

# RESTORING CREDIT TO MANUFACTURERS

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HEARING  
BEFORE THE  
SUBCOMMITTEE ON  
ECONOMIC POLICY  
OF THE  
COMMITTEE ON  
BANKING, HOUSING, AND URBAN AFFAIRS  
UNITED STATES SENATE  
ONE HUNDRED ELEVENTH CONGRESS  
FIRST SESSION  
ON  
EXAMINING WHAT POLICIES CONGRESS SHOULD CONSIDER TO HELP  
RESTORE CREDIT TO U.S. MANUFACTURERS

OCTOBER 9, 2009

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# RESTORING CREDIT TO MANUFACTURERS

FRIDAY, OCTOBER 9, 2009

U.S. SENATE,  
SUBCOMMITTEE ON ECONOMIC POLICY,  
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,  
*Washington, DC.*

The Subcommittee met at 9:34 a.m., in room SD-538, Dirksen Senate Office Building, Senator Sherrod Brown (Chairman of the Subcommittee) presiding.

## OPENING STATEMENT OF CHAIRMAN SHERROD BROWN

Chairman BROWN. This hearing of the Economic Policy Subcommittee of the Senate Banking Committee will come to order. This is the fourth in a series of hearings on the challenges facing America's manufacturing, one of the most important parts of our economy, as we know.

Our manufacturing sector, let us face it, is in crisis. While key productivity indicators have shown recent signs of growth, both manufacturing output and employment have dropped precipitously, as we know too well, over the past year. We must act now to move from continuous erosion to consistent expansion because U.S. manufacturing is not optional for our country. It is indispensable.

As manufacturing goes, so go our national security, our global economic leadership, our stability as a democracy. Our democratic Nation needs a strong, stable middle class, and a stable middle class needs manufacturing jobs.

Manufacturing equips our military and accounts for 12 percent of U.S. gross domestic product. That is \$1.6 trillion. It generates nearly three-fourths of the Nation's research and development. It employs 12 million Americans. Compromised access to credit is the newest threat to American manufacturing. It is not a minor problem. It is a major concern.

As one manufacturer I spoke with put it, "Credit makes this country great." But the credit stream has slowed to a trickle. The Federal Reserve Board's flow of funds accounts have shown a consistent reduction in net lending to manufacturing sectors. Every day there are more small and medium-sized manufacturers, like those in Ohio, at risk of going out of business because they cannot get the loans they need.

For manufacturers in the auto supply chain, the struggle to find a lender is even tougher. I heard from one Ohio manufacturer who has been in business 25 years and has had access to credit through a trusted lender. The manufacturer has a strong credit history. The bank recently capped its credit line at \$5 million because a percent-

age of their business involves auto supply components. Almost 100 percent of the manufacturer's customers pay their invoices within 60 days. The company feels penalized in spite of the fact that they have a strong record.

To be clear, this hearing will not be about vilifying banks or anyone else. I realize some banks are only just beginning to rebound from the financial meltdown and are concerned about taking on too much risk. We have the problem also of the frozen debt securitization markets, which allow banks to repackage loans and sell them to investors. Banks and bankers are finding it increasingly difficult to repackage their loans to free up capital.

This problem of access to credit is, unfortunately, not unique to Ohio and Michigan and Indiana and other manufacturing States. As I mentioned, the goal of this hearing is not to lay blame on anyone's doorstep. Given the harsh economic conditions we face, we have an opportunity to take stock of where manufacturers and lenders are.

Despite the challenges I have outlined, we must find a way to get credit flowing again. In that vein, I hope this hearing helps us answer the following questions: Are there signals that show credit is easing? How have steps the Administration has taken worked, and how have they evolved? What new mechanisms should Congress and the Administration consider to bridge the gap?

I look forward to the testimony of our witnesses. I will introduce each of the three of you and take as long as you need on your opening statements. I will ask questions of all of you, and we will proceed.

I will start with David Andrea, Vice President of Industry Analysis and Economics of the Original Equipment Suppliers Association in Michigan. The Original Equipment Suppliers Association represents suppliers of components, modules, systems, materials, equipment, and services used by the original equipment automotive industry. The association represents 353 companies with global sales of more than \$300 billion. Before joining OESA as Vice President 5 years ago, Mr. Andrea was the chief financial officer at the Center of Automotive Research. Over the past 20 years, he has been director of forecasting for several financial companies. In his position as OESA, Mr. Andrea is responsible for coordinating research with outside consulting firms and other special projects.

Robert Kiener is Director of Member Outreach of Precision Machined Products Association in Brecksville, Ohio. Mr. Kiener has been on the staff of the Precision Machines Products Association since February 1991. His primary duties with the association include membership development, recruitment, retention, and member communications. In his current capacity as Director of Member Outreach, he visits regularly with the association's 500 member companies across the U.S., companies which manufacture highly engineered precision machine parts. Mr. Kiener has daily interaction with owners and senior managers from small to medium-sized domestic manufacturers.

Stephen Wilson is Chairman and CEO of LCNB National Bank in Lebanon, Ohio. Mr. Wilson has been active within the financial service industry, having served in various capacities with the American Bankers Association, the Ohio Bankers League, the

American Institute of Banking, and the Bank Administration Institute. Mr. Wilson has served as a board member of the Federal Reserve Bank of Cleveland; Chairman of the Advisory Board for Miami University in Middletown, Ohio, of which he is a graduate; Vice Chair of the Warren County Port Authority in southwest Ohio; and various charitable and civic organizations.

Mr. Andrea, your testimony, please. Welcome, all of you. Thank you.

**STATEMENT OF DAVID ANDREA, VICE PRESIDENT, INDUSTRY ANALYSIS AND ECONOMICS, ORIGINAL EQUIPMENT SUPPLIERS ASSOCIATION, MOTOR AND EQUIPMENT MANUFACTURERS ASSOCIATION**

Mr. ANDREA. Thank you, and good morning, Mr. Chairman. I want to thank you for the opportunity to discuss the automotive supplier industry and the availability of credit. My name is David Andrea, and I am Vice President for Industry Analysis and Economics for the Original Equipment Suppliers Association, an affiliate of the Motor and Equipment Manufacturers Association, and I am testifying on behalf of both of those associations today.

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. Suppliers produce two-thirds of the value of today's vehicles and contribute nearly 30 percent of the total automotive research and development investment.

Over the past 10 months, significant and unprecedented Government and industry actions have prevented a collapse of the U.S. auto industry. However, future expansion, employment, economic contributions and structural viability of the supply base are all dependent upon continued access to credit at reasonable terms.

Without a doubt, the U.S. Treasury Auto Supplier Support Program and the way the U.S. Government handled the bankruptcies of General Motors and Chrysler helped avert a potential implosion of the supply base. However, ongoing with the bankruptcy, past the bankruptcies, as well as the Treasury support program failed to improve ongoing access to traditional sources of capital for the vast majority of the supply base.

Even though suppliers have dramatically reduced every element of their working capital requirements from payroll to raw material inventories, they continue to require a significant cash cushion, and that requires ongoing access to credit. In the short term, constrained lending to the auto suppliers is showing up in an inordinate effort to keep the supply base running as production increases. In the long term, a growing number of our members are reporting investment challenges, including required research and development, restructuring, productivity enhancements, and business expansion strategies. Both these short-term and longer-term capital constraints will play themselves out in the ability or inability of the U.S. to support a globally competitive and productive auto industry.

According to the September 2009 OESA Automotive Supplier Barometer Survey, a survey of our members, the majority of all respondents over the past 3 months have not seen a significant im-

provement in lending practices. Smaller suppliers actually report they face even tighter terms. Lending is constricted due to the continued inherent risks in the industry, even though we are on the other side of the GM and Chrysler bankruptcies, but, as well, indiscriminate restrictions on lending by the banks.

In 2010, we expect ongoing company failures 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 restructure and consolidate the industry in a rational, effective manner.

In order to help restore lending throughout the entire supply chain, MEMA and OESA believe that Congress and the Administration should focus on three key areas. The first is on general lending.

Given low production volumes and the valuations of industry assets, many loans to viable suppliers are, in the short term, "out of formula" for banks to consider. One solution that has merit is to scale the Michigan Supplier Diversification Fund up to a national level. While we believe the current definitions in this program may be too restrictive to assist all of our members, we do believe, along with several bankers that we have spoken with, that this program could be one way to reengage the banks with the industry.

The second area would be to focus on small suppliers down through the supply chain. A steady access to lines of credit and asset-backed loans is essential for the survival of the supply base. The Small Business Administration's 7(a) loan guarantee program is limited to \$2 million. Given the scale that the auto industry operates on, this limit is too low to help many even smaller suppliers. A recent OESA survey indicated that a \$3.5 to \$10 million limit would be more helpful for the auto supplier sector. Because of these requirements, actually the recent changes to the SBA program have not assisted auto suppliers.

The third area we would focus on is technology funding. The technology needs for the auto industry require significant investment in research and development and retooling existing facilities to compete against global competition.

MEMA and OESA support S. 1617, the IMPACT Act, that is currently under consideration, and H.R. 3246, the Advanced Vehicle Technology Act, which has passed the House. These bills will provide greater Federal funding for essential technology innovation and U.S. manufacturing capability.

In conclusion, the industry does not come before you today requesting a bailout. We understand and support the need to consolidate the industry. However, we believe that without sufficient capital to provide a stable environment to restructure from, the industry and its employees will witness unnecessary disruptions. Without assistance, this country will needlessly lose manufacturing capability and capacity, technology development, and jobs.

Thank you.

Chairman BROWN. Thank you, Mr. Andrea.

Mr. Kiener, thank you.



**STATEMENT OF ROBERT C. KIENER, DIRECTOR OF MEMBER  
OUTREACH, PRECISION MACHINED PRODUCTS ASSOCIATION**

Mr. KIENER. Chairman Brown, Ranking Member DeMint, and the Subcommittee, thank you for the opportunity to testify today. My name is Rob Kiener. I have been with the Precision Machined Products Association for 18 years working for and with domestic manufacturing, producing highly engineered components for the defense, medical, automotive, and agriculture industries, among others.

Many small and medium-sized manufacturers began experiencing challenges accessing credit in October 2008 and now are often trapped between the troubles of their much larger customers and lenders. Today many companies in our industry report their business is down roughly 40 percent and that they have significantly reduced their workforce as they struggle to secure adequate and timely access to credit, despite most having decades-long relationships with their banks and a history of profitability.

Today, even when a manufacturer seeks to renew a loan with its existing bank, it can take 3 to 4 months to process the loan based on new lending requirements and the paperwork to complete, a process that took no more than 30 days in the past. In our industry, manufacturers are expected to deliver products just in time. Any delays can cause significant disruption in our Nation's critical supply chain, including emerging green industries, thus stifling economic growth and risking national security. If our customers cannot receive the products they need due to the credit crisis, they will source from overseas, and these lost jobs will never come back to the United States.

For example, a company was recently asked to leave their bank despite not violating loan terms over a 23-year relationship simply because they were reducing their exposure in manufacturing and automotive industries—this despite the lender receiving TARP funding.

Last evening, as I prepared the testimony, I received a call from a PMPA member who recently completed a major acquisition to support their ongoing operations as a domestic manufacturer. To secure the necessary funding to make this acquisition possible and keep their business globally competitive, this member was forced to seek financing in Germany since they could not access the required financing in the United States as a small manufacturer in the current lending environment. Despite having well-established relationships with two major lending institutions and a strong record of profitability, this member was forced to go offshore to find the required financing to support their operations.

As the economy picks up, will manufacturers be able to secure the capital required to invest in employees, equipment, and raw materials? If not, there is no doubt in my mind that we will lose those jobs to overseas manufacturers. While the Federal Government is urging manufacturers to diversify into green industries without adequate and timely access to capital, companies cannot make this investment and transition, which will only further China's goal of producing 90 percent of the world's solar panels.

We already see companies trying to expand their operations due to consolidation in the industry who are not able to access capital

to fill job orders, purchase raw materials and machinery, and hire workers. The Cash for Clunkers program is a perfect example of the challenges ahead. As dealers and automotive manufacturers have depleted their inventories, they are looking to suppliers to increase their output.

To simply blame the banks is not an accurate representation of the current crisis. Many lenders fear having their rating level reduced by Federal regulators, due in part to manufacturing loans on their books. This scenario is extremely troubling. In these economic times, the Federal Government's policies should not create an environment in which manufacturers struggle to access adequate and timely credit.

We must reassure financial institutions that returning to sound lending practices with manufacturers is good for their business and critical for the country. Many are simply temporarily impaired, but have a long history of profitability, do not break loan covenants, and maintain steady relationships with their lenders. These manufacturers struggle today through no fault of their own but because they are in the manufacturing business.

We believe the Administration has the authority to work with creditors and borrowers to establish a mechanism by which lenders can loan to manufacturers without fear of a reduced credit rating. In addition, the Department of Treasury, through existing loan facility funds, should reassure the financial institutions that lending to small and medium-sized manufacturers will deliver a return on investment through a public-private guarantee of loans or accounts receivable program.

Many small and medium-sized manufacturers need a return to traditional lending, while other companies and lenders require reassurance that their customers will pay their outstanding accounts receivable. With this Committee's leadership, we are working with the Department of Commerce and members of the Administration on such proposals.

Policymakers place much emphasis on the Small Business Administration as the primary solution to the credit crisis facing small and medium-sized manufacturers. However, at a meeting in Michigan with manufacturers, they were told in June 2009 by the head of the SBA in Michigan that no banks will lend to automotive suppliers under current SBA programs. In the current environment, lenders do not believe manufacturers are bankable, even under a 90-percent Government guarantee program. The Michigan example aside, our members report additional challenges with SBA programs. Most manufacturers cannot put forth the personal guarantee under SBA programs which may require their family home and children's assets to secure a loan. More than 70 percent of manufacturers are family owned companies, meaning it is the family that must provide the guarantee; whereas, the a traditional C Corporation will not face similar burdens. Yet another example of discrimination against small manufacturers.

Mr. Chairman, we must all work together—lenders, manufacturers, and the Government—to ensure that we foster an environment that encourages manufacturing in America. We must remove disincentives for lenders to invest in small and medium-sized businesses. If these trends continue, stimulus projects will go

unfulfilled, inventories will not rebound, and medical and defense supplies will not reach our citizens and soldiers.

