for 5 minutes.

Mr. DINGELL. Mr. Chairman, to follow up quickly on the question just raised by Mr. Schauer, Mr. Andrea, Mr. Anderson, Mr. Trute, we just saw that one of the major auto manufacturers turned back a significant amount of money that had been earmarked to go down to the suppliers. I'm curious. Is that a problem? Are those funds being flowed through to the suppliers in the proper fashion, particularly with regard to not only tier 1, but 2 and 3?

Mr. ANDREA. My understanding of the situation right now for distressed supplier funding is that amount within each of the vehicle manufacturers is going down. To answer your specific question, though, sir, in terms of is that money—by returning that money, is that going to harm the suppliers, I can't answer that specifically.

Mr. DINGELL. Well, it would be pretty clear it's not going to help them.

Mr. ANDREA. No.

Mr. DINGELL. Mr. Anderson?

Mr. ANDERSON. To be perfectly honest, with 25 start-up businesses that I'm engaged with, I don't have enough specific experience with the suppliers you're referencing to be able to answer that.

Mr. DINGELL. Mr. Trute?

Mr. TRUTE. Certainly, as you say, it can't be helping the suppliers. I only have personal evidence to the extent that one of the automakers is actively embracing keeping the local supply base alive, and one of them is not.

Mr. DINGELL. Ms. Carnrike, are depository institutions contributing or in a position to help turn around the local economy? And then why or why not, if you please.

Ms. CARNRIKE. Depository institutions are a very important part of turning around our local economy, and they contribute to that every day. We're talking specifically today about lending practices, but we also have to remember that those institutions are very important to supporting other community and economic development programs. We need the strength of their continued contribution. They will be very strong partners in our economic turnaround and transformation.

Mr. DINGELL. Mr. Andrea, as you're aware, and we have discussed some of those things at an earlier meeting that you and I had, the Administration recently increased the capital in Small Business Administration 7(a) and 504 loans. Is this going to help suppliers? How many of them will take advantage of it? And further, is raising the capital on these loans sufficient to address the capital needs of the suppliers?

Mr. ANDREA. I think from our survey, we're looking at the minimum amount was $5 million would bring in significantly more suppliers. Now we have to work—so I don't know the specific number that would pull in. We also, though, have to work on the lending side to make that capital available. My only anecdote for you there is I know speaking with the Michigan Small Business Administration office, it's continually difficult for him to place loans through the—automotive loans through the SBA programs here.

Mr. DINGELL. Thank you. Now to all of our witnesses, Mr. Art Johnson of the American Banker's Association implies that the Department of the Treasury should increase the cap of banks participating in the Administration's small business lending initiatives from $1 billion to $5 billion. Do you agree with that assessment, and what would your comments be? Ms. Carnrike, starting with you.

Ms. CARNRIKE. There is a need for increased capacity, whether it be the SBA existing loan programs, as well as many other programs. There's not enough capacity and enough available resources currently to help our small business community.

Mr. DINGELL. Mr. Andrea?

Mr. ANDREA. That would help the supply side, yes.

Mr. DINGELL. Mr. Anderson?

Mr. ANDERSON. I would absolutely agree.

Mr. DINGELL. Mr. Staebler?

Mr. STAEBLER. I couldn't agree more.

Mr. DINGELL. Whose family are old friends of mine. And you, Mr. Trute, please.

Mr. TRUTE. Absolutely, as well.

Mr. DINGELL. Now, in August of this year, I met with the banks and auto suppliers, as many of you will recall, to discuss methods by which to increase lending to suppliers. One question discussed during that meeting was the national adoption of the supplier diversification program which it is currently operating successfully in Michigan. This program would decrease an individual bank's risk in lending to suppliers by ensuring up-front deposits of loan principal by the Federal Government or its designee, and the risks buoyed across financial institutions participating in the program.

Do you believe that such a program would benefit banks and increase small business lending across the country? And how could we see to it that it's expanded here in Michigan? Ms. Carnrike?

Ms. CARNRIKE. A national supplier diversification program would certainly be very helpful to our overall efforts for suppliers across the Nation, but I would like to talk specifically to this area and this State and suggest that we look at other opportunities to shore up our State program and would ask that, perhaps, you consider is there flexibility within the SBA? We have been talking about existing SBA programs. Is there an opportunity to be flexible to create new programs with SBA resources that respond to timely economic situations? Especially for economic disadvantaged areas like Detroit right now.

Mr. DINGELL. Thank you, Mr. Chairman.

Chairman MOORE OF KANSAS. Thank you, sir, and thanks to the witnesses for their testimony. I thank our first panel for your testimony. We are going to have to move along here. The first panel is excused, and I would like to invite the next panel to the witness table, please, and thanks to all the witnesses who have testified here today.

And while the next panel is being seated, we're going to make one minor adjustment, too, instead of—

[Discussion off the record.]

Chairman MOORE OF KANSAS. We will now hear from Mr. Art Johnson, chairman and CEO of the United Bank of Michigan and United Community Financial Corp, as well as the chairman of the American Bankers' Association.

Next, will be Mr. Doug Chaffin, president and CEO of Monroe Bank & Trust and the immediate past president of the Michigan Bankers' Association. After him, we will hear from Mr. Michael Kus, who is with Kus, Ryan & Associates, and serves as legal counsel to the Michigan Association of Community Bankers, and concluding this panel will be Mr. Dave Adams, CEO for the Michigan Credit Union League.

Without objection, your written statements will be made a part of the record. I say this to each of the witnesses.

Mr. Johnson, sir, you are recognized. We are going to have to change this—I apologize for this, but we're kind of on a tight schedule here—to 3 minutes for witness statements, if you would, please, and your statements will be received into the record, though, and each member will then have 5 minutes to conduct and ask questions.

Mr. JOHNSON. Very good. I will do my best.

Chairman MOORE OF KANSAS. Thank you, sir. And I will let you know when the time is up.

Mr. JOHNSON. Good, thank you.

## STATEMENT OF ARTHUR C. JOHNSON, CHAIRMAN & CEO, UNITED BANK OF MICHIGAN; AND CHAIRMAN, AMERICAN BANKERS ASSOCIATION (ABA)

Mr. JOHNSON. My bank has been serving the banking needs of west Michigan communities for more than 120 years. And for our bank to prosper and endure, we must create long-term value for our customers, our communities, our employees, and our investors. Each of these groups is very interdependent so that to fail with one group means failing them all.

For this reason, our bank has clung to the core values of honesty and fairness in all of our dealings, mutual respect for others, and a thirst for excellence in our individual performance and professionalism. As chairman of the American Bankers' Association, I'm pleased to share the banking's industry's perspective on ways to promote capital assistance and improve business lending in this distressed economy.

This recession is certainly one of the worst we have ever faced. While the statisticians will say that the recession has ended, that's little comfort to areas in Michigan and elsewhere in the United States that still suffer from very high levels of unemployment and business failures. The impact of the downturn is being felt by all businesses, banks included. The cumulative impact nationally of seven straight quarters of job losses and many more than that in Michigan is placing enormous financial stress on some individuals. With the jobs lost, work hours cut, it does not take long for the financial pressure to become overwhelming. This, in turn, has increased losses and reduced the capital of banks.

This is not, of course, the first recession faced by banks, and certainly not the first in Michigan. Most banks like mine have served their communities for decades and expect to serve them for many more. In fact, one of every three banks in the United States has been in business for more than 100 years, and these numbers tell a dramatic story about the staying power of the banks and their commitment to the communities they serve.

In the face of a still weak and struggling economy, bankers are working very hard every day to ensure that the credit needs of our communities are met. My bank, as most community banks, entered this recession with strong capital levels, and that is the foundation of bank lending. Without adequate capital, which our regulators are demanding, it becomes extremely difficult to make new loans.

As this subcommittee is aware, in some areas of the country, including southeast Michigan, it's impossible for banks to raise new capital—new private capital. Without new sources of capital, banks will end up shrinking in order to keep regulatory capital asset ratios in acceptable ranges.

We believe that there are some comparatively small steps the government can take now that would make a huge difference in keeping credit available to our customers and our communities. In a letter to Treasury Secretary Geithner this past September, I laid out specific recommendations to assist well-managed, viable community banks so that they would have the capital necessary to more easily meet the credit needs in their communities.

We proposed the Treasury invest up to $5 billion in community banks with an expectation that this investment be matched dollar for dollar by private capital. However, in some areas of the country, Michigan included, capital markets have become completely dysfunctional. In these areas, either no private capital matching or a lesser requirement should be considered.

On a related note, we believe the President's new small business lending initiative has the potential to improve access to credit for small businesses by providing lower-cost capital to community banks that submit a plan to increase small business lending. We have urged the Treasury to increase the cap size so that more community banks will be able to participate, which, in turn, increases the potential capital available for small businesses.

Chairman MOORE OF KANSAS. Mr. Johnson—

Mr. JOHNSON. In conclusion—

Chairman MOORE OF KANSAS. Thank you.

Mr. JOHNSON. —the success of many local economies, in Michigan and throughout the Nation, depends in large part on the success of the community banks. We must work together to get through these difficult times.

Chairman MOORE OF KANSAS. Thank you, sir.

[The prepared statement of Mr. Johnson can be found on page 215 of the appendix.]

Chairman MOORE OF KANSAS. Mr. Chaffin, you are recognized, sir, for 3 minutes.

**STATEMENT OF H. DOUGLAS CHAFFIN, PRESIDENT & CHIEF EXECUTIVE OFFICER, MONROE BANK & TRUST; AND IMMEDIATE PAST PRESIDENT, MICHIGAN BANKERS ASSOCIATION**

Mr. CHAFFIN. Thank you, Chairman Moore. I would also like to thank Congressman Peters for arranging this today and to recognize Representative Schauer and my own Congressman, John Dingell. Thank you for attending, gentlemen.

Thank you for the opportunity to discuss the critical issue of improving lending to small business in Michigan and the needs of traditional banks to do so. I'm Doug Chaffin, president and CEO of Monroe Bank & Trust. We are a $1.4 billion traditional community bank with locations in Monroe and Wayne Counties, obviously, in the epicenter of our current financial crisis. Our bank has been in existence for over 150 years. We did not engage in the type of irresponsible lending behavior that created this crisis, and our intent is to continue for the next 150 years and beyond.

I'm also proud to represent at this hearing the 169 members of the Michigan Bankers' Association as its immediate past chairman. The MBA represents 93 percent of all commercial banks doing business in our great State. Our members employ approximately 40,000 Michigan residents and have provided more than $200 billion in loans to both consumers and businesses.

Unemployment in Michigan is currently the highest in the Nation, exceeding 15 percent, and this has been well documented in some areas exceeding greater than 20 percent in the State of Michigan. During this recession, 75 percent of all auto-related jobs have been lost with 1 out of 5 in all jobs in Michigan lost since the year 2000.

Banks in Michigan have continued to lend throughout this crisis, while at understandably lower levels compared to our national peers. In fact, loans to businesses and individuals by Michigan banks have grown throughout this decade with the first 9 months of 2009 representing the only actual decline in loans outstanding within any current banker's memory. However, the high levels of unemployment has brought about increased delinquencies, loan defaults, and resulting losses for over 40 percent of Michigan banks.

This has had a direct effect on depleting capital. While the demand for loans has declined dramatically as few of our customers are willing to take risks in this environment, many of our banks in Michigan lack the capital to serve the needs of the few businesses that are managing to find growth opportunities.

Further complicating this issue is the fact that traditional local sources for capital have been stressed by the economy, and outside investors lack the confidence to invest in Michigan due to our economic woes. Over the past 2 years, the Michigan Bankers' Association has explored a number of potential private and public solutions to provide capital for viable banks. This has included a collaborative effort with the Michigan Economic Development Corporation that resulted in the establishment of the Michigan Supplier Diversification Fund, which was mentioned previously. This fund was intended to provide both needed startup capital and cash flow support for manufacturers attempting to diversify in other industries.

Sadly, the budgetary challenges within our fair State leave this initiative woefully underfunded. Efforts by State leadership to seek Federal funding for these programs have thus far proved unsuccessful. It's important to note that lending does not lead an economic recovery. In fact, increased lending traditionally follows increased employment and new business opportunities resulting from improvements in the economy.

Michigan banks are anxious to do their part in any recovery effort, but many lack the capital that will allow them to do so. The only answer for many of our banks in Michigan is to look for governmental support to supply the capital necessary to allow them to lend to viable companies.

Thank you for the opportunity to discuss this critical issue for our local businesses and communities. We are confident that capital support to Michigan banks will pay huge benefits and will provide the necessary boost to employment as Michigan recovers.

[The prepared statement of Mr. Chaffin can be found on page 195 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Chaffin.

Mr. Kus, you're recognized for 3 minutes, sir.

**STATEMENT OF MICHAEL A. KUS, KUS, RYAN & ASSOCIATES, PLLC; AND LEGAL COUNSEL, MICHIGAN ASSOCIATION OF COMMUNITY BANKERS**

Mr. KUS. Thank you, Chairman Moore. Thank you, Congressman Peters, for arranging this meeting, and also thank you Congressman Schauer and Congressman Dingell for being here today. It's important that we understand that Michigan is in a very unique position.

I represent the Michigan Association of Community Bankers. I am their spokesperson and their counsel. I am also a practicing attorney representing numerous community banks in the State of Michigan.

Small business represents 99 percent of all employer firms and employs approximately 50 percent of all private sector workers in the United States. The majority of new job creation in the past 10 years has been the result of the 26 million small businesses in America. It is clear that for any meaningful recovery to occur in America, it's important that small businesses start hiring people again.

And small businesses rely heavily on community banks for the credit they need to operate their businesses. Even though community banks represent only about 12 percent of all bank deposits in the United States, they make up 31 percent of the dollar amount of all small business loans that are less than $1 million and 50 percent of all small business loans under $100,000.

While the majority of community banks have money to lend, some Federal regulatory agencies have taken an aggressive stance towards community banks, forcing the banks to write down their assets which were largely secured by commercial real estate at an unprecedented pace, thereby destroying capital and severely curtailing community banks' ability to fulfill their vital role in making loans to small businesses.

The recent joint policy statement on prudent commercial real estate loan workouts issued on October 30th by the Federal bank regulators is a step in the right direction. It is also in keeping with the type of suggestions that the MACB has made in the past to various Members of Congress and the State Legislature. More initiatives like this one are important, and we need to continue to look to Washington for such guidance. However, as community bankers in Michigan who have recently been examined can tell you, instead of working with community bankers to help both banks and their customers overcome current economic stress, some examiners have become extremely harsh in their assessment of the values of commercial real estate loans.

The President recognizes the need to support economic recovery and job creation by improving access to credit for small businesses, and on October 21st, announced further initiative towards that goal. The MAC supports that effort and particularly looks to the support given to—or suggestions be provided to banks under a billion dollars in assets. However, we have serious concerns about the onerous conditions that may be placed on it, and it's important that these conditions placed on the lending of that money to small—to community banks be not as onerous as the cap program was.

Another concept that Congress should be considering is the creation of programs where community banks could obtain long-term stock loans from the Federal Reserve under a program for the Small Business Administration. Banks are comfortable borrowing from the Federal Reserve, and the Federal Reserve is familiar with the banks.

Another consideration is allowing a larger portion that allows for loan loss reserves to be used towards capital. Currently, it's at 1.25 percent only. Allow banks to include as part of their capital the face amount rather than market price of government-sponsored enterprise securities that are held to maturity in their investment. We currently do support the Small Business Administration programs and its suggested increases. It's important, however, that the programs be allowed to be used at a higher level by small banks. Again, we appreciate the opportunity to speak today. Thank you.

[The prepared statement of Mr. Kus can be found on page 226 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, and I will remind each of the witnesses that your testimony will be received into the record.

Mr. Adams, you are recognized, sir, for 3 minutes.

**STATEMENT OF DAVE ADAMS, CHIEF EXECUTIVE OFFICER, MICHIGAN CREDIT UNION LEAGUE**

Mr. ADAMS. Thank you, Mr. Chairman, and a special thanks to Congressmen Peters, Dingell, and Schauer. I appreciate on behalf of credit unions the way that you demonstrate balance and the way that you approach legislation, and what I wanted to say at the beginning is what we're talking about with the SBA proposal and small business lending, it really can't be looked at in isolation, but rather, when you look at the financial services industry, a $60 trillion industry of which credit unions are a very small piece, I would urge you Congressmen present here today and your colleagues to help us, as I know that you're already doing, help us understand the importance of balance because we want to protect consumers' interests with regard to foreclosure, we want to protect small business' interests, but what credit unions and the banking sector are experiencing right now in terms of increased loan losses and loan charge-offs, whether it be small business loans or mortgage loans or consumer loans, it's unprecedented.

So with that caveat—and I'm talking about overdraft fee legislation, interchange fee legislation, extending the Community Reinvestment Act to credit unions, whatever it might be, the CFPA proposal, we need to be able to make sure that small lenders are not faced with increased burden, because that plays into their willingness and their ability to lend to small businesses and to other sectors.

Three points that I would like to make that are contained in my written comments: One, credit unions are lending in this environment. The credit union sector of the financial services industry saw small business loans increase by 17 percent from June 30, 2008, to June 30, 2009. Small business lending with not-for-profit credit unions increased by over 100 percent in Michigan during the past 3 years. So credit unions are lending. Our Invest in America program where we partnered with GM and Chrysler has resulted in over 200,000 car and truck sales for GM and Chrysler. I received a note from GM's V.P. of Marketing and Sales recently saying, "Thank you, Mr. Adams, for believing in us when no one else would." I will never forget that. Credit unions are lending in all sectors, including small business lending.

Point number two, we support the SBA proposals wholeheartedly. However, as the loan caps are raised, we encourage that the guarantees continue, as well, because the 90 percent guarantee level is absolutely critical.

The third and most important point, credit unions are lending in the area of small business loans, but we are restricted with an arbitrary and, really, ridiculous cap on our small business lending that is restricted at 12 percent of assets. Representative Paul Kanjorski has sponsored H.R. 3380, it has 30 cosponsors, and quite simply, it would raise the small business loan cap on credit unions from the 12 percent level to 25 percent, and provides some other provisions that will simply allow credit unions to make more small business loans. We encourage your support for that legislation. That is the single piece of input I could give you. Our national association has estimated that it would immediately infuse $10 billion of capital for small business loans, and would create over 100,000 jobs.

So I appreciate your allowing me to testify, and we share the real interest in addressing this very serious problem. Thank you very much.

Chairman MOORE OF KANSAS. Thank you, sir.

[The prepared statement of Mr. Adams can be found on page 49 of the appendix.]

Chairman MOORE OF KANSAS. I now recognize myself for 5 minutes for questions, and I would like to ask all four of you the first question: Is the decline we saw in lending in the last quarter due to banks and credit unions being more cautious about making loans on their own initiative, or is it pressure from regulators and examiners to stop making business loans? Mr. Johnson, if you would like to start, sir.

Mr. JOHNSON. I'm inclined to think that it's a combination of those two and some other factors. It's not surprising that credit standards at banks have become a little more harsh today than they were 3 years ago, which most people would recognize that maybe it was a little looser than it should have been then. So that's not surprising.

It is also not particularly surprising that in this kind of an environment, regulators are being harsh during examinations. We can argue about whether the degree is appropriate, but that shouldn't be surprising.

Chairman MOORE OF KANSAS. Thank you, sir. Mr. Chaffin?

Mr. CHAFFIN. I would agree with that. I would also like to add that we're also finding, frankly, decreased demand, particularly in southeast Michigan, for small business lending and medium-sized business lending. In our own case, we have seen the backlog of loan applications for business lending to go down to less than 10 percent of what it was a year ago, and I think banks across the State and, in fact, across the country are experiencing something similar, so in addition to Art's comments, it is partly a demand issue.

Chairman MOORE OF KANSAS. Thank you. Mr. Kus?

Mr. KUS. I would agree. I think one of the things that we're finding with banks in southeast Michigan, they're in capital preservation mode. They're afraid to make additional new loans, concerned with whether or not they're going to get additional criticism from the regulators, at the same time, they're unable to find often sufficient collateral, bankable collateral to be used as collateral for those loans.

Chairman MOORE OF KANSAS. Thank you, sir. Mr. Adams?

Mr. ADAMS. Yes, I would like to see more public focus or more congressional focus on the plight of financial institutions as opposed to consumer interests. We represent the consumer sector of the financial services industry. We are consumer cooperatives, but there's a very delicate balance that needs to be maintained here, as I mentioned in my comments. I think it is a combination. Regulators are really clamping down on lenders of all types, they should do that, they have to do that in a tough economy, but as I mentioned earlier, despite that, credit unions have been able to increase their loan volumes in all sectors during this period that we're talking about.

So the lending can be done, but it has to be done very carefully in a tough economic environment like we're in right now.

Chairman MOORE OF KANSAS. Thank you. Mr. Johnson, what unique challenges do Michigan banks face in lending to local small and mid-sized businesses in addition to regular business loans? I worry about the state of the commercial real estate market and the reluctance or inability for banks to make those kinds of loans to small or mid-sized businesses. How does the status of the auto industry fit into calculating how risky a loan may be if there's an auto supplier at the other end of the loan?

Mr. JOHNSON. Let me give as brief an answer as I can.

Chairman MOORE OF KANSAS. Thank you.

Mr. JOHNSON. One of the biggest factors is simply the value of collateral. Virtually every asset on the books of every small business and certainly of most banks is worth less today than it has been in the past, and in many instances, considerably less, and at the same that banks are requiring lower loan-to-value ratios in their loan approvals, the value has gone down, and frankly, it's kind of a double whammy.

Chairman MOORE OF KANSAS. Thank you, sir. Do any other witnesses care to comment on that?

Mr. CHAFFIN. Maybe I could just add some anecdotal support to the property value issue. In Monroe County, Michigan, and Wayne County, Michigan, we have seen residential property values decline over the last 3 years at the rate of 1 percent per month, which means today, those properties are worth, roughly, a third of what they were 2 or 3 years ago. That extends to commercial property values, as well. It's a very similar statistic, and as Art commented earlier, it is partly a fact of the availability of the collateral.

Chairman MOORE OF KANSAS. Thank you. My time is about to expire, and go ahead and start, and if it does expire, I would ask the other witnesses if you have comments to please submit those in writing for the record. Okay, Mr. Kus?

Mr. KUS. The only comment that I would make is that not only have real estate values fallen, but concentration levels that the regulators are demanding, they want them to decrease, so unfortunately in some segments, they're unable to lend into those segments because they have reached their concentration level.

Chairman MOORE OF KANSAS. Thank you. The Chair next recognizes Mr. Peters for 5 minutes for questions, sir.

Mr. PETERS. Thank you, Mr. Chairman. Thank you again for all of our testimony. Let me get back to a question that I asked of the other panelists, the difference between the large, money-center banks, the community banks, and our credit unions that are here in Michigan, and what we have noticed, particularly with the new information with the decline in loans, it was interesting that the largest decline of loans to small businesses and loans generally were from the very large banks, the big, money-center banks, which are also the prime beneficiaries of significant TARP money and significant assistance from the Federal Government, and we have seen those banks turn—it looks like they have turned course, are profitable now, and yet, they're not loaning out to Main Street and to our small businesses.

Mr. Johnson, you represent the American Bankers' Association, you have banks from every size available, and I just wanted your reaction to that, as well as the other panelists to that. And when I was before a Financial Services Committee hearing and I had the executives from the leading five banks in the country, they, more or less, mentioned to me that Michigan is being red-lined, in a sense. They didn't use that term, obviously, but they could not find loans in Michigan, and they did all acknowledge that they're loaning less in Michigan than they are in other States.

What do we have to do to get these money-center banks loaning? Where is the problem? What's your reaction to the fact that the folks who have most of the deposits and the money are simply pulling back?

Mr. JOHNSON. Well, I'm inclined to think that the solution for money-center banks and community banks is not terrifically different. If we can get regulatory agencies to look at capital ratios a little more creatively, if they can look at not requiring write-down of assets quite as rapidly as we have, the problem is essentially the same for everybody. It's capital ratios, and in banks, that capital means something a little bit different than it does more generally. It's the actual amount of equity in the business, and we are—banks of every size are really being required to move toward higher equity capital levels in their bank, and there's really only two ways to do that. One is to raise more capital from some source, and the other is to shrink the balance sheet, and in the largest companies, they are shrinking the balance sheet, and I think that has a huge impact.

Mr. PETERS. Mr. Chaffin mentioned the TARP funds to some community banks. One way to help that balance sheet is the TARP funds bringing in some Federal resources, and, yet, community banks are reluctant to accept TARP funds. Do you want to elaborate on that, what we need to do, maybe, to make it so community banks are willing to accept it?

Mr. CHAFFIN. First of all, the application process for the capital purchase program for the TARP program has expired for community banks, I believe it expired at the end of November, and there may be some today that if that was available, they certainly would reconsider that. At the time the applications were taking place, our economic woes were not as severe as they are today.

In our own case, our own bank declined to participate in that, and that application process was over a year ago. At the time, we were concerned about some of the what we'll call onerous requirements that were part of that program. We were concerned about some of the unknown requirements that might become a part of that program at a later date, and I think if those type of restrictions are lifted from some future program, you would see more community banks taking part in it.

Mr. PETERS. Community banks would take—so we can have outlined at a future time exactly what needs to be done if we open that up. Mr. Kus, I just also want it mentioned the forbearance that you talked about in your testimony, at least the written testimony, with the pressure that the regulators have, you made the comparison of Michigan being very similar to what happened in the farm crisis with banks there and the forbearance. Now we have approached the regulators, we'll ask them again when they're here before us, they have said that's not something they're willing to pursue, and they think that only postpones the problems for the banks. How would you respond? You understand the reluctance from the regulators. How should I respond to them when they give me those responses?

Mr. KUS. I understand their reluctance, but we need to do something to assist. We have what I call almost a systemic risk problem of the banking industry in the State of Michigan. If we don't do something to help shore up the banks of southeast Michigan, we're going to have more fail, and the question is what can we do to help shore it up.

The proposed cap program is not a bad idea that's coming out to support banks under $1 billion, but many of the banks that need the TARP money aren't able to get it because of the restriction that if you're at low CAMEL 3 composite rated or 4 or 5, you're not going to get the money. So are there other programs that could be made available? And some of the ideas are to somehow limit the amount of charge-off that has to occur over a longer period of time as opposed to in that quarter, so again, some of those suggestions are in that paper.

Chairman MOORE OF KANSAS. Thank you, and the Chair next recognizes Congressman Dingell for 5 minutes, sir.

Mr. DINGELL. Mr. Chairman, with your permission, I would like to yield to Mr. Schauer.

Chairman MOORE OF KANSAS. Absolutely.

Mr. SCHAUER. Thank you, Mr. Dingell.

Thank you all for being here. I think I will ask Mr. Johnson, you represent banks of all sizes. I think Mr. Trute alluded to this earlier, of businesses that have had 20-plus-year relationships with their large bank—I will use the term that has been used here, money-centered banks, and those banks literally are calling those loans. These are customers that have the demonstrated cash flow, they are still in business, they have not been winnowed out, and they're diversifying.

Why is that happening? How can that be good for that bank's balance sheet or for their future balance sheet if they have a customer that's demonstrated that it's risk worthy, that it's viable? That's an example that I can give you of how our recovery is being hindered, and it's a story that probably every community can tell you.

Mr. JOHNSON. Well, excuse me, first of all, while I do represent all the members of the American Bankers' Association, I am a community banker.

Mr. SCHAUER. And I appreciate that.

Mr. JOHNSON. And have never worked at—

Mr. SCHAUER. You have a tough job.

Mr. JOHNSON. I work at the largest bank I have ever worked at right now, it's the only bank I have ever worked at, and it's only $435 million, with an "m," and so I think, as I mentioned before, and some of the other panelists have mentioned, there are a number of factors. Exposure to certain industries with what economists are saying about the restructuring of the auto industry. It's—if you have the ability to be diversified across many States, many communities, you are able to pick and choose what industries you want to have your assets invested in.

If, however, you were located in one community, and you can only do, as community banks are, you can only do what's going on in that community, that's what you have to do. You don't really have that diversification ability. And so it's not surprising that they're making the very tough but, perhaps, rational decision that they don't want quite as much exposure to particular industries as they have.

Mr. SCHAUER. And I appreciate that is probably the best answer you can give. The frustration is that these are businesses that have demonstrated that history of cash flow and demonstrated that relationship for a generation. So is the answer that you—community banks and credit unions, up to the ability that you can, refinance these loans? And will the President's 3 percent interest rate help you do that, your $5 billion proposal give you the ability to do that? Because candidly, in my community, that's what we're sort of left with, we're going to you, including credit unions, to say, how can you take out this other lender to help this business stay in business or help this business diversify and grow.

Mr. JOHNSON. I think those are all great ideas. If I might, I had a thought while I was sitting back listening to the previous panelists about an observation that I have. Between the mid-1980's and mid-1990's, our bank in Grand Rapids was the largest originator of SBA 7(a) loans in the State of Michigan for 9 years in a row, and so we are very familiar with SBA programs.

During that period of time, the SBA was relatively decentralized, and we made semiannual trips down to the Detroit office and the McNamara Building to meet with SBA officials, talk to them about what was going on, and talk about what was going on in our loan portfolio. That's not the case anymore. The SBA has been very centralized, and we're now dealing with offices in California and Virginia, and from an organizational perspective, I would say that if district offices of the SBA had a lot more authority to deal with their lenders on local issues, there could be some on-the-street improvement.

Mr. SCHAUER. I appreciate that recommendation. Mr. Adams, you wanted to comment?

Mr. ADAMS. Congressman, in your district, one credit union, Consumers' Credit Union's CEO Kit Snyder, you may know him—

Mr. SCHAUER. Yes.

Mr. ADAMS. —is an example of many credit unions in Michigan that have reached this arbitrary statutory 12 percent cap that I talked about. The single thing that can be done without a single taxpayer dollar to help infuse more money for small businesses would be to raise that cap that is currently placed on credit unions for small business lending. The only reason it's in place is that the banking industry lobbied for that back in 1998. They're the only ones who benefit from it, and yet, it's a clear example of how small businesses could benefit from additional capital.

Mr. SCHAUER. My time is up. Mr. Chairman, if I could ask for written follow-up from you, Mr. Adams, on that point in terms of, I know the bill that has been introduced would allow you to take that cap up to 25 percent—

Mr. ADAMS. Right.

Mr. SCHAUER. —but if you could give me some evaluation on—of how many jobs could be created, how many loans could be made for different increments, if you could go to 15 percent, 20 percent, 25 percent—

Mr. ADAMS. I would be happy to do that.

Mr. SCHAUER. —I think that would be very helpful.

Chairman MOORE OF KANSAS. Thank you.

Congressman Dingell, you're recognized, sir, for 5 minutes.

Mr. DINGELL. Thank you, Mr. Chairman. In his testimony, gentlemen, which you heard, Mr. Andrea observed that about 60 percent of the supply base may be indiscriminately cut off from necessary access to capital. He further stated the group of OESA's chief purchasing officer concluded that predicting the failure of a supplier has more to do with their banking relationships than it does with their operational efficiency or revenue outlook.

Do you agree that the banks are indiscriminately denying automotive suppliers to credit they desperately need to remain in business? Mr. Johnson? Mr. Chaffin? Mr. Kus?

Mr. JOHNSON. I can only speak firsthand from what's going on in my own bank, and that's certainly not the case there. I would think that if that phenomenon is occurring, it is very isolated, it— I doubt that it's widespread.

Mr. DINGELL. Mr. Chaffin?

Mr. CHAFFIN. I could relay some comments, I think, and also following up on Congressman Shauer's question. There is, in fact, a challenge with a lot of auto manufacturers, simply because they do not demonstrate the ability to service debt, whether it's recent history or whether it's collateral. The supplemental programs that we have talked about in the past that the State has tried to initiate would counteract that.

What we find in our own case when a larger institution has denied credit or actually denied renewing the credit and we receive an application, probably 9 times out of 10, it's with merit, it's with the fact that there is insufficient collateral or insufficient cash flow, so these—

Mr. DINGELL. I want to make it clear I know nothing about that with regard to the community banks, and you, Mr. Chaffin, run a very fine institution.

Mr. CHAFFIN. Thank you.

Mr. DINGELL. I do observe with some distress I have had small business people, particularly suppliers, come into my office and observe that they have been informed that their bank was not going to loan anymore in the auto industry, and this is a matter of no small concern to me, as you might well know. Mr. Kus?

Mr. KUS. I don't think it's indiscriminate, but I think Doug hit the nail on the head in that. The problem is when these people come back for loans today, when these companies come in, the value of their equipment has gone down significantly, the value of their commercial real estate has gone down, they have absolutely no assets, per se, they become very hard to bank.

And so unfortunately, if the bank was to make this loan, they would be under severe criticism from the regulators who would likely have to classify the asset almost immediately, so unfortunately, we're kind of in a Catch-22.

Mr. DINGELL. Now one of the suggestions made during that meeting was the national adoption of the supplier diversification program, one which is successfully working in Michigan. This program would decrease individual banks' risks in lending to suppliers' banks by ensuring follow-up deposit—by ensuring upfront deposits of principal by the suppliers by ensuring upfront deposits by the Federal Government or its designee in risk pooling. Would that be of assistance in the problem we're discussing?

Mr. CHAFFIN. Absolutely.

Mr. DINGELL. Mr. Johnson?

Mr. JOHNSON. I'm not a great believer in a single, silver-bullet approach here.

Mr. DINGELL. Oh.

Mr. JOHNSON. I think a lot of programs should be thrown out there and tried.

Mr. DINGELL. I thoroughly agree. Mr. Kus?

Mr. KUS. I would agree with that, and I—

Mr. DINGELL. Gentlemen, there's one issue—my time's about out—but there's one issue that we have heard everywhere this morning amongst all of our panelists, and that is the way assets are being rated down because of the loss of value. That's causing, as you have observed, a severe constriction on banks' ability to loan money and upon the requirements that are imposed on them to maintain a hard capital structure.

We have two problems that this relates to, the first of which is the problem that you have in making loans, but the other is the fact that we have some folks who are "too-big-to-fail," and we have to watch to see that—that we terminate that risk to our society. What do we do about this, gentlemen? And if my time runs out, submit that to us in writing so that we can get that in the record, please.

Mr. JOHNSON. Well, I think there are really two related issues there, and the ABA has a position on creating a systemic regulator, which we think is important, and importantly, the resolution—the difficult part of that is what is the proposed resolution process for a bank, or an institution? Not just banks but a systemically important financial institution, what do we do once we have determined that they should fail, and how do we—without inducing chaos, how do we run that business down? How do we solve that problem?

Mr. DINGELL. It's probably too long for us to address this morning.

Mr. JOHNSON. Well, it's another whole hearing, I'm sure.

Mr. DINGELL. Thank you, Mr. Chairman.

Chairman MOORE OF KANSAS. Thank you, and Mr. Chairman here to my left has been a chairman for many, many years in Congress, so I appreciate his understanding, as well.

We are at this time going to take—I want to thank the second panel for your testimony. You are excused, and before we hear from the third panel, we're going to take a short break for a little lunch break, I guess, and resume here at 1:15. If everybody would be back then and be seated and ready to go. We all have to get back to D.C.—I think, we have planes to catch later, so we do want to start at 1:15, and I do appreciate the understanding of our members. We will see you back here in just a few minutes.

[luncheon recess]

Chairman MOORE OF KANSAS. The hearing will come to order. We're going to convene your final group of panelists and have a chance to hear their testimony and ask questions.

I ask unanimous consent to enter into the hearing record several statements from Members of Congress, Congressman Sandy Levin, he was unable to attend, but has a written statement, and also a statement from the National Association of Federal Credit Unions, and a letter from the Building Industry Association of Southeastern Michigan.

Is there any objection?

Mr. DINGELL. No.

Chairman MOORE OF KANSAS. Without objection, it is so ordered. These will be received in the record.

I also welcome our final group, Panel Three.

First, we will hear from Mr. Jon Greenlee, Associate Director of the Division of Banking Supervision and Regulation for the Board of Governors of the Federal Reserve system. Next, will be Mr. Anthony Lowe, Director of the Chicago Region Office for the FDIC. Third, will be Mr. Bert Otto, District Deputy Comptroller for the OCC, and finally, we will hear from Mr. Ken Ross, Commissioner for the Office of Financial and Insurance Regulation for the State of Michigan.

Without objection, your written statements will be received and made a part of the record.

Mr. Greenlee, you are recognized, sir, for 5 minutes—excuse me, for 3 minutes. We have cut down here. We are trying to get out of here by about 2:00—some of us are heading on to a place called Washington, D.C. So please understand, and we are not trying to cut you short. All of your statements will be received into the record.

Mr. Greenlee, sir?

## STATEMENT OF JON D. GREENLEE, ASSOCIATE DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. GREENLEE. Thank you. Chairman Moore, Congressman Peters, Congressman Dingell, I appreciate the opportunity to appear here before you today to examine several issues related to the condition of the banking industry.

Although conditions and sentiment in financial markets have improved, the overall business environment is very challenging for both large and small businesses as unemployment has continued to rise. Borrowing from businesses and households remains weak, and overall, the banking system continues to face significant challenges as the economic downturn and weaknesses in real estate markets has resulted in significant loan quality problems and losses at a number of banking organizations, many of which are also facing questions about capital adequacy.

In Michigan, Indiana, and Ohio, the performance of banking organizations has also deteriorated because of weaknesses in the overall economic environment. In particular, banks in Michigan have seen asset quality indicators continue to deteriorate, further pressuring the institutions' profitability and capital adequacy.

Against this backdrop, four banks have failed in Michigan in recent months. The Federal Reserve has been focused on the important role banks play in meeting the needs of their community, and along with the other Federal Bank regulatory agencies, issued a press release in November of 2008 encouraging banks to make sound loans to creditworthy borrowers, including small businesses.

More recently, on October 30, 2009, the Federal and State bank regulatory agencies issued additional interagency guidance on CRE loan restructurings and workouts. This guidance, the development of which was led by the Federal Reserve, is designed to address concerns that examiners may not always take a balanced approach to the assessment of CRE credits.

This statement is especially relevant to small businesses because owner-occupied CRE often serves as collateral for many small business loans. Given the importance of this issue, the Federal Reserve has already held initial training for its examiners, and on November 20th, participated with the other Federal banking agencies in a teleconference with the industry to discuss this guidance.

Finally, the TALF program, which the Federal Reserve established in November of 2008 to facilitate the extension of credit to households and small businesses, has been successful in helping restart securitization markets. To date, the TALF program has helped finance 2½ million auto loans, 750,000 student loans, more than 100 million credit card accounts, 480,000 loans to small businesses, and 100,000 loans to larger businesses. Included among those business loans are 4,700 loans to auto dealers to help finance their inventories.

Perhaps even more encouraging, a substantial fraction of asset-backed securities is now being purchased by investors that do not seek TALF financing, and ABS issuers have begun to bring non-TALF eligible deals to market. Further, on November 16th, the availability of TALF financing also facilitated the first issuance of CMBS's backed by newly originated mortgages in almost 18 months.

In summary, it will take some time for the financial markets to fully recover. The Federal Reserve is committed to working with the other banking agencies and the Congress on these important matters that will promote the concurrent goals of fostering credit availability in local communities across the country and promoting a safe and sound banking system. Accordingly, we thank you for holding this hearing. I look forward your questions.

[The prepared statement of Mr. Greenlee can be found on page 201 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Greenlee.

Mr. Lowe, you are recognized, and your statement will be received into the record, as well.

**STATEMENT OF M. ANTHONY LOWE, DIRECTOR, CHICAGO REGION OFFICE, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)**

Mr. LOWE. Thank you. Chairman Moore, Congressmen Peters and Dingell, I appreciate the opportunity to testify on behalf of the FDIC regarding the availability of credit to small and medium-sized businesses. FDIC-insured institutions are a major source of financing for small businesses, supplying over 60 percent of the credit used by small businesses to run and grow their businesses. Most of these institutions are community banks. We share your concerns about ensuring the availability of credit to Main Street businesses in Michigan and across the country.

The number of problem institutions and bank failures has risen steadily as the effects of this recession, which began in the financial markets, have taken hold in many parts of the country. As a result, credit availability has suffered, and this is due not only to more conservative credit standards by lenders but also due to erosion of collateral values and the financial condition of borrowers. At the same time, bank supervisors are encouraging FDIC-insured lenders to deal with problem loans and recognize losses where necessary, while also encouraging loan workouts where they're appropriate.

Financial data from Michigan and the industrial Midwest in general reflect the ongoing struggle of the U.S. manufacturing sector which contracted during this decade, and like employment growth among other sectors, job growth in the manufacturing sector did not rebound after the 2001 recession even while overall U.S. economic growth was strong. This led Michigan to experience a sharp increase in joblessness since the start of the national recession in 2007, and the State's unemployment rate has more than doubled from 7.3 percent to 15.1 percent.

With respect to small business lending, available data do not clearly distinguish recent trends in availability of small business credit in Michigan. However, recent surveys by the NFIB show that while small business loans have clearly become more difficult to obtain, deteriorating business conditions appear to represent an even larger problem.

We understand the critical role that credit availability plays as the lifeblood of the national economy, especially for small businesses, and we also recognize the tight credit conditions in the market and continue to identify strategies for improving the current situation. Last year, along with the other regulators, we issued a statement reinforcing our view that continued origination and refinancing of loans to creditworthy borrowers is essential to the vitality of our domestic economy. We all have a mutual interest in seeing community banks thrive and continue to support their local communities. Community-based lenders can be a stabilizing force by providing credit for consumers and small businesses.

Thank you for the opportunity to testify, and I'll be happy to take questions.

[The prepared statement of Mr. Lowe can be found on page 231 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, sir.

Mr. Otto, sir, you are recognized for 3 minutes.

Mr. OTTO. Thank you.

**STATEMENT OF BERT A. OTTO, DISTRICT DEPUTY COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)**

Mr. OTTO. Chairman Moore and members of the subcommittee, I appreciate the opportunity to discuss ways to improve responsible lending to small businesses in Michigan and other parts of the country. The OCC recognizes the important roles that credit availability and prudent lending play in our Nation's economy. Our goal is to ensure that national banks meet the credit needs of their communities and customers while remaining safe and sound.

During this economic cycle, we are extremely mindful of the need to maintain a balanced approach to our supervision of national banks. Our message to bankers has been straightforward: bankers should continue to make loans to creditworthy borrowers; they should not make loans that they believe are unlikely to be repaid in full; and they should continue to work constructively with troubled borrowers but recognize repayment problems in loans when they see them.

Just as critical, we strive to ensure that our examiners maintain that balance in their bank examinations and oversight. Examiners should not dictate loan terms, but will ensure that bank management realistically identifies and addresses problems as they emerge, even as they work with struggling borrowers.

As bank regulators, we share the goal of ensuring banks meet the credit needs of their small and mid-sized business customers and have taken steps to see that this happens. The OCC is also helping to educate examiners and bankers about programs that can reduce credit risk in loans to small and mid-sized businesses. Federal and State programs designed to make credit more accessible while reducing lenders' credit exposure can be effective in promoting lending to creditworthy borrowers while limiting the risks lenders face in the economic cycle.

National banks actively participate in government guarantee programs for small business lending: 5 of the 18 nationally chartered banks in Michigan are SBA preferred or express lenders offering SBA guaranteed loans, and the 10 large national banks doing business in Michigan are also designated as SBA-preferred or express lenders. The OCC fully supports the Administration's initiatives to expand credit availability and begin the process of financial recovery.

Beyond our safety and soundness examination activities, OCC encourages lending to small and mid-sized businesses in a variety of other ways. Among these are our evaluation of the national banks' performance under the Community Reinvestment Act, our extensive community affairs activities, and our formal outreach programs. The OCC's community affairs activities and publications are specifically developed to increase examiner, banker, and community group awareness of programs that promote lending to small businesses that support communities throughout the country. Recent banker roundtables, newsletters, information, and informational publications have highlighted various aspects of small business lending opportunities and incentives.

In conclusion, credit availability and prudent lending to small businesses play an important role in our Nation's economy. The OCC shares the committee's goal of ensuring banks continue to meet the credit needs of their customers in a safe and sound manner. We also recognize that banks are operating in an economic environment that continues to pose challenges to them and their customers.

We have and will continue to support and encourage prudent lending to small and mid-sized businesses in Michigan and across the country through our supervisory activities, guidance to bankers, and CRA process, small business related programs, publications, and ongoing outreach efforts. Thank you for this opportunity to testify and present our views.

[The prepared statement of Mr. Otto can be found on page 244 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Otto.

Mr. Ross, you are recognized, sir, for 3 minutes.

**STATEMENT OF KEN ROSS, COMMISSIONER, OFFICE OF FINANCIAL AND INSURANCE REGULATION, STATE OF MICHIGAN**

Mr. ROSS. Thank you, Mr. Chairman, and Representatives Peters and Dingell. My name is Ken Ross and I am commissioner of the Michigan Office of Financial and Insurance Regulation. I thank you for the opportunity to testify today. I have taken a red pen aggressively to my oral testimony and I will try to talk fast.

My agency supervises 118 of Michigan's 147 federally insured commercial and savings institutions which collectively hold approximately $50 billion in combined assets. I also regulate over 200 credit unions which have just over $20 billion in assets. Historically, Michigan has averaged 1 bank closure roughly every 5 years over the last several decades. In the last 13 months, 4 Michigan banks and 1 credit union have been closed.

Given time, I believe that many Michigan banks would be able to work their way through the challenges associated with historic job losses in the auto industry, but unfortunately, some will not be able to weather the additional stress associated with the huge devaluation of real property that we have seen across the State. Michigan is not alone in that, but we have seen somewhere between 30 and 40 percent on average across the State in real estate devaluation.

Community bankers who weren't, by and large, involved in subprime lending and weren't reaping fortunes from the national securitization machine, however, are paying the ultimate price for those who benefited from the fundamental causes of the underlying financial crisis that we have been going through, and while much of the national focus has been on buttressing systemically important information, our attention in Michigan has been working with community banks struggling with the myriad of challenges facing them in this environment.

Federal policy hasn't treated the challenges faced by community banks with the same expediency or creativity that they have accorded to their systemically important brethren. Over the last year, nearly 300 community banks nationwide have failed or merged out of existence, while their large counterparts have only gotten bigger. Additional capital, both public and private, must be the building block for success ultimately for community and regional banks.

While TARP has provided a source of capital for some of these institutions, I have—as I'm sure you have heard—been told many times that the process is both cumbersome and expensive for community banks, and is an opaque process, as well. While there have been some positive signs in the outlook nationally where capital flows have been coming into the system, unfortunately, Michigan banks have been largely shut out of capital markets.

We have heard, as you have heard many times, that Michigan is being red-lined. With that, I will just stop because I know the time has run out, and I will be glad to answer any questions.

[The prepared statement of Mr. Ross can be found on page 258 of the appendix.]

Chairman MOORE OF KANSAS. Thank you to our panelists for their testimony, and again, your statements are part of the record.

I would like to direct my first question to Mr. Greenlee. I know one of the areas of the economy the Fed has been particularly focused on is commercial real estate. How does that particular type of lending play into the larger challenge to make credit available to small and mid-sized businesses? Do you have a comment on that, sir?

Mr. GREENLEE. Yes, as I mentioned in my oral statement, we have focused a lot on commercial real estate lending for two reasons. There are a lot of banks with commercial real estate concentrations. The second piece of this is really the owner-occupied commercial real estate portfolio where small businesses will pledge their building or property to secure a loan, and so we have tried to fix on that as a key priority to make sure that our examiners are taking a balanced approach to that, particularly on the owner-occupied commercial real estate properties, so we look at a borrower's ability to repay, not necessarily just the value of the property.

Chairman MOORE OF KANSAS. Thank you. Do any other witnesses care to comment on this question?

Okay, next question. If there is one message that you as examiners and regulators of depository institutions would like to send to banks here in Michigan that are unsure if they should make small business loans to small businesses desperate for that credit, what would that message be? What message would you like to send to small businesses here in this area? Mr. Greenlee, again, I will start with you, sir.

Mr. GREENLEE. I think the Federal Reserve's view on credit availability, again, is that we want banks to make prudent loans to creditworthy borrowers. I think our main message to the banks is that it is in everybody's best interests to do that. That was consistent with what we put out in the November 2008 statement and that we want banks to look at the borrower's ability to repay the loan under reasonable terms, and that really should be the driving force here.

Chairman MOORE OF KANSAS. Do any other witnesses care to comment? Yes, sir, Mr. Lowe?

Mr. LOWE. Yes, dovetailing on that exact same comment, from the FDIC standpoint, we look at collateral as a secondary source of repayment. So as long as we see that a loan is performing—there is sustainment for repayment over the loan term—that type of credit generally will not be criticized. The collateral is only one aspect that we're looking at when we're analyzing credits.

Chairman MOORE OF KANSAS. Mr. Otto?

Mr. OTTO. Yes. We have talked to banks about this, and if a business has a sound plan, I think we definitely encourage them to make those loans. We have some community affairs officers—one of whom is here today listening to this hearing—in Michigan who meet with bankers and community organizations and others to try to put people together in supporting small business loans and all lending.

Chairman MOORE OF KANSAS. Thank you. Mr. Ross?

Mr. ROSS. Yes, only insofar as earlier on in the crisis, I think we had some bankers who were overly optimistic and weren't—in my estimation, they had some rose-colored glasses on in terms of the overall ability of the local economy to bounce back.

I think today we're in a much different place, and I think bankers are much more aggressively looking at credits and doing extensive evaluations looking at the entire picture, all sources of possible support for the loans, so I think we're in a much different place today than we were a year-and-a-half ago.

Chairman MOORE OF KANSAS. Thank you. Congressman Peters, if you would like to ask your questions now, sir.

Mr. PETERS. Thank you, Mr. Chairman. Generally, to kind of distill what I have been hearing here today is we have two problems here in Michigan: First, we have to get the big banks, the big-money-center banks who have already been the beneficiaries of significant amount of taxpayer and Federal Reserve intervention from the Treasury, from the Federal Reserve, to get them to loan in Michigan, which they aren't doing, and the statistics certainly bear that out.

The second is to give our community banks who are here, community banks and credit unions who are in our communities the tools that they need in order to continue to make those loans in the communities in which they operate and which they continue to express their frustration with regulators as putting on the squeeze on them, asking them to take fire sale markdowns on assets, putting them in a real untenable position, so let me just put out one of the—seem to make some sense in the community bankers, put out three conditions or three changes that they thought would make sense, particularly in a place like Michigan, which I think does have a lot of similarities to the farm crisis in the 1980's, which we talked about earlier, and some forbearance may make some sense in order to keep these banks functioning. They suggest that we allow banks to include in their capital all or a significantly higher portion of the 1.25 percent that's currently allowed to be carried in their allowances for loan and lease losses. They also believe we should allow banks to include as part of their capital the face amount rather than the market price, so GSEs, Government-Sponsored Enterprises, that they intend to hold to maturity, and three, allow banks to amortize losses over a 7-to-10-year period instead of the loss in the quarter in which it is experienced.

Give me your reaction to those. Do those conditions seem to make some common sense, particularly in the situation here in Michigan? Mr. Lowe, maybe from the FDIC's perspective first?

Mr. LOWE. I will definitely address the part about amortizing loans over 7 to 10 years and the forbearance. We did have the forbearance program back in the 1980's for the agriculture crisis. We had 200 to 300 banks that participated. FDIC has always been an advocate for open and honest transparency with regard to financial reportings, so at this point in time, we would not be supporting a forbearance program. But I would say again with the guidance on meeting the needs of creditworthy borrowers that we issued in 2008, and the guidance on workouts issued just last month, we are continuing to encourage all of our institutions to lend, continue lending, and continue refinancing credits as long as it is done in a prudent and reasonable manner. We are not going to be looking to criticize credits just because the collateral value has declined. We will continue to stress that bankers analysis of the repayment capacity of the borrower.

Mr. PETERS. My understanding is, in the 1980's, the forbearance program was successful, was reasonably successful, that it prevented banks from going under; is that an accurate assessment or not?

Mr. LOWE. Of the 200 to 300 banks that participated, the majority of them did survive. There were a very small number that did end up failing, so you could couch that as a success, but again, a difference at that point in time was that there were some very stringent guidelines for banks to be able to participate. One of those criterion was that the institution had to have been well-managed and well-run throughout all its history. That is not saying institutions here in Michigan or across the country are not, but there were some very stringent guidelines for banks to be participants.

Mr. PETERS. If we reinstituted some of those guidelines and did something similar to what we did in the 1980's, would that be something—maybe Mr. Otto and Mr. Greenlee could get involved, as well—Mr. Lowe, is that something that you would be open to if we moved in that direction similar to what we did in the 1980's, which was—it seems to me it's cheaper, especially from the FDIC's perspective, as well, to keep these banks operating as opposed to coming in and having to finance that?

Mr. LOWE. We would have to take a close look at forbearance because, again, we do advocate for transparency with regard to the financial statements.

Mr. OTTO. I agree with Anthony. I think that it's something that you could look at, but I was in central Illinois in the Peoria office, and most of my banks that I supervised there were agriculture banks, and while they did participate in the forbearance program, there was a lot of pain involved in that, and I think we would have to be very specific as to people getting in and how they come out of the forbearance program because a lot of the banks that I had were bought by another bank rather than fail.

So I think that we have to be careful about how that is structured. And I agree on the amortization of loss, that was one other point that you had made, I think that's a slippery slope if you amortize losses over, what did you say, a 1- to 7-year period?

Mr. PETERS. A 7- to 10-year period.

Mr. OTTO. Yes, 7, that would be just forgoing or pushing out the problems as opposed to dealing with them right away.

Mr. PETERS. I get a little disconcerted—one more question.

Chairman MOORE OF KANSAS. One more question, certainly.

Mr. PETERS. Okay, the question regarding that—the other is the capital, and it was brought up with the American Bankers' Association that the FDIC's failure resolution policies, it's difficult to raise capital here in Michigan given the—where the economy is and the auto industry, but your resolution policies actually create incentives for investors to wait until the bank has failed as opposed to investing earlier.

Why is that the case? Why can't we change that? We want to keep these banks before they fail, before it starts costing money. Why is that policy in place, and can we change it?

Mr. LOWE. We don't have a policy where we're trying to have that disincentive—of forcing banks to fail.

Mr. PETERS. Well, it's FDIC-guaranteed financing for winning bidders of failed banks or loss-sharing agreements. So you have that guaranteed financing where, obviously, that doesn't exist before a bank fails.

Mr. LOWE. Before a bank fails, when we do have a problem institution, we're working with the institution and advocating that they go out into the market and try to look at finding a merger partner or someone that can buy them. We definitely would rather have the assets of the bank stay in private hands versus coming onto the FDIC's balance sheet. That is something that we do advocate before an institution fails, something that may not be public, but we are all the time working with institutions, working with the regulatory agencies, working with the commissioners for the State-chartered banks trying to arrange and to act to some degree as a broker to find means for an institution to be taken over while it is still open and operating.

Mr. PETERS. Thank you. Thank you for your indulgence, Mr. Chairman.

Chairman MOORE OF KANSAS. Certainly. The Chair next recognizes the Honorable John Dingell. Congressman Dingell?

Mr. DINGELL. Mr. Chairman, I hope this won't be charged against my time, but I want to say thank you for being here, tell you how much we appreciate your assistance and kindness to listen to our constituents, and tell you how much, Mr. Chairman, we're going to miss you when you leave Congress.

Chairman MOORE OF KANSAS. Thank you.

Mr. DINGELL. Mr. Moore is leaving the Congress, and I think it's a prodigious loss to the body and, frankly, to our country.

Chairman MOORE OF KANSAS. Thank you.

Mr. DINGELL. Now, if I could begin my time?

Chairman MOORE OF KANSAS. Yes, sir. Now his time starts.

Mr. DINGELL. I have had on two separate occasions constituents in the supplier business come in and talk to me, and they told me that they have been told clearly that loans were not going to be made in Michigan or loans were not going to be made into the auto industry or to suppliers. Does that, as a matter of policy, does that kind of red-lining have the approval of your respective agencies, Mr. Greenlee, Mr. Lowe, and Mr. Otto?

Mr. LOWE. I can tell you from an FDIC standpoint, we have not indicated to our examiners or anyone on our staff that any specific type of lending should not be done. Again, we're encouraging lending as long as it is prudent and reasonable.

Mr. DINGELL. Apparently, these banks were not hearing it. Do you approve of this, Mr. Greenlee?

Mr. GREENLEE. Absolutely not, sir.

Mr. DINGELL. How about you, Mr. Otto?

Mr. OTTO. No, absolutely not.

Mr. DINGELL. What should we do about it?

Mr. OTTO. I think—

Mr. DINGELL. If one of my constituents comes in, can I call you up and say, Mr. Greenlee, Mr. Lowe, Mr. Otto, these scoundrels are not giving my people money because they're in the auto business? And if I did, what would you do about it?

Mr. GREENLEE. Sir, I have heard these concerns voiced in Washington from Members—

Mr. DINGELL. As my old daddy used to say, "A few good public hangings would help the situation considerably," but I'm going to ask that you give us a response for the record, each of you, if you would, please.

Now, gentlemen, I have—the question has been raised here about focusing on small automobile suppliers, and to do so by creating a public/private capital partnership to lower the risk of lending to the industry. Such proposals have been discussed by me and by bankers and others, it's known as the National Manufacturing Diversification Fund, NMDF. Do you and your agencies favor this legislation or not? Mr. Greenlee? Mr. Lowe? Mr. Otto?

Mr. GREENLEE. Congressman, I will have to look into that and get back to you with a written response.

Mr. DINGELL. Would you respond for the record, please.

Mr. GREENLEE. Yes.

Mr. DINGELL. Mr. Lowe?

Mr. LOWE. I will do the same.

Mr. DINGELL. And you, Mr. Otto?

Mr. OTTO. I will do the same.

Mr. ROSS. I will do the same.

Mr. DINGELL. If I could count on you to deliver that to us, because this is important information.

Now, gentlemen, if—in 25 words or less—if you had the opportunity to tell the Congress what it is we ought to do to increase lending, and whether you have enough authority or appropriations to see to it that we could have an enforceable, workable policy to get money to the community banks, which are really hurting, so that they can get it to the suppliers and small businesses, what would your advice be? Mr. Greenlee?

Mr. GREENLEE. I can speak to what we have done broadly at the Fed along these lines—

Mr. DINGELL. I want to hear what we're going to do in the future, though, since, "What's past is prologue"—

Mr. GREENLEE. And we are continuing to work hard and look closely at—

Mr. DINGELL. But what would you suggest to us that we do?

Mr. GREENLEE. I think alternatives to look at capital for small businesses, different programs are options, and we—

Mr. DINGELL. Could you give us—could you submit for the record, make a clear statement of what you and your agency would suggest to us? That would be immensely helpful, because I'm not satisfied what's happening is doing us enough good.

Mr. Lowe, would you tell us, do you have enough statutory authority, and do you have enough funds, and what should the Congress do about these matters?

Mr. LOWE. Something to consider if we go forward with additional TARP or capital purchase programs—I know that is being proposed by the Administration—is to include some additional incentives for the CDFI's for minority institutions and for institutions that have purchased other failing banks if perhaps there would be some way to build in some incentives in that regard for those institutions to get some lower-cost capital.

Mr. DINGELL. Thank you. Mr. Otto?

Mr. OTTO. I can give you something later for the record, but I do think it does follow in on the capital piece. I think if there are ways we can get capital and make it an incentive for banks to lend, as you're saying, that would be positive. But I can get something more specific for you if that's all right.

Mr. DINGELL. It would be appreciated.

Mr. Ross, do you have any comments?

Mr. ROSS. Yes, just following up on what Tony indicated, I think reopening the TARP program but tweaking it a bit would help by instead of doing a pre-viability, a post-viability standard. So if the bank, with the injection, provided they can come up with some coupling capital, be viable, and they have strong management, I think it has been the hurdle here in Michigan—in many cases because we were at the front end of the recession—many of our banks were in a worse off position to begin with so they couldn't even get into—

Mr. DINGELL. You also are in good part dependent on what is done at the Federal level.

Mr. ROSS. We are.

Mr. DINGELL. And what do you suggest we should do about that?

Mr. ROSS. Well, I think we have a pretty good working relationship, quite frankly, but we at the State level at our agency, try to stake out a very independent position in the sense that if we don't agree with a finding on a joint examination, we won't put our name to it. So we try to maintain our independence, although, we work very closely with our Federal counterparts.

Mr. DINGELL. Gentlemen of the panel, I thank you for your courtesy. I hope I have not offended any of you.

Chairman MOORE OF KANSAS. I think that brings us to the end of our hearing today, and I certainly appreciate the panelists being with us. I want to thank, again, Congressman Gary Peters for inviting our subcommittee to Michigan for this field hearing; and I certainly want to thank my good friend, Congressman Dingell, for participating in this hearing, as well as Mr. Schauer, for being here. He had to leave for another engagement, but he did really contribute a lot to our hearing here today.

I want to thank our witnesses, this panel, and the other panels, for their testimony today. I believe today's hearing gives us a better understanding of the challenges facing small and mid-sized businesses, the urgent need for increased, prudent lending while keeping depository institutions safe and sound. I look forward to working with Congressman Peters, Congressman Dingell, and Congressman Schauer and other Members of Congress to address these difficult challenges.

The Chair notes that some members may have additional questions for our witnesses which they may wish to submit in writing, and if they do, I would ask that the witnesses respond. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

I think this has been a very productive, educational experience, this hearing today, a chance to ask some questions of people who are in a position to give us really good answers, and I think all of us will think about these things when we go back to Congress and relate some of what has happened today and the testimony we have heard from our witnesses today to our colleagues in Congress.

And I hope that our country moves forward and moves out of this horrible fiscal economic situation which has hurt not only our country but our people.

But we are on the mend. I just hope it happens sooner rather than later because a lot of people are still hurting out there right now.

Thanks to everybody here today, and we will at this time adjourn the hearing.

[Whereupon, at 1:50 p.m., the hearing was adjourned.]

# A P P E N D I X

November 30, 2009

**"Improving Responsible Lending to Small Businesses"**
Subcommittee on Oversight and Investigations
House Financial Services Committee
November 30, 2009

Opening Statement from Chairman Dennis Moore [KS-03]

Just last week we learned from the F.D.I.C. that lending by U.S. banks plunged by 3 percent in the third quarter, the largest drop since at least 1984 when this kind of information was first collected. This represents the fifth consecutive quarter in which banks have reduced lending. According to the report, banks reduced the amount of money extended to their customers by $210 billion between July and September, cutting back in almost every category, from mortgage lending to business lending.

What frustrates me the most about this report is the largest banks, the ones that received tens of billions of taxpayer dollars, were responsible for a disproportionate amount – nearly 75 percent – of the lending decline. And this is happening in a quarter when banks posted an aggregate profit of $2.8 billion.

More than any other time, the banking industry needs to be reinvesting those profits in communities and the local businesses found in the Detroit area and throughout the country so we can turn around this economic decline. Economists say small businesses account for up to 60% of new jobs. It's time to put people back to work and invest in the small businesses that can be an engine of economic growth.

I look forward to hearing from the business community here in Michigan so we can have a better understanding of the obstacles small and mid-sized firms continue to face in finding credit. We will also hear testimony from banks and credit unions and the challenges they face in increasing prudent lending while remaining safe and sound. Finally, we will hear from regulators responsible for supervising these firms as they work hard to curb the rise in bank failures.

"Improving Responsible Lending to Small Businesses," the title of today's hearing, is not an easy thing to do in the current economic environment. But I'm hopeful this hearing will help Congress better appreciate these challenges and allow us to consider new ideas and solutions to address this problem.

In a joint statement released over a year ago, bank regulators warned: "If underwriting standards tighten excessively or banking organizations retreat from making sound credit decisions, [it would lead] to slower growth and potential damage to the economy." FDIC Chairman Sheila Bair said last week, "We need to see banks making more loans to their business customers."

I completely agree, and I hope this hearing will drive home a clear message to all stakeholders – banks, credit unions, regulators and the business community. We are all in this together, and until we see an increase in responsible lending to small and mid-sized businesses, I fear the economic recovery our country desperately needs will take too long to materialize.

I look forward to taking the lessons we learn from today's hearing back to Washington, D.C., and working with Republicans and Democrats on thoughtful, bipartisan solutions to this significant challenge.

MCUL
MICHIGAN CREDIT UNION LEAGUE

*Helping Credit Unions Serve Their Members*

November 30, 2009

U.S. House Financial Services Oversight and Investigations Subcommittee
Re: Special Michigan Field Hearing: "Improving Responsible Lending to Small Businesses"

Honorable Members of the U.S. House Financial Services Oversight & Investigations Subcommittee:

It has been a difficult year for financial institutions, however credit unions have continued to lend and support the cities and towns where they do business. Credit unions are not-for-profit, member-owned, locally-driven financial institutions. They did not contribute to the financial crisis through risky lending and have not received any government bailout funds. Michigan's 335 credit unions have added stability and security to the lives of over 4 million members statewide and over 92 million in the U.S. Each one of these credit unions is invested in their communities and continues to keep lines of credit open for their members. This is evidenced in Michigan's tough economy as credit union loan volumes in virtually all categories have shown strong growth in the 12-month period ending June 30, 2009. I would like to take a few minutes to discuss our perspectives on the small business lending environment, the Administration's efforts to modify the SBA lending programs, and the business lending restrictions currently affecting credit unions.

However, I would be remiss if I failed to encourage the Committee and the U.S. Congress to revisit its current policies regarding consumer protection at the expense of the strength and stability of the $60 trillion financial services industry, of which the credit union industry represents a small but important 2 percent of the pie. Proposals that would limit overdraft protection fees and card interchange income as well as those that would increase regulation through the Consumer Finance Protection Agency, extend the Community Reinvestment Act to credit unions or allow discharge of mortgage debt through bankruptcy proceedings are but a few examples of well-intentioned, pro-consumer legislation that taken individually or collectively, will impose added costs and restricted income on small institutions like credit unions that can ill-afford these pressures in the current environment. The economic pressures and these potential new policies may create the unintended consequences of forcing credit unions and small banks out of business or, at the very least, restricting their ability to lend to consumers and small businesses.

Particularly germane to the hearing today, on behalf of the nation's 7,800 credit unions, I urge you and your colleagues to lift the current statutory restriction on member business loans. Credit unions want to lend more. They are ready to lend but many are constrained by this arbitrary restriction that is supported only by the banking industry that does not want the competition from credit unions. Such a policy is a disaster for the small business community and we need your help to bring change by supporting H.R. 3380 "The Promoting Lending to America's Small Business Act" in an effort to increase the capital available to small businesses and economic development by credit

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unions. This bill would amend the Federal Credit Union Act to increase the ability of credit unions to promote small business growth and economic development opportunities.

**Small Business Lending Environment:**
Credit unions help keep their members' savings invested in the local economy, supporting small business expansion and job growth. They commonly provide better rates, more personal service, and the knowledge that the efforts of credit union staff go into member benefits, not-for-profit maximization. Small businesses are finding it increasingly difficult to obtain credit due to the uncertainty that has enveloped the economy in the wake of the sub-prime lending crisis as well as the massive consolidation in the commercial banking arena that has occurred over the last several years. Many small business owners are also seeing their existing credit lines with banks reduced or cut off. The struggles of the CIT Group have only exacerbated the problems small businesses face. Those small business owners who are able to obtain credit often complain that the loan terms are much less attractive than they would be with additional lenders in the market. Small businesses need more options – not fewer.

When credit tightened up in late 2008 and early 2009, credit unions stepped up to continue lending to members and local businesses. Michigan credit unions hold $37.4 billion in assets statewide, including $776 million in small business loans (as of 6/30/09). As other institutions moved away from small business loans, credit union small business lending has risen 17 percent from June 2008 to June 2009. An overall look at the credit union loan picture shows a 5.8 percent growth over a 12-month period from June 2008 to June 2009. This is the highest growth rate in four years for credit unions. (A detailed profile on Michigan and U.S. credit union performance trends is attached.)

Also during the past year, the Big Three automakers struggled with sales as credit remained tight. Credit unions rolled out an innovative partnership called "Invest in America." The program initially offered credit union members' discounts on General Motors and Chrysler vehicles, while letting members know credit unions have money to lend and are willing to lend it. The program has facilitated the sales of more than 200,000 vehicles since its inception, assisting in Michigan's economic recovery efforts. While many would agree that some large lenders have "redlined" the state of Michigan, Michigan headquartered credit unions continue to play a key role in small business economic development as well as helping consumers with vitally important access to credit for all purposes.

**Administration's Efforts to Improve Access to Credit for Small Businesses**
There is no question that Michigan's economy faces historic challenges. Michigan's credit unions are extremely encouraged by the recent efforts of the Administration in an effort to increase SBA lending. We have never seen the SBA move faster to implement change or be more supportive than they have been in 2009. While the credit union industry is pleased that Community Development Financial Institution (CDFI) certified credit unions will be eligible to apply for subordinated debt at rates equivalent to those offered to CDFI banks and thrifts, we would like to see all CUs have the ability to access the proposed 2 percent cost of capital.

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Additionally, while reducing the cost of capital to community banks in the new Capital Purchase Program (CPP) is good, we also believe credit unions should also be eligible to access the 3-percent cost of capital. The higher guaranty percentage and lower fees on SBA substantially increased lending activity, but is set to soon expire. Congress should quickly extend this initiative beyond the discussed February extension date and send a strong and clear message to the small business and lending communities. Increasing the loan size to $5M (for regular "7A" SBA loans) could be helpful, but would be particularly effective if the guaranty percentage stays at 90 percent. At the standard 75 percent guaranty amount the residual risk to a lender for a $5M loan is $1.25M. By their very definition, SBA loans are higher risk. How many lenders are going to make higher risk loans with $1.25M of residual loss exposure?

Increasing the SBA 504 loan limit could have a huge impact on supporting capital investment. These loans have much lower risk to the lender and we would expect the volume would skyrocket. These loans all have to be secured with capital assets, so what we would like to also see is a counter part to the SBA 504 program that would allow the debenture portion to serve as virtual equity in the small business. By aligning the 504 debenture itself to the unsecured portion, lenders could continue to provide conventional senior low risk debt while the SBA's enhancement of the higher risk portion would provide meaningful long term capital to many qualified small businesses. This would be particularly helpful to the many small businesses that have survived these challenging times, see opportunities ahead, but who would otherwise be considered too risky for traditional lending programs.

**Member Business Lending Restrictions Affecting Credit Unions**
Credit unions have been making member business loans (MBL) since the early 1900s. Throughout most of this period there were no limits on the volume of member business loans credit unions could originate or hold. In fact, statutory limits on credit unions' member business lending did not appear until passage of the Credit Union Membership Access Act of 1998 (CUMAA). Michigan's credit unions are in a position to help our small businesses, but are restricted by this statutory cap on business lending. Currently, credit unions can only lend 12.25 percent of the credit union's total assets to member businesses. There was no economic rationale for the limit when it was enacted. And, no rationale exists today.

While Michigan credit unions hold more than three-quarters of a billion dollars in small business loans, their authority could increase by as much as $1 billion if the federally imposed cap on member business lending (12.25 percent of assets) were lifted by Congress. Enabling credit unions to support their communities and make the small commercial loans that large banks are unwilling or incapable to support is a necessary step in assisting Michigan with its economic recovery efforts. Nationally, more than $10 billion in additional capital could become available to small businesses by increasing this cap.

A one-page profile that contrasts credit union business lending to banking institutions is attached. It shows that the average size credit union business loan is approximately $193,270 in the U.S. and

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collectively they hold just over one percent of all outstanding business loans. For the three years ending December 31, 2008, credit unions have experienced a 72-percent increase in business loans compared to 26 percent for other banking institutions. In Michigan, the contrast is even starker with business loans up 103 percent.

In a recent NCUA media advisory issued on November 24, NCUA Chairman Debbie Matz urged the Department of Treasury to support increasing or eliminating the statutory cap on credit union member business lending, and allow NCUA to establish the regulatory parameters. The NCUA believes lending limitations should be regulatory, not statutory. The agency is positioned to set requirements and maintain limits on member business lending, utilizing their direct supervisory knowledge and application of firm safety and soundness standards. The NCUA's correspondence was in response to a request from Treasury Counsel Gene Sperling for additional policy suggestions following last week's Small Business Financing Forum, hosted by Treasury and the Small Business Administration and attended by Chairman Matz.

NCUA Chairman Matz was quoted in the media advisory:
**"Historically, credit unions have been successful at making member business loans. NCUA supports a proper balance of serving business lending needs with a prudent regulatory framework to protect safety of the institutions and of the National Credit Union Share Insurance Fund. NCUA encourages the Department of Treasury and the Small Business Administration to support legislative and regulatory enhancements that will empower well-managed credit unions to make more business loans to members who need them. This will in turn help achieve your over-arching goals to create jobs and grow the economy. "**

In late July of 2009, Congressman Paul Kanjorski (D-PA) introduced H.R. 3380, "the Promoting Lending to America's Small Business Act" in an effort to increase the capital available to small businesses and economic development by credit unions. This bill would amend the Federal Credit Union Act to increase the ability of credit unions to promote small business growth and economic development opportunities. More than thirty other members of Congress have co-sponsored this legislation to date. Today, credit unions have about $30 billion in outstanding business loans, but nearly $18 billion has been extended by credit unions approaching or exceeding the cap. (A small number of credit unions have a "grandfather" exemption from the cap imposed in 1998).

Credit unions with important experience in business lending are approaching their capacity to help business owners absent Congressional action. In addition to the proposed SBA efforts of the Administration, the MCUL encourages Congress and the U.S. Department of Treasury to support legislative and regulatory enhancements to increase the business lending authority of credit unions.

In conclusion, Michigan's strong and vibrant credit union industry is prepared to assist Michigan's small businesses further with their challenges in securing credit. As of June 30, 2009, Michigan

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credit unions are funding more than 6,300 small business loans. Nearly 1,000 of these loans have been funded by credit unions since January 1, 2009, totaling more than $100 million in new small business credit. On behalf of the 335 credit unions across the State of Michigan, I thank you for allowing the Michigan Credit Union League the opportunity to testify on this important topic, and look forward to assisting the administration and Congress with programs and legislation to further our ability to increase small business lending in Michigan.

Sincerely ,

CEO
Michigan Credit Union League & Affiliates (www.mcul.org)
CUcorp, CU Village, HRN

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# Help America's Small Businesses: Support H.R. 3380 -- the Promoting Lending to America's Small Business Act

**Small Businesses are Experiencing Difficulty in Obtaining Credit from Banks**

- Small businesses are finding it increasingly difficult to obtain credit due to the uncertainty that has enveloped the economy in the wake of the subprime lending crisis as well as the massive consolidation in the commercial banking arena that has occurred over the last several years.
- Small business owners are also seeing their existing credit lines with banks reduced or cut off. The struggles of CIT have only exacerbated the problems small businesses face.
- Those small business owners who are able to obtain credit often complain that the loan terms are much less attractive than they would be with additional lenders in the market.
- Small businesses need more options – not fewer.

**Credit Unions Have a History of Making Loans to Their Business-Owning Members**

- Credit unions have been making member business loans (MBL) since the early 1900s.
- Throughout most of this period there were no limits on the volume of member business loans credit unions could originate or hold. In fact, statutory limits on credit unions' member business lending did not appear until passage of the Credit Union Membership Access Act of 1998 (CUMAA).

**Credit Unions are in a Position to Help, but are Restricted by a Statutory Cap on Business Lending**

- Credit unions are subject to a cap on the amount of business loans they can extend which is essentially 12.25% of the credit union's total assets.
- There was no economic rationale for the limit when it was enacted. And, no rationale exists today.
- Credit union MBL loss rates are lower than those on credit union consumer loans and are a fraction of commercial loan loss rates at commercial banks, even during these difficult economic times.

**Credit Unions Need Congressional Action to Continue to Serve Members Who Own Small Businesses**

- Today, credit unions have about $30 billion in outstanding business loans, but nearly $18 billion has been extended by credit unions approaching or exceeding the cap. (A small number of credit unions have a "grandfather" exemption from the cap imposed in 1998).
- Credit unions with important experience in business lending are approaching their capacity to help business owners absent Congressional action.

**Congress Should Give Credit Unions the Opportunity to Serve Their Business-Owning Members**

- Congress has the opportunity to help small business owners by raising the credit union member business lending cap, and encouraging credit unions to lend to their business-owning members.
- Credit unions approaching the cap have the most experience in business lending – experience that facilitates this activity being done in a safe and sound manner.
- CUNA estimates that, if the Promoting Lending to America's Small Business Act was law, credit unions could extend up to $10 billion in additional business loans to their members.

**H.R. 3380, the Promoting Lending to America's Small Businesses Act, Represents Economic Stimulus that Does Not Cost the Taxpayers a Dime and Does Not Expand the Size of Government**

# 2008 United States Business Lending Profile

A recent study by the Small Business Administration finds that bank consolidation has led to a decrease in access to capital for the nation's small businesses.

Member-owned credit unions are a natural choice for business owners faced with these bank consolidation-related pressures. Credit unions are, by definition, locally owned and controlled with local decision-making and a strong service-oriented philosophy.

For many credit unions, however, the current 12.25% member business loan (MBL) limit effectively bars entry into the business lending arena. That's because the startup costs and requirements such as the need to hire experienced lenders exceeds their ability to cover those costs with a small portfolio. Expansion to 20% would thus allow more credit unions to generate the level of income needed to cover startup costs and would expand business lending access to many credit union members.

The MBL provisions in CURIA are not simply an attempt to solve a problem, but also to give flexibility to credit unions that might decide to enter this market in the future.

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At year end there were 7,949 credit unions in the United States serving 90 million members (roughly 30% of the nation's population).

Total Assets:

| Credit Unions | Banking Institutions |
|---|---|
| $825.0 Billion | $13.8 Trillion |

Average asset size:

| Credit Unions | Banking Institutions |
|---|---|
| $103.8 Million | $1.7 Billion |

Market share of deposits:

| Credit Unions | Banking Institutions |
|---|---|
| 9.04% | 90.96% |

---

* 2,026 Credit Unions in the country have outstanding MBLs
  — this represents 24% of the 7,949 credit unions in the country

* Average MBL granted at United States credit unions is: $193,270

* Total amount of business lending:

| Credit Unions | Banking Institutions |
|---|---|
| $33 0 Billion | $3.1 Trillion |

* Market share of business lending:

| Credit Unions | Banking Institutions |
|---|---|
| 1.06% | 98.94% |

* Business loans as a % of assets:

| Credit Unions | Banking Institutions |
|---|---|
| 4.00% | 22.31% |

* 3 Year Change in United States business lending:

| | Credit Unions | Banking Institutions |
|---|---|---|
| Amt | $13.8 Billion | $632.0 Billion |
| % | 71.5% | 25.9% |

CUNA

Source: All financial data is December 2008. Population taken from Census Bureau Estimates for July 2008.
Credit union data is from NCUA. Bank data is from FDIC.
***Produced by CUNA's Economics & Statistics Department.***

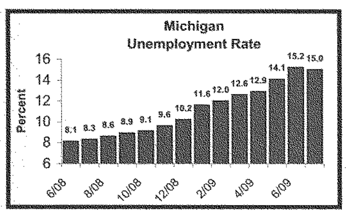
# Michigan Profile

## Second Quarter 2009

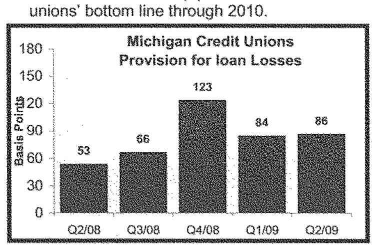
- Credit risk and margin compression weighed heavily on Michigan credit union earnings in the 2nd quarter. With Michigan's unemployment rate climbing in the 2nd quarter, credit union members increased their pace of deposit growth and reduced their pace of loan growth.

- Credit risk is made up of two components: default risk and collateral risk. Default risk relates to a borrower's willingness and ability to repay a debt. Collateral risk relates to the market value of the asset securing the debt. Therefore, the unemployment rate and home price indexes can be useful economic indicators predicting future loan chargeoff rates.

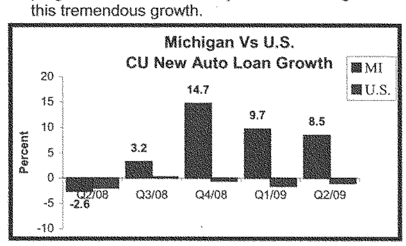
- Michigan's unemployment rate recently hit a cyclical high of 15.2% in June, but then dropped to 15% by July. This is almost double the rate of a year earlier. There were 740,000 unemployed at the end of the 2nd quarter, up from 609,000 three months earlier, according to the Bureau of Labor Statistics. The number of employed in Michigan at the end of the 2nd quarter was 4.129 million, down from 4.232 million at the end of the 1st quarter.




- Michigan credit union provisions for loan loss rose to 86 basis points (0.86 percent) of average assets in the second quarter, up from 53 basis points (bps) a year earlier, but below the national average of 116 bps. Credit unions should expect continued increases in provisions for the rest of the year because provisions historically have lagged unemployment by 3-6 months. This will keep pressure on credit unions' bottom line through 2010.




- Michigan credit union net loan chargeoffs as a percent of average loans appears to have stabilized over the last two quarters. However, the leveling off is probably due to recent fast loan growth, rather than improving credit quality. The loan chargeoff rate for the loan category "all other consumer" declined from 1.40% in the first quarter to 1.34% in the second. This decline is explained by the rapid pace of new auto loan growth (8.5%) in the second quarter compared to a -1% decline nationwide. The Invest in America auto lending program was one of the major factors driving this tremendous growth.

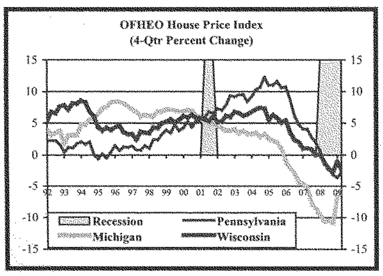



- We can gauge mortgage loan collateral risk by investigating the percentage change in home prices. During the year ending in the 2nd quarter 2009, Michigan home prices declined 5.89%, according to the Office of Federal Housing Enterprise Oversight, a slightly slower

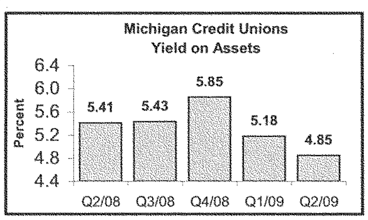
# Michigan Profile

## Second Quarter 2009

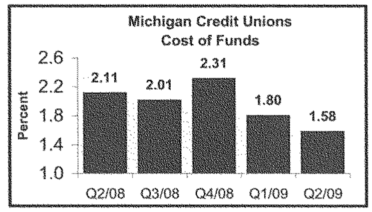
pace than the -6.6% set in the first quarter. Both the 1st mortgage loan delinquency rate and net chargeoff rate have roughly doubled over the last year, (2.06% versus 1.11% for delinquency and 0.57% and 0.29% for net chargeoffs). There is some good news. The pace of home price decline is slowing. But with excess housing inventory plaguing the Michigan market, home prices will likely continue to fall for the next few quarters. This will mean more homeowners underwater with their mortgage, and more homeowners with an incentive to walk away from their homes.



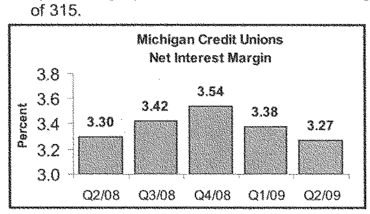

- Michigan credit union asset yields fell 33 bps in the 2nd quarter from the first, as investments and loans repriced down to the remarkably low current short-term interest rates. One year ago, Michigan credit unions reported a yield on assets of 5.41%. In the second quarter of 2009, they reported 4.85%. With the Federal Reserve indicating they will keep short-term interest rates low for an extended period of time, credit unions should expect their yield on assets to decline further into 2010.



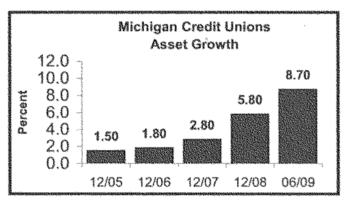

- On a brighter note, Michigan credit union cost of funds dropped 22 bps in the second quarter as credit unions, in an attempt to maintain their net interest margins, aggressively lowered their deposit interest rates.




- With yield on assets falling faster than cost of funds, net interest margins continued their downward slide in the second quarter. Michigan credit unions reported 327 bps of spread, slightly better than the national average of 315.




- Over the last twelve months Michigan credit unions reported asset growth of 8.7%, slightly faster than the national average of 8.2%, and significantly faster than last year's pace of 5.8%. With consumers still in no mood to spend, credit unions should expect strong deposit flows for the next few quarters.



# Michigan Profile

## Second Quarter 2009

### Michigan CU Profile

| | US | Michigan Credit Unions | | | | | Asset Groups - Jun 2009 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Demographic Information** | **Jun 09** | **Jun 09** | **2008** | **2007** | **2006** | **2005** | **< $5Mil** | **$5-$20** | **$20-$100** | **> $100 Mil** |
| 1 Number of CUs | 7,846 | 335 | 344 | 360 | 376 | 395 | 44 | 74 | 135 | 82 |
| 2 Assets per CU ($ mil) | 112.5 | 111.7 | 100.0 | 90.3 | 84.1 | 78.7 | 1.9 | 11.9 | 50.3 | 361.9 |
| 3 Median assets ($ mil) | 15.9 | 36.9 | 32.2 | 27.9 | 27.7 | 27.1 | 1.9 | 11.8 | 46.5 | 225.3 |
| 4 Total assets ($ mil) | 882,352 | 37,422 | 34,409 | 32,518 | 31,639 | 31,088 | 85 | 878 | 6,787 | 29,673 |
| 5 Total loans ($ mil) | 581,314 | 22,810 | 22,363 | 21,231 | 21,040 | 20 346 | 39 | 445 | 3,775 | 18,551 |
| 6 Total surplus funds ($ mil) | 268,310 | 12,947 | 10,447 | 9,675 | 9,117 | 9 384 | 45 | 405 | 2,705 | 9,794 |
| 7 Total savings ($ mil) | 746,239 | 31,654 | 29,016 | 27,292 | 26,466 | 26,100 | 69 | 756 | 5,883 | 24,946 |
| 8 Total members (thousands) | 90,928 | 4,415 | 4,394 | 4,400 | 4,402 | 4,408 | 27 | 186 | 1,060 | 3,142 |
| **Growth Rates** | | | | | | | | | | |
| 9 Total assets | 8.2 | 8.7 | 5.8 | 2.8 | 1.8 | 1.5 | 1.5 | 4.0 | 6.8 | 23.5 |
| 10 Total loans | 4.5 | 5.8 | 5.3 | 0.9 | 3.4 | 7.1 | -0.2 | 3.6 | 4.6 | 16.8 |
| 11 Total surplus funds | 18.5 | 15.3 | 8.0 | 6.1 | -2.8 | -9.1 | 3.4 | 5.1 | 10.8 | 40.9 |
| 12 Total savings | 8.5 | 8.6 | 6.3 | 3.1 | 1.4 | -0.1 | 2.9 | 4.9 | 7.3 | 22.6 |
| 13 Total members | 1.8 | 0.2 | -0.1 | 0.0 | -0.1 | 0.1 | -1.2 | -2.7 | 0.1 | 11.9 |
| 14 *% CUs with increasing assets* | 76.3 | 82.1 | 77.6 | 57.2 | 44.4 | 41.5 | 54.5 | 77.0 | 85.9 | 95.1 |
| **Earnings - Basis Pts.** | | | | | | | | | | |
| 15 Yield on total assets | 503 | 512 | 555 | 580 | 555 | 505 | 441 | 485 | 492 | 518 |
| 16 Dividend/interest cost of assets | 188 | 173 | 219 | 250 | 216 | 159 | 108 | 108 | 140 | 183 |
| 17 Fee & other income * | 197 | 220 | 134 | 146 | 144 | 133 | 115 | 308 | 188 | 225 |
| 18 Operating expense | 320 | 375 | 393 | 377 | 379 | 361 | 438 | 590 | 407 | 361 |
| 19 Loss Provisions | 110 | 87 | 72 | 45 | 39 | 43 | 37 | 42 | 61 | 94 |
| 20 Net Income (ROA) after Stab Exp * | 23 | 33 | 5 | 54 | 65 | 75 | -138 | -49 | -6 | 45 |
| 21 *% CUs with positive ROA ** | 50.7 | 42.7 | 67.7 | 87.5 | 87.2 | 86.1 | 15.9 | 29.7 | 48.9 | 58.5 |
| **Capital adequacy** | | | | | | | | | | |
| 22 Net worth/assets | 10.0 | 11.1 | 11.9 | 12.6 | 12.6 | 12.2 | 18.0 | 13.1 | 12.0 | 10.9 |
| 23 *% CUs with NW > 7% of assets* | 96.0 | 96.7 | 98.3 | 98.6 | 98.9 | 98.2 | 100.0 | 98.6 | 94.1 | 97.6 |
| **Asset quality** | | | | | | | | | | |
| 24 Delinquencies (60+ day $)/loans (%) | 1.58 | 1.79 | 1.68 | 1.35 | 1.08 | 1.09 | 3.87 | 1.75 | 1.84 | 1.77 |
| 25 Net chargeoffs/average loans | 1.15 | 1.08 | 0.83 | 0.61 | 0.55 | 0.61 | 0.84 | 0.62 | 1.00 | 1.10 |
| 26 Total borrower-bankruptcies | 330,400 | 19,666 | 15,805 | 11,465 | 9,530 | 20,631 | 50 | 500 | 3,794 | 15,322 |
| 27 Bankruptcies per CU | 42.1 | 58.7 | 45.9 | 31.8 | 25.3 | 52.2 | 1.1 | 6.8 | 28.1 | 186.9 |
| 28 Bankruptcies per 1000 members | 3.6 | 4.5 | 3.6 | 2.6 | 2.2 | 4.7 | 1.8 | 2.7 | 3.6 | 4.9 |
| **Asset/Liability Management** | | | | | | | | | | |
| 29 Loans/savings | 77.9 | 72.1 | 77.1 | 77.8 | 79.5 | 78.0 | 56.4 | 58.9 | 64.2 | 74.4 |
| 30 Loans/assets | 65.9 | 61.0 | 65.0 | 65.3 | 66.5 | 65.4 | 45.9 | 50.6 | 55.6 | 62.5 |
| 31 Long-term assets/assets | 34.3 | 34.6 | 37.3 | 32.3 | 30.1 | 28.9 | 5.2 | 19.1 | 26.4 | 37.0 |
| 32 Liquid assets/assets | 16.9 | 16.6 | 13.7 | 16.6 | 16.0 | 14.4 | 41.6 | 29.5 | 21.1 | 15.2 |
| 33 Core deposits/shares & borrowings | 36.6 | 34.5 | 34.7 | 35.7 | 38.4 | 40.8 | 81.8 | 56.8 | 44.1 | 31.5 |
| **Productivity** | | | | | | | | | | |
| 34 Members/potential members | 7 | 6 | 6 | 7 | 8 | 10 | 35 | 9 | 7 | 5 |
| 35 Borrowers/members | 50 | 51 | 50 | 50 | 50 | 50 | 26 | 38 | 44 | 54 |
| 36 Members/FTE | 379 | 382 | 379 | 386 | 388 | 392 | 405 | 434 | 398 | 374 |
| 37 Average shares/member ($) | 8,207 | 7,170 | 6,604 | 6,203 | 6,012 | 5,921 | 2,518 | 4,066 | 5,550 | 7,940 |
| 38 Average loan balance ($) | 12,723 | 10,215 | 10,172 | 9,611 | 9,494 | 9,187 | 5,453 | 6,216 | 8,139 | 10,974 |
| 39 Employees per million in assets | 0.27 | 0.31 | 0.34 | 0.35 | 0.36 | 0.36 | 0.80 | 0.49 | 0.39 | 0.28 |
| **Structure** | | | | | | | | | | |
| 40 Fed CUs w/ single-sponsor | 13.9 | 3.3 | 3.5 | 3.6 | 3.5 | 3.5 | 13.6 | 4.1 | 1.5 | 0.0 |
| 41 Fed CUs w/ community charter | 15.1 | 17.9 | 16.9 | 17.2 | 16.2 | 15.4 | 6.8 | 24.3 | 19.3 | 15.9 |
| 42 Other Fed CUs | 32.0 | 15.8 | 16.6 | 17.5 | 18.4 | 19.0 | 25.0 | 10.8 | 17.8 | 12.2 |
| 43 CUs state chartered | 39.0 | 63.0 | 63.1 | 61.7 | 62.0 | 62.0 | 54.5 | 60.8 | 61.5 | 72.0 |

**Earnings, net chargeoffs, and bankruptcies are annualized.**
**Due to significant seasonal variations, balance sheet growth rates are for the trailing 12 months.**
**US Totals include only credit unions that are released on the NCUA FOIA file.**

*Credit Unions did not uniformly report stabilization expense or reversals of the expense.
Therefore some income and expense ratios are not comparable to previous periods.
Use extreme caution when coming to conclusions from this data.
Source: NCUA and CUNA E&S.

# Michigan Profile

## Second Quarter 2009

## Michigan CU Profile

| | US | Michigan Credit Unions | | | | | Asset Groups - Jun 2009 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Growth Rates** | Jun 09 | Jun 09 | 2008 | 2007 | 2006 | 2005 | < $5Mil | $5-$20 | $20-$100 | > $100 Mil |
| 1 Credit cards | 6.0% | 2.7% | 2.0% | 8.0% | 5.4% | 4.6% | -6.0% | 1.2% | 1.6% | 11.2% |
| 2 Other unsecured loans | 1.8% | -2.0% | 0.2% | 4.1% | 5.2% | -0.1% | 2.7% | -4.0% | -4.2% | 7.9% |
| 3 New automobile | -3.8% | 32.6% | 5.1% | -1.7% | -2.7% | 10.4% | -6.7% | 8.4% | 23.4% | 49.0% |
| 4 Used automobile | 5.2% | 14.0% | 8.4% | -2.5% | -5.0% | -0.1% | 0.7% | 2.6% | 6.6% | 23.3% |
| 5 First mortgage | 8.1% | 2.7% | 7.6% | 3.1% | 8.4% | 11.5% | 29.0% | 7.3% | 4.6% | 14.4% |
| 6 HEL & 2nd Mtg | 0.5% | -2.0% | 0.1% | -0.4% | 4.6% | 9.3% | 10.1% | -0.4% | -0.8% | 9.9% |
| 7 Member business loans | 13.6% | 17.3% | 32.4% | 21.3% | 31.3% | 67.8% | -10.3% | 35.5% | 3.8% | 24.3% |
| 8 Share drafts | 4.0% | 0.5% | 2.2% | -0.3% | -4.9% | 3.5% | -10.4% | -2.7% | 0.2% | 6.8% |
| 9 Certificates | 4.1% | 0.5% | 0.2% | 12.8% | 22.0% | 20.3% | 7.4% | 2.9% | 4.8% | 9.7% |
| 10 IRAs | 16.7% | 19.9% | 11.7% | 9.0% | 4.5% | 1.1% | -10.0% | 12.2% | 20.0% | 31.3% |
| 11 Money market shares | 15.3% | 25.0% | 19.4% | 3.0% | -8.9% | -10.0% | -2.4% | 16.5% | 14.1% | 45.9% |
| 12 Regular shares | 8.2% | 4.4% | 3.4% | -6.2% | -4.9% | -5.4% | 3.8% | 4.2% | 6.6% | 22.8% |
| **Portfolio $ Distribution** | | | | | | | | | | |
| 13 Credit cards/total loans | 5.7% | 5.9% | 6.2% | 6.4% | 6.0% | 5.9% | 0.5% | 6.0% | 5.8% | 5.9% |
| 14 Other unsecured loans/total loans | 4.3% | 4.5% | 4.8% | 5.1% | 4.9% | 4.8% | 18.8% | 10.8% | 5.5% | 4.1% |
| 15 New automobile/total loans | 13.8% | 9.7% | 8.5% | 8.5% | 8.7% | 9.2% | 26.5% | 15.1% | 10.2% | 9.4% |
| 16 Used automobile/total loans | 16.9% | 16.1% | 15.4% | 14.9% | 15.5% | 16.8% | 37.6% | 24.1% | 19.4% | 15.2% |
| 17 First mortgage/total loans | 37.5% | 42.9% | 43.2% | 42.3% | 41.4% | 39.5% | 3.5% | 23.5% | 37.2% | 44.6% |
| 18 HEL & 2nd Mtg/total loans | 16.3% | 14.3% | 15.1% | 15.9% | 16.1% | 15.9% | 3.6% | 12.9% | 15.5% | 14.1% |
| 19 Member business loans/total loans | 6.0% | 3.4% | 3.2% | 2.6% | 2.1% | 1.7% | 0.4% | 0.9% | 1.9% | 3.8% |
| 20 Share drafts/total savings | 10.7% | 12.0% | 12.3% | 12.8% | 13.2% | 14.1% | 4.3% | 12.6% | 12.0% | 12.0% |
| 21 Certificates/total savings | 31.5% | 27.9% | 29.9% | 31.8% | 29.0% | 24.1% | 8.6% | 18.0% | 27.8% | 28.3% |
| 22 IRAs/total savings | 9.7% | 8.5% | 8.3% | 7.9% | 7.5% | 7.3% | 2.9% | 6.7% | 7.9% | 8.8% |
| 23 Money market shares/total savings | 19.9% | 26.8% | 25.1% | 22.4% | 22.4% | 24.9% | 2.3% | 14.0% | 18.1% | 29.3% |
| 24 Regular shares/total savings | 26.9% | 23.2% | 22.9% | 23.5% | 25.9% | 27.6% | 77.5% | 44.2% | 32.3% | 20.3% |
| **Percent of CUs Offering** | | | | | | | | | | |
| 25 Credit cards | 51.2% | 75.2% | 74.1% | 72.2% | 72.9% | 74.2% | 2.3% | 71.6% | 90.4% | 92.7% |
| 26 Other unsecured loans | 97.8% | 99.1% | 99.4% | 99.4% | 99.5% | 99.0% | 95.5% | 100.0% | 99.3% | 100.0% |
| 27 New automobile | 94.7% | 97.3% | 96.8% | 96.4% | 96.5% | 97.2% | 79.6% | 100.0% | 100.0% | 100.0% |
| 28 Used automobile | 95.7% | 98.2% | 98.3% | 98.3% | 98.1% | 98.2% | 86.4% | 100.0% | 100.0% | 100.0% |
| 29 First mortgage | 58.4% | 79.4% | 78.8% | 78.1% | 77.4% | 76.7% | 4.6% | 71.6% | 95.6% | 100.0% |
| 30 HEL & 2nd Mtg | 58.0% | 70.5% | 69.8% | 67.5% | 66.2% | 63.5% | 6.8% | 63.5% | 80.7% | 93.9% |
| 31 Member business loans | 27.7% | 43.3% | 42.7% | 34.7% | 31.1% | 28.9% | 4.6% | 23.0% | 45.2% | 79.3% |
| 32 Share drafts | 73.9% | 89.6% | 89.0% | 88.3% | 88.3% | 88.6% | 27.3% | 96.0% | 100.0% | 100.0% |
| 33 Certificates | 77.4% | 86.0% | 85.5% | 85.0% | 83.8% | 84.1% | 34.1% | 82.4% | 97.0% | 98.8% |
| 34 IRAs | 64.5% | 82.7% | 82.6% | 81.7% | 80.6% | 80.8% | 22.7% | 78.4% | 94.1% | 100.0% |
| 35 Money market shares | 43.4% | 69.0% | 67.2% | 65.3% | 63.3% | 60.5% | 4.6% | 55.4% | 81.5% | 95.1% |
| **Penetration** | | | | | | | | | | |
| 36 Credit cards | 14.2% | 15.0% | 15.0% | 15.3% | 15.6% | 15.7% | 0.3% | 10.8% | 14.2% | 15.7% |
| 37 Other unsecured loans | 10.9% | 13.4% | 13.3% | 13.5% | 12.8% | 12.7% | 12.2% | 11.8% | 10.5% | 14.5% |
| 38 New automobile | 6.1% | 3.5% | 3.2% | 3.2% | 3.1% | 3.1% | 3.2% | 2.8% | 2.7% | 3.9% |
| 39 Used automobile | 11.0% | 10.0% | 9.7% | 9.2% | 9.5% | 9.7% | 7.5% | 8.2% | 9.0% | 10.5% |
| 40 First mortgage | 1.8% | 2.4% | 2.4% | 2.2% | 2.2% | 2.0% | 0.1% | 0.9% | 1.8% | 2.6% |
| 41 HEL & 2nd Mtg | 3.0% | 3.0% | 3.1% | 3.1% | 3.1% | 3.0% | 0.2% | 1.2% | 2.1% | 3.4% |
| 42 Member business loans | 0.2% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.0% | 0.0% | 0.1% | 0.2% |
| 43 Share drafts | 46.1% | 46.8% | 46.3% | 46.9% | 45.6% | 45.0% | 9.3% | 33.8% | 42.1% | 49.5% |
| 44 Certificates | 13.8% | 13.8% | 13.7% | 13.5% | 12.1% | 10.3% | 2.5% | 5.7% | 11.2% | 15.3% |
| 45 IRAs | 5.9% | 5.1% | 4.9% | 4.9% | 4.7% | 4.6% | 0.6% | 2.2% | 3.7% | 5.8% |
| 46 Money market shares | 7.6% | 13.5% | 13.0% | 9.1% | 8.7% | 8.7% | 0.4% | 3.8% | 5.7% | 16.9% |

*** Current period flow statistics are trailing four quarters.**

Source: NCUA and CUNA E&S.

# Michigan Profile

Second Quarter 2009

## Michigan CU Profile - Quarterly Results

| | | US | Michigan Credit Unions | | | | |
|---|---|---|---|---|---|---|---|
| | **Demographic Information** | **Jun 09** | **Jun 09** | **Mar 09** | **Dec 08** | **Sep 08** | **Jun 08** |
| 1 | Number CUs | 7,846 | 335 | 340 | 344 | 350 | 353 |
| | **Growth Rates (Quarterly % Change)** | | | | | | |
| 2 | **Total loans** | 1.1 | 1.6 | 5.5 | 4.0 | 2.2 | 2.0 |
| 3 | Credit cards | 3.2 | 2.3 | -1.7 | 5.5 | 2.8 | 1.4 |
| 4 | Other unsecured loans | 1 1 | 0.5 | -1.5 | 3.0 | 2.3 | 0.8 |
| 5 | New automobile | -1 0 | 8.5 | 9.7 | 14.7 | 3.2 | -2.6 |
| 6 | Used automobile | 2 3 | 4.0 | 4.4 | 4.8 | 4 2 | 2.3 |
| 7 | First mortgage | 2.0 | 0.6 | 7.7 | 2.5 | 1 3 | 3.6 |
| 8 | HEL & 2nd Mtg | -1.3 | -2.0 | 5.0 | 3.0 | 1 4 | -0.1 |
| 9 | Member business loans | 3.8 | 4.2 | 4.1 | 9.0 | 3.6 | 9.3 |
| 10 | **Total savings** | 1.8 | 2.5 | 13.3 | 5.4 | -2.6 | 1.8 |
| 11 | Share drafts | 0.1 | 0.1 | 8.2 | 8.6 | -10.0 | 1.4 |
| 12 | Certificates | -1.2 | -0.7 | 7.0 | 4.8 | -3.0 | -2.2 |
| 13 | IRAs | 3.7 | 4.6 | 11.6 | 9.1 | 1.2 | 2.2 |
| 14 | Money market shares | 5.2 | 6.2 | 20.7 | 6.4 | 4.5 | 5.0 |
| 15 | Regular shares | 3.0 | 2.7 | 17.8 | 2.6 | -5.6 | 4.0 |
| 16 | **Total members** | 0.8 | 0.4 | 4.5 | 2.3 | 0.5 | 0.7 |
| | **Earnings (basis points)** | | | | | | |
| 17 | Yield on total assets | 489 | 485 | 518 | 585 | 543 | 541 |
| 18 | Dividend/interest cost of assets | 176 | 158 | 180 | 231 | 201 | 211 |
| 19 | Fee & other income * | 277 | 286 | 139 | 110 | 134 | 142 |
| 20 | Operating expense | 311 | 358 | 377 | 481 | 368 | 364 |
| 21 | Loss Provisions | 116 | 86 | 84 | 123 | 66 | 53 |
| 22 | Net Income (ROA) * | 196 | 218 | -166 | -140 | 42 | 54 |
| 21 | *% CUs with positive ROA* | 54.5 | 46.3 | 10.0 | 67.7 | 75.4 | 80.7 |
| | **Capital adequacy (%)** | | | | | | |
| 22 | Net worth/assets | 10.0 | 11.1 | 10 8 | 11.9 | 12.5 | 12.2 |
| 23 | *% CUs with NW > 7% of assets* | 95.9 | 96.7 | 95 3 | 98.3 | 99.1 | 98.3 |
| | **Asset quality (%)** | | | | | | |
| 24 | **Loan delinquency rate - Total loans** | 1.59 | 1.79 | 1.70 | 1.68 | 1.44 | 1.33 |
| 25 | Total Consumer | 1.55 | 1.65 | 1.68 | 1.86 | 1.75 | 1.71 |
| 26 | Credit Cards | 1.98 | 2.36 | 2.36 | 2.28 | 1.95 | 1.87 |
| 27 | All Other Consumer | 1.49 | 1.54 | 1.57 | 1.79 | 1.72 | 1.68 |
| 28 | Total Mortgages | 1.62 | 1.89 | 1.72 | 1.56 | 1.23 | 1.08 |
| 29 | First Mortgages | 1.70 | 2.06 | 1.88 | 1.66 | 1.25 | 1.11 |
| 30 | All Other Mortgages | 1.43 | 1.41 | 1.27 | 1.25 | 1.17 | 0.99 |
| 31 | Total MBLs | 3.00 | 2.91 | 2.73 | 1.99 | 2 17 | 1.92 |
| 32 | Ag MBLs | 2.13 | 0.00 | 0.00 | 0.00 | 0 00 | 0.95 |
| 33 | All Other MBLs | 3.04 | 2 91 | 2.73 | 1.99 | 2 17 | 1.93 |
| 34 | **Net chargeoffs/average loans** | 1.22 | 1 06 | 1.05 | 1.14 | 0.77 | 0.73 |
| 35 | Total Consumer | 2.04 | 1 70 | 1.68 | 1.88 | 1.46 | 1.37 |
| 36 | Credit Cards | 4.52 | 3.95 | 3.42 | 3.35 | 2.84 | 2.66 |
| 37 | All Other Consumer | 1.69 | 1.34 | 1.40 | 1.63 | 1.22 | 1.14 |
| 38 | Total Mortgages | 0.52 | 0.57 | 0.59 | 0.61 | 0.29 | 0.29 |
| 39 | First Mortgages | 0.23 | 0.37 | 0.43 | 0.41 | 0.18 | 0.19 |
| 40 | All Other Mortgages | 1.18 | 1.19 | 1.07 | 1.17 | 0.62 | 0.60 |
| 41 | Total MBLs | 0.30 | 0 65 | 1.25 | 0.90 | 0.11 | 0.47 |
| 42 | Ag MBLs | 0.00 | 0 00 | -0.01 | 0.00 | 0.00 | -0.03 |
| 43 | All Other MBLs | 0.31 | 0 65 | 1.25 | 0.91 | 0.11 | 0.47 |
| | **Asset/Liability Management** | | | | | | |
| 44 | Loans/savings | 77.5 | 72.0 | 72.6 | 77.0 | 77.6 | 74.0 |

**Earnings & net chargeoffs are annualized quarterly results not seasonally adjusted.**
**Delinquency rates are 60+ day dollar delinquencies. Net chargeoffs are dollar chargeoffs net of recoveries.**
**Totals include only credit unions that are released on the NCUA FOIA file.**

*Credit Unions did not uniformly report stabilization expense or reversals of the expense.
Therefore some income and expense ratios are not comparable to previous periods.
Use extreme caution when coming to conclusions from this data.
Source: NCUA and CUNA E&S.

# Michigan Profile

## Second Quarter 2009

### Michigan Credit Unions

June 2009

**Loan Penetration per 1000 Members**

| | Credit Union Name | Total # loans/ member | Ranking among all US CUs | Ranking among US CUs 03/09 |
|---|---|---|---|---|
| 1 | Michigan First CU | 1067.7 | 42 | 505 |
| 2 | First General CU | 957.6 | 71 | 58 |
| 3 | Shawbox Community FCU | 864.6 | 128 | 116 |
| 4 | Community West CU | 835.7 | 152 | 100 |
| 5 | GR Consumers CU | 824.2 | 171 | 138 |
| 6 | Frankenmuth CU | 820.6 | 182 | 177 |
| 7 | Saginaw Medical FCU | 791.1 | 230 | 238 |
| 8 | Aeroquip CU | 780.3 | 249 | 222 |
| 9 | TBA CU | 778.5 | 254 | 253 |
| 10 | Community First FCU | 756.9 | 287 | 315 |

**Auto Loan Penetration per 1000 Members**

| | Credit Union Name | Total # auto loans/ member | Ranking among US CUs | Ranking among US CUs 03/09 |
|---|---|---|---|---|
| 1 | Auto Body CU | 374.3 | 112 | 112 |
| 2 | TBA CU | 366.6 | 122 | 136 |
| 3 | Michigan One Community CU | 329.4 | 209 | 259 |
| 4 | Community First FCU | 305.2 | 321 | 288 |
| 5 | Shawbox Community FCU | 295.0 | 372 | 353 |
| 6 | Lenco Credit Union | 290.7 | 393 | 384 |
| 7 | Premier Financial CU | 286.2 | 413 | 465 |
| 8 | Financial Plus FCU | 280.9 | 455 | 572 |
| 9 | Cornerstone Community Financial | 245.5 | 833 | 881 |
| 10 | United FCU | 240.1 | 915 | 863 |

**1st Mortgage Loans per 1000 Members**

| | Credit Union Name | Total # FM loans/ member | Ranking among US CUs | Ranking among US CUs 03/09 |
|---|---|---|---|---|
| 1 | Country Heritage CU | 98.1 | 24 | 32 |
| 2 | Marshall Community CU | 93.7 | 30 | 26 |
| 3 | Ukrainian Selfreliance Michigan | 85.7 | 41 | 40 |
| 4 | PAC Federal Credit Union | 85.6 | 42 | 45 |
| 5 | Community First FCU | 74.1 | 70 | 82 |
| 6 | HPC CU | 72.3 | 76 | 79 |
| 7 | Limestone FCU | 70.6 | 83 | 72 |
| 8 | Ukrainian Future CU | 68.2 | 94 | 90 |
| 9 | Tahquamenon Area CU | 65.0 | 105 | 103 |
| 10 | Northland Area FCU | 61.3 | 138 | 116 |

**Home Equity Penetration per 1000 Members**

| | Credit Union Name | Total # HE loans/ member | Ranking among US CUs | Ranking among US CUs 03/09 |
|---|---|---|---|---|
| 1 | Community Financial Members F | 72.8 | 26 | 110 |
| 2 | Farm Bureau Family CU | 57.4 | 68 | 65 |
| 3 | United Educational CU | 54.8 | 86 | 98 |
| 4 | Marshall Community CU | 49.4 | 125 | 118 |
| 5 | Lapeer County School ECU | 45.6 | 158 | 163 |
| 6 | Allegis CU | 43.9 | 183 | 173 |
| 7 | Lake Huron CU | 42.3 | 204 | 387 |
| 8 | UP Catholic CU | 41.8 | 209 | 179 |
| 9 | BestSource CU | 39.5 | 251 | 236 |
| 10 | Dow Chemical ECU | 37.9 | 295 | 288 |

**Average Savings Balance**

| | Credit Union Name | Average Savings/ Member | Ranking among US CUs | Ranking among US CUs 03/09 |
|---|---|---|---|---|
| 1 | Ukrainian Selfreliance Michigan FC | 20,893 | 48 | 50 |
| 2 | Dow Chemical ECU | 19,779 | 60 | 62 |
| 3 | Marshall Community CU | 15,141 | 142 | 142 |
| 4 | Detroit Metropolitan CU | 14,142 | 188 | 229 |
| 5 | Communications Family CU | 14,006 | 200 | 203 |
| 6 | Michigan Schools & Government C | 13,844 | 211 | 208 |
| 7 | Ukrainian Future CU | 13,653 | 218 | 219 |
| 8 | Sterling Van Dyke CU | 13,342 | 237 | 227 |
| 9 | Lapeer County School ECU | 12,810 | 265 | 309 |
| 10 | Flint Area School ECU | 11,840 | 361 | 360 |

**Share Draft Penetration per 1000 Members**

| | Credit Union Name | # SD/ Member | Ranking among US cus | Ranking among US CUs 03/09 |
|---|---|---|---|---|
| 1 | Community First FCU | 1343.3 | 4 | 3 |
| 2 | My Personal CU | 992.6 | 19 | 13 |
| 3 | Telcom CU | 847.1 | 26 | 28 |
| 4 | FM Financial CU | 662.0 | 108 | 155 |
| 5 | Michigan State University FCU | 641.0 | 154 | 150 |
| 6 | Consumers CU | 635.5 | 170 | 160 |
| 7 | University of Michigan CU | 635.1 | 171 | 137 |
| 8 | Dow Chemical ECU | 627.7 | 192 | 209 |
| 9 | MemberFocus Community CU | 626.3 | 196 | 199 |
| 10 | First Community FCU | 616.2 | 220 | 265 |

### Michigan Credit Unions Milestones

June 2009

**Assets**

| Credit Union Name | Current Assets | Three months prior | % Chg |
|---|---|---|---|
| *Exceeded $1 Million* | | | |
| Ann Arbor Postal FCU | $1.01 | $0.95 | 6.5% |
| *Exceeded $5 Million* | | | |
| Lake Superior CU | $5.01 | $4.88 | 3.2% |
| West Michigan Postal Service FC | $5.09 | $4.89 | 4.2% |
| *Exceeded $10 Million* | | | |
| St Cletus CU | $10.08 | $9.85 | 2.3% |
| *Exceeded $25 Million* | | | |
| Limestone FCU | $25.79 | $24.19 | 6.6% |
| Southeast Michigan State EFCU | $25.84 | $24.25 | 6.6% |
| Credit Union Advantage | $26.28 | $24.39 | 7.7% |
| *Exceeded $50 Million* | | | |
| Michigan Tech EFCU | $50.17 | $48.39 | 3.7% |
| Metro Shores Credit Union | $54.45 | $45.43 | 19.9% |
| *Exceeded $100 Million* | | | |
| My Personal CU | $100.15 | $96.18 | 4.2% |
| Community West CU | $102.20 | $95.13 | 7.4% |
| HPC CU | $103.80 | $98.60 | 5.3% |
| Chief Financial FCU | $106.45 | $82.94 | 28.4% |
| *Exceeded $250 Million* | | | |
| Bemen Teachers CU | $250.68 | $241.24 | 3.9% |
| *Exceeded $500 Million* | | | |
| Communications Family CU | $512.70 | $485.23 | 5.7% |

**Members**

| Credit Union Name | Current Members | Three months prior | % Chg |
|---|---|---|---|
| *Exceeded 10 000 Members* | | | |
| River Valley CU | 10,680 | 9,139 | 16.9% |
| *Exceeded 25,000 Members* | | | |
| Catholic FCU | 25,221 | 24,648 | 2.3% |

**Loans**

| Credit Union Name | Current Loans | Three months prior | % Chg |
|---|---|---|---|
| *Exceeded $1 Million* | | | |
| Kramer Homes FCU | $1.02 | $0.97 | 5.9% |
| Saginaw VA Hospital FCU | $1.08 | $0.97 | 11.8% |
| *Exceeded $2.5 Million* | | | |
| Larvan Heritage FCU | $2.57 | $2.35 | 9.2% |
| Lake Superior CU | $2.67 | $2.43 | 9.7% |
| *Exceeded $5 Million* | | | |
| Gogebic County FCU | $5.01 | $4.68 | 7.1% |
| Frankfort Community FCU | $5.04 | $4.95 | 1.9% |
| *Exceeded $10 Million* | | | |
| Alpena Community CU | $10.98 | $8.79 | 24.9% |
| *Exceeded $25 Million* | | | |
| Community Driven CU | $25.20 | $21.50 | 17.2% |
| Sterling Van Dyke CU | $25.22 | $23.59 | 6.9% |
| East Traverse Catholic FCU | $25.42 | $24.73 | 2.8% |
| *Exceeded $50 Million* | | | |
| Affinity Group CU | $50.48 | $49.32 | 2.4% |
| Chief Financial FCU | $52.60 | $47.72 | 10.2% |
| *Exceeded $100 Million* | | | |
| TBA CU | $101.20 | $98.02 | 3.3% |
| *Exceeded $250 Million* | | | |
| Consumers CU | $261.08 | $244.11 | 7.0% |

TESTIMONY OF

THOMAS E. ANDERSON, Ph.D., MBA

SENIOR DIRECTOR, AUTOMATION ALLEY

BEFORE THE

U.S. HOUSE FINANCIAL SERVICES COMMITTEE

NOVEMBER 30, 2009, 11:00AM

LAWRENCE TECHNOLOGICAL UNIVERSITY, SOUTHFIELD, MI

Good afternoon, Chairman Moore and members of the Committee. My name is Tom Anderson, senior director and director of entrepreneurship at Automation Alley. Automation Alley is a technology business association driving the growth of Southeast Michigan's economy through a collaborative culture that focuses on workforce and business development initiatives. I want to express my sincere appreciation to Mr. Peters for the invitation to address the vital issue of the critical credit gap facing emerging technology companies.

Automation Alley acts as a catalyst to enhance the image of Southeast Michigan and to help local technology company's grow their businesses by providing products and services that stimulate and highlight the technological excellence and diversity of our regional economy. Since its founding in 1999, Automation Alley has expanded to include more than 1,000 businesses, educational institutions and government entities from the City of Detroit and the surrounding eight county region. Automation Alley promotes regional prosperity through entrepreneurial and exporting assistance, workforce development and technology acceleration.

Automation Alley's Executive Director, Ken Rogers, also serves on the State of Michigan's 21st Century Jobs Fund Strategic Economic Investment and Commercialization Board. The Board sets the strategic direction for funding competitive edge technologies, approves funding decisions and oversees the administration of the program. Automation Alley and the 21st Century Jobs Fund both seek to foster the growth of Michigan's high-tech economy by investing in the best Michigan research and commercialization opportunities available in vital competitive-edge technology areas such as: advanced automotive; manufacturing and materials; alternative energy; homeland security; defense; and life sciences. It is a pleasure for me to offer testimony today, specifically on Automation Alley's business accelerator and seed investment program.

To date, 25 investments have been made by our three seed investment funds totaling $4.85 million: our Advanced Automotive Seed Fund, initiated in 2004, our Michigan

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Field Hearing
Rep. Dennis Moore, Chair
November 30, 2009

Strategic Fund Contract for an Automotive Technology Business Accelerator program, initiated in 2006 and our Michigan Economic Development Corporation (MEDC) Seed Fund, awarded September, 2008. Additionally, we've also recently expanded our options for early-stage entrepreneurs by offering a microloan program to conceptual companies through the current statewide SmartZone pre-seed fund. Additional VC and private capital exceeding $38 million has been invested in these companies, and employment is over 150.

Automation Alley frequently interacts with our invested companies through a variety of activities including quarterly financial reporting. I serve on the boards of several of these companies and actively provide strategic input and advice to the rest, as does the SBTDC (Small Business and Technology Development Centers) counselor who works with us. Automation Alley employs a Technology Business Client Champion who works on a full-time basis with our seed-invested companies. Our internal Investment Review Board has quarterly reviews of each of the investments, and reports to our Board of Directors. When appropriate, we engage in strategic 'repurposing discussions' with companies, since with startups, things often go somewhat differently than originally planned. We assist with introductions to our members and engage our invested companies in business development programs offered through the Alley, including export trade missions.

Here are some company profiles and highlights:

- DanoTek Motion Technologies, LLC (Canton) – A wind energy company, that recently repaid our initial loan, successfully completed prototype development and testing for the Clipper and is moving forward with growth capital investment of a $1 million bridge loan and up to $4 million to support product development, staffing and equipment. DanoTek's five year sales target is $250 million.
- Critical Signal Technologies, Inc. (Farmington Hills) – Founded by the former president of Guardian Alarm, this health and security monitoring company is currently operating in a dozen states, targeting 50 by the end of 2009. Automation Alley's seed funding enabled them to meet initial milestones required by the venture capital firm prior to investing $6 million, which has now occurred. CST closed on a second $6 million round of VC and in the next 12 months plans to finance expansion and acquisition.
- 3IS, Inc. (Novi) –Recently completed another round of funding totaling $335,000, and is partnered with Menlo Innovations, a leading and innovative software development firm in Ann Arbor, to deliver their next version. They have secured subscriptions from Ford, GM, Chrysler, Fujitsu, and Yazaki, and currently have trial subscription arrangements with TRW and Freescale, among others.
- SpaceForm, Inc. (Detroit) – Located at Wayne State University's TechTown, is also a recipient of 21st Century Jobs Fund investment. SpaceForm has successfully negotiated to broaden the scope of their technology license from Delphi, begun to acquire customers including Honda and Harley Davidson, and

has completed a merger with another welding technology firm to expand their product line.

- ElectroJet, Inc. (Brighton) – Also a 21st Century Jobs Fund funded company. Automation Alley took this company with its small engine fuel injection technology on its trade mission to China in the fall of 2006, and as a result of meetings with carburetor manufacturers supplying the local Chinese motorcycle/scooter industry, POs are now in place for ElectroJet to sell into that market. Additionally, their emission-reducing product is now certified by the China National Lab. The company's current challenge has been locating operating capital to fulfill multi-million dollar purchase orders.
- Limo-Reid Technologies, Inc. (Deerfield) – Automation Alley funded Limo-Reid to compete for the Hybrid Truck Users Forum RFP, which they won against several large competitors such as Eaton Corporation. Limo-Reid received $250,000 from the Michigan SmartZone Pre-Seed Fund and a development contract from the U.S. Army TARDEC for military vehicle demonstrations. Most recently, they were awarded funds through Michigan's 21st Century Jobs competition that led to West Coast VC investment and the repayment of Automation Alley's initial loans.
- ParkingCarma, Inc. (Flint) – Automation Alley's funding joined $250,000 from the Michigan SmartZone Pre-Seed Fund and $250,000 from the Mott Foundation to bring this business and entrepreneur from San Diego to Flint, Michigan. This company currently has a 3-year contract with Cal Trans in San Francisco, as well as a strong relationship with NavTech in Chicago. Limited access to working capital has caused the company to consolidate and downsize operations.
- Cielo MedSolutions, LLC (Ann Arbor) – This firm has successfully commercialized U of M- developed clinical management software for physicians and health systems, and currently has 9 employees. At present, 200,000 patients are managed through CieloClinic, and the company also has an evaluation contract from the Centers for Medicaid and Medicare Services for quality reporting. CieloMed has also attracted Michigan SmartZone Pre-Seed Fund, and private investment from the Altarum Institute.
- CircleBuilder Software, LLC (Franklin) – This firm has successfully created social networking platform, similar to "Facebook," for faith communities with a $250,000 investment from Automation Alley's seed fund. The software has appeal for organizations seeking to provide safe and family-friendly content and enables useful communication and coordination between and among members and the organization. At present over 500 centers of worship are using the platform.
- Ventech, LLC (Wixom) – This firm has developed a revolutionary rapid heating system technology called the Liquid Heat Generator to provide instant heat for comfort and safety inside school buses and for automotive, heavy-duty, emergency, off-highway, transit and military markets. We validated the product,

market and contingent purchase orders from OEMs before investment. However, the firm is challenged to secure working capital to fulfill purchase orders.

**Why does Michigan have the highest unemployment rate in the country?**

Rising productivity at home and abroad, global competition, and restricted access to credit markets have all contributed to the Nation's dismal unemployment. Michigan's unemployment is currently the highest in the country for a few reasons. We have a history of being one of the premier manufacturing states in the country. A history which served us well for many decades, and drove creation of a substantial middle class accessible to even workers with only a high school education. The level of income attainment in Michigan relative to educational level was in the upper quartile of all states. But that's a manufacturing environment which is now only historical, and we are looking to re-invent the state and its workforce to address the future. We've experienced a global disruption and improvement in manufacturing productivity over the last decade, and while that has resulted in the loss of many jobs in Michigan, it's also resulted in job losses in other manufacturing states and in manufacturing centers around the globe, including China.

Our closest peer state in geography as well as industrial demographics, Ohio, has also been hard-hit. Today's modern plant requires only a small fraction of the workers it once did, and those workers require additional skills, often created on a backdrop of additional education. According to the U.S. Bureau of Economic Analysis, only Michigan and Ohio have experienced a decrease in real Gross Domestic Product (GDP) over the period of 2004-2008.[1] Still, we need to remember that although we have high unemployment, if we compare Michigan's state gross product today versus its most recent peak in 2003, our output is down ONLY 4%. And manufacturing is not dead, though it is off over 15%. Michigan can and must promote the emergence of high-technology entrepreneurship and workforce reeducation, or it will lag its competitors in the inevitable economic recovery.

**What policies should the Congress pursue to promote economic recovery?**

Automation Alley supports the Obama Administration's proposal to support further economic recovery and job creation by ensuring that credit is available to small businesses. Of particular interest are the measures that would: raise lending limits on SBA's 7(a) and 504 programs from $2 million to $5 million; raise the manufacturing company limit to $5.5 million, and raise lending limits on the Microloan program from $35,000 to $50,000.

[1] http://www.ssti.org/Digest/Tables/061009t.htm

For companies looking to diversify, the value of existing plant and equipment has fallen and is often inadequate to fund the credit lines needed to move into new markets. Supplier diversification funding from the federal government and the state has helped in the past, but those deployed funds had a narrow technology focus. Many new economy companies do not have the same need for physical plant and equipment. In absence of such easily valued assets, these firms face a distinct disadvantage to garner working capital. I urge the committee to consider mechanisms to address this.

Capital to move from seed stage to VC fundable (or bootstrap able) is scarce. A subordinated debt fund targeted at innovation companies would assist in this regard.

Regarding policies to promote job growth, we would suggest that many of the current efforts are exactly the right thing to be doing. Increased educational access through the "No Worker Left Behind" funding, the market diversification summits hosted by MEDC in cooperation with organizations throughout the state and the three Department of Labor WIRED programs currently active to facilitate worker transition to new industries. The best way to promote job growth is by making opportunities visible and accessible. Key to this is attracting new and growing businesses to Michigan, and perhaps even more importantly, supporting our small businesses that are beginning to gain market share and revenue and that would benefit from increased access to capital and business development resources. Michigan has put in place programs to substantially increase access to seed and pre-seed capital, and to Venture Capital, but the gap persists, and companies that successfully leverage the initial investment of $200-500k are finding it difficult to raise the next pre-VC round of $1M or so.

Michigan has been working to leverage federal investments wherever possible, and Automation Alley supports manufacturing diversification and R&D in collaboration with the U.S. Army Tank Automotive Research Development & Engineering Command (TARDEC), the state's only federal research laboratory. The Detroit Arsenal, as it is known, includes the military's ground vehicle laboratories and procurement arm, TACOM, procures between $14 and $30 billion per year. Michigan has taken two significant steps to capitalizing on this opportunity through the Michigan Defense Contract Coordination Center and the Michigan Procurement Technical Assistance Centers.

Automation Alley has been active in helping Michigan manufacturers to diversify into the defense space. Automation Alley has maintained a Cooperative Research and Development Agreement with the Army since 2002. Automation Alley, itself, is now a defense contractor, having recently been awarded a $1.5 million contract to help identify new manufacturers of replacement parts. Automation Alley was also awarded a $295,000 contract from the U.S. Army TARDEC in 2008 to evaluate its current Small Business Innovation Research (SBIR) contract program, benchmark it against other programs nationally and in different government agencies, and provide recommendations for improvement. There is approximately $25 million available annually from this program to meet Army R&D needs, principally ground transportation related. Automation Alley also works to ensure that small companies become knowledgeable about these available programs.

The infrastructure to launch Michigan's technology future is in place. It is delivering results for taxpayers, and has capacity to do much more with an unfreezing of the capital markets. As these programs continue to create new and dynamic companies, job opportunities will follow.

In closing, the largest gap currently in the funding continuum for start-ups is the availability of follow-on investment for companies moving successfully beyond the seed stage. Those who are beginning to generate revenue but are not yet profitable, and for that reason or others are not candidates for venture capital funding. Michigan has launched programs that have successfully expanded availability of angel/pre-seed funds and venture capital, but the gap persists.

In conclusion, Automation Alley is very appreciative of the attention received by Congress and federal agencies during this catastrophic economic downturn in our state. We believe that a continuum of available funding and local support for technology entrepreneurs remains a vital piece in the economic development puzzle. Thank you very much for your time this afternoon. I would be happy to answer any questions you have.
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**Testimony of the**

**Motor & Equipment Manufacturers Association**

**Before the**

**U.S. House of Representatives Financial Services**

**Oversight and Investigation Subcommittee**

**Michigan Field Hearing on Small Business Lending**

**Monday, November 30, 2009**

**U.S. House of Representatives Financial Services**

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The Motor & Equipment Manufacturers Association (MEMA) represents nearly 700 companies that manufacture motor vehicle parts for use in the light vehicle and heavy-duty original equipment and aftermarket industries. MEMA represents its members through three affiliate associations: Automotive Aftermarket Suppliers Association (AASA), Heavy Duty Manufacturers Association (HDMA), and Original Equipment Suppliers Association (OESA). *(See Attachment 1)*

Motor vehicle parts suppliers are the nation's largest manufacturing sector, directly employing over 685,000 U.S. workers and contributing to over 3.2 million jobs across the country. In fact, automotive suppliers are the largest manufacturing employer in eight states: Indiana, Kentucky, Michigan, Missouri, Ohio, Oklahoma, South Carolina and Tennessee. *(See Attachment 2)* Furthermore, suppliers are responsible for two-thirds of the value of today's vehicles and nearly 30 percent of the total $16.6 billion automotive research and development investment and are providing much of the intellectual capital required for the design, testing, and engineering of new parts and systems.

Without a healthy automotive supplier industry, the United States will lose a significant portion of this country's manufacturing innovation and employment base. The financial health of families and communities nationwide and the promise of a 21st century motor vehicle industry depend on a strong supplier sector.

Over the past eleven months, significant and unprecedented government and industry actions have prevented a collapse of the automotive industry, the largest manufacturing sector in the United States. The industry is positioning itself for a recovery. Forecasters generally estimate 2010 North American vehicle production will increase by two million units or 25 percent in 2010 to approximately 10.5 million units. However, the future expansion, employment, economic contributions and structural viability of the supply base are dependent on continued access to credit. Only through continued coordinated action by industry, the financial community and the government will industry ramp-up and retooling costs be minimized.

MEMA and OESA urge Congress and the Administration to:

- Assure sufficient capital for restructuring, consolidating and diversifying the industry;
- Address the specific needs of small suppliers for sufficient capital for ongoing operations; and

- Create technology-funding programs that support suppliers' long-term product and manufacturing technology innovation.

**The Current Situation**

OESA has identified 48 U.S. suppliers (*See Attachment 3*) that have filed for bankruptcy in 2009. Throughout the year, MEMA, OESA and other industry analysts warned about an impending implosion of the supply base. The risk was real. However, industry, government and the financial communities contributed significantly to prevent this implosion. The following events were critical in preventing such an implosion:

- The U.S. Government provided debtor-in-position (DIP) funding for GM and Chrysler bankruptcies preventing these companies from liquidating
- The U.S. Treasury Auto Supplier Support Program assisted several hundred suppliers
- Virtually all GM and Chrysler production suppliers were granted essential supplier status in bankruptcy and were paid 100 percent of their cure amounts
- GM paid its June 2nd payables on May 28th, supporting the cash flow of many suppliers

- The industry production volume ramp-up was delayed until the Car Allowance Rebate System (cash for clunkers) took effect in July and August
- Major suppliers filing for Chapter 11 obtained DIP financing from traditional and non-traditional sources preventing liquidation of major component suppliers

OESA has no definitive number of suppliers who have closed facilities. However, Plante & Moran estimates that up to 200 suppliers may have liquidated. According to Grant Thornton (*See Attachment 4*), there have not been significantly more bankruptcies because:

- Many suppliers have liquidated without filing for bankruptcy protection
- OEMs have announced plans to source only 50-75 percent of their current supply base on future programs, yet these shifts have not fully occurred
- Many other companies are undergoing out-of-court restructurings with drastic cost-cutting measures

To survive through this period, suppliers have dramatically reduced their cost structures. Surveys of OESA member companies indicate that just between the beginning of 2009 and present suppliers have reduced their estimated North American production break-even point (the level of industry production where they begin profitability) by 1 million units or almost 10 percent. Such dramatic reductions in a short time period are significant. In fact, a recent survey by Watson Wyatt (*See Attachment 5*) shows that automotive suppliers took significantly more radical actions to control human resource costs than the broader, national industries. A few of Watson Wyatt's findings include:

- *Salary Reductions*: 71 percent of OESA member companies implemented versus 16 percent of the national sample
- *Increased Health Care Premiums*: 43 percent of OESA member companies implemented versus 25 percent of the national sample
- *Reduced Employer 401(k) Match*: 57 percent of OESA member companies implemented versus 22 percent of the national sample
- *Mandatory Shutdowns*: 69 percent of OESA member companies implemented versus 18 percent of the national sample
- *Reduced Workweek*: 74 percent of OESA member companies implemented versus 19 percent of the national sample

The transition costs have been significant to these families and communities, as the industry has restructured. For the industry, the restructuring will eventually pay off as, suppliers, on average, should be above their financial breakeven point in 2010. However, currently there is significant pressure on the entire system to access adequate working capital to bring the manufacturing system back up.

Lending continues to be restricted as significant risks – particularly surrounding GM and Chrysler - remain with the industry and lenders alike. While GM and Chrysler have exited bankruptcy, their old businesses continue to be liquidated and significant issues surround the success of the new entities. Grant Thornton (*See Attachment 4*) indentifies these major risks to include:

- The full impact of new equity ownership structures
- The success of new product launches, must-have products, competitive pricing, brand repositioning and improved quality rankings
- The ability to create momentum while industry conditions improve
- Government influence related to new-vehicle development and vehicle emission regulation
- The success of new board seat composition

Overall, lending continues to be constrained because there remains excess capacity based on suppressed demand levels and historically low levels automotive asset valuations. There must be increased access to capital through the entire supply chain – from the largest tier one suppliers to the smallest family-owned firm so that the supply base can:

- Rehire workers and purchase raw materials for production increases
- Retool for new programs
- Restructure internal operations and consolidate external capacities

From being completely frozen in the first quarter, capital availability into automotive has improved through the third quarter of 2009. Examples include the fact that a few suppliers have been able to raise capital in secondary market, additional suppliers have secured DIP and exit financing to facilitate bankruptcy reorganizations and implied interest rates have fallen on automotive paper. While quarter-over-quarter lending improvements have been recorded through 2009 , GE Capital in their Fourth Quarter 2009 Industry Research Monitor: Auto & Auto Parts (*See Attachment 6*) reports that North American syndicated loan volume in the auto and auto parts sector is still down 60 percent year-to-date in September 2009. This, of course, reflects a combination of credit availability as well as company demand.

So, while the situation is improving, is it improving fast enough to support the industry's required new model launches and technology development projects? It is very typical to have a $100 million supplier to support $5 to 10 million in customer tooling costs. Access to capital is the cushion that keeps our supply base liquid. As one of our members said, "I pay my employees weekly, my leases every four weeks, my vendors every six weeks, and my customers pay me every eight weeks." The need for additional capital is evident.

While there has not been a widespread failure of the automotive industrial system as suppliers have restructured or liquidated, issues regarding access to capital are showing up and an inordinate amount of attention is required to keep the supply base running. These are just a few examples from our membership:

- A minority owned supplier which just was announced being added to an OEM joint research development program can only obtain a one-year line of credit
- A smaller metal fabricating business could not get a loan to purchase equipment for a new line to deepen his capital base and keep his Midwest workforce competitive
- A small metal fabricator could not raise additional capital to invest in his Michigan operations and lost the business to Mexico
- A supplier looking for tooling capital for "one of the most secure" OEMs was turned down by traditional lenders and nearly 100 alternative sources of funds
- A very large international resin supplier needs to have daily phone calls with a domestic OEM to review production schedules as the resin supplier has supply issues with a sub-tier supplier in Chapter 11
- A large international supplier could not get an additional loans to purchase specialized equipment to diversify into the aerospace industry as they are up against tight loan covenant terms

These are not examples of supplier capacity in need of rationalization. These are examples of suppliers that are on forward OEM vehicle programs looking to invest in the U.S., compete against global competition and support a profitable, productive domestic auto industry.

According to the OESA Automotive Supplier Barometer September survey (*See Attachment 7*); the majority of all respondents have not seen any significant change in lending practices as judged by metrics from the cost of credit lines to commercial loan interest rates, covenants or collateral requirements. In fact, 23 to 46 percent of the respondents actually saw tightening across these various terms between July and September. When OESA examined the responses by size of company (above or below $500 million in revenue), it is clear that smaller suppliers face the possibility of even tighter terms. This is an industry worth investing in. However, industry production volumes (driven by weak consumer spending) and low levels of asset valuations restrict credit availability even to suppliers that will be needed on the other side of this crisis.

Banks are forming their lists of which suppliers they will work with and those they will not. The OESA Automotive Supplier Barometer survey from July noted that 23 percent of suppliers characterized their banker as actively engaged with them while 19 percent described their banker as actively exiting the industry. We are worried about the 60 percent of the supply base in between that may be indiscriminately cut off from necessary access to capital. In fact, in a recent review of supplier financial distress monitoring systems, a group of OESA chief purchasing officers concluded that predicting the failure of a supplier has more to do with their banking relationships than it does with their operational efficiency or revenue outlook.

Given the parts sector is operating just above 50 percent capacity utilization, we believe that there will be a continued stream of bankruptcies and closures through the rest of 2009. In 2010, we expect ongoing closures as the industry continues to operate at low – albeit increasing – production volumes. Although much of this is to be expected in an industry in transition, adequate capital is necessary to consolidate the industry in a rational, effective manner. Otherwise, production disruptions and failure of companies with critical capabilities may ensue.

**MEMA and OESA believe Congress and the Administration should focus on two areas to lower the risk of potential production disruptions and unintended employment loss as well as to establish longer-term programs to enhance product and manufacturing technology advancement.**

**Focus on Smaller Suppliers**

Given the industry's significant capital requirements and the general mismatch of funding, a steady access to lines of credit and asset-backed loans is essential for the survival of the supply base. For example, many small suppliers invest $2 to $4 million for the design, engineering and tooling for a component on a new vehicle program. However, typically suppliers receive payment for this investment after the launch of production through the piece price of the component. The supplier might not begin receiving any cash flow on their investment for 12 to 24 months and will not completely be reimbursed until the product ends production in another 36 to 60 months. There is a need to provide capital for tooling progress payments. As such, there is an opportunity to create a private-public capital partnership to lower the risk of lending into the industry, particularly in the current period of systemic risk.

Small Business Administration (SBA) programs have been at the foundation of small supplier support for decades. However, the SBA programs are not scaled to assist small automotive component suppliers – particularly suppliers not in a start-up phase. Since suppliers are expected to fund a great deal of the R&D and tooling for new vehicle launches, the net worth and loan amounts have limited utility to our industry. Given the scale the auto industry operates on, this limit is too low to help many suppliers. A recent OESA survey indicated that a $3.5 - $10 million level would be far more helpful to small and medium automotive suppliers. Although small manufacturers should be able to turn to the SBA for loan programs, the current system is simply not designed to meet the needs of manufacturers with substantial raw material, research and development costs. The announced revisions to the SBA program are certainly a step in the right direction.

Given low production volumes and temporary low valuations of industry assets, many loans to long-term viable suppliers are, in the short-term, "out of formula" for banks to consider. One idea the industry– along with several bankers we have spoken to – believes has merit is the Michigan Supplier Diversification Fund. The $12 million program, currently in a "pilot" stage, is being funded by the State of Michigan and addresses three critical impediments to lending:

- *Cash flow* – by purchasing a portion of a commercial credit facility and offering preferred terms for up to 36 months to borrowers.
- *Collateral value* – by supplementing the collateral value on loan requests and depositing cash pledged to the bank.
- *Transitional risk* – by creating a mezzanine (bank of banks) model that can spread risk among several lenders and make both debt and equity investments.

It is important to investigate scaling this type of program up to a national level in all states to support a broad range of manufacturing entities.

**Focus on Technology Funding**

The supplier industry has worked with its customers and developed a wide range of new technologies that promote increased safety and improved fuel efficiency. This work includes:

- Batteries and engines for hybrid vehicles
- Clean diesel engines
- Direct fuel injection systems
- Fuel cell technology
- Lightweight materials
- Innovative glass
- Advanced safety technology

Suppliers are constantly called upon to innovate new products and processes. The industry works daily with vehicle manufacturers to make vehicles safer, stronger, lighter, more fuel efficient, more economical and more environmentally friendly. This innovation takes investment in people, capital equipment engineering and research and development. Governmental R&D programs aimed at the supplier industry are needed.

MEMA and OESA support S. 1617, the IMPACT Act, currently under consideration, and H.R. 3246, the Advanced Vehicle Technology Act, which has passed the House. These bills will provide greater access to funding for the supply base. The technology needs of the auto industry will require suppliers to invest in additional research and development, retool existing facilities and compete with sophisticated technology from overseas.

**Conclusion**

We understand and support the need to consolidate the industry. However, we believe that without sufficient capital to provide a stable environment in which to restructure, the industry and its employees will witness unnecessary disruptions. Without assistance, this country will needlessly lose manufacturing capacity, technology development and jobs.

In conclusion, automotive suppliers remain in a period of significant industry-wide transformation. Smaller firms at the foundation of the supply chain pyramid have shown continued difficulty accessing capital. Given the supply base's significance to the economy and innovation it is imperative that the government, industry and financial communities work together to provide access to credit at reasonable terms. In parallel, given the number of technology options the industry needs to develop and commercialize, all parties must work together to clarify these technology paths and reduce the investment risk for the development and manufacture of these advanced technologies so as to encourage capital back into the auto industry. We welcome an opportunity to work with the Committee.

# Attachment 1

**MEMA Description**

Attachment 1

**About MEMA, OESA, AASA and HDMA**

**Motor & Equipment Manufacturers Association (MEMA):**

http://www.mema.org

Since 1904, MEMA has exclusively represented and served manufacturers of motor vehicle components and systems for the original equipment (OE) and aftermarket segments of the light vehicle and heavy-duty industries. The experience of being a valued partner helps MEMA anticipate the needs of its members and strengthens its ability to predict industry trends accurately and consistently.

MEMA is comprised of three market segment associations: Original Equipment Suppliers Association, Automotive Aftermarket Suppliers Association and Heavy Duty Manufacturers Association.

**Original Equipment Suppliers Association (OESA):**
OESA, the OE market segment association of MEMA, serves members focused on the light vehicle original equipment market.
http://www.oesa.org

Original equipment suppliers manufacture the many parts that are equipped on a new vehicle. In North America alone, the new vehicle parts market is worth approximately $300 billion a year. Original equipment suppliers are among the nation's most competitive and high-tech manufacturers and operate on a global basis, responding to the needs and requirements of their customers across the globe. Moreover, the role these suppliers occupy continues to increase. Suppliers now shoulder the overwhelming majority of the engineering, design and manufacturing of the vehicle. The percentage of content from suppliers is expected to increase to a resounding 70 percent by 2010.

**Automotive Aftermarket Suppliers Association (AASA):**
AASA, a market segment association of MEMA, was created to help MEMA focus on key industry issues that affect its aftermarket member companies.
http://www.aftermarketsuppliers.org

The automotive aftermarket, which consists of companies that produce, distribute, sell and install replacement products, employs approximately 3.7 million Americans. The industry continues to benefit from a larger vehicle population and more miles driven. Sales of products in this industry exceed $250 billion and continue to increase year after year. Consumers have come to depend on the aftermarket for its high level of customer service. People expect their vehicles to be repaired fast and at an affordable price — something the aftermarket excels in. Indeed, the aftermarket industry keeps Americans productive and on the road.

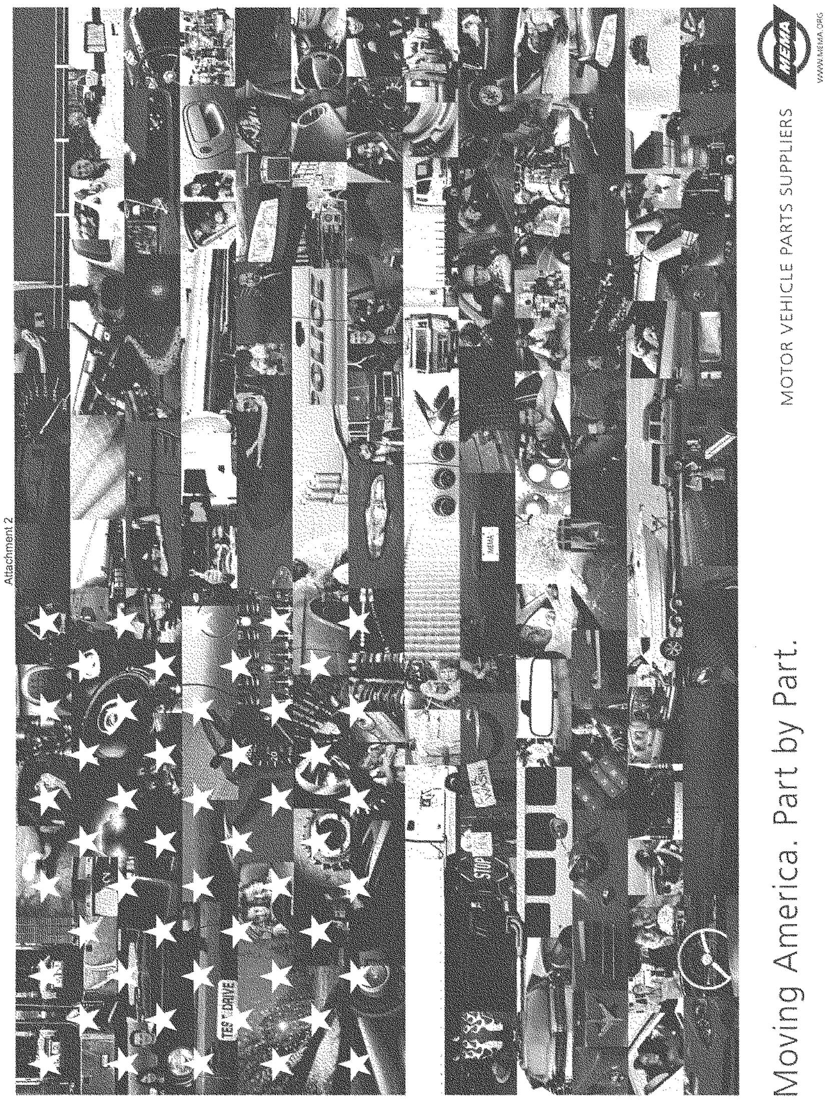
**Heavy Duty Manufacturers Association (HDMA):**
HDMA, MEMA's heavy-duty market segment association, serves member companies in the Class 4 to Class 8 heavy-truck market.
http://www.hdma.org

Heavy-duty trucks keep America's economy rolling. The trucking industry hauls 9.3 billion tons of goods or close to 70 percent of total U.S. freight. About 70 percent of U.S. communities depend solely on trucking for the delivery of goods. The trucking industry also employs more than 9 million Americans nationwide. Moreover, as important as the trucking industry is, trucking component manufacturers are making sure these vehicles are safe. Although there are more than 2.3 million large trucks on the road in the United States today, highway fatalities and injuries involving heavy trucks have steadily decreased over the years even though the number of trucks and miles logged has increased. Trucks also play major roles in exporting and importing goods across borders and helps ensure that the supplier industry's highly effective just-in-time delivery strategies are seamlessly executed.

# Attachment 2

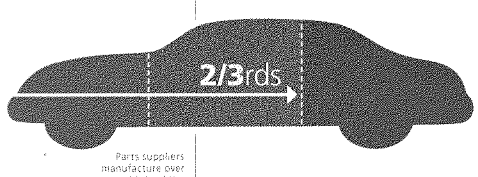
**MEMA Economic Significance Study**

Attachment 2



# Building the Foundation for Transportation. Part by Part.

Transportation is essential to our way of life in this country. We drive to work, take our children to school, and run errands. We take buses across city streets and time zones. We buy groceries that were delivered to our neighborhood store by commercial trucks. We maintain our vehicles with a broad range of services, parts and accessories. Safe, efficient transportation is essential to keeping our economy moving.




Parts suppliers manufacture over two-thirds of the value in today's vehicles.

It is the parts in a vehicle that make it safe and economical to use. The next time you sit in your car, think for a minute about what is inside – the instrument panel, audio system, overhead consoles, climate control system, seats and other components. Think about what makes your car safer and more fuel-efficient – airbags, seatbelts, headlights, brakes, catalytic converters, tires. You begin to understand that the car is really the sum of its parts. In fact, more than two-thirds of the value in today's vehicles and the majority of parts used to service your vehicle over its lifespan are produced by parts suppliers.

**686,000**
Direct workers in the United States

**4.8**
Additional indirect jobs contributed

**3.29 Million**
Total number of jobs the industry impacts

Parts suppliers are the backbone of the vehicle manufacturing industry and the country's manufacturing base. The industry constitutes the largest manufacturing sector in the United States, directly employing nearly 686,000 individuals across the country and contributing to more than 3.29 million jobs. Without the contributions of the nation's parts suppliers, domestic vehicle manufacturing and maintenance would almost certainly grind to a halt, adversely affecting the way we drive and go about our daily lives.

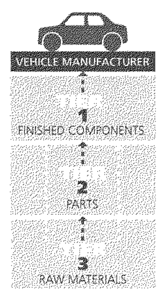
Attachment 2

## Building a 686,000 Person Industry. Part by Part.

Collectively, U.S. motor vehicle parts suppliers are a $388-billion industry, comprising three distinct segments: original equipment, heavy duty and aftermarket.

# $388-Billion Industry

Collectively, the motor vehicle parts supplier industry is a $388-billion industry in the U.S.




The Original Equipment sector is often divided into levels or tiers. Given this illustration, it is easy to see the interdependency of the entire vehicle manufacturing industry.

LIGHT VEHICLE ORIGINAL EQUIPMENT (OE)

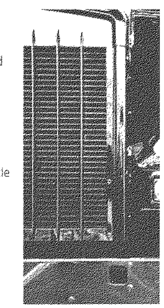
Original equipment suppliers design, engineer and manufacture parts required for the assembly of passenger cars and light trucks. OE suppliers interact directly with vehicle manufacturers, and their success is tied directly to the number of domestically produced vehicles. Each year, more than 300 new light vehicle models are sold in the U.S. – and each model contains 8,000 to 12,000 parts or components.

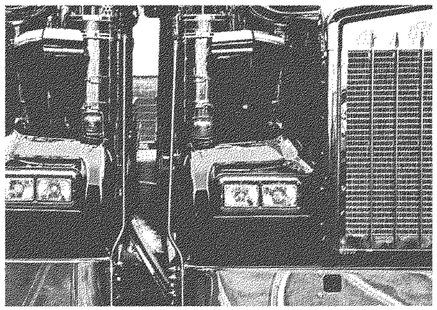
The OE sector is often divided into levels or tiers. Tier 1 suppliers provide full design and engineering support and sell finished components, such as transmissions, seats and instrument panels directly to the vehicle manufacturer. Tier 2 suppliers sell parts like transmission gears, electronics, speedometers and seat covers to the Tier 1 suppliers. Tier 3 suppliers provide raw materials to either of the other suppliers. Each tier depends on the financial health of the other tiers for its survival. Ultimately, all suppliers depend on the financial health of the domestic and foreign vehicle manufacturers at the top of the supply chain pyramid. Given this illustration, it is easy to see the interdependency of the entire vehicle manufacturing industry.

HEAVY DUTY

Passenger cars share the road with commercial vehicles like medium- and heavy-duty trucks, which are used to move the vast majority of goods in the United States. Additionally, we depend on school and transit buses and emergency vehicles to operate in a safe and efficient manner. Heavy-duty suppliers provide the original equipment parts used to manufacturer commercial vehicles and aftermarket replacement parts needed to maintain the vehicles in service and on the road. Heavy-duty suppliers are also responsible for developing most of the technologies that keep these vehicles safe.

Due to shipping costs and vehicle size and weight, most heavy-duty vehicle





| MODE | TONS (MILLIONS) | VALUE (BILLIONS) | TONS | VALUE |
|---|---|---|---|---|
| ALL MODES, TOTAL | 19,487 | $13,052 | 100% | 100% |
| Truck | 11,712 | 9,075 | 60% | 70% |
| Rail | 1,979 | 392 | 10% | 3% |
| Water | 1,668 | 673 | 9% | 5% |
| Air (including truck and air) | 6 | 563 | 0% | 4% |
| Pipeline | 3,529 | 896 | 18% | 7% |
| Parcel, U.S. Postal Service, or courier | 27 | 1,022 | 0% | 8% |
| Other multiple and unknown modes | 567 | 430 | 3% | 3% |

Trucks are responsible for 70% of the value and 60% of the tonnage of commercial freight in the United States.

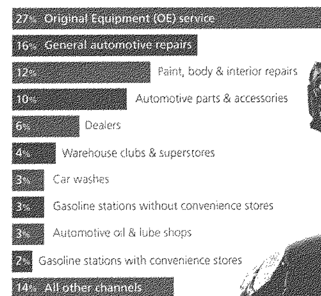
part manufacturing remains in the United States. As with the light-vehicle OE market, suppliers are generally divided into three tiers. This industry is dependent on a healthy economy generating freight ton-miles demand. Supplier success is impacted by economic cycles, changing manufacturer demands, production schedules, tight credit markets, and new diesel emission-reduction requirements that have caused both spikes and steep drops in demand.

## AUTOMOTIVE AFTERMARKET

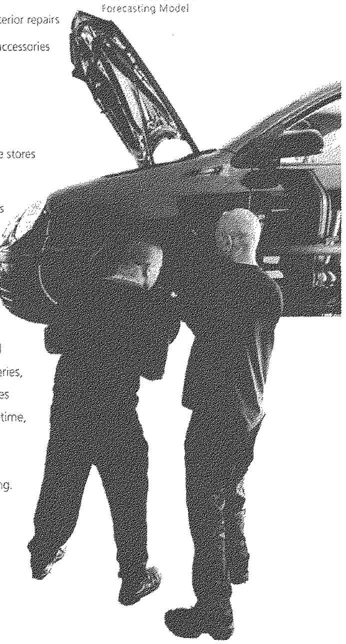
U.S. aftermarket suppliers support the light-, medium- and heavy-duty vehicle markets. The aftermarket segment includes the manufacturing, remanufacturing, distribution, retailing and installation of all vehicle parts, chemicals, tools, equipment and accessories necessary to keep the vehicles on our roads operating safely and efficiently.

Most aftermarket repair work takes place in a vehicle manufacturer's dealership service facility or an independent repair shop. There is also a strong "do-it-yourself" market – individuals who perform their own vehicle maintenance. Considering how many oil changes, brake jobs, batteries, filters, hoses, belts and tires a vehicle requires in its lifetime, it is easy to see why the $244-billion aftermarket segment is steadily growing.

## AFTERMARKET SALES BY CHANNEL



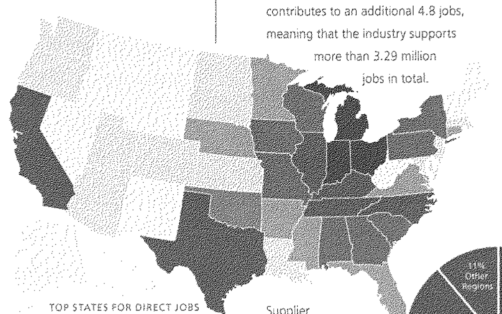

*Aftermarket Sales by Channel;* Joint Motor Vehicle Aftermarket Channel Forecasting Model



Attachment 2

# Supporting Jobs in Our Communities. Part by Part.

The motor vehicle parts supplier industry is the U.S.'s largest manufacturing sector, employing 686,000 workers. In turn, every direct job with a parts supplier contributes to an additional 4.8 jobs, meaning that the industry supports more than 3.29 million jobs in total.



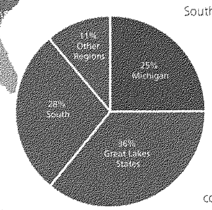
TOP STATES FOR DIRECT JOBS
50,000-100,000+
25,000-50,000
10,000-25,000
5,000-10,000
1,000-5,000
0-1,000

*Importance of Parts Suppliers to Local Manufacturing*
Counting only direct employment, parts suppliers are the largest manufacturing sector in eight states: Indiana, Kentucky, Michigan, Missouri, Ohio, Oklahoma, South Carolina and Tennessee.

Supplier operations are often one of the largest employers in small communities, making parts suppliers the foundation of hundreds of communities across the country.

Suppliers support a vast network of operations that stretches from coast to coast. While 25 percent of supplier facilities are in Michigan, 36 percent are located in other Great Lakes states, 28 percent are in the South, and the remaining 11 percent are in other regions (see chart below).

Most of the supplier industry's growth in recent years has taken place in the South. As foreign-owned vehicle manufacturers established plants in states like Kentucky, Tennessee, Alabama, Mississippi and South Carolina, their suppliers followed. Sixty-seven percent of the parts plants located in the South opened between 1980 and 2006, now constituting a significant part of the economy of Southern states.




Of the 3.29 million jobs supported by motor vehicle suppliers, close to one-third are related to manufacturing. In addition, the complexity of the motor vehicle itself requires a large range of raw materials – including steel, plastics, non-ferrous metals and rubber. Over 290,000 people in these and other industries depend upon a competitive U.S. motor vehicle supplier industry.

| EMPLOYMENT | INTERMEDIATE | EXPENDITURE-INDUCED |
|---|---|---|
| Manufacturing | 145,100 | 235,200 |
| Metals, Minerals, Machinery | 35,200 | 65,300 |
| Fabricated Metal Prod. Mfg. | 44,700 | 43,600 |
| Motor Vehicle Mfg. | 14,500 | 7,100 |
| Plastics, Rubber Prod. Mfg. | 16,200 | 15,100 |
| Electrical or Computer Products | 3,200 | 20,700 |
| Other Manufacturing | 31,300 | 83,400 |
| Non-Manufacturing | 753,000 | 1,466,600 |
| Professional, Tech Services | 141,200 | 86,300 |
| Mgmt. of Companies, Enterprises | 35,800 | 18,200 |
| Admin., Waste Services | 145,500 | 34,900 |
| Wholesale Trade | 83,000 | 60,400 |
| Retail Trade | 75,900 | 220,000 |
| Transp., Warehousing | 52,600 | 83,100 |
| Finance, Insurance | 54,000 | 72,000 |
| Other Services (excl. Govt) | 142,600 | 616,600 |
| Other Non-Manufacturing | 22,800 | 273,100 |
| TOTAL | 898,500 | 1,701,800 |

*Intermediate and Expenditure-Induced Employment*

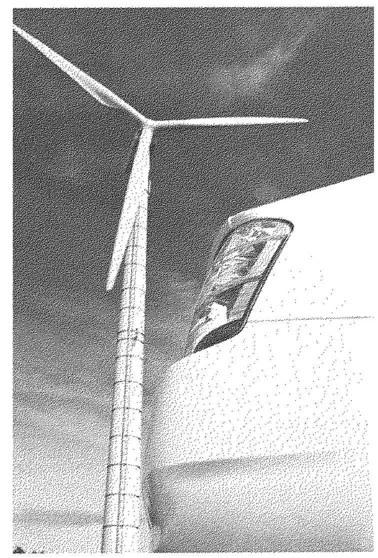
# Sustaining Our Environment. Part by Part

Suppliers have consistently demonstrated a commitment to advancing technologies and practices that will secure a sustainable environment through product innovation and more environmentally friendly manufacturing operations.

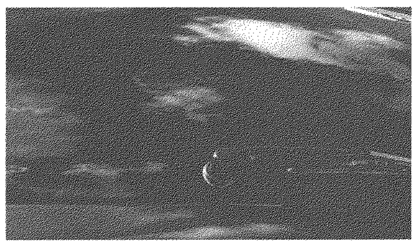
VEHICLE AND ENGINE TECHNOLOGIES

The industry has worked with its customers and developed a wide range of new technologies that promote fuel efficiency. Most of these technologies, with a few exceptions, are available for both passenger vehicles and heavy-duty vehicles, including:

- Batteries and Engines for Hybrid Vehicles. Hybrid vehicles convert the energy normally wasted during coasting and braking into electricity. This energy is stored in a battery until needed by the electric motor. Some hybrids also automatically shut off the engine when the vehicle comes to a stop and restart it when the accelerator is pressed, preventing wasted energy from idling.
- Clean Diesel Engines. Clean diesel can provide 30 to 35 percent better fuel economy and generally emits 25 percent less greenhouse gas than gasoline. Additionally, diesel engines offer more power and greater acceleration than gasoline engines.
- Direct Fuel Injection Systems. Direct fuel injection systems work by first reducing fuel to a fine spray, then injecting it directly into an engine's cylinders without first mixing with incoming air. Greater fuel economy is achieved as the technology allows fuel to burn more efficiently.
- Fuel Cell Technology. Fuel cell vehicles create their own electricity and are propelled by an electric motor, resulting in low or no emissions. Though not likely to be widely available in the near term, fuel cells represent an enormous opportunity and an important technological advance.
- Lightweight Materials. By using lightweight materials such as aluminum, plastic and other composite materials, manufacturers can build more fuel-efficient vehicles without sacrificing safety, durability or comfort. For every 10 percent eliminated from a vehicle's total weight, fuel economy improves by seven percent.



- Innovative Glass. Advances in glass technology allow for cooler vehicle interiors, which reduce the demand for air conditioning, resulting in increased fuel economy and reduced greenhouse gas emissions.



- Anti-Idling Technology. Aimed specifically at commercial vehicles, anti-idling technology reduces the need for drivers to idle their engines on long-haul trips. Anti-idling technology can reduce idling fuel consumption by 60 percent and greatly reduce idling emissions.

VEHICLE MAINTENANCE

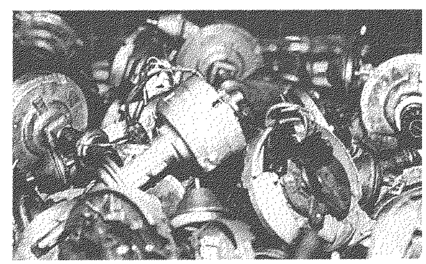
One simple key to conserving fuel and reducing emissions is regular vehicle maintenance. According to the U.S. Department of Energy, vehicle maintenance and repair can improve mileage by an average of 4 percent, while fixing a serious maintenance problem can improve your mileage by as much as 40 percent. These repairs can take a variety of forms.

- Replacing clogged air filters protects the engine and can improve mileage in older vehicles by as much as 14 percent.
- Performing regular engine tune-ups and vehicle maintenance checks improves efficiency because worn spark plugs, dragging brakes, low transmission fluid and transmission problems can all hinder fuel economy.
- Keeping tires properly inflated and aligned can improve mileage by more than three percent.

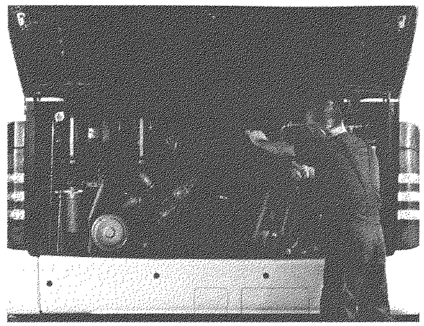
RECYCLING VEHICLE PARTS AND MATERIALS

Recycling is critical for suppliers. The lead and plastic casings in vehicle batteries are recycled to make new batteries. Used oil filters are recyclable because they are made of steel and can be reprocessed into new steel products, such as cans, appliances, vehicles and construction materials.

Additionally, suppliers who remanufacture vehicle parts and components have cut down on energy use, waste disposal and capital and labor inputs. Through remanufacturing, products that are worn, imperfect or discarded are brought to a manufacturing environment where they are cleaned and checked. Reusable product parts are brought up to factory or performance specifications; parts that cannot be reused are replaced. Remanufacturing preserves the value of the original manufacturing – including energy costs and waste



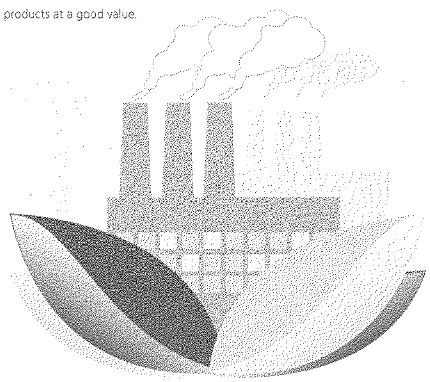
Attachment 2



disposal – which recycling alone cannot do. Remanufacturing also provides a number of benefits to the economic and environmental well-being of this country, including domestic job creation and extending the useful life of consumer products at a good value.

ACCOUNTING FOR THE CARBON FOOTPRINT

Many suppliers adhere to strict product stewardship guidelines. Stewardship involves thinking about a product's lifecycle – from the raw materials that go into a product to how a product, at the end of its service life, can be reused or recycled. Companies are also increasing the use of renewable raw materials, such as natural rubber and plant-based oils and biofuels. Other innovations include conserving basic resources at manufacturing facilities. For example, a supplier company in upstate New York recycles approximately 100,000 gallons of rainwater annually. The rainwater is collected from its 10,000-square-foot roof and stored in cooling towers used to transfer heat generated from the plant's air compressors.



# Supplying Safety Innovation. Part by Part.

Motor vehicle parts suppliers are responsible for more than two-thirds of the value of a new vehicle. In 2006, suppliers were responsible for nearly 30 percent of the total $16.6-billion automotive research and development investment and are providing much of the intellectual capital required for the design, testing and engineering of new parts and systems.

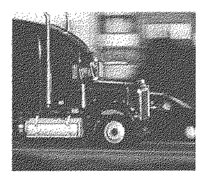
## ADVANCED SAFETY TECHNOLOGIES

Suppliers play a critical role in the advancement of vehicle technologies and will continue to drive initiatives that reduce critical safety problems on America's roads. Two of the most well-known safety innovations are seatbelts and airbags, which combine to save countless lives every day. Suppliers work very closely with the National Highway Traffic Safety Administration (NHTSA) and the Federal Motor Carrier Safety Administration (FMCSA), the government agencies that regulate vehicle safety.

One of the newest safety advances is electronic stability control (ESC), mandated by NHTSA for all passenger cars and light trucks beginning with the 2009 model year. ESC is a system that uses sophisticated sensors to detect and prevent skids or loss of control by automatically adjusting individual brakes to safely reposition the vehicle on its intended course. Suppliers are also responsible for safety advancements like adaptive cruise control, advanced all-wheel drive systems, blind zone management systems, collision detection systems, mirror displays and side alert detectors. All these systems are designed to respond to consumer demand and make vehicles safer.

## HEAVY TRUCK SAFETY TECHNOLOGIES

Suppliers are also developing the technology that keeps heavy-duty trucks and other commercial vehicles safe – a tremendously important task given the volume of trucks on the roads. According to the U.S. Department of Transportation, there were more than 4,800 fatalities and nearly 84,000 injuries resulting from accidents involving heavy-duty vehicles in 2007. FMCSA and NHTSA have identified rear-end collisions, sideswipe accidents, or running off the road or out of the lane as the critical event that caused more than 60 percent of these accidents. Brake problems were a factor in 30 percent of these crashes.



Continually challenged to provide innovation that will reduce accidents, suppliers play a key role in developing technology to address these "critical event" concerns. New technologies include brake stroke monitoring, collision warning, lane departure warning, and stability control. The industry is working with Congress to develop a tax incentive for the purchase of these technologies to spur their use.

## PROTECTING INNOVATION

Additionally, it is very important for suppliers to protect their innovation. According to private-sector estimates, parts suppliers lose an estimated $12 billion worldwide and $3 billion domestically in sales annually to product counterfeiting. Counterfeit parts also present a potential safety concern. The supplier industry is working with Congress and Administration officials to promote legislation that would improve anti-counterfeiting efforts.

## Trillions of Miles Driven, and Still Moving.

Americans drive an astonishing three trillion vehicle miles per year. There is little that we can accomplish without driving. From our daily commute to our weekend getaways, from safely moving commerce to safely driving our children to school; we depend on reliable, safe and efficient transportation.

Motor vehicle suppliers design, engineer and manufacture the quality parts that fulfill our need for efficient transportation, and they are helping improve new vehicle safety, fuel efficiency and emission reductions. Suppliers also provide quality jobs that support our communities. With a constant focus on the future and what will best meet public need, automotive and heavy-duty suppliers continue to keep the country moving, part by part.

Attachment 2

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"Moving America, Part by Part." Based on research undertaken by the Center for Automotive Research on behalf of the Motor & Equipment Manufacturers Association (MEMA); Who Really Made Your Car?, Thomas Klier and James Rubenstein, Upjohn Institute; and information compiled by MEMA, April 2009.

# Attachment 3

**OESA Supplier Bankruptcy List**

Attachment 3

# Supplier Bankruptcy Filings for 2009

| No. | Company | Date | Assets (Millions) | Debt (Millions) | Revenue* (Millions) | Ownership | DIP Financing (Millions) | Components Produced | Bankruptcy Case Number |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Fuba Printed Circuits GMBH | 1/15/2009 | | | $84 | | | Printed circuit boards for automotive, industrial, and telecommunications. | Filed in Germany |
| 2 | Checker Motors Corp | 1/16/2009 | $24.5 | $21.8 | $9.4 | | | Stamping and welding for hood assemblies, rear panels and other parts | U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-42392. |
| 3 | Von Weise Inc. | 1/16/2009 | | | | Sun Capital Partners Inc. | | | U.S. Bankruptcy Court, District of Delaware, No. 09-10186 |
| 4 | Smurfit-Stone Container Corp | 1/26/2009 | $7,450 | $5,580 | $7,500 | | $750 | Corrugated packaging maker (paperboard and paper-based packaging) | U.S. Bankruptcy Court, District of Delaware, No. 09-10235 |
| 5 | Contech LLC | 1/30/2009 | > $100 | > $100 | $222.8 | Marathon Automotive Group, LLC<br>Marathon Asset Management | | Light-weight cast components for cars and trucks it also produces forged steel automotive components, and fabricates tubular steel components. | Contech U.S., LLC - U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-42392<br>Contech, LLC - U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-42405<br>MAG Contech, LLC - U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-42409 |
| 6 | Edscha AG | 2/2/2009 | | | $1,080 (Euros) | The Carlyle Group | | Door hinges and door checks in the Hinge Systems Division; Convertible Roof Systems; Driver Controls - foot controls and parking brakes | Filed in Germany |
| 7 | Mathson Industries | 2/4/2009 | $2 | $8 | | | | Powder injection molded, plastic and ceramic components | U.S. Bankruptcy Court, No. 09-42894-TJT |
| 8 | Fluid Routing Solutions Inc | 2/6/2009 | $10 $50 | $10 - $50 | $211.5 | Sun Capital | $12 | Hoses and other parts | U.S. Bankruptcy Court, District of Delaware, No. 09-10384 |
| 9 | Court Valve | 2/6/2009 | | | | Court Holdings Ltd. of Beamsville | | Manufactures power train transmission components | Filed in Canada |
| 10 | Aleris International | 2/12/2009 | $4,900 | $4,200 | $5.91 | TPG | $1,075 | Producer and recycler of aluminum products | U.S. Bankruptcy Court, District of Delaware, No. 09-10478 |
| 11 | Foamex International Inc | 2/18/2009 | $363.8 | $379.7 | $980 | | $95 | Polyurethane foam for bedding and cushions | U.S. Bankruptcy Court, District of Delaware, No.09-10560 |
| 12 | Wiltec Industries | 2/25/2009 | | | | | | Precision machined parts | U.S. Bankruptcy Court, District of Minnesota |
| 13 | Plastal Group AB | 3/5/2009 | | | | | | Injection molded and surface-treated plastic to the automotive industry | Filed in Sweden |
| 14 | Fabtech Industries, Inc | 3/9/2009 | | | | | | Suspension systems and accessories for off-road | U.S. Bankruptcy Court, Central District of California, No. 09-14185 |
| 15 | Milacron Inc | 3/10/2009 | $523.3 | $752 | $175 | Avenue Capital Group and DDJ Capital Management LLC | $135 | Largest U.S. maker of plastics machinery — also makes industrial fluids used in metal cutting. | U.S. Bankruptcy Court in Cincinnati, Ohio & Canada<br>Filing did not affect DME |
| 16 | Pelican Metal Products | 3/27/2009 | | | | | | Manufacturer of Welded and Painted Shipping Racks and Containers, and Custom Formed Products for Automotive and Related Industries | U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-49428 |
| 17 | Silicon Graphics Inc | 4/1/2009 | $390.5 | $526.5 | $354 | | | Servers and data storage products | U.S. Bankruptcy Court, Southern District of New York, No. 09-11701 |
| 18 | AE Group AG | 4/3/2009 | | | $200 | | | Automotive aluminum die castings | Filed in Germany |
| 19 | Lindenmaier AG | 4/6/2009 | | | $113 | | | Machining and Assembly - Powertrain components | Filed in Germany |
| 20 | Karmann | 4/8/2009 | | | | | | Convertible tops | Filed in Germany |
| 21 | LKI Enterprises, Inc. d/b/a Superlift Suspension Systems | 4/8/2009 | | | | | | Manufactures and supplies suspension systems | U.S. Bankruptcy Court, Western District of Louisiana, No. 09-30674 |
| 22 | B & C Corporation d/b/a JR Engineering | 4/10/2009 | $42 | $25 | | | | Specializing in high-volume production of difficult precision components for both OEM and aftermarket applications | U.S. Bankruptcy Court, Northern District of Ohio, No. 09-51455 |

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# Supplier Bankruptcy Filings for 2009

| No. | Company | Date | Assets (Millions) | Debt (Millions) | Revenue* (Millions) | Ownership | DIP Financing (Millions) | Components Produced | Bankruptcy Case Number |
|---|---|---|---|---|---|---|---|---|---|
| 23 | Noble International Ltd. | 4/15/2009 | $190.8 | $38.7 | | | | Laser-welded tubes, roll-formed products and other steel components | Noble International - U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-51720<br>Tailor Steel America LLC - U.S. bankruptcy Court, Eastern Michigan, No. 09-51752 |
| 24 | LyondellBasel | 4/24/2009 | $33,800 | $30,300 | | Access Industries | $8,000 | Fuels, chemicals and plastics | U.S. Bankruptcy Court, Southern District of New York, No. 09-10021 & 09-10023 |
| 25 | Mark IV Dayco Products | 4/30/2009 | $500 | $1,000 | $1,200 | Sun Capital Partners Inc | $90 | Power transmission, air intake and cooling, and information display systems | Mark IV Industries, Inc. - U.S. Bankruptcy Court, Southern District of New York, No. 09-12795<br>Dayco Products, LLC - U.S. Bankruptcy Court, Southern District of New York, No. 09-12803<br>F-P Technologies Holding Corp. - U.S. Bankruptcy Court, Southern District of New York, No. 09-12805 |
| 26 | Hayes Lemmerz | 5/11/2009 | $1,300 | $1,400 | $1,900 | | $200 | Steel & aluminum wheels | U.S. Bankruptcy Code, District of Delaware, No. 09-11655 |
| 27 | Sanderson Industries | 5/11/2009 | $12.9 | $16.5 | | | | Metal stampings and welded components to Tier 1 and Tier 2 | U.S. Bankruptcy Court, Northern District of Georgia, No. 09-72311 |
| 28 | Visteon Corp | 5/27/2009 | $4,580 | $5,320 | $9,544 | | | Climate systems, interior parts, lighting and electronic systems | U.S. Bankruptcy Court, District of Delaware, Lead Case No. 09-11786 |
| 29 | Metaldyne | 5/27/2009 | | $929 | $1,570 | Asahi Tec Corporation | $18.5 | Components, assemblies and modules for transportation-related powertrain and chassis applications | U.S. Bankruptcy Court, Southern District of New York, Lead Case No. 09-13412 |
| 30 | Fort Wayne Foundry Corporation | 6/3/2009 | $1 - $10 | $10 - $50 | | Cole Pattern and Engineering Co. (who also filed for bankruptcy) | | Aluminum Sand Castings | U.S. Bankruptcy Court, Northern District of Indiana, No. 09-12423 |
| 31 | Tricon Industries | 6/8/2009 | | | $19 | | | Injection molding | Shutdown and auctioned. No filing found. |
| 32 | Advanced Nitriding Solutions, LLC | 6/15/2009 | | | | | | Ion Nitriding for Surface hardening on Crank Shafts & Die Casting Molds | U S Bankruptcy Court, Southern District of Indiana, No. 09-92060 |
| 33 | Kiekert & Nieland | 6/25/2009 | | | $11 | | | Automotive stampings | Filed in Germany |
| 34 | Advanced Accessory Holdings Corporation | 6/26/2009 | $0 | $72 | | Castle Harlan | | Manufactures roof racks, towing hitches and pickup truck rails | U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-60110 |
| 35 | Grede Foundries, Inc | 6/30/2009 | $144 | $148 | | | | Ductile/gray iron and specialty metal parts. One of the largest US cast-iron foundries. | US Bankruptcy Court, Western District of Wisconsin, No. 09-14337 |
| 36 | Global Safety Textiles Holdings LLC | 6/30/2009 | $100 - $500 | $100 - $500 | | International Textile Group Inc | | Automotive airbag fabric | U.S. Bankruptcy Court, District of Delaware, No. 09-12234 |
| 37 | Proliance International Inc. | 7/2/2009 | $50 - $100 | $133.5 | $350 | | | Radiators | Proliance - U.S. Bankruptcy Court, District of Delaware, No. 09-12278<br>Aftermarket LLC - U.S. Bankruptcy Court, Southern District of New York, No. 09-12281 |
| 38 | Advanced Materials Group | 7/2/2009 | | | | | | Advanced metals manufacturing & processing | Advanced Materials Group - U.S. Bankruptcy Court, Central District of California, No. 09-16529<br>Advanced Materials, Inc. - U.S. Bankruptcy Court, Central District of California, No. 09-16548 |
| 39 | Lear | 7/7/2009 | $1,300 | $4,500 | $13,570 | | $500 | Automotive seating systems, electrical distribution systems and electronics | U.S. Bankruptcy Court, Southern District of New York, No. 09-14326 |
| 40 | e International Metals & Chemicals Gro | 7/7/2009 | | | | | | Manufactures and markets non-ferrous metals and chemicals | U.S. Bankruptcy Court, Eastern District of Pennsylvania |

Attachment 3

# Supplier Bankruptcy Filings for 2009

| No. | Company | Date | Assets (Millions) | Debt (Millions) | Revenue* (Millions) | Ownership | DIP Financing (Millions) | Components Produced | Bankruptcy Case Number |
|---|---|---|---|---|---|---|---|---|---|
| 41 | J.L. French | 7/13/2009 | $100 - $500 | $100 - $500 | | | $15 | Aluminum die-cast auto parts | U.S. District Court, District of Delaware No 09 12445 |
| 42 | RathGibson Inc. | 7/13/2009 | > $305 | $319 | | DLJ Merchant Banking Partners | | Global manufacturer of stainless steel and high-alloy tubing products | U.S. Bankruptcy Court, District of Delaware, No 09 12452 |
| 43 | Stant Corp. | 7/27/2009 | $50 - $100 | $50 - $100 | | | $11 | 111-year-old maker of automotive fuel systems, fuel and radiator caps and thermostats | U.S. Bankruptcy Court, District of Delaware, No. 09-12647 (Stant Parent Corp.) |
| 44 | B&C Machine Co., LLC | 7/27/2009 | | | | 96% owned by Bilinovich family<br>rest - B&C Partners LLC | | Manufacture, heat treatment, finishing and assembly of precision-machined components | U.S. Bankruptcy Court, Northern District of Ohio, No. 09-53294 |
| 45 | Vincent Industrial | 7/29/2009 | | | | | | Plastic injection molded components used on virtually every vehicle made in North America | |
| 46 | Cooper-Standard Holdings Inc. | 8/3/2009 | $1,700 | $1,800 | $2,600 | Goldman Sachs and Cypress Group LLC each own 49.2 percent | $175 | Sealing and fluid systems as well as parts to cut down on noise and vibration in cars and trucks | U.S. Bankruptcy Court, District of Delaware, No. 09-12743 |
| 47 | Meridian Automotive | 8/7/2009 | | | | | | Bumpers and lighting parts | U.S. Bankruptcy Court, District of Delaware, No. 09- 12806 |
| 48 | FormTech Industries LLC | 8/26/2009 | $100 - $500 | $50 - $100 | | | | Provider of forged metal components to the automotive light vehicle, heavy truck and industrial markets in North America. | FormTech Industries, LLC - U.S. Bankruptcy Court, District of Delaware, No. 09-12964<br>FormTech Industries Holdings LLC - U.S. Bankruptcy Court, District of Delaware, No. 09-12965 |
| 49 | Auto Cast Inc. | 8/24/2009 | $1-$10 | $1-$10 | | | $4 | Aluminum and zinc die cast | U.S. Bankruptcy Court, Western District of Michigan, No. 09-9958 |
| 50 | Alternative Distribution Systems, Inc. (ADS Logistics) | 9/2/2009 | $0-$.05 | $10-$50 | | | | A metals targeted logistics company that facilitates supply chain management of metals products | U.S. Bankruptcy Court, District of Delaware, No. 09-13099 |
| 51 | Gertz Schiele Holding GMbH | 9/11/2009 | | | | | | Automotive forgings | U.S. Bankruptcy Court, Eastern District of Michigan |
| 52 | Accuride Corporation | 10/8/2009 | $682 | $847 | | | | Steel & aluminum wheels | U.S. Bankruptcy Court, District of Delaware, No. 09-13449 |
| 53 | Recticel Interiors North America LLC<br>Recticel North America Inc. | 10/30/2009 | $10 - $50 | $100 - $500 | $28 | | | Coatings for interior components including dashboards and door panels | Recticel Interiors North America LLC: U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-73419<br>Recticel NA: U.S. Bankruptcy Court, Eastern District of Michigan, No. 09-73411 |

Other known failures
May & Scofield did not file Chapter 11, but were foreclosed by Bank of America January, 2009
Player Wire Wheels Ltd., filed chapter 11 on March 21, 2009

Updated Nov. 11, 2009
Note: This listing and details are as complete as currently known by OESA.

* At the end of the last fiscal year

# Attachment 4

**Grant Thornton Automotive Industry Review**

Attachment 4

Grant Thornton

# Automotive Industry Review

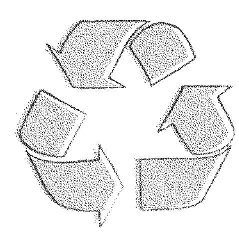
**Corporate Advisory Services** 2009 Volume 3

## 3rd Quarter U.S. Automotive Highlights

**Impact from CARS Program**

The Car Allowance Rebate System (aka "CARS" or "Cash for Clunkers") was a temporary program under which the government provided up to $4,500 for the purchase of a new, more fuel-efficient passenger vehicle or pickup truck from a participating dealer when an older, less fuel-efficient vehicle was traded in.

The original program began on July 24, 2009 and was expected to end at the earlier of 1) Nov. 1, 2009 or 2) when the first $1 billion in funds appropriated by the National Highway Traffic Safety Administration (NHTSA) was exhausted. Given the popularity of the program, the original $1 billion ran out in one week. On July 31, another $2 billion in funds was approved with the expectation that the program would last until Labor Day. These funds were exhausted early as well, causing the program to conclude on Aug. 24, 2009.



Despite various criticisms about the program, it proved to be generally successful. The U.S. Department of Transportation reported that nearly 700,000 so-called clunkers were taken off the roads and were replaced by somewhat more fuel-efficient vehicles. Rebate applications totaled about $2.9 billion by the program's deadline, just under the $3 billion provided by Congress to run the program.

continued>

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# 3rd Quarter U.S. Automotive Highlights (continued)

According to government reports, the program had the following impact:

Macroeconomic Impact
- Boosted economic growth in the third quarter by 0.3–0.4 percentage points on an annualized basis, thanks to increased auto sales in July and August.
- Will sustain the increase in GDP in the fourth quarter because of increased auto production to replace depleted inventories.
- Created or saved 42,000 jobs in the second half of 2009, with those jobs expected to remain available after the program's close.
- Each U.S. state reported more than $2 million in voucher amounts, and nine states exceeded $100 million; these amounts equate to millions of dollars generated in state and local sales tax revenue, much of it in states that perhaps needed it most.

Environmental and OEM Impact
- 84 percent of consumers traded in trucks, and 59 percent purchased passenger cars.
- New vehicles purchased through the program had an average of a 58 percent (or 9.2 mpg) fuel economy improvement compared with the average fuel economy of the vehicles traded in (trade-in average: 15.8 mpg; purchased average: 24.9 mpg).
- More than half of the top 10 new vehicles purchased under the program were manufactured in the United States.

**CARS program share vs. YTD share**

| | CARS program | 2009 YTD | Diff. |
|---|---|---|---|
| Asian | 58.6% | 48.3% | 10.3% |
| Domestic | 38.6% | 44.6% | -6.0% |
| European | 2.7% | 7.2% | -4.5% |

Note: Figures may not add up to 100% due to rounding
Source: U.S. Department of Transportation (August 26, 2009)

- Significant U.S. light-duty vehicle inventory drawdown: a drop in days supply levels from 48 days in August to 30 days in September — the lowest inventory level the industry has seen in years.
- Asian OEMs captured nearly three out of five vehicles purchased under the program, with Toyota, Honda and Nissan leading the growth of Asian share.
- Hybrid vehicles accounted for 4.5 percent of new vehicles purchased under the program, compared with 3 percent of all new-vehicle sales in June 2009.
- Of those who purchased a hybrid vehicle, 77 percent traded in an SUV or a truck.

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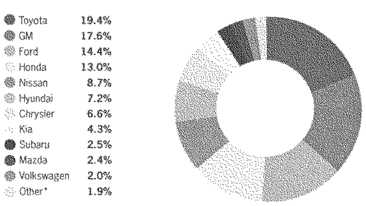
**CARS program mix by automaker**




*Other includes Suzuki, Mitsubishi, Mini, Smart and Volvo
Source: U.S. Department of Transportation (August 26, 2009)

# 3rd Quarter U.S. Automotive Highlights (continued)

**CARS purchases vs. trade-ins**

| Top 10 vehicles purchased |
|---|
| 1 Toyota Corolla |
| 2 Honda Civic |
| 3 Toyota Camry |
| 4 Ford Focus FWD |
| 5 Hyundai Elantra |
| 6 Nissan Versa |
| 7 Toyota Prius |
| 8 Honda Accord |
| 9 Honda Fit |
| 10 Ford Escape FWD |

| Top 10 vehicles traded-in |
|---|
| 1 Ford Explorer 4WD |
| 2 Ford F150 Pickup 2WD |
| 3 Jeep Grand Cherokee 4WD |
| 4 Ford Explorer 2WD |
| 5 Dodge Caravan/G. Caravan 2WD |
| 6 Jeep Cherokee 4WD |
| 7 Chevrolet Blazer 4WD |
| 8 Chevrolet C1500 Pickup 2WD |
| 9 Ford F150 Pickup 4WD |
| 10 Ford Windstar FWD |

Source: U.S. Department of Transportation (August 26, 2009)
Note: See text for ranking methodology

- All of the top 10 vehicle models traded in were domestic models, whereas eight of the top 10 vehicle models purchased were foreign models.
- The government reported the top vehicles purchased under the program by drive configuration — just as the Environmental Protection Agency (EPA) does — to rate fuel economy. Edmunds.com indicated that this type of reporting misrepresented actual sales results. For instance, the Ford Escape comes as a front-wheel drive (FWD), an all-wheel drive (AWD) and a hybrid version. The government reported statistics for those versions individually, whereas Edmunds.com counted all versions of the Ford Escape as one and the same. Further, Edmunds.com reported that the Ford Focus, Ford Escape, Honda Civic, Ford F-150 and Toyota Camry were the top five program buys. In contrast, the government reported that the Toyota Corolla and Honda Civic earned the top spots.

## GM and Chrysler Post-Bankruptcy Fallout: New Stakeholder Implications

Prior to the bankruptcies of Chrysler and GM, the implosion of the supply base and the significant reduction in vehicle sales were feared as the most significant risks to each company's sales outlook and/or future viability.

Now that GM and Chrysler have emerged from bankruptcy, it is evident that both processes were well-planned and well-executed.

- Protections were in place to allow cure payments to flow to the suppliers.
- While a reduction in sales was observed, consumers did not completely abandon the automakers' products.
- Government oversight, financing and warranty backstop helped these companies through the process.

At the same time, questions surrounding new implications for stakeholders remain. Key issues include:

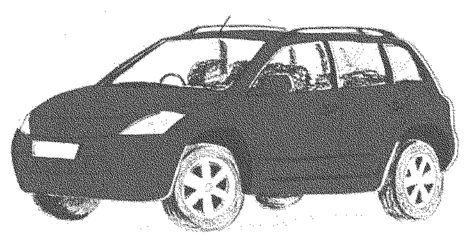
- The full impact of new equity ownership structures.
- Government influence related to new-vehicle development and vehicle emission regulations.
- The success of new board seat composition.
- The government's exit strategy.
- Taxpayer recovery.

continued>

**Shareholder implications**

| Item | 2009 Chrysler | 2009 GM |
|---|---|---|
| U.S. gov't ownership/equity | 8.0% equity | 60.8% equity |
| Debt pre-filing | $9B | $54B |
| Debt post-filing | $7B | $26B |
| UST debt (post-filing) | $6B | $12B |
| Board of directors (UST appointees) | 4 of 9 | 4 of 13 |

Source: Grant Thornton



# 3rd Quarter U.S. Automotive Highlights (continued)

**Supply Base Consolidation — Not Exactly**

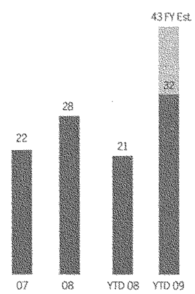
Given that pre-recession sales levels are not expected to be regained until the 2013 timeframe — and given that foreign-headquartered suppliers are capturing a larger portion of the market — a significant reduction of North American (N.A.) production capacity must be achieved.

Over the course of the year, GM has announced a number of plant closures and the termination of its Saturn and Pontiac brands, as well as more than 2,000 of its dealerships, by 2010. Throughout its bankruptcy process, Chrysler cut many assembly, stamping and powertrain facilities and shed almost 800 dealerships. As facilities and dealerships close their doors, so too will suppliers, although not to the same extent.

Through the first half of 2009, the number of significant automotive bankruptcy filings increased by more than 50 percent compared with last year. A number of big-name suppliers have recently filed for bankruptcy, including Visteon, Lear, J.L. French, Stant Corp., Cooper-Standard and Meridian Automotive Systems. Given the current environment, why have there been so few Chapter 7 and Chapter 11 bankruptcy filings? There are a number of key reasons:

1. Many suppliers have liquidated without filing for bankruptcy protection.
2. OEMs have announced plans to source only 50–75 percent of their current supply base on future programs, yet these shifts have not fully occurred.

**Select major auto bankruptcy filings**
(Number of U.S. bankruptcy filings, YTD through September)




Sources: Grant Thornton and Capital IQ

3. Many other companies are undergoing out-of-court restructurings with drastic cost-cutting measures, including but not limited to: a) forced use of vacation (paid and unpaid); b) 32 hour work week (i.e., 20 percent pay cut); c) benefit reductions; and d) reduced research and development spending.
4. Some suppliers will migrate down the chain to the Tier 2 level.

Certainly, the adaptability of the supply base was largely unanticipated. To what extent this will create issues later for OEMs remains to be seen.

**Domestic OEMs Receive In Excess of $400 Million in New Battery Grants**

On Aug. 5, 2009, grants totaling $2.4 billion were awarded to 48 new advanced battery and electric drive projects under the American Recovery and Reinvestment Act. Selected by the Department of Energy, these projects will accelerate the development of U.S. manufacturing capacity for advanced batteries as well as electric drive components and vehicles. Ford, General Motors and Chrysler were among the largest beneficiaries of the grants, collectively receiving more than $400 million for research and development work.

The Department of Energy reported that the new awards cover the following areas:

- $1.5 billion in grants to U.S.-based manufacturers to produce batteries and their components and to expand battery recycling capacity;
- $500 million in grants to U.S.-based manufacturers to produce electric drive components for vehicles, including electric motors, power electronics and other drive train components; and
- $400 million in grants to purchase thousands of plug-in hybrid and all-electric vehicles for test demonstrations in several dozen locations; to deploy such vehicles and evaluate their performance; to install electric charging infrastructure; and to provide education and workforce training to support the transition to advanced electric transportation systems.

continued>

# 3rd Quarter U.S. Automotive Highlights (continued)

**Renewed Focus: Segmentation Gaps**
Throughout the past year, the automotive industry has undergone some extremely challenging times caused by a sequence of unprecedented events. A new way of managing the business has emerged, causing a much sharper focus on achieving results while reducing costs under a condensed timeframe. The ability to compete in today's market starts with a product portfolio (as shown below) and a market share assessment. See page 19 for a market share analysis.

The table below outlines each major U.S. automaker's product portfolio by segment and can be used to identify potential opportunities by segmentation gap, as highlighted in orange.

Consumer preferences and regulatory requirements point to increased demand for smaller, more fuel-efficient vehicles, namely compact vehicles, CUVs and select premium model offerings. These segments tend to be areas where the Asian OEMs dominate. As the industry moves in this direction, we expect these segments will lead future growth. As competition enters into these segments, Asian OEMs may see minor market share adjustments.

At the same time, sales of larger vehicles, including SUVs and pickups, have declined, yet these products are clearly not dead. Indeed, the domestic automakers continue to perform well in these segments; however, their product portfolios are still too highly reliant on these offerings. Going forward, the ability to maintain and/or grow share will come down to product placement in areas where brand and segmentation expansion makes sense. For non-premium companies such as Chrysler, it may not make sense to launch vehicles under the Chrysler brand name into certain compact premium segments. In contrast, for premium automakers such as BMW, whose marketing slogan is "The Ultimate Driving Machine," it may not make sense for the BMW brand to cross over into certain non-premium compact vehicle segments. Therefore, this transition applies to all OEMs — not just the domestics.

Not every new-product launch into a new segment has proven successful. The Asian OEMs have launched various "loss leaders," which include the Honda Ridgeline, Toyota Tundra, Nissan Titan, Toyota FJ Cruiser, Honda Element and Scion xD. Despite the limited success of these products, these automakers have still managed to maintain or grow market share as a result of their expansion into segments where coverage did not exist before.

Certainly filling segmentation gaps is easier said than done. However, as competition becomes more fierce, all major U.S. OEMs will be forced to address these gaps. In the next few years, we expect segmentation results to look significantly different, due in part to increased contract manufacturing, global platform sharing, alliances and brand extensions. •

**Product portfolio segmentation**

| | Compact | | | | | Compact premium | | | Midsize | | | | | | Midsize premium | | | | Large | | | | Large premium | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Basic | Conv. | Sporty | CUV | SUV | Conv. | Sporty | CUV | Conv. | Sporty | CUV | SUV | Pickup | Van | Conv. | Sporty | CUV | SUV | Conv. | SUV | Pickup | Van | Conv. | Sporty | Pickup | SUV |
| GM | x | x | | x | | x | | | x | x | x | | x | | x | x | x | | x | x | x | x | x | | x | x |
| Ford | | x | | x | | x | | | x | x | x | x | x | | x | | x | | x | x | x | x | x | | | x |
| Chrysler | | x | | x | x | | | | x | x | x | x | x | x | | x | | | x | | x | x | | | | |
| Toyota | x | x | x | x | x | x | | | x | x | x | x | x | x | x | x | x | x | x | x | x | | x | | | x |
| Honda | x | x | | x | | x | x | x | x | | | x | x | x | x | | x | | | | | | | | | |
| Renault-Nissan | x | x | | x | x | x | x | x | x | | x | x | x | x | x | x | x | | x | x | x | | | | | x |
| Hyundai | x | x | x | x | | | | | x | | x | x | | x | x | | | | x | | | | | | | |
| VW-Porsche | | x | x | x | | x | x | x | x | | | | | x | x | x | x | | | | | | x | x | | |
| Daimler | x | | | | | x | x | x | | | | | | | x | x | x | | | | | | x | x | | x |
| BMW | | x | | | | x | x | x | | | | | | | x | | x | | | | | | x | x | | |

Sources: Grant Thornton and J.D. Power and Associates
Note: Orange highlight denotes potential opportunities by segmentation gap

Attachment 4

# Financial/Economic Snapshot

## Economic Metrics

In the third quarter, various national economic indicators have pointed to the beginnings of an economic recovery. Still, a number of economists have reported that consumers were not as optimistic about their own finances, and employment conditions remain problematic. Although various economic data sources offer mixed interpretations, the directional outlook across economists is largely the same.

- The recession is over, according to the Bureau of Economic Analysis Q3 2009 gross domestic product (GDP) advance estimate which shows that the economy grew at a rate of 3.5 percent. By some estimates, more than 90 percent of the growth was driven largely by one-time government stimulant measures, including the "Cash for Clunkers" program and tax credits for first time home buyers.

- To weather the recessionary environment, businesses have taken creative approaches to cost cutting. Companies have significantly reduced capital expenditures and research and development investment, which has helped boost margins. Given this positive momentum and low inventory levels, we expect GDP levels to continue to show growth in the fourth quarter of this year.

| Economic metrics | Period | Value | Chg. |
|---|---|---|---|
| **GDP growth rate** | | | |
| Current period (advance quarterly estimate) | Q3-09 | -3.5% | 2.8% |
| Prior period (quarterly final) | Q2-09 | -0.7% | |
| **Inflation (CPI - unadjusted)** | | | |
| Current period (YoY) | Sep-09 | 0.1% | -0.1% |
| Prior period (YoY) | Aug-09 | 0.2% | |
| **Inflation (PCE, 1 mo. annualized)** | | | |
| Current period (monthly) | Sep-09 | 1.4% | -2.8% |
| Prior period (monthly) | Aug-09 | 4.2% | |
| **U of M consumer confidence** | | | |
| Current period (monthly) | Sep-09 | 73.5 | 7.8 |
| Prior period (monthly) | Aug-09 | 65.7 | |
| Prior period (prior year) | Sep-08 | 70.3 | |
| **ISM - PMI index** | | | |
| Current period (monthly) | Sep-09 | 52.6 | -0.3 |
| Prior period (monthly) | Aug-09 | 52.9 | |
| **Unemployment rate (seasonally adjusted)** | | | |
| Current period (monthly) | Sep-09 | 9.8% | 0.1% |
| Prior period (monthly) | Aug-09 | 9.7% | |
| Prior period (prior year) | Sep-08 | 6.2% | |
| **Leading indicators index** | | | |
| Current period (monthly) | Sep-09 | 1.0% | 0.4% |
| Prior period (monthly) | Aug-09 | 0.6% | |
| **Lagging indicators index** | | | |
| Current period (monthly) | Sep-09 | -0.3% | -0.1% |
| Prior period (monthly) | Aug-09 | -0.2% | |

Source: Grant Thornton

- In September, the **PMI** — an indicator generally viewed as a key measure of economic health in the manufacturing environment — registered 52.6 percent, indicating that economic activity in the manufacturing sector expanded (although at a slow pace) for the second consecutive month, according to the latest Manufacturing ISM *Report on Business*.

continued>

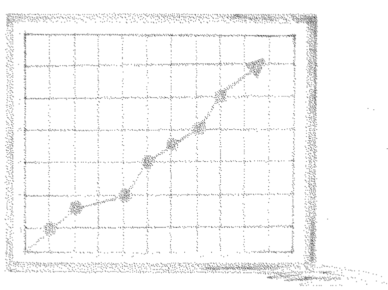
# Financial/Economic Snapshot (continued)

- **Overall unemployment levels** spiked to 9.8 percent, an increase of 3.6 percentage points over the prior year, with the total number of people unemployed now at 15.1 million.

  Since the start of the recession in December 2007, the number of unemployed has increased by 7.6 million and the unemployment rate has risen by 4.9 percentage points. The sectors most affected by the recession — manufacturing and construction — continued to lose jobs in September.
  - Manufacturing employment declined by 51,000 jobs over the month and has declined by 2.1 million jobs, or 27.6 percent of the total number of unemployed, since the start of the recession.
  - Construction employment dropped by 64,000 jobs in September and has decreased by 1.5 million jobs, or 19.7 percent, since December 2007.
  - Other sectors incurring steep September job losses include: retail trade — lost 39,000 jobs and government — lost 53,000 jobs.
  - Employment in the health care sector increased by 19,000 jobs in September; the industry has gained 559,000 jobs since the beginning of the recession.
- **Unemployment levels** increased across the majority of U.S. states in August 2009. As of the publication date, September 2009 results by state had not been reported.
  - Twenty-seven states and the District of Columbia posted month-over-month (MoM) unemployment rate increases, 16 states registered rate decreases, and seven states reported no change. So far this year, the unemployment rate has increased in all 50 states and the District of Columbia.
  - Fourteen states and the District of Columbia reported jobless rates at or higher than 10.0 percent:

| | | |
|---|---|---|
| 1. | Michigan | 15.2 |
| 2. | Nevada | 13.2 |
| 3. | Rhode Island | 12.8 |
| 4. | California | 12.2 |
| 5. | Oregon | 12.2 |
| 6. | South Carolina | 11.5 |
| 7. | District of Columbia | 11.1 |
| 8. | Kentucky | 11.1 |
| 9. | North Carolina | 10.8 |
| 10. | Ohio | 10.8 |
| 11. | Tennessee | 10.8 |
| 12. | Florida | 10.7 |
| 13. | Alabama | 10.4 |
| 14. | Georgia | 10.2 |
| 15. | Illinois | 10.0 |

  - Michigan's unemployment rate, which is more than five points higher than the national average, is the highest unemployment rate of any state in 25 years. (The last state to post an unemployment rate of 15.0 percent or higher was West Virginia in March 1984.)
  - Nine states posted unemployment rates of at least 9.0 percent but less than 10.0 percent.
  - Nine states reported unemployment rates above 8.0 percent but less than 9.0 percent, bringing the total number of states with an unemployment rate above 8.0 percent to 33 states.
  - North Dakota had the lowest unemployment rate, at 4.3 percent for the month. •



**Advisory Services Viewpoint**

For the remainder of 2009, the economic environment will remain challenging. We continue to expect that any further increase in unemployment, especially in the most highly populated U.S. states, will offset any modest decline in jobless claims or growth in job postings elsewhere. Therefore, we do not expect a significant improvement in the jobless rate in the near term. This, along with other pressures, including oil price volatility and stricter credit standards, will continue to weigh heavily on personal spending. Looking forward, seasonal holiday sales may indicate the strength of consumer spending heading into the winter.

Attachment 4

# On the Radar for Next Quarter

### Fuel Economy Standards – Will the Auto Shows Enhance Clarity of Product Focus?

Rising fuel prices, environmental regulations and changes in government policy over the last several years have prompted automakers to make significant changes to the powertrain systems that propel their vehicles. These challenges are not limited to the U.S., but are growing issues in foreign countries as well.

For the past few decades, gasoline has dominated most markets as the primary automotive fuel. However, Europe has experienced a large-scale transition to diesel and Brazil has migrated to various gasoline and alcohol blends. The move towards alternative fuels and enhancement of engine and transmission systems with more advanced technologies here in the United States is old news, although numerous recent public announcements by OEMs surrounding production readiness are giving the transition a new sense of tangibility.

The industry is becoming significantly more global, with many of these technologies now expected to be produced and sold on a global scale. As observed from the news coming out of the 2009 Tokyo Motor Show, the main theme of the show was fuel efficiency. Japanese OEMs are taking fuel economy and emissions regulations seriously and illustrated their commitment to these future technologies.

With the four major North American auto shows -- Detroit, Chicago, New York and Los Angeles — scheduled to occur over the next six months, the big questions remain will domestic OEMs also be able to establish themselves as leaders in advanced technology production readiness and will the products displayed at these events capture the purchasing interest of the average consumer? Since cost is the most-cited reason among buyers for not purchasing a hybrid vehicle, will new technologies be priced within the reach of the average consumer?

As we enter into the auto show season, this certainly could be the start of the most powertrain-focused period the industry has ever experienced.

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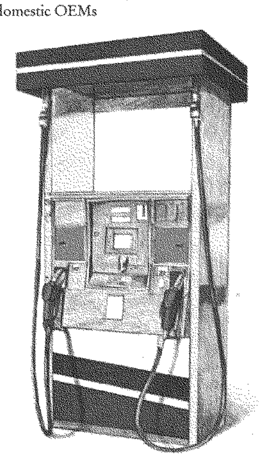


# On the Radar for Next Quarter (continued)

**OEMs – Will They Meet Future Government Regulations?**

The Environmental Protection Agency (EPA) drafted its version of fuel economy rules setting a 35.5 mpg standard for vehicles by 2016. In effect, the proposed rules would identify the requirements for automakers, and the role of state governments and the Obama administration to regulate vehicle emissions.

Under the plan, the EPA is developing a strategy to limit vehicle emissions as well as balance environmental concerns against certain regulations that negatively impact struggling sectors of the U.S. economy. In fact, the proposed strategy prevented California and more than a dozen other states from setting their own standards, a move many warned could create unnecessary challenges for automakers and consumers.

The rules will provide automakers a clear direction about how the new standards can be met, starting in 2012. The plan also allows the industry and the public an opportunity to comment on the proposal for at least 90 days after the release date. However, the administration is expected to set final rules by next spring.

- Each manufacturer has a unique CAFE target based on the composition of its vehicle fleet.
- Average U.S. additional cost to meet regulations is estimated at $1,300 per vehicle (volume weighted).

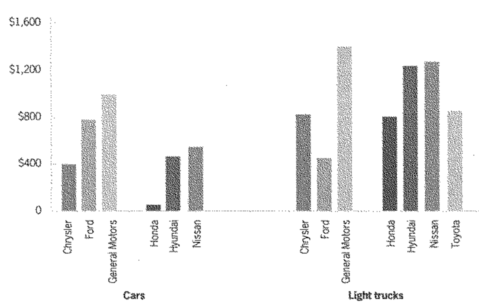
continued>

**Comparison of government regulatory programs**

| | NHTSA (35.5mpg) | EPA (155gm/km) |
|---|---|---|
| **Organization** | National Highway Traffic Safety Administration | Environmental Protection Agency |
| **Regulation** | Corporate Average Fuel Economy (CAFE) 35.5 mpg U.S. fleet average by 2016 MY | Greenhouse Gas Standard ($CO_2$) 250 gm/mile (155.4 gm/km) of $CO_2$ in MY2016 (35 mpg) |
| **Standard** | Targets for each vehicle based on footprint (track x wheelbase) | Targets for each vehicle based on footprint (track x wheelbase) |
| **Measure** | Individual targets for each OEM based on OEM fleet average calculated by vehicle fuel economy x sales volume | Individual targets for each OEM based on OEM fleet average calculated by vehicle fuel economy x sales volume |
| **Credits1** | Trading allowed between cars and trucks | Trading allowed between cars and trucks |
| **Credits2** | Not allowed | Credits allowed for "Eco-Innovations" (HVAC improvements, tires, solar roofs, super credits for EVs, active aerodynamics, adaptive cruise, etc) |

Source: CSM Worldwide

**Per vehicle compliance cost by OEM ($)**




Source: CSM Worldwide

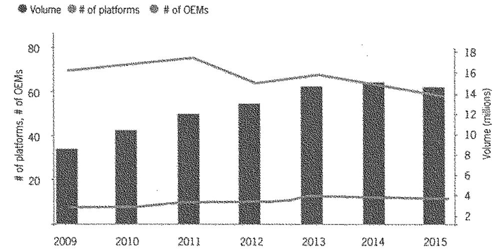
# On the Radar for Next Quarter (continued)

**Common Platforms – The New Industry Focus**

The number of OEMs producing vehicles in North America is expected to reach 16 by 2015, as new competition enters the domestic market. At the same time, production levels are expected to trend upward, reaching more than 15.0 million units by 2014.

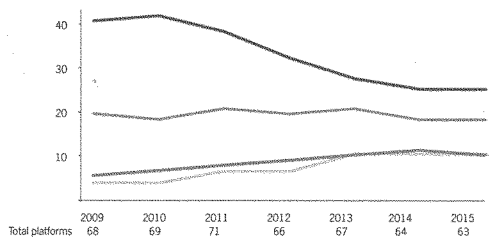
As automakers restructure for the industry rebound, a number of existing brands, facilities, employees and dealerships face the chopping block. Now, the new announced area of focus is platforms and product portfolios: a move to increasingly share common platforms globally. Many automakers have announced that such a move will significantly reduce engineering, machinery, assembly and other capital expenses, as well as provide economies of scale and increase manufacturing flexibility.

**North America production** Volume (in units, millions)



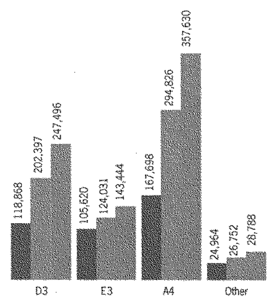

Source: CSM Worldwide

**North America production** # of platforms by origin




Source: CSM Worldwide
'Other' includes: FAW, Fisker, Fuji, Geely, Proton/Tesla, Mitsubishi, Suzuki and V-Vehicle

**North America production**
Volume per platform by origin (units produced)




Source: CSM Worldwide

As automakers migrate toward a more global model, the number of platform offerings in North America will remain relatively flat over the next several years. Despite the significant uplift in production levels that are expected by 2015, the number of platforms is expected to decline sharply, dropping from 68 to 63 over this timeframe.

Certainly, as OEMs migrate toward a more global platform structure, suppliers who are not sourced on these new global platforms will face more severe business risk. For instance, automakers are moving quickly to launch these new platforms and therefore the "sourcing window" for key U.S. market platforms is closing as many supplier contracts have already been determined. The quality of a supplier's booked business will hinge on these new platforms. The need to be on GM and Ford's future high volume platforms, as well as the new A4/E3 platforms will be increasingly important to the long term success of many suppliers.

continued>

# On the Radar for Next Quarter (continued)

**4th Quarter Production Levels Spike Upward: Much to Do About Nothing?**
After more than a one year-long period of disappointing production results, the news of an increase in Q4 2009 production levels is certainly uplifting news. The CARS program exceeded expectations, bringing a wave of buyers into the market in unparalleled fashion, as noted by the 15.6 percent lift in sales between Q2 2009 to Q3 2009.

Since the CARS program only applied to in-stock vehicles, this rather immediate surge in demand caused inventory levels to reach historic lows, bottoming out at 30 days' supply as of September 1, 2009.

In response, automakers increased production output, the lights were turned back on at certain assembly facilities and some idled workers were even called back to work. This increase in demand translates to nearly a 16.0 percent increase in Q4 2009 production levels, or an uptick of more than 375,000 units from Q3 2009. Chrysler and Ford are each ramping up production by more than 20.0 percent, the most among all North American OEMs.

Despite this positive news, inventory levels returned to more normal levels by the end of September following the conclusion of the CARS program, and are now averaging about 55 days' supply. At the same time, production schedules remain on track which could cause challenges if the full-year sales results come in around the low 10 million unit range. This decline in sales volume would equate to more than a 20 percent drop in sales levels from Q4 2009 from Q3 2009. If actual sales results disappoint to this level, most automakers will enter next year with higher than ideal inventory levels, causing a necessary correction in the first quarter of 2010. •

**North America production by OEM**

| | Q3 2009 | Q4 2009 | % Chg. |
|---|---|---|---|
| BMW | 31,056 | 28,684 | -7.6% |
| Chrysler | 281,744 | 338,230 | 20.0% |
| Daimler | 30,622 | 32,537 | 6.3% |
| Ford | 502,380 | 608,658 | 21.2% |
| Fuji Heavy | 25,625 | 28,080 | 9.6% |
| General Motors | 526,671 | 619,506 | 17.6% |
| Honda | 274,966 | 314,392 | 14.3% |
| Hyundai | 58,754 | 61,558 | 4.8% |
| Mitsubishi | 6,406 | 7,326 | 14.4% |
| Tesla/Proton | 290 | 274 | -5.5% |
| Renault/Nissan | 194,957 | 227,873 | 16.9% |
| Toyota | 350,676 | 378,662 | 8.0% |
| Volkswagen | 74,472 | 88,914 | 19.4% |
| **Grand total** | **2,358,619** | **2,734,694** | **15.9%** |

Source: CSM Worldwide

# Financial Indexes and Other Key Trading Metrics

| | Value 09/30/2009 | Value 12/31/2008 | % Chg. YTD | 52-week range Low | 52-week range High | % of 52-week quartile |
|---|---|---|---|---|---|---|
| **Indexes – U.S. stock[1]** | | | | | | |
| DJ Industrial Average | 9,712.28 | 8,776.39 | 10.7 | 6,547.05 | 10,831.07 | 73.9 |
| NASDAQ Composite | 2,122.42 | 1,577.03 | 34.6 | 1,268.64 | 2,146.30 | 97.3 |
| S&P 500 | 1,057.08 | 903.25 | 17.0 | 676.53 | 1,161.06 | 78.5 |
| DJ Wilshire 5000 | 10,911.69 | 9,087.17 | 20.1 | 6,858.43 | 11,808.80 | 81.9 |
| Russell 2000 | 604.28 | 499.45 | 21.0 | 343.26 | 671.59 | 79.5 |
| **Indexes – global stock[1]** | | | | | | |
| DJ World Index | 217.80 | 171.95 | 26.7 | 130.29 | 222.28 | 95.1 |
| MSCI EAFE[2] | 1,552.84 | 1,237.42 | 25.5 | 911.39 | 1,580.58 | 95.9 |
| CAC 40 | 3,795.41 | 3,217.97 | 17.9 | 2,519.29 | 4,080.75 | 81.7 |
| DAX | 5,675.16 | 4,810.20 | 18.0 | 3,666.41 | 5,806.33 | 93.9 |
| FTSE 100 | 5,133.90 | 4,434.17 | 15.8 | 3,512.10 | 5,172.90 | 97.7 |
| Hang Seng | 20,955.25 | 14,387.48 | 45.6 | 11,015.84 | 21,768.51 | 92.4 |
| Bombay Sensex | 17,126.84 | 9,647.31 | 77.5 | 8,160.40 | 17,126.84 | 100.0 |
| Nikkei | 10,133.23 | 8,859.56 | 14.4 | 7,054.98 | 11,368.26 | 71.4 |
| **Indexes – commodity & currency[1]** | | | | | | |
| DJ-AIG Commodity | 127.68 | 117.24 | 8.9 | 101.99 | 167.48 | 39.2 |
| JPMorgan US Dollar Index | 83.90 | 88.60 | -5.3 | 83.70 | 96.00 | 1.6 |

| | Value % 9/30/2009 | Value % 6/30/2009 | Value % 12/31/2008 | % Chg. Quarterly | % Chg. YTD |
|---|---|---|---|---|---|
| **Financial metrics[1]** | | | | | |
| Fed funds target rate | 0-0.25 | 0-0.25 | 0.25 | 0.0 | 0.0 |
| Prime rate | 3.25 | 3.25 | 3.25 | 0.0 | 0.0 |
| LIBOR, 3-month | 0.29 | 0.60 | 1.43 | -51.7 | -79.7 |
| LIBOR, 6-month | 0.63 | 1.11 | 1.75 | -43.3 | -64.0 |
| 5-Yr. CD, fixed, annual yield | 2.71 | 2.64 | 3.19 | 2.7 | -15.0 |
| 30-Yr. mortgage, fixed | 5.29 | 5.48 | 5.37 | -3.5 | -1.5 |
| New car loan, 48-month | 7.36 | 7.30 | 6.78 | 0.8 | 8.6 |
| Home-equity loan, $30,000 | 5.74 | 5.86 | 5.30 | -2.0 | 8.3 |
| 2-Yr. Treasury, yield | 0.95 | 1.12 | 0.76 | -15.0 | 25.7 |
| 10-Yr. Treasury, yield | 3.31 | 3.53 | 2.22 | -6.3 | 49.3 |

[1] Sources: Reuters, WSJ Market Data Group
[2] Europe, Australia, Far East; figures in U.S. dollars

- The major stock indexes continue to rally, as all indexes posted double digit YTD percentage increases. With nearly nine months of steady improvement, will this rally cause consumer outlook to turn more optimistic? Much will depend on how Q4 finishes.
- The government's $8,000 first-time home buyer tax credit and low mortgage rates helped stabilize the housing market; however, the pull-forward effect could cause further weakness in the near-term as we enter into what is historically a low-growth, seasonally weak housing period (September through March).

continued>

Attachment 4

# Financial Indexes and Other Key Trading Metrics (continued)

| Other key data[1] | Value 9/30/2009 | 6/30/2009 | 12/31/2008 | % Chg. Quarterly | % Chg. YTD |
|---|---|---|---|---|---|
| **Petroleum derived** | | | | | |
| Resin, $ per metric tonne | 1,187.50 | 1,137.50 | 587.50 | 4.4% | 102.1% |
| Crude oil, $ per barrel | 70.61 | 69.89 | 44.60 | 1.0% | 58.3% |
| Natural gas, $/MM Btu | 3.28 | 3.70 | 5.63 | -11.4% | -41.7% |
| Heating oil, $ per gallon | 1.79 | 1.72 | 1.45 | 4.1% | 23.4% |
| Retail gasoline, $ per gallon | 2.50 | 2.64 | 1.61 | -5.4% | 55.0% |
| **Metals** | | | | | |
| Aluminum, $ per metric tonne | 1,856.00 | 1,596.75 | 1,507.75 | 16.2% | 23.1% |
| Magnesium, $ per metric tonne | 2,750.00 | 2,650.00 | 2,850.00 | 3.8% | -3.5% |
| Zinc, $ per metric tonne | 1,943.25 | 1,522.50 | 1,180.25 | 27.6% | 64.6% |
| Nickel Plating, $ per pound | 8.60 | 7.70 | 5.54 | 11.7% | 55.2% |
| Nickel Melting, $ per pound | 850.45 | 755.23 | 533.86 | 12.6% | 59.3% |
| Copper, $ per pound | 2.83 | 2.37 | 1.38 | 19.4% | 105.1% |
| Silver, $ per troy ounce | 16.65 | 13.61 | 11.39 | 22.4% | 46.2% |
| Gold, $ per troy ounce | 1,007.70 | 926.60 | 882.05 | 8.8% | 14.2% |
| Platinum, $ per troy ounce | 1,298.00 | 1,177.25 | 934.50 | 10.3% | 38.9% |
| Palladium, $ per troy ounce | 296.00 | 250.75 | 187.00 | 18.0% | 58.3% |
| FerroMolybdenum, $ per pound | 16.75 | 9.75 | 16.50 | 71.8% | 1.5% |
| Hot-rolled steel, $ per net ton | 580.00 | 440.00 | 560.00 | 31.8% | 3.6% |
| Steel scrap, No. 2 Heavy, gross ton | 258.00 | 182.00 | 180.00 | 41.8% | 43.3% |
| Stainless steel, $ per ton | 2,334.00 | 2,045.00 | 3,141.00 | 14.1% | -25.7% |
| **Other commodities** | | | | | |
| Rubber, $ per kg | 2.18 | 1.67 | 1.40 | 30.5% | 55.7% |
| **Currencies** | | | | | |
| Euro, US $ per € | 1.464 | 1.403 | 1.397 | 4.3% | 4.8% |
| British Pound, U.S. $ per £ | 1.598 | 1.646 | 1.459 | -2.9% | 9.5% |
| Yen, ¥ per U.S. $ | 89.700 | 96.360 | 90.640 | -6.9% | -1.0% |

Note: Last business day of quarterly results
[1] Sources: Reuters, WSJ Market Data Group, Bloomberg, American Metal Market

- Volatile price fluctuations result in increased risk exposure to many companies whose operating/business models are not typically structured for rapid swings in commodity prices and changes in consumer buying habits.
  - Commodity prices are on the rise, with steady increases observed in the price of aluminum (16.2 percent), zinc (27.6 percent), copper (19.4 percent), and rubber (30.5 percent).
  - Despite a slight increase in the price of crude oil (1.0 percent), the price of retail gasoline fell by 5.4 percent in the third quarter. •

Attachment 4

# 2009 Light-Duty Vehicle Sales Outlook as of 3rd Quarter

**2009 Full-year U.S. sales outlook – estimate** (figures in millions)

| Company | Q4 2008 Date | Q4 2008 Sales | Q1 2009 Date | Q1 2009 Sales | Q2 2009 Date | Q2 2009 Sales | Q3 2009 Date | Q3 2009 Sales |
|---|---|---|---|---|---|---|---|---|
| **Bank** | | | | | | | | |
| Citigroup Global Markets | – | – | 1/12/2009 | 10.8 | – | – | – | – |
| Goldman Sachs | 11/26/2008 | 11.0 | 1/12/2009 | 11.0 | 4/23/2009 | 11.0 | 8/31/2009 | 10.5 |
| JP Morgan | – | – | 2/4/2009 | 10.0 | – | – | 9/30/2009 | 10.0 |
| Credit Suisse | – | – | 1/14/2009 | 12.0 | 7/1/2009 | 9.9 | – | – |
| Merrill Lynch | – | – | 1/16/2009 | 11.5 | – | – | 9/30/2009 | 10.8 |
| Deutsche Bank | – | – | 1/13/2009 | 11.5 | – | – | – | – |
| Barclays | – | – | 1/30/2009 | 10.2 | 4/3/2009 | 11.0 | 8/31/2009 | 10.5 |
| **Average** | | **11.0** | | **11.1** | | **10.6** | | **10.5** |
| **OEM** | | | | | | | | |
| Chrysler | 12/20/2008 | 11.1 | 1/12/2009 | 11.0 | 4/1/2009 | 10.5 | 7/23/2009 | 10.0 |
| Ford Motor Company | 12/20/2008 | 12–12.5 | 1/12/2009 | 12.2 | 7/1/2009 | 10.8 | 8/19/2009 | 10.8 |
| General Motors | 12/1/2008 | 11.7 | 1/15/2009 | 10.5 | – | – | 8/31/2009 | 10.5 |
| **Average** | | **11.7** | | **11.2** | | **10.7** | | **10.4** |
| **Other** | | | | | | | | |
| J.D. Power and Associates | 12/31/2008 | 11.4 | 1/13/2009 | 10.4 | 6/30/2009 | 10.0 | 8/19/2009 | 10.3 |
| Standard and Poor's | 12/1/2008 | 12.3 | – | – | – | – | – | – |
| Global Insight | 10/8/2008 | 13.4 | 1/7/2009 | 10.3 | – | – | 8/19/2009 | 10.3 |
| NADA | – | – | 1/26/2009 | 12.7 | 6/3/2009 | 11.0 | – | – |
| CSM Worldwide | 1/1/2009 | 11.5 | 3/20/2009 | 9.7 | 6/25/2009 | 9.7 | 7/1/2009 | 9.9 |
| IRN | – | – | 2/25/2009 | 11.0 | 5/12/2009 | 10.0 | – | – |
| Edmunds.com | 10/8/2008 | 13.7 | – | – | – | – | – | – |
| **Average** | | **12.5** | | **11.1** | | **10.2** | | **10.2** |
| **Total average** | | **12.0** | | **11.1** | | **10.4** | | **10.4** |

Source: Publicly available documents
Note: "–" denotes information that has not been publicly reported.

The above table presents a publicly available list of 2009 U.S. vehicle sales estimates.

Despite the July and August sales lift observed from the Cash for Clunkers (CARS) program, a steep decline in consumer demand after the program ended pulled sales levels back in line with the historic lows seen earlier in the year. This decline caused most analysts to maintain their 2009 outlook, with consensus estimates for 2009 U.S. sales adjusted downward to below 10.5 million units, a decline of more than 2.5 million units compared with the prior year. •

**Advisory Services Viewpoint**

Despite some sporadic indications of economic stabilization, we expect consumer spending during the holiday season to be dampened by declines in consumer wealth among most Americans. Further, we expect ongoing consumer turmoil and a continued pullback in disposable income to weigh heavily on sales. As a result, our FY 2009 view remains cautious, and we maintain our 2009 U.S. sales estimate of 10.2 million units.

For 2010, the wildcard remains economic stability, which we think will likely present more downside risk to an 11.0 million-unit forecast for 2010.

# Quarterly Spotlight: U.S. Sales Analysis

### U.S. Sales Review

- In the third quarter of 2009, demand levels pointed upward compared with the first two quarters of the year mainly due to the "Cash for Clunkers" program. However, sales results in September, after the program ended, were disappointing, dragging down quarterly results by more than 10 percent compared with the same period a year ago and causing increased uncertainty of future consumer expenditures on autos.

**U.S. sales**

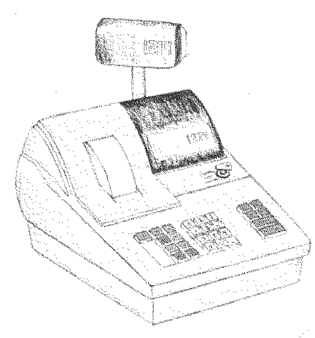
| | Q3 2008 | Q3 2009 | QoQ % Chg. | YTD 08 | YTD 09 | Unit diff. | % Chg. |
|---|---|---|---|---|---|---|---|
| Cars | 1,784,419 | 1,695,147 | -5.0% | 5,755,448 | 4,206,926 | (1,548,522) | -26.9 |
| Light trucks | 1,559,547 | 1,304,699 | -16.3% | 4,985,310 | 3,593,745 | (1,391,565) | -27.9 |
| **Total sales** | **3,343,966** | **2,999,846** | **-10.3%** | **10,740,758** | **7,800,671** | **(2,940,087)** | **-27.4** |

Source: J.D. Power and Associates

- The CARS program caused a quick surge in consumer demand and helped increase consumer awareness surrounding fuel efficiency. As observed during and immediately following the program, various automakers announced more aggressive strategies to develop more fuel-efficient vehicles and advanced technologies. Certainly the CARS program helped establish the appearance of future growth potential to the auto market, and we expect more related announcements throughout the auto show timeframe. In fact, the most fuel-efficient vehicles (small and midsize passenger vehicles) generally posted the largest sales gains during the program. See page 3 for more model-level analysis.

  - Trucks accounted for the majority of the quarterly sales volume decline, or about 254,000 units (70.1 percent).
  - In contrast, for the first nine months of 2009, cars accounted for 52.7 percent of the volume drop, or 1.5 million units.
  - In August, demand for cars reached the highest level so far this year, capturing 58.2 percent of the market. See page 19 for more analysis on segment shifts.

continued>



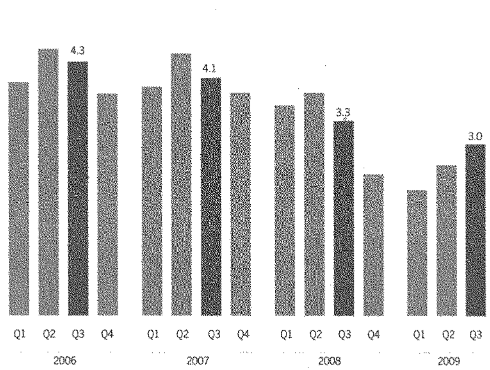
# Quarterly Spotlight: U.S. Sales Analysis (continued)

Since the start of the year, the sales trend line by quarter has been pointing upward. The low point of 2.2 million vehicles sold (Q1 2009) marks the worst sales quarter of the recession.

- The relatively steady uptick in sales observed in the third quarter of 2009 is a result of the CARS program, ongoing incentive offerings and a slight increase in consumer confidence levels.

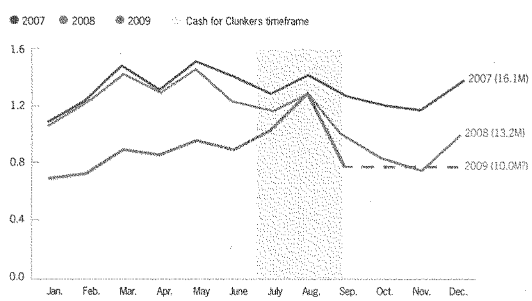
As shown, the 2009 sales trend remains significantly depressed compared with 2007 (16.1 million units) and 2008 (13.2 million units) results for the same time period. To articulate the magnitude of the decline, as stated previously, the current depressed level even incorporates the fact that the trend line surged upward in July and August due to the CARS program. Just as Q1 2009 was the worst single quarter, the low point of 655,000 vehicles sold in January 2009 was the worst sales month of the recession.

**U.S. sales by quarter** (sales volume, units in millions)




Source: J.D. Power and Associates

**U.S. sales results by month** (sales volume, units in millions)




Sources: Grant Thornton LLP and J.D. Power and Associates

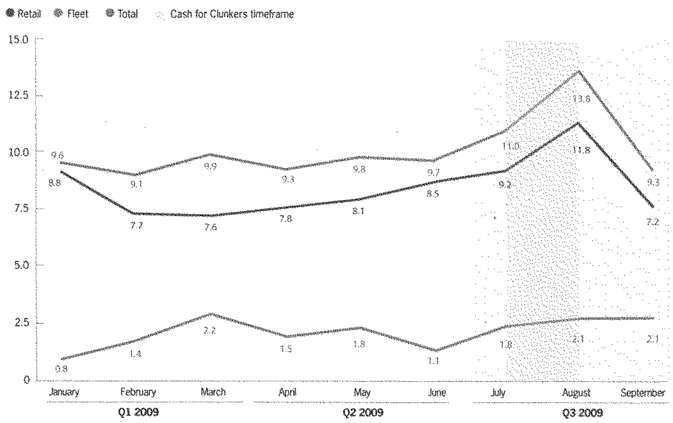
- **To achieve above 10.0 million unit sales**, activity in the remainder of the year would need to average about 750,000 units per month, which may be challenging given that sales in the second half of the year are historically lower than first-half sales.
- In the third quarter, three new models reached dealer showrooms, including the Ford Transit Connect (July), Lexus HS 250H (August) and Lincoln MKT (September). Collectively, these new models provided only a modest sales lift, totaling only 6,404 incremental sales to the quarterly top-line results.
- Monthly top-line sales decreased in two of the three months in the third quarter, with posted year-over-year results in July, August and September of -12.2 percent, +0.9 percent, and -23.0 percent, respectively.

continued>

Attachment 4

# Quarterly Spotlight: U.S. Sales Analysis (continued)

**U.S. seasonally adjusted annual rate (SAAR) by month** (sales volume, units in millions)




Retail and fleet figures may not equal total due to rounding.
Sources: Grant Thornton LLP and J.D. Power and Associates

## SAAR Results

- The seasonally adjusted annual selling rate **(SAAR) in the third quarter** averaged 11.4 million units, up 1.8 million units from the Q2 2009 SAAR, which averaged 9.6 million units and was 1.5 million units lower than the same period during 2008.
- **Retail sales (non-fleet)** on a quarterly SAAR basis have been on an upward trajectory for the year, averaging 8.0 million, 8.1 million and 9.4 million units for Q1, Q2 and Q3, respectively. However, September's retail sales were weaker due to the pull-forward demand from the CARS program thus affecting sales due to inventory shortages stemming from the program's success.
- The industry's **fleet SAAR** averaged 2.0 million units in Q3, **up 0.5 million units from the pace in Q2**, as OEMs have noticably returned to deliveries of fleet sales.

continued>

Retail sales (non-fleet) on a quarterly SAAR basis have been on an upward trajectory for the year, averaging 8.0 million, 8.1 million and 9.4 million units for Q1, Q2 and Q3, respectively.

# Quarterly Spotlight: U.S. Sales Analysis (continued)

## Vehicle Incentives

**Average incentive** ($)

| | YTD 2009 | YTD 2008 | Diff. |
|---|---|---|---|
| D3 | $3,849 | $3,564 | $285 |
| A3 | $1,827 | $1,490 | $337 |
| **Total** | **$2,832** | **$2,551** | **$281** |

- **For the first nine months of 2009,** the average incentive across the industry increased by almost $300 compared with the same period in the prior year.

- In **September**, after the government's CARS program ended, the average incentive per vehicle increased by about $100 — still hovering in the $2,500-per-vehicle range, although several hundred dollars less than the high point of $3,200 per vehicle reached in March 2009.

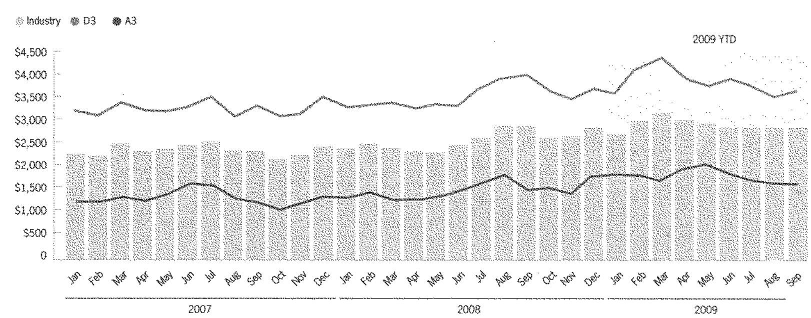
- **OEM results:** Toyota, Ford and Hyundai reduced incentive spending in September after receiving an extra sales gain during the CARS program. Chrysler's incentives ranked the highest in the industry, averaging more than $3,800 per vehicle.

- **More OEM results :** As shown below, the average incentive offered by the domestic OEMs remains about $1,800 more than the Asian 3 OEMs. However, these automakers are increasingly using incentives to drive sales and retain/grow market share. Worth noting here, Hyundai's average incentive totaled about $3,000 so far this year, up about $1,000 per vehicle compared with less than $2,000 last year.

- **Segment results:** According to Edmunds.com, premium sports cars had the highest average incentives — $10,128 per vehicle sold — followed by premium luxury cars at $6,551. Subcompact cars had the lowest average incentives per vehicle sold at $1,309, behind compact cars at $1,477.

continued>

**U.S. new vehicle incentives** (average incentive, $)

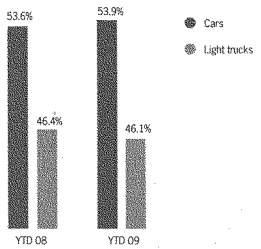



Sources: Grant Thornton LLP and Edmunds.com

Attachment 4

# Quarterly Spotlight: U.S. Sales Analysis (continued)

**U.S. market share mix car vs. truck**
(market share, % of total)




Source: J.D. Power and Associates

## Car/Truck Mix Changes

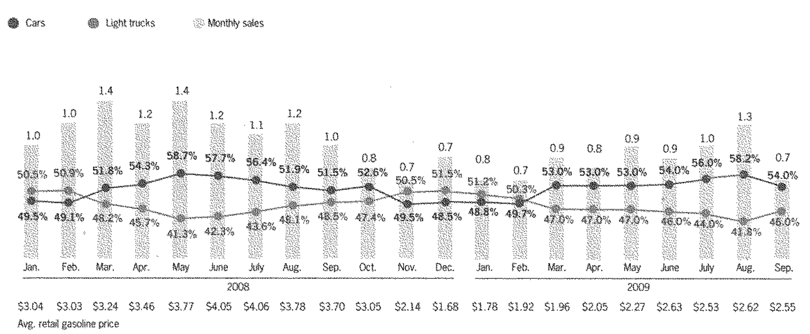
For the first nine months of the year, consumers preferred cars by only a small margin, as car sales made up 53.9 percent of industry sales during this period.

- In the third quarter, both car and truck segments declined at a significant rate over the prior year, with volumes declining by 89,272 and 254,848 units, respectively.
- The recent CARS program, which was designed to promote fuel efficiency, helped cars gain a larger mix of total vehicle sales. In fact, the car share reached 58.2 percent of industry sales in August — the highest level so far this year.
- A closer look at the car/truck mix trend line over the last 19 months suggests that consumer buying preferences correlate with the monthly change in the average retail price of gasoline.

continued>

The recent CARS program, which was designed to promote fuel efficiency, helped cars gain a larger mix of total vehicle sales.

**U.S. sales by month** (sales volume, units in millions)
Car vs. truck share (market share, % of total)




Sources: J.D. Power and Associates and Energy Information Administration

# Quarterly Spotlight: U.S. Sales Analysis (continued)

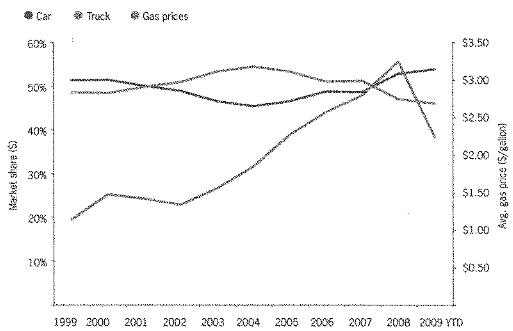
- Trucks have maintained about 46 percent of the market — which may be attributed to reduced gasoline prices, increased sales promotions and incentives for many high-volume truck models, as well as new model offerings and vehicle redesigns.

**Advisory Services Viewpoint**

In our view, the probability is low that a meaningful rebound in fourth-quarter sales volumes will be enough to offset the slow first nine months of 2009. We expect 2009 U.S. vehicle sales to come in around 10.2 million units.

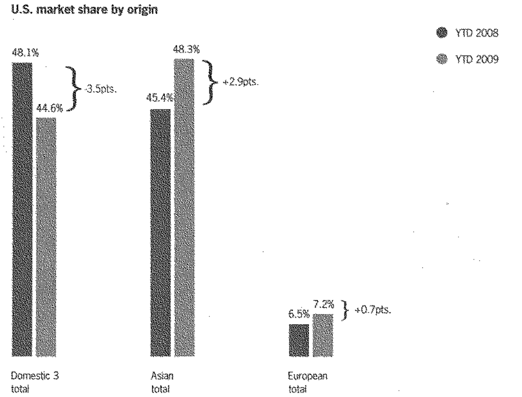
**Car/truck segments**

U.S. sales market share performance (% of total) vs. avg. retail gasoline price ($ per gallon)




Sources: Bloomberg and J.D. Power and Associates

**U.S. market share by origin**




Source: J.D. Power and Associates
Figures rounded.

### GM Remains Sales Leader Post-Bankruptcy, Despite Domestic Market Share Loss

The adjacent chart is a snapshot of U.S. market share by OEM origin during the first three quarters of 2009.

As presented, the Asian automakers continue to gain market share against their domestic rivals, stretching closer to 50 percent of the U.S. market due to an increase of 2.9 points. Despite posting double-digit sales declines, both the Asian and European automakers collectively performed better than the industry's overall decline of 27.4 percent, with Asian volume dropping by 22.8 percent and European volume declining by 19.2 percent.

continued>

# Quarterly Spotlight: U.S. Sales Analysis (continued)

Meanwhile, the Domestic 3 continue to lose market share, dropping to less than 45 percent of total U.S. vehicle sales — a decline of 3.5 points year-over-year.

- On a volume basis, the Domestic 3 experienced a sales decline of 1.7 million units year-to-date (down 32.7 percent).

- At the same time, the Asian automakers experienced a sales decline of 1.1 million units (down 22.8 percent), and the European OEMs posted a decline of less than 150,000 units (a drop of 19.2 percent).

To the credit of the domestic OEMs, 2009 has been an extremely challenging recessionary year, with two of the three automakers having entered and exited highly complex bankruptcies. Although they continue to lose share on a collective basis, these OEMs remain significant players in the U.S. market; in fact, Ford has gained share.

- GM remains the top-selling U.S. automaker, maintaining a more than 240,000 unit lead YTD over Toyota, the second-largest automaker, based on 2009 YTD U.S. sales results.

- Chrysler, the fifth-largest automaker by U.S. market share, maintains a nearly 135,000 unit lead over sixth-place Hyundai. Despite going through the bankruptcy process and navigating through a challenging environment, Chrysler still captures a larger share of the market than BMW, Mazda, Volkswagen and the manufacturers listed in the "other" group, combined.

continued>

**U.S. sales overview** (YTD 2009 vs. YTD 2008)

| | YTD 2009 | YTD 2008 | Diff. | % Chg. |
|---|---|---|---|---|
| General Motors Group | 1,536,903 | 2,412,649 | (875,746) | -36.3 |
| Ford Group | 1,223,453 | 1,572,333 | (348,880) | -22.2 |
| Chrysler Group | 715,516 | 1,183,519 | (468,003) | -39.5 |
| **Domestic 3 ("D3")** | **3,475,872** | **5,168,501** | **(1,692,629)** | **-32.7** |
| Honda Group | 884,137 | 1,180,583 | (296,446) | -25.1 |
| Hyundai Group | 580,787 | 565,752 | 15,035 | 2.7 |
| Isuzu Motors | 642 | 4,189 | (3,547) | -84.7 |
| Mazda Motors | 160,189 | 215,408 | (55,219) | -25.6 |
| Mitsubishi Motors | 42,839 | 80,105 | (37,266) | -46.5 |
| Renault-Nissan Group | 580,296 | 785,698 | (205,402) | -26.1 |
| Fuji Heavy | 158,421 | 143,789 | 14,632 | 10.2 |
| Suzuki Group | 33,525 | 74,443 | (40,918) | -55.0 |
| Tata | 26,881 | 34,736 | (7,855) | -22.6 |
| Toyota Group | 1,296,422 | 1,793,302 | (496,880) | -27.7 |
| **Asian ("A10")** | **3,764,139** | **4,878,005** | **(1,113,866)** | **-22.8** |
| BMW Group | 179,219 | 236,327 | (57,108) | -24.2 |
| Daimler Group | 147,834 | 195,454 | (47,620) | -24.4 |
| Porsche-VW | 233,607 | 262,471 | (28,864) | -11.0 |
| **European ("E3")** | **560,660** | **694,252** | **(133,592)** | **-19.2** |
| Passenger car total | 4,206,926 | 5,755,448 | (1,548,522) | -26.9 |
| Light truck total | 3,593,745 | 4,985,310 | (1,391,565) | -27.9 |
| **Total light vehicle sales** | **7,800,671** | **10,740,758** | **(2,940,087)** | **-27.4** |

Source: J.D. Power and Associates
Note: Tata figures are estimated and include Jaguar and Land Rover

**U.S. market share overview**

| Rank | OEM | Market share % YTD 2009 | YTD 2008 | Diff. |
|---|---|---|---|---|
| 1 | GM | 19.7 | 22.5 | -2.8 |
| 2 | Toyota | 16.6 | 16.7 | -0.1 |
| 3 | Ford | 15.7 | 14.6 | 1.0 |
| 4 | Honda | 11.3 | 11.0 | 0.3 |
| 5 | Chrysler | 9.2 | 11.0 | -1.8 |
| 6 | Hyundai | 7.4 | 5.3 | 2.2 |
| 7 | R/N | 7.4 | 7.3 | 0.1 |
| 8 | VW | 3.0 | 2.4 | 0.6 |
| 9 | BMW | 2.3 | 2.2 | 0.1 |
| 10 | Mazda | 2.1 | 2.0 | 0.0 |
| 11 | Fuji Heavy | 2.0 | 1.3 | 0.7 |
| 12 | Daimler Group | 1.9 | 1.8 | 0.1 |
| | Other | 1.4 | 1.9 | -0.5 |
| | **Total light vehicle sales** | **100.0** | **100.0** | — |

Source: J.D. Power and Associates
Note: "Other" includes Mitsubishi, Suzuki, Tata and Isuzu; red denotes market share declines for the period.

## Quarterly Spotlight: U.S. Sales Analysis (continued)

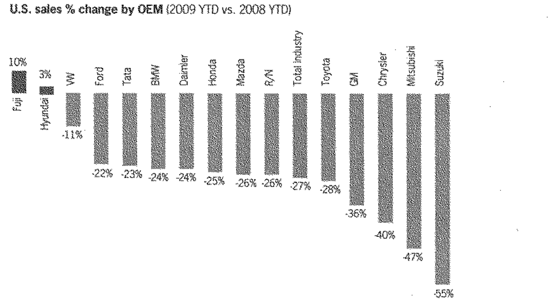
- Ford Motor Company, which continues to make progress on its restructuring plan, managed to avoid government financial assistance and has launched several redesigned products which have helped the company perform better than its domestic counterparts and the industry as a whole. Through the first nine months of 2009, the company's market share increased to 15.7 percent, an increase of approximately 1.0 percent, which represents the largest market share increase after Hyundai for the year to date.

The chart below illustrates sales volume performance by OEM (excluding Isuzu) for the first nine months of 2009. Eight of the 15 OEMs performed better than the industry's average decline this year vs. last year. Among the 15 OEMs, only two automakers — Fuji (+10.2 percent) and Hyundai (+2.7 percent) — posted year-over-year gains compared with the prior year.

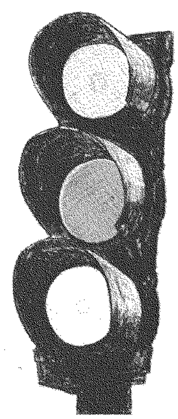
Despite having sold the most vehicles under the government's "Cash for Clunkers" program, Toyota's sales declined 27.7 percent (more than the industry average) for the year, led by deteriorating sales performance of its Scion brand (down 51.7 percent).

continued>

**U.S. sales % change by OEM** (2009 YTD vs. 2008 YTD)




Source: J.D. Power and Associates
Note: Tata figures include Jaguar and Land Rover; Isuzu was excluded.



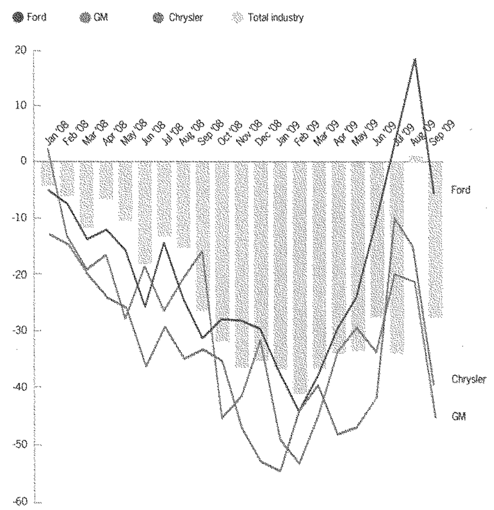
Attachment 4

# Quarterly Spotlight: U.S. Sales Analysis (continued)

On April 30, 2009, Chrysler LLC filed for Chapter 11 bankruptcy protection and announced a plan for a partnership with Fiat. Less than two months later, the sale of Chrysler's "good assets" to a newly formed company, Chrysler Group LLC, or "New Chrysler," was completed. Fortunately for Chrysler, only one full month of sales results (May 2009) was affected while the company was going through bankruptcy. As shown, the process dampened Chrysler's results in May, with an observed decline of 47.9 percent compared with the prior period. However, when analyzing the company's sales decline relative to the industry average, "New Chrysler" posted even worse results in August, as well as in September following the end of the CARS program.

During the same Spring timeframe, GM's sales performance remained much closer to the industry average until the company filed for bankruptcy on June 1, 2009. In June, GM's sales declined by 33.4 percent. On July 10, 2009, GM emerged from Chapter 11 bankruptcy reorganization, yet relative to the industry's decline, the company performed worse in both August and September of this year, as compared with June results.

**U.S. light vehicle sales** (2008 vs. 2009 YoY % Chg.)




Source: J.D. Power and Associates

- During their respective bankruptcy processes, Chrysler's sales were more severely affected by the bankruptcy filing compared with GM.
- Following the bankruptcy process, Chrysler's sales results outperformed GM's in both August and September 2009 on a percentage change year-over-year as compared with total industry sales per month.

Ford, a company that managed to weather the industry downturn without government financial support, has remarkably outperformed the overall industry over the past six months. To date, Ford's market share stands at 15.7 percent, up approximately 1.0 point over its 2008 level. •

**Advisory Services Viewpoint**

In the near term, given disappointing macroeconomic indicators, we believe that the fourth quarter will not represent a period of return to growth. Now that the CARS program has concluded, we expect that the fourth quarter could be the most challenging sales quarter we've seen in years. As automakers announce their new product lineups during the upcoming auto show season, we continue to look for positive signs of economic stability, improved employment levels and a return to steady growth in GDP.

Attachment 4

# Grant Thornton Viewpoint: What lies ahead for GM and Chrysler?

One year ago, both GM and Chrysler faced concerns surrounding their financial and operational viability as demand for new vehicles plummeted. At that time, some industry observers raised the notion that bankruptcy, government involvement and/or outright failure seemed imminent, although the executive ranks dismissed such speculation. One year later, through the support of the federal government and a speedy bankruptcy process, these companies have managed to avert collapse and have maintained a significant share of the overall market (although their share is somewhat reduced in the domestic market).

Having exited from bankruptcy, a new debate has emerged as familiar concerns about their companies' viability have again been raised – what is to prevent the same thing from happening again? At the same time, others see these companies becoming stronger and more competitive than ever with the likelihood of initial public offerings (IPOs) not that far off. Either way, in this round, the stakes are much higher. What does it all mean, now that the government has a hand in the automakers' affairs? Will the new management teams at GM and Chrysler succeed? Will taxpayers receive a return on their investment and, if so, when? Will the automakers' products meet the increasingly changing needs of the consumer? Will their products prove to be segment-leading performers?

**Near-term priorities**

| General Motors | Chrysler |
|---|---|
| • Growth in Global Markets & Reintegrate Opel | • Integrate with Fiat |
| • Ability to Raise Capital - Focus on Structural Costs | • Ability to Raise Capital - Fund New Product Rollout |
| • Management's Ability to Execute | • Fiat's (Management) Ability to Execute |
| • Follow Customer vs Covering Cost | • Improved Transaction Prices vs Incentives |
| • Brand Image & New Product Rollout | • Company Image & Brand Performance |

Source Grant Thornton

After ridding themselves of massive debt burdens, underperforming operations and uncompetitive work rule and benefit obligations, these companies should now be able to focus on their core operations. Without question, both companies are now better structured financially than in recent history, so it now comes down to product execution. Both companies must work to rebuild their reputation with consumers in terms of product, brand and company image and their message must translate into improved sales performance.

GM and Chrysler face unique, and yet different, sets of challenges. The road to returning to public ownership will be challenging. In broad terms, these companies will be required to:

1) Increase financial transparency, set new target milestones (i.e., profitability, earnings, cash flow, debt, etc.) and deliver results.
2) Stop market share losses through successful new product launches, must-have products, competitive pricing, brand repositioning/strengthening and improved quality rankings.
3) Maintain a more diversified regional mix with a growing presence in foreign/emerging markets.
4) Convince investors, their boards of directors and government oversight bodies that their plans are achievable.
5) Maintain their forward momentum while market and industry conditions improve to more healthy levels (e.g., consumer demand, capacity utilization).

Certainly, the next several months will be telling. Chrysler recently unveiled its long-awaited five-year business plan; GM is expected to unveil its business plan and budget in early December. Although these actions are signs of significant progress in the works, the debut of Chrysler and GM as new and improved public companies depends on their ability to execute, even if the nation still faces economic turmoil and a delayed economic recovery. •

Attachment 4

# Key Developments

## Automotive Industry – Select Merger & Acquisition Activity (Announced Date)

- September 30, 2009 – Penske Automotive Group, Inc. (NYSE:PAG) cancelled the acquisition of **Saturn Corp.** from Onstar Corporation on September 30, 2009. The deal has been cancelled due to concerns directly related to the future supply of vehicles beyond the supply period already negotiated and as a result Saturn and its dealership network will be phased out.
- September 30, 2009 – American Securities and its funds American Securities Partners V, L.P., American Securities Partners V(B), L.P., American Securities Partners V(C), L.P. signed a definitive agreement to acquire **GenTek Inc.** (NasdaqGS: GETI) for approximately $410 million in cash.
- September 24, 2009 – Akebono Brake Industry Co. Ltd. (TSE: 7238) acquired **North American brakes operations from Robert Bosch GMBH** for $10 million. As reported under the terms of the agreement, Akebono acquired Clarksville, Tennessee and Columbia, South Carolina production sites, as well as certain assets and administrative functions at six other locations in United States for producing basic parts such as disc brakes and drum brakes.
- September 23, 2009 – Monro Muffler Brake Inc. (NasdaqGS: MNRO) acquired the assets of **Midwest Tire, Inc.** for $2 million.
- September 23, 2009 – Belron US, Inc. entered into an agreement to acquire all of the **vehicle glass repair and replacement assets of IGD Industries.**
- September 21, 2009 – Iochpe-Maxion S.A. (BOVESPA: MYPK3) signed an agreement to acquire **steel wheel business from Arvin Innovation, Inc.** for approximately $180 million.
- September 4, 2009 – Alamo Group Inc. (NYSE: ALG) signed an agreement to acquire majority of the assets and assume certain liabilities of **Bush Hog, L.L.C.** from C.C. Industries Ltd. for $23.7 million in stock.
- September 3, 2009 – Worthington Cylinder Corporation acquired **Structural Composites Industries, Inc.** from Harsco Corp. (NYSE: HSC).
- September 1, 2009 – Eaton Corporation (NYSE: ETN) acquired the remaining 50% stake in **Micro Innovation Holding AG.**
- August 31, 2009 – North River Capital LLC acquired the assets and business of **Wayne Manufacturing Corporation** from Wayne Tool & Design Inc.
- August 31, 2009 – The Chrysler Group acquired the remaining stake in **Global Engine Manufacturing Alliance** from Hyundai Motor Co. (KOSE: A005380) and Mitsubishi Motors Corp. (TSE: 7211).
- August 31, 2009 – iSi Automotive GmbH acquired **European Airbag Activities from Delphi Corp.**
- August 26, 2009 – Hephaestus Holdings, Inc. signed an agreement to acquire **FormTech Industries, LLC** for $40 million in a credit bid.
- August 24, 2009 – Systems Evolution Inc. (OTCPK: SSEV) acquired **Highline Hydrogen Hybrids, Inc. and Hoss Motor Sports, Inc.** from Steven Humphries. Under the terms of the transaction, the shareholders of Highline Hydrogen and Hoss Motor will take a combined 30% interest in Systems Evolution.
- August 19, 2009 – Motorcar Parts of America, Inc. (Nasdaq:MPAA) acquired certain assets of **Reliance Automotive, Inc.**
- August 19, 2009 – Robert Bosch North America, Inc. agreed to acquire **Akustica, Inc.**
- August 17, 2009 – UAP, Inc. entered into an agreement to acquire **18 Palmar truck parts stores from Palmar, Inc.**
- July 31, 2009 – Katcon, S.A. De C.V. made a stalking horse bid to acquire **global exhaust business of Delphi Corp.** (OTCPK: DPHI.Q) for approximately $17 million.
- July 31, 2009 – Halla Climate Control Corp. (KOSE: A018880) entered into a purchase and sale agreement to acquire 80% interest in **Halla Climate Systems Alabama Corp.** from Visteon Corp. (OTCPK: VSTN) for KRW 46.9 billion in cash.
- July 29, 2009 – JTEKT Corporation (TSE: 6473) signed definitive sale and purchase agreement to acquire the assets of **Needle Roller Bearings business from Timken Co.** (NYSE: TKR) for approximately $330 million in cash.
- July 28, 2009 – H.I.G. Capital, LLC agreed to acquire remaining stake in **Stant Corporation** for $81 million.
- July 27, 2009 – Hephaestus Holdings, Inc. (HHI) agreed to acquire the **Powertrain operations from Metaldyne Corporation.**
- July 27, 2009 – Revstone Industries, LLC agreed to acquire the **Chassis operations from Metaldyne Corporation.**
- July 27, 2009 – JPMorgan Chase Bank, National Association, Elliott Management Corporation, Silver Point Capital L.P., Monarch Alternative Capital LP and other creditors of Delphi Corp. agreed to acquire substantially all assets of **Delphi Corp.** (OTCPK: DPHI.Q) for $3.5 billion.
- July 19, 2009 – Fuel Systems Solutions, Inc. (NasdaqGS: FSYS) signed a purchase agreement to acquire power systems business of **Teleflex Inc.** (NYSE: TFX) for $15 million in cash.

## Key Developments (continued)

- July 17, 2009 – American Industrial Partners IV, L.P. (AIP) signed an asset purchase agreement to acquire substantially all assets of motorized recreational vehicle business of **Fleetwood Enterprises Inc.** (OTCBB: FLTW.Q) for $53 million.
- July 17, 2009 – Nebraska Industries Corporation and D&D Industries acquired **Kecy Products, Inc.**
- July 17, 2009 – Ford Motor Co. (NYSE: F) made a tender offer to acquire the remaining 3.27% stake in **Automobile Craiova SA Craiova** (RASDAQ: AUCS) for RON 10.9 million.
- July 16, 2009 – Snap-on Inc. (NYSE: SNA) acquired the remaining 50% stake of **Snap-on Credit LLC** from CIT Group, Inc. (NYSE: CIT) for $8.2 million.
- July 14, 2009 – Revstone Industries, LLC agreed to acquire the assets of **INTERMET Corporation** for $13 million.
- July 13, 2009 – Aabar Investments PJSC (ADX: AABAR) acquired 4% stake in **Tesla Motors, Inc.** from Daimler AG (XTRA: DCX).
- July 10, 2009 – Vehicle Acquisition Holdings LLC entered into a master sale and purchase agreement to acquire substantially all assets of **General Motors Corporation** (OTCPK: GMGM.Q). The acquired assets included 11.4 million shares of Hydrogenics Corporation. Under the terms of agreement, consideration will include the assumption of certain debt, including a credit bid in an aggregate amount equal to $55 billion plus accrued interest, issuance of 50 million shares of Vehicle Acquisition Holdings, issuance of warrants to acquire 90.91 million shares of Vehicle Acquisition, and warrants originally issued by General Motors Corporation to U.S. Treasury.
- July 9, 2009 – Deuer Manufacturing Inc. (a subsidiary of Flex-N-Gate) acquired operating units of **Bumper Systems business** from Meridian Automotive Systems, Inc.

## Automotive Industry – Significant Bankruptcy Filings (Filing Date)

- September 28, 2009 – **Holley Performance Products Inc.**, along with its affiliates, filed a voluntary petition for reorganization under Chapter 11 in the U.S. Bankruptcy Court for the District of Delaware on September 28, 2009. The affiliates include Holley Performance Systems, Inc., Nitrous Oxide Systems, Inc., and Weiand Automotive Industries, Inc. The company listed both assets and liabilities ranging between $100 million to $500 million.
- August 26, 2009 – **FormTech Industries, LLC** filed a voluntary petition for reorganization under Chapter 11 for the US Bankruptcy Court for the District of Delaware. The company listed assets of $100 million to $500 million and debts of $50 million to $100 million.
- August 7, 2009 – **Meridian Automotive Systems, Inc.** filed a voluntary petition for liquidation under Chapter 7 in the U.S. Bankruptcy Court for the District of Delaware. The company listed assets of $25.59 million and liabilities of $204.47 million.
- August 3, 2009 – **Cooper-Standard Holdings Inc.**, along with Cooper-Standard Automotive Inc., Cooper-Standard Automotive FHS Inc., Cooper-Standard Automotive Fluid Systems Mexico Holding, North American Rubber, Inc., Sterling Investments Company, Nisco Holding Company, Cooper-Standard Automotive NC L.L.C, Csa Services Inc., and Cooper-Standard Automotive OH filed a voluntary petition for reorganization under Chapter 11 in the U.S. Bankruptcy Court for the District of Delaware. The company listed assets at $1.73 billion and liabilities at $1.78 billion.
- July 27, 2009 – **Stant Corporation**, along with its affiliates, filed a voluntary petition for reorganization under Chapter 11 in the U.S. Bankruptcy Court for the District of Delaware. The company listed both assets and liabilities ranging between $50 million to $100 million.
- July 13, 2009 – **JL French Automotive Castings, Inc.** along with its affiliates including J.L. French Corporation, Nelson Metal Products Corporation, and Allotech International Inc. jointly filed a voluntary petition for reorganization under Chapter 11 in the US Bankruptcy Court for the District of Delaware. The company listed assets and debts of $100 million to $500 million.
- July 7, 2009 – **Lear Corporation**, along with its affiliates, filed a voluntary petition for reorganization under Chapter 11 in the U.S. Bankruptcy Court for the Southern District of New York. The company listed assets of $1.27 billion and liabilities of $4.54 billion.
- July 2, 2009 – **Advanced Materials Group, Inc.** filed a voluntary petition for reorganization under Chapter 11 in the US Bankruptcy Court for the Central District Of California. The company listed assets and debts of $1 million to $10 million.
- July 2, 2009 – **Proliance International Inc.** and its affiliate Aftermarket LLC filed a voluntary petition for reorganization under Chapter 11 in the U.S Bankruptcy Court for the District of Delaware. The company listed assets of $160.3 million and liabilities of $133.5 million.

Attachment 4

# Financial Statistics

**Automotive industry – public market multiples**
**As of 9/30/2009** (monetary figures in U.S. $)

| Company | Ticker | Stock price | | | Equity market cap (M) | Enterprise value (EV) (M) | Net debt/ LTM[2] EBITDA | EPS | | Price earnings | | EV/ LTM[2] EBITDA |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Current | % of 52-week high | Quartile[1] | | | | LTM[2] | NTM[3] | LTM[2] | NTM[3] | |
| **OEM** | | | | | | | | | | | | |
| Daimler AG | DCX | $50.31 | 96% | 93% | $51,511 | $127,603 | 36.0x | NM | $1.06 | NM | 47.3x | 62.2x |
| Ford Motor | F | $7.21 | 81% | 79% | $23,225 | $123,903 | 61.5x | NM | $0.58 | NM | 12.5x | 76.8x |
| General Motors | MTLQ.Q | $0.71 | 7% | 5% | $431 | $43,875 | NM | NM | NM | NM | NM | NM |
| Honda Motor | TSE:7267 | $30.90 | 86% | 71% | $56,076 | $96,822 | 5.7x | NM | $1.52 | NM | 20.3x | 14.1x |
| Nissan Motor | TSE:7201 | $6.78 | 83% | 73% | $27,633 | $68,534 | 7.4x | NM | NM | NM | N/A | 13.6x |
| Toyota Motor | TSE:7203 | $39.90 | 79% | 51% | $125,122 | $225,273 | 32.5x | NM | $0.85 | NM | 47.0x | 77.6x |
| Volkswagen AG | DB:VOW | $164.95 | 11% | 1% | $66,018 | $147,742 | 12.0x | $6.18 | NM | 26.7x | N/A | 22.6x |
| Mean | | | | | | | | | | 26.7x | 31.8x | 44.5x |
| Median | | | | | | | | | | 26.7x | 33.7x | 42.4x |
| **Supplier** | | | | | | | | | | | | |
| American Axle | AXL | $7.08 | 80% | 79% | $392 | $1,390 | 87.4x | NM | $0.61 | NM | 11.7x | 121.9x |
| ArvinMeritor | ARM | $7.82 | 59% | 58% | $578 | $1,689 | 11.5x | NM | $0.31 | NM | 25.6x | 18.0x |
| Autoliv | ALV | $33.60 | 90% | 86% | $2,859 | $3,809 | 2.3x | NM | $1.86 | NM | 18.0x | 9.7x |
| BorgWarner | BWA | $30.26 | 82% | 71% | $3,530 | $4,152 | 2.4x | NM | $1.28 | NM | 23.7x | 17.2x |
| Cooper Tire | CTB | $17.58 | 93% | 92% | $1,037 | $1,310 | 0.8x | NM | $1.85 | NM | 9.5x | 6.2x |
| Cummins | CMI | $44.81 | 92% | 87% | $9,043 | $9,130 | (0.3)x | $1.02 | $1.76 | 44.0x | 25.4x | 15.4x |
| Dana Holding | DAN | $6.81 | 92% | 91% | $914 | $1,966 | 2.3x | NM | NM | NM | N/A | 24.9x |
| Delphi | DPHI.Q | $0.06 | 39% | 32% | $36 | $6,034 | NM | $7.09 | NM | 0.0x | NM | NM |
| Eaton Corporation | ETN | $56.59 | 93% | 87% | $9,371 | $12,535 | 3.0x | $2.00 | $4.02 | 28.4x | 14.1x | 12.1x |
| Federal-Mogul | FDML | $12.07 | 81% | 77% | $1,200 | $3,340 | 6.5x | NM | $0.87 | NM | 13.9x | 10.4x |
| Gentex | GNTX | $14.15 | 91% | 85% | $1,949 | $1,599 | (3.6)x | $0.18 | $0.66 | 80.3x | 21.5x | 16.2x |
| Goodyear Tire | GT | $17.03 | 90% | 88% | $4,119 | $8,308 | 5.9x | NM | $0.53 | NM | 32.3x | 14.9x |
| Hayes Lemmerz | HAYZ | $0.05 | 2% | 1% | $5 | $682 | 7.6x | NM | NM | NM | N/A | 8.4x |
| Johnson Controls | JCI | $25.56 | 85% | 79% | $15,220 | $18,626 | 3.0x | NM | $1.53 | NM | 16.7x | 17.2x |
| Lear | LEA | $0.36 | 3% | 2% | $28 | $2,448 | 8.4x | NM | NM | NM | NM | 8.6x |
| Linamar | TSX:LNR | $13.27 | 100% | 100% | $859 | $1,134 | 1.8x | NM | $0.67 | NM | 19.9x | 8.2x |
| Magna Intl. | TSX:MG.A | $42.50 | 83% | 68% | $4,788 | $3,923 | (3.2)x | NM | $2.97 | NM | 14.3x | 14.4x |
| Navistar Intl. | NAVZ | $37.42 | 69% | 56% | $2,643 | $7,161 | 8.4x | NM | $4.28 | NM | 8.7x | 13.5x |
| Tenneco | TEN | $13.04 | 72% | 71% | $617 | $1,979 | 5.3x | NM | $0.61 | NM | 21.3x | 7.9x |
| TRW Automotive | TRW | $16.75 | 80% | 79% | $1,934 | $4,542 | 4.5x | NM | $1.95 | NM | 8.6x | 8.3x |
| Visteon | VC | $0.18 | 8% | 7% | $23 | $2,242 | 13.4x | NM | NM | NM | NM | 15.6x |
| Mean | | | | | | | | | | 38.2x | 17.8x | 18.4x |
| Median | | | | | | | | | | 36.2x | 17.3x | 13.9x |
| **Dealer** | | | | | | | | | | | | |
| AutoNation | AN | $18.08 | 85% | 81% | $3,219 | $5,188 | 4.1x | $1.30 | $1.26 | 13.9x | 14.4x | 10.9x |
| Asbury Automotive | ABG | $12.68 | 85% | 83% | $409 | $1,224 | 6.9x | NM | $0.98 | NM | 12.9x | 10.4x |
| CarMax | KMX | $20.90 | 97% | 95% | $4,604 | $4,861 | 0.9x | $0.67 | $0.88 | 31.4x | 23.8x | 16.1x |
| Group 1 Automotive | GPI | $26.85 | 80% | 77% | $649 | $1,519 | 6.0x | NM | $2.15 | NM | 12.5x | 10.4x |
| Lithia Motors | LAD | $15.59 | 95% | 94% | $330 | $743 | 6.3x | $0.51 | $0.83 | 30.6x | 18.8x | 11.4x |
| Penske Automotive | PAG | $19.18 | 90% | 87% | $1,755 | $3,813 | 8.6x | NM | $1.05 | NM | 18.3x | 16.0x |
| Sonic Automotive | SAH | $10.50 | 69% | 68% | $547 | $1,814 | 8.1x | NM | $0.90 | NM | 11.7x | 11.6x |
| Mean | | | | | | | | | | 25.3x | 16.1x | 12.4x |
| Median | | | | | | | | | | 30.6x | 14.4x | 11.4x |

[1] Quartile is calculated as (current stock price minus 52-week low) divided by (52-week high stock price minus 52-week low)
[2] Latest 12 months (LTM) diluted earnings per share before extraordinary items
[3] Next 12 months (NTM) estimated diluted earnings per share

NM = Not meaningful

Sources: Capital IQ and Grant Thornton Automotive Analytics

# Financial Statistics (continued)

**Automotive industry – comparative quarterly metrics**
**As of 9/30/2009** (monetary figures in U.S. $)

| Company | Ticker | Stock price | | | | | LTM[1] revenues | | | | | LTM[1] EBITDA | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Current | 1 Month | | 1 Year | | Current | 1 Quarter | | 1 Year | | Current | 1 Quarter | | 1 Year | |
| | | | Prior | % △ | Prior | % △ | | Prior | % △ | Prior | % △ | | Prior | % △ | Prior | % △ |
| **OEM** | | | | | | | | | | | | | | | | |
| Daimler A.G. | DCX | $50.31 | $45.21 | ↑11% | $53.20 | ↓-5% | $115,524 | $117,980 | ↓-2% | $142,111 | ↓-19% | $2,052 | $2,550 | ↓-20% | $10,310 | ↓-80% |
| Ford Motor | F | $7.21 | $7.60 | ↓-5% | $4.17 | ↑73% | $112,996 | $113,850 | ↓-1% | $160,256 | ↓-29% | $1,613 | $2,949 | ↓-45% | $13,216 | ↓-88% |
| General Motors | MTLQ.Q | $0.71 | $0.81 | ↓-13% | $8.51 | ↓-92% | $129,027 | $148,979 | ↓-13% | $178,980 | ↓-28% | $(8,822) | $(4,653) | ↑90% | $5,610 | ↓-257% |
| Honda Motor | TSE:7267 | $30.90 | $31.62 | ↓-2% | $30.58 | ↑1% | $94,952 | $101,180 | ↓-6% | $112,467 | ↓-16% | $6,872 | $8,361 | ↓-18% | $13,997 | ↓-51% |
| Nissan Motor | TSE:7201 | $6.78 | $7.00 | ↓-3% | $6.92 | ↓-2% | $77,687 | $78,947 | ↓-2% | $100,284 | ↓-23% | $5,046 | $5,276 | ↓-4% | $11,659 | ↓-57% |
| Toyota Motor | TSE:7203 | $39.90 | $42.99 | ↓-7% | $43.72 | ↓-9% | $186,832 | $188,430 | ↓-1% | $240,281 | ↓-22% | $2,905 | $4,233 | ↓-31% | $28,860 | ↓-90% |
| Volkswagen | DB:VOW | $164.95 | $194.74 | ↓-15% | $392.40 | ↓-58% | $154,323 | $152,113 | ↑1% | $159,554 | ↓-3% | $6,529 | $7,287 | ↓-10% | $15,121 | ↓-57% |
| **Supplier** | | | | | | | | | | | | | | | | |
| American Axle | AXL | $7.08 | $6.18 | ↑15% | $5.65 | ↑25% | $1,561 | $1,679 | ↓-7% | $2,361 | ↓-34% | $11 | $(8) | ↓-246% | $154 | ↓-93% |
| ArvinMeritor | ARM | $7.82 | $7.31 | ↑7% | $12.39 | -37% | $4,108 | $5,346 | ↓-23% | $7,167 | ↓-43% | $94 | $178 | ↓-47% | $354 | ↓-73% |
| Autoliv | ALV | $33.60 | $32.07 | ↑5% | $33.98 | ↓-1% | $4,639 | $4,858 | ↓-5% | $7,064 | ↓-34% | $392 | $383 | ↑2% | $893 | ↓-56% |
| BorgWarner | BWA | $30.26 | $29.67 | ↑2% | $31.55 | ↓-4% | $3,695 | $3,984 | ↓-7% | $5,705 | ↓-35% | $242 | $328 | ↓-26% | $732 | ↓-67% |
| Cooper Tire | CTB | $17.58 | $14.28 | ↑23% | $9.29 | ↑89% | $2,642 | $2,633 | ↑0% | $3,011 | ↓-12% | $211 | $86 | ↑146% | $133 | ↑59% |
| Cummins | CMI | $44.81 | $45.32 | ↓-1% | $41.69 | ↑7% | $10,688 | $11,851 | ↓-10% | $14,570 | ↓-27% | $592 | $790 | ↓-25% | $1,478 | ↓-60% |
| Dana Holding | DAN | $6.81 | $5.23 | ↑30% | $4.83 | ↑41% | $5,256 | $5,856 | ↓-10% | $8,731 | ↓-40% | $79 | $75 | ↑5% | $402 | ↓-80% |
| Delphi | DPHLQ | $0.06 | $0.04 | ↑49% | $0.08 | ↓-18% | $13,621 | $15,333 | ↓-11% | $20,224 | ↓-33% | $(585) | $(403) | ↑45% | $55 | ↓-1164% |
| Eaton | ETN | $56.59 | $53.95 | ↑5% | $53.77 | ↑5% | $12,229 | $13,315 | ↓-8% | $15,263 | ↓-20% | $1,034 | $1,212 | ↓-15% | $2,004 | ↓-48% |
| FederalMogul | FDML | $12.07 | $12.58 | ↓-4% | $12.66 | ↓-5% | $5,241 | $5,553 | ↓-6% | $7,295 | ↓-28% | $320 | $371 | ↓-14% | $767 | ↓-58% |
| Gentex | GNTX | $14.15 | $14.59 | ↓-3% | $15.19 | ↓-7% | $489 | $487 | ↑1% | $672 | ↓-27% | $99 | $89 | ↑11% | $171 | ↓-43% |
| Goodyear Tire | GT | $17.03 | $16.49 | ↑3% | $14.86 | ↑15% | $15,999 | $16,786 | ↓-5% | $20,513 | ↓-22% | $559 | $555 | ↑1% | $1,832 | ↓-69% |
| Hayes Lemmerz | HAYZ | $0.05 | $0.05 | ↑2% | $2.73 | ↓-98% | $1,589 | $1,904 | ↓-17% | $2,202 | ↓-28% | $81 | $148 | ↓-45% | $175 | ↓-53% |
| Johnson Controls | JCI | $25.56 | $24.77 | ↑3% | $29.32 | ↓-13% | $28,497 | $29,937 | ↓-5% | $38,062 | ↓-25% | $1,084 | $1,294 | ↓-16% | $2,744 | ↓-60% |
| Lear | LEA | $0.36 | $0.29 | ↑24% | $10.55 | ↓-97% | $10,183 | $11,881 | ↓-14% | $15,270 | ↓-33% | $283 | $473 | ↓-40% | $967 | ↓-71% |
| Linamar | TSX:LNR | $13.27 | $11.54 | ↑15% | $9.94 | ↑33% | $1,565 | $1,646 | ↓-5% | $2,304 | ↓-32% | $139 | $183 | ↓-24% | $340 | ↓-59% |
| Magna Intl. | TSX:MG.A | $42.50 | $45.07 | ↓-6% | $52.76 | ↓-19% | $16,784 | $17,648 | ↓-5% | $25,704 | ↓-35% | $273 | $368 | ↓-26% | $1,858 | ↓-85% |
| Navistar Intl. | NAVZ | $37.42 | $43.24 | ↓-13% | $51.26 | ↓-27% | $12,154 | $13,599 | ↓-11% | $14,055 | ↓-14% | $531 | $937 | ↓-43% | $891 | ↓-40% |
| Tenneco | TEN | $13.04 | $15.70 | ↓-17% | $10.62 | ↑23% | $4,535 | $4,778 | ↓-5% | $6,273 | ↓-28% | $250 | $247 | ↑1% | $419 | ↓-40% |
| TRW Automotive | TRW | $16.75 | $17.65 | ↓-5% | $16.04 | ↑4% | $11,527 | $13,241 | ↓-13% | $15,971 | ↓-28% | $549 | $744 | ↓-26% | $1,335 | ↓-59% |
| Visteon | VC | $0.18 | $0.12 | ↑46% | $2.13 | ↓-92% | $6,307 | $6,694 | ↓-6% | $10,758 | ↓-41% | $144 | $43 | ↑235% | $511 | ↓-72% |
| **Dealer** | | | | | | | | | | | | | | | | |
| AutoNation | AN | $18.08 | $18.98 | ↓-5% | $10.75 | ↑68% | $11,295 | $11,739 | ↓-4% | $14,899 | ↓-24% | $475 | $471 | ↑1% | $629 | ↓-25% |
| Asbury Automotive | ABG | $12.68 | $12.50 | ↑1% | $11.30 | ↑12% | $3,829 | $3,965 | ↓-3% | $4,623 | ↓-17% | $118 | $119 | ↓-1% | $152 | ↓-23% |
| CarMax | KMX | $20.90 | $17.31 | ↑21% | $14.09 | ↑48% | $6,900 | $6,583 | ↑5% | $7,996 | ↓-14% | $302 | $156 | ↑93% | $210 | ↑43% |
| Group 1 Automotive | GPI | $26.85 | $28.17 | ↓-5% | $20.85 | ↑29% | $4,509 | $4,696 | ↓-4% | $6,020 | ↓-25% | $146 | $137 | ↑7% | $198 | ↓-26% |
| Lithia Motors | LAD | $15.59 | $12.81 | ↑22% | $4.50 | ↑246% | $1,809 | $1,858 | ↓-3% | $2,131 | ↓-15% | $65 | $59 | ↑11% | $54 | ↑21% |
| Penske Automotive | PAG | $19.18 | $17.69 | ↑8% | $11.66 | ↑64% | $9,239 | $9,621 | ↓-4% | $12,441 | ↓-26% | $238 | $240 | ↓-1% | $356 | ↓-33% |
| Sonic Automotive | SAH | $10.50 | $12.82 | ↓-18% | $8.68 | ↑21% | $5,098 | $5,193 | ↓-2% | $5,881 | ↓-13% | $156 | $142 | ↑10% | $211 | ↓-26% |

[1]Latest 12 months figures before extraordinary items ($, in millions)
↑Up ↓Down —Same

NM = Not meaningful

Source: Capital IQ and Grant Thornton Automotive Analytics

Attachment 4

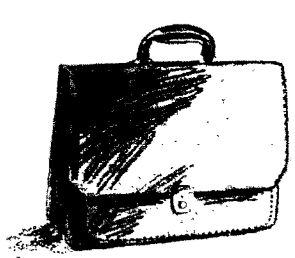
# About the *Automotive Industry Review*

### About the publication

The *Automotive Industry Review* is published quarterly by the automotive analytics team of Grant Thornton LLP's Advisory Services practice. The automotive analytics team, along with other financial and operationally focused professionals in our organization, holds extensive experience in the manufacturing industry, including supply chain advisory.

### About the team

Our breadth of experience includes a unique blend of financial and operational manufacturing understanding coupled with a deep knowledge of issues and events affecting the manufacturing industry. Our diversely skilled team provides unparalleled services in a variety of areas including due diligence, performance improvement, supply chain advisory and crisis management.



Strengths and advantages include:

- A dedicated, experienced team of over 50 advisory professionals working exclusively within the manufacturing industry to provide creative, tailored solutions to our clients' needs.
- A unique mix of financial and operational professionals with industry certifications including professional engineering (PE), inventory management (CPIM), operations (CIRM), Six Sigma and lean (Black Belt and Green Belt), purchasing (CPM), quality (CQA), program management (PMP), supply chain management (CSCP), manufacturing engineering (CMfgE), accounting (CPA), restructuring (CIRA), finance (CFA), and fraud (CFE).
- Extensive experience providing supply chain advisory services to a variety of manufacturing entities — from proactive monitoring and strategic analysis assignments to on-site supplier intervention (financial and operational).
- An innovative technology team that has developed a world-class, Web-based Vontik system allowing customers to collect critical data directly from their supply chain and generate performance scorecards and benchmarks to proactively identify risk/exposure and strengthen their supply base.
- Worldwide manufacturing experience, knowledge and resources to serve clients on a global basis through Grant Thornton International Ltd member firms. •

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| Dallas | Detroit |
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| McLean | New York |
| San Fransisco | |

# Attachment 5

**Watson Wyatt HR Program Survey**

Attachment 5

watsonwyatt.com

# The Effect of the Economy on HR Programs – OESA HR Council Update

October 22, 2009

**SPEAKERS**
Michael Hawkins
Watson Wyatt Worldwide
248.936.7542

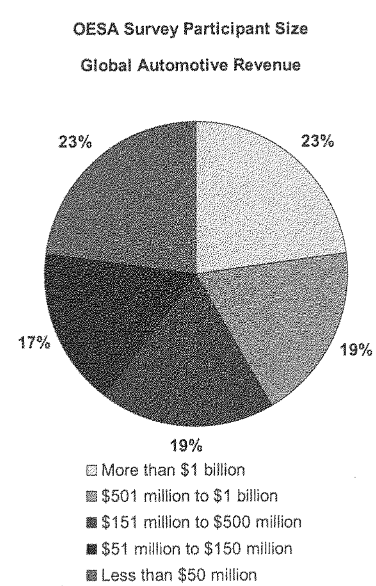
Susan Russell
Watson Wyatt Worldwide
248.936.7522

Watson Wyatt Worldwide

Attachment 5

# About the Survey

- Part of our series of ongoing research on the economic crisis
- Purpose is to understand what adjustments companies are making to their HR programs (e.g., staffing, pay, benefits) in response to the economic downturn
- National Results
  - Fielded from August 3 – August 7, 2009
  - 175 participants from large, U.S.-based companies
- OESA Results
  - Fielded October 2009
  - 49 participants

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Attachment 5

# OESA Participating Companies

- ADAC Automotive
- Anchor Danly
- AWA/ATC-A
- Behr-Hella Thermocontrol, Inc.
- Brose North America
- Camcraft Inc
- Cascade
- Charter Automotive
- Continental Automotive
- Cooper-Standard Automotive Inc.
- CRH North America Inc.
- CSM Worldwide Inc
- Faurecia
- Freudenberg-NOK General Partnership
- GHSP
- Gibbs Die Casting
- Grand Rapids Controls Co., LLC
- GST AutoLeather, Inc
- Hella
- HUSCO Automotive, LLC
- IAV Automotive Engineering Inc.
- Inergy Automotive Systems
- MANN+HUMMEL USA, INC
- MEMA
- Metaldyne
- Michigan Spring and Stamping
- MPC
- Mubea
- NGK Spark Plugs
- NTN
- Peterson American Corporation
- Phillips Industries
- Plastomer Corporation
- PPG Industries
- Remy Inc
- Robert Bosch, LLC.
- Schuler Inc.
- Sellner-Behr Corporation
- SKF USA Inc. Sealing Solutions
- Spartan Light Metal Products
- Stoneridge, Inc.
- TAG Holdings, LLC
- TI Automotive
- Toyoda Gosei North America Corporation
- TWB Company LLC
- Van-Rob
- Viking Plastics
- Yazaki North America
- ZF

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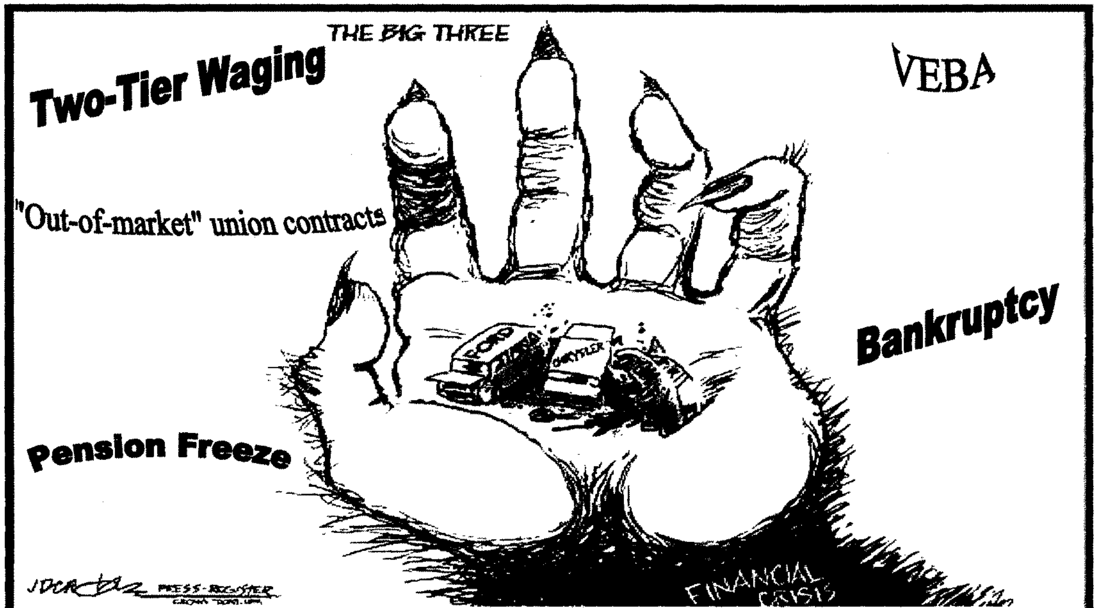
Attachment 5

# How Will the Automotive Industry be Positioned When the Economic Recovery Begins?

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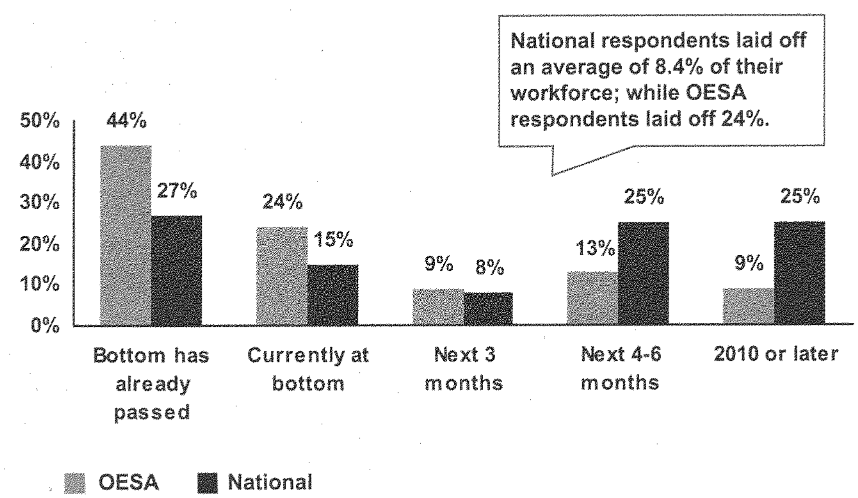
Attachment 5

Figure 1: With regard to the recession, when do you think your company's results will "bottom out" and begin to improve?

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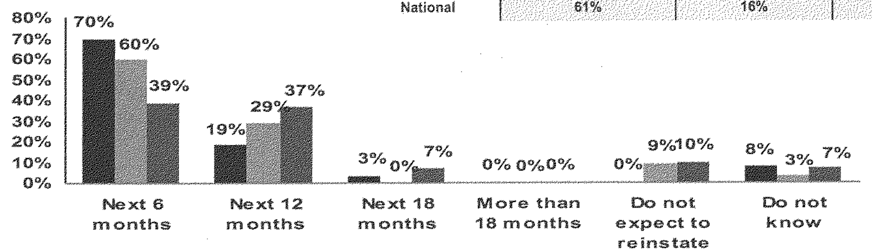
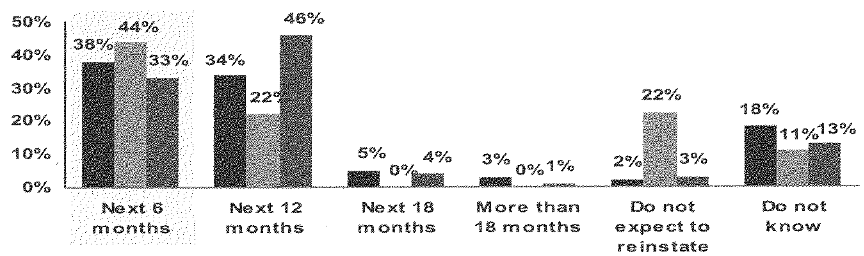
## Figure 2: If you have made changes to your hiring and pay practices, when do you expect to reverse/reinstate the changes?

| Percent that made change | Hiring freeze | Salary reduction | Salary freeze |
|---|---|---|---|
| OESA | 79% | 71% | 90% |
| National | 61% | 16% | 61% |

OESA




NAT'L

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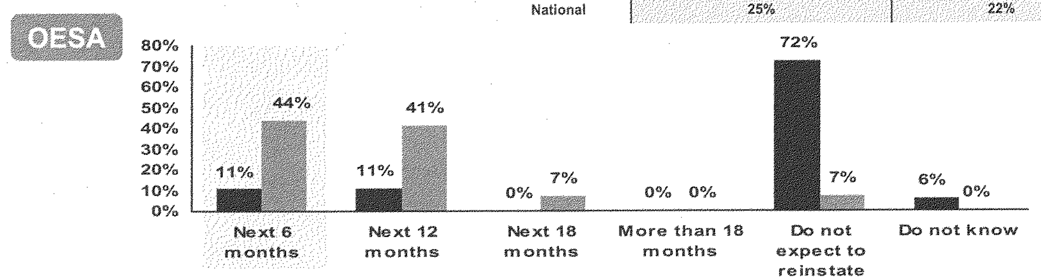
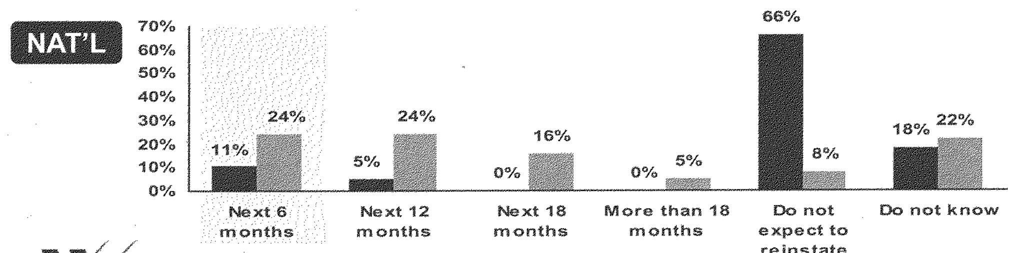
## Figure 3: If you have made changes to your benefits programs, when do you expect to reverse/reinstate the changes?

| Percent that made change | Raise percentage employees pay for health care premiums | Reduce employer 401(k)/403(b) match |
|---|---|---|
| OESA | 43% | 57% |
| National | 25% | 22% |

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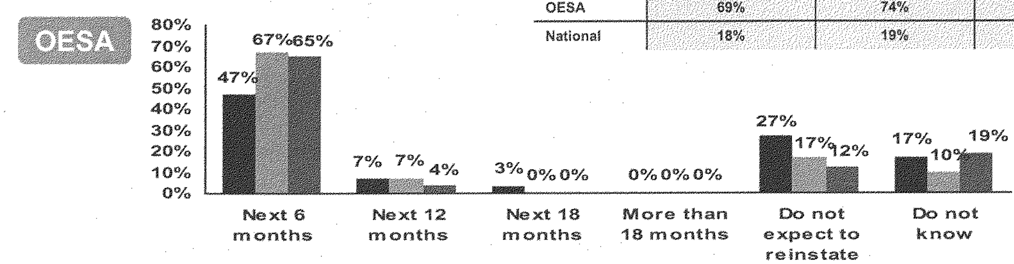
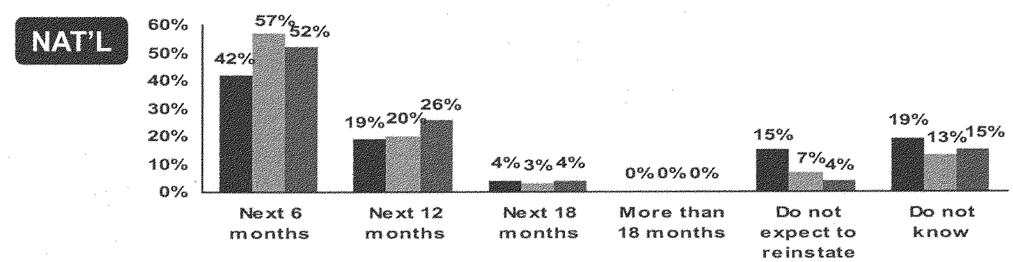
## Figure 4: If you have made changes to worker hours, when do you expect to reverse/reinstate the changes?

| Percent that made change | Mandatory shutdown | Reduced workweek | Mandatory furlough |
|---|---|---|---|
| OESA | 69% | 74% | 62% |
| National | 18% | 19% | 17% |

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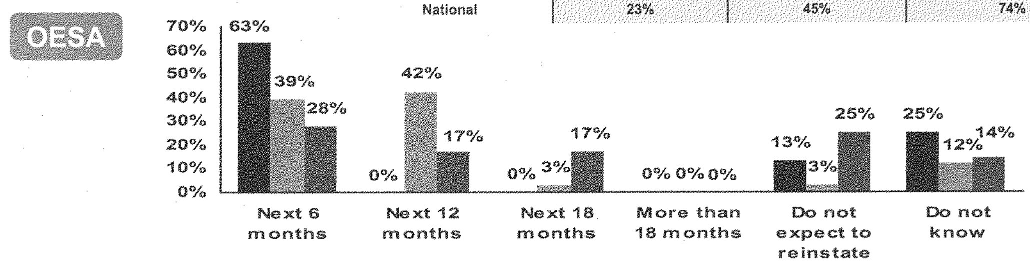
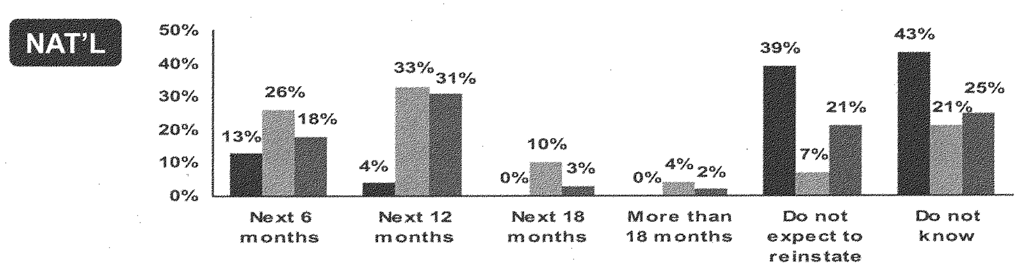
## Figure 5: If you have made changes to other programs, when do you expect to reverse/reinstate the changes?

| Percent that made change | Increase use of recognition plans | Eliminate or reduce training programs | Add/increase restrictions to company travel policy |
|---|---|---|---|
| OESA | 26% | 73% | 83% |
| National | 23% | 45% | 74% |

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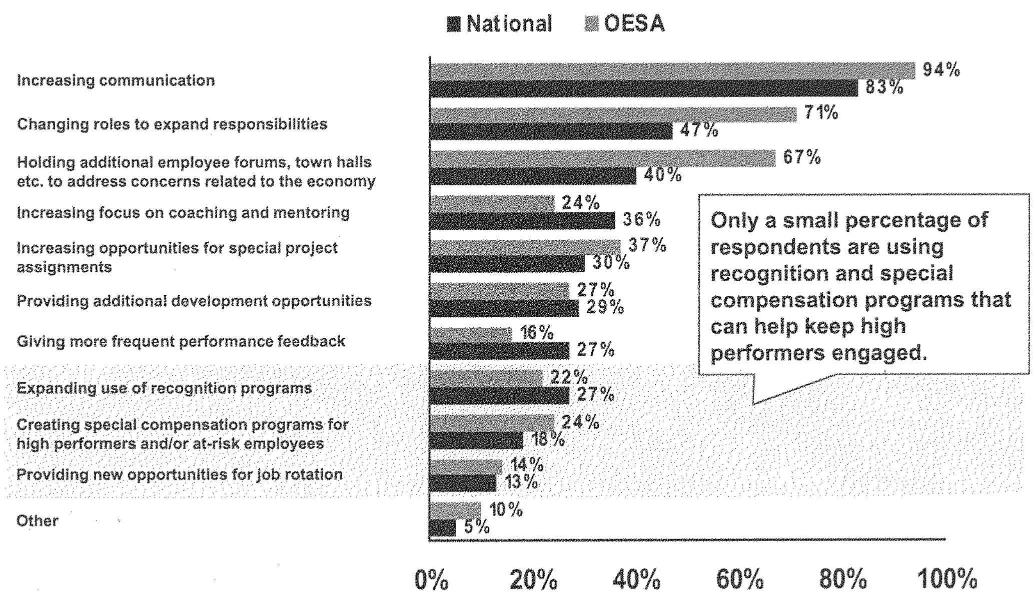
## Figure 6: In light of changes/cuts you have made to HR programs, what are you doing to try to keep employees engaged?

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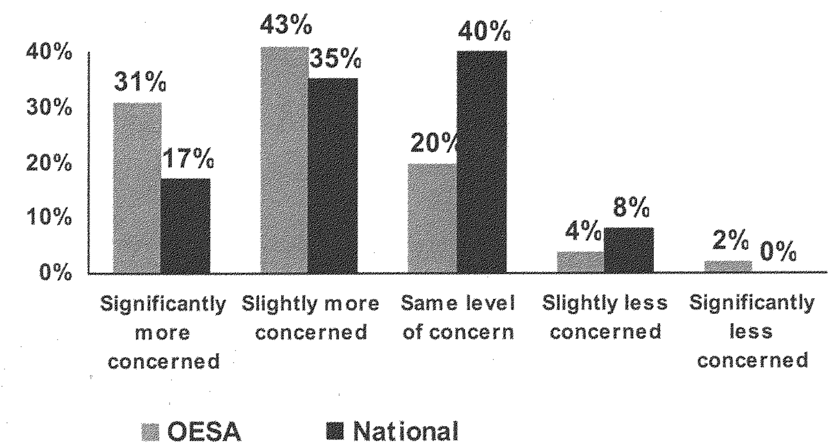
Attachment 5

Figure 7: Compared to your level of concern about retention before the economic crisis hit, to what extent are you concerned about losing critical-skill or top-performing employees when the economy begins a recovery?

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## Figure 8: Looking ahead 3-5 years at your company, do you expect any of the following to permanently change compared to pre-economic crisis levels (September 2008)?

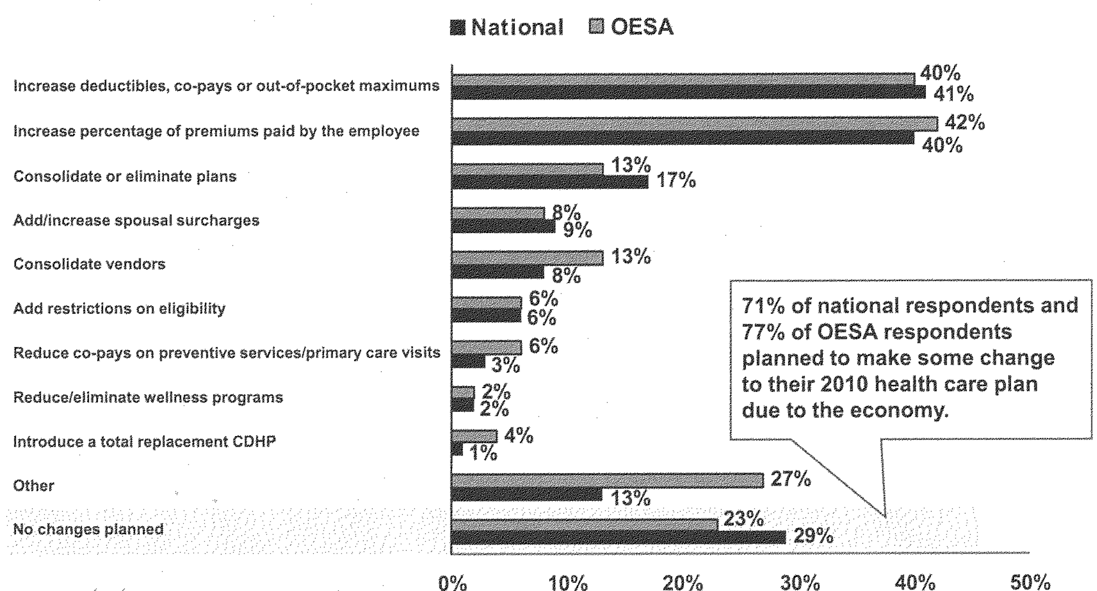
| | Increase | | No change | | Decrease | |
|---|---|---|---|---|---|---|
| | OESA | National | OESA | National | OESA | National |
| Employees working past their desired retirement age | 81% | 83% | 16% | 17% | 2% | 0% |
| Percentage of health care costs paid by employee | 69% | 68% | 27% | 31% | 4% | 2% |
| Development programs for employees | 70% | 52% | 23% | 44% | 6% | 4% |
| Difficulty retaining critical-skill employees | 63% | 49% | 31% | 46% | 6% | 4% |
| Difficulty attracting critical-skill employees | 48% | 46% | 35% | 48% | 17% | 7% |
| Salary increase levels | 39% | 37% | 33% | 42% | 28% | 21% |
| Staff sizes | 35% | 29% | 10% | 28% | 55% | 43% |
| Employer contributions for defined contribution plan (e.g., 401k) | 16% | 14% | 69% | 75% | 14% | 11% |
| Employer contributions for pension plan | 0% | 13% | 77% | 64% | 22% | 23% |

Watson Wyatt Worldwide

Attachment 5

## Figure 9: What changes have you made or will you make to your 2010 health care plan as a result of the economic downturn?




Watson Wyatt Worldwide

Attachment 5

## Figure 10: In the last two months, what changes have you noticed in participant activity in 401(k) or 403(b) plans?

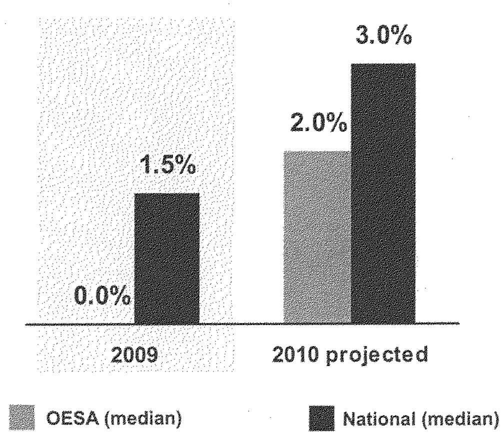
| | Increased | | Stayed the same | | Decreased | |
|---|---|---|---|---|---|---|
| | OESA | National | OESA | National | OESA | National |
| Rate of lending to participants | 51% | 37% | 49% | 63% | 0% | 1% |
| Rate of hardship withdrawals | 54% | 36% | 41% | 63% | 5% | 1% |
| Percent of assets invested in equities | 0% | 5% | 61% | 56% | 39% | 39% |
| Percent of pay contributed by participants | 5% | 2% | 46% | 68% | 49% | 30% |

Watson Wyatt Worldwide

Attachment 5

**Figure 11: Indicate your organization's merit increase budget for 2009 and projection for 2010 (as a percentage of your total payroll).**

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Attachment 5

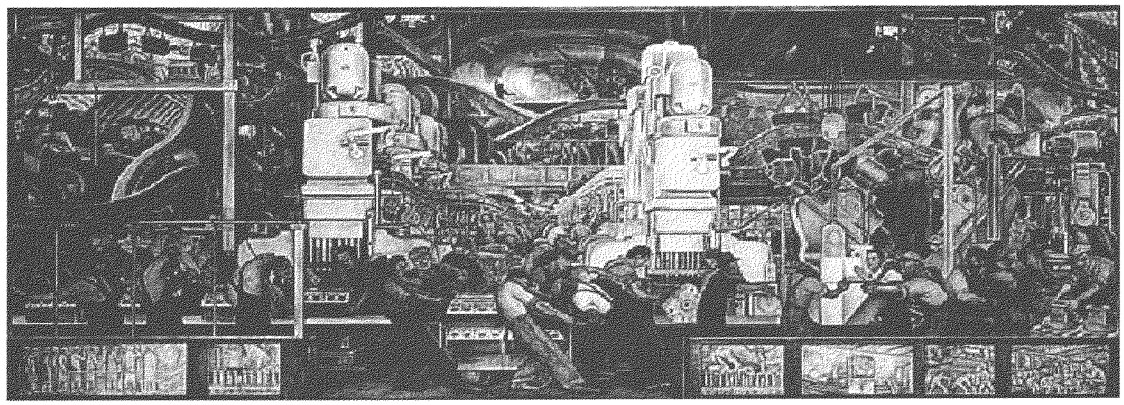
## Figure 12: If your organization offers a short-term incentive plan, how was it funded in the most recently completed year, and what is the projected funding for the current year?

| | Funded last year | | Expect to fund this year | |
|---|---|---|---|---|
| | OESA | National | OESA | National |
| Median STI funding | 20% | 81% | 10% | 76% |

Watson Wyatt Worldwide

Attachment 5

# The Changing Employment Deal



How must the employment deal change in the coming years for an automotive company to remain competitive both within the industry as well as with non-automotive companies?

**What should HR be thinking about – both strategically and tactically?**

Watson Wyatt Worldwide



J:\Hr\00025\09\proj\102209_OESA HR Council Survey Results.ppt

# Attachment 6

**GE Capital Autos Industry Research Monitor**

Attachment 6

GE Capital

Auto & Auto Parts
4Q09

# Industry Research Monitor

To sign up to receive an electronic copy of this Industry Research Monitor, please visit: **www.gelending.com/IRM**

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## Industry Headlines

- Global light vehicle sales have continued to recover with sales up 3% YoY in September to a 64 million unit annualized rate (albeit down 9% YT-Sept). Most of this recovery has been driven by China which – having doubled its sales in recent months from trough December 2008 levels – has now surpassed the U.S. and Western Europe to become the largest light vehicle market in the world so far this year.
- U.S. light vehicle sales dropped back to 9.2 million units on a SAAR basis in September following the end of the U.S. "cash for clunkers" program, which had lifted sales as high as 14 million SAAR units in August. Our regression model suggests sales should recover 12% in 2010 to a level somewhat below a consensus forecast range of 11.5-12.0 million units.
- North American light vehicle production is down 42% YT-September, but rose 34% sequentially in 3Q 2009 vs. 2Q. Inventories have consequently risen off their August lows, but remain relatively low at 56 days supply in September – 9% below the trailing 5-year September average.
- New and used vehicle pricing continues to firm, with Manheim's used vehicle pricing index up 7% YoY in September. Meanwhile, average auto manufacturer incentives dropped 9% YoY in September in the U.S. according to Edmunds.com.
- North American Auto & Auto Parts syndicated loan volume is down 60% in YT-September 2009 based on LPC data for BB+ and lower or unrated credits (largely reflecting absence of $13.4 billion U.S. Treasury loan to GM). Global volume, however, is up 10% over this period (largely reflecting a $14.6 billion Porsche loan).

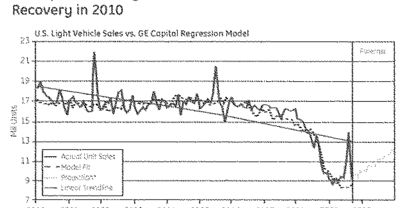
imagination at work

## Current Environment

### Demand:

Global light vehicle sales have continued to rebound from their January lows, with sales up 3% YoY in September (albeit down from a "cash for clunkers" induced spike in August). Developing world demand continues to be the main driver, with September Chinese, Indian and Brazilian passenger car unit sales up 78%, 21% and 25% YoY, respectively. Russia remained the outlier "BRIC" country with unit sales down 52% YoY in September (though up 11% MoM). This booming recovery abroad has helped lift otherwise beleaguered Detroit-3 sales, with GM for example seeing its YT-September sales in China rise 56% and Ford seeing record September sales in Brazil.

**GE Capital's U.S. Light Vehicle Sales Model Points to Recovery in 2010**





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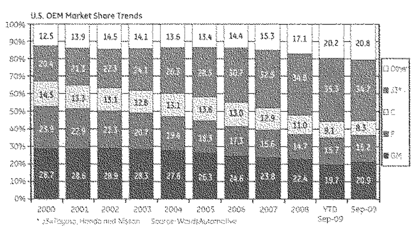
In the developed world, demand has seen improvement, but primarily reflecting various auto scrappage incentive programs.

In Western Europe, light vehicle sales rose 5% in September. In 2009, scrappage incentives are estimated to lift Western European car sales by perhaps 2 million units according to JD Power (Note: Western European YT-September light vehicle annualized sales rate has been about 14.6 million units vs. 15.4 in all of 2008.) In Japan, light vehicle sales were down 15% YT-September but flat YoY in the month of September.

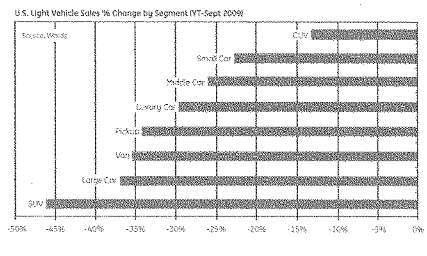
Turning to North America, U.S. light vehicle sales fell back to 9.2 million units on a SAAR basis in September after the "cash for clunkers" program expired in August (with sales in August having spiked to over a 14 million SAAR – see chart p1). Looking forward, GE Capital Research's U.S. light vehicle sales regression model suggests modest improvement vs. September through the balance of 2009 and then a more marked recovery over the course of 2010. Our model's forecast of 11.3 million units in 2010 (vs. an estimate of 10.2 in 2009) is on the low end of the range of concensus expectations, with stubbornly high unemployment a significant drag in our model. However, our model could prove too conservative since it does not really take into account building pent up demand reflective of a sales rate that has been well below the scrappage rate for most of the past year.

**D3 Collective Share Still Falling Despite Ford Lift**




On the U.S. market share front, as shown in the graph above, the Detroit 3's collective share has continued in its downward trend, falling 3.6 percentage points YT-September 2009 to 44.5% vs. full year 2008 share of 48.1%. Ford has been the exception, bucking the trend with a gain of 1.0 percentage point of share YT-September 2009 vs. full year 2008. GM has seen some recent improvement in share from bankruptcy induced lows early this year, but Chrysler continues to shrink. Meanwhile the Asian brands continue to enjoy gains, with the Japanese 3 up 0.5 points and Hyundai up a notable 1.4 points YT-September vs. full year 2008.

**Weakness Spread Across Mix; CUV Sales Less Bad**

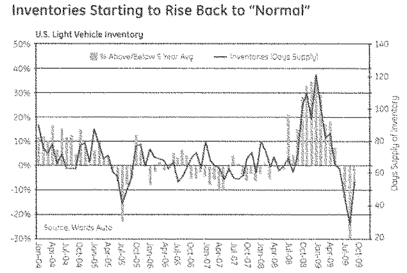



Part of the shift in market share performance continues to reflect shift in share among the product segments, with larger vehicles such as SUVs, vans and pickup trucks continuing to suffer share loss compared to CUVs and smaller cars, YT-September.

## Supply:

**North American light vehicle production has fallen 42% YT-September**, but has risen 34% sequentially in 3Q 2009 vs. 2Q as GM and Chrysler have restarted shuttered idled plants. Inventories have consequently risen off their August lows of only 29 days supply to 56 days supply in September. However, this figure is still relatively low, trailing 9% below the last 5-year average for the month of September.

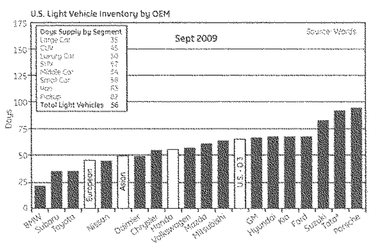
**Inventories Starting to Rise Back to "Normal"**




Note however that "normal" days supply, which used to be in the mid 60's, may be in the process of shifting down toward the mid 50's as the D3 close dealers and move toward more efficient Japanese 3 (J3) dealer throughput levels. As can be seen in the following graph, D3 inventory levels still remain above their European and Asian rivals.

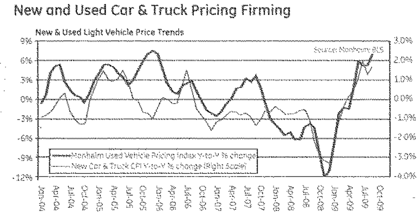
D3 Inventories Still Modestly Higher Than Average




## Pricing & Raw Material Cost Trends:

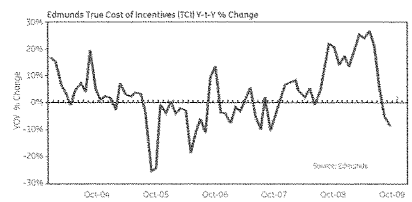
**Light vehicle pricing has generally been firming in recent months,** despite weak sales, reflecting sharp production cuts and low inventories previously discussed. As can be seen in the following graph, both new and used vehicle pricing have risen sequentially since bottoming in December 2008. Manheim's widely followed index of used vehicle pricing has now risen at over a 5% YoY pace over the past four months, with the September figure up 7% YoY. The rise in used car pricing is a particularly favourable omen for the auto industry because: 1) rising used car pricing lifts equity values on trade-ins which helps lift new car sales; 2) a narrower discount for used car pricing supports more new car sales; and 3) leasing offers can be made more attractive based on higher residual value assumptions. New car and truck consumer price index (CPI) has also been rising, up 1-2% YoY in each of the past few months.

New and Used Car & Truck Pricing Firming



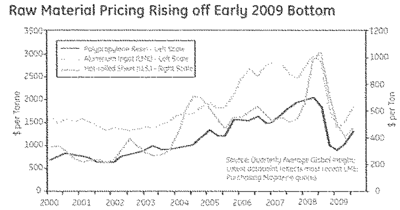

**Relatedly, incentive spending by manufacturers in the U.S. declined 5% in August and 9% in September, YoY** according to Edmunds.com. On an absolute dollar basis, Edmund's measure of U.S. manufacturing incentives have been dropping from a peak of $3,169 in March 2009 to $2,557 in September. The September figure however did rise $83 from the recent August low.

U.S. Light Vehicle Incentives Down YoY




**On the raw material input side, pricing has been on the rebound.** Average spot London Metals Exchange base metals pricing (as measured by the GSFM index) and polypropylene pricing have surged 80% and 160% from their monthly average lows in January 2009. Flat-rolled steel pricing has also rallied sharply, with spot U.S. hot-rolled sheet up 40% since early June 2009 lows (though there have been signs of spot price weakness very recently). Automotive raw material cost trends tend to trail actual spot commodity price movements due to contract pricing that can lag by up to one year in some cases. Consequently, raw material related margin pressures could return in 2010, if present commodity price appreciation trends continue.

Raw Material Pricing Rising off Early 2009 Bottom



## Other Recent Developments

- In early August, the White House senior advisor to the task force on the Auto industry, Ron Bloom, said he believed General Motors could have an initial public offering (IPO) in 2010 and that the company had lowered its breakeven cost sufficiently to be able to break even at a U.S. industry light vehicle SAAR of 10 million units. GM has received about $50 billion for the U.S. government, entitling it to about a 61% ownership position.

- In early October, GM decided to abandon its Saturn brand following a breakdown of negotiations with Penske Automotive. Penske was considering buying Saturn, but failed to strike a deal with another auto manufacturer to take over GM's manufacturing role. Consequently, more than 350 Saturn dealerships are now planned to shut.

- In early October, Ford's CEO Alan Mullaly reaffirmed the company's commitment to be back in the black by 2011 (with some speculating this could come as soon as 3Q 2009 results to be released Nov. 2nd). Somewhat dampening the good news of Ford's market share gains and financial progress was an announcement on October 13th of Ford's largest recall in its history. The National Highway Traffic Safety Administration said the recall involved a total of 16 million Ford Motor vehicles, and was related to a faulty cruise control deactivation switch manufactured by Texas Instruments.

- Chrysler's management team has scheduled the unveiling of its new 2010-2014 plan for November 4th, 2009. The event will be held at the Chrysler Technology Center in Auburn Hills, Michigan.

## Supplier Pressures/Consolidation Continues; Competitive Landscape Shifting.

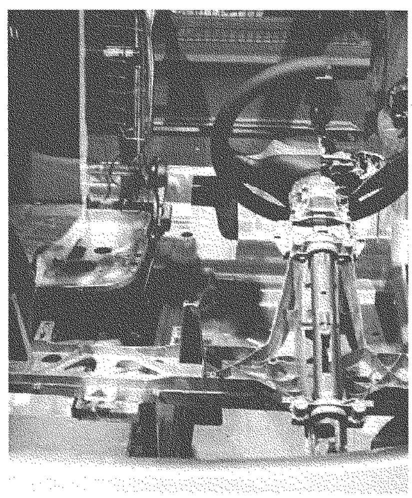
- There has been a surge "into the hundreds" of liquidations of smaller U.S. auto suppliers of late with industrial auctions of auto supplier assets such as stamping presses, CNC machines, assembly line equipment and robotics at their highest level in years (source: Crain's Detroit Business).

- Many auto suppliers are facing liquidity pressures as OEM's ramp up production following plant closures earlier this year. Suppliers can struggle to obtain cash to bridge a typical 45-60 day gap between the start-up of parts production and the receipt of sales revenue. In an effort to alleviate some of this stress while damping the volatility of its own cash outflows, GM announced that beginning December 22nd, it will begin to pay all parts & logistics suppliers to their North American plants on a weekly basis rather than monthly with an intent to eventually expand the program globally.

- Delphi finally exited bankruptcy on October 6th, four years after filing for Ch. 11 on October 8th, 2005. The company emerged following the sale of most of its "core" assets to Delphi LLC, owned by GM and a group led by two hedge funds – Elliot Management and Silver Point Capital. The group agreed to forgive $3.4 billion in loans and invest $900 million in capital. Precise details of the company's plans have not been disclosed. GM, which is dependent on Delphi for about 10% of its parts, put up $1.7 billion to ensure Delphi could emerge. The company, which once had 40 plants in the U.S and over 50,000 employees, now has just 14,000 employees and just 4 plants with one slated to close.

- Lear, which filed for Chapter 11 on July 7th, refinanced its $500 million DIP loan from prepetition lenders with a new $400 million exit loan in early October. Pricing on the $400 million, five-year TLB was flexed down to LIB+550 from LIB+575, and the OID offering narrowed and with subsequent pricing in secondary trade moving above par.

- Visteon, which filed for bankruptcy in May 2009, is in the process of shrinking its non core and unprofitable business, with the Detroit 3, and Nissan is discontinuing certain component parts purchases from Visteon's U.S. plants through a combination of re-sourcing supply agreements to other suppliers or through the sale of some of Visteon's U.S. plants, according to a bankruptcy court filing in early October.



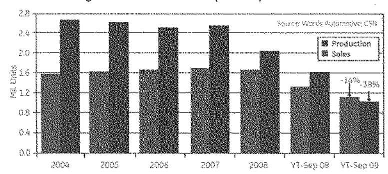
 

# Canada Watch

## Light Vehicle Sales Continue to Slide

Canadian light vehicle sales dropped 7.5% YoY in September and 14% YT-September according to Wards Automotive Group data on a daily selling rate (DSR) basis. September sales also declined 4.5% on a DSR basis vs. August, despite several OEM's marketing campaigns in September that were similar to the "cash for clunkers" prgram in the U.S. but not funded by the Canadian government (Note: the Canadian government recently rejected OEM pleas to fund such a program). Light vehicle production was also down 13% in September and down 38% YT-September.

**Canadian Light Vehicle Sales Slip in September**




GM & Chrysler together have lost 6.5% market share YTD September 2009 vs. a year ago, although Chrysler did see some recovery in the month of September. Meanwhile Hyundai and Ford continue to stand out with share gains of 2.4% and 2.9% YT-September, respectively.

**Canadian Light Vehicle Market Share Trends**

| | YTD Sept 09 % | YTD Sept 08 % | Share Change |
|---|---|---|---|
| GM | 17.8 | 21.8 | -4.0 |
| Ford | 15.7 | 12.8 | 2.9 |
| Toyota | 13.5 | 14.2 | -0.7 |
| Chrysler | 11.0 | 13.5 | -2.5 |
| Honda | 9.6 | 10.7 | -1.1 |
| Hyundai | 7.4 | 5.0 | 2.4 |
| Nissan | 5.5 | 5.1 | 0.4 |
| Mazda | 5.2 | 5.3 | -0.1 |
| VW | 3.5 | 2.8 | 0.7 |
| BMW | 1.9 | 1.6 | 0.3 |
| Other | 8.9 | 7.2 | 1.7 |

Source: Wards Automotive

## Key Developments:

- Contract talks resumed between Ford and the Canadian Auto Workers (CAW) on October 26th. Ford is looking to garner the same concessions the CAW gave GM and Chrysler earlier this year. The CAW continue to look for a guarantee that Ford will maintain its footprint in Canada. Ford thus far refused and says it has no new products planned for its assembly plant in St. Thomas and an engine plant in Windsor, Ontario beyond 2011.

- The purchase of Opel by Canadian auto parts maker Magna International came into question after the EU challenged the agreement over concerns that Germany influenced the deal with 4.5 billion euros in loans and guarantees. The German government called the EU's concerns a misunderstanding and wrote to GM and Opel making clear aid would be available "irrespective of the choice of investor."

- The Nissan-Renault Alliance has signed a MoU with Vancouver and BC Hydro to bring Nissan's LEAF EV into fleet use a year before it goes on sale worldwide. Vancouver already has a plug-in hybrid electric version of the Toyota Prius in its fleet with a conversion module that allows for charging on the grid. It also has an agreement with Nissan competitor Mitsubishi to test two of the Japanese automaker's i-MiEV models, scheduled to arrive later this year. Vancouver now has a bylaw requiring all new single-family homes and off-street bicycle storage rooms to have dedicated electric plug-in outlets.

- Used car pricing has risen steadily in Canada since the summer. Supply has dried up as new car sales have slowed and due to less off lease supply. Also rental agencies are tending to keep cars for a year or more vs. a few months previously.

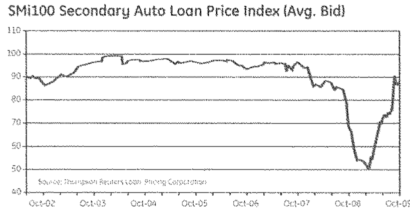
- The Business Development Bank of Canada (BDC) announced that it has introduced a new temporary Purchase Order Financing initiative to help auto parts manufacturers resume production as demand improves. To be eligible for the financing, suppliers have to be commercially-viable and have a minimum of 40% of sales in auto parts manufacturing. The minimum individual purchase order is CA$125,000 and there must be a confirmed purchase order from a qualified buyer. Individual loans are repayable through regular, short-term financing facilities, and the loan must be secured mainly by financed goods. Other guarantee requirements may apply.

# Loan Market Trends

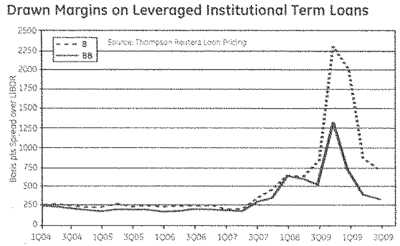
U.S. loan markets saw continued improvement in 3Q 2009 driven by a dramatic rally in the secondary loan market. As of mid October, the automotive sub component of the SMi100 had rallied to near 90 (see chart). The rally has been driven by a lack of new issuance, enhanced liquidity from loan paydowns and improving macroeconomic indicators.

**SMi100 Secondary Auto Loan Price Index (Avg. Bid)**



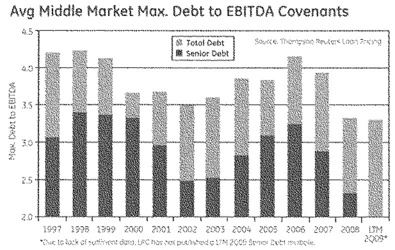

In the primary market, investors are continuing to favor higher quality credits as evidenced by a still wide spread between BB and B rated credits, though both have seen spreads narrow from peak end 2008 levels.

**Drawn Margins on Leveraged Institutional Term Loans**



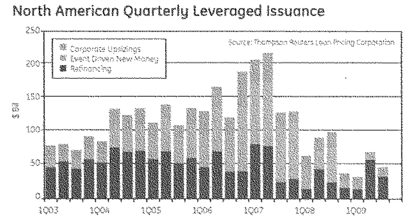

Middle market covenant levels continued to tighten in H1 2009.

**Avg Middle Market Max. Debt to EBITDA Covenants**



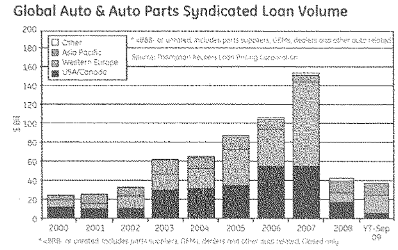

Leverage loan issuance dropped 53% in 3Q 2009 YoY to $47 billion, with most of the volume continuing to be driven by refinancings. "Event driven new money" issuance was down 95%.

**North American Quarterly Leveraged Issuance**



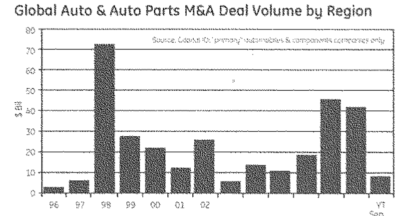

Auto & Auto Parts sector total global syndicated loan volume for BB+ and lower or unrated credits is actually up 10% YT-September 2009, but this reflects the outlier impact of a $14.6 billion loan to Porsche. North American loan volume is down 60% YT-September.

**Global Auto & Auto Parts Syndicated Loan Volume**




Global Auto & Auto Parts M&A activity has slowed considerably vs. the elevated levels seen in the 2004-2008 period, but is expected to pick up in the quarters ahead.

**Global Auto & Auto Parts M&A Deal Volume by Region**



## Spotlight Transaction

On September 8th 2009, GE Capital, Corporate Finance announced it was administrative agent for a $151 million asset-based credit facility to Kumho Tire U.S.A., Inc., the U.S. distributor of South Korea-based Kumho Tire Co., Inc. GE Capital Markets served as co-lead arranger. The loan will be used for working capital needs.

Founded in 1975 and headquartered in Rancho Cucamonga, CA, Kumho Tire U.S.A. is the U.S. distribution arm of Kumho Tire Co., the Seoul, South Korea manufacturer and distributor of tires for passenger cars, trucks and other vehicles.

**"GE Capital has served Kumho since 2006 and they are extremely knowledgeable about our business and the automotive marketplace at large," said J. B. Kim, president and CEO of Kumho Tire U.S.A. "GE's significant financial commitment helps us meet our day-to-day working capital needs."**

"We specialize in working with clients to understand the challenges and opportunities in key sectors such as automotive," added Tom Quindlen, president and CEO, GE Capital, Corporate Finance. "This knowledge helps us provide clients with smarter liquidity to support their business plans."

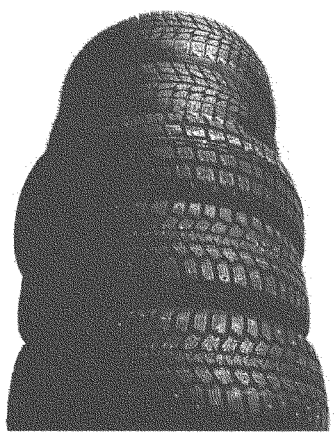
Administrative Agent
Co-Lead Arranger

$151,000,000
Asset-Based Credit Facility

Provided to:

KUMHO TIRES

Auto & Auto Parts



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# Attachment 7

**September 2009 OESA Supplier Barometer**

Attachment 7

# OESA
# Automotive Supplier Barometer

## September 2009

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# September 2009 OESA Supplier Barometer Summary

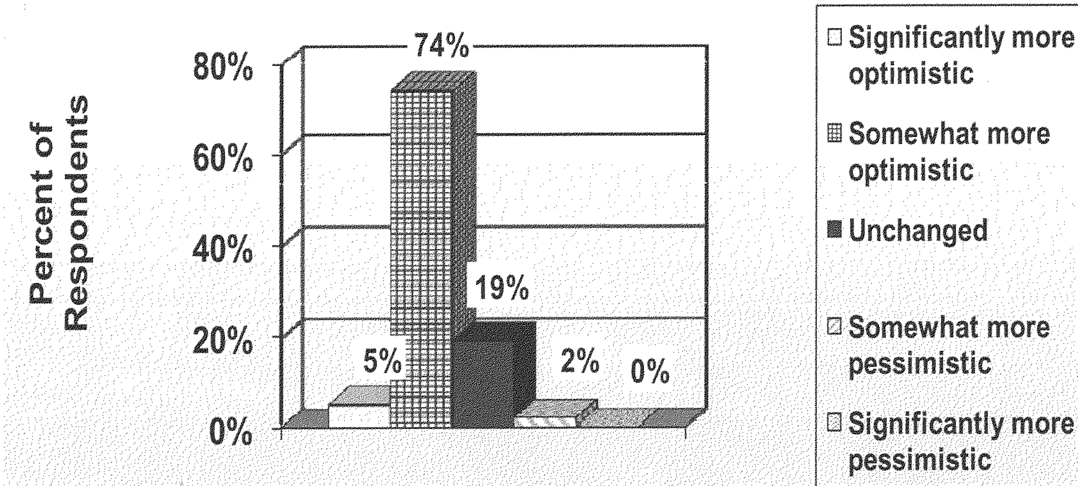
- "Cautiously optimistic" is the best description of the North American supply base. Cash for clunkers - from the suppliers' perspective - was a great success, triggering an increase in production orders, general business confidence and capital expenditure programs. The OESA Automotive Supplier Barometer Sentiment index rose a full 10 points to 72 in September. However, the respondents sprinkled their comments with phrases such as "a blip" and "too early to celebrate" such that it is easy to see there is a great amount of reserve that the spike in production schedules is far from permanent.
- A positive thread through the commentary relates to the level of cost reduction and restructuring that has taken place. Here, suppliers are optimistic that even if production schedules do fall off in the later part of the fourth quarter and into 2010 they still will remain profitable.
- The result of this painful cost cutting and restructuring is a much lower breakeven point for the supply base. The median breakeven unit level for this group of respondents is 9.5 million units. The respondents, in turn, estimate 2010 North American production volume will be 10.1 million units. This means that even with a modest increase in production, suppliers, on average, should be above their breakeven point next year.
- While there are indications that bank credit is easing and opening up for the suppliers, the respondents to this survey indicate that not a significant amount has changed over the past three months. In fact, when the sample is divided between companies larger and smaller than $500 million in revenue, it is clear that the borrowing conditions for smaller suppliers has not improved. Across all the dimensions describing lines of credit and commercial lending - including terms, costs and maturities - smaller suppliers report a greater variation of lending conditions that leans towards tighter conditions.

# September 2009 OESA Supplier Barometer Summary (continued)

- The sample base is generally confident that they will have access over the short-term to capital in the amounts and costs necessary to fund their businesses. However, smaller firms are less confident they will have adequate access to necessary capital for plant and equipment acquisitions, M&A opportunities and program consolidation leads.
- Suppliers are looking at all strategies - including in-sourcing - to manage fixed costs, minimize supply chain risk and control critical capabilities. Thirty-seven percent of the suppliers responding to this survey noted their companies had increased the level of vertical integration over the last 6 months.
- One issue that has been contentious between vehicle manufacturers and suppliers is the issue of progress payments for tooling programs. This is also an issue for bankers as program cancellations, payment delays and volume volatility introduces significant risk into the lending equation. The respondents indicate costs can be reduced and working relationships improved if tooling progress payments were introduced. Interestingly, it appears a customer might get a competitive advantage with better access to technology, greatly improving costing accuracy and a quicker response time from its suppliers.
- While the supplier comments indicate caution regarding further government assistance for the industry, there clearly is a desire to make the R&D tax credit permanent and to expand direct grants for R&D. Other governmental assistance, such as loan guarantees, account receivable guarantees and direct loan programs are more attractive to smaller suppliers than larger suppliers. This is consistent with the previous commercial lending questions where smaller suppliers indicated lending was constrained in their sector.
- Short-term risk to the suppliers' business plans are centered around production volumes, energy and material price and availability and the viability of the OEMs.

Attachment 7

**Question 1:** Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:




Responses = 112

## Question 1 Comments: Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

**Significantly More Optimistic**

- "Liquidity appears to be easing. Consumer confidence is rising and industrial purchasing managers' data strengthening. However, the "significantly more optimistic" outlook still reflects a 2010 business level that is more than 20 percent lower than 2008. The cost structure of our business is now radically different from what it was in 2008."
- "NA sales and production have hit bottom. Even though sales are at dismal levels, inventory is down and fleet demand should improve boosting production above breakeven points, at least for the balance of the year."
- "While competitors were cutting back, we became much more aggressive. Increased effort resulted in two business awards."

**Somewhat More Optimistic**

- "Some personnel who were laid-off are back on payroll due to increasing sales."
- "Very modest vehicle production recovery forecasted, with a whole bunch of caution around 1st quarter 2010 and potential "W" recovery cycle."
- "New program awards have provided our company with some optimism, but the overall over-capacity in our industry coupled with uncertain future sales demand keeps our optimism in check."

**Question 1 Comments (continued):** Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

**Somewhat More Optimistic (Continued)**

- "August and September releases have been much stronger than prior periods. There is concern that this may be a temporary reaction to the vehicle inventory depletion spurred by the cash for clunkers program and that the higher level releases will not be sustained through the 4th quarter and into the 1st quarter 2010."
- "We see an up-tick in sales and our cost cutting activities now have full traction."
- "We have gained some new business opportunities."
- "We are about 5 percent above our forecast for August and September."
- "Customer demand for product has increased slightly but consistently over the last couple of forecasts."
- "Customer programs, which were delayed, are being implemented/launched in early 2010."
- "OEM releases steadily increased in each of the last two months for our 2nd half (October to March) across all OEMs, Detroit Three and Asian Four."

## **Question 1 Comments (continued):** Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

**Somewhat More Optimistic (continued)**

- "Trend for incoming orders is up, but there is caution given the end of the "clunker program."
- "Only increased in 2009 due to cash for clunkers becoming a reality."
- "Although Q3 and Q4 shows improvement in North and South America, we are realistic that production recovery in the auto sector is going to continue at a slow pace into 2010 in North America and Europe. Scrappage sales rates do not equate to sustainable demand, so we expect the forecasts by CSM and PWC Auto Institute will be closer to reality. Fiat-Chrysler impact on the U.S. market remains a question mark in the near-term. Following restructuring actions in the past year, we are positioned to make money at lower volume levels in North America, but continue to pursue restructuring actions in Europe, where overcapacity reigns and the pace of recovery is slack."
- "Forecasts from customers beyond 60 days are still cloudy."
- "Build schedules have gone up significantly but I worry that the increase will only be temporary."
- "Somewhat cautious as we are hopeful the increased volumes will be more predictable."
- "Recession has formally ended. However, employment will remain weak until 3Q09 from what I can see."
- "Appear to have reached the bottom. Indications of a slight up-tick in activity."
- "Slight recovery in NA."

## **Question 1 Comments (continued):** Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

**Somewhat More Optimistic (continued)**

- "Great deal of uncertainty about the consumer's willingness to buy. Would like to believe the volume increases OEMs are ordering will be taken up by the market."
- "Volumes have stabilized somewhat, long way to go but trend is upward rather than downward."
- "We are seeing customer demand/pulls increase for the rest of 2009. However, this may be just a short-term increase do to pipeline fill and replacement of short stock at the dealer level. In 2010 we still believe that there is significant weakness in the market."
- "There are still many unknown issues. GM, Ford, and Chrysler are coming after givebacks for 2009. How can the supply base survive after this economic disaster?"
- "Releases are up."
- "Depends on aftermath from the clunkers deal."
- "July through October have been/will be decent months for us in terms of sales. We have gained market share within the last 12 months."
- "More optimistic, but the question is how long will the optimism last. One month, two months, three months . . ."
- "Too early to get too excited. Things can go right back in the tank very quickly."
- "We have seen a definite increase in releases from customers and in CSM's forecast for 2010."
- "Slow recovery."

## Question 1 Comments (continued): Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

**Unchanged**

- "We are expecting 2010 volumes to be only slightly better than 2009."
- "Economic recovery forecasted to be slow. Orders will pick-up due to cash for clunkers then subside in November and December as car sales remain weak."
- "Cash for clunkers is only a blip."
- We continue to take a somewhat pessimistic view of the next year based on a weaker European vehicle market in 2010."
- "Concerned that the commercial real estate bubble will burst and lingering unemployment will suppress a quick recovery."
- "Still concerned with a fall off in November and December as a result of cash for clunkers."
- "We see a slow and protracted market recovery - unchanged."
- "Very guarded. While some indicators seem positive, production schedules remain volatile and customers continue to string out receivables."
- "Although currently optimistic, concerned that the cash for clunkers program stole a good Q3 and ramp into 2010 and pushed it into Q3 leaving us another decline we need to experience before things get better."
- "Other than short-term volume improvements, I do not see any significant up-tick in expected volumes for 2010 versus what we knew last quarter."

Attachment 7

OESA

**Question 1 Comments (continued):** Describe the general twelve month outlook for your business. Over the past two months, has your opinion become:

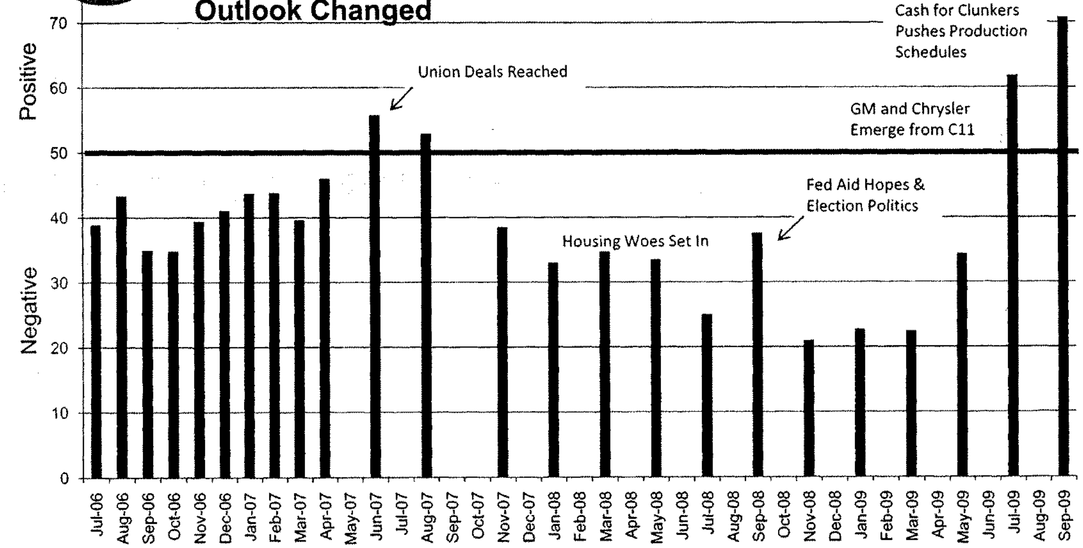
**Somewhat More Pessimistic**

- "Things have stabilized as far as sales, but still extremely slow."
- "Orders seemed to up-tick in July and August, now customers are pulling orders in anticipation of weak 4th quarter."

Attachment 7

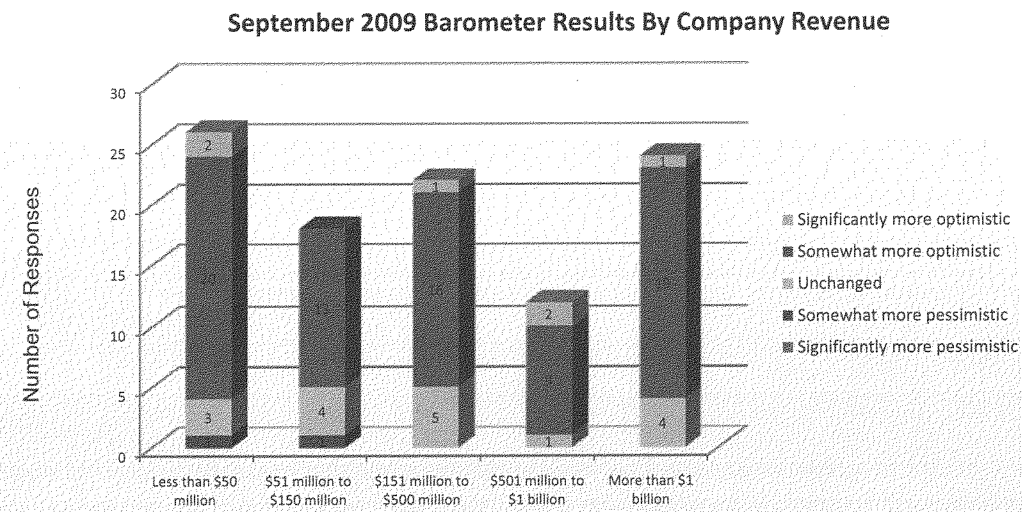
# Supplier Sentiment Index

## Compared to Two Months Ago, How has Your 12 Month Outlook Changed



Attachment 7

# September 2009 Barometer Results By Company Revenue



Attachment 7

**Question 2:** Considering your lead commercial bank, over the past three months how have the terms of your commercial and industrial loan or credit line applications changed? (Number of Respondents)

| | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| **Cost of credit lines** | 15 | 25 | 46 | 3 | 0 |
| **Maximum maturity of credit lines** | 8 | 13 | 63 | 2 | 0 |
| **Maximum size of commercial loans** | 15 | 10 | 61 | 2 | 0 |
| **Commercial loan interest rates** | 13 | 24 | 47 | 3 | 0 |
| **Commercial loan covenants** | 14 | 23 | 48 | 2 | 0 |
| **Commercial loan collateralization requirements** | 12 | 11 | 60 | 3 | 0 |
| **Maximum maturity of commercial loans** | 11 | 8 | 63 | 2 | 0 |

*Rated 1-5 using the following guidelines: 1=Tightened Considerably; 2=Tightened Somewhat; 3=Remained Basically Unchanged; 4= Eased Somewhat; 5=Eased Considerably*

Responses = 89

Attachment 7

**Question 2:** Considering your lead commercial bank, over the past three months how have the terms of your commercial and industrial loan or credit line applications changed?
(Number of Respondents by Company Revenue)

| Cost of credit lines | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 4 | 6 | 17 | 0 | 0 |
| $500 Million or less | 10 | 18 | 26 | 2 | 0 |

| Maximum maturity of credit lines | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 3 | 6 | 18 | 0 | 0 |
| $500 Million or less | 4 | 6 | 41 | 2 | 0 |

| Maximum size of commercial loans | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 5 | 3 | 18 | 1 | 0 |
| $500 Million or less | 8 | 7 | 39 | 1 | 0 |

*Rated 1-5 using the following guidelines: 1=Tightened Considerably; 2=Tightened Somewhat; 3=Remained Basically Unchanged; 4= Eased Somewhat; 5=Eased Considerably*

Attachment 7

**Question 2:** Considering your lead commercial bank, over the past three months how have the terms of your commercial and industrial loan or credit line applications changed?
(Number of Respondents by Company Revenue)

| Commercial loan interest rates | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 5 | 5 | 17 | 0 | 0 |
| $500 Million or less | 8 | 17 | 27 | 2 | 0 |

| Commercial loan covenants | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 4 | 6 | 16 | 1 | 0 |
| $500 Million or less | 8 | 17 | 28 | 1 | 0 |

| Commercial loan collateralization requirements | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 4 | 3 | 19 | 0 | 0 |
| $500 Million or less | 7 | 8 | 37 | 2 | 0 |

| Maximum maturity of commercial loans | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 4 | 3 | 19 | 0 | 0 |
| $500 Million or less | 6 | 4 | 40 | 2 | 0 |

Attachment 7

**Question 3:** Over the next 4 to 6 months, do you have confidence that you will be able to access required levels of capital at appropriate costs for the following uses? (Number of Respondents)

| | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| **Inventory financing** | 42 | 41 | 18 | 4 | 1 |
| **Accounts payable financing** | 39 | 39 | 23 | 3 | 1 |
| **Plant and equipment investment** | 25 | 40 | 20 | 15 | 5 |
| **Other working capital needs** | 29 | 38 | 26 | 10 | 2 |
| **Merger & acquisition opportunities** | 17 | 22 | 26 | 17 | 19 |
| **Program consolidation opportunities** | 15 | 32 | 38 | 9 | 6 |

*Rated 1-5 using the following guidelines: 1= Significant confidence; 2= Moderate confidence; 3= Neither confident or unconfident; 4= Moderately unconfident; 5= Significant low confidence*

Responses = 106

**Question 3:** Over the next 4 to 6 months, do you have confidence that you will be able to access required levels of capital at appropriate costs for the following uses?
(Number of Respondents by Company Revenue)

| Inventory financing | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 14 | 9 | 8 | 1 | 1 |
| $500 Million or less | 26 | 28 | 8 | 3 | 0 |

| Accounts payable financing | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 14 | 10 | 7 | 1 | 1 |
| $500 Million or less | 24 | 24 | 15 | 2 | 0 |

| Plant and equipment investment | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 10 | 12 | 5 | 4 | 2 |
| $500 Million or less | 15 | 23 | 14 | 10 | 3 |

*Rated 1-5 using the following guidelines: 1= Significant confidence; 2= Moderate confidence; 3= Neither confident or unconfident; 4= Moderately unconfident; 5= Significant low confidence*

Attachment 7

**Question 3:** Over the next 4 to 6 months, do you have confidence that you will be able to access required levels of capital at appropriate costs for the following uses? (Number of Respondents by Company Revenue)

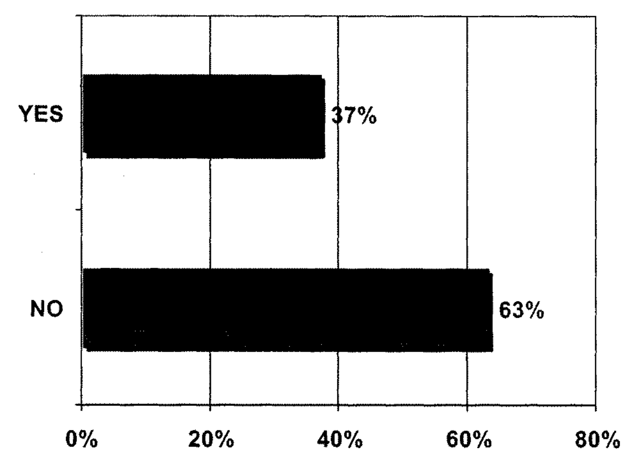
| Other working capital needs | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 10 | 11 | 8 | 2 | 1 |
| $500 Million or less | 18 | 23 | 17 | 7 | 1 |

| Merger & acquisition opportunities | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 7 | 9 | 10 | 4 | 3 |
| $500 Million or less | 10 | 11 | 15 | 12 | 14 |

| Program consolidation opportunities | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 7 | 8 | 13 | 2 | 2 |
| $500 Million or less | 8 | 21 | 23 | 7 | 3 |

*Rated 1-5 using the following guidelines: 1= Significant confidence; 2= Moderate confidence; 3= Neither confident or unconfident; 4= Moderately unconfident; 5= Significant low confidence*

**Question 4:** Over the past six months, has your company in-sourced material fabricating or component manufacturing that was previously produced by an outside supplier?




Responses = 109

Attachment 7

**Question 5:** Considering North American light duty vehicle production, what is your 2010 planning volume and estimated breakeven volume? (in millions of units)

| | 2010 NA Light Duty Vehicle Production Planning Volume | 2010 Estimated NA Light Duty Breakeven Point |
|---|---|---|
| **Mean** | 10.37 | 9.51 |
| **Median** | 10.10 | 9.50 |
| **Upper Quartile** | 11.00 | 10.00 |
| **Lower Quartile** | 9.90 | 8.93 |

Responses = 95

## **Question 6a:** How would your calculated tooling cost of capital and overall tooling costs change if the customer provided tooling progress payments? (number of similar responses and representative comments)

**Slight Reduction (no or under 5% cost reductions) (33 responses)**

- "Straight mathematical offset to price."
- "Yes we would build less hedge in it."
- "They would decrease 3% - 5%."
- "Not significantly. We have shifted burden to suppliers and are using EDC financing. Maybe a few percent pick-up."
- "We expect progress payments. Add interest + risk premium if they do not pay in progress payments."
- "This would likely reduce our cost of tooling by 5% as it would help the tool shops operate and survive and reduce financing costs. It would also increase the number of shops quoting."

**Significant Change (greater than 10% identified) (3 responses)**

- "The cost would be reduced by at least 30%."

**NO CHANGE or Not an Issue (25 responses)**

- "They would clearly improve, but tooling costs are what they are and we would not discount for progress payments."
- "Assuming a 9 month tooling lead time to PPAP very little to zero. Its so competitive right now that for standard lead time tooling there is very little cost of capital allowed in the tooling bid."

## **Question 6a (continued):** How would your calculated tooling cost of capital and overall tooling costs change if the customer provided tooling progress payments? (number of similar responses and representative comments)

**Cash flow improvement (5 responses)**

- "Of course, it will help on cash flow for tooling. Other than that we don't see much change."
- "Since we currently fund $5-$10 million in customer tooling costs at any point in time, our cash flow would be significantly improved (note: our annual sales are just over $100 million)."
- "Positive improvement to cash required, now demanding their payments to mirror our supply base."

**Already Receiving Progress Payments (5 responses)**

- "Currently we are asking most customer to make tool progress payments. This not change much for our corporation."
- "Customers already give us 40/30/30 progress payments in most sectors."

**Not Applicable (9 responses)**

## **Question 6a (continued):** How would your calculated tooling cost of capital and overall tooling costs change if the customer provided tooling progress payments?

**General Comments:**

- "We have a very disciplined formula which would comprehend that benefit."
- "It would improve our confidence on being paid. No other significant impact."
- "We are pushing hard for progress payments on every tool. Nearly 50% of new tool launches come with some sort of progress payment."
- "Would time sequence the payments into our discounted cash flow model to calculate program NPV and IRR."
- "With the tight credit market we may not be able to secure financing for new cap expense. We do need help from the OEM or Tier 1's to support new capital investment. Progress payment for tooling is needed from customers, we can no longer support the up front investment."
- "Tooling progress payments in this environment are almost necessary. Currently no major tooling programs in process, but conditions would not be viable without some form of financing."
- "This is almost a mandatory requirement going forward in this industry unless the financial situation changes."
- "We're more focused on the cash flow side: can the program's cash flow be positive while paying for tooling. "
- "Would free up working capital to be invested in other areas"
- "We would be more aggressive in purchasing capital for future programs."

## **Question 6b:** How would your customer working relationships change if the customer provided progress payments? (number of similar responses and representative comments)

**It would Improve Working Relationships (50 responses)**

- "The relationship would see major gains. A HUGE portion of the customer relationship is burdened by conversations about program risk, volumes, investment recovery, etc."
- "Upper management would definitely be more willing to do business with automotive customers."
- "There would be more of a partnership relationship and we would be more willing to assist the OEM when they were in trouble."
- "Relationship would improve and we would be less conservative on pricing due to the customer sharing some of the volume risk. We are hedging our bets now."
- "It would improve and it would increase our companies response time for basic part quotations."
- "It would help our relationships and we would be more inclined to investment in advanced development activities."
- "As we need to look at the total cost of supporting a project, from Design & Developmet to tooling to manufacturing cost, any chance we have to lower our cost by receiving progress payments allow for us to lower our piece price to the customer."
- "It would reduce the stress from payment delaying activities."
- "Progress payments on tooling would improve cash flow and reduce risk and exposure on tooling. This would relieve some of the pressure to final approvals for billing. Other critical factors include getting accurate and timely PO's from the customer."
- "It would improve greatly. Their cost of capital is less then ours and they have more availability. The environment is changing and suppliers can no longer fund major capital or tooling expense with advances or progress payment."

## **Question 6b (continued):** How would your customer working relationships change if the customer provided progress payments? (number of similar responses and representative comments)

**No significant change seen (22)**

- "We work well with our customers and have an open dialogue regarding business issues
- Eliminating the financing burden could potentially increase our flexibility in negotiating, however it's unclear whether the OE tooling audits would become increasingly invasive and increase the frequency of disputes.

- **Currently Operating with Progress Payments (7)**
- Some of our customers (Tier 1) provide progress payments, such as 1/3 down, 1/3 initial samples, and 1/3 at PPAP. We typically quote more aggressively with these types of payment terms.
- Not much because already in place to some extent.

- More difficult (3)

- **Not Applicable (8)**

Attachment 7

**Question 7:** As you look at your capital requirements and your access to capital over the next 3 to 6 months, how valuable would the following governmental actions be to improve your business situation? (Number of Respondents)

| | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| **Guarantees to support account receivables borrowing** | 12 | 20 | 20 | 10 | 29 |
| **Revolving loans for retooling and re-equipping supplier facilities** | 14 | 22 | 19 | 14 | 22 |
| **Loan guarantees to support commercial lending** | 28 | 12 | 24 | 7 | 20 |
| **Direct grants for R&D and product development** | 23 | 24 | 19 | 12 | 15 |
| **DIP lending fund for restructuring in bankruptcy** | 6 | 6 | 11 | 15 | 50 |
| **Permanent R&D tax credit** | 30 | 25 | 19 | 10 | 10 |
| **Consumer tax credits for purchasing advanced technology products** | 18 | 16 | 20 | 17 | 18 |

*Rated 1-5 where: 1 = most valuable and 5 = least valuable* Responses = 93

**Question 7:** As you look at your capital requirements and your access to capital over the next 3 to 6 months, how valuable would the following governmental actions be to improve your business situation? (Number of Respondents by Company Revenue)

| Guarantees to support account receivables borrowing | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 5 | 2 | 7 | 1 | 13 |
| $500 Million or less | 7 | 17 | 13 | 7 | 15 |
| **Revolving loans for retooling and re-equipping supplier facilities** | **1** | **2** | **3** | **4** | **5** |
| > $500 Million | 6 | 3 | 8 | 3 | 8 |
| $500 Million or less | 7 | 19 | 10 | 10 | 13 |
| **Loan guarantees to support commercial lending** | **1** | **2** | **3** | **4** | **5** |
| > $500 Million | 6 | 1 | 9 | 2 | 10 |
| $500 Million or less | 20 | 11 | 15 | 4 | 9 |

*Rated 1-5 where: 1 = most valuable and 5 = least valuable*

Attachment 7

**Question 7:** As you look at your capital requirements and your access to capital over the next 3 to 6 months, how valuable would the following governmental actions be to improve your business situation? (Number of Respondents by Company Revenue)

| Direct grants for R&D and product development | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| > $500 Million | 11 | 5 | 4 | 3 | 6 |
| $500 Million or less | 11 | 17 | 14 | 9 | 8 |
| **DIP lending fund for restructuring in bankruptcy** | **1** | **2** | **3** | **4** | **5** |
| > $500 Million | 3 | 2 | 5 | 2 | 15 |
| $500 Million or less | 3 | 4 | 6 | 12 | 33 |
| **Permanent R&D tax credit** | **1** | **2** | **3** | **4** | **5** |
| > $500 Million | 14 | 5 | 3 | 2 | 5 |
| $500 Million or less | 16 | 17 | 15 | 8 | 4 |
| **Consumer tax credits for purchasing advanced technology products** | **1** | **2** | **3** | **4** | **5** |
| > $500 Million | 8 | 2 | 11 | 2 | 5 |
| $500 Million or less | 10 | 13 | 8 | 14 | 12 |

**Question 8:** Identify the top three perceived risks to your 2010 North American business plan. Top 8 mentions ranked by total number of mentions (number of first, second and third place mentions provided).

1. Production volumes and schedule accuracy risk (63, 18, 7 responses)
2. Energy and raw material availability and pricing (4, 12, 16 responses)
3. OEM/customer financial viability (4, 15, 11 responses)
4. Sustained economic recovery (19, 4, 6 responses)
5. Lack of commercial and consumer credit (2, 15, 10 responses)
6. Supply base financial viability (1, 9, 9 responses)
7. Inflation (3, 2, 4 responses)
8. Program cancellations, delays (0, 5, 3 responses)

**Other issues receiving multiple mentions:**

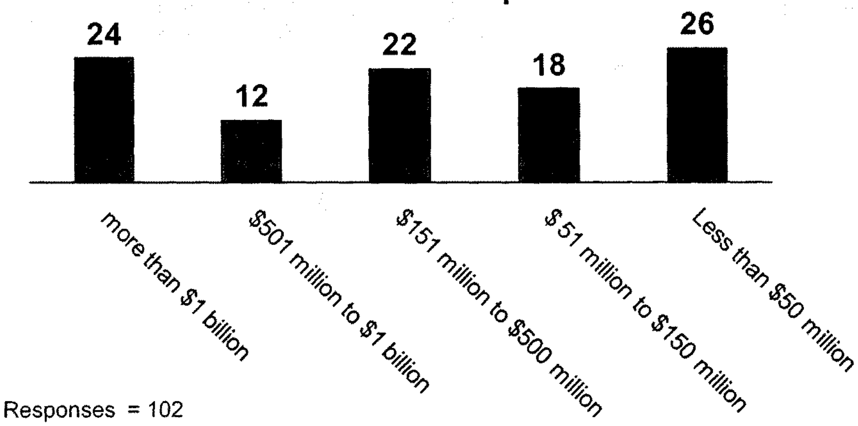
- Workforce - retention and engagement
- Production mix changes
- Exchange rates
- Negative pricing
- Cash flow
- Offshore sourcing

Attachment 7

## Respondent Profile

There were 112 individual respondents from 100 OESA member companies. The September 2009 OESA Automotive Supplier Barometer was conducted between September 21 – 23, 2009.

**Global Automotive Revenue**
**Number of Respondents**




Responses = 102

Attachment 7

## *THANK YOU FOR YOUR PARTICIPATION*

***The OESA Automotive Supplier Barometer survey is published every-other month. The next survey will be launched on Monday, November 2, 2009 and will be released, Friday, November 6, 2009.***

For comments and suggestions for future Barometer surveys, contact:

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Detroit**Regional**Chamber
*Powering the economy for Southeast Michigan*

**Testimony of**

**Tammy Carnrike**
**Chief Operating Officer**
**Detroit Regional Chamber**

**Before the**

**Committee on Financial Services**
**Subcommittee on Oversight and Investigations**
**United States House of Representatives**

**"Improving Responsible Lending to Small Businesses"**

**Lawrence Technological University**

**21000 West Ten Mile Road**
**Southfield, Michigan**

**November 30, 2009**

Mr. Chairman and Members of the Committee, thank you for this opportunity to testify regarding our concerns of small businesses getting adequate access to capital.

My name is Tammy Carnrike, and I am chief operating officer of the Detroit Regional Chamber.

With over 20,000 members, the Detroit Regional Chamber is the largest chamber of commerce in the country. The chamber's mission to power the economy of Southeast Michigan is carried out through business attraction efforts, advocacy, strategic partnerships and valuable benefits to members. Our members range in size, scope, and sector…they contribute significantly to the vitality of our region.

Approximately 75% of our member firms are small businesses with 50 employees or less. Recognizing the impact of staying connected with the small business sector and its needs, the chamber maintains a Small Business Advisory Committee, made up of members that volunteer their time to keep the chamber abreast of issues that are most important to small businesses. The chamber has received a clear message, through focus groups and small business representatives who have shared their experiences, that the credit crunch and cash flow challenges have placed increased stress on their daily operations.

Access to capital has been a strategy on our small business agenda for over the last five years. This has been a long-standing issue for us. But it has been compounded by the financial crisis that struck the state of Michigan, and the entire nation, in the past year. Without question, the economic crisis we're in is stunning. Increased availability of capital to small businesses can support retaining jobs and also provide opportunity for job growth and business expansion.

Our country is in the midst of the largest entrepreneurial surge ever witnessed. Considering the Small Business Administration projections of more than 1.3 million new companies with employees started in the last two years, this represents one of the largest growth rates in history – even outpacing the height of the dot-com craze. When it comes to the vitality and economic prosperity of our country, there is nothing "small" about small business.

The pace of change in the banking industry is being matched by the unprecedented growth of small business and we find ourselves in a situation that requires attention. As of August there were eighty bank closures nationally and analysts are predicating more than three hundred bank failures over the next couple of years. Yet, we believe that this crisis presents an opportunity.

Today we're here discuss Southeast Michigan's small business community and their need for access to capital, but we also want to recognize that there are many supportive lending institutions that contribute regularly to small business success in this region. Besides their programs and services, these institutions also provide support and resources to our small business programs and resources. They serve on committees, boards, are engaged in economic and community development activities, and focus on our region's need for automotive supplier diversification.

We need both our small business sector as well as the banking industry to be successful in order to strengthen our economy and create jobs. Create an opportunity for solid working relationships between them, and organizations like ours commit to be there to provide support and connection to resources.

The Detroit region is more economically stressed than many other areas of the nation. Just look at our high unemployment rates and the staggering loss of jobs. Regardless of where the job loss occurs, it ultimately impacts the small business community.

Michigan lost more private sector jobs since the year 2000 than any other state – nearly half of all private sector jobs lost in the U.S. during this time. The Detroit Regional Chamber, along with many other business organizations, are focused on the need for transformation of our economy through new targeted sectors for growth – and for helping small businesses to diversify their business to support these new sectors. Additional resources to support supplier diversification would have a significant impact and help expedite economic transformation efforts. Small business can and will create jobs with the available resources.

We recently reached out to a targeted segment of our membership with a survey on access to capital.

Based on the survey results, small businesses are currently looking at a number of methods to gain access to capital.

Nearly half (41.9%) had applied for financing in the past 12 months, and 70.2% anticipate a need for financing in the next 12 months. The diversity of financing used in the past by these small businesses range from lines of credit/working capital loans, to term loans, SBA Guaranteed Loans, asset based financing, equipment leasing, commercial mortgage and various other financial services. Not surprisingly, 67% are relying on credit cards and 45% relying on friends and family.

When asked which sources would be utilized in the future, there was an indication of increased interest in SBA guaranteed loans (29.6% vs. 14% in the past). This shows growing interest and an opportunity for the expansion of SBA programs.

Over half, 56%, indicated that banks not lending is the biggest barrier regarding access to capital. The second biggest barrier, at 38%, is "trouble getting non-traditional business model approved," and third, at 29.9% cited 'amount of funds available' as their biggest barrier to accessing capital.

Seventy-three percent of those responding indicated that financing is necessary for general working capital. 23.8% indicated they would look for financing for a new project; 16.8% for acquiring equipment; 12.9% for expansion or acquisition of facility; 6.9% for buying a business and 5.9% to start a new business.

Additional concerns shared include rising interest rates on credit cards and lines of credit and the continued strain on capital due to growing receivables as a result of economic crisis experienced over the last year.

We appreciate the attention by President Obama to the problem and applaud the administration's effort to provide flexibility to SBA loans and make it easier for some banks to access capital from Treasury. Other ideas would be to continue to provide flexibility through the SBA and promote lending without over burdensome new regulations.

The small business community of Southeast Michigan is suffering from the economic crisis, and needs help now. Michigan is suffering more than any other state in the nation with loss of jobs. Expansion of opportunities for access to capital is critical for small business survival.

Even before there was a full-scale credit contraction, there's always been a pervasive Catch-22 in the banking industry when it comes to financing small businesses.

The start-up phase is often the most crucial time when small businesses need capital...but it's at this delicate stage when bank financing is rarely an option.

Industry-standard underwriting criteria usually include the ability to repay based on cash flow and collateral...an established credit history...business equity and experience.

Startup businesses simply don't have a financial track record.

So that's where the rubber meets the road for banks...finding a way to support small businesses at their most critical time of need even when you can't lend to them.

America – and Detroit, for that matter – has always been at its best in times of crisis and challenge. This is one of them ... and it offers us an opportunity to change...innovate...and ultimately lead.

Thank you for allowing us this opportunity.

*Testimony of*

**H. Douglas Chaffin**

*On Behalf of the*

**Michigan Bankers Association**

*Before the*

**Subcommittee on Oversight and Investigations**

Of the

**Committee on Financial Services**

**United State House of Representatives**

*November 30, 2009*

Michigan Bankers Association

**Testimony of H. Douglas Chaffin**
**On behalf of the**
**Michigan Bankers Association**
**Before the**
**Subcommittee on Oversight and Investigations**
**Of the**
**Committee on Financial Services**
**United States House of Representatives Field Hearing**
**November 30, 2009**

Chairman Moore, Ranking Member Biggert, Congressman Peters and members of the Subcommittee, I am Doug Chaffin, president and CEO of Monroe Bank and Trust (MBT). MBT is a community bank headquartered in Monroe Michigan with $1.4 billion in assets. We serve the southernmost portion of southeast Michigan. I am immediate past chairman of the Michigan Bankers Association (MBA) and I am here on behalf of the MBA which is the voice of the banking industry in Michigan representing virtually all the banks in the state.

We are pleased to share Michigan's unique perspective on the challenges of extending credit in a severely distressed economy and offer our thoughts on capital assistance and improving business lending.

A total of 182 banks are currently doing business in Michigan and a full 93 percent or 169 of those banks are MBA members. Banks of every size from the smallest one-branch community bank to large institutions share membership in the MBA. Approximately 40,000 Michigan residents are employed by the industry and the Michigan banking industry provides more than $200 billion in loans to consumers and businesses.

**Michigan Challenges:**

The state of Michigan has been challenged with an economic downturn and continued job loss for the past nine years. It consistently ranks highest in unemployment rates across the country topping 15 percent statewide with some significantly impacted counties reaching well over 20 percent unemployment. The last time Michigan had an unemployment rate below the national average was November of 2002. In 2007, the state saw its highest average annual rate since 1993. Unemployment is expected to soar to 15.8 percent next year according to the University of Michigan Research Seminar in Quantitative Economics (RSQE) annual forecast.

As far back as 2005, southeast Michigan was taking a beating in the job market. Between September 2004 and September 2005 the Detroit area lost more jobs than any other metropolitan area in the nation recording a loss of 21,600 jobs, nine times more jobs than second place Baton Rouge, Louisiana according the U.S. Bureau of Labor Statistics.

Michigan's decline has been deep and broad. According to the Mackinac Center's James Hohman, between 2002 and 2008, Michigan lost 19 percent of its manufacturing jobs, 17 percent of its construction jobs, 12 percent of its natural resources and mining jobs, 11 percent of its information jobs, and lesser losses in financial activities, professional and business services and government. The manufacturing sector will account for 36 percent (91,000) of the state's job losses in 2009. Michigan is predicted to lose another 24,000 manufacturing jobs in 2010 and 16,000 more in 2011 says the RSQE forecast.

The whole country knows that unemployment is very high in Michigan, and most people also know that the automotive manufacturing industry has taken a nose dive in the past five years. During this recession almost 75 percent of auto jobs that existed in mid-2000 were wiped out according to the RSQE.

The U.S. Bureau of Labor statistics indicate that between October 2008 and October 2009 Michigan lost 262,700 jobs. Total job loss in Michigan for 2009 is projected at 283,000, the worst loss in any given calendar year for the past 70 years. One out of five jobs in Michigan has disappeared since 2000.

Michigan suffered from both the highest unemployment rate in the country at more than 15.3 percent in September 2009, and one of the nation's worst mortgage foreclosure rates. . According to research done by The PEW Center on the States 2009, projections are that by the end of this decade, Michigan will have lost one million jobs, more than a third of those in 2009 and more than 268,000 in the auto industry. The RSQE outlook calls 2009 one of the worst economic years of our modern history, maybe the worst, and job losses in Michigan are projected to continue through much of 2011.

In addition, Michigan ranks last among the states in economic momentum, according to an analysis published in the State Policy Reports newsletter, a project co-sponsored by the National Governors Association and the National Conference of State Legislatures. Michigan received a -1.45 on the index placing it a full 1.5 percent behind the 49th worst state.

Even replicating the rapid growth rates of the 1990s, it would be 2025 or 2030 before all of the jobs lost this decade would be replaced. Economic forecasters from Moody's Economy.com said they do not expect to see another peak in Michigan's business cycle during their entire 30-year forecasting horizon. The jobless rate for the fourth quarter of 2009 will average out to 15.6 percent and is predicted to drop modestly in 2011 to 15.4 percent, the third-highest rate in four decades.

**Impact on Bank Lending**

In addition to record high unemployment rates, housing values have dropped causing both residential and commercial properties to lose their collateral value. The condition of Michigan borrowers is dismal and forward looking income projections are equally dire since the condition of borrowers drives loan qualification. It is important to understand that credit follows recovery, it does not lead it. Borrowers must be credit worthy and employed, business must have collateral and sufficient earning projections to qualify for credit. Both of these are severely strained in the state of Michigan.

Hard hit by the demise of the auto industry and manufacturing, Michigan banks, like all Michigan businesses, are working hard to serve their communities, support their customers' needs and support their employees.

Unfortunately, our State's nine straight years of job losses are taking a huge toll on our citizens and our businesses. These job losses make it difficult for many to meet current obligations or to qualify for new credit. In addition, the value of homes and business properties has declined, which again affects credit lines. So, it's not surprising that loan demand is down and qualifying for credit can be challenging. Every Michigan bank is going to great lengths to keep people in their homes, but no amount of credit adjustment can replace a lost job and lost income. For those still employed, personal income is expected to drop 3.4 percent this year.

In spite of a declining economy, Michigan Banks continued to find ways to lend to their customers. Loan balances at Michigan banks reflected respectable rates of growth as compared to other banks in the nation through 2006. As Michigan's unemployment rate increased to levels significantly above the national average, bank profitability declined, capital ratios fell and loan growth rates were reduced in 2007 and 2008 to 4.9 percent and 2.7 percent respectively. While still positive, these rates of growth paled by comparison to national peers which posted an average loan growth of 9.5 percent over those two periods. For the first nine months of 2009, loan balances at Michigan banks declined by .67 percent as a result of capital levels falling significantly below that of national peers.

Credit standards are tighter today than they were two years ago. Collateral values, the value of the homes and businesses used to secure lending, are down. Business performance is diminished and for many, income is down. When banks lend, they are legally and ethically obligated to expect that these loans are repaid. The no-income, no-down payment, no-problem loans made popular by those who promised "low-monthly-payments-please-do-not-bother-to-read-the-documents" loans with low teasers rates have proven a disaster for the borrowers and everyone else.

Virtually none of these "exotic" loans were made by banks. They were made by brokers who took their full commission at closing and have no financial interest whatsoever in whether the loan is repaid. They were made by an industry that never saw a regulatory exam, unlike banks who ALL have their loan files examined at least every 18 months by both federal and state examiners.

In accordance with bank regulators who are cautioning banks to only make good solid secure loans, banks are carefully looking for the capacity of borrows to pay back the loans and provide sufficient collateral if the unforeseen happens.

Capital is being frozen due to uncertainty of real estate value, the proliferation of empty production facilities and the value of the equipment within. If the auto industry continues to shed jobs in 2010, lending options can only continue to grow more challenging. Without some kind of federal support, banks will be unable to provide the credit needed to stem Michigan's recession. Changes in banking regulations are expected to further hamper banks' ability to lend as additional regulatory burdens add to costs and inhibit options.

The biggest issue for the Michigan banking industry is access to capital and its impact on business lending. Any programs the government can offer to increase lending, especially those targeting business lending, will help shore up the credit available to Michigan industry and commerce as well as boost the state's struggling economy.

**Conclusion**

Thank you, Chairman Moore, Ranking Member Biggert and Congressman Peters for the opportunity to present the views of MBA on the challenges ahead for Michigan banks and their communities.

First and foremost, now is not the time to saddle an already heavily regulated industry with new regulations. The Michigan banking industry supports consumer protection but adding the burdens of the CFPA will quite possibly strangle community banks. Overly restrictive efforts to attack banks on interchange and overdraft fees at this time could further damage community bank revenue.

However, we do support: extending similar standards to the relatively unregulated lending community; curing the too big to fail doctrine and systemic risk controls; and the committee's actions to address damaging procyclicle accounting standards as outlined in Rep. Perlmutter's amendment to the Financial Stability Improvement Act.

Faced with an economy reeling from a nine-year recession and the collapse of the auto industry in Michigan, our banks are making monumental efforts to provide for the credit needs of our residents.

For release on delivery
11 a.m. EST
November 30, 2009

Statement of

Jon D. Greenlee

Associate Director

Division of Bank Supervision and Regulation

Board of Governors of the Federal Reserve System

before the

Subcommittee on Oversight and Investigations

Committee on Financial Services

United States House of Representatives

November 30, 2009

Chairman Moore, Ranking Member Biggert, and members of the Subcommittee, I appreciate the opportunity to appear before you today to examine several issues related to the condition of the banking system. First, I will discuss overall credit conditions and bank underwriting standards, credit availability to small businesses, and I will briefly address conditions in this region, particularly in Michigan. I will then describe current conditions in commercial real estate markets (CRE), and outline Federal Reserve activities to enhance liquidity and improve conditions in financial markets to support the flow of credit to households and businesses. Finally, I will discuss the ongoing efforts of the Federal Reserve to ensure the overall safety and soundness of the banking system, as well as actions taken to promote credit availability.

**Background**

The Federal Reserve has supervisory and regulatory authority for bank holding companies (BHCs), state-chartered banks that are members of the Federal Reserve System (state member banks), and certain other financial institutions and activities. We work with other federal and state supervisory authorities to ensure the safety and soundness of the banking industry, foster stability of the financial system, and provide for the fair and equitable treatment of consumers in financial transactions. While the Federal Reserve is not the primary federal supervisor for the majority of commercial banks, it is the consolidated supervisor of BHCs, including financial holding companies, and conducts inspections of those institutions.

The primary purpose of inspections is to ensure that the holding company and its nonbank subsidiaries do not pose a threat to the BHC's depository subsidiaries. In fulfilling this role, the Federal Reserve is required to rely to the fullest extent possible on information and analysis provided by the appropriate supervisory authority of the BHC's depository, securities, or insurance subsidiaries. The Federal Reserve is also the primary federal supervisor of state member banks, sharing supervisory responsibilities with state agencies. In this role, Federal Reserve supervisory staff regularly conducts on-site examinations and off-site monitoring to ensure the safety and soundness of supervised state member banks.

The Federal Reserve is involved in both regulations, establishing the rules within which banking organizations must operate, and supervision, ensuring that banking organizations abide by those rules and remain safe and sound. Because rules and regulations in many cases cannot reasonably prescribe the exact practices each individual bank should use for risk management, supervisors design policies and guidance that expand upon requirements set in rules and regulations and establish expectations for the range of acceptable practices. Supervisors rely extensively on these policies and guidance as they conduct examinations and assign supervisory ratings.

Beginning in the summer of 2007, the U.S. and global economies entered a period of intense financial turmoil that has presented significant challenges for the financial services industry. These challenges intensified in the latter part of 2008 as the global economic environment weakened further. As a result, parts of the U.S. banking system have come under severe strain, with some banking institutions suffering sizable losses. The number of bank failures also has risen this year.

**Conditions in Financial Markets and the Economy**

While conditions and sentiment in financial markets have improved, corporate bond spreads are high by historical standards as expected losses and risk premiums remain elevated. Encouragingly, economic growth appears to have moved back into positive territory last quarter, in part reflecting a pickup in consumer spending and a slight increase in residential investment.

However, the nationwide unemployment rate has continued to rise, reaching 10.2 percent in October.

Throughout the year, borrowing by households and businesses has remained weak. Residential mortgage and consumer debt outstanding fell sharply in the first half of the year, and the decline in consumer credit continued in the third quarter. Outstanding obligations of nonfinancial businesses also decreased modestly in the first half of 2009 and contracted further in the third quarter as net decreases in commercial paper, commercial mortgages, and bank loans more than offset a solid pace of corporate bond issuance.

Loan quality deteriorated significantly for both large and small institutions during the third quarter of this year. At the largest 50 bank holding companies, nonperforming assets climbed more than 10 percent, raising the ratio of nonperforming assets to 4.8 percent of loans and other real estate owned. Most of the deterioration was concentrated in residential mortgage and CRE, but commercial loans also experienced rising delinquencies. Results of the banking agencies' Shared National Credits review; released in September, also document significant deterioration in the performance of large syndicated loans, signaling likely further deterioration in commercial loans.[1] At community and small regional banks, nonperforming assets increased to 4.6 percent of loans at the end of the third quarter, more than seven times the level for this ratio at year-end 2006, before the financial crisis began. Home mortgages and CRE loans accounted for most of the increase, but commercial loans have also shown marked deterioration during recent quarters.

When combined with job losses and lower consumer spending, the environment is very challenging for both large and small businesses. Small businesses, which tend to have less

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[1] See Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision (2009), "Credit Quality Declines in Annual Shared National Credits Review," joint press release, September 24.

financial flexibility in a recessionary environment, have been particularly affected during this cycle. Of note, small businesses rely on banks for 90 percent of their financing needs, compared to large businesses, which use banks for only 30 percent of their financing. There are more than 27 million small businesses nationally that employ about half of the nation's private-sector workforce and these businesses have approximately $1 trillion in debt outstanding. Access to credit markets is expected to remain a challenge for these firms, but at the same time, with inventory and capital spending levels at near historic lows, the demand for credit has remained weak.

The most recent results from the Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices indicate that both the availability and demand for bank loans are well below pre-crisis levels. In October, more banks reported tightening their lending standards on consumer and business loans than reported easing, although the degree of net tightening continues to decline from peaks reached late last year. The survey also confirms that demand for consumer and business loans has remained weak. Indeed, decreased loan demand from creditworthy borrowers was the most common explanation given by respondents for the contraction of business loans this year.

Credit losses at banking organizations continue to rise, and banks face risks of sizable additional credit losses given the outlook for production and employment. In addition, while the year-on-year decline in housing prices has slowed, continued adjustments in the housing market suggest that foreclosures and mortgage loss severities are likely to remain elevated. Moreover, the value of both existing commercial properties and land, which collateralize commercial and residential development loans, has declined sharply, suggesting that banks are vulnerable to significant further deterioration in their CRE loans. In sum, banking organizations continue to face significant challenges, and credit conditions remain tight.

**Performance of the Banking System**

Despite these challenges, the stability of the banking system has improved since last year. Importantly, the rigorous Supervisory Capital Assessment Program (SCAP) stress test, a program that was led by the Federal Reserve earlier this year, helped to increase public confidence in the banking system during a period of high stress. A number of institutions in the SCAP demonstrated that they have the capacity to withstand more-adverse macroeconomic conditions than are expected to develop and have repaid the investments made under the Troubled Asset Relief Program. Many financial institutions have accessed various sources of funding and have raised significant amounts of new capital. The firms that were determined to need to raise capital increased common equity by more than $75 billion since the SCAP results were released in May. [2] Depositors' concerns about the safety of their funds during the immediate crisis last year have also largely abated. As a result, financial institutions have seen their access to core deposit funding improve.

However, a number of banking organizations face significant challenges. Two years into a substantial economic downturn, loan quality continues to deteriorate across many asset classes and, as noted earlier, has declined further as weakness in housing markets affects the performance of residential mortgages and construction loans. Higher loan losses are depleting loan loss reserves at many banking organizations, necessitating large new provisions that are producing net losses or low earnings. In addition, although capital ratios are considerably higher

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[2] For more information about the SCAP, see November 9, 20009 Federal Reserve Board Press Release http://www.federalreserve.gov/newsevents/press/bcreg/20091109a.htmsee

than they were at the start of the crisis for many banking organizations, poor loan quality, subpar earnings, and uncertainty about future conditions raise questions about capital adequacy for some institutions. Diminished loan demand, more-conservative underwriting standards in the wake of the crisis, weak economic conditions, and a focus on working out problem loans also have limited the degree to which banks have added high-quality loans to their portfolios, an essential step to expanding profitable assets and thus restoring earnings performance.

For banking organizations in this region of the country, including Michigan, Ohio, and Indiana, the overall weakness of economic conditions has had a negative impact on institutions. In particular, for banking organizations in Michigan, aggregate net earnings have turned negative, due mostly to high provision expenses; and asset quality indicators continue to trend downward, driven by weakness in commercial and residential real estate. Michigan entered the recession about three years before the rest of the country and has the highest unemployment rate in the nation. Moreover, weak economic conditions have become more pronounced as the manufacturing sector continued to decline and shed jobs. Notably, statistics from the Michigan Association of Realtors indicate that the average statewide residential home sales' price has fallen to 1995 levels.

Against this backdrop, banking organizations in Michigan face a number of challenges. Four Michigan institutions with assets totaling nearly $842 million have been closed in recent months. Of particular concern, 15 percent of Michigan banks reported recently that they are less than well-capitalized.

**Current Conditions in Commercial Real Estate Markets**

All across the country and in this region in particular, it is clear that significant financial challenges remain. Indeed, some large regional and community banking firms that have built up unprecedented concentrations in CRE loans will be particularly affected by emerging conditions in real estate markets.

The Federal Reserve has been focused on CRE exposures at supervised institutions for some time. In response to rising CRE concentrations, especially in some large regional and community banking firms in the early part of this decade, and the central role of CRE loans in the banking problems of the late 1980s and early 1990s, we led an interagency effort to develop supervisory guidance on CRE concentrations. The guidance was finalized in 2006 and published in the Federal Register in early 2007.[3] In that guidance, we emphasized our concern that some institutions' strategic- and capital-planning processes did not adequately recognize the risks arising from their CRE concentrations. We stated that institutions actively involved in CRE lending should perform ongoing assessments to identify and manage concentrations through stress testing and similar exercises that identify the impact of adverse market conditions on earnings and capital.

As weaker housing markets and deteriorating economic conditions have impaired the quality of CRE loans at supervised banking organizations, the Federal Reserve has devoted significantly more resources to assessing the quality of CRE portfolios at regulated institutions. These efforts include monitoring the impact of declining cash flows and collateral values on CRE portfolios, as well as assessing the extent to which banks have been complying with our CRE guidance. Federal Reserve Banks that are located in more adversely affected geographic areas have been particularly focused on evaluating exposures arising from CRE lending.

[3] See Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation (2007), "Interagency Guidance on Concentrations in Commercial Real Estate," Supervision and Regulation Letter SR 07-1 (January 4), www.federalreserve.gov/boarddocs/srletters/2007/SR0701.htm.

As job losses have accelerated nationwide, demand for commercial property has declined and vacancy rates have increased. The higher vacancy levels and significant decline in the value of existing properties have placed particularly heavy pressure on construction and development projects that do not generate income until after completion. Developers typically depend on the sales of completed projects to repay their outstanding loans, and with prices depressed amid sluggish sales, many developers are finding their ability to service existing construction loans strained.

Federal Reserve examiners are reporting a sharp deterioration in the credit performance of loans in banks' portfolios and loans in commercial mortgage-backed securities (CMBS). At the end of the second quarter of 2009, approximately $3.5 trillion of outstanding debt was associated with CRE, including loans for multifamily housing developments. Of this amount, $1.7 trillion was held on the books of banks and thrifts, and an additional $900 billion represented collateral for CMBS, with other investors holding the remaining balance of $900 billion. Also at the end of the second quarter, about nine percent of CRE loans in bank portfolios were considered delinquent, almost double the level of a year earlier. [4] Loan performance problems were the most striking for construction and development loans, especially for those that finance residential development. More than 16 percent of all construction and development loans were considered delinquent at the end of the second quarter.

The current fundamental weakness in CRE markets is exacerbated by the fact that the CMBS market, which previously had financed about 30 percent of originations and completed construction projects, completely shut down. Until mid-November, when the first CMBS issuance came to market with financing provided by the Federal Reserve's Term Asset-Backed

[4] The CRE loans considered delinquent on banks' books were non-owner-occupied CRE loans that were 30 days or more past due.

Securities Loan Facility (TALF), essentially no CMBS have been issued since mid-2008. Delinquencies of mortgages backing CMBS have increased markedly in recent months. Market participants anticipate these rates will climb higher by the end of this year, driven not only by negative fundamentals but also by borrowers' difficulty in rolling over maturing debt. In addition, the decline in CMBS prices has generated significant stresses on the balance sheets of financial institutions that must mark these securities to market, further limiting their appetite for taking on new CRE exposure.

**Federal Reserve Activities to Help Revitalize Credit Markets**

The Federal Reserve has taken a number of actions to strengthen the financial sector and to promote the availability of credit to businesses and households. In addition to aggressively easing monetary policy, the Federal Reserve has established a number of facilities to improve liquidity in financial markets. One such program is the TALF, a joint Federal Reserve – Treasury program that was begun in November 2008 to facilitate the extension of credit to households and small businesses.

Before the crisis, securitization markets were an important conduit of credit to the household and business sectors. Securitization markets (other than those for mortgages guaranteed by the government) closed in mid-2008, and the TALF was developed to promote renewed issuance. Under the TALF, eligible investors may borrow to finance purchases of the AAA-rated tranches of various classes of asset-backed securities. The program originally focused on credit for households and small businesses, including auto loans, credit card loans, student loans, and loans guaranteed by the Small Business Administration. Investors may also use the TALF to purchase both existing and newly issued CMBS, which were included to help mitigate the refinancing problem in that sector.

The TALF has been successful in helping restart securitization markets. Issuance has resumed and rate spreads for asset-backed securities have declined substantially. The TALF program has helped finance 2½ million auto loans, 750,000 student loans, more than 100 million credit card accounts, 480,000 loans to small businesses, and 100,000 loans to larger businesses. Included among those business loans are 4,700 loans to auto dealers to help finance their inventories. Perhaps even more encouraging, a substantial fraction of Asset Backed Securities (ABS) is now being purchased by investors that do not seek TALF financing, and ABS-issuers have begun to bring non-TALF-eligible deals to market.

The availability of TALF financing facilitated the first issuance of CMBS backed by newly originated mortgages in almost 18 months on November 16. Investor demand for the new issuance was high, in part because of the improved investor protections put in place so that securities would be eligible collateral for TALF loans. In the end, non-TALF investors purchased almost 80 percent of the TALF-eligible securities. By improving credit market functioning and adding liquidity to the system, the TALF and other Fed programs have provided critical support to the financial system and the economy.

**Availability of Credit**

As part of our effort to help stimulate appropriate bank lending, the Federal Reserve and the other federal banking agencies issued regulatory guidance in November 2008 to encourage banks to meet the needs of creditworthy borrowers, including small businesses.[5] The guidance was issued to encourage bank lending in a manner consistent with safety and soundness; specifically, by taking a balanced approach in assessing borrowers' abilities to repay and making

[5] See Board of Governors of the Federal Reserve System, FDIC, Office of the Comptroller of the Currency, and Office of Thrift Supervision (2008), "Interagency Statement on Meeting the Needs of Creditworthy Borrowers," joint press release, November 12, www.federalreserve.gov/newsevents/press/bcreg/20081112a.htm.

realistic assessments of collateral valuations. This guidance has been reviewed and discussed with examination staff within the Federal Reserve System and ongoing training continues.

More recently, the Federal Reserve led the development of interagency guidance issued on October 30 regarding CRE loan restructurings and workouts. [6] This policy statement provides guidance for examiners, and for financial institutions that are working with CRE borrowers who are experiencing diminished operating cash flows, depreciated collateral values, or prolonged delays in selling or renting commercial properties. The statement is especially relevant to small businesses because owner-occupied CRE often serves as collateral for many small business loans.

The Federal Reserve recognizes that prudent loan workouts are often in the best interest of both financial institutions and borrowers, particularly during difficult economic conditions. Accordingly, the policy statement details risk-management practices for loan workouts that support prudent and pragmatic credit and business decision-making within the framework of financial accuracy, transparency, and timely loss recognition.

To underscore expectations regarding the guidance, the Federal Reserve has already conducted a System-wide teleconference with examiners that focused specifically on the new guidance. In addition, on November 20, we participated in an industry outreach teleconference call to discuss the guidance. Examiner training and industry outreach will be ongoing. Beginning in January 2010, a comprehensive, System-wide training initiative will commence to further underscore our expectations.

Prudent real estate lending depends upon reliable and timely information on the market value of the real estate collateral. This has been a cornerstone of the regulatory requirements for

[6] Interagency Policy Statement on CRE loan Restructurings and Workouts (November 2009); http://www.federalreserve.gov/newsevents/press/bcreg/20091030a.htm

real estate lending and is reflected in the agencies' appraisal regulations. In that regard, the Federal Reserve requires a regulated institution to have real estate appraisals that meet minimum appraisal standards, including the Uniform Standards of Professional Appraisal Practice, and contain sufficient information to support the institution's credit decision. Over the past several years, the Federal Reserve has issued several appraisal-related guidances to emphasize the importance of a bank's appraisal function and the need for independent and reliable appraisals. More recently, the Federal Reserve and the other federal agencies issued a proposal to revise the Interagency Appraisal and Evaluation Guidelines, which is expected to be finalized in the coming months. These guidelines reinforce the importance of sound appraisal practices.

Given the lack of sales in many real estate markets and the predominant number of distressed sales in the current environment, regulated institutions face significant challenges today in assessing the value of real estate. We expect institutions to have policies and procedures for obtaining new or updated appraisals as part of their ongoing credit review. An institution should have appraisals or other market information that provide appropriate analysis of the market value of the real estate collateral and reflect relevant market conditions, the property's current "as is" condition, and reasonable assumptions and conclusions

The Federal Reserve has directed examiners to be mindful of the effects of excessive credit tightening in the broader economy, and we have taken steps, including additional examiner training and industry outreach, to underscore these intentions. We are aware that bankers may become overly conservative in an attempt to ameliorate past weaknesses in lending practices, and we are working to emphasize that it is in all parties' best interests to continue making loans to creditworthy borrowers.

**Conclusion**

While financial market conditions have improved in the United States, the overall environment remains under stress, and some geographic areas are experiencing more difficulty than others, as is the case in Michigan, Ohio, and Indiana. The Federal Reserve, working with the other banking agencies, has taken strong action to ensure that the banking system remains safe and sound and is able to meet the credit needs of our economy. We also have aggressively pursued monetary policy actions and have provided liquidity to help restore stability to the financial system and support the flow of credit to households and businesses. In our supervisory efforts, we are mindful of the risk-management deficiencies at banking institutions revealed by the financial crisis and are ensuring that institutions develop appropriate corrective actions.

It will take some time for the banking industry to work through this current set of challenges and for the financial markets to fully recover. In order to promote credit availability, the Federal Reserve is encouraging banks to deploy capital and liquidity in a responsible way that avoids past mistakes and does not create new ones. The Federal Reserve is committed to working with other banking agencies and the Congress to promote the concurrent goals of fostering credit availability and a safe and sound banking system.

Thank you again for your invitation to discuss these important issues at today's hearing. I would be happy to answer any questions that you may have.

*Testimony of*

**Arthur C. Johnson**

*On Behalf of the*

AMERICAN **BANKERS** ASSOCIATION

*Before the*

**Subcommittee on Oversight and Investigations**

Of the

**Committee on Financial Services**

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**Field Hearing, Southfield, Michigan**

AMERICAN BANKERS ASSOCIATION®

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**Field Hearing, Southfield, Michigan**
**November 30, 2009**

Chairman Moore, Ranking Member Biggert, Congressman Peters and members of the Subcommittee, my name is Arthur C. Johnson. I am Chairman and Chief Executive Officer of United Bank of Michigan, headquartered in Grand Rapids, Michigan. I serve as Chairman of the American Bankers Association (ABA), and I chair the ABA Community Bank Solutions Task Force, a committee dedicated to finding ways to address problems most acutely affecting community banking during this economic downturn. I am pleased to be here today representing ABA. ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.5 trillion in assets and employ over 2 million men and women.

We are pleased to share the banking industry's perspective ways to promote capital assistance and improve business lending in this distressed economy. Small businesses of all kinds – including banks – are certainly suffering from the severe economic recession. While some might think the banking industry is composed of only large global banks, the vast majority of banks in our country are community banks – small businesses in their own right. In fact, over 3,000 banks (41 percent) have fewer than 30 employees.

This is not the first recession faced by banks, and certainly not the first downturn we have seen in Michigan. In fact, most banks have been in their communities for decades and intend to be there for many decades to come. The United Bank of Michigan has survived many economic ups and downs for 132 years. We are not alone, however. In fact, there are 62 banks in Michigan that have been in business for more than 50 years, 20 of which have been in business for more than a century. Nationwide, more than 5,000 banks – 62 percent of the industry – have been serving their communities for more than 50 years. These numbers tell a dramatic story about the staying power of banks and their commitment to the communities they serve. My bank's focus, and those of my fellow bankers throughout this great state and across our country, is on developing and maintaining long-term relationships with customers, many of which are small businesses. We cannot be successful without such a long-term philosophy and without treating our customers fairly.

This recession is certainly one of the worst we have ever faced. While the statisticians will say the recession has ended, that is little comfort to areas in Michigan and elsewhere in the United States, that still suffer from very high levels of unemployment and business failures. The impact of the downturn is being felt by all businesses, banks included. As the economy has deteriorated, it has become increasingly difficult for consumers and businesses to meet their financial obligations. The cumulative impact of seven straight quarters of job losses – over 7 million since the recession began – is placing enormous financial stress on some individuals. With jobs lost and work hours cut, it does not take long for the financial pressure to become overwhelming. This, in turn, has increased delinquencies at banks and resulted in losses and reduced the capital of banks.

My bank, as with most community banks, entered this recession with strong capital levels. As this subcommittee is aware, however, it is extremely difficult to raise new capital in this financial climate. In some areas of this country, it is impossible to raise new capital. Michigan is particularly hard hit, as the long-term outlook remains cloudy; but we are not alone. There are many communities across this country that are suffering, and the need for capital is acute. Capital underpins every loan that is made. Loan losses resulting from the recession have reduced capital and with it, reduced the capacity to make new loans. Without new sources of capital, banks will inevitably end up shrinking in order to keep regulatory capital-to-assets ratios in acceptable ranges. This, of course, makes it increasingly difficult for community banks to continue to meet the credit needs of their communities.

We believe there are actions the government can take to assist viable community banks to weather the current downturn. By providing needed capital – which enhances the lending capacity of banks – the entire community will benefit. In fact, the success of many local economies – and, by extension, the success of the broader national economy – depends in large part on the success of community banks. Comparatively small steps taken by the government now can make a huge difference to these banks, their customers, and their communities – keeping capital and resources focused where they are needed most.

In a letter to Treasury Secretary Geithner on September 21, 2009, I laid out specific recommendations for ways the existing unused Troubled Asset Relief Program (TARP) funds could be used to assist well-managed, viable community banks and, therefore, be more effective in achieving its objectives. We recommended modification of the existing Capital Assistance Program (CAP), but there are certainly other unused resources available under the TARP program that certainly could – and should – be made available for this purpose. ABA's recommendations may be summarized as follows:

- Invest up to $5 billion of Troubled Asset Relief Program (TARP) funds in community banks that did not receive Capital Purchase Program (CPP) funds;
- Limit the maximum investment by Treasury in any one bank to five percent of the bank's risk-weighted assets;
- Require participating banks to issue Treasury senior preferred securities; require participants to show that they have commitments from private equity to match Treasury's investment dollar for dollar; and
- Allow any bank with total assets of $5 billion or less to apply but condition approval upon the submission of an acceptable capital restoration plan.

The ABA believes that this type of program can provide capital assistance to community banks that they need to work through their current issues. In thinking through the details of a program such as this, it is important to consider areas of this country that are unlikely to draw new sources of capital even with matching support from the Treasury. Even in these "economic disaster zones" there are still viable banks, good borrowers and a desperate need for capital to stimulate economic activity. The market for capital, however, is completely dysfunctional. For these areas, it may well be necessary to have some disaster zone exception that would still provide capital without as severe a matching requirement.

On a related note, we appreciate the recent announcement of the President's New Small Business Lending Initiatives designed to improve access to credit for small businesses by providing lower-cost capital to community banks that submit a plan to increase small business lending. While this program addresses a different issue than the one I have outlined above, we nevertheless think that it is potentially helpful in stimulating additional lending to small businesses. ABA has urged Treasury to increase the cap on the size of participating banks from $1 billion to $5 billion, as doing so would expand the eligible pool of community banks that could participate and thereby increase access to credit for small businesses.

In my statement, I would like to focus on the following points:

- Capital injections for well-managed, viable community banks can be a highly effective method to maintain credit availability and facilitate an economic rebound in distressed areas.

- Banks continue to lend in this difficult economic environment, but both lenders and borrowers are exercising a prudent approach to credit.

- Changes in the regulatory environment would improve the situation for small business lending.

I will address each of these points in turn.

## I. Capital Injections Will Facilitate an Economic Recovery

Strong capital is essential to helping community banks work through the problems caused by declines in asset values. Capital is absolutely critical to any bank, as it is the financial underpinning of any loan that is made. While conditions have improved over the past year in the economy overall, many community banks are finding that the lagging impacts of job losses and declines in property values are negatively affecting their institution, causing declines in their capital at a time when new capital often is hard to find. There are some areas, such as southeast Michigan, where the economic conditions are so severe that new capital is nearly impossible to obtain. There are many other areas in the country that are feeling a similar pain and are finding capital impossible to obtain.

Governmental actions have exacerbated community banks' problems and in so doing have made it harder for them to raise capital. For instance, the banking agencies are requiring many banks to raise capital at a time when sources of capital are scarce and at precisely the time when capital should be available to absorb losses. This can put these banks in an untenable position, precipitating the failure of a viable bank that has a good franchise and could survive if capital was made available. In addition, the FDIC failure resolution policies (such as FDIC-guaranteed financing for winning bidders of failed banks or loss-sharing agreements) are creating incentives for investors to wait until a bank has failed before investing. This has kept capital on the sidelines instead of being injected into existing banks.

The influences come on the heals of government decisions to place Fannie Mae and Freddie Mac into receivership which caused a sudden and unexpected loss of billions of dollars to the banks that held shares of Fannie's and Freddie's stock. Moreover, the serial implementation of the Capital Purchase Program (CPP) meant that the applications of many non-public financial institutions were not considered until further into the recession. As a result, banks that perhaps would have qualified for CPP funds early in the process were denied the opportunity to participate once a deteriorating economy started to adversely affect the banks' condition.

The government's investment of billions of dollars in the largest financial institutions has improved the competitive position of these institutions, making it easier for them to raise capital and issue debt. However, the relative condition of many of the community banks that did not receive CPP funds has looked worse as a result.

The ABA recommends that Treasury modify the criteria for CAP to assist viable community banks that need help working through their current issues. We propose that Treasury offer assistance to those banks that did not qualify for CPP funds but that nevertheless can demonstrate the ability to operate safely and soundly and survive if given the chance to obtain necessary capital. This ability would be demonstrated in three ways:

- First, a bank would have to present evidence that private investors are contractually committed to match Treasury's investment dollar for dollar.
- Second, the private investors would have to agree to receive securities that are subordinate to Treasury's interests.
- Third, the bank would have to submit a capital restoration plan to its primary regulator that, when factoring in the proposed investments by Treasury and private equity, satisfies the requirements of the "Prompt Corrective Action" rules. As part of that plan, the bank also would have to show that it has adequate management to address its problems.

The suggested aggregate investment by Treasury of $5 billion is based on the amount of funds, when matched by private equity on a dollar-for-dollar basis, needed to bring all insured depository institutions with assets under $5 billion to capital levels equal to a Tier 1 risk-based capital ratio of 8 percent and a total risk-based capital ratio of 12 percent ***assuming the stressed scenarios used by the banking regulators in the Supervisory Capital Assessment Program (SCAP).*** These capital levels significantly exceed the thresholds established by the banking regulators for a bank to be deemed "well capitalized" under the Prompt Correct Action rules and would provide a cushion that could enable participating banks to continue meeting the credit needs of their communities without having to shrink to comply with minimum regulatory capital requirements. A $5 billion commitment by Treasury is well below ***half*** of the dividends and warrant repurchases received by Treasury from CPP participants and ***less than 4 percent of the total of CPP funds invested to date***. Our projections show that an estimated 2,000 community banks would be potentially eligible, although it is highly unlikely that all 2,000 would choose to, or be approved to, participate.

As noted above, this program would involve matching investments by private equity investors. It is important that private equity qualify regardless of whether it comes from existing shareholders or new investors. Either way, the bank is receiving a strong vote of confidence in its viability from stakeholders who stand to lose their investments. Moreover, current investors and management often are in the best position to judge the prospects of a bank and to determine the advisability of investing in that bank.

As I mentioned at the outset, it is important to consider areas of this country that are economic disaster zones and unlikely to draw new sources of capital even with matching support from the Treasury. There are still viable banks, good borrowers and a need for capital to stimulate economic activity. The market for capital, however, is completely dysfunctional and it may well be necessary to have some disaster zone exception that would still provide capital without as severe a matching requirement. These banks would have to demonstrate their ability to operate safely and soundly even though they cannot currently raise private capital in their market area. This capital support may particularly be helpful for the banks that are facing increasing problems with commercial real estate loan problems in these deeply troubled markets.

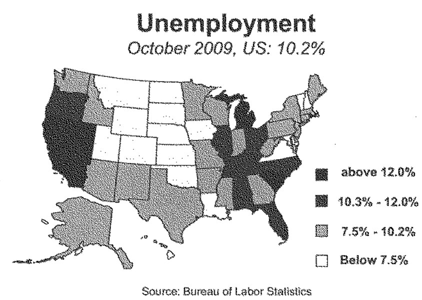
Moreover, improved access to capital through the President's New Small Business Lending Initiatives should also help improve access to credit for small businesses. This program, in addition to the one I have outlined above, can help stimulate additional lending to small businesses.

The Fact Sheet describing Treasury's proposed initiative limits the program to community banks with less than $1 billion in assets. Expanding the cap to $5 billion would expand the eligible pool of community banks that could participate in this proposed new program and thereby expand access to credit for small businesses. We urged Treasury, in a letter dated November 19, 2009, to offer this lower cost capital to banks under $5 billion in assets that demonstrate their ability to operate safely and soundly.

Community banks are the backbone of our economy and are critical to the overall improvement of our economy. For a nominal investment, Treasury can preserve viable community banks, which in turn would provide more resources for lending and would help preserve jobs and communities.

## II. Lenders and Borrowers are Exercising a Prudent Approach to Credit

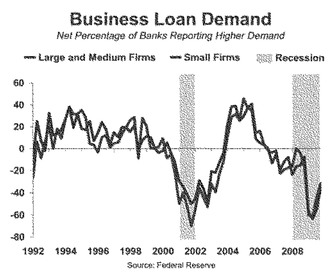
What makes our current national economic circumstances so difficult to discuss is that there are such dramatic regional differences in economic performance. This chart, showing unemployment levels for states across the U.S., makes the variability clear. Most states are either in recession or very close.




Against the backdrop of a very weak economy it is only reasonable and prudent that all businesses – including banks – exercise caution in taking on new financial obligations. Both banks and their regulators are understandably more cautious in today's environment. Bankers are asking more questions of their borrowers, and regulators are asking more questions of the banks they examine. This means that some projects that might have been funded when the economy was stronger may not find funding today.

We recognize that there are some consumers and businesses in the current situation that believe they deserve credit that is not being made available. We do not turn down loan applications because we do not want to lend – lending is what banks do. In some cases, however, it makes no sense for the borrower to take on more debt. Sometimes, the best answer is to tell the customer no, so that the borrower does not end up assuming an additional obligation that would be difficult if not impossible to repay.

Given the economic conditions, it is clear that the risk of lending is much greater today than several years ago when the economy was much stronger. This means that the credit terms are different today, with higher downpayments required, and smaller loans consistent with diminished collateral values. Banks are looking at the risk of a loan and re-evaluating the proper pricing of that risk. This is a prudent business practice and one expected by our bank regulators.




Not only are banks being prudent in this environment, but it comes as no surprise that businesses are being very cautious in taking on new debt. As a result, loan demand is down considerably. This is due, according to the National Federation of Independent Businesses (NFIB), to "widespread postponement of investment in inventories and historically low plans for capital spending." The NFIB reports that in spite of the difficult economic environment, 33 percent of businesses reported regular borrowing in October (up one point from September) compared to 9 percent who reported problems in obtaining the financing they desired (down 1 point). The NFIB also noted that only 4 percent of business owners reported "financing" as their number one business problem. This is extremely low compared with other recessions. For example, in 1983 – just after the last big recession – 37 percent of business owners said that financing and interest rates were their top problem.

The difficult recession, falling loan demand, and loan losses have meant that loan volumes for small businesses have declined somewhat this year. Our expectation is that loan demand in this economy will continue to decline. Let me be very clear here: even in a weak economy there are very strong borrowers. Every bank in this country is working hard to ensure that our customers – particularly the small businesses that are our neighbors and the life blood of our communities – get the credit they deserve.

However, we believe that as business confidence continues to improve, inventory and capital investments will increase, and lending volumes will rebound. ***As the economy starts to grow again and loan demand increases, the ability of banks to meet these needs will be stunted if adequate capital is not available to back increased lending.***

## III. Changes in the Regulatory Environment Would Improve the Situation for Small Business Lending

As I noted above, banks are not immune from the economic downturn; job losses and business failures have resulted in greater problem loans and much higher loan losses. Nonetheless, banks are working every day to make credit available. Those efforts, however, are made more difficult by regulatory pressures and accounting treatments that exacerbate, rather than help to mitigate, the problems.

Of course, the current regulatory environment is unquestionably impacted by concerns flowing from the economic downturn. A natural reaction of regulators is to intensify the scrutiny of commercial banks' lending practices. But just as too much risk is undesirable, a regulatory policy that discourages banks from making good loans to creditworthy borrowers also has serious economic consequences. Wringing out the risk from bank loan portfolios means that fewer loans will be made, and that only the very best credits will be funded.

Worsening conditions in many markets have strained the ability of some borrowers to perform, which often leads examiners to insist that a bank make a capital call on the borrower, impose an onerous amortization schedule, or obtain additional collateral. These steps can set in motion a "death spiral," where the borrower has to sell assets at fire-sale prices to raise cash, which then drops the comparable sales figures the appraisers pick up, which then lowers the "market values" of other assets, which then increases the write-downs the lenders have to take, and so on. Thus, well-intentioned efforts to address problems can have the unintended consequence of making things worse.

We appreciate the recently-issued guidance that addresses the need for banks to have the flexibility to work out loans. However, we continue to hear anecdotes from our members of examiners who continue to take an inappropriately conservative approach in their analysis of asset quality and who are consistently requiring downgrades of loans whenever there is any doubt about the loan's condition.

What the regulators want for the industry is what the industry wants for itself: a strong and safe banking system. To achieve that goal, we need to remember the vital role played by good lending in restoring economic growth and not allow a credit crunch to stifle economic recovery. We must work together to get through these difficult times. Providing a regulatory environment that renews lines of credit to small businesses is vital to our economic recovery.

### Conclusion

I want to thank you, Chairman Moore, Ranking Member Biggert, and Congressman Peters for the opportunity to present the views of ABA on the challenges ahead for the banks and the communities they serve. These are difficult times and the challenges are significant. In the face of a still weak and troubled economy, however, bankers are working hard every day to ensure that the credit needs of our communities are met.

I am happy to answer any questions the Subcommittee may have.

Michigan Association of
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*...Community banks...the foundation of strong communities!*

Testimony of

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On behalf of the
**Michigan Association of Community Bankers**

Before the

United States House Financial Services Committee
Subcommittee on Oversight and Investigations

Field Hearing on

**"Improving Responsible Lending to Small Businesses"**

November 30, 2009
Southfield, Michigan

Congressman Peters, Members of the House Financial Services Committee Subcommittee on Oversight and Investigations, my name is Michael A. Kus. I am legal counsel for the Michigan Association of Community Bankers ("MACB"), a full service trade association exclusively serving community banks, and their financial services partners, throughout Michigan. I am pleased to provide testimony on behalf of the MACB and its members.

**Critical Economic Role of Small Business and Community Banks**
Small businesses represent 99% of all employer firms and employ approximately 50% of private sector workers in the United States. The majority of new job creation in the past 10 years has been the result of the 26 million small businesses in America. It is clear that for any meaningful economic recovery to occur in America, America's small businesses must have access to credit to operate and grow.

And small businesses rely heavily on community banks for the credit they need to operate their businesses. Even though community banks represent only about 12% of all bank assets in the U.S., they make up 31% of the dollar amount of all small business loans that are less than $1 million, and 50% of all small business loans under $100,000 in the U.S.

As recently as May 29, 2009, at the establishment of the FDIC Advisory Committee on Community Banking, FDIC Chairman Sheila C. Bair recognized that "community banks are the lifeblood of our nation's financial system, supplying much-needed credit to countless individuals, small businesses, nonprofit organizations and other entities in large and small towns around the country."

**Access to Capital for Community Banks = Access to Capital for Small Business**
While the majority of community banks have money to lend, some federal regulatory agencies have taken an aggressive stance toward community banks, forcing the banks to write down their assets, which are largely secured by commercial real estate, at an unprecedented pace, thereby destroying capital and severely curtailing community banks' abilities to fulfill the vital role they can play in revitalizing the country's ailing economy.

Some federal regulatory agencies have insisted that banks purge their balance sheets at fire sale prices and are requiring community banks to make enormous infusions of capital – even when the bank's capital levels far exceed the statutory levels needed to be considered "well capitalized." And the capital markets have not responded positively by infusing capital into community banks on the scale necessary to restore the robust flow of credit to small businesses vital to the economic recovery of this country.

The recent joint Policy Statement on Prudent Commercial Real Estate Loan Workouts ("Guidance") issued on October 30, 2009 is a step in the right direction by the federal banking regulators and the FFIEC. It is also in keeping with the type of suggestions made by the MACB in its Executive Summary of August 2009, a copy of which was provided to Governor Jennifer Granholm, OFIR Commissioner Ken Ross, Senate Majority Leader Mike Bishop, Senator Randy Richardville, Speaker of the House Andy Dillon and Representative Andy Coulouris.

More initiatives like this on the part of the federal banking regulators are needed to provide immediate assistance to community banks. The Guidance states that the federal regulators recognize prudent commercial real estate ("CRE") loan workouts are often in the best interest of the banks and creditworthy CRE borrowers. The tone of the Guidance would suggest that the federal bank regulators understand the need to assist banks in working through the current economic environment.

However, as any community bank in Michigan who has recently been examined can tell you, instead of working with community banks to help both banks and their customers overcome current economic stress, some federal examiners have become extremely harsh in their assessment of the value of CRE loans and their collateral. This extreme examination environment is adding to the credit contraction for small businesses. Community banks are effectively being forced to avoid making good loans out of fear of examination criticism, forced write-downs and the resulting loss of income and capital.

More aggressive measures are needed to direct capital assistance toward the banks who play the most central role in small business lending – community banks.

**Administration Efforts to Help Small Businesses Access Credit**
The President recognizes this need to support economic recovery and job creation by improving access to credit for small businesses and on October 21, 2009 announced further initiatives toward that goal. The MACB supports the central concept of the Administration's initiative of making lower-cost capital available to community banks under $1 billion in assets, however we have serious concerns about how such an initiative will ultimately look.

Many community banks either did not or could not take advantage of the Troubled Asset Relief Plan, Capital Purchase Program ("CPP"). Those who did not were concerned about the onerous requirements and restrictions required of CPP participants. If the new initiative incorporates those same onerous requirements and restrictions, it is unlikely the initiative will have any appreciable impact on community bank lending to small businesses. In addition, if the initiative is administered like CPP, only "viable" banks will be able to participate – effectively shutting out the very banks who would benefit most from the initiative.

**Alternative Capital Resources for Community Banks**
Another concept that Congress should consider is the creation of a program where community banks could obtain long term stock loans from the Federal Reserve Bank under a program by the Small Business Administration ("SBA"). Banks are comfortable borrowing from the Federal Reserve Bank and the operational structure for such borrowings are already in place.

A long term borrowing program would permit community banks to leverage new capital immediately and provide banks with longer term financing that could be supported and repaid with future bank earnings. If community banks could get an exemption or other concession on the amount of leveraged CRE or small business loans created by new capital obtained under such a loan program, the banks would have the ability to continuing lending to small businesses whose loans are largely secured by commercial real estate.

Other considerations to boost community bank capital include:

- Allow banks to include in their capital all (or a significantly higher portion than the 1.25% of assets currently allowed) of the amount currently carried in their allowance for loan and lease losses (ALLL).

- Allow banks to include as part of their capital the face amount, rather than the market price, of Government Sponsored Enterprises (GSE)[i] securities that are held to maturity in their investment portfolios.
- Allow banks to amortize losses over a 7 to 10 year period, instead of the current requirement to realize the loss in the quarter in which it is experienced, thereby preserving capital.

**Proposed Small Business Administration Reforms to Stimulate Small Business Lending**
Proposed reforms of the SBA loan programs are also a step in the right direction to stimulate the flow of credit to small businesses. The MACB strongly supports reforms that would make SBA lending more "user friendly" for community banks. Before the financial crisis began, nearly 60% of all SBA loans were made by 10 banks.

As noted earlier in my testimony, if Congress wants to get credit into the hands of small business, it must start with community banks who have largely built their banks on relationships with America's small businesses. The SBA loan program should be able accessible to all lenders, and the elimination of the SBA's "LowDoc" program effectively removed many community banks from the SBA lending arena.

The more than 8,000 community banks across America can support a large number of SBA loans if community banks can more easily access SBA lending programs. The traditional "one-size-fits-all" type program is tailored to large bank lenders and does not fit the community bank model. If Congress wants to supply small businesses with the capital they need to operate and grow, the SBA needs to do a better job of reaching out to community banks so that all lenders can more easily participate. Enabling non-preferred lender program community banks to use their own underwriting paperwork and to submit a short, simple and streamlined SBA 9(a) application would result in a significant increase in SBA lending by community banks to their small business customers.

The MACB also supports the proposed increases in SBA 7(a) and 504 loan sizes. Many small businesses need bigger loans to grow or start their businesses. MACB also supports the proposal to allow alternative SBA loan size standards for determining eligible small business borrowers. These measures will enable more small businesses access to the capital they so desperately need to operate and grow their business.

**In conclusion**, the MACB encourages Congress to continue to work with community bank groups and small business groups to focus on ways to assist community banks obtain and retain the capital they need to increase the flow of credit to the small businesses in America who are so vital to any hope of economic recovery for our country.

We hope Congress will be receptive to "outside the box" proposals from business and industry groups such as those testifying today that will enable small businesses to grow and be successful. The recovery of the U.S. economy is dependent on innovative solutions to the current economic crisis.

[i] GSEs include: Federal Home Loan Banks, Fannie Mae, Freddie Mac, Federal Agricultural Mortgage Corporation, Farm Credit System, the Financing Corporation and the Resolution Funding Corporation *(see Federal Reserve Statistical Release Z.1 Flow of Funds of Accounts of the United States, Schedule F.124 Government Sponsored Enterprises.)*

**EMBARGOED UNTIL DELIVERY**

**STATEMENT OF**

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**CHICAGO REGIONAL OFFICE**
**DIVISION OF SUPERVISION AND CONSUMER PROTECTION**
**FEDERAL DEPOSIT INSURANCE CORPORATION**

**on**

**CREDIT AVAILABILITY FOR SMALL BUSINESSES**

**before the**

**FINANCIAL SERVICES COMMITTEE**
**SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**
**U.S. HOUSE OF REPRESENTATIVES**

**November 30, 2009**
**Southfield, Michigan**

Chairman Moore and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the availability of credit to small- and medium-sized businesses. As federal insurer for all banks and thrifts, and primary federal supervisor for just over 5,000 state chartered banks, including approximately 100 headquartered in Michigan, the FDIC is very aware of the challenges faced by financial institutions and their customers during these difficult economic times.

FDIC-insured institutions are a major source of financing for small businesses. FDIC insured banks and thrifts supply over 60 percent of the credit used by small businesses to run and grow their businesses. Most of these institutions are community banks. We share your concerns about making commercial loans available to these Main Street businesses across the country. This recession has had a major impact on the community institutions that traditionally lend to small business. The number of problem institutions and bank failures has risen steadily as the effects of this recession -- which began in the financial markets -- have taken hold in many parts of the country.

As a result, credit availability has suffered. This is due not only to more conservative credit standards by lenders, but also due to the erosion of collateral values and the financial condition of borrowers. The focus again is on the ability of borrowers to repay their loans, which means determining that loans are affordable and sustainable over the long term. Few would argue that a return to fundamentals in credit underwriting is not warranted after the excesses that were observed in some sectors leading up to the recent crisis. At the same time, bank supervisors are encouraging FDIC-insured lenders to deal with problem loans and recognize losses where necessary, while encouraging loan workouts where they are appropriate.

In my testimony, I will briefly describe the conditions currently creating obstacles to credit availability and credit conditions generally, as well as in Michigan. I also will discuss the efforts the FDIC is making to encourage prudent lending.

**Factors Affecting Overall Credit Availability**

Earlier in this decade, credit was generally abundant for many types of U.S. borrowers including large firms, small businesses, and households. Borrowers enjoyed relatively low cost financing which stimulated economic growth and a housing boom in many areas of the country. However, we now know that a significant amount of this lending was poorly underwritten. Conditions in the financial markets masked substantial credit risks that were inherent in the lending practices, resulting in loans that were not sustainable once home prices stopped rising and credit conditions became more stringent. This, in turn, resulted in large losses to financial institutions and other creditors when economic conditions did not match overly optimistic expectations. The emergence of large volumes of problem real estate loans led to a dramatic shift in credit market liquidity since mid-2007 that has changed the landscape for lenders and borrowers alike.

Across the country, financial services companies that make or arrange loans have significantly tightened credit standards as they seek to preserve capital and reduce credit losses. Tighter credit standards and weak demand among both commercial and household borrowers have contributed to five consecutive quarters of declining loan balances at FDIC-insured institutions. Bankers are understandably concerned about credit quality as delinquencies, credit losses, and repossessed assets have risen substantially since the beginning of 2008. Recent measures of credit quality have weakened to levels not seen since the 1990-1991 recession.

**Loan Growth by Asset Size Groups, Third Quarter 2009**

| Asset Size | Number of Institutions | Number Reporting Decline in Loans | Number Reporting Increase in Loans | Aggregate Total Loans 3Q 2009 ($ Billions) | Aggregate Net Change in Loans 2Q 09 - 3Q 09 ($ Billions) | Percent Change |
|---|---|---|---|---|---|---|
| > $100 Billion * | 53 | 41 | 12 | 4,137 | -155 | -3.62% |
| $10 - $100 Billion | 77 | 62 | 15 | 1,270 | -40 | -3.04% |
| $1 - $10 Billion | 568 | 357 | 211 | 981 | -15 | -1.46% |
| < $1 Billion | 7,401 | 3,274 | 4,127 | 1,029 | 0 | 0.02% |
| | | | | | | |
| All Insured Institutions | 8,099 | 3,734 | 4,365 | 7,418 | -209 | -2.82% |

* The Greater than $100 Billion category includes affiliates that would otherwise fall in smaller size groups.
Data have been adjusted to reflect mergers and acquisitions in the prior quarter.
Source: Call Reports and Thrift Financial Reports

**Obstacles to Credit Availability for Michigan and the Midwest**

The financial data for banks in Michigan and the industrial Midwest in general reflect the ongoing struggle of the U.S. manufacturing sector, which contracted throughout this decade. Unlike employment growth among other sectors, job growth in the U.S. manufacturing sector did not rebound after the 2001 recession, even while overall U.S. economic growth was strong. Payroll employment in Michigan has declined by over 800,000 jobs, or 17 percent, since December 2000, with over half of these losses occurring within the manufacturing sector itself. The recent economic crisis served to compound the challenges faced by Michigan's manufacturing companies, especially its automotive and auto supplier companies. Michigan has experienced a sharp increase in joblessness since the start of the national recession in December 2007. The state's unemployment rate has more than doubled from 7.3 percent to 15.1 percent, well above the national rate of 10.2 percent. Long-term economic distress has contributed to higher than average past due rates for Michigan financial institutions throughout the decade. More recently, loss rates on problem loans have increased as the effects of the recession have intensified.

Perhaps the best way to compare lending patterns in Michigan to the rest of the nation is to focus on *community institutions*, or banks and thrifts with assets of $1 billion or less, which tend to lend mostly in their local areas. At Michigan community institutions, asset quality has been in a long downward trend, resulting from a generally depressed economic environment and exceptionally high levels of unemployment.

Michigan's ongoing economic challenges are evident in increasing levels of noncurrent loans across virtually all categories. As of September 30, 2009, the ratio of noncurrent loans to total loans was 3.93 percent, up from 3.18 percent one year earlier.[1] This compares to a noncurrent loan rate of 3.32 percent for all U.S. community institutions. Net charge-offs for Michigan community institutions totaled a substantial 1.30 percent through September 2009, compared to 0.89 during the same period a year

[1] *Noncurrent loans* are 90 days or more past due or in nonaccrual status.

ago. Also, through the third quarter, 39 percent of Michigan's insured financial institutions were unprofitable.

Credit quality deterioration has been broad based among the major loan types. Construction and development (C&D) loan portfolios in Michigan community institutions reported the highest noncurrent rate of any loan type at 14.24 percent as of September 30, 2009, up from 12.52 percent one year earlier. However, C&D loans represent a moderate share of Michigan community institutions' total loans, at seven percent -- somewhat less than the levels held by community institutions nationwide.

Community institutions in Michigan are more heavily concentrated in nonfarm nonresidential real estate loans and one-to-four family residential loans, which collectively comprise 64 percent of loan portfolios in the state compared to 55 percent for the U.S. as a whole. Credit losses and noncurrent loan rates on these portfolios are elevated and above national levels.

Michigan community institutions have contracted their loan portfolios somewhat during the past year. On a merger-adjusted basis, community institutions in Michigan saw total loans and leases decline by 1.8 percent during the year ending September 30, 2009, compared to loan growth of 2.9 percent a year ago and peak loan growth of 9.6 percent in 2004. Most loan categories receded during the past year. In fact, among the largest loan categories, representing at least 10 percent of the total loan portfolio, only nonfarm nonresidential real estate loans grew -- increasing by 4.2 percent. By comparison, community institutions nationwide grew their loan portfolios by 2.2 percent during the past year on a merger-adjusted basis, and their largest loan type, nonfarm nonresidential real estate, grew by 9.7 percent.

**Small Business Lending**

With respect to small business lending, available data do not clearly distinguish recent trends in the availability of small business credit in Michigan compared to the nation as a whole. Recent surveys of small businesses conducted by the National Federation of Independent Business (NFIB) show that while small business loans have clearly become more difficult to obtain, deteriorating business conditions appear to represent an even larger problem.

In the October NFIB survey, the percent of respondents who said that loans were "harder" to get in the last three months outnumbered those who said loans were "easier" to get by 14 percentage points -- among the highest margins recorded since 1981. However, at the same time, the percent of respondents who said that sales were "lower" in the last three months outnumbered those who said sales were "higher" by 31 percentage points.

As of October, the percent of respondents citing "finance and interest rates" as their single most important business problem stood at just 4 percent, compared to 5 percent one year ago. By comparison, a 33 percent plurality of respondents cited "poor sales" as their biggest business problem, up from 23 percent a year ago.

Ensuring the provision of credit to small businesses has been a policy priority since the onset of the financial crisis last Fall. The American Recovery and Reinvestment Acct (ARRA), signed into law last February, temporarily raised the guarantee levels on Small Business Administration (SBA) 7(a) loans and eliminated upfront borrowing fees on SBA loans in the 7(a) and 504 programs. ARRA also provided a range of tax cuts and tax incentives for small businesses, helping them to cope with the unusually harsh economic environment. In addition, the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF) was authorized to provide financing for SBA-backed loans. After these measures were implemented in early 2009, both the volume of SBA loan originations and the volume traded in the secondary market have risen above pre-crisis levels.[2]

**Supervisory Response to Tight Credit Conditions**

A strong policy response is warranted by the historic dislocations in U.S. real estate markets and economic activity that have created a challenging environment for small business lenders and borrowers alike. Since March 2006, home prices in Detroit have fallen by 45 percent on average as measured by the S&P-Case Shiller home price index, while home prices in 20 large U.S. cities (including Detroit) have fallen by 30

[2] U.S. Department of Treasury, "Treasury, SBA Host Small Business Financing Forum," November 18, 2009, http://www.treas.gov/press/releases/tg411.htm

percent. Price indices for commercial real estate properties have fallen by similar magnitudes. These declines in real estate prices have impaired the value of collateral that small business borrowers frequently pledge to obtain funding at the same time that their cash flows are being affected by weak sales.

This dramatic deterioration in real estate market conditions has made it clear that some institutions were carrying excessive concentrations of real estate loans or had employed weak underwriting standards that are now contributing to losses. While the banking supervisors issued a number of warnings to the industry and provided guidance for enhancing risk management in the period leading up to the real estate bust, it seems clear in retrospect that the agencies could have articulated their concerns in a clearer and more timely fashion. And after almost a decade of economic distress in Michigan and the longest and deepest U.S. recession since the 1930s, even institutions that employed sound lending and risk management practices are seeing an increase in problem loans.

Bankers are well aware of these current credit conditions, observing first hand the challenges that their borrowers face every day. This environment has caused some lenders to seek refuge in more liquid, low-risk investments, such as U.S. Treasury securities, rather than taking on additional lending risks. Moreover, banks with large concentrations of credit in the real estate sector in many cases are seeking to reduce those exposures.

The FDIC is committed to ensuring that our examiners understand their proper role and carry out their responsibilities in an objective and even handed manner. The examination process focuses on assessing banks' own risk management process and identifying any weaknesses for consideration and correction by bank management.

For the past several years, the FDIC and the other banking agencies expressed growing concern about the relaxed underwriting standards and non-traditional mortgage products that were increasingly evident in the marketplace. As long as real estate values continued to rise, or even remained stable, the true nature of some of these poorly underwritten and poorly structured loans was masked. While a significant portion of the risky lending was done outside the regulated banking industry, its impact on the market has affected all participants.

We understand the critical role that credit availability plays as the lifeblood of the national economy, especially for small businesses. We also recognize the tight credit conditions in the market and continue to identify strategies for improving the current situation. Over the past couple of years, we have issued several guidance papers to the institutions we regulate to encourage banks to maintain the availability of credit. In November 2008, we joined the other federal banking agencies in issuing the *Interagency Statement on Meeting the Needs of Creditworthy Borrowers*. The statement reinforces our view that the continued origination and refinancing of loans to creditworthy borrowers is essential to the vitality of our domestic economy. The statement encourages banks to continue making loans in their markets, work with borrowers who may be encountering difficulty during this challenging period, and pursue initiatives such as loan modifications to prevent unnecessary foreclosure.

Building on previous guidance, in October of this year the regulators again called attention to credit availability by issuing a policy statement on *Prudent Commercial Real Estate Loan Workouts.* The issuance encourages banks to continue making good loans to commercial real estate borrowers -- most of which are small businesses -- and to work with borrowers that are experiencing difficulties in their repayment capacity because of the economic downturn. This guidance provides a framework to enable examiners to adhere to a balanced approach in assessing an institution's risk management practices for loan workout activity in light of economic circumstances and realistic business alternatives. Our examination professionals have received specific instruction on properly applying the aforementioned guidance in the supervision of FDIC supervised institutions.

In light of the present challenges facing banks and their customers, we continue to reach out to financial institutions, in efforts to identify potential obstacles to sound lending. In doing so, we have established an Advisory Committee on Community Banking, which provides advice and recommendations to the FDIC on a broad range of policy issues that have a particular impact on small community banks throughout the United States. The Committee will review various issues related to the latest examination policies/procedures, credit/lending practices, deposit insurance assessments, insurance coverage issues, and regulatory compliance matters, as well as any obstacles to the continued growth and ability of community banks to extend financial services in their local markets in the current environment.

**Conclusion**

We all have a mutual interest of seeing community banks thrive and continue to support their local communities. People are rightly worried about the economy, their jobs, paying their bills, and keeping their homes. A strong network of healthy community-based lenders can be a stabilizing force by providing credit for consumers and small businesses.

Prudent, responsible lending is good business and benefits everyone. Community banks are uniquely equipped to meet the credit needs of their local markets, and have a proven tradition of doing so, through good times and bad. A majority of the banks in the Midwest have largely avoided the undue concentrations and reckless lending practices that led to the present crisis, and most of them have a solid capital and funding base and will be in a good position to help finance the recovery.

Banks should be encouraged to make good loans, work with borrowers that are experiencing difficulties during this challenging period whenever possible, avoid unnecessary foreclosures, and continue to ensure that the credit needs of their communities are fulfilled. We expect that the ongoing process of loss recognition and balance sheet repair that banks and thrifts have undertaken in recent quarters will, over time, put the industry in a better position to meet a rising demand for credit as the economy recovers.

Further, we support the Administration's proposals to expand the Small Business Administration loan programs, to cut taxes for small businesses, and to make low-cost capital available to small business lenders. These proposals are concrete steps to address the very real problems facing Main Street businesses as a result of the recession and the historic distress in real estate markets.

Thank you for the opportunity to testify today, and I would be happy to take any questions.

For Release Upon Delivery
11:00 a.m., November 30, 2009

**TESTIMONY OF**

**BERT A. OTTO**

**DEPUTY COMPTROLLER, CENTRAL DISTRICT**

**OFFICE OF THE COMPTROLLER OF THE CURRENCY**

**before the**

**SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**

**of the**

**COMMITTEE ON FINANCIAL SERVICES**

**UNITED STATES HOUSE OF REPRESENTATIVES**

**November 30, 2009**

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

**Introduction**

Chairman Moore, Ranking Member Biggert and members of the subcommittee, my name is Bert Otto and I am the Deputy Comptroller for the Office of the Comptroller of the Currency's Central District. I appreciate the opportunity to appear before the Subcommittee to discuss ways to improve responsible lending to small businesses in Michigan and other parts of the country. In addition to responding to the Committee's inquiry, I am also here to listen and hear other viewpoints on this important topic.

I have been a National Bank Examiner with the OCC for thirty-six years and have served in a variety of positions in the field and in our Washington D.C. Headquarters. For almost my entire career, I have been involved in the direct supervision of community and midsize national banks. In my present capacity, I am responsible for the oversight of nationally chartered community banks in ten states, including Michigan, which comprises a large part of the Midwestern United States.

To put OCC's regulatory role in Michigan in perspective, OCC supervises a relatively small portion of the banks headquartered in the state. There are 18 nationally chartered community banks headquartered in Michigan, holding aggregate assets of roughly $3.4 billion. By comparison, there are a total of 131 thrifts and state banks holding assets of over $70.0 billion. It is also important to note, however, that several large OCC supervised which are headquartered outside of Michigan do a significant volume of business and operate a large number of banking offices in Michigan. These numbers are also reflective of a steady decline in the number of financial institutions, a trend both in Michigan and across the United States.

The OCC recognizes the importance of small and midsize businesses to the overall health and vitality of Michigan and the U.S. economy. As Secretary of the Treasury Geithner stated earlier this month at the Small Business Conference that he co-hosted with SBA Administrator Karen Mills, "America's small businesses are critical engines of job growth and have historically led us out of recessions." Secretary Geithner further noted that small businesses rely on banks for 90 percent of their financing, in contrast with large businesses that get 30 percent of their financing from banks.

Clearly, the subject of today's hearing – "Improving Responsible Lending to Small Businesses", is particularly timely here in Michigan. To put my remarks into context, it is important to point out that, just like much of the United States, Michigan is presently facing serious economic challenges. While the national economy has been in recession since 2008, Michigan has been experiencing a much more protracted contraction.

It is no secret that Michigan's economy has experienced a material contraction of its most significant industry – automobile manufacturing. The state's population has been experiencing "out-migration" since 2005, with further declines expected as the state's manufacturing base continues to downsize.

As in other parts of the country, employment has been declining. However, in Michigan this trend began as early as 2001 and has persisted since. Current unemployment numbers now approximate levels recorded in the early 1990s. At 15 percent, Michigan's unemployment rate is the highest in the nation, up six percentage points from a year ago. Even areas of the service sector that normally hold their own in recessions—including financial activities, professional and business services, and information services—are experiencing declines in revenue and employment.

We are, however, seeing a modest recovery in education and health services and tourism is holding up better than in some other states. Defense, alternative energy, and life sciences appear set to expand. Some auto suppliers are diversifying into products for the new economy, with four lithium battery plants and a wind turbine assembly facility planned for the state.

As might be expected, the economic stress on households is pushing up loan delinquency rates. Twelve percent of all mortgages in Michigan are now past due, an increase of three percentage points over the past year, and two percentage points higher than the national average. Other loan categories show similar deterioration.

The steady erosion of the state's manufacturing base has taken its toll on commercial property markets, and delinquency rates have increased as a result. Vacancy rates in Detroit, for example, exceed 20 percent for both office and retail properties.

Deteriorating economic fundamentals are certainly causing increasing stress on small businesses. However, most small businesses will survive the current storm and continue to produce goods and services. In fact, new firms are opening their doors, and some established firms are retooling for the new economy, moving into such new fields as alternative energy. Whatever their specialty, the small business sector will continue to need credit.

The banking industry remains the most important supplier of credit to small businesses in the United States. For banks with assets of less than $1 billion, 56 percent of their business loans are small business loans, as of June 2009. For banks with assets over $1 billion, 21 percent of their business loans are small business loans, as of June 2009.

National banks continue to be accessible to small businesses. Although the total number of depository institutions has been declining, the number of banking offices, including offices and branches, continues to increase. In June 2008, 7,380 depository institutions (independent institutions and bank and financial services holding companies) operated in the United States.

Against this backdrop, the OCC recognizes the important roles that credit availability and prudent lending play in our nation's economy, and we are particularly aware of the vital function that national banks play in meeting the credit needs of the small businesses in their communities. Our goal is to ensure that national banks meet the credit needs of their communities and customers while remaining safe and sound.

During this stressful economic period we are extremely mindful of the need to maintain a balanced approach in our supervision of national banks. We strive continually to ensure that our examiners are doing just that. Although in today's weaker economic environment, credit demand among businesses and consumers has significantly declined, we are encouraging banks to work constructively with borrowers who may be facing difficulties and to make new loans to creditworthy borrowers. Our message to our bankers has been straightforward:

- Bankers should continue to make loans to creditworthy borrowers;
- But they should not make loans that they believe are unlikely to be repaid in full; and
- They should continue to work constructively with troubled borrowers – but recognize repayment problems in loans when they see them.

Likewise, examiners should not dictate loan terms, but will ensure that bank management realistically recognizes and addresses problems as they emerge, even as they work with struggling borrowers. The OCC strives to get this balance right through strong, thoughtful and consistent supervision and clear two-way communication with the banks we supervise.

**Lending to Creditworthy Small Businesses**

Although a small business is defined as having fewer than 500 employees, most small businesses are *very* small—the majority of employer firms have fewer than five employees and many are home-based, providing small incomes for mostly part-time owners. These companies provide economic opportunities to diverse groups of people and offer valuable products and services in the market.

As bank regulators, we recognize the important role that credit availability plays in the viability of these small companies. We share the goal of ensuring banks meet the credit needs of their small and midsize business customers, and have taken steps to see that this happens. Through the *Interagency Statement on Meeting the Needs of Creditworthy Borrowers* issued in November of 2008, all the federal regulatory agencies reiterated our view that, at this critical time, it is important that all banking organizations meet the needs of creditworthy borrowers. The OCC is reinforcing the message of the interagency statement through our examination process.

In addition, our ability to monitor small business lending will be enhanced by steps we are presently taking to obtain more frequent reporting of small business lending data. Bank regulators are currently in the process of revising the quarterly Report of Condition to provide this information. We are working to gather more data on small business loans by moving from annual to quarterly reporting of information in the March 2010 call report. This will allow us to better understand and track this lending segment, which is much larger than just Small Business Administration (SBA) loans.

**Bank Participation in SBA Programs**

One way banks can reduce their credit risk in loans to small and midsize businesses in this environment is to utilize federal and state programs that are designed to make credit more accessible and reduce lenders' credit exposure. The SBA loan guarantee program is one of the best known of these programs. In evaluating the underwriting and quality of small business loans, OCC views government guarantees or support provided through other programs positively as effective mitigants of credit risk. In fact, guidance provided to our examiners in the *Comptroller's Handbook for Rating Credit Risk* specifically states that those portions of credits having a government guarantee are usually assigned a "pass" rating. This standard is applied uniformly by our examiners in Michigan and across the country.

National banks actively participate in government guarantee programs for small business lending. Five of the 18 nationally chartered banks in Michigan are SBA Preferred or Express Lenders offering SBA guaranteed loans and 10 large national banks doing business in Michigan are designated as SBA Preferred or Express Lenders.

The American Recovery and Reinvestment Act (ARRA) expanded several existing Small Business Administration (SBA) programs and created new ones to help stimulate small business lending by banks and other financial institutions. Changes to the

SBA's flagship 7(a) loan guarantee program reduced the credit risk exposure that banks have on these loans. Under the 7(a) program, SBA provides a guarantee to banks originating small business loans. In the event that the borrower defaults on the loan, the SBA reimburses lenders for their loss up to the SBA guarantee limit. ARRA increased that limit from 85 percent to 90 percent. ARRA also temporarily eliminated the upfront guarantee fees, which typically range from 2 percent to 3.5 percent of the loan amount, depending on the size and duration of the loan, although the funding for this has now been exhausted. SBA has reported that these two key ARRA provisions have supported more than $14 billion in lending to small businesses.

The SBA also permanently expanded the SBA 504 certified development company program, in which banks and the SBA co-lend to finance small business plant and equipment. This expanded authority will allow businesses to restructure eligible debt to improve cash flow and enhance capacity for growth and job creation or retention.

We believe these initiatives are having a positive impact on banks' ability and willingness to lend and have sparked a resurgence of interest and participation in SBA programs. SBA has seen its average weekly loan volume increase by more than 75 percent. Over 1,250 lenders have returned to making SBA loans since October 2008. SBA 7(a) loan volume from May to September 2009 totaled $5 billion and SBA 504 loan volume in the same period totaled $2.2 billion. The trends in the third quarter are up when compared to the comparable period in 2008 — by $247 million for SBA 7(a) and $305 million for SBA 504. The National Federation of Independent Businesses' Small

Business Optimism Index is also trending up and more small business owners are reporting that the next three months are a "good time to expand."

These changes have been so successful at spurring small business lending that the Administration has indicated its support for legislation that Congress is considering to increase the maximum size of both 7(a) loans and 504 loans from $2 million to $5 million and increasing the maximum 504 loan limits from $4 million to $5.5 million for manufacturers, as well as raising lending limits on the Microloan program from $35,000 to $50,000.

Just recently Treasury announced a "new" program under TARP that will provide lower-cost capital to community banks that submit a plan to increase small business lending. Treasury is working with community banks and small business interests to finalize terms. This new initiative only applies to banks and bank holding companies with less than $1 billion in total assets. It lowers the dividend rate to 3 percent from the 5 percent level under the current CPP program. The standard for viability and for banking agencies' recommendations for approval has not changed—if a bank was not approved under the Capital Purchase Program, then this program will also be unavailable.

At the same time Treasury also announced a program geared to CDFIs, including credit union CDFIs. This program also envisions an approval by the CDFI's federal banking regulator. The rate on these funds is two percent for eight years

In our examination processes we are just starting to see the use of the new SBA programs. We have been active in working with the SBA and Treasury to facilitate small business lending. We need to ensure these programs provide flexibility for bankers to work with sustainable small businesses. Specifically, we facilitated a meeting in August between representatives from the Treasury and national bankers to provide a forum to explore ways to assist small businesses through the SBA. We have also met directly with SBA staff to discuss their programs so we can ensure examiners understand their programs and are consistently analyzing SBA loans in the field.

**Community Reinvestment Act**

Beyond our safety and soundness examination activities, OCC encourages lending to small and midsize businesses in a variety of other ways. Among these are our evaluations of national banks' performance under the Community Reinvestment Act (CRA), our extensive Community Affairs activities and our formal outreach programs.

The CRA encourages each insured financial institution to help meet the credit needs of the community in which it operates. The number and dollar volume of loans to small businesses, particularly those with annual revenues of less than $1 million, are important considerations in the OCC's evaluation of how well an institution is meeting local credit needs and in the assignment of its public CRA rating. OCC's CRA examination process ensures that a national bank's lending to small and midsize businesses is carefully assessed and subject to public scrutiny, and that these activities have a direct influence on the institution's CRA rating. The bank's knowledge that it will receive positive CRA consideration creates additional incentive to responsibly lend to creditworthy small business borrowers.

**Outreach Activities and Community Affairs**

OCC management and examiners regularly conduct outreach meetings and participate in industry and interagency forums with bank directors, chief executive officers, and senior credit officers to promote sound lending, including loans to small and midsize businesses.

OCC's Community Affairs Department is instrumental in providing information and resources to our examiners, bankers, industry associations and community groups. This OCC function is comprised of staff located in our Washington, D.C. headquarters, as well as Community Affairs Officers located in ten major metropolitan areas across the country. These individuals play an active role in agency initiatives to promote existing programs and innovative ideas for advancing small business lending.

The OCC's community affairs activities and publications are specifically developed to increase examiner, banker and community group awareness of programs that promote lending to small businesses. Recent newsletters, informational publications, conferences and teleseminars have highlighted various aspects of small bank lending opportunities and incentives:

- OCC and the other bank regulatory agencies regularly convene seminars for financial institutions to promote bank involvement in CRA activities, including small business lending. During 2009, OCC, the other bank regulatory agencies and SBA held eleven seminars focused exclusively on small business issues. The OCC is continuing this outreach.
- A recent edition of the *Community Development Investments* newsletter, which illustrated various ways multi-bank community development corporations have collaborated to provide financing to small businesses. This newsletter highlighted legislative changes in the Housing and Economic Recovery Act to the "Part 24" public welfare investment authority of national banks which will encourage increased bank investment in community development finance activities. We are particularly appreciative of Chairman Frank's strong leadership in connection with the passage of this important legislation.
- Over the past three years, the OCC has developed two *Community Development Insights* reports which serve as primers for banks considering participation in the SBA 7(a) or 504 Certified Development Corporation loan programs. After the release of these reports, OCC held national informational telephone seminars which drew a combined 3,000 listeners. We are updating both of these reports to reflect program changes and we will publicize the SBA program changes through our ongoing CRA outreach to bankers at training seminars and conferences.
- OCC's public Website also houses a wealth of information on small business lending on its Small Business Resource Guide Webpage.

**Conclusion**

The OCC recognizes the important roles that credit availability and prudent lending to small businesses play in our nation's economy, and we share the Committee's goal of ensuring that banks continue to meet the credit needs of their customers. We recognize that banks are operating in an economic environment that continues to pose significant challenges to them and their customers. However, we have and will continue to support and encourage lending to small and midsize businesses – in Michigan and across the country – through our supervisory activities, the CRA process, guidance to bankers, small business related programs and publications and ongoing outreach efforts.

While many challenges lie ahead, especially with regard to the significant decline in credit quality, OCC believes that the collective measures that government officials, bank regulators, and many bankers have taken in recent months have put our financial system on much more sound footing. The OCC is firmly committed to a balanced approach that encourages bankers to lend and to work with borrowers in a safe and sound manner, while recognizing and addressing problems on a timely basis.

Thank you for this opportunity to testify and present our views.

TESTIMONY OF

KEN ROSS

COMMISSIONER

MICHIGAN OFFICE OF FINANCIAL AND INSURANCE REGULATION

On

"Improving Responsible Lending to Small Businesses"

Before the

FINANCIAL SERVICES SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

UNITED STATES HOUSE OF REPRESENTATIVES

November 30, 2009, 11:00 a.m.

Lawrence Technological University, Southfield, Michigan

**INTRODUCTION**

Good afternoon, Mr. Chairman and distinguished members of Congress. My name is Ken Ross. I am the Commissioner of the Michigan Office of Financial and Insurance Regulation. Thank you for the opportunity to testify today on the condition of the banking industry in Michigan and the impact federal policies and initiatives are having upon Michigan financial institutions.

My agency supervises 118 of Michigan's 147 FDIC-insured commercial and savings institutions; they hold over $50 billion in combined assets. In addition, it supervises six trust banks, approximately 200 state-chartered credit unions, over 2,700 mortgage brokers, lenders and servicers, and well over 200,000 insurance agents and companies.

I do want to note at the outset that while Michigan's credit unions play an integral part in Michigan's diversified financial services landscape, my primary focus will be on the community banking sector.

In my testimony today, I will discuss the overall condition of Michigan's banking industry and actions taken by my agency to effectively supervise our regulated entities and protect consumers in this challenging economic environment. Finally, I will discuss some recommendations for Congress and my federal counterparts as we coordinate our efforts to improve supervision and the health of the banking industry.

**STATUS OF MICHIGAN'S BANKING INDUSTRY**

Because of Michigan's historically cyclical economy, its bankers are by and large very conservative, even in comparison with their counterparts elsewhere in the nation. They've traditionally held capital in amounts in excess of the national average in order to provide the strength to weather typical economic downturns. But as we all know, the current downturn has been far from typical. Michigan did not experience a recovery following the 2001 recession, and its banks have been dealing with a sluggish economy since then. Until the real estate crisis struck a couple years ago, they'd been holding their own. At the end of 2006, around the beginning of the real estate crisis, the average leverage capital ratio for Michigan's banks was 9.5%. At mid-2009, that average ratio was 8.8%.

As this economy has worsened, more and more borrowers, both individual and corporate, have lost the capacity to repay. Unemployment across the state has risen from 7.1% in 2006 to over 15% today.[1] Auto sector-related employment has plummeted by more than 40% since 2006.[2] Corporate reserves set aside to weather a normal downturn gradually have been exhausted. This is showing up as rising loan delinquency and foreclosures in bank loan portfolios across the state. At the end of 2006, non-performing and delinquent loans at Michigan banks amounted to 1.9% of total loans. At mid-year

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[1] U.S. Bureau of Labor Statistics

[2] Michigan Office of Labor Market Information & Strategic Initiatives

2009, 5% of loans were non-performing and another 2.7% were delinquent. Almost 20% of construction and development loans were not current on their payments, along with almost 10% of multi-family residential loans, over 5.5% of commercial real estate loans, and 6% of individual credit cards. [3]

Increasing levels of non-performing and delinquent loans affect bank earnings in a couple ways. First, credit-related revenues are declining. Second, banks' costs of managing collection, workout/modification, and foreclosure activities and then managing and selling foreclosed properties have skyrocketed.

Rising delinquency and plummeting collateral values (median home prices in Michigan have fallen by over one-third since 2006[4]) also mean that banks must set aside increasing amounts for reserves against potential loss. With earnings at some institutions insufficient to fund loan loss reserves, capital accounts are being eroded. As capital falls below adequate levels, struggling institutions are losing access to lines of credit and other liquidity sources.

In 2006, only about 7% of Michigan's banks were unprofitable. At June 30 this year, nearly 40% of the state's banks reported that they did not make a profit in the quarter. Some institutions have merged to reduce costs and strengthen their ability to survive this business cycle. We've seen the number of banks in Michigan decline from 171 at the end of 2006 to 147 today.

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[3] FDIC.gov, Statistics on Depository Institutions

[4] Michigan Association of Realtors

In a state that averaged one bank closure roughly every five years for the past several decades, four Michigan banks and one credit union have been closed in the past 13 months. The number of Michigan banking institutions facing significant challenges is higher than at any time since the Great Depression.

Michigan banks have been able to weather the economic malaise and over time they might have been able to work their way through the challenges associated with the historic job losses in the auto industry, but some will not be able to weather the additional stress associated with the huge devaluation of real property seen across the state.

The current crisis was in many ways fueled by various arms of the nation's largest commercial and investment banks, a number of which were saved by aggressive capital bolstering at the federal level. For systemically important big banks, the rules have been bent and broken, but community banks have been given little flexibility and are paying the price for the economic problems created by their larger counterparts.

In my view, it is unreasonable to force community bankers, who weren't, by and large, in subprime lending and who weren't reaping fortunes from the national securitization machine, to pay the ultimate price for those who benefited from the fundamental underlying causes of the financial crisis.

**STATE ACTIONS TO IMPROVE SUPERVISION AND PERFORMANCE OF THE INDUSTRY**

My staff is working hard, in coordination with FDIC and Federal Reserve examiners, to monitor the condition of Michigan's state-chartered banks. We have accelerated examination starts for institutions showing signs of trouble in interim monitoring reports. Troubled institutions are examined more frequently, generally jointly by my staff and federal examiners, and are subject to interim on-site visits to review progress in addressing problems.

The most seriously troubled institutions are:

- placed under formal enforcement actions that clearly identify issues that need to be addressed and have to report to us regularly on their progress.
- instructed, to stop taking deposits that would not be FDIC-insured, to eliminate expeditiously, by restructuring or otherwise, uninsured amounts in existing deposit accounts, and to report weekly on their uninsured deposits. We do this because we have very real concerns about the impact of bank failures on Michigan citizens, already financially stressed, local units of government, small businesses and other public funds depositors holding uninsured deposits.

In a time of economic uncertainty, we've stepped up our outreach to financial institutions. Last year, my agency, in partnership with the Michigan Association of Community Bankers, launched a new semi-annual Bank Directors College to help directors stay abreast of emerging issues, regulatory expectations, and changes in laws and rules. This year, my staff worked hand in hand with the banking industry to draft and pass changes in Michigan's Banking Code that gave bankers more time to work with troubled borrowers before being required to charge off loans that aren't paying and that better recognize the intrinsic value of underlying collateral. Additionally, for the past several years, my senior staff and I have participated in banker and credit union industry forums presented by the state's two banker associations to facilitate frank dialogue between bankers and their regulators about important issues.

For the past several years, I have communicated to bank and credit union executives the vital importance of preparing all staff for media and customer questions. We have emphasized to all institutions the importance of having and regularly testing back-up liquidity plans. Testing liquidity plans has become especially critical as many out-of-state liquidity sources have reduced their exposures in Michigan.

I have reinforced with bankers and with staff the importance of regular and ongoing communication with regulators during and between exams in order to minimize surprises. Because the stakes are high, we are spending more time assuring that our examination findings are accurate, that bankers' views are carefully considered and that our conclusions are correct.

Consumer confidence in the state's financial institutions is critical, and I take every opportunity to reinforce to the public the strength of the deposit insurance guarantee. We have worked closely with the media to contextualize public enforcement actions in order to preserve confidence in the system. My consumer assistance staff are ready and able to assist callers at our toll-free line with their questions about the health of the industry, how to protect their deposits or resolve complaints. And they're becoming adept at assisting consumers in negotiating mortgage loan modifications.

**CAPITAL IS KING**

As our nation entered the financial crisis, observers and experts alike touted the overall strong capital base of the banking industry, especially compared to previous periods of economic stress. At the same time, banks are highly leveraged operations and when losses materialize, capital erodes quickly. While this is true for all institutions, it is more pronounced in the nation's largest banks. According to the Federal Deposit Insurance Corporation (FDIC), as of December 31, 2007, banks over $10 billion in assets had an average leverage capital ratio of 7.41%. This was 200 basis points (b.p.) less than banks with assets between $1 billion and $10 billion; 256 b.p. less than banks with assets between $100 million and $1 billion; and an astonishing 610 b.p. less than banks with assets less than $100 million. As the financial crisis was unfolding and the serious economic recession began, these numbers show the country's largest institutions were poorly positioned, leading to the extraordinary assistance by the federal government to protect the financial system. Even with this assistance, this differential continues today with the largest institutions holding considerably less capital than the overwhelming majority of the industry.

Last year, the Federal government took unprecedented steps to protect the financial system by providing capital investments and liquidity facilities to the nation's largest institutions. Financial holding company status was conferred on a number of major investment banks and other financial concerns with an eagerness that was jawdropping. However, federal policy has not treated the rest of the industry with the same expediency, creativity, or fundamental fairness. Over the last year, nearly 300 community banks nationwide have failed or been merged out of existence, while the largest institutions, considered too big to fail, have only gotten bigger. Nationally, there have been over 130 bank failures, four of which have occurred in Michigan, in this economic downturn.[5] Unfortunately, this cycle will continue for the next few years. In addition, my fellow state Commissioners and I expect an estimated 125 additional unassisted, privately negotiated mergers due to poor banking conditions.

Additional capital, both public and private, must be the building block for success for community and regional banks. While TARP has provided a source of capital for some of these institutions, the process has been cumbersome and expensive for the community and regional banks, whether they actually received the investment of funds or not.

Furthermore, if TARP is to be an effective tool to strengthen community and regional banks, the Treasury should change the viability standard, which currently requires successful applicants to be viable prior to TARP assistance. Instead, capital should be provided to institutions which will be viable after the TARP investment. Expanded and appropriate access to TARP capital will go a long way to saving the FDIC and the rest of the banking industry a lot of money. To date, this has been a lost opportunity for the federal government to support community and regional banks and provide economic stimulus.

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[5] FDIC

Last month, the Administration announced plans to develop a program to provide lower-cost capital, under the Financial Stability Plan, to community banks that submit a plan to increase small business lending. This program has great promise but must be expedited. We strongly encourage the Administration to structure this program with minimal burden to the institutions and a very quick application process. This will ensure the funds reach the market quickly providing valuable economic stimulus and jobs for the American people.

While there are positive signs on the national scene that private capital may be flowing into the system, Michigan banks have largely been shut out of the capital markets. For the six months ending June 30, 2009, over 2,200 U.S. banks have injected $96 billion in capital. While capital injections were achieved by all sizes of institutions, the group with assets under $1 billion showed the smallest percentage of banks raising capital, 25%. Here again, the federal support for the largest financial institutions seems to be conferring a benefit not broadly enjoyed by the industry. A recent study found that banks with more than $100 billion in assets paid 1.15% for funds, while the rest of the banking industry paid 1.93% late last year and early this year for funding. This translates into an annual subsidy worth up to $34.1 billion for the eighteen biggest banking companies.[6]

Michigan banks, unfortunately for the most part, are not experiencing an influx of private capital. I hear all too frequently from bankers that Michigan is being "redlined" by the capital markets.

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[6] Dean Baker and Travis McArthur, "The Value of the 'Too Big to Fail' Big Bank Subsidy," Center for Economic and Policy Research Issue Brief (September 2009).

**SUPERVISION DURING THE CRISIS**

In light of the very serious challenges facing the industry and financial regulators, my fellow state regulators and I have increased our outreach with the industry in order to develop a common understanding of these challenges. Banks are core financial intermediaries, providing a safe haven for depositors' money while providing the necessary fuel for economic growth and opportunity. While some banks will create—and have created—their own problems by miscalculating their risks, it is no surprise that there are widespread problems in banks when the national economy goes through a serious economic recession.

As a regulator, I will never be able, nor would I desire, to have a completely risk-free banking industry. While they are highly regulated and hold the public trust, depository institutions are largely private enterprises. As such, they should be allowed to take risks, generate a return for shareholders, and suffer the consequences when they miscalculate. Over the last year, the nation has experienced a steady stream of bank failures. While unfortunate and expensive, this does provide a dose of reality to the market and should increase the industry's self-discipline and regulators' focus on key risk issues. In contrast to institutions deemed too big to fail, market discipline and enhanced supervisory oversight may well result in fewer, but stronger community and regional banks.

**AREAS REQUIRING ATTENTION**

This is a time for us to be looking forward, not backward. As regulators, we need to be working to proactively resolve the problems in the banking industry. To do this, we need to ensure our supervisory approach is fair and balanced and gives those banks which deserve it the chance to improve their financial positions. Industry and regulators must work together to fully identify the scope of the problems. Individual bank management and regulators must work together to fully identify the scope of the problems facing each institution. Understandably, some banks will be too damaged to successfully rebound, regardless of the time and effort afforded senior management. Given the pivotal role that community banks play in local economies across Michigan, regulators are well advised, however to not take an overly rigid approach to banks that can rebound, afforded a reasonable amount of time and flexibility. A reasonable approach will take time and effort, but it will likely result in less cost to the Deposit Insurance Fund and will benefit communities and the broader economy.

I would like to highlight a few areas of particular concern. In the course of participating in banker forums and other industry events, Michigan's bankers have repeatedly articulated serious concerns to me about a perceived biased regulatory treatment against banks located in Michigan that manifests itself in a variety of ways, including:

- regulatory pre-conceptions about Michigan have affected the state's banks' ability to qualify for TARP CPP funds;
- examiners arriving at the start of an examination having pre-determined the bank's ratings;
- that those pre-determinations are being driven by those who are not familiar with Michigan;

- that material loss reports by the FDIC's Office of Inspector General that charge laxity in supervision of failed banks have had the effect of driving examiners to become unnecessarily rigid.

I've heard these kinds of comments with enough frequency to ascribe some truth to the notion that Michigan banks, due to the very challenging economic circumstances in the state, have been given little quarter by some examiners. Additionally, the challenges of obtaining reasonably accurate appraisals in a volatile and downward-driven market flush with a constant stream of new foreclosures that have artificially suppressed collateral values have been particularly vexing.

Having said that, we've found some instances where bankers didn't have adequate processes in place to accurately assess the value of the collateral backing loans and this understandably caused friction as examiners were forced to develop alternative valuation models. Additionally, earlier in the cycle, I know that there were many bankers who remained overly optimistic and underestimated the depth of the problems that we are facing.

Those days are gone.

I have been actively encouraging Michigan bankers to more aggressively communicate with examiners pre-exam, during an exam, post-exam, and between exams in order to stay on top of developments in local submarkets, regional and statewide exam trends. I believe that Michigan bankers have got this message loud and clear.

<u>Increase Access to Capital</u>

First, as discussed earlier, capital must be allowed to flow into the system. The regulatory environment should not discourage private capital investments. We need to encourage this inflow through direct investments in existing institutions and the formation of new banks. To the extent that private investors do not themselves have bank operating experience or intend to dismantle institutions without consideration of the social and economic consequences, such shortcomings can and should be addressed by denial of holding company or bank applications or through operating restrictions in charters or regulatory orders. Conversely, where private equity groups have employed seasoned management teams and proposed acceptable business plans, such groups should be granted the necessary regulatory approvals to invest or acquire.

Expedite Mergers

Second, banks must be allowed to merge, especially if it allows for a resolution of a problem institution. Unfortunately, there are too many roadblocks in the approval process. There should be more transparency and certainty from the Federal Reserve on the process and parameters for approving mergers. To be clear, I am not talking about a merger of two failing institutions. Facilitating the timely merger of a weak institution with a stronger one is good for the system, good for local communities, and is absolutely the least-cost resolution for the FDIC.

Brokered Deposits

Third, over the last several years the industry has explored more diversified funding, including the use of brokered deposits. Following the last banking crisis, restrictions were placed on use of brokered deposits by banks falling below "well capitalized." I appreciate the efforts of FDIC Chairman Bair in working to provide more consistency and clarity in the application of this rule. However, I am concerned the current approach leads to unnecessary failures. For some institutions with large amounts of brokered deposits, the sudden inability to renew existing brokered deposits may trigger a liquidity event. Many of the recent failures of community and regional banks have been the result of a sudden and precipitous loss of liquidity. Regulators allowed banks to increase their reliance on this funding in the first place, and I believe we have a responsibility to assist them in gradually unwinding their dependency as they work to clean up their balance sheets. My colleagues in other states have numerous institutions that could have benefited from a brokered deposit waiver granted by the FDIC.

Open Bank Assistance

Fourth, open bank assistance has the potential to stem the rising tide of bank failures and reduce the growth rate of troubled asset acquisition by the FDIC; but the FDIC is seriously constrained in providing any institution with open bank assistance. I am concerned that these constraints are being subjected to excessively strict interpretation. There are opportunities to provide this assistance which do not benefit the existing shareholders and allow for the removal of bank management. This is a much less disruptive approach and could prove to be much less costly for the FDIC. This is essentially the approach applied to Citibank and Bank of America, granting loan guarantees without removing management or eliminating the stockholders. The Capital Purchase Program under TARP can be a source of capital for transactions that restructure banks or assist in mergers to the same effect. I am not suggesting that such support be without conditions necessary to cause the banks to return to health. Congress has the authority to modify the "least cost analysis" requirement, which is today preventing consideration of alternatives to closure before a troubled institution has effectively failed.

Regulatory Guidance

One positive recent development can be found in the recent issuance of the FFIEC policy statement on Prudent Commercial Real Estate Loan Workouts. This policy statement stresses that performing commercial real estate loans, including those that have been renewed or restructured on reasonable modified terms, made to creditworthy borrowers will not be subject to adverse classification solely because the value of the underlying collateral declined. The policy statement recognizes that prudent commercial loan workouts are often in the best interest of financial institutions and creditworthy commercial real estate borrowers.

**LOOKING AHEAD**

This crisis will produce a host of legacy items, designed to address both real and perceived risks to the financial system. They deserve our considered deliberation to ensure a balanced and reasoned approach which provides a solid foundation for economic growth and stability.

Discussions around regulatory reform are well underway in Washington, D.C. Our nation's leaders would do well to remember the instability a year ago of certain firms, which put the U.S. financial system and economy at the cliff's edge. The bank failures that we are seeing today must not cloud the real and substantial risk facing our financial system—firms which are too big to fail, requiring extraordinary government assistance when they miscalculate their risk.

The community bank and credit union models embrace community engagement and strive to deliver high-touch lending. However, regulators will continue to focus on appropriate concentrations, better risk diversification, and improved risk management. Ultimately, we need to ensure financial institutions are viable competitors for consumer finance and ensure they are positioned to lead in establishing high standards for consumer protection and financial literacy.

There must be recognition of bankers' need to buttress capital and reserve positions in good times in order to weather protracted downturns. Counter-cyclical reserving patterns have unnecessarily stressed the financial sector in this cycle.

We need to consider how the Deposit Insurance Fund can help to provide a counter-cyclical approach to supervision. Congress should revisit the cap on the Fund and require the FDIC to build the Fund during strong economic times and reduce assessments during periods of economic stress. This type of structure will help the entire industry when it is most needed.

**CONCLUSION**

Michigan has been among the states hardest hit by the recent recession and bursting of the real-estate bubble, and it likely will be among the last states to recover. I urge you to keep this in mind in considering the future of TARP and stimulus programs now in place and be wary of the premature termination of programs before all boats are again afloat.

Thank you for the opportunity to testify today on the challenges facing the banks in Michigan, and how initiatives undertaken by the federal government can impact these institutions.

I look forward to any questions you may have.

TESTIMONY OF

NED STAEBLER

VICE PRESIDENT, CAPITAL ACCESS AND BUSINESS ACCELERATION

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION

On
"Improving Responsible Lending to Small Businesses"

Before the
FINANCIAL SERVICES SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
UNITED STATES HOUSE OF REPRESENTATIVES

November 30, 2009, 11:00 a.m.
Lawrence Technological University, Southfield, Michigan

Good afternoon Mr. Chairman and distinguished Members of Congress. My name is Ned Staebler and I am the Vice President for Capital Access and Business Acceleration at the Michigan Economic Development Corporation. I sincerely appreciate the opportunity to testify today on this very important subject.

Today, manufacturers in the United States face considerable uncertainty after a protracted recession that threatened to bring down the entire economy. While some firms are cautiously optimistic about the overall economic recovery, the persistent lag in credit markets continues to pose a serious and permanent threat to manufacturers and to our country's industrial capacity.

The timing for this credit lag couldn't be worse. Our manufacturing capacity is the key ingredient for a successful transition to the new, green economy that will propel America's future growth. But we are falling behind. As we speak, China, Germany, and other nations are seizing the opportunity by heavily investing in their industrial capacities, and will take the lead in the new economy unless we act soon.

The situation is exacerbated by conflicting reports on the state of the market. On one hand, in recent months, the Institute for Supply Management reported an increase in the ISM Manufacturing Index, indicating an uptick in economic activity[1]. The Federal Reserve, on the other hand, recently reported what was described in the Wall Street Journal as "a sharp slowdown in U.S. manufacturing activity" during the month of October that "raised concerns that the economy's nascent recovery is losing steam"[2]. What is clear from a deeper reading of

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[1] "Manufacturing ISM Report". Institute for Supply Management. October, 2009.
[2] Kelly Evans. "Manufacturing Slows, Clouding Recovery". Wall Street Journal. November 18, 2009.

both reports is that while conditions are somewhat improved from the lows seen in the first quarter of 2009, U.S. manufacturing output is still very weak compared to historical levels and utilized capacity remains at, or near, all time lows.[3]

In Michigan, and from our view at the Michigan Economic Development Corporation (MEDC), the state of the market is clear. Unemployment in the state is at 15.1%[4]. A recent University of Michigan report projected the state will have lost nearly 1 million jobs by the time we reach bottom, over half of those losses coming from the manufacturing sector[5]. And A.T. Kearney estimates that 50 percent of tier one automotive suppliers are at risk of bankruptcy[6]. Perhaps most troubling is that the automotive industry has one of the largest economic multipliers of any sector in the U.S. economy[7], a reminder that other non-auto jobs are tightly linked to the success or failure of the auto industry. Finally, we know by the steady demand from banks and borrowers for our new manufacturing loan enhancement programs at MEDC, that action is necessary to induce new loans more quickly.

Even with the interventions of TARP, designed to improve the health of the banking sector and increase available capital to businesses, commercial and industrial lending across the U.S. has fallen 8% over the last twelve months[8]. In Michigan, the decline is over 10.5%[9]. Clearly, the recovery plan has not done enough to increase the flow of credit from private lenders.

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[3] Federal Reserve Statistical Release, Industrial Production and Capacity Utilization, November 17, 2009
[4] "Labor Market Information". Michigan Department of Labor, Energy, and Economic Growth. October, 2009.
[5] George A. Fulton. "RSQE Forecasts". University of Michigan Seminar in Quantitative Economics. November 20, 2009.
[6] Doug Harvey. "Happier Times Ahead for Auto Suppliers?" A.T. Kearney. April, 2009.
[7] David Cole. "The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers". Center for Automotive Research. November 4, 2008.
[8] "Quarterly Banking Profile". Federal Deposit Insurance Corporation. Second Quarter.
[9] Michigan Bankers Association.

This scarcity of credit is particularly impactful on the manufacturing sector which is very capital intensive and often requires the financing of inventories and receivables over long periods of time. Additionally, today's depressed asset values have been especially detrimental to manufacturers that have historically used property, plant, and equipment and receivables as collateral to finance operations.

This juncture is critical for three reasons: (1) manufacturers need capital to reorganize and consolidate efficiently and in an orderly fashion to improve their financial health; (2) those manufacturers who have 'right-sized' and are now seeking to fill new orders are finding that with their reduced borrowing bases, it is difficult to access capital to scale back up; and (3) those manufacturers seeking to utilize their core competencies in advanced manufacturing in non-traditional verticals (wind, solar, medical device, homeland defense) are increasingly unable to finance this transition.

We applaud many of the efforts of Congress and the Obama Administration to address these issues. Increasing access to, cost of, and timing for capital to manufacturers will be an essential part of our nation's economic recovery. Increasing SBA guarantee levels, reducing fees, and reducing administrative hurdles should continue to be Administration goals and we urge this Committee to support them.

However, we feel that these measures overlook the deep interdependence between the health of banks and the health of borrowers. TARP and many of the SBA adjustments described above focus on the health of banks but fail to fully address the problem. We agree that banks need to be healthier, and access to cheaper capital helps. But to grow our deflated manufacturing sector, borrowers must be made healthier as well. Lowering the cost of capital to banks, increasing guarantees, and reducing fees and bureaucracy do not change the fundamental business of banks: making loans to borrowers with reliable cash flows and sufficient collateral values on a margin. Nor should they. We are not suggesting that underwriting standards be lowered at all.

Rather, the best way to widen the scope of lenders to include manufacturers and other historically healthy firms, in this environment, is to enhance borrowers' financial qualifications from a commercial loan underwriter's perspective. This requires mechanisms targeted specifically at borrowers' shortcomings: cash flow and collateral.

In recognition of this fact, the MEDC created the Michigan Supplier Diversification Fund (MSDF), which has been very successful in inducing new loans that were otherwise unqualified from the bank's perspective, many of which provided funds for diversification into emerging, green industries.

The Fund does this via two mechanisms designed to address the financial health of the borrower. One mechanism supports the cash flow of borrowers by purchasing a portion of a loan and offering a grace period on that portion. Another mechanism supports depressed collateral values by depositing cash collateral into the lending institution.

MSDF also supports the health of participating banks in two ways. The cash flow support mechanism supports the bank by offsetting its default risk exposure and supporting its debt service coverage. The collateral support mechanism actually deposits cash collateral into lending institutions which increases collateral coverage and core deposit base which helps the bank's capitalization ratio.

Also crucial is that the program targets its support of banks and borrowers at the individual loan request level. This ensures that projects move forward at the time of the deployment of funds. The program only expends capital when a development project (and its associated job creation) occurs. In essence, the program self regulates by ensuring that the lending activity happens right away, in contrast to TARP, where follow on lending has severely lagged.

MSDF leverages the market expertise, prudent risk management practices, and financial capacity of private lenders, who source, underwrite, lead, and service the deals, while injecting targeted public dollars at the level of individual loan requests. So far, every $1 in public funds has leveraged $3 in private funds.

MSDF has been well received by the lending and manufacturing communities in Michigan. In less than three months since inception, over 85 percent of the limited ($13.2 million) fund has been committed and the pipeline of deal flow far exceeds the initial fund capitalization. It is critical that more funds be deployed. There is an estimated need of at least $1 billion in Michigan, and approximately $8-10 billion nationally[10].

[10] Robert E. McKenna. "Emergency Financial Assistance Request". Motor & Equipment Manufacturers Association. June, 2009.

Should we fail to address this gap, a chain reaction of bankruptcies is a real possibility, particularly in a protracted period of slow growth and high unemployment. Auctions would be held at the doorsteps of failed manufacturers. And the beneficiaries will be China and India, who will use our best equipment, which they will have purchased at cents on the dollar.

As evidenced by the 15+ percent unemployment rate in Michigan, the transition of the American manufacturing base from traditional sectors to new high tech verticals is a challenging one. However, the speed of this transition is crucial to the retention of an advanced manufacturing cluster in the United States.

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Oversight and Investigations
Field Hearing
Improving Responsible Lending to Small Businesses
November 30, 2009

**Herbert W. Trute**

## CURRICULUM VITAE

**HERBERT W. TRUTE**

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**EDUCATION**

*University Of Michigan, Ann Arbor, MI*
**B.S. Mechanical Engineering** **1977**

**RELATED EXPERIENCE**

*Richard & Trute Tool & Die Corporation*
**President – CEO** **1977 – 1990**

Managed banking relationships, Including successful implementation of an Industrial Revenue Bond to finance growth and acquisition of advanced technology.

Negotiated union contracts with the bargaining unit UAW local 155

Supervised all aspects of the business – technical as well as sales and financial

Supervised orderly dissolution of the business subsequent to the sudden loss of bank financing.

*T & W Tool & Die Corporation*
**President – CEO** **1983 – Present**

Managed banking relationships financing all aspects of business credit requirements.

Supervised all aspects of the business, concentrating on growth and technical currency.

Fostered and managed strategic customer relationships.

Researched business opportunities and potential relationships in the Pacific Rim.

Successfully negotiated the GM, Chrysler Bankruptcies without loss of money owed the corporation.

In the absence of adequate and useable bank financing, successfully negotiated progressive payment plans with largest key customers allowing the business to remain viable.

*TMTA – Tooling, Manufacturing & Technologies Association*
**Chairman of The Board of Directors**

**2005 - Present**

Transitioned from a Michigan based association to multi-state.

Actively represented members' interests in Washington, DC with multiple visits during the GM, Chrysler, and Ford financial aid hearings.

Meetings with Senator Stabenow, Michigan Governor Granholm, and other members of Congress during the Automotive Hearings.

Served in an advisory capacity to the Obama Transition Team with respect to domestic manufacturing and the need to "Build it here".

Helped in a united effort with the CPA – Coalition For A Prosperous America, with a common goal of furthering the interests of American Manufacturing.

**MEMBERSHIPS**

TMTA – Tooling, Manufacturing and Technologies Association

**History:**

*A business, or an industry for that matter does not find itself at a particular point or in a particular situation in a vacuum. There is almost always an evolution, or progression of events that results in a situation or crisis. The current crisis with respect to small and mid-sized manufacturing in the Industrial Midwest is no exception, so a bit of history is in order, along with a perspective from the tooling side.*

1950's – In the 1950's The entire industry prospered. America consumed what the auto industry produced. The auto companies grew and a huge supplier base began to grow with it. The American dream became a reality for millions.

1970's – In the 1970's the auto Execs decided that they would build their own highly automated toolrooms, believing they could produce tooling more efficiently inside than purchasing tooling from the supply base. A few of the least efficient large tool suppliers went out of business, but those workers were hired by the big three. In addition, virtually all of the automated modern equipment was purchased from American machine tool manufacturers.

1980's – In the 1980's the auto Execs decided that their internal tool building efficiency was not what they had hoped for, and realizing that cost-effective tooling could be purchased in the supply base, they did so, thereby boosting profits, and securing substantial bonuses as a result. Yes, a few toolrooms were closed, but the workers were picked up by the supply base and everything worked out. But herein lie the roots of the cycle of greed that then took over.

1990's – In the 1990's the auto Execs decided that to save money short term, they would purchase less expensive tooling from Japan. The effects of this were felt in the domestic supply base, which began belt tightening in the face of foreign competition. Profits were slim, and there was little funding available for modernization and or growth. The automakers however were able to boost profits, along with substantial bonuses for auto execs. In addition, this is how our manufacturing knowledge base was shipped offshore on a silver platter. The domestic machine tool industry was decimated in this decade, as Japanese machine tools flooded the market.

2000's – In the 2000's the auto Execs, searching for the next quantum leap in tooling savings, identified China and Korea as not only inexpensive tooling sources, but in the case of China a vast potential market for its products. Because of China's strict and unilateral laws on domestic content, the big three went to work investing heavily there building factories in order to create a market for its products. The added bonus was cheap tooling for the domestic side. Short-term profits rose, along with bonuses. The American tooling industry was decimated, as was almost all domestic manufacturing, as the landslide of cheap consumer products flooded our shores.

**Personal Perspective:**

I have been in this business for 32 years as an owner and entrepreneur, and have managed to weather all the changes necessary to survive to this point. In the 1980's I employed 200 people in three companies, supplying tooling and automation to the domestic automakers. My employees had families, mortgages, bought automobiles, and sent their children to college. They received competitive wages, full benefits, and pensions.

When the Japan influx started in the early 1990's, demand for domestic tooling and automation decreased dramatically. Determined to survive, I restructured and downsized. Downsizing is a word that doesn't begin to convey the pain inherent to the process. 140 jobs were lost in my manufacturing businesses, as well as thousands more locally. All was still "well" however. They migrated south to work for some of the transplants who had built assembly plants here.

In our leaner form, we were able to survive until the 2000's when the China tooling landslide hit. *The automakers were so manic in their zeal to build a market in China, it became apparent that if I wanted to submit a bid on a particular tooling program, I would have to certify that I would outsource part of it to China, or another Low Cost Country. At this point the automakers even mandated that the largest 1st tier suppliers of production parts have their tooling sourced to Low Cost Countries. Being faced with that or the prospect of no business, I complied.*

I traveled to China to develop business contacts. What I saw appalled me on two levels. On one hand was the vast modern factories built using money funneled into the industry by our own automakers. On the other hand, I saw the employees of these same plants living in what we would consider squalor, and working in dirty unsafe conditions.

I took on a sizeable tooling program, and proceeded to have it designed in India, by a firm introduced to me by my customer. The design was a total disaster. It was weeks overdue, and resulted in an end product totally unusable. I had to bear the cost of a total redesign domestically. During the process however, this Indian design house gained significant knowledge about how we do things, and are now able to compete. *Once again, we had outsourced our knowledgebase.*

Faced with time constraints and sizeable cost overruns due to design delays, I had to build the entire program domestically utilizing all-out overtime to meet production schedules. It was a huge cost disaster for us, but we shipped quality tooling on time.

The past year, faced with the dramatic slowdown in our industry, I re-structured again, cutting benefits, wages, and personnel in order to be able to compete on the new playing field. Again, we were able to hit the formula right. We began to win business in direct competition with foreign sources. We bid on and won a sizeable tooling program from Chrysler for their new Jeep. These programs take upwards of 40 weeks to build, payment to be made 60 or 90 days after shipment. Almost a year. During this time all costs associated with the program need to be financed – payroll, materials, outside services, etc.

I have a 15 year relationship with Comerica Bank that historically had made this possible. When I approached the bank, order in hand to obtain financing as I have done before, I was told that they were considering reducing their exposure to the auto industry and might not be able to finance this project.

Subsequent negotiations with the bank did not result in a financing package adequate to sustain manufacturing operations through build and eventual payment. Faced with the alternative of turning the work back and closing the business, we were able to secure progressive payment from our key customers in exchange for a discount, and thus remain viable. Many small and mid-sized manufacturers were not as fortunate, and have closed, with the loss of thousands of jobs.

The irony here is that I have survived, as have some others. We are successfully competing on a world stage as tier 1 suppliers. *The automakers have received the aid they have sought, but there are no controls in place to stop them from funneling money to offshore emerging markets, and the domestic manufacturing sector will be wrecked.*

The automakers are assemblers, not manufacturers. The type of manufacturing that takes raw materials, adds value to them and turns them into the tools that allow the automakers to do what they do takes place on the 1st tier. The economic trickledown effect as well as the implications of this is huge. *If wholesale outsourcing of tooling and purchased parts that are only assembled here is not stopped, our economy will not be helped, and we will have lost our ability to manufacture anything here.*

**Current Situation:**

*A vital distinction that has been lost is not "Where was it purchased?", but rather, "Where was it built?"*

American multinationals have orchestrated a situation that has mandated that its 1st tier suppliers must buy from China and other low cost countries in order to compete, *while being able to state that they are buying locally from large 1st tier suppliers.* This smoke and mirrors act has decimated small and mid-sized manufacturing in the United States.

The current bank crisis, resulting in the banks unwillingness to lend to a decidedly precarious small manufacturing base has provided a convenient reason for large multinationals to continue sourcing overseas. Our company, along with other surviving manufacturers is proof that it is possible to manufacture domestically with only limited support from the banking industry, but in many cases we are not even offered the opportunity to compete.

General Motors has sourced virtually all of the tooling and purchased parts for the Volt, Gamma, and Delta programs in the Pacific Rim. *The only part of these major tooling programs we, and others were allowed to even submit proposals on were the uncrating of tooling produced in China for the new Chevrolet Volt. In addition to representing only a small portion of the tooling revenue on these major programs, it is an insult added to injury.* In the case of the Gamma and Delta programs, the aggregate amounts of tooling and purchased parts (known to me) is in the neighborhood of $100,000,000. This would represent employment for thousands of American workers.

*Where is the outrage? These are American taxpayer dollars being funneled out of this country in an effort to build an overseas market. And, while the banking situation is very real, the devastation being wreaked upon American small and mid-sized manufacturers is the direct result of the automakers deliberate sourcing of tooling and purchased parts offshore. The lending situation, caused in large part by outsourcing, is now a convenient excuse.*

**Issues For The Field Hearing:**

1. The general issues faced by small and mid-sized manufacturing businesses in the Industrial Midwest are largely the result of deliberate offshore sourcing by the automakers. They are using American taxpayer dollars to do this. To be sure, readily available credit would have helped many local manufacturing businesses to survive, but as long as work is being deliberately funneled offshore, no amount of credit will turn the situation around.
2. The banks are unwilling to assume any risk with respect to lending to small manufacturers. We were offered a loan package totally inadequate to finance the large amount of work we had been awarded. The interest rates were steep, collateral requirements outrageous, and the amount offered would not have been enough. There is definite need, but that is not part of the equation for the banks. They will assume no risk. My own belief is that the needs, along with the benefits far outweigh the risks in lending to small businesses. Small business provides a shot in the arm to any local community.
3. We have found it possible to survive on little or no credit, but if financing were readily available, we would easily be able to double our employment. This would be even more dramatic for a business that has had to close due to lack of financing. Most small businesses create jobs in the local communities surrounding them. The direct result would be reduction in unemployment and injection of dollars into local economies, thereby helping other small businesses
4. Any plan that fosters an increase in responsible lending to small business is a good thing, but I would reiterate that the banks will assume no risks whatsoever. In order for a plan to work, it would have to use the framework of the bank to act as a conduit for funds without risk to itself. While responsible lending is important, in order to maximize a rapid recovery it is unfair to expect the entrepreneur to assume all the risk of the loan personally.
5. Local manufacturing businesses are finding it almost impossible to access credit in any amount that would be of help.

In specific, I requested a $4,000,000 credit line to process $6,000,000 worth of new work, that would have provided jobs for my laid off workforce. I was offered $2,000,000 at high interest rates, with formulas for percentages of work in process and receivables, that would have made it impossible to even borrow the $2,000,000. This was coupled with blanket, and asset specific personal guarantees that made the offering unacceptable. Had I not been able to secure financing from my customer, Chrysler, I would have had to close the business. I have heard from colleagues who are also competitors, that some have been asked to pledge personal collateral in amounts triple to the amount of the loan as security.

**Summary:**

My belief is that the current crisis in our manufacturing sector is the culmination of years of short-sighted greed by large American multinational corporations, coupled by other countries' predatory trading practices. Our industries have been systematically targeted for extinction by our foreign competitors. The unfair international playing field has exacerbated the situation, making it almost impossible for small business to compete globally.

Yes, credit is almost impossible to get, and yes, readily available credit will help. But if the big three, and other large American corporations will not even try to buy American, there will be no recovery, and we will have lost our ability to manufacture anything. The arsenal of democracy will cease to exist.

Ironically, I was approached by Honda just last week. They are interested in buying tooling that is made in the United States. In conversation with the tooling buyer, I learned that even though they are owned by a Japanese parent company with access to cheap Chinese tooling, they have been instructed to buy tooling here. Why? Because they have gotten the message that since they are selling cars here, it is in their best interest to spend their tooling dollars here in order to reap the sales resulting from the trickledown effect.

They understand the concept of: "Where was it built?" versus "Where did you buy it?"

Our own taxpayer dollars are being used to create jobs overseas...

*Where is the outrage?*

NAFCU
**National Association of Federal Credit Unions**
3138 10th Street North • Arlington, Virginia • 22201-2149
(703) 522-4770 • (800) 336-4644 • Fax (703) 522-2734

**Fred R. Becker, Jr.**
*President and CEO*

November 25, 2009

The Honorable Dennis Moore
Chairman
Subcommittee on Oversight & Investigations
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Gary Peters
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Moore and Representative Peters:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association that exclusively represents the interests of our nation's federal credit unions, regarding next week's hearing, entitled "Improving Responsible Lending to Small Businesses."

As you may be aware, our nation's small businesses represent 99.7 percent of all employer firms, employ half of all private sector employees, pay more than 45 percent of total U.S. private payroll, and have generated 60 to 80 percent of net new jobs annually over the last decade. NAFCU therefore believes that the strength of the economy is strongly influenced by the health and well-being of the small business community. Many small business owners are members of credit unions around the country and rely on our services to help make their small businesses a success. Our nation's credit unions stand ready to help in this time of crisis, and, unlike many institutions, have the assets to do so. Unfortunately, an antiquated and arbitrary member business lending cap prevents credit unions from doing more for America's small business community.

The *Credit Union Membership Access Act* established an arbitrary cap on credit union member business lending (MBL) of 12.25% of assets in 1998. Many credit unions have the capital to provide small businesses with low-cost sources of funds that other lenders are not positioned to in this current economic environment, but are hamstrung by this arbitrary limitation. It is with this in mind that NAFCU strongly supports the passage of H.R. 3380, the *Promoting Lending to America's Small Businesses Act of 2009*, introduced by Representatives Paul Kanjorski and Ed Royce. This important piece of legislation would raise the member business lending cap to 25%, while also allowing credit unions to supply much-needed capital to underserved areas, which have been among the hardest hit during the economic downturn.

NAFCU also strongly supports steps to aid credit unions in obtaining access to Small Business Administration (SBA) lending programs, such as through H.R. 3854, the *Small Business Financing and Investment Act of 2009*, or the reintroduction of the *Credit Union Small Business Lending Act*, first introduced by House Small Business Committee Chairwoman Nydia Velazquez in the 110th

Congress. This bill would have exempted credit union participation in SBA lending programs from the MBL limits currently in place. These particular programs are invaluable tools, helping many Americans to successfully start and run their own businesses.

Additionally, the recent proposal to make funds from the *American Recovery and Reinvestment Act of 2009* available for small business lending would only allow small business members of a select group of credit unions (Community Development Financial Institutions, or CDFIs) to obtain low-cost loans through recovery funds. There are many credit unions around the country that are not designated as CDFIs that could also offer low-cost loans through recovery funds to their small business members.

Credit unions stand ready to assist our nation's small businesses, and many have the capital other lenders cannot provide in the current environment. It is with this in mind that we ask that you assist credit unions in providing much-needed capital to America's small businesses.

If my staff or I can be of assistance to you, or if you have any questions regarding these issues, please feel free to contact myself or NAFCU's Director of Legislative Affairs, Brad Thaler, at 703-842-2204.

Sincerely,

Fred R. Becker, Jr.
President/CEO

**FDIC**
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

JAN 14 2010

Office of Legislative Affairs

January 11, 2010

Honorable John D. Dingell
Chairman Emeritus
Committee on Energy and Commerce
House of Representatives
Washington, D.C. 20515

Dear Congressman Dingell:

Thank you for the opportunity to respond to the questions you submitted subsequent to testimony by Mr. Anthony Lowe, Regional Director of the Federal Deposit Insurance Corporation's Chicago Regional Office at the House Committee on Financial Service's November 30, 2009 field hearing on improving lending to small businesses.

Enclosed is the FDIC's response to the questions. Your interest in this matter is appreciated. If you have further questions, the Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

Paul Nash

Paul Nash
Deputy to the Chairman for External Affairs

Enclosure

**Response to questions from**
**the Honorable John D. Dingell**
**by the Federal Deposit Insurance Corporation**

**Q1. Does the Administration presently have sufficient authority and resources with which to address the pressing capital needs of small businesses? If not, what further resources, whether they be in the form of statutory authority or appropriations, does the Administration require to address this matter satisfactorily?**

A1. As an independent federal agency, the Federal Deposit Insurance Corporation is not sufficiently informed of the resources available to the Administration to address the capital needs of small businesses. However, as primary federal supervisor to about 5,000 community banks that are key lenders to small businesses, the FDIC has been encouraging institutions to continue lending to creditworthy borrowers. Further, the FDIC supports the Administration's proposals to expand the Small Business Administration loan program, cut taxes for small businesses, and make low-cost capital available to small business lenders.

**Q2. In his testimony, Dave Andrea of the Original Equipment Suppliers Association (OESA) states that his organization is "worried about the 60 percent of the supply base that may be indiscriminately cut off from necessary access to capital." Andrea further states that "a group of OESA chief purchasing officers concluded that predicting the failure of a supplier has more to do with their banking relationships than it does with their operational efficiency or revenue outlook." Do you agree that banks are indiscriminately denying automotive suppliers the credit they so desperately need to remain in business? If this is true, what more should be done by banks to extend credit to suppliers? Moreover, what more should be done by the Federal government to encourage banks to extend credit to suppliers?**

A2. We are not aware that banks are indiscriminately denying credit to automotive suppliers. As Mr. Lowe indicated in his testimony, the downward cycle of the economy has resulted in lending contraction at institutions across the board--particularly in Michigan. No one industry is targeted, but rather the depressed economic environment and high levels of unemployment have caused many lenders to be cautious in making new loans, especially while they are frequently dealing with a substantial volume of troubled existing credits.

Further, as mentioned in our testimony, the FDIC and the other federal agencies have issued guidance on *Meeting the Needs of Creditworthy Borrowers* and *Prudent Commercial Real Estate Loan Workouts*. Both issuances encourage banks to continue making good loans and work with borrowers that are experiencing difficulties in their repayment capacity because of the economic downturn.

**Q3. When can we expect to see the first loans granted through the Administration's Small Business Lending Initiatives? Approximately how much money will be loaned to small businesses via these initiatives?**

A3. The FDIC does not have enough information to respond as to when the first loans may be granted through the Administration's Small Business Lending Initiatives. You may want to contact the U.S. Department of the Treasury for more information on these initiatives. However, the FDIC is very supportive of the Administration's efforts in this regard.

**Q4. There has been much discussion about the Administration's actions to increase Small Business Administration (SBA) 7(a) and 504 loans, initiating the Capital Purchase Program (CPP) through the Treasury, and Small Business Lending Initiatives. In your view, are these efforts sufficient to meet justifiable demand for credit by small and medium-sized businesses in the country? If not, what more should be done? Should existing programs be improved? If so, how? Should new programs be created? If so, how would these programs function, and how would they be funded?**

A4. As previously indicated, the FDIC fully supports any of the Administration's initiatives to meet loan demand by small- and medium-sized businesses and anticipates that some SBA lending initiatives will be beneficial. SBA Commissioner Karen Mills recently announced that efforts were underway to increase the guarantee amounts for SBA loans and perhaps waive lender fees to boost participation among banks in the agency's lending programs. You may want to contact the SBA about this matter.

**Q5. Mr. Andrea also states in his testimony that more focus on smaller automotive suppliers is required, specifically by creating a private-public capital partnership to lower the risk of lending to the industry. I discussed one such proposal with suppliers and banks in my district this past August. The proposal, known as the National Manufacturing Diversification Fund (NMDF), is a public-private partnership, which would decrease risk to banks in making loans to manufacturers. How does your agency regard this proposal? Does the Administration plan to pursue implementation of this proposal? What problems does the Administration see in this proposal? Further, will the Administration work with the Congress to address these problems?**

A5. The FDIC found Mr. Andrea's proposal interesting and believes it warrants further consideration. One such pool was created in Grand Rapids, Michigan – the Kent County MicroBusiness loan program. That fund was established in 1999 and lasted six years. The FDIC's role included bringing the various parties together (30 banks, government representatives, business development organizations), and providing technical assistance.

**Q6. In his testimony, Thomas Anderson of Automation Alley states that more access to venture capital is required by small businesses. Do you agree with this assessment? How will present Administration initiatives address this concern? Further, does the Administration believe currently existing Federal lending initiatives are sufficient to satisfy this concern? If no, what will the Administration do to address this concern?**

**A6.** The FDIC agrees that venture capital is important to entrepreneurs and small businesses particularly in the current economic environment. Elevated risk profiles and lack of collateral are often the case for start-up businesses. The FDIC, as an independent federal agency, is not sufficiently informed about the details of the Administration's planned lending initiatives, but certainly supports efforts to do so.

**Q7. In his testimony, Art Johnson of the American Bankers Association implies that the Department of the Treasury should increase the cap of banks participating in the Administration's Small Business Lending Initiatives from $1 billion to $5 billion. Do you agree with this assessment? Please explain why or why not.**

**A7.** FDIC would be supportive of efforts to raise the cap on the Small Business Lending Initiatives if that were to result in increased small business lending by financial institutions.

**Q8. Finally, there have been calls for the Congress to increase credit unions' statutory lending cap from 12.25 percent of total assets to 25 percent. Do you support such an initiative? Please explain why or why not. Further, what effect, in your estimation, would such an increase have on the stability of credit unions from the perspective of capital reserves, as well as on consumer lending to existing credit union members?**

**A8.** Whether to increase credit unions' statutory lending cap is a matter for Congress to consider and is a matter of public policy. The FDIC has no official position on whether such an increase would affect either the stability of credit unions or increase consumer lending.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20215

January 19, 2010

The Honorable John D. Dingell
United States House of Representatives
Washington, DC 20515-2215

Dear Congressman Dingell:

Enclosed please find my responses to your questions in follow up to the House Committee on Financial Services' November 30, 2009, Subcommittee field hearing on improving lending to small businesses. I would note that many of your questions concern specific proposals or programs conducted outside of the OCC, and would be best addressed to officials at the Treasury Department or the Small Business Administration.

If you have questions or need additional information, please contact John Hardage, Director for Congressional Liaison, at 202-874-1881.

Sincerely,

Bert A. Otto

Bert Otto
Deputy Comptroller, Central District

Enclosure

cc: Honorable Barney Frank
Chairman, Committee on Financial Services

Honorable Spencer Bachus
Ranking Member, Committee on Financial Services

Honorable Dennis Moore
Chairman, Subcommittee on Oversight and Investigations

Honorable Judy Biggert
Ranking Member, Subcommittee on Oversight and Investigations

Honorable Nydia M. Velazquez
Chairwoman, Committee on Small Business

Honorable Sam Graves
Ranking Member, Committee on Small Business

Honorable Gary Peters

1. **Does the Administration presently have sufficient authority and resources with which to address the pressing capital needs of small businesses? If not, what further resources, whether they be in the form of statutory authority or appropriations, does the Administration require to address this matter satisfactorily?**

As the regulator of national banks, the Office of the Comptroller of Currency (OCC) is responsible for ensuring that national banks prudently meet the credit needs of their local communities and deal with their customers in a fair manner. As I noted in my testimony, we recognize the important role that credit availability plays in the viability of small companies, and we continue to stress that bankers should continue to extend credit to creditworthy borrowers, and work with those borrowers who are facing financial difficulties. We have adequate resources to carry out our roles and responsibilities.

We also support various initiatives that are being undertaken by the Administration to help provide additional capital to small businesses, including the implementation of the provisions of the American Recovery and Reinvestment Act (ARRA) that expanded several existing Small Business Administration (SBA) programs and created new ones. In September 2009, the OCC held a telephone seminar with the SBA for bankers to discuss how banks could use these program enhancements to facilitate small business lending. We believe the changes that ARRA facilitated are having a positive effect on banks' interest and participation in SBA programs. To the extent that some of these programs are being constrained by funds available to the SBA, it may be appropriate to seek additional appropriations. However, this is an issue that is best directed to Treasury and the SBA.

2. **In his testimony, Dave Andrea of the Original Equipment Suppliers Association (OESA) states that his organization is "worried about the 60 percent of the supply base [...] that may be indiscriminately cut off from necessary access to capital." Andrea further states that "a group of OESA chief purchasing officers concluded that predicting the failure of a supplier has more to do with their banking relationships than it does with their operational efficiency or revenue outlook." Do you agree that banks are indiscriminately denying automotive suppliers the credit they so desperately need to remain in business? If this is true, what more should be done by banks to extend credit to suppliers? Moreover, what more should be done by the Federal government to encourage banks to extend credit to suppliers?**

I do not believe that national banks are indiscriminately denying credit to automobile suppliers or any other class of borrowers. Given the current economic environment, bankers are taking a closer look at their loan portfolios and the condition of their borrowers. During economic downturns, many borrowers frequently begin to have cash flow problems and their repayment capacity may become weakened or impaired, which may require the banker to "classify" the loan to reflect the increased risk in the credit relationship. Such a designation, however, does not directly affect the borrower nor preclude the bank from working with the borrower. Indeed, we expect, and in fact, encourage bankers to continue working with this group of "classified" borrowers who are viable.

As noted in my testimony, we also are encouraging banks to make new loans to creditworthy borrowers. We support the use of various federal and state programs by national banks to help mitigate the credit risks for small, higher risk borrowers, and we believe such programs may be particularly useful mechanisms in facilitating credit for some of the suppliers represented by Mr. Andrea.

3. **When can we expect to see the first loans granted through the Administration's Small Business Lending Initiatives? Approximately how much money will be loaned to small businesses via these initiatives?**

The Administration has announced a series of initiatives to spur small business lending, the vast majority of which are being administered in partnership with the SBA. Since we are not directly involved with the administration of these programs, I would defer to Treasury and the SBA on specifics about the anticipated timing and amount of funds to be lent under these initiatives.

4. **There has been much discussion about the Administration's actions to increase Small Business Administration (SBA) 7(a) and 504 loans, initiating the Capital Purchase Program (CPP) through the Treasury, and Small Business Lending Initiatives. In your view, are these efforts sufficient to meet justifiable demand for credit by small- and medium-sized businesses in the country? If not, what more should be done? Should existing programs be improved? If so, how? Should new programs be created? If so, how would these programs function, and how would they be funded?**

As noted above, the OCC has supported these initiatives and national bank participation in them in several ways.

This summer, we facilitated a meeting with bankers who are active small business lenders and representatives from Treasury to discuss ways that the SBA programs could be enhanced. The primary purpose of the meeting was to provide a forum for Treasury to hear from bankers who work with the SBA lending programs on a daily basis, discuss potential improvements and enhancements to the programs, and explore new ways to help small business customers. Although the bankers supported the intent and goals of the various SBA programs, including the new America's Recovery Capital (ARC) program, they cited several obstacles to more widespread use of the ARC program, including low loan limits, cumbersome documentation requirements, and prohibition on using funds towards working capital. Suggestions offered to improve the program included: increasing all SBA program limits to provide more flexibility; allowing proceeds from the ARC program to go toward small businesses' working capital funds; and extending funding for the existing stimulus programs. In September 2009, the OCC and SBA partnered to present a web and telephone seminar for bankers regarding SBA lending opportunities. The seminar explained the newly created programs, such as ARC, and the SBA's efforts to stimulate the secondary market for SBA loans; the new fee structure for these loans; how to obtain payment from the SBA (on the guaranteed portion) if an SBA-guaranteed loan defaults; how banks can conduct small business lending during the current credit cycle; and the Community Reinvestment Act benefits of SBA lending.

As you know, Secretary Geithner has recently extended the temporary authority provided to him under the Emergency Economic Stabilization Act to October 2010, and announced that Treasury will limit new commitments in 2010 to three areas, including recently launched initiatives to provide capital to small and community banks, which are important sources of credit to small businesses, and reserving funds for additional efforts to facilitate small business lending.

Finally, our Community Affairs staff, and the publications they produce, are valuable resources that bankers, community groups, and examiners can use to become more familiar with programs that can support small business lending. Our efforts include holding seminars on small business issues, hosting telephone seminars on SBA programs, and developing various publications such as our *Community Developments Investments* newsletters and *Community Developments Insights* reports that have highlighted opportunities for national banks to provide credit to small businesses. Our Fall 2008 edition of the *Community Developments Investments* newsletter, for example, illustrated various ways multi-bank community development corporations have collaborated to provide financing to small businesses. Our February 2006 and September 2008 *Community Developments Insights* reports provided primers for national banks on the SBA 504 Certified Development Corporation loan and SBA 7(a) loan programs, respectively. Copies of these reports are enclosed.

5. **Mr. Andrea also states in his testimony that more focus on smaller automotive suppliers is required, specifically by creating a private-public capital partnership to lower the risk of lending to the industry. I discussed one such proposal with suppliers and banks in my district this past August. The proposal, known as the National Manufacturing Diversification Fund (NMDF), is a public-private partnership, which would decrease risk to banks in making loans to manufacturers. How does your agency regard this proposal? Does the Administration plan to pursue implementation of this proposal? What problems does the Administration see in this proposal? Further, will the Administration work with the Congress to address these problems?**

Although I have not studied this particular proposal, I would note that we generally support public-private partnerships as an effective mechanism to help direct credit to certain segments of the economy. Ultimately, the decision on whether and where to direct public funds to support such initiatives are public policy decisions that Congress must make. I am not in a position to comment on how the Administration may view this proposal.

6. **In his testimony, Thomas Anderson of Automation Alley states that more access to venture capital is required by small businesses. Do you agree with this assessment?**

**How will present Administration initiatives address this concern? Further, does the Administration believe currently existing Federal lending iniatives are sufficient to satisfy this concern? If not, what will the Administration do to address this concern?**

We agree that greater access to venture capital by small businesses would be beneficial. While not specific to venture capital, we believe that Treasury's announced initiatives to make direct purchases of securities backed by loans from SBA's 7(a) program and first-lien mortgage securities connected to SBA's 504 loan program are examples of initiatives that can help provide increased funding to this credit sector.

7. **In his testimony, Art Johnson of the American Bankers Association implies that the Department of the Treasury should increase the cap of banks participating in the Administration's Small Business Lending Initiatives from $1 billion to $5 billion. Do you agree with this assessment? Please explain why or why not.**

Mr. Johnson's remarks refer to part of the Administration's new Small Business Lending Initiatives that were announced in October, and in particular to a proposal that would provide access to lower-cost capital to viable community banks with less than $1 billion in assets. According to the Administration's proposal, receiving this capital would be contingent on first submitting a plan in which participants would explain how the capital will allow them to increase lending to small businesses. Participants would also be required to submit quarterly reports detailing their small business lending activities.

It is too early for us to offer specific comments on this program or Mr. Johnson's assessment that the cap on banks eligible to participate should be increased. Many details of this program have not been finalized, including applicable term sheets, application forms, and guidelines for submitting proposed business plans. As a result, we are not aware of any banks participating in this program to date.

8. **Finally, there have been calls for the Congress to increase credit unions' statutory lending cap from 12.25 percent of total assets to 25 percent. Do you support such an initiative? Please explain why or why not. Further, what effect, in your estimation, would such an increase have on the stability of credit unions from the perspective of capital reserves, as well as on consumer lending to existing credit union members?**

Any change to credit unions' statutory lending cap could have an impact on the safety and soundness of these institutions. As the OCC regulates national banks, we are not in a position to possess the supervisory information or judgment required to respond to this question.



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