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Chairman Gutierrez, Ranking Member Hensarling, and Members of the Subcommittee, thank you for the opportunity to testify today regarding the participation of small banks in the Troubled Asset Relief Program (TARP) under the Emergency Economic Stabilization Act of 2008 (EESA).

Small and medium-sized banks play a vital role in the economic fabric of our society, and the health of these institutions is essential to any continued economic recovery and the long-term success of the economy as a whole.

Targeting Participation of Small Financial Institutions

At every stage of the implementation of TARP, Treasury has sought to fulfill the dual purposes of stabilizing the financial system and protecting taxpayer interests. Understanding the critical role that small financial institutions play in supporting and strengthening communities, the Administration has strived to recognize the importance of, and protect the health of, smaller financial institutions throughout the implementation of TARP. EESA directed Treasury to ensure "[t]hat all financial institutions are eligible to participate in the program, without discrimination based on size, geography, form of organization…" The very first, and largest, program implemented under TARP, the Capital Purchase Program (CPP), was designed to provide capital to financial institutions of all sizes, with equal treatment on economic terms.

Smaller financial institutions make up the vast majority of participants in the CPP. Importantly, this participation rate is consistent with the fact that smaller financial institutions make up the majority of financial institutions in the country. Of the 707 CPP applications approved and funded by Treasury through the CPP by its close date of December 31, 2009, 473 or 67 percent were institutions with less than $1 billion in assets.

CPP Initial Portfolio Profile ($ in billions)

	CPP Participants		Investment	
Asset Range*	**Number**	**Percent**	**Amount**	**Percent**
<$1bn	473	66.9%	3.8	1.9%
$1bn - $10bn	177	25.0%	10.0	4.9%
>$10bn	57	8.1%	191.1	93.3%
Total	**707**	**100.0%**	**$ 204.89**	**100.0%**

*Institutions with less than $10 billion in assets are considered small or medium-sized.

Throughout its efforts to stabilize the financial system, Treasury has continued to focus on ensuring that smaller financial institutions have access to critical capital. When, in May 2009, many larger institutions were able to start raising capital from the debt and equity markets, it was apparent that smaller institutions did not have the same available access to the capital markets as larger institutions. Therefore, on May 21, 2009, the Administration re-opened the application window for participation in CPP only to institutions with less than $500 million in assets, extending the application deadline to November 21, 2009. The funding deadline for all CPP applications was December 31, 2009.

Further, to ensure adequate funding levels, Treasury also increased the amount of capital these institutions could receive under the program. Initially, institutions were eligible for a capital amount that represented up to three percent of risk-weighted assets. Upon re-opening the CPP for smaller institutions, Treasury raised the amount of funds available to five percent of risk-weighted assets, and did not require additional warrants in the institution for an investment over three percent of risk-weighted assets.

Treasury also recognized that for small institutions to participate in CPP, the program would need to accommodate their particular structures. To that end, Treasury prepared CPP transactional documents and applications for private institutions, mutual holding companies, Community Development Financial Institutions ("CDFIs") and S Corporations. These documents addressed the structural complexity of these types of institutions in a way best suited for each.

Program Eligibility and Application Process

I want to take this opportunity to provide additional information regarding the eligibility requirements for participation in CPP, and the process for reviewing and approving applications.

In designing CPP, one of the central questions facing the previous Administration was how to structure an investment program that would comply with the stated goals of EESA to promote financial stability and also protect the taxpayer. It was decided by the prior Administration in October 2008, after consultation with financial market participants and economic experts, that injecting capital into viable financial institutions would maximize program effectiveness in helping stem the tide of panic and credit constriction that was threatening to engulf the country.

Therefore, the program was designed to make investments in financial institutions that meet the regulatory viability standard. The CPP application process worked as follows: an institution wishing to participate in the program applied to its primary banking regulator – the Federal Reserve, Office of the Comptroller of the Currency, the Office of Thrift Supervision, or the Federal Deposit Insurance Corporation. The primary regulator then made a viability assessment for the financial institution. Viability is determined with a consistent standard utilized by the four primary financial regulators, and is based on whether an institution is viable without TARP funds. The regulators are in the best possible position to make this determination since they conduct regular reviews and analyses of the individual institutions in conjunction with their oversight responsibilities.

Then, if a financial institution is deemed viable by its primary regulator, the regulator forwarded the application it recommended for funding to the Treasury's Office of Financial Stability (OFS) for further review. For cases that met certain supervisory criteria, applications were first forwarded to a council made up of the four federal banking regulators for review prior to submission to Treasury. Once an application was received by Treasury, experienced examiners from the various federal banking regulators, on-site at Treasury, assisted Treasury personnel in reviewing the application for completeness and summarizing key points. Treasury staff and the experienced examiners then presented the application to an internal Treasury investment committee consisting of high-level officials who reviewed the application in its entirety, and recommended an action to the Assistant Secretary for Financial Stability.

Treasury has not approved any application for funding without a determination of viability from the primary regulator. This approach ensures program consistency and fairness to institutions, regardless of their size. Treasury has worked to provide responses to institutions that have applied for CPP funds as quickly as possible, based on our available resources, recognizing how important these applications can be, especially to smaller institutions.

Further, this consistency is applied to program exit as well. In order for an institution to repay TARP funds, it must secure the approval of its primary regulator. Treasury employs this framework for all institutions participating in CPP, regardless of size.

Continuing Efforts to Make Capital Available to Small Financial Institutions

Treasury has invested in 650 small and medium-sized financial institutions through the CPP. The Administration believes that more can be done to build upon these important efforts.

One of the reasons smaller institutions are so critical to our economic recovery is the role they play in our local communities, particularly in supporting small businesses. Most small banks extend the majority of their business loans to small businesses, compared to their larger bank counterparts. For instance, banks under $1 billion in assets do 56 percent of their business lending to small businesses, compared to only 21 percent for larger banks. In addition, small businesses may have few other options for financing outside of bank loans, so small and medium-sized banks are that much more critical to the future of these businesses.

On October 21, 2009, the President outlined a new program designed to provide lower-cost funds to viable small banks, with the goal of increasing lending to small businesses. As President Obama explained: "[t]o spur lending to small businesses, it's essential that we make more credit available to the smaller banks and community financial institutions that these businesses depend on. These are the community banks who know their borrowers; who gave them their first loan; who've watched them grow from down the street…"

Since the October announcement, officials across the Administration have been working diligently to design a program that will provide the maximum benefit to small businesses, while simultaneously providing taxpayer protection and encouraging credit markets. We plan to provide the details of this program soon.

In addition to the small business lending initiative, Treasury is also developing a program that will make low-cost capital available to CDFIs, which conduct more than 60 percent of their lending and economic development in low-income and underserved communities.

We look forward to finalizing these programs in the near future and hope to encourage robust participation across the country. Previous TARP programs may have seen reduced participation as a result of a several factors, including perception concerns and certain statutory restrictions. Smaller institutions, in particular, have struggled with the executive compensation restrictions that are nearly the same for all institutions, regardless of size. This creates a situation where, for example, a small community bank might not be permitted to make severance payments to a bank teller or secretary. While the imposition of restrictions by Congress on institutions receiving assistance under EESA was entirely appropriate, the uniform application of such restrictions has presented challenges for program implementation.

In closing, let me restate Treasury's firm commitment to supporting small and medium-sized financial institutions. They are a critical link to small businesses, which are vital to our continued economic recovery and the long-term success of the economy as a whole. Treasury has been focused on making capital available to smaller financial institutions, and will continue to do so. There are always challenges in implementing any program of this kind, but we look forward to working with you to meet those challenges and help our businesses and communities flourish.

Thank you.