Thank you for the opportunity to testify before you today, and I look forward to continuing to work with you to strengthen manufacturing in America.

Chairman BROWN. Thank you very much, Mr. Kiener.

Mr. Wilson, please proceed. Welcome again. Thanks.

**STATEMENT OF STEPHEN P. WILSON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, LCNB NATIONAL BANK, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION**

Mr. WILSON. Thank you, Chairman Brown. My name is Stephen Wilson, Chairman and CEO of LCNB National Bank in Lebanon, Ohio. I am pleased to be here today on behalf of the American Bankers Association to share our view on the impact this recession is having on lending to small and medium-sized manufacturers.

Small businesses of all kinds—including banks—are certainly suffering from the severe downturn. This is not the first recession that faces many banks. My bank has survived several economic ups and downs in its 132 years of existence, and we are not alone. In fact, there are more than 2,500 banks—or 31 percent of the banking industry—that have been in business for more than a century. These numbers tell a dramatic story about the staying power of banks and their commitment to the communities that they serve. We cannot be successful without such long-term philosophy and without treating our customers fairly.

As you know, Mr. Chairman, in my area of Ohio, three plant closures alone have recently taken place, which have eliminated over 13,000 jobs. This will have a sharp impact on our region. The automobile supply chain has been particularly hard hit in Ohio, Michigan, and neighboring States. The problems with the large auto companies, together with the loss of income and wealth by consumers, have dealt a particularly hard blow to the suppliers. Many of them have lowered production and slimmed down to wait out the storm; others have retooled in order to create parts for other industries. The economic downturn has also affected the value of their collateral. This double whammy of severely decreased cash-flows and low collateral values has made borrowing difficult to find, especially without established relationships with lenders.

We recognize that there are some consumers and businesses today that are not getting the credit they have asked for. However, sometimes the best answer for our customer is no. It does not make sense for a borrower to take on more debt that would be difficult of impossible to repay.

I will give you an example. We had a customer whom we turned down on an application for a loan. The reaction was as you would think. The customer was frustrated, the customer was angry, the customer left our bank. I recently received an e-mail that he sent to say that he should not have been granted the credit and that he is coming back to our bank. He said that if he would have accepted our “no” response instead of looking elsewhere, he would be in much better financial shape now.

He moved back to our bank, he said, because he appreciates the fact that when we underwrite loans, we are concerned about the

success of the customer and whether the loan makes sense for them or not.

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 are the lifeblood of our communities, get the credit that they deserve.

Our effort to make loans is made more difficult by regulatory pressures which exacerbate rather than mitigate the problems. For example, because of worsening conditions in many markets, examiners often insist that the bank ask for more capital or more collateral from already stressed borrowers. These steps can set in motion a death spiral where the borrower has to sell assets at fire-sale prices to raise the necessary cash, which then drops the comparable sales figures that appraisers pick up, which lowers the market values of their other assets, which then increases the writedowns the lenders have to take on, and so on and so on. Thus, well-intentioned efforts to address problems can have an unintended consequence of making things quite worse.

What regulators want is what the industry wants: a strong and safe banking system. Providing a regulatory environment that renews lines of credits to small businesses is vital to the economic recovery in communities large and small across this Nation.

Mr. Chairman, I thank you for this opportunity to testify, and I would be happy to answer any questions.

Chairman BROWN. Thank you very much, Mr. Wilson. Thank you for your perspective and your service to our country and to our communities.

Mr. Andrea, talk to us more about the Michigan Supplier Diversified Fund. Is it large enough or are the loans they are making large enough? How does this reduce risk among lenders? Talk to me about that. Do you think that is a model we can follow? Discuss it more with us.

Mr. ANDREA. Within the State of Michigan, we appropriate \$12 million for this, I would call it a pilot program. In Mr. Kiener's testimony, as he said, to be able to diversify into these clean energy technology areas, you have to have a viable supply base to transition in. So that is what this fund is for.

The fund really looks at three purposes. The first—and picking up on some of the issues that Mr. Wilson had in his testimony as well. The first is collateral shortfall. So for an asset-backed loan, if the bank checks off all the other boxes that it is a viable supplier but the collateral is under shortfall that makes it out of formula, public funds would come into the loan at a maximum level of 49 percent of the loan.

The second area would be in a cash-flow shortfall, so because of the reduction in production, if a bank would see that a supplier may not be able to meet its interest expense obligations, again, this fund could purchase that loan or supplement the cash-flows in that purchase.

The third element of the fund was really to create a public-private mezzanine fund to help restructure the industry as well.

The \$12 million I believe have already been committed for in terms of the loans that have been applied. Several national banks

have participated in the program with suppliers, and they all mentioned that they would not have made these loans had those public funds not been available in a public-private partnership that way.

Chairman BROWN. What can SBA learn from Michigan's experience?

Mr. ANDREA. I think this could have a—if we could create Federal funds that could ramp this up, because, again, it is only \$12 million, but at least the mechanism seems to work—seemed to work, that through—maybe it is through SBA that a type of loan enhancement program might be an ongoing solution, not just even for the short-term crisis here, but I think on an ongoing way that could help support manufacturing going forward.

Chairman BROWN. The three things that your association urges Congress and the Administration to do, the third is to create—the first two, assure sufficient capital for restructuring, consolidating, diversifying the industry; second was address the specific needs of the smallest suppliers in the auto or other manufacturing supply chain; the third was technology programs. Expand on your ideas of creating technology funding programs, if you would.

Mr. ANDREA. Sure. There I would look at it from almost a funded mandate, if you will. As you look at the CAFE requirements that are in front of the industry and the need to reinvest to meet the Corporate Average Fuel Economy provisions, as well as the investment and considerable retooling that is required for hybrid technologies and fuel cells way off into the future.

Here I think the two bills that we are looking at I think are positive from a couple of different perspectives. One is they provide direct grants to these suppliers. They also enhance loans as well. And they also provide it through public-private partnerships as well that way. So those are the elements.

I think that the positive things that we have seen in the bills is that, in addition to identifying the longer-term technology investments that the industry needs, they also allow the supply base—or they also allow funding into the supply base for the short-term current needs that we need to get in place, again, for the Corporate Average Fuel Economy laws that are on the books right now that we have to retool for.

In the supplier industry, it takes at least 18 to 24 months to put any of these new programs in place, and one of the other elements that was not brought up earlier that is a hurdle for the supply base here is for tooling investment. The traditional way that the auto industry pays for tooling is that that is on the supplier's back funding for until those programs go into production. So, again, the Federal funding coming into these new technologies I think would help in that element as well, because that also adds risk to the banks as these suppliers take on those types of capital requirements for a program that may be 2 years from now and we truly do not know how the volumes will come out.

Chairman BROWN. Thank you, Mr. Andrea. More for you in a moment, too.

Mr. Kiener, you said in your testimony, "Cash for Clunkers is a perfect example of the challenges ahead." Would you explain what you mean by that?

Mr. KIENER. Well, just the fact that through the Cash for Clunkers program, essentially I think what we saw was taking, you know, current inventory loads that were there, going through those, going through that production very quickly, and then having to startup—what would happen was, for many, many months, obviously, the automobiles were sitting there. The program helped get them out, helped the vehicles be purchased. But at the same time, our members needed to ramp up for the production.

Once those vehicles went through and they needed to rebuild the inventory—prior to that they did not have access to the capital. Now all of a sudden they need to purchase tooling that was brought up. They need to purchase additional pieces of equipment to fill those orders. And all this additional capital required was—I would not say unanticipated, but it certainly presents challenges for the companies of our association.

Chairman BROWN. Was the success of the program, success in terms of number of sales and speed at which the cars were sold—I guess that is one definition of “success.” That came as a bit of a—the suppliers were in some sense unprepared for that? Not to blame them for that, necessarily.

Mr. KIENER. No, no, absolutely not. I would not say that. To answer this question correctly, I would need to have better information at this time, and perhaps I would turn it over to my friend here who is a little bit better versed in that area.

Chairman BROWN. OK. Do you want to comment, Mr. Andrea?

Mr. ANDREA. If you look from the second half of the year to the first half of the year, our production numbers are going to be up about 42 percent for the North American industry overall that the supply base ships into. And if you look at any of the analysts’ reports, inventories are a green light. Production right now is a green light. But, still, sales, ongoing sales, are still a red light in terms of uncertainty. So we do not know how much of this will be carried over into 2010 or how much of this will just be to buildup inventory short term and then the industry will go down.

But in terms of for the supply base, our members describe themselves as going into hibernation over the last 6 to 8 months. They took out all of the workforce that they possible could, all of the inventories in the system, and so now as you get these production schedules coming back up, all the way back to the steel mills who are operating themselves at 35 or 40 percent capacity utilization at that time, needs to ramp back up to these higher levels. And that is the situation we are in right now.

Chairman BROWN. Thank you. One more question, Mr. Kiener, and then I will move on to Mr. Wilson. Mr. Andrea mentioned S. 1617, the IMPACT Act, which I and some others introduced to set up a guaranteed loan fund to help companies transition—not just from auto but from auto supply, for example, to wind turbines, solar panel fuel cells, biomass, alternative energy. Can you give us an estimate of how many manufacturers are looking to retool or diversify into new technologies? I do not expect precise numbers, but can you give me your thoughts on that, Mr. Kiener?

Mr. KIENER. I would not be comfortable giving you a percentage, but I could give you a couple of stories maybe that would illustrate what our members are doing.

Our companies are highly diversified. The majority of them are not in one particular sector. We do have a certain percentage of ours that are in the auto industry, but they produce components for many other industries. So they are always looking at new opportunities, whatever is out there. They can do everything from medical work to defense-related industries, very small components up to large components.

The opportunities for the green industry, some of our members have begun to manufacture component parts for the wind power industry and also solar. Obviously, any new opportunities out there for them to expand their business and be more competitive, and thus a stronger company, certainly they would be looking at that.

In terms of a percentage at this time, I would not feel comfortable in putting one to it. I just know there are a number of our members that are doing that.

Chairman BROWN. Thank you, Mr. Kiener.

Mr. Wilson, what do you need to see as a banker? Use your own bank as an example as you think through this, and then look at larger banks, community banks, regional banks, the largest banks in the country. What do you all need to see from manufacturers before banks start loaning to them in larger numbers? And I think it is accurate to say that manufacturers—people applying for loans, if they are manufacturers, they are less likely to get it than if they are not; and if they are auto manufacturers, they are less likely to qualify than if they are—I mean, I know each case is different, but give me your thoughts on that. What do you need to see from Mr. Kiener and Mr. Andrea and their members before credit flows a little more liberally, if you will?

Mr. WILSON. Well, I think first of all you have to divide it into two different components. Number one, the customers that we have worked with for years, and we have loans that are on the books, and we are trying to continue to work with them. We know them and that is a whole set of circumstances where we are going to—we have the long-term relationship. We are going to work on loan modifications, if they need that. We are going to work with them in every way we can—short of getting in major difficulty with our regulators, as we can go there at some point in time.

But that is a little different from the new customer coming in with a new request, which we are seeing a lot of now. Because some other sources of funding, whether it be the secondary market or whatever, have dried up, they are coming to those of us that have money to lend. And there we are looking at—for a new customer, we are looking for cash-flow, we are looking for collateral. We are looking for skin in the game. A bank our size, we look for a commitment from the owner of the business to sign personally, to inject capital, to in some way be involved.

Chairman BROWN. What are your assets? What is the size of—

Mr. WILSON. \$750 million in the bank. So our lending limit is \$8 million, to give you some idea of the size of business that we can work with, short of doing a participation with another bank.

But that is 99 percent of the businesses and industries within the six-county area that we serve. Within our footprint, that allows us to work with most requests and most needs. We certainly cannot meet the needs of a Procter & Gamble or whatever, but most of the

businesses that are the lifeblood of our community are small businesses.

So we are looking for the cash-flow, we are looking for the collateral, we are looking for the commitment from the owners to be part of the solution.

Chairman BROWN. Do you see any difference between large banks and community banks with respect to willingness to lend to manufacturers?

Mr. WILSON. I guess the answer to that would have to be no, with this caveat: Certainly, the large banks were hit harder by the liquidity crisis. I think that the banks of the size and type of ours, not 100 percent but for the most part, came through that time period with liquidity, with capital, with the ability to continue to lend. And there was a point in time—because the larger banks depend on their funding from the capital markets a lot more than we do. Our funding comes mostly from deposits. Depositors put their money in, and we loan back into the community. And those sources, as you know, during the liquidity crisis dried up for the larger banks.

So from that standpoint, there certainly has been a difference. Now, that is beginning to turn. Certainly many of the programs that were put in place by Congress have helped restore liquidity back into the system. And I see a loosening of that, but we are certainly not out of the woods yet.

Chairman BROWN. About a year ago at this time, I spent much of 2 weeks calling banks your size—some smaller, some larger, but many banks your size around Ohio. This is a bit off the subject of this hearing, but just for my information, if you would—about what was happening in their area and as we were looking to the response to what was happening on Wall Street, of course. Some banks spent a lot of time talking to depositors about not withdrawing their deposits because of the fear they had.

What was the experience with your bank during that period a year ago?

Mr. WILSON. We have had quite a growth in deposits, and I believe that was as a result of a flight to safety. When the stock markets were under stress, when other alternatives for dollars were under stress, people became more conservative. The savings rate went from negative to positive, which was good for our deposit base. We were seen, with the FDIC insurance, with the conservative nature of our institution, we were seen as a safe haven. And so our deposits so far this year, for example, have grown by \$60 million. When you think of us as a \$750 million bank, that is significant.

And so we have not had to go out to the capital markets for funding, *et cetera*, and I believe that to be the experience of many small banks in the State of Ohio and across the country.

Chairman BROWN. You have mentioned, in answer to my first question, about the difficulty with regulators, and I would like you to expand on that. What regulatory requirements are hindering or dampening in any way the bank's ability to lend to manufacturers?

Mr. WILSON. Well, as I said in the testimony, certainly our goal and their goal is the same in that we want a safe and sound banking system. However, where we differ is that when we have a loan,



for example, with a manufacturing firm and that manufacturing firm is under stress, we still want them to be successful. If making modifications to that loan, meaning that we lower interest rates, ask for interest only, extend terms, whatever modification that would help them in a cash-flow crisis, or if we show some forbearance on capital requirements, we have an incentive to do that.

Certainly, the regulators do not have that incentive. They are coming in and they are saying, "Now, wait a minute, we want your capital standards to be this on this loan, and we want your collateral levels to be this on this loan, and cash-flow should be 1.2 times." And they have these standards, and when they apply those standards without realizing or wanting to compromise in a particular situation, then that becomes very difficult.

Again, as I said in the testimony, if we make a collateral call on a business that is already in stress and there is no other way to raise capital, they have to sell assets to increase that cash to meet that collateral call. That can be a death spiral for a company. And we do not want any company to fail. That is not in our best interest; it is not in the best interest of our customer or our community, the jobs in our community.

And so we have a tendency to be more flexible than regulators allow, and that is where you find the conflict.

Another example, if I may?

Chairman BROWN. Of course.

Mr. WILSON. Commercial real estate I think has been in the news a lot, because there is a supposed guideline of any bank that has 300 percent of their capital in commercial real estate, they have too much; or if they have that, they are going to have to put in other systems, *et cetera*. And that is supposed to be a guideline.

But it is not unusual and it has not been unusual in this crisis for examiners to come into banks and to say you have 400 percent, that is above the 300, and you need to get to the 300.

Well, the problem that caused is what you read about in the newspapers, that the bank has two alternatives to get that ratio back in sync with what the examiners are demanding. And that would be to raise capital, which at that point in time was impossible; or lower the amount of loans outstanding. Thus, you heard the stories of banks calling loans, not renewing credit lines, not extending credit, cutting off certain sectors—*i.e.*, commercial real estate. And that was real and that happened, and to my way of thinking, a lot of that was a result of regulatory inflexibility.

Chairman BROWN. Take that further. After the Federal interventions of the last year, TARP and TALF—based on what you said, elaborate—why are manufacturers still experiencing challenges in accessing credit? Is it beyond what you just said? Is it regulators requiring capital requirements that are too high?

Mr. WILSON. That is only a piece of it.

Chairman BROWN. Tell me, talk through that, if you would.

Mr. WILSON. Sure. I think it is a number of things.

Number one, your statement is based on some situations where people have stories of not being able to gain credit, and it is, I am sure, on the fact that overall credit extended to the manufacturing sector is down. But I think what one must remember is that manufacturing firms, like everybody else, know how to weather a storm,

and there is simply a lot less demand for credit right now overall. Certainly, regulatory constraints can hurt lending, and the other thing is that banks, of course—as I said again in my testimony, banks, of course, are not going to want to make a loan to a customer if they are not going to be successful in paying it back. In other words, we are doing a disservice to them if we extend credit to them beyond their capabilities.

I think capability, decreased demand, and regulatory intervention, all three play a major factor in the question that you ask.

Chairman BROWN. OK. I want to get back to SBA with all of you, but ask Mr. Andrea and Mr. Kiener a question about manufacturing generally. We have seen a relatively positive uptick in the economy in recent weeks in terms of some economic growth, some GDP growth. Do you see it extending to manufacturing, Mr. Andrea and Mr. Kiener? Mr. Andrea, do you want to start?

Mr. ANDREA. It is from the standpoint for our production schedules without a doubt coming off of the Cash for Clunkers program. But one of the councils that we run is a small and medium suppliers council, which are for the presidents and CEOs of suppliers under \$250 million in revenue. And I asked them how their third—this was just a month and a half ago—how their third and fourth quarter production schedules were looking, but if they had enough confidence that that uptick in production schedules was great enough for them to start hiring back people.

And I went around a room of about 20 of the CEOs there. Without a doubt, short-term production uptick, they had profits in June and July, which are generally unheard of in the auto industry because that is our seasonal downturn. But almost to a person, the increase in production was being handled by either contract workers, temporary workers, shifts coming back but were not permanently rehired. So there is not that confidence that going into the first quarter this uptick will hold.

Chairman BROWN. Mr. Kiener.

Mr. KIENER. Yes, I would agree with that statement by Dave. What we have seen is these inventory levels have gotten so low at our members customers that at some point production was going to begin to increase. We did have three successive months of double-digit increases on our sales index for our membership. However, you know, with them still being off 40 percent—

Chairman BROWN. Beginning June? Beginning July?

Mr. KIENER. In June. In June, yes. So that is when we started to see these increases. But I would echo the comments of the gentleman next to me. There is no long-term confidence that, you know, we are out of the woods. It seems to be refilling inventory. Their machines are busy. They are producing components. But there is not a real confidence beyond the rest of the fourth quarter that this is going to continue. They are not seeing signs, I would say, from the customers of a long-term—

Chairman BROWN. That makes sense. Is manufacturing different from the rest of the economy in this way? You know, with some economic growth now, we are not seeing particularly—we are not seeing growth in jobs, obviously. On the contrary. We also, as we have—back up. In the last many months, especially until summer,

but in the last many months as we saw job loss, we have also seen number of hours per worker worked per week decline.

So as the economy begins—as manufacturing—and historically in this country, as you know, auto and housing have been the sort of leaders in pulling us out of recession, if that historical trend reoccurs. So as auto jobs—as auto production and the supply chain increase and output increases, sales increase, do we see employers who have 30-hour-a-week workers move them up to 40 before we see new hires? Or is manufacturing not so reflective of 30-hour work weeks instead of 40?

Mr. ANDREA. The employment numbers will lag in manufacturing because of just what you point out, being able to increase the number of hours before bringing back people permanently.

The other thing, in terms of the restructuring, I think this is where this—what we just went through is so fundamentally different of every other economic cycle, is typically things came back very quickly. But now what you are looking at are suppliers who truly have gone from five or six plant locations and have consolidated those down to three.

So in terms of the overall employment coming back, until 2014, 2015, before people really see production come back to 2006 and 2007 levels, you will still see weakness, at least from the auto sector side, until that production comes back.

Chairman BROWN. Are your members as likely to have—I mean, I talk to employers all the time who, rather than lay people off, or at least to minimize layoffs, cut work back to—my wife works at the Plain Dealer in Cleveland, and they cut her—they required—I mean, the union took a vote: Do you want to lay more people off or do you want to take a wage cut? And the wage cut turned out to be 12 percent, which really turned out to be days of furlough where you will work fewer days or fewer hours.

Is manufacturing as likely to do that as other parts of the economy, to say we will not lay you off, but we are cutting you back to 35 hours—either with a union agreement or just the management making that decision?

Mr. ANDREA. From our members of what we saw, it was all across the board of however those owners could manage their workforce and keep their skilled workforce that they know they needed coming out of this and the critical capabilities.

So we saw it go from three shifts to two shifts. Then we saw the 1-day and 2-day furloughs. Without a doubt, I have never received more e-mails from people who at the bottom said, “I am on a 2-week furlough, and I cannot answer any voice mails or e-mails.” So it was all a mix of that, as well as cutting back 401(k) contributions, cutting back on health care, cutting back on all the benefits as well to scale down compensation and total benefit costs.

Chairman BROWN. And the furloughs then in place of furloughing ten people instead of laying off two, or whatever the ratios would be at a company, were done partly to cushion the blows to individual employees, to share the sort of pain, but also so those companies, thinking of an upturn in the economy 6 months, 12 months, 18 months out, would have the skilled workforce to startup in a more focused, direct way.

Mr. ANDREA. Absolutely. There are members who took people who were in skilled trades classifications, reclassified them for non-skilled work so that they could keep them employed, keep health care benefits for those employees through this downturn.

Chairman BROWN. And none of them were leaving to look elsewhere to find—because they could not find—I mean, they—

Mr. ANDREA. Well, the other thing, of course, we have in the State of Michigan, particularly, are housing values. They have been hit so much that it has kept an anchor on a lot of employees as well.

Chairman BROWN. Mr. Kiener, any comments on that?

Mr. KIENER. Yes. Our members are typically smaller than the companies in Dave's group, so they are 40-employee-type of companies. They work very closely with their employees, so when they do make that decision to eliminate positions, it is done with careful consideration.

What they have attempted to do is really protect those skilled workers for when there is the increase back in business. They will be able to move forward with a highly skilled and trained workforce.

So that is very similar to the tale that Dave has just described to you.

Mr. ANDREA. If I could just pick up on one point, Mr. Chairman, there. I received a number of phone calls from our members as the consultancies were reducing their forecasts in production levels down through—really starting in January and February, and then throughout the year. I would get phone calls to say, "Do you believe those forecast numbers? Because if you believe that it is another ratchet down, I am up against taking out another 10 or another 20 people out of my shops."

So that is how careful the people did take a look at this, because there was no way coming back, once you take those people out, if you believe those forecast numbers, which did end up coming true.

Chairman BROWN. Mr. Wilson, let us talk for the last part of this hearing about the SBA and what we can do, if you have thoughts on improving it. Understanding the very important caution in your story was, I thought, illuminating about the gentleman that came to you that you turned down, that later was grateful that you had the sobering analysis that came to that conclusion, understanding that, why are more banks not taking advantage of the 90-percent guarantee on SBA loans? The SBA has tried to take hold of some of the problems and help struggling people that cannot get credit, coming to SBA and SBA has changed its patterns of behavior in the last few months to try to reach out better, why is that not mattering enough?

Mr. WILSON. Well, I think there are a couple of answers to that question. I think the first is, remember what I said about the demand not really being there. Certainly in our bank, we are making a lot more of the SBA loans, the ARC loans. We are looking to—when we have a stressed manufacturing firm, business of any kind, a stressed loan, we are looking for any way to help them to modify. So definitely our SBA lending is up, our overall lending is up, because we are looking to use those.

There is a great reluctance, oftentimes, on the part of our customer. They have never been involved with a Government program. They have always dealt directly with us. They have seen what happened to us. You know, we accepted the CPP money at our bank, for example, because we thought it was our duty to do that. CPP, if you remember, went to the strong banks, and we did exactly what we were asked to do. We received on February ninth \$13.4 million. By the end of February, we had leveraged that into \$65 million worth of loans and investments. And our reward for that was we were vilified in the press. We were vilified in these hallowed halls. And that was seen by our customers.

A lot of our customers are very reluctant to use a Government program because they fear they will be seen as taking a bailout, and they do not want any part of that.

Now, SBA—

Chairman BROWN. Even SBA.

Mr. WILSON. Even SBA.

Chairman BROWN. If you are extended something that has been around as long with a generally good reputation.

Mr. WILSON. But you are talking about customers that have never used that before.

Chairman BROWN. So it is new to them.

Mr. WILSON. It is new to them. I mean, yes, you and I both know about SBA, but customers there, they are in trouble, we say, you know, "We think we could help you meet this need if you are willing to let us got for an SBA 504 or an ARC loan," or whatever it might. And they are saying, "Oh, no, no. I do not want to get involved with that. I do not want to be any part of a Government bailout." And we say, "No, no. These programs have been in place for a long time. These programs are meant for this purpose." And oftentimes we can walk that customer through that, and we can get that customer to understand and be part of that.

But there is that piece of the puzzle there that there has been such a beating up, if you will, of those of us that participated in the Government programs like the CPP, the Capital Purchase Program, that they are cautious. Demand is down, another reason. And then simply there are some that are so stressed that they just do not qualify for the SBA financing.

Chairman BROWN. Mr. Kiener, are your companies reluctant to use SBA?

Mr. KIENER. Yes, very much so.

Chairman BROWN. Based on?

Mr. KIENER. Based on a couple of factors. One is the perceived—and I am not an expert in SBA by any stretch of the imagination, but the amount of paperwork and documentation required to go forward with the SBA process. Also, the personal guarantee. These small family owned companies that are 30 employees, for them to put everything in the game—you know, for them it is everything in the game. They feel like they have put so much into the business already, but then to put their personal assets into it as well as part of the guarantee, they are just not willing to make that type of a leap.

In addition to that, when our folks have looked at SBA, especially most recently with the automotive side of things, if they had

anything to do with automotive, as I mentioned earlier in the testimony, they are just not bankable in terms of a loan for our companies.

So most of ours have just, frankly, written SBA off as a solution for them.

Chairman BROWN. Mr. Andrea, if I could guess, I would think that you would say that the biggest problem with SBA for your members is that the loan limit is not large enough. Is that your biggest complaint with SBA?

Mr. ANDREA. When we have done written surveys in terms of participation, it is the loan limit that comes up as the number one issue. As I talk individually with the executives, the personal guarantee part comes up in conversation. But I think what is interesting, though, is when you get the bankers and the SBA office, at least up in Michigan, in the same room with the suppliers, that personal guarantee piece becomes less of a specific issue. But you never know. But it is the limit for ours members.

Chairman BROWN. I am going to ask all three of you to conclude the hearing with one question, the same question, and each of you start—I guess I will start right to left this time. What can Congress and the Administration do to further loosen credit for manufacturers? What is the most important thing that I should take out of this hearing? As you said, Mr. Wilson, two or three times, compellingly, that we all want the same thing. The three of you do, I do, we want to see you loan to manufacturing operations that are successful and you are making money and they are making money and they help to pull us out of this recession and we do not have the tragedies that are too common in your part of the State, really in our whole State. And you say DHL in Batavia and Moraine and crippling that has been for our State and our economy.

What can Congress and the Administration—what are the most important one or two or three things you should tell us that we should be doing?

Mr. WILSON. I think be careful of the rhetoric. Be as positive as possible about not only the prospects for an improving economy but about these programs we are talking about. Do not overreact to the lack of immediate acceptance of these programs by saying, well, that program did not work, let us cancel that.

I think that there is an ongoing place for TALF; I think there is an ongoing place for SBA; I think there is an ongoing place for the ARC loans. I think all of those remaining in place will keep us from having a second dip, and I think you would not want to overreact to that.

And then I think education is possible. What we are talking about, I think, is oftentimes a misperception on the part of the end user as to how difficult it is, how they might not be qualified, how it is so difficult or so onerous or they are going to be vilified or whatever. And I think a constant reassurance by SBA, by the banks, by the manufacturing trade groups that this is an alternative, this is something you ought to take a look at would be meaningful.

Chairman BROWN. Thank you very much, Mr. Wilson.

Mr. Kiener.

Mr. KIENER. What I feel, and I think I speak for our association on this issue, is the banks need to feel more comfortable in lending to manufacturers. And how do we make them feel more comfortable? A federally backed loan guarantee program that utilizes existing loan facilities for private lending to manufacturers. The banks need assurances that the Federal regulators will not come down on them for making sound lending decisions. And a return to the sound lending decisions will allow for available and affordable credit for manufacturers.

I think it is crucial to the recovery of the economy to allow renewed capital expenditures and facility expansions, investment in R&D, and in the end increase hiring and employment and get things back and rolling. So that is really what we are looking for.

Chairman BROWN. Mr. Andrea.

Mr. ANDREA. When we have done surveys of our members and asked about the level of engagement between the bankers and their operations, about 20 percent of our members say that their bankers are very engaged with them and working with them day in and day out. About 20 percent of the members say that their bank is trying to exit the auto industry. And there is 60 percent or so that are in the middle.

And so for us, we are not worried about the suppliers where their banks are engaged, and the 20 percent in terms of the disengagement, many of those suppliers and capacity probably do need to go away in terms of poor lending risk that way. So we are worried about the group in the middle.

And then I think short term you have to look at reducing the level of risk, and it could be loan guarantees, it could be some of the programs that we talked about in terms of the loan enhancements, to reduce the risk as our production levels will continue to remain low and collateral levels are low. And then, second, I think you look at the types of long-term and permanent programs that we could provide to assist in tooling and technology investment to retool the industry going forward.

Chairman BROWN. Good. Thank you. Thank you all. Your testimony was very helpful, your answers to questions were very good, and I very much appreciate that.

The Subcommittee will be submitting questions for the record to both the Treasury Department and the Commerce Department. If you have thoughts that you would like us to entertain to turn into questions to Treasury and Commerce, certainly submit those to us. We will invite both Departments to testify at a future hearing on this issue.

The record will remain open for 7 days, so if you have additional testimony or want to expand on anything you told the Subcommittee, certainly feel free to do that.

Again, thank you from joining us, and the Subcommittee will adjourn.

[Whereupon, at 10:39 a.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

**PREPARED STATEMENT OF CHAIRMAN SHERROD BROWN**

This hearing of the Economic Policy Subcommittee will come to order. This is the fourth in a series of hearings on the challenges facing manufacturers.

Let's face it. Our manufacturing sector is in crisis. While key productivity indicators have shown recent signs of growth, both manufacturing output and employment have dropped precipitously over the past year.

We must act now to move from continuous erosion to consistent expansion, because U.S. manufacturing isn't optional, it is indispensable. As manufacturing goes, so go our national security, our global economic leadership, and our stability as a democracy. Our democratic Nation needs a strong, stable middle class, and a stable middle class needs manufacturing jobs.

Manufacturing equips our military and accounts for 12 percent—\$1.6 trillion—of U.S. Gross Domestic Product (GDP). It generates nearly three-fourths of the Nation's research and development. It employs nearly 12 million Americans.

Compromised access to credit is the newest threat to American manufacturing. It's not a minor problem, it's a major concern.

As one manufacturer I spoke with put it, "credit makes this country great."

But the credit stream has slowed to a trickle. The Federal Reserve Board's flow of funds accounts have shown a consistent reduction in net lending to manufacturing sectors.

Every day there are more small and medium-sized manufacturers—like those in Ohio—at risk of going out of business because they cannot get the loans they need.

For manufacturers in the auto supply chain, the struggle to find a lender is even tougher.

I heard from one Ohio manufacturer who has been in business for 25 years and has had access to credit through a trusted lender. The manufacturer has a strong credit history.

The bank recently capped their credit line at \$5 million because a percentage of their business involves auto supply components. Almost 100 percent of the manufacturer's customers pay their invoices within 60 days.

The company feels penalized in spite of the fact that they have a strong record.

To be clear, this hearing is not about vilifying banks or anyone else. I realize that some banks are only just beginning to rebound from the financial meltdown and are concerned about taking on too much risk.

We also have the problem of the frozen debt-securitization markets, which allow banks to repackage loans and sell them to investors. Banks are finding it increasingly difficult to repackage their loans to free up capital.

This problem of access to credit is unfortunately not unique to Ohio, Indiana, Michigan, and other manufacturing States.

As I mentioned, the goal of this hearing is not to lay blame on anyone's doorstep.

This is an opportunity to take stock of where manufacturers and lenders are given the harsh economic conditions.

Despite the challenges I have outlined, we must find a way to get credit flowing again.

In that vein, I hope this hearing helps answer the following questions:

Are there signals that show credit is easing?

How have steps the Administration has taken worked and evolved? What new mechanisms should Congress and the Administration consider to bridge the gap?

I look forward to the testimony of our witnesses.

**PREPARED STATEMENT OF DAVID ANDREA**

VICE PRESIDENT, INDUSTRY ANALYSIS AND ECONOMICS, ORIGINAL EQUIPMENT  
SUPPLIERS ASSOCIATION, MOTOR AND EQUIPMENT MANUFACTURERS ASSOCIATION

OCTOBER 9, 2009

The Motor and 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 10 months, significant and unprecedented Government and industry actions have prevented a collapse of the largest manufacturing sector in the United States—the auto industry. It is estimated that the auto industry will expand production by two million units or 25 percent in 2010 over 2009. 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 a future, potential crisis be prevented.

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.

#### **History of Auto Supplier Support Program and GM and Chrysler Bankruptcies**

To give some background, the Auto Supplier Support Program announced by the Auto Task Force on March 20, 2009, addressed only a finite set of issues. Small suppliers, suppliers manufacturing in the U.S. and shipping to Canada and Mexico, and suppliers directly providing replacement and warranty parts and tooling were among the entities that found themselves without access to this program. The program, as administered, assisted a portion of the industry in surviving the downturn in production and vehicle sales. However, the program failed to improve required ongoing access to traditional sources of capital for the vast majority of the industry.

With the bankruptcy filings of GM and Chrysler, 30 percent of the North American vehicle production base is in significant restructuring and transition. The Auto Supplier Support Program, which provided up to \$5 billion to guarantee the payment of supplier receivables, did help prevent widespread loan covenant violations and demands for changes in customer payment terms. However, OESA surveys indicated that while half of the direct suppliers to GM and/or Chrysler were eligible to participate, only half of those eligible suppliers were actually able to take part in the program.

There was a significant gap between those eligible and those able to participate because of issues in loading the thousands of purchase orders into the Citibank system and the general limitations on the types of eligible receivables and supplier bank restrictions. Even though in both the Chrysler and GM bankruptcies, most direct suppliers were treated as critical vendors and received pre-petition payments on various terms, the process failed to address the serious needs of hundreds of suppliers to other vehicle manufacturers.

Without a doubt, the U.S. Treasury Auto Supplier Support Program helped avert a potential implosion of the supply base. However, significant risks remain to the industry and lenders alike. The major examples include:

1. *GM*—As the announcement last week of Penske Auto Group pulling out of a deal to purchase the Saturn distribution system shows, there is still significant uncertainty as to how brands, vehicle platforms, and supply base consolidation will occur.
2. *Chrysler/Fiat*—We will not know until later this year final product cycle plans, manufacturing locations and other details that will provide lenders a view into which suppliers have forward business opportunities and which do not.
3. *The old GM and Chrysler companies in bankruptcies*—Until all the assets are completely disposed of, there will remain uncertainty over potential liabilities. Bankruptcy courts can still have oversight over ongoing operations and the value of certain receivables to lend against.
4. *Bankruptcy of major suppliers*—While it appears these bankruptcies are moving smoothly through the courts, we cannot forget that few sub-tier suppliers

are receiving critical vendor status and, as a consequence, most are not receiving full pre-petition payments.

### **The Current Situation**

Suppliers have dramatically reduced every element of their working capital requirements from payroll to raw material inventories. Certainly, this is in part a response to the dramatically reduced production levels and an effort to conserve cash in a period of significantly reduced cash flows.

However, many—if not most—of these changes will become permanent. These include:

- Workforce reductions;
- Plant closures;
- Compensation and benefit reductions; and, of course,
- Permanent closure of companies.

Our research indicates that there have been 47 identified major suppliers that have filed for Chapter 11 protection this year. (See Attachment 3) We have no definitive number of suppliers who have closed facilities, but Plante and Moran estimates that up to 200 suppliers have liquidated.

The result of this painful cost cutting and restructuring is a much lower break-even point for the supply base. In the September survey of OESA members (See Attachment 4), the median break-even unit level for 2010 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 break-even point next year. However, currently there is significant pressure on the entire system to access adequate working capital to bring the manufacturing system back up.

There must be increased access to capital through the entire supply chain—from the largest tier one to the smallest family owned firm in order to:

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

Lending conditions did improve in the second quarter of 2009 from the first quarter of the year. However, we need to keep in perspective how deeply frozen the credit markets had become (the supply side) and how significantly large the ongoing capital needs of the industry are (the demand side). GE Capital, in their Third Quarter 2009 Industry Research Monitor of the U.S. automotive base, reports that U.S. institutional term loan issuance was off 55 percent in the first half of 2009 *versus* 2008; in the second quarter, term loan issuance was still off 31 percent year over year.

The situation is improving, but is it improving fast enough? To give you a perspective of the capital requirements for this industry, it is not unusual to have a \$100 million supplier support \$5 to 10 million in customer tooling costs at any point of time. 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 4 weeks, my vendors every 6 weeks, and my customers pay me every 8 weeks.” The need is evident.

There has not been a widespread failure of the system as suppliers have restructured or liquidated. However, 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 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;
- 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; and
- A small metal fabricator could not raise additional capital to invest in his Michigan operations and lost the business to Mexico.

These are not examples of capacity that needs to be rationalized. These are examples of suppliers that are 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, 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 over the past 3 months. 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.

A very positive thread through the comments 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 latter part of the fourth quarter and into 2010, the trend toward regaining profitability will continue. This is an industry worth investing in. However, industry production volumes (driven by weak consumer spending) and absolutely 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 could be indiscriminately cut off from necessary access to capital. In fact, in a recent review of supplier financial distress monitoring systems, a group of 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.

Outside analysts confirm the views of our membership. According to the Summer 2009 Grant Thornton report, *The North American Automotive Industry in 2012: Supplier Opportunities*: “. . . as many as 30 percent of North American suppliers are at high risk of failure.” Grant Thornton expects restructuring will reduce supplier capacity by 30 to 45 percent. Using 1,700 suppliers for their base numbers, they forecast:

- 170 to 340 companies risk Chapter 11 restructuring;
- 340 companies risk liquidation;
- 170 to 340 companies need acquisition financing for consolidation;
- 50 companies require targeted financing for restructuring; and
- 630 to 970 companies may not need special financing assistance.

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 this year. 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.

There are three areas MEMA and OESA believe Congress and the Administration should focus on 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 General Lending**

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 believes—along with several bankers we have spoken to—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 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, it is not unreasonable for a small supplier to be called on for the investment of \$2 to \$4 million to assist with 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 be completely reimbursed until the product ends production in another 36 to 60 months.

Small Business Administration (SBA) programs have been at the foundation of small supplier support for decades. However, the SBA loan programs are limited to only \$2 million loans. Since suppliers are expected to fund a great deal of the research and development in the projects, 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. Because of these limitations, recent changes to the SBA program have not dramatically impacted the ability of small suppliers to access capital.

#### **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; and
- Advanced safety technology.

Suppliers are constantly called upon to innovate. 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, engineering, capital equipment, and research and development. 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. (See Attachment 5)

#### **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.

This industry does not come before you requesting a bail out. However, we urge Congress and the Administration to invest with us in our future to achieve a stable economic environment, a strong employment base and a vibrant opportunity for technology research and development. We welcome an opportunity to work with the Committee.

[Attachment 1]

## THE SUPPLIER INDUSTRY

### Heavy Duty Suppliers

Heavy-duty suppliers provide the original equipment parts used to manufacture commercial vehicles and the aftermarket replacement parts needed to maintain the vehicles for service and repair. Heavy-duty suppliers are also responsible for developing most of the advanced technologies that keep these vehicles safe, low-emission, and fuel efficient. There are currently over 500 US suppliers in the heavy duty commercial vehicle supplier industry. These companies provide most OEM parts to the four major US truck manufacturers, PACCAR, Navistar, Volvo/Mack and Freightliner/Daimler Truck. The vast majority of these suppliers, over 85%, are considered small businesses.

Due to vehicle size, weight, lower volumes and shipping costs, most heavy-duty vehicle and part manufacturing remains in the United States. This industry is dependent on a healthy economy generating freight ton-miles demand. Supplier success is impacted by economic cycles, changing vehicle manufacturer demands, production schedules, tight credit markets, and new diesel emission-reduction requirements that have caused both spikes and steep drops in demand. Class 6, 7 and 8 trucks have seen an increase in cost of \$25,000 per vehicle since the initial stages of the EPA 3-phase "clean-diesel" regulations were enacted in 2002. This drives truck owners to avoid the cost of the next generation vehicles with a pre-buy on new trucks, causing a spike and cliff in sales patterns.

The US heavy duty commercial vehicle industry is in its 27<sup>th</sup> month of recession. Current class 8 vehicle (tractor-trailer type) sales are down 65% since EPA 2007 regulations were enacted. The current year class 8 sales pace is running at 105,000 units; 51% behind 2008. The expected recovery in 2008 was quashed by a dramatic reduction in truckable economic activity; the main driver of new commercial vehicle sales. While EPA 2010 regulations were expected to drive a pre-buy starting late in 2008; none of the market analysts are currently predicting a significant increase in production during this year.

Although there is not as much attention paid to this sector, heavy duty suppliers are witnessing unprecedented challenges. Eighty-five percent of the association heavy duty members have reported declining sales and less than half are able to meet financial obligations in a timely manner. Access to operating capital and build rates that are well below the break-even point of nearly all heavy duty suppliers place many in serious jeopardy of failure.

### Automotive Aftermarket Suppliers

U.S. aftermarket suppliers support the light and medium 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.

## [Attachment 1]

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.

**Light Vehicle Original Equipment (OE) Suppliers**

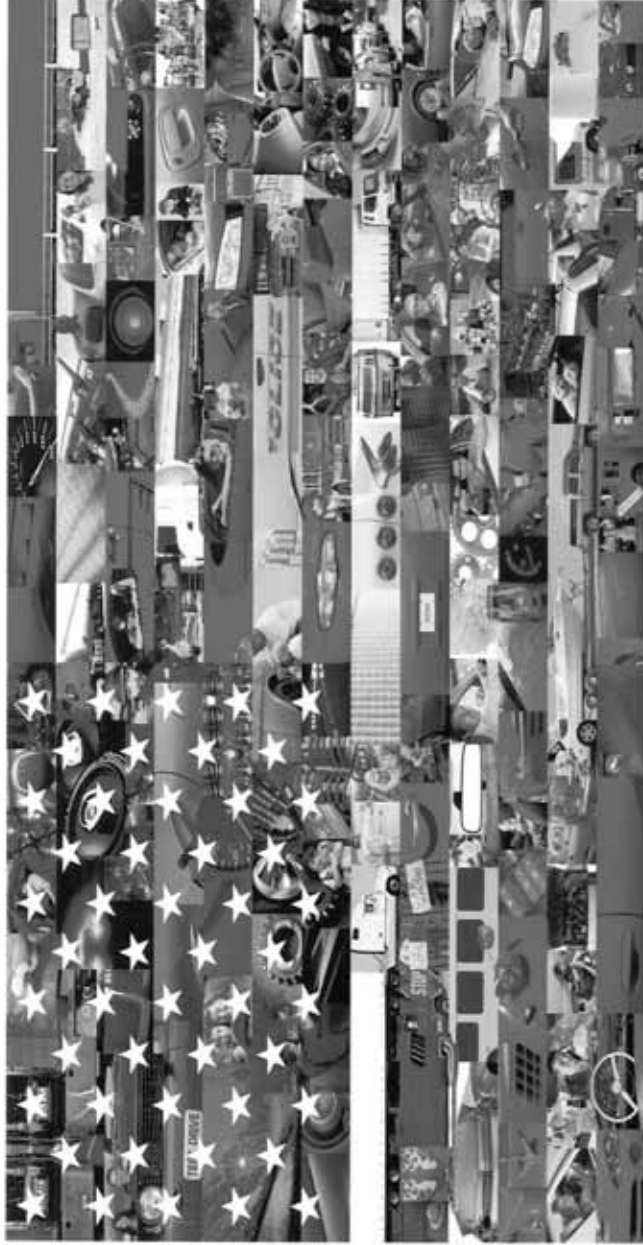
Original equipment suppliers design, engineer, and manufacture parts required for the assembly of passenger cars and light trucks. OE suppliers interact directly with vehicle manufacturers, and their success is tied directly to the number of domestically produced vehicles. Each year, more than 300 new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

The auto supply base is one of the most complex industrial complexes. On one side is the vehicle manufacturers – a dozen or so major original equipment manufacturers (OEMs) that dominate world production with sales measured in tens to hundreds of billions of dollars. On the other side are a dozen or so major material suppliers – the steel, aluminum and plastics providers – that too have sales measured in the tens of billions of dollars. In between are some 3,000 suppliers that produce the 10,000 parts that make up every passenger car and truck. Supplier sales range from \$25 billion to a million dollars. The distribution of those 3,000 suppliers is in the shape of a pyramid with two-thirds of the supply base having revenues under \$250 million. Because of the sheer volume of parts, the industry considers a "small" supplier to be under \$250 million in sales. A \$250 million supplier might typically have 300 – 500 employees. A \$10 million supplier would be considered exceedingly small, and might represent a specialty tool shop or fixture supplier.

The suppliers that make up this pyramid are mutually dependent upon one another – a supplier can compete against another on one vehicle program and act as a supplier or customer to that same supplier on another vehicle program. The OEMs and the suppliers are also mutually dependent. Just as an example, 51% of GM's suppliers are also in Ford's supply base. By revenue dollars, the interdependency is even more dramatic: Ninety percent of the dollar amount that GM spends with suppliers is with suppliers that also supply Ford.

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. Suppliers are addressing a range of technologies on a daily basis.

[Attac ant 2]



Moving America. Part by Part.

MOTOR VEHICLE PARTS SUPPLIERS



WWW.NEMMA.COM





[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



Parts suppliers manufacture over 1 billion parts for today's vehicles.

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.

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 systems, 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.

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.



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

**4.8**  
Additional indirect jobs contributed

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

MOTOR VEHICLE PARTS SUPPLIERS



[Attachment 2]

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

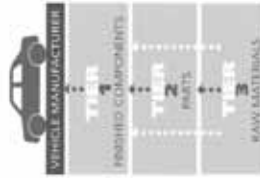
Collectively, U.S. motor vehicle parts suppliers are a \$388-billion industry, comprising three distinct segments: original equipment, heavy duty and aftermarket.

and sell finished components, such as transmissions, seats and instrument panels directly to the vehicle manufacturers. Tier 2 suppliers sell parts like transmission gears, electronics,

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 dynamic. Given this illustration, it is easy to see the interdependency of the entire vehicle manufacturing industry.

# \$388-Billion Industry

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



### 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

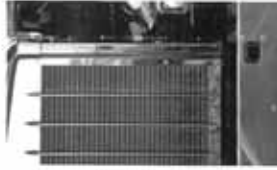
speedometers and seat covers to the Tier 1 suppliers. Tier 3 suppliers provide raw materials to either of the other



### 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 manufacture 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



[Attachment 2]



Market	Value (\$Bn)	% of Total	Total
Light Vehicle	10,200	81.1%	12,500
Medium Vehicle	1,800	14.4%	12,500
Heavy Vehicle	500	4.0%	12,500
Light Vehicle	10,200	81.1%	12,500
Medium Vehicle	1,800	14.4%	12,500
Heavy Vehicle	500	4.0%	12,500
Light Vehicle	10,200	81.1%	12,500
Medium Vehicle	1,800	14.4%	12,500
Heavy Vehicle	500	4.0%	12,500

Trucks are responsible for 70% of the value and 80% of the tonnage freight 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

**AFTERMARKET SALES BY CHANNEL**



Aftermarket  
James De Chermid  
Invest Global Institute  
Forecasting Market



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.

[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 4.9 jobs, meaning that the industry supports more than 3.29 million jobs in total.



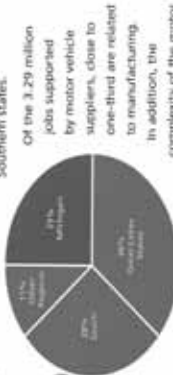
**TOP STATES FOR DIRECT JOBS**  
 50,000-100,000+  
 10,000-50,000  
 5,000-10,000  
 1,000-5,000  
 0-1,000

**Importance of Parts Suppliers**  
 On average, every direct employment, parts suppliers sector in eight states: Kentucky, Michigan, Missouri, Tennessee, 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	INDUSTRY VALUE	EXPORTS
Manufacturing	143,100	332,000
Non-Manufacturing	293,000	5,465,000
<b>TOTAL</b>	<b>436,100</b>	<b>5,797,000</b>

Immediate and  
 Expenditure-induced Employment

### MOTOR VEHICLE PARTS SUPPLIERS



## Sustaining Our Environment. Part by Part

[Attachment 2]

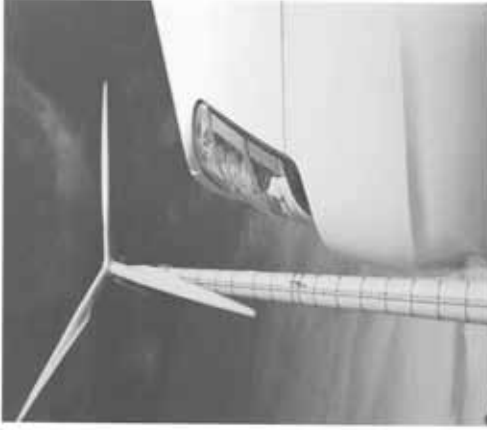
Suppliers have consistently demonstrated a commitment to advancing technologies and practices that will secure a sustainable environment through product innovation and more environmentally friendly manufacturing operations.

### 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.



[Attachment 2]

- 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.

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 steel 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

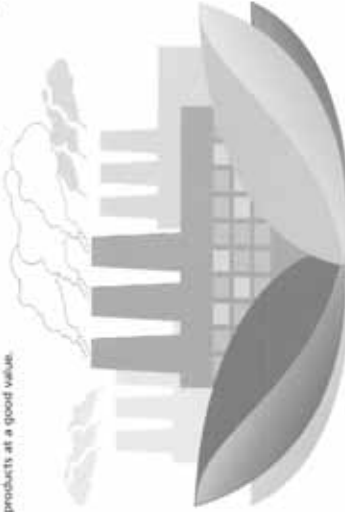


[Attachment 2]



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.



[Attachment 2]

### 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 warnings, 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.



MOTOR VEHICLE PARTS SUPPLIERS





[Attachment 2]



### Trillions of Miles Driven, and Still Moving.

Americans drive an astonishing three trillion vehicle miles per year. There is a car that we can't accomplish without driving. From our daily commute to our weekend getaways, from safety, moving commerce to safety driving our children to school, we depend on reliable, safe and efficient transportation.

Auto vehicle suppliers design, engineer and manufacture the quality parts that fuel our need for efficient transportation, and they are helping improve two vehicle safety, fuel efficiency and emission reductions. Suppliers also provide quality parts that support our commuters. 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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[Attachment 3]

**Supplier Bankruptcy Filings for 2009**



No.	Company	Date	Assets (Millions)	Liabilities (Millions)	Debt (Millions)	Recovery* (Millions)	Ownership	SEP Financing (Millions)	Competition Products	Bankruptcy Case Number
1	Pulse Protein (Canada) GmbH	1/15/2008				0			Protein sweeteners for soft drinks, industrial, and other products.	Filed in Germany
2	Chickadee Markets Corp	1/13/2008	\$24.3	\$21.8	\$3.4				Food packaging for food processors, retail packs, and other products.	U.S. Bankruptcy Court, Eastern District of Michigan, No. 08-42383
3	Star-Walton Inc.	2/18/2008					Star Capital Services Inc.		U.S. Bankruptcy Court, District of Delaware, No. 08-10338	
4	Essex49 (Essex Consumer Corp)	1/18/2008	\$7.408	\$1.840	\$5.568			\$170	Consumable packaging (paper) (paper based and paper based packaging).	U.S. Bankruptcy Court, District of Delaware, No. 08-10228
5	Clonkath LLC	1/16/2008		+ \$100		\$222.8	Microfilm Applications Strunk, LLC Meyerson Asset Management		High strength and lightweight flexible and rigid plastic products for use in automotive components, and various other consumer products.	U.S. Bankruptcy Court, Eastern District of Michigan, No. 08-42400
6	Edifice AB	2/17/2008				\$1,200	The Carlyle Group		Power transformers and other electrical equipment (transformers, converters and reactors) (power devices - heat sinks and other parts).	Filed in Germany
7	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court, District of Delaware, No. 08-10384
8	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	Filed in Canada
9	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court, District of Delaware, No. 08-10378
10	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	Filed in Canada
11	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	Filed in Canada
12	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court, District of Delaware, No. 08-14303
13	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court in Delaware, Ohio & Canada
14	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court in Delaware, Ohio & Canada
15	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court, Eastern District of Michigan, No. 08-42418
16	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court, Eastern District of Michigan, No. 08-42418
17	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court, Eastern District of Michigan, No. 08-42418
18	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court, Eastern District of Michigan, No. 08-42418
19	Planet Fitness (Planet Fitness Inc)	3/20/2008	\$100.202	\$107.100	\$6.898	\$213.5	Planet Fitness Corp	\$12	Non-ferrous metal fasteners (nuts, bolts, washers, screws, rivets, etc.).	U.S. Bankruptcy Court, Eastern District of Michigan, No. 08-42418

[Attachment 3]

**Supplier Bankruptcy Filings for 2009**



No.	Company	Date	Assets (Millions)	Debt (Millions)	Receivables (Millions)	Order Ship	1099 Processing (Millions)	Competition Products	Bankruptcy Case Number
20	B & C Corporation A/N/A M Engineering	6/10/2008	\$12	\$28				Specializing in high volume production of different precision components for both OEM and aftermarket applications.	U.S. Bankruptcy Court, Northern District of Ohio, No. 08-01489
21	Rock International Ltd.	4/13/2009	\$180.8	\$98.7				Large welded tanks, roll formed products and other steel components	United States Bankruptcy Court, Eastern District of Michigan, No. 08-01728 U.S. Bankruptcy Court, Southern District of New York, No. 08-13123
22	Lyndebankhead	4/24/2008	\$18,800	\$55,300			\$8,000	Paths, tunnels and pistons	U.S. Bankruptcy Court, Southern District of New York, No. 08-10212 & 08-10213
23	M&N Toyon Products	4/24/2008	\$200	\$1,000	\$1,200	San Capital Partners Inc	\$60	Power transmissions, air intake and cooling, and information display systems	U.S. Bankruptcy Court, Southern District of New York, No. 08-11795 U.S. Bankruptcy Court, Southern District of New York, No. 08-12805
24	Harco Lummus	5/11/2008	\$1,300	\$1,400	\$1,300		3,000	Heat & admission exhaust	U.S. Bankruptcy Court, District of Delaware, No. 08-12823
25	Sanabank Industries	5/11/2008	\$12.8	\$38.9				Major clamping and welding components for 1 and 2 ton systems, interior parts, lighting and electrical systems	U.S. Bankruptcy Court, Northern District of Illinois, No. 08-72212
26	Vision Corp	5/21/2008	\$3,800	\$1,400	\$1,400			Components, accessories and modules for transportation related passenger and chassis applications	U.S. Bankruptcy Court, District of Delaware, Lead Case No. 08-11795
27	Metallpro	5/27/2008		\$819	\$1,510	Apex Inc Corporation	\$12.8		U.S. Bankruptcy Court, Southern District of New York, Lead Case No. 08-12812
28	First Wayne Family Corporation	6/27/2008	\$1 - \$10	\$10 - \$50		Core Partners and (subs and New For (bankruptcy)		Automotive Lead Castings	U.S. Bankruptcy Court, Northern District of Illinois, No. 08-13483
29	Tricon Industries	6/28/2008			\$15			Automotive and truck body hardware on Chevy trucks & (Ford F-Series Models)	U.S. Bankruptcy Court, Southern District of Illinois, No. 08-82580
30	Advanced Imaging Solutions, LLC	6/16/2008						Print in Germany	
31	Kobler & Nisner	6/25/2008			\$11			Automotive and truck body hardware on Chevy trucks & (Ford F-Series Models)	U.S. Bankruptcy Court, Eastern District of Michigan, No. 08-60161
32	Advanced Imaging Solutions, LLC	6/26/2008	\$0	\$22		Graphi Verlag		Print in Germany	
33	Strata Formatics, Inc	6/26/2009	\$184	\$148		International Vehicle Group Inc		Automotive and truck body hardware on Chevy trucks & (Ford F-Series Models)	U.S. Bankruptcy Court, Southern District of New York, No. 08-13427
34	Global Safety Vending Holdings LLC	6/26/2008	\$100 - \$500	\$100 - \$500				Automotive and truck body hardware on Chevy trucks & (Ford F-Series Models)	U.S. Bankruptcy Court, District of Delaware, No. 08-11134

[Attachment 3]

**Supplier Bankruptcy Filings for 2009**



No.	Company	Date	Assets (Million)	Debt (Million)	Revenue* (Million)	Ownership	NAEP Financing (Million)	Commodity Produced	Bankruptcy Case Number
35	Proterra International Inc.	3/1/2009	\$10 - \$100	\$113.3	\$100			Trailers	Proterra U.S. Bankruptcy Court, District of Delaware, No. 09-13318 (Abercrombie LLC - U.S. Bankruptcy Court, Southern District of New York, No. 09-13318)
36	Advanced Materials Group	3/1/2009						Advanced metals manufacturing & processing	Advanced Materials Group - U.S. Bankruptcy Court, Central District of California, No. 09-24829
37	Law	3/1/2009	\$1,300	\$4,800	\$18,570		\$100	Automotive seating systems, electrical distribution systems and alternators	U.S. Bankruptcy Court, Southern District of New York, No. 09-14336
38	A.I. Perotti	3/1/2009	\$100 - \$500	\$100 - \$500			\$15	Automotive seating systems, electrical distribution systems and alternators	U.S. Bankruptcy Court, District of Delaware, No. 09-13424
39	Radisson Hotel	3/1/2009	< \$100	\$10		51.1		Hotel manufacture of stainless steel and high alloy cast iron pipes and fittings	U.S. Bankruptcy Court, District of Delaware, No. 09-13493
40	Hotel Corp.	3/1/2009	\$10 - \$100				\$11	Manufacture of automotive fuel systems, fuel and injection systems and related parts	U.S. Bankruptcy Court, District of Delaware, No. 09-13494
41	B&C Machine Co., LLC	3/1/2009						Manufacture, head treatment, assembly and assembly of precision-machined components	U.S. Bankruptcy Court, Northern District of Ohio, No. 09-61894
42	Chassis Structural Holdings Inc.	4/1/2009	\$1,000	\$1,800	\$1,600		\$170	Body and final systems as well as parts for use direct on chassis and sub-chassis in cars and trucks	U.S. Bankruptcy Court, District of Delaware, No. 09-12743
43	Meridian Automation	5/22/2009						Structural and lighting parts	U.S. Bankruptcy Court, District of Delaware, No. 09-13609
44	Pervech Industries LLC	6/24/2009	\$100 - \$500	\$10 - \$100				Manufacturer of components for the automotive light vehicle, heavy truck and industrial markets in North America	Pervech Industries LLC - U.S. Bankruptcy Court, District of Delaware, No. 09-13705
45	Pervech Industries LLC	6/24/2009	\$100 - \$500	\$10 - \$100				Manufacturer of components for the automotive light vehicle, heavy truck and industrial markets in North America	Pervech Industries LLC - U.S. Bankruptcy Court, District of Delaware, No. 09-13705
46	Whitman-Turner Industries, Inc.	6/27/2009	\$0 - \$10	\$10 - \$100			\$1	Automotive and other parts	U.S. Bankruptcy Court, Western District of Michigan, No. 09-10008
47	Voyager Industries	8/11/2009						Parts supplier for various components used in various heavy trucks used in North America	U.S. Bankruptcy Court, District of Delaware, No. 09-13508

\*Revenue figures are based on the most recent financial statements available for each company as of January 31, 2009. Revenue figures are based on the most recent financial statements available for each company as of March 31, 2009. Updated September 3, 2009. Note: This filing was updated as it complete as currently known by OESA.





[Attachment 4]

**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 dealers from volume in November and December as car sales remain weak."
- "We continue to take a somewhat pessimistic view of the next year based on a weaker European vehicle market in 2010."
- "Economic recovery will be slow."
- "SIB concerned with a bit off in November and December as a result of cash for dealers."
- "Some and somewhat muted recovery, but not big."
- "Very cautious. While some indicators suggest production schedules remain stable and customers continue to bring out reorders, production schedules remain volatile and through company 2010 sales could not be as good as the past few years due to a good experience below freight cost earlier."
- "Other than about two volume improvements, I do not see any significant up-tick in expected volumes for 2010 versus what we have just done."

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**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."
- "We are still in a bit of a lull in July and August. Now customers are pulling orders in anticipation of what is to come."

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**Supplier Sentiment Index Compared to Two Months Ago, How has Your 12 Month Outlook Changed**

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**September 2009 Barometer Results By Company Revenue**

**September 2009 Barometer Results By Company Revenue**

- Significantly more pessimistic
- Unchanged
- Significantly more optimistic

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[Attachment 4]

**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	75	45	3	0
Maximum maturity of credit lines	8	53	43	3	0
Maximum size of commercial loans	13	30	51	7	0
Commercial loan interest rates	3	24	47	8	0
Commercial loan covenants	16	32	48	7	0
Commercial loan collateralization requirements	3	41	66	8	0
Maximum maturity of commercial loans	11	8	53	7	0

Notes: 1-5 using the following guidelines: 1= Tightened Considerably, 2= Tightened Somewhat, 3= Remained Basically Unchanged, 4= Relaxed Somewhat, 5= Relaxed Considerably

Progress: 89

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**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 Revenue	1	2	3	4	5
Cost of credit lines	6	3	11	0	0
Maximum maturity of credit lines	6	17	27	3	0
Maximum size of commercial loans	1	3	3	3	3
Commercial loan interest rates	4	5	24	3	0
Commercial loan covenants	9	17	24	1	0
Commercial loan collateralization requirements	1	3	5	3	3
Maximum maturity of commercial loans	4	7	17	0	0
Maximum size of commercial loans	7	6	17	0	0
Commercial loan covenants	3	7	3	0	3
Commercial loan collateralization requirements	4	5	19	0	0
Maximum maturity of commercial loans	6	4	16	3	0

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**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 Revenue	1	2	3	4	5
Cost of credit lines	6	3	17	3	0
Maximum maturity of credit lines	10	18	24	2	0
Maximum size of commercial loans	3	7	1	3	0
Commercial loan interest rates	2	6	18	0	0
Commercial loan covenants	4	9	41	7	0
Commercial loan collateralization requirements	2	7	6	2	0
Maximum maturity of commercial loans	1	3	19	1	0
Maximum size of commercial loans	8	7	20	1	0

Notes: 1-5 using the following guidelines: 1= Tightened Considerably, 2= Tightened Somewhat, 3= Remained Basically Unchanged, 4= Relaxed Somewhat, 5= Relaxed Considerably

Progress: 104

OESA Automotive Supplier Benchmark September 2006

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**Question 2 Comments:** 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?



**Company Revenue > \$500 Million**

- "We are still frustrated with the high cost of credit except with suppliers (auto parts suppliers)"
- "We have no commercial loans."
- "We amended our covenants in February and have taken no action since then."
- "We are investing in new program financing and capital was not a problem."
- "Recent restructuring of our asset, while completed successfully, calls for much closer adherence to annual guidance than in the past. We aim to reduce our debt and to restructure in the months ahead."
- "Borrow from parent company."
- "Cannot get any lines of credit."
- "The banking sector appears to be emboldened to run their play-to maximize profits and revenue due while leaving the auto industry as it was before."

OESA Automotive Supplier Benchmark September 2006

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[Attachment 4]

**Question 2 Comments (continued):** 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?



**Company Revenue \$500 Million or less**

- "Tightest issue is that leasing of equipment is non-existent. No one even wants to discuss it."
- "Lenders generally want to get out of lending to automotive. Government support is critical to keep us afloat."
- "We renegotiated our bank agreements in April 2009 and our situation has not changed since then. Overall liquidity actually has improved."
- "No external debt at our U.S. subsidiary. Financing is provided internally through foreign parent."
- "We renewed the line with our bank in February and nothing has changed since then."
- "Just completing Chapter 11 process and there have been large changes with bank terms."
- "In the process of refinancing loan agreement. Terms are more aggressive in all areas."

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**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	47	41	14	0	1
Accounts payable financing	39	39	23	3	0
Plant and equipment investment	71	0	0	15	0
Other working capital needs	29	34	34	10	3
Merger & acquisition opportunities	17	12	34	17	14
Program consolidation opportunities	10	12	34	0	0

Refer to using the following guidelines: 1= Significant confidence; 2= Moderate confidence; 3= Neither confident or unconfident; 4= Moderately unconfident; 5= Significant low confidence

Source: n = 98 OESA Automotive Supplier Barometer September 2009 18

**Question 2 Comments (continued):** 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?



**Company Revenue \$500 Million or less (continued)**

- "Banks have been really renegeing... this will cause a lot of shifting of relationship to other banks as more improvements come with time."
- "Our firm had that very tight credit issue during the slowdown."
- "We are being forced to turn back to reduce their exposure at much higher interest rates and fees."
- "Lenders do not come from outside banks."
- "Our lead bank wants out of automotive and will do anything to facilitate that desire."
- "We are a year-and-a-half away, so that for the first year revenue has been neutral... we are evenly communicating with our stakeholders... including the banks."
- "Unable to establish relationship, the process would have generally been completed in the past event scenario, the process would have generally been completed to establish relationship, but we have had expressed interest from non-bank financing sources to provide financing."

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**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)



	1	2	3	4	5
\$500M or less	14	39	0	1	3
\$500M to \$1B	26	29	0	0	0
\$1B to \$500M	14	12	1	1	0
\$500M to \$1B	24	24	15	1	0
\$1B to \$500M	1	1	1	1	0
\$500M or less	15	23	14	16	0

Refer to using the following guidelines: 1= Significant confidence; 2= Moderate confidence; 3= Neither confident or unconfident; 4= Moderately unconfident; 5= Significant low confidence

Source: n = 98 OESA Automotive Supplier Barometer September 2009 20

[Attachment 4]

**Question 3 Comments:** 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?

**Company Revenue > \$500 Million**

- "We will continue to receive financial support from our headquarters."
- "These companies with no debt. No issues."
- "New debt agreements provides less flexibility than under past economic conditions."
- "Not planning on borrowing."
- "I really couldn't tell and factory's security upgraded us."

OECSA Automotive Supplier Barometer September 2009 23

**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)

Confidence Level	1	2	3	4	5
< \$500 Million	10	11	8	4	3
\$500 Million or less	16	23	17	7	1
<b>Total</b>	<b>26</b>	<b>34</b>	<b>25</b>	<b>11</b>	<b>4</b>
<b>3-Step Method</b>	<b>3</b>	<b>9</b>	<b>11</b>	<b>8</b>	<b>3</b>
\$500 Million or less	10	11	15	14	14
> \$500 Million	1	2	3	4	3
\$500 Million or less	1	9	13	4	1
> \$500 Million or less	9	21	23	1	1

Rated 1-5 using the following guidelines: 1= Significant confidence, 2= Moderate confidence, 3= Neutral confidence or uncertain, 4= Moderately unconfident, 5= Significant lack of confidence.

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**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?

Response	Percentage
YES	37%
NO	63%

Responses = 199

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**Question 3 Comments (continued):** 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?

**Company Revenue \$500 Million or less**

- "We are currently in discussions with our suppliers to see if we can get some financing for getting the business through competitors. The bank does not seem to respond very quickly."
- "Access to acquisitions are being supported."
- "Credit remains very tight for all needs."
- "We are currently in discussions with our suppliers to see if we can get some financing for getting the business through competitors. The bank does not seem to respond very quickly."
- "We are currently participating in the Volvo Supply Chain Financing program."
- "Accounts payable helps finance inventory--it should not have been on this survey."
- "Ford Chapter 11 balance sheet and capital position will be good."
- "We are working hard to reduce our risk and are not putting new money in the auto market."
- "For a company of our size, we have plenty of access to capital for the above transactions."
- "Bank liquidity improved with low position, and cost reductions year to date."
- "We will likely be more restrictive in seeking capital than being able to obtain it."

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[Attachment 4]

**Question 4 Comments:** Over the past six months, has your company in-sourced material fabricating or component manufacturing that was previously produced by an outside supplier?



- YES**
- "Integrated a spring manufacturer"
  - "Tried to shift the burden of decreased volumes with our supply base and only in-sourced a few items that were not profitable to produce in-house."
  - "Took on work of a bracket supplier by purchasing their equipment. We saw this as both an offensive and defensive move as the suppliers of this product were all dormant then, and the expertise required was better in another product we already manufacture."
  - "Integrated a spring manufacturer"
  - "Brought in engineering from a firm that was previously subcontracted."
  - "We continue to in-source bearings in our Mexican operations."
  - "In-sourcing was part of the cost reduction program early 2009, but we still left work with suppliers of strategic importance."
  - "We are currently evaluating and considering in-sourcing items in capacity freed by the downturn."
  - "Yes, but not a significant amount."

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**Question 4 Comments (continued):** Over the past six months, has your company identified, allocating or component manufacturing that was previously produced by an outside supplier?



- YES (Continued)**
- "No longer using contract manufacturers for our final assembly, we are doing less low volume."
  - "Began work on vertical integration and capacity utilization, we are in-sourcing to fill open capacity at a contract manufacturer."
  - "Plastic components."
  - "We have moved work in on terminal frames: a unique component produced across several for assembly work centers."
  - "We have in-sourced die to supplier factors. We are loyal to our die die suppliers in light of..."
  - "A metal subproduct supplier."
  - "Machining."

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**Question 4 Comments (continued):** Over the past six months, has your company in-sourced material fabricating or component manufacturing that was previously produced by an outside supplier?



- NO**
- "We have had limited failures in our supply base and have been able to transfer subcontracting to alternative suppliers."
  - "Tooling repair and some significant maintenance items have been completely in-sourced."
  - "We are currently considering in-sourcing a critical component due to supply base constraints."
  - "Our supply chain is relatively stable."
  - "Nothing significant."
  - "However, we are in-sourcing processing of materials we manufacture."
  - "No, we have looked at it even though there is not a significant amount of business in that area."
  - "We have had some business in the future with our automotive Tier 1s, but we have not pulled any business inside."
  - "However, joint work to in-source certain components within the next 6-12 months."
  - "We have discussed non-core or marginal parts of the business and dramatically reduced our Tier 1 footprint."
  - "And that business, we have done some more subcontracting."
  - "We in-sourced in 2008-2009, but nothing since then. Everything that we could in-source we have already done."

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**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	10.77	9.53
Median	10.10	9.50
Upper Quartile	11.00	10.00
Lower Quartile	9.50	8.53

Response = 88

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[Attachment 4]


**Question 5 Comments (continued):** Considering North American light duty vehicle production, what is your 2010 planning volume and estimated breakeven volume? (in millions of units)



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- "Averaged for 2010, even though we expect 2nd half of year to be average."
- "We can breakeven at 11 million NA volume but we will not generate any resources for growth."
- "We are currently at 11 million NA volume but we will not generate any resources for growth."
- "We need to continue to reduce our operating footprint."
- "This question is not applicable to our firm. We serve very specific markets and are typically planning, even as it is only 13% of our total business."
- "Global fleet's breakeven changed in 2010 forecast since March 2009. It is been around 9.8-10.0."
- "No to the breakeven."


**Question 5 Comments:** Considering North American light duty vehicle production, what is your 2010 planning volume and estimated breakeven volume? (in millions of units)



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- "Our non-auto business is larger than our automotive business and profitable. Therefore, the competition can be profitable at current vehicle volumes, but will require approximately 12 million vehicles annually to be profitable in the automotive business sector."
- "We are currently at 11 million NA volume but we will not generate any resources for growth."
- "We expect 2010 volume to suffer from the cash for customers pull ahead."
- "This is an interest effect, it had we are an engineering services provider. However, if the market corrects 11 million units, then my customers will be provided to open the floor coffers."
- "We are currently at 11 million NA volume but we will not generate any resources for growth."
- "These are for fiscal year 2010 from April '10 to March '11."
- "We are now structured to break even at significantly lower volumes than in the past."

**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)



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**Cash flow improvement (8 responses)**

- "Of course, it will help to cash flow for tooling. Other than that we don't see much change."
- "Tooling we currently fund \$5-\$10 million in customer tooling costs at any point in time, our cash flow would be significantly improved from our current state as just over \$100 million."
- "Cash flow improvement to cash payments, now deferring their payments to meet our supply base."

**Already financing Progress Payments (8 responses)**

- "Currently we are asking most customers to make tool progress payments. This cost change would be our customer."
- "Customers already give us 40-50% of progress payments in most sectors."

**Not Applicable (8 responses)**

**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)



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**Slight Reduction (in or under 4% cost reductions) (23 responses)**

- "Straight mathematical effect to price."
- "Yes, we would build less tooling in it."
- "We are currently at 11 million NA volume but we will not generate any resources for growth."
- "Not applicable. We have shifted burden to suppliers and are using EOC financing. Maybe a few percent pick up."
- "We expect progress payments. Add interest + risk premium if they do not pay in progress."
- "This would likely reduce our cost of tooling by 3% as it would help the low floors operate and reduce our tooling costs. It would also increase the number of shops tooling."

**Significant Change (greater than 4% reduction) (2 responses)**

- "This cost would be reduced by at least 10%."


**NO CHANGE or Not at Issue (28 responses)**

- "There would likely improve, but tooling costs are what they are and we would not increase our tooling costs."
- "Adding a 3 month tooling lead time to PPAP, very little to zero, is a competitive edge. Now that for automotive lead time tooling there is very little cost of capital allowed in the buying tool."



[Attachment 4]


**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)



Company Revenue	1	2	3	4	5
\$100 million	0	0	1	1	0
\$500 million or less	11	17	17	14	8
More than \$500 million	0	2	2	3	3
None Addressed	0	1	1	1	1
Some Addressed	5	6	6	6	12
All Addressed	1	1	1	1	1
Don't Know	14	0	3	1	1
Total	16	17	15	8	4
Valid Responses	1	1	1	1	1
Invalid Responses	0	0	0	0	0
Total	1	1	1	1	1

OESA Automotive Supplier Barometer September 2009 28

**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)




Company Revenue	1	2	3	4	5
\$100 million	0	0	1	1	1
\$500 million or less	7	17	13	9	10
More than \$500 million	1	3	3	4	5
None Addressed	0	1	1	1	1
Some Addressed	5	10	10	10	13
All Addressed	1	1	1	1	1
Don't Know	0	1	1	1	1
Total	10	13	13	4	10

Valid 1-5 where 1 = most valuable and 5 = least valuable

OESA Automotive Supplier Barometer September 2009 27

**Question 7 Comments (continued):** 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?




**Company Revenue \$500 Million or less**

- "Government being to support capital investments to make growth plan more viable"
- "Government should be out of this - it's time for the market to sort itself out"
- "Not sure we want government help, would allow the marketplace to sort things out or there is no reward for those of us who planned properly and ran our business conservatively"
- "Many of the above are already in use by our company"
- "Government should take a high technology, (and the other) never be approached and it's worse. Government would take a high technology, (and the other) items are implementing now"
- "Government guarantees will help to get 100% credit for re-investments and help up additional cash for working capital"

OESA Automotive Supplier Barometer September 2009 40

**Question 7 Comments:** 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?



**Company Revenue > \$500 Million**

- "I responded for my contractors, as I responded for our suppliers, I would give almost all a '1' or '2' in order to reduce our risk of more suppliers going bankrupt"
- "Not relevant"
- "Phase 41 depend on cost. The DM program did not help as it was too expensive."
- "Our liquidity and cash flow is stable"
- "Government should not 'help' the industry any more"
- "Government should help the industry by providing more support for research and development, technologies that the broad population could benefit from. Financial supports only benefit a narrow portion of the market."

OESA Automotive Supplier Barometer September 2009 38

[Attachment 4]

**Question 7 Comments (continued):** As you look at your capital structure, how valuable would the following governmental actions be to improve your business situation?



- Company Revenue \$500 Million or less (continued)**
- "Our bank will not increase exposure because of government guarantees. Personally, I feel the government is too engaged already. Yes, it may be nice to help a company survive but I am opposed to that. I think the government should be more involved in the industry and help with the recovery." (O'Flynn / GM CH 117)
  - "We as an industry make the mistake in 2008 and 2009 of getting too heavily involved in government. Government needs to get out of direct control of individual firms. Some firms need help for the short term but we need to get healthy. Broad law policy to help our overall job function is most valuable and that industry would get healthy. Broad law policy to help our overall job function is most valuable and that industry would get healthy. Broad law policy to help our overall job function is most valuable and that industry would get healthy. Broad law policy to help our overall job function is most valuable and that industry would get healthy." (I feel that the firms that the bank regulators are doing well out ways the good the government can do. I think the working back of the over-fortification risk avoidance required by the regulator would help more than government guarantees.)

**Question 8 Comments:** Identify the top three perceived risks to your 2010 North American business plan.



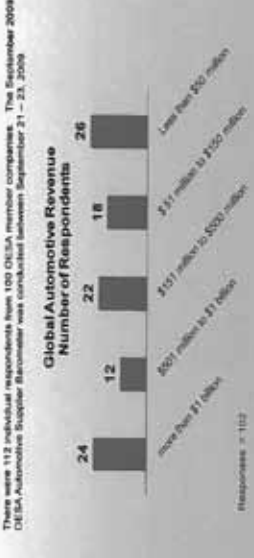
- "If our bank suddenly withdraws through issue loans, and immediately launch the new program, we would have a very tight 2010 year."
- "Too much uncertainty."
- "Too much focus on short term cash generation at the expense of longer term investment in growth. Bank side subsidies again, there is no way to make a profit without a major restructuring of the bank."
- "Being small business we do not understand the potential impact of cap and trade, health care changes, etc."
- "Balance employment recovery will be biggest indicator of improving business conditions."
- "Highly dependent on government support. The difficulty is the program financing. It will be difficult to establish relationships with the program financing."
- "Vehicle sales volume is the number one risk factor. Increases volume will help ease the credit market."

**Question 9 Comments:** Identify the top three perceived risks to your 2010 Global Automotive Supplier Business September 2009



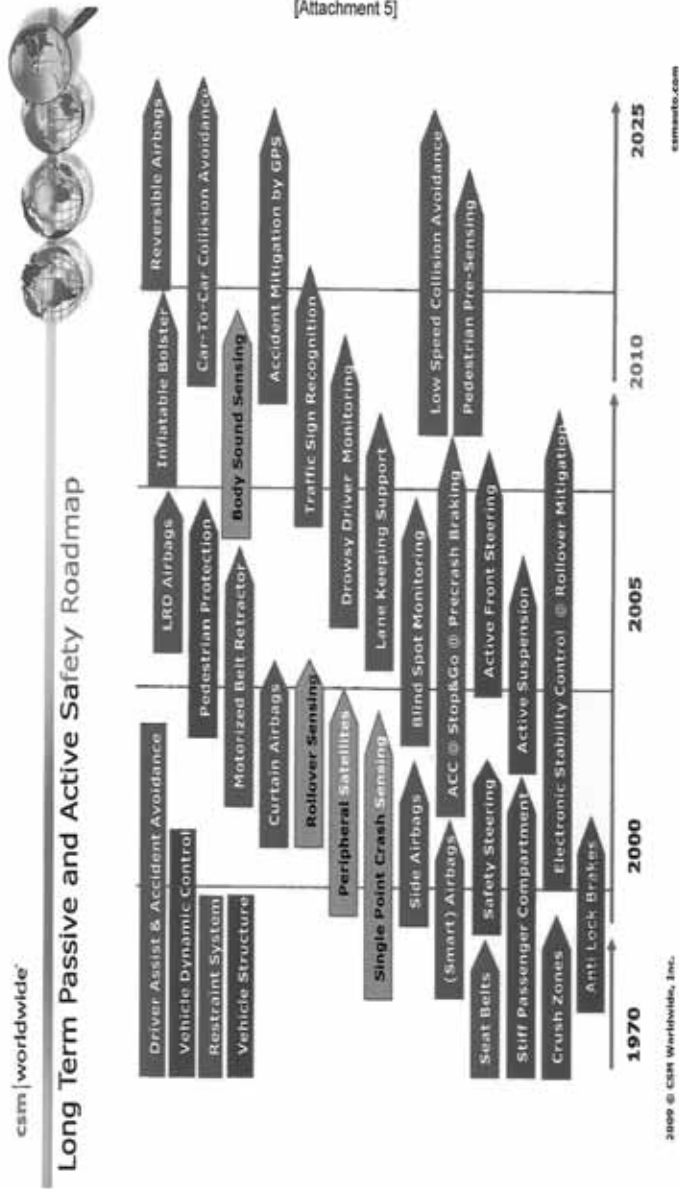
- Production volume and schedule accuracy risk (33, 18, 7 responses)
  - Energy and raw material availability and pricing (4, 12, 16 responses)
  - OEM/customer financial stability (4, 15, 17 responses)
  - Sustained economic recovery (13, 4, 6 responses)
  - Supply chain financial stability (1, 5, 9 responses)
  - Governmental and consumer credit (2, 15, 19 responses)
  - Supply chain financial stability (1, 5, 9 responses)
  - Program cancellations, delays (0, 3, 3 responses)
- Other issues including multiple mentions:**
- Workforce - restriction and engagement
  - Exchange rate changes
  - Negative pricing
  - Credit flow
  - Oil/shore sourcing

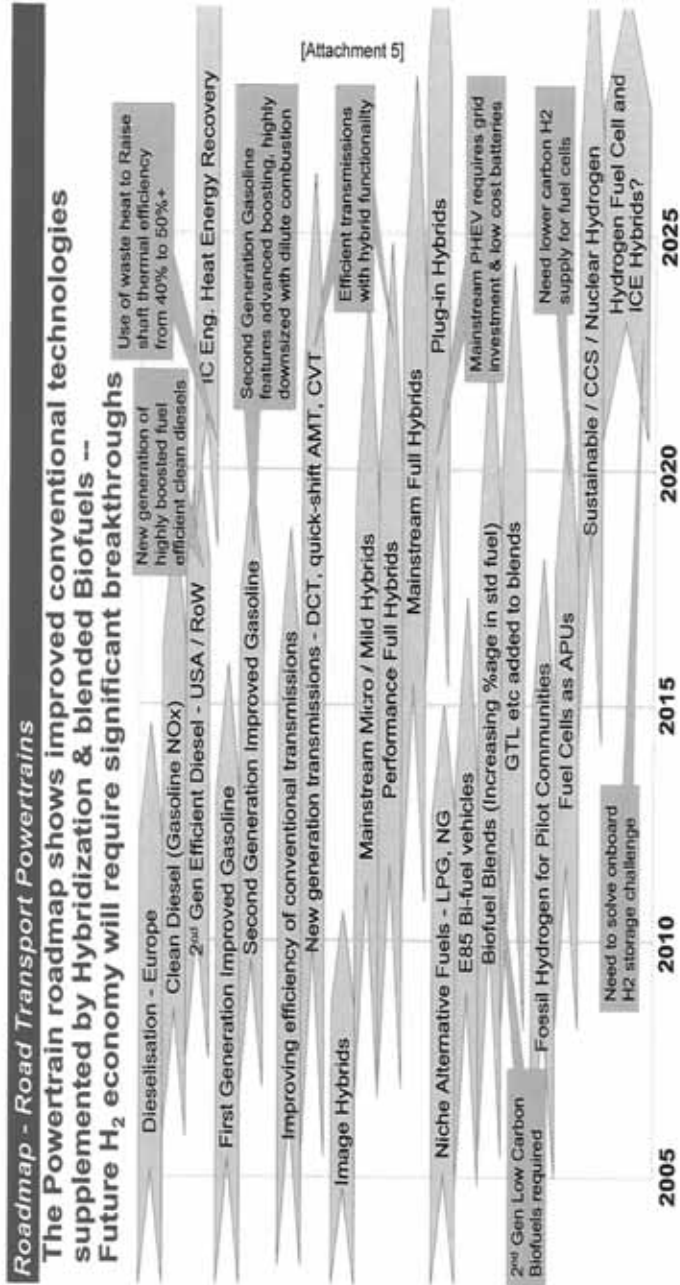
**Question 10 Comments:** Identify the top three perceived risks to your 2010 Global Automotive Supplier Business September 2009





[Attachment 5]





**PREPARED STATEMENT OF ROBERT C. KIENER**

DIRECTOR OF MEMBER OUTREACH, PRECISION MACHINED PRODUCTS ASSOCIATION

OCTOBER 9, 2009

Chairman Brown, Ranking Member DeMint, Members of the Committee, thank you for the opportunity to testify before you today on restoring credit to small and medium-sized manufacturers (SMMs). My name is Rob Kiener and I have been with the Precision Machined Products Association (PMPA) for 18 years working with our nearly 500 members—companies from around the country. Prior to joining PMPA, I worked on the shop floor in a precision parts company, having spent time during high school and college at a screw machine shop in the secondary machining department and quality lab. More than half of our members have fewer than 50 employees. They manufacture highly engineered components using a variety of materials such as: steel, stainless steel, aluminum, brass, and aerospace alloys for the defense, medical, automotive, and agriculture industries, among others.

**Current SMM Credit Crisis**

Small and medium-sized manufacturers are often trapped between the troubles of their much larger customers and financial institutions. SMMs began reporting challenges accessing traditional lines of credit in October 2008. Today, many companies in our industry report their business is down roughly 40 percent and that they have significantly reduced their workforce.

Countless members I speak with who still manage to maintain profitability tell me they have held decades long relationships with their bank but are now being told they must offer their life insurance collateral to help secure a loan—this is a true story from an Ohio-based manufacturer.

Even when a manufacturer seeks to renew a loan with its existing bank, it can take 3 to 4 months to process based on all the new lending requirements and paperwork to complete, despite taking no more than 30 days in the past. In our industry, small manufacturers are required to purchase raw materials on their own, in some cases not seeing full payment for up to 6 months. Without access to adequate and timely credit, these delays can cause significant disruptions in the Nation's critical supply chain including in emerging green industries, stifle economic growth, and risk national security. If our customers cannot receive the products they need, they will source them from overseas—these lost jobs, once outsourced, will never come back to the U.S.

Several surveys of metalworking manufacturing companies estimate that roughly 75 percent of these businesses cannot secure sufficient credit for day-to-day operations, equipment acquisition, and expansion, among other activities. In most cases, an SMM will see their line of credit significantly reduced, revoked, or a loan called due to the health of their manufacturing customers or lenders and not because of their own business decisions. While we understand some in the Administration and industry believe we have an overcapacity in the manufacturing sector that requires some consolidation, without a financial bridge to support acquisition by those remaining companies disruptions in the supply chain will continue.

I recently heard a story of a company asked to leave their bank despite violating no terms of their loans over a 23-year relationship with the lending institution. The bank told this business that they were reducing their exposure in manufacturing and automotive industries and that they would have to leave the bank—this despite the lender receiving TARP funding. Another Ohio company incurred more than \$600,000 in added expenses due to changes their lender demanded in their loan agreement.

Beyond access to credit today, one of our major concerns is as the economy picks up and we see an increase in job orders, will manufacturers be able to have the capital they need to invest in employees, equipment, and raw materials? If they do not, there is no doubt in my mind that we will lose those jobs to overseas manufacturers who already maintain a production cost advantage over U.S. businesses. The Federal Government is urging manufacturers to diversify into green industries, but without adequate and timely access to capital companies cannot make this investment and transition, which will only further China's goal of producing 90 percent of the world's solar panels.

A survey of metalworking companies shows 72 percent anticipate challenges accessing adequate lines of credit when volume grows. We are already seeing companies that are trying to expand their operations due to consolidation in the industry who are not able to access capital to fill job orders, purchase steel, and hire workers. The cash-for-clunkers program is a perfect example of the challenges ahead. As dealers and automotive manufacturers have depleted their inventories, they are looking to suppliers to increase their output. Similarly, manufacturers of wind tur-

bines and solar panels will see shortages of domestic suppliers if SMMs cannot adequately ramp up production to meet a surge in demand as Federal funds continue to flow to those technologies. The current system does not even reward our small business exporters, as manufacturers are unable to borrow against their foreign sales even if their customer's headquarters is in the U.S. A lack of access to capital to fill these job orders will cause disruption in the supply chain, risk our national and economic security, and Americans will lose the opportunity to sustain and create jobs to overseas competitors.

To simply blame the banks is not an accurate representation of the current crisis. Several manufacturers who also serve on the boards of financial institutions have indicated that many banks are not lending to manufacturing businesses because of fear of having their rating level reduced by Federal regulators. This scenario is extremely troubling if indeed widespread. In these economic times, the Federal Government's policies should not create an environment in which manufacturers struggle to access adequate and timely credit. The Nation's economy, in which manufacturing accounts for 12 percent of GDP, cannot recover without a sound manufacturing base.

### **Restoring Credit to SMMs: Opportunities and Potential Challenges**

In order to ensure a timely and sustained recovery, the Administration and Congress must take proactive steps to support manufacturing in America. The first step is to reassure financial institutions that returning to sound lending practices with manufacturers is good for their business and critical for the country. Many of these companies are simply temporarily impaired and need a bridge into the next year as business conditions improve. These temporarily impaired manufacturers have a long history of profitability, did not break loan covenants, and maintained steady relationships with their lenders—they struggle today through no fault of their own but because they are in the manufacturing business.

We believe the Administration has the authority to work with creditors and borrowers to establish a mechanism by which lenders can loan to manufacturers without fear of a reduced credit rating. In addition, the Department of Treasury, through existing loan facility funds, should reassure financial institutions that lending to small and medium-sized manufacturers will deliver a return on investment through a public-private guarantee of loans or accounts receivable program. Many SMMs need a return to traditional lending, while other companies and their lenders require reassurance that their customers will pay their outstanding accounts receivable. While guaranteeing loans is critical to supporting all manufacturers, guaranteeing accounts receivable is particularly important to SMMs requiring an immediate injection of cash to continue operations. PMPA and other metalworking industries are working with the Department of Commerce Manufacturing Council and members of the Administration on such proposals.

Since enactment of the stimulus bill, policymakers place much emphasis on the Small Business Administration as a primary solution to the credit crisis facing SMMs. One anecdote from Michigan tells much of the story: when a metalworking executive asked an SBA official in June 2009 if he was aware of any banks lending to automotive suppliers under SBA programs in the State he stated he was not. In the current environment, lenders do not believe many manufacturers are "bankable." If these businesses are not "bankable" even under a 90 percent Government guarantee program, then it is clear the Federal Government must take additional steps to reassure lenders that investing in manufacturing is a sound decision.

The Michigan example aside, our members report additional challenges with SBA programs such as 7(a) and 504 from the borrower's perspective. The first concern remains the personal guarantee required under SBA programs. Most manufacturers cannot put forth their family home and children's assets to secure a loan. More than 70 percent of SMMs are structured as family owned S Corporations or LLPs, meaning it is the family that must provide the guarantee whereas a traditional C Corporation will not face similar burdens. This is another aspect of the current financial structure that demonstrates a discrimination against small and medium-sized manufacturers. Even when an SMM decides that they have no choice but to apply using a personal guarantee, the lengthy and costly process and paperwork involved is too much for smaller applicants who lack the full time and unlimited internal accounting services that their larger competitors maintain. Although several of our members indicated that increasing the SBA 7(a) loan limit to \$5 million may make this program more attractive, most still cite an even larger personal guarantee requirement.

Mr. Chairman, we must all work together—lenders, manufacturers, and Government—to ensure we foster an environment that encourages manufacturing in America. A number of factors in the current financial conditions serve as disincentives

for lenders to invest in small- and medium-sized businesses. Our customers will still require parts, regardless of our financial condition. We must maintain a strong domestic supply chain with solid and stable lending to manufacturers to fill job orders and are prevent millions more manufacturing jobs from going offshore. If these trends continue, stimulus projects will go unfulfilled, inventories will not rebound, and medical and defense supplies will not reach our citizens and soldiers.

We appreciate your efforts and that of your staff in drawing additional public attention to this important issue. Thank you for the opportunity to testify before you today and I look forward to continuing to work with you to strengthen manufacturing in America.

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**PREPARED STATEMENT OF STEPHEN P. WILSON**

CHAIRMAN AND CHIEF EXECUTIVE OFFICER, LCNB NATIONAL BANK, ON BEHALF OF  
THE AMERICAN BANKERS ASSOCIATION

OCTOBER 9, 2009

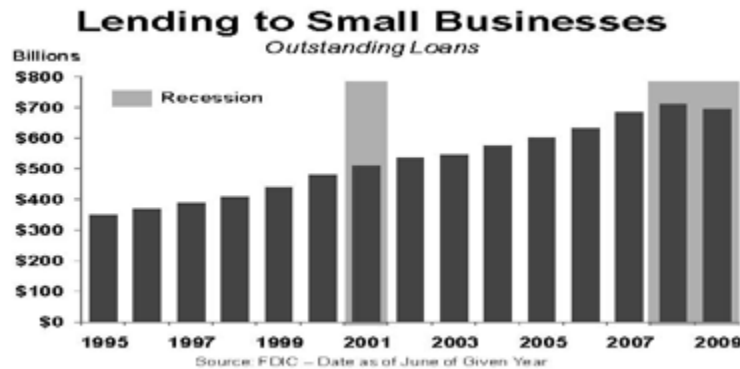
Chairman Brown, Ranking Member DeMint, and Members of the Subcommittee, my name is Stephen Wilson, Chairman and CEO, LCNB Corp. and LCNB National Bank, Lebanon, Ohio. I currently serve as the chairman of the Government Relations Council of the American Bankers Association (ABA) and will assume the role of Chairman-Elect of the association at the end of this month. LCNB National Bank is a full-service bank offering trust and brokerage services, along with insurance through a subsidiary. We have over \$700 million in assets, and our bank has served our community for 132 years. I am pleased to be here today on behalf of ABA.

The American Bankers Association 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 \$13.3 trillion in assets and employ over two million men and women.

We are pleased to share the banking industry's perspective on the impact this recession is having on lending to small and medium-sized manufacturers. 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. In fact, most banks have been in their communities for decades and intend to be there for many decades to come. The LCNB National Bank has survived many economic ups and downs for 132 years. We are not alone, however. In fact, there are 2,556 banks—31 percent of the banking industry—that have been in business for more than a century; 62 percent (5,090) of banks have been in existence for more than half a century. 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 the 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.

In this severe economic environment, it is only natural for businesses and individuals to be more cautious. Businesses are reevaluating their credit needs and, as a result, loan demand is declining (see chart below). Banks, too, are being prudent in underwriting, and our regulators demand it. With the economic downturn, credit quality has suffered and losses have increased for banks. Fortunately, community banks like mine 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. The difficult recession, falling loan demand, and loan losses have meant that loan volumes for small businesses have declined somewhat this year (see chart below). 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.



We believe there are actions the Government can take to assist viable community banks to weather the current downturn. The success of many local economies—and, by extension, the success of the broader national economy—depends in large part on the success of these 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 my statement, I would like to focus on the following points:

1. Banks continue to lend in this difficult economic environment, but the broadening economic problems have already started to impact lending.
2. Lenders and borrowers are exercising a prudent approach to credit.
3. Changes in the regulatory environment would improve the situation for small business lending.

I will address each of these points in turn.

**1. Banks Continue To Lend in This Difficult Economic Environment, but the Broadening Economic Problems Have Already Started To Impact Lending**

Since the recession began over 21 months ago, banks have continued to provide credit to their customers. The impact of the downturn, however, 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 six straight quarters of job losses—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. The impact of job losses on delinquencies is illustrated in the chart above.



One small business segment that has been particularly hard hit in my region is the automobile supply chain. Manufacturers that produced for the automobile industry were dealt a hard blow with the economic downturn and the subsequent drop-off in automobile sales. Suppliers' customers went bankrupt, wiping out receivables in the process. Many suppliers lowered production and slimmed down to wait out the storm; others hoped to retool in order to create parts for other industries. The economic downturn had also affected the value of their collateral. This double-whammy of severely decreased cash flows and low collateral values made new borrowing difficult to find, especially without established relationships with lenders.

However, even this segment is seeing some improvements. In the September 2009 Supplier Barometer survey, produced by the Original Equipment Suppliers Association (OESA), automotive suppliers report a growing optimism for the 12-month outlook. In addition, they report they are "generally confident that they will have access over the short-term to capital in the amounts and costs necessary to fund their businesses." This echoes the sentiment reported in PNC's recent Small Business Survey, released this week, which noted small business owners are much less pessimistic about their own company's prospects over the next 6 months. Last spring, 36 percent of owners reported pessimism, whereas this autumn, that figure had dropped to 25 percent, comparable with the outlook among small business owners prior to the Lehman collapse. There is still a long way to go, but we remain hopeful that the recovery is underway.

## **2. Lenders and Borrowers Are Exercising a Prudent Approach to Credit**

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 higher-risk projects that might have been funded when the economy was stronger may not find funding today.

It comes as no surprise, then, that businesses are being very cautious. 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, 32 percent of businesses reported regular borrowing in August (down one point from July) compared to 7 percent who reported problems in obtaining the financing they desired (down 3 points). 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.

Our expectation is that loan demand in this economy will continue to decline. Loan delinquencies and losