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U.S. HOUSE COMMITTEE ON
OVERSIGHT AND GOVERNMENT REFORM

STATEMENT OF THE HONORABLE CHRISTY ROMERO

SPECIAL INSPECTOR GENERAL

FOR THE TROUBLED ASSET RELIEF PROGRAM

(SIGTARP)

BEFORE THE
U.S. HOUSE COMMITTEE ON
OVERSIGHT AND GOVERNMENT REFORM

April 24, 2013

Chairman Issa, Ranking Member Cummings and members of the Committee, I am honored to appear before you today to present the Office of the Special Inspector General for the Troubled Asset Relief Program's ("SIGTARP") April 9, 2013 audit report "Banks that Used the Small Business Lending Fund to Exit TARP."

SIGTARP serves as the watchdog over the Troubled Asset Relief Program ("TARP"), the Federal bailout resulting from the financial crisis. SIGTARP protects the interests of those who funded TARP programs – American taxpayers – by conducting criminal investigations and audits. Our mission is to promote economic stability through transparency, robust enforcement, and coordinated oversight.

This Committee is committed to examining the management and effectiveness of Treasury's Small Business Lending Fund ("SBLF"). Lending was a key goal of TARP and SBLF. TARP was intended to increase lending. However, that did not happen and small businesses were left struggling. On February 26, 2010, then-Treasury Assistant Secretary for Financial Stability Herbert Allison testified before Congress in support of the proposed SBLF program, stating that SBLF funds could increase banks' capital by 30-50%, capital that "can be leveraged to support a great deal more in lending." The idea behind SBLF was not simply that the banks would lend out the SBLF funds it received, but instead that they would leverage those funds to make loans in many multiples of the SBLF dollars. In September 2010, Congress authorized Treasury to invest $30 billion in small banks through SBLF. Viewed by members of Congress as a fix for TARP's failure to require or incentivize banks to lend the money, SBLF provided participating banks with incentives to increase small-business lending.

The scope and scale of SBLF were not as expected. Fifty-eight percent of the community banks in TARP applied for SBLF, while only 9% of the roughly 6,700 community

banks not in TARP applied. Given that TARP status should not have been indicative of loan demand, the wide differential in applications should have been a warning sign to Treasury that TARP banks were looking to SBLF as an opportunity to exit TARP.[1] Treasury only invested $4 billion of the available $30 billion, two-thirds of which ($2.7 billion) went to 137 TARP banks. These TARP banks used approximately $2.1 billion of the SBLF funds as a vehicle to exit TARP, escape TARP's restrictions on executive compensation and luxury expenditures, and pay less for taxpayer money (in the form of reduced dividends).[2] As part of its mission of transparency and oversight, SIGTARP conducted an audit to determine whether Treasury and Federal banking regulators consistently evaluated applications submitted by TARP banks to refinance into SBLF.

Although Congress allowed TARP banks to participate in SBLF, it intended that all banks in the program increase their loans to small businesses, and gave Treasury authority to choose which TARP banks best fit the program's goal. Some members of Congress noted that SBLF substantially resembled TARP and expressed doubt that lending would increase. Concerned that some banks may view SBLF as a TARP exit strategy with little benefit to small businesses, in September 2010, SIGTARP recommended that when choosing banks, Treasury not count TARP capital in assessing the health of the bank, stating "it makes little sense to convert a bank into SBLF – a program intended to incentivize increased lending – if the institution does not have the necessary capital to support such increased lending."

[1] In a 2011 GAO survey, some TARP banks cited the opportunity to exit TARP as the primary reason for applying for SBLF funds.

[2] In addition, when discussing in press releases and blog posts how much Treasury has received in TARP repayments, Treasury includes the more than $2 billion of SBLF funds that banks used to repay TARP. In a letter to Secretary Geithner, Senator Chuck Grassley asked Treasury to ensure that TARP funds repaid by SBLF not be counted as funds repaid to the Government.

SIGTARP continued, "An institution that would not have an adequate capital base but for the Government's investment likely will not have the necessary capital to support increased lending." SIGTARP designed the recommendation not to penalize TARP banks, but to ensure that banks did not use SBLF to escape TARP, and its restrictions, without effectively increasing small-business lending, a concern that unfortunately has come to fruition.

SBLF Has Not Effectively Increased Lending by Former TARP Banks that Used SBLF To Exit TARP

Former TARP banks in SBLF have not effectively increased small-business lending because they used approximately 80% of SBLF funds ($2.1 billion of the $2.7 billion) to pay off TARP, rather than to increase lending. Twenty-four TARP banks actually decreased their small business lending by $741 million while in SBLF, which was more than the $501 million they received in SBLF.[3] Furthermore, 14 of these 24 former TARP banks paid dividends to shareholders while in SBLF, despite decreasing their small business lending. Given that SBLF's sole goal was to increase small business lending, the number of banks that Treasury should have allowed to decrease their lending in SBLF after two years should be zero.

TARP banks had much to gain and little to lose from refinancing into SBLF irrespective of their small-business lending capability or willingness to lend. If the former TARP banks fail to increase lending, there is no meaningful penalty. The "fees" and "penalties" resulting from a TARP bank's failure to increase lending in SBLF bring the cost of capital in line with the cost under TARP.[4]

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[3] The source for all SBLF lending data used in this report is Treasury's *Use of Funds Report*, published on January 7, 2013, that reflects SBLF lending as of September 30, 2012, the latest data available at the time SIGTARP drafted its report. At that time, 132 of the 137 TARP banks remained in SBLF, five had paid off SBLF and exited the program.

[4] If the bank had remained in TARP, it would pay a 5% dividend for each of five years, after which (in 2013 or 2014) the rate would increase to 9%. If a TARP bank that refinanced into SBLF fails to increase

Treasury determined that as a matter of policy, both TARP and non-TARP banks applying to SBLF would have to project lending growth at least equal to the amount of SBLF funds they received; however, that was the minimum, and Treasury expected banks that received SBLF funds to increase lending in multiples of every SBLF dollar. In a March 16, 2010 hearing before the House Committee on Appropriations, former Treasury Secretary Geithner testified about the proposed SBLF program stating that, "the capital could be leveraged several times into new loans." He further testified, "one of the best use of a dollar of scarce resources is capital to a small bank because that will turn into $8 to $10 in additional lending capacity." In a press release, Treasury announced that it was investing more than $4 billion to "help propel lending by Main Street banks in many multiples of that amount." On October 18, 2011, former Treasury Secretary Timothy Geithner testified at a hearing on a review of the Small Business Jobs Act by the Senate Committee on Small Business and Entrepreneurship on, that SBLF (and TARP) investments in banks "are by any measure one of the most efficient uses of taxpayers' money we have because every dollar of capital you make available to a bank who can't get capital from other sources is worth somewhere between $8 and $10 of lending capacity."[5]

SIGTARP conducted an analysis to determine whether TARP banks increased small business lending in multiples of every SBLF dollar, in line with Treasury's statements

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its small-business lending after two years, its dividend rate will increase by 2 percentage points from, 5% to 7% (in 2014). In addition, if a SBLF bank fails to increase lending after the bank's 9th quarter in SBLF, there would be a 2% "lending incentive fee" to 9% on the fifth anniversary of the TARP investment.

[5] Some members of Congress believed that lending had the potential to increase by multiples of ten, stating that SBLF would lead to $300 billion in new small-business loans because the banks would be able to lend as much as $10 for every $1 in SBLF funds. Senator Maria Cantwell, a member of the Senate Committee on Small Business and Entrepreneurship, quoted an estimate by the Independent Community Bankers of America that the $30 billion SBLF fund will generate up to $300 billion in small-business lending. In June 2010, Congresswoman Melissa Bean cited a Congressional Budget Office estimate that SBLF "can be leveraged by banks into over $300 billion in new small-business loans," based on SBLF's potential as a $30 billion small-business investment fund.

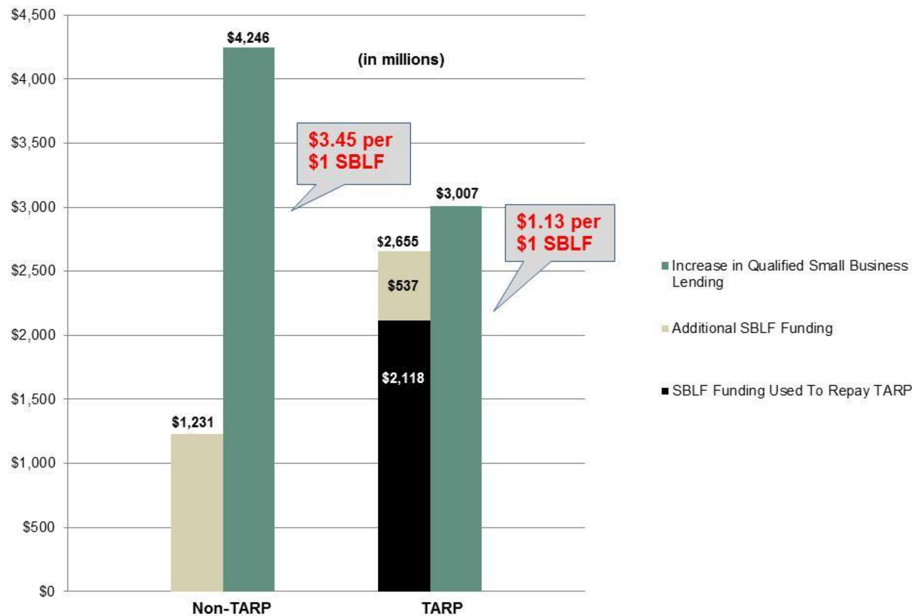
and policy. This simple method shows the value the SBLF banks are providing to taxpayers and takes into account the taxpayer dollars invested in the banks; something not provided just looking at loan growth. While any increase in lending is helpful, not all lending increases deliver the same degree of value to taxpayers, particularly in light of the fact that small business lending at TARP banks had declined so much during the crisis.

Beyond the 24 banks that decreased lending while in SBLF, the remaining TARP banks in SBLF increased lending, but they significantly underperformed compared with non-TARP banks. Former TARP banks in SBLF increased lending by just $1.13 for each $1 in SBLF funds they received (a multiple of one for every SBLF dollar). By comparison, banks that did not participate in TARP but received SBLF funding have increased small-business lending by more than three times that amount – $3.45 for each $1 in SBLF funds (a multiple of three for every SBLF dollar).

Figure 1 shows a comparison of SBLF funding levels and lending increases of TARP banks and non-TARP banks.

FIGURE 1

DIFFERENCES IN INCREASES IN LENDING BY TARP AND NON-TARP BANKS IN SBLF



Note: Increases are calculated as the difference between Qualified Small Business Lending as of September 30, 2012, and the quarterly average of these loan balances for the four quarters preceding the legislation's passage (the same "baseline" period used by the program to calculate lending growth).

Source: SIGTARP analysis based on Treasury's SBLF *Transactions Report* as of December 31, 2012, and Treasury's *Use of Funds Report*, data as of September 30, 2012.

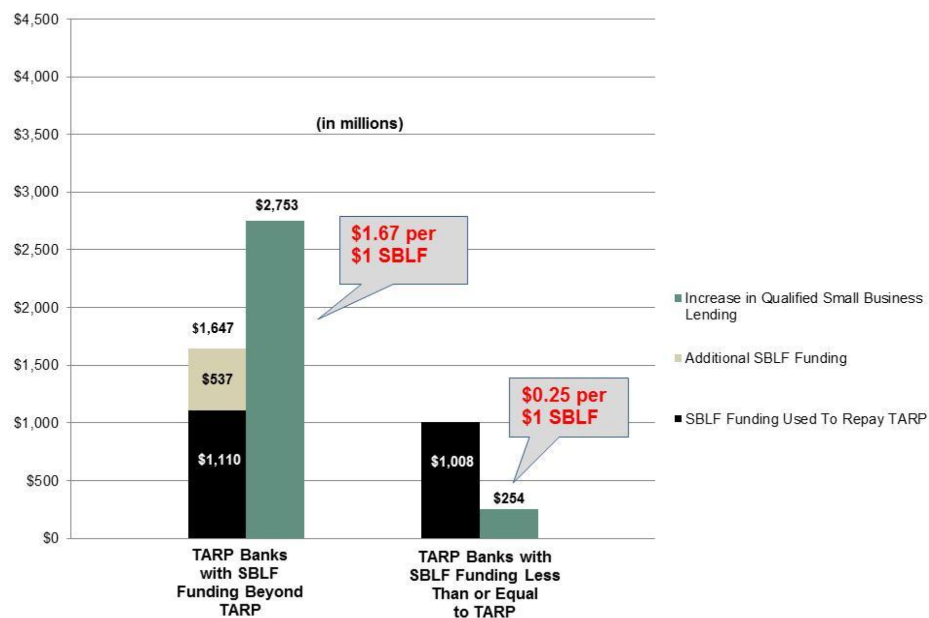
Although as a group, the former TARP banks remaining in SBLF increased lending by $1.13 for each $1 in SBLF funds received, there was a significant difference in lending depending on whether the bank received only enough SBLF funds to repay TARP or received additional funds.

<u>SIGTARP found that 42 TARP banks that received only enough SBLF funds to pay off TARP have lent out significantly less than they received in SBLF funds – increasing lending by only 25¢ for each $1 in SBLF funds.</u> If Treasury had implemented SIGTARP's 2010 recommendation, it could have addressed the obvious question about these banks' ability

to meet the SBLF's program's lending goal if all the SBLF funds they received would be used to repay TARP. TARP banks that received additional money beyond the outstanding TARP balance have increased lending by $1.67 for every $1 in SBLF funds. Therefore, TARP banks in SBLF have not propelled lending in many multiples of the amount of SBLF funds they received, as Treasury promised. Figure 2 shows differences in lending increases in former TARP banks in SBLF that only received enough SBLF funds to repay TARP compared to those that received additional SBLF funds.

FIGURE 2

DIFFERENCES IN INCREASES IN LENDING BY TARP BANKS IN SBLF, BASED ON AMOUNT OF SBLF FUNDING



Note: Increases are calculated as the difference between Qualified Small Business Lending as of September 30, 2012, and the quarterly average of these loan balances for the four quarters preceding the legislation's passage (the same "baseline" period used by the program to calculate lending growth).

Source: SIGTARP analysis based on Treasury's SBLF Transactions Report as of December 31, 2012, and Treasury's *Use of Funds Report*, data as of September 30, 2012.

Treasury and Federal Banking Regulators Did Not Adequately Assess Whether Banks' Plans To Increase Small-Business Lending Were Actually Achievable

Treasury had the ability to exclude TARP banks that were not a good fit for the SBLF program. Congress' safeguard of requiring that banks submit a small-business lending plan, a requirement not present in TARP, did not have the intended effect because Treasury and the Federal banking regulators did not adequately assess whether the banks' plans to increase small-business lending were achievable.[6] Overall, Treasury and regulators did not conduct consistent, meaningful reviews of the plans focusing on whether the TARP banks were prepared to lend SBLF capital. SIGTARP found that, during the application review process, regulators did not consistently provide adequate input to Treasury on the SBLF lending plans and generally did not scrutinize the credibility of the information presented in the lending plans, focusing instead on the applicant's viability.

Treasury's application review process was almost entirely focused on the banks' ability to repay the funds to Treasury, overshadowing any consideration of the applicants' preparedness to lend SBLF money. Treasury determined that as a matter of policy, both TARP and non-TARP applicants would have to project lending growth at least equal to the amount of SBLF funding they received. However, Treasury did not adequately evaluate the credibility of those projections, limiting the effectiveness of that policy. Absent consistent and meaningful scrutiny by Treasury or regulators of banks' lending plans, some institutions refinanced from TARP into SBLF seemingly unable to fulfill the sole purpose of the program – to increase lending to small businesses.

[6] The Federal banking regulators are the Federal Reserve Board ("Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC").

Treasury & Federal Banking Regulators Did Not Effectively Communicate with Each Other; Each Relied on the Other To Assess the Banks' Plans To Increase Lending

Lending plans submitted by SBLF applicants did not receive appropriate and consistent Government scrutiny during the application review process in part because Treasury and Federal banking regulators did not collaborate effectively with each other, each claiming that the other had responsibility to assess the lending plans. Treasury's SBLF program director told SIGTARP that Treasury did not perform an independent analysis of the projections in the lending plans, a statement borne out by SIGTARP's document review. He told SIGTARP that the analysis of the lending plans was the regulators' responsibility, rather than Treasury's, because the Jobs Act required that the lending plans be submitted to regulators.

Regulators, however, did not agree with Treasury's view, and OCC and FDIC officials told SIGTARP that they perceived their role to be that of a conduit, passing along the lending plans to Treasury. SIGTARP asked Federal Reserve's Manager of Community Banking Organizations whether the Federal Reserve had considered whether the lending goals reported in TARP applicants' lending plans were attainable when some institutions used all the SBLF capital they received to repay TARP. He responded that such consideration was the responsibility of Treasury, not the regulators. The result of this lack of effective communication was an overall lack of scrutiny by Treasury and regulators to determine whether the banks' plans were credible. Notably, Treasury and regulators did not deny SBLF funding to any TARP bank based on its lending plan.

Regulators Did Not Consistently Take Action To Preserve the Intent of Congress and SBLF by Meaningfully Reviewing the Banks' Proposals To Increase Lending

During the SBLF application review process, regulators missed opportunities to protect the interests of taxpayers because they did not ensure that the banks were prepared to lend SBLF funds to small businesses consistent with the intent of Congress. Given their institutional expertise as bank supervisors, regulators were well suited to weigh in on the credibility of the applicant banks' plans to increase small-business lending. Instead regulators generally focused on the banks' viability, in a process described by one regulator as "left over" from TARP. Despite the fact that the law that created SBLF required that applicants submit a small-business lending plan to their Federal banking regulator, regulators did not consistently take action to preserve the intent of Congress by meaningfully reviewing the banks' proposals to increase lending. Even where the regulator provided input to Treasury on the lending plans, the regulator did not recommend that Treasury deny funding to the TARP bank based on the lending plan, and former TARP banks have not effectively increased small-business lending.[7]

[7] SIGTARP found that, during the application review process, regulators did not review banks' plans to increase lending in the same manner. According to an FDIC official interviewed by SIGTARP, the FDIC (who regulated 69% of the TARP applicants) did not analyze the lending plans and served only as a conduit to Treasury. FDIC guidelines instructed its staff that no input was necessary unless the plan presented safety and soundness concerns. An OCC official told SIGTARP that OCC viewed itself as a conduit for the lending plan, with Treasury having primary responsibility for lending plan review, and OCC weighing in on reasonableness. The Federal Reserve's review of lending plans appears to have differed depending on whether it was the primary regulator of the bank or the regulator of the bank holding company (who received the funds). A Federal Reserve official told SIGTARP that the Federal Reserve focused on the impact of the plan on the safety and soundness of the bank, not on the adequacy and achievability of the proposed lending, and deferred responsibility to FDIC or OCC, which regulated the subsidiary bank. In these statements, the official is referring to applicants where the Federal Reserve regulated the bank holding company, but not the subsidiary bank. In addition, in SIGTARP's review of 32 applications by TARP banks for SBLF, the FDIC only provided input to Treasury on the applicant lending plans for 4 of 23 FDIC-regulated banks, the OCC provided input on 5 of 5 OCC-regulated banks, and the Federal Reserve provided input to Treasury on the lending plans of only 7 of the 27 banks where

Treasury's Review of Banks' Plans To Increase Lending Was Superficial and Employed a "Check-the-Box" Review

Even with limited input from the regulators on banks' proposed lending plans, the plans could have been adequately assessed had Treasury's own review been substantive. Instead, Treasury's application review process was almost entirely focused on the banks' ability to repay the funds to Treasury, overshadowing any consideration of the applicant's preparedness to lend SBLF money. Treasury's review of the lending plans submitted by SBLF applicant banks was superficial, with Treasury merely filling in a "check-the-box" review form that did not provide specific details to support the applicant's ability to increase lending as proposed. Treasury's evaluation of the lending plans as seen in its Small Business Lending Fund Lending Plan Evaluation reproduced in Figure 3 focused on form over substance, scoring the banks on how many of the 12 elements the bank included, assigning equal weight for the bank's description of its use of media outlets for outreach as it did for describing its emphasis on small-business lending.[8] Treasury gave little to no consideration to key risk factors, such as the source of funds to support new lending, despite obvious questions about TARP banks' ability to meet the SBLF program's lending goals for those banks that would use SBLF funds to repay TARP.

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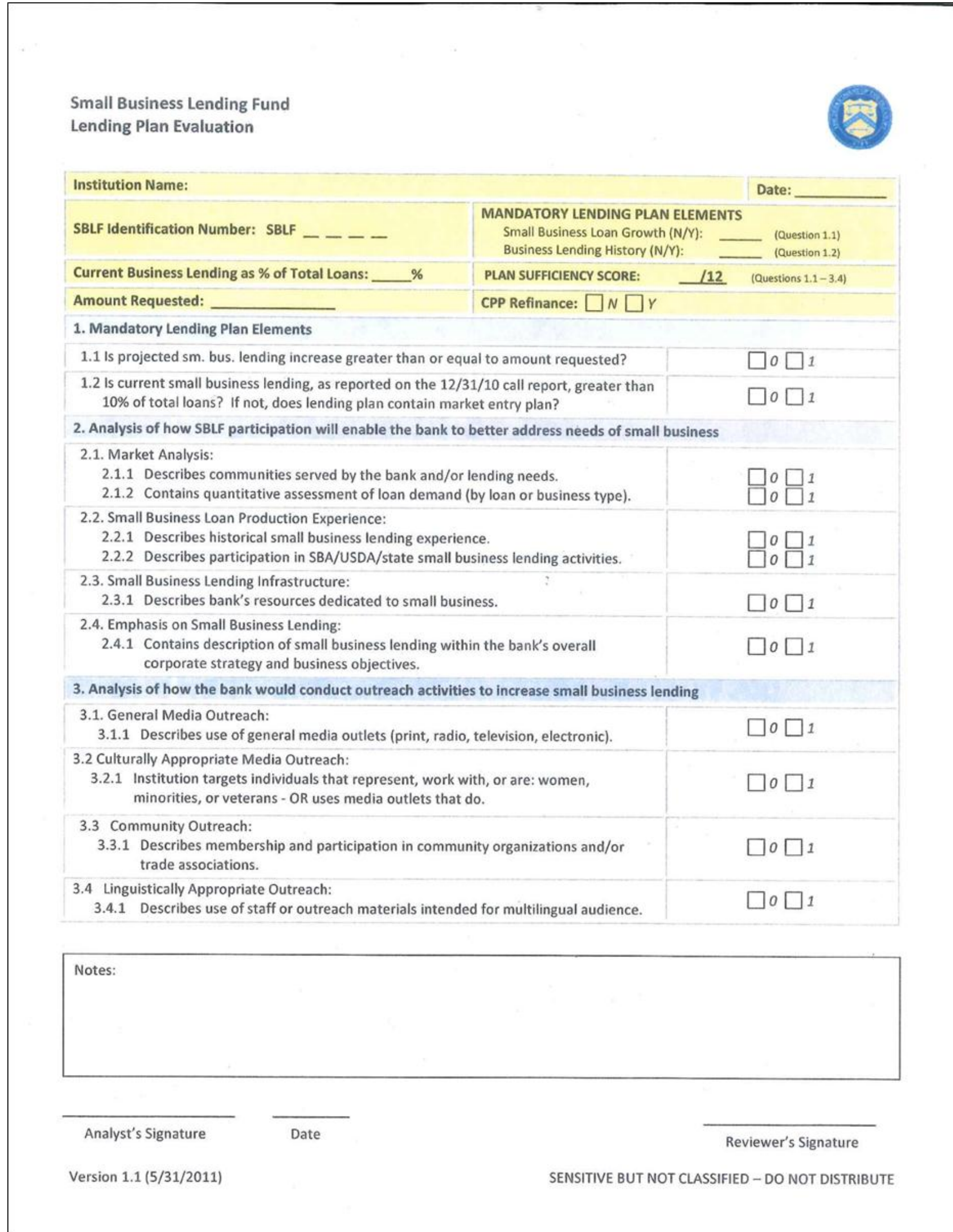
the Federal Reserve regulated the bank holding company and all 4 applicant banks primarily regulated by the Federal Reserve.

[8] Treasury did not require the banks to provide other information that would be helpful to assess the credibility of whether the banks could achieve their proposed increases in lending. For example, plans could pass review without TARP banks describing where they would get the funds to lend, how small-business lending fit within banks' lending, or without specifying the amount of resources banks planned to devote to small-business lending. In addition, SIGTARP's review of meeting minutes and documentation for its review of 32 TARP banks that applied for SBLF evidences that, for those banks, Treasury officials generally did not assess whether the banks' plans to increase small-business lending were achievable. Treasury invested SBLF funds in some banks, even though the banks submitted lending plans that were deficient on their face. In its review of 32 applications, SIGTARP found obvious deficiencies in lending plans that Treasury and Federal banking regulators should have caught, even in a superficial review.

FIGURE 3

TREASURY'S SMALL BUSINESS LENDING FUND LENDING PLAN EVALUATION FORM



Small Business Lending Fund
Lending Plan Evaluation

Institution Name:	Date: ________
SBLF Identification Number: SBLF __ __ __ __	MANDATORY LENDING PLAN ELEMENTS Small Business Loan Growth (N/Y): _____ (Question 1.1) Business Lending History (N/Y): _____ (Question 1.2)
Current Business Lending as % of Total Loans: _____%	PLAN SUFFICIENCY SCORE: ___/12 (Questions 1.1 – 3.4)
Amount Requested: ____________	CPP Refinance: ☐ N ☐ Y

1. Mandatory Lending Plan Elements	
1.1 Is projected sm. bus. lending increase greater than or equal to amount requested?	☐ 0 ☐ 1
1.2 Is current small business lending, as reported on the 12/31/10 call report, greater than 10% of total loans? If not, does lending plan contain market entry plan?	☐ 0 ☐ 1
2. Analysis of how SBLF participation will enable the bank to better address needs of small business	
2.1. Market Analysis:	
2.1.1 Describes communities served by the bank and/or lending needs.	☐ 0 ☐ 1
2.1.2 Contains quantitative assessment of loan demand (by loan or business type).	☐ 0 ☐ 1
2.2. Small Business Loan Production Experience:	
2.2.1 Describes historical small business lending experience.	☐ 0 ☐ 1
2.2.2 Describes participation in SBA/USDA/state small business lending activities.	☐ 0 ☐ 1
2.3. Small Business Lending Infrastructure:	
2.3.1 Describes bank's resources dedicated to small business.	☐ 0 ☐ 1
2.4. Emphasis on Small Business Lending:	
2.4.1 Contains description of small business lending within the bank's overall corporate strategy and business objectives.	☐ 0 ☐ 1
3. Analysis of how the bank would conduct outreach activities to increase small business lending	
3.1. General Media Outreach:	
3.1.1 Describes use of general media outlets (print, radio, television, electronic).	☐ 0 ☐ 1
3.2 Culturally Appropriate Media Outreach:	
3.2.1 Institution targets individuals that represent, work with, or are: women, minorities, or veterans - OR uses media outlets that do.	☐ 0 ☐ 1
3.3 Community Outreach:	
3.3.1 Describes membership and participation in community organizations and/or trade associations.	☐ 0 ☐ 1
3.4 Linguistically Appropriate Outreach:	
3.4.1 Describes use of staff or outreach materials intended for multilingual audience.	☐ 0 ☐ 1

Notes:

Analyst's Signature   Date   Reviewer's Signature

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Source: Treasury.

Congress intended that SBLF fix the significant lost opportunity in TARP that banks were not required or given incentives to lend. The lending plans were the safeguard to provide that fix, but without consistent, meaningful review of those plans by Treasury and the Federal banking regulators, there was no substantive difference between TARP's application review process and SBLF's application review process for TARP banks, as it related to lending. Many of the TARP banks that refinanced into SBLF are demonstrating an inability or unwillingness to fulfill the sole purpose of the program – increase lending to small businesses. Many TARP banks may not have had the wherewithal to increase lending because they used their SBLF funds to repay TARP. Other TARP banks may not have received enough additional funds to achieve the increases in lending they proposed. Treasury and regulators would have detected this with proper and consistent scrutiny of applicants' lending plans and required the banks to demonstrate a source of funds to lend. If the banks could not credibly demonstrate a source of funds to lend beyond the SBLF funds they used to repay TARP, Treasury should have found the banks unsuited to participate in the program and kept them in TARP.

Unlike TARP's first bank program, which was created during an emergency, SBLF was not designed in the same crisis mode that existed in 2008. Treasury and regulators had a year to develop and implement meaningful SBLF application review procedures that would achieve the intended purpose of promoting lending. By not doing so, Treasury and the regulators lost sight of Congress' primary goal of the program – to increase lending to small businesses. Treasury and the regulators should have assessed the credibility of the information provided by each applicant TARP bank in its lending plan to ensure that those banks exiting TARP through SBLF were well positioned and well prepared to meet SBLF's sole purpose to increase lending to small businesses. At a minimum, Treasury and the

regulators should have required TARP bank applicants to identify another source of capital to increase lending when the institutions sought to use all of the SBLF capital they received to repay TARP. If these TARP banks had been unable to demonstrate a credible source of capital to lend, regulators and Treasury may have identified some of the applicants as unsuited to exit TARP using SBLF funds. Had these banks remained in TARP, they would have been subject to TARP's limitations on executive compensation, luxury expenditures, and cumulative dividends at a higher payment to taxpayers. Instead, SBLF served as a vehicle for a significant number of TARP banks to exit TARP using Government funds with more favorable terms than TARP with little resulting benefit for small businesses.

Lessons Learned & SIGTARP Recommendations

In conducting this audit, SIGTARP identified a lack of effective coordination and communication between Treasury and the Federal banking regulators. Early communication and coordination of which entity was responsible for assessing the credibility of banks' lending plans would likely have ensured the effectiveness of the lending plans – Congress' critical safeguard to ensure that banks lent the money. Implementing appropriate corrective action could prevent Treasury and regulators from repeating past mistakes in future collaborative endeavors. SIGTARP recommended: (1) that Treasury and the Federal banking regulators coordination when collaborating on current and future initiatives by defining roles and documenting processes; (2) that Treasury work with the banks to establish new, achievable plans to increase lending going forward; and (3) to preserve the capital former TARP banks participating in SBLF have to lend, the primary Federal banking regulators should not approve dividend distributions to shareholders of former TARP banks that have not effectively increased small-business lending while in SBLF.

Treasury disagreed with SIGTARP's audit findings, relying on the lending that has happened, without addressing the lending that has not happened. This is the equivalent of Treasury focusing on the 862,000 homeowners active in a HAMP permanent mortgage modification, rather than focus on the 3 to 4 million homeowners who were supposed to be helped by HAMP, many of whom could still be helped by HAMP. It is unfortunate for small businesses that Treasury's response to SIGTARP's report is to take a defensive posture and reject SIGTARP's recommendations. Treasury shows no realization that more can be done, or that change is needed to the status quo. The actions SIGTARP recommends are prudent and not difficult to accomplish. TARP banks in SBLF need help from Treasury to work on new small-business plans to achieve their promise to increase small business lending.

Chairman Issa, Ranking Member Cummings, and members of the Committee, thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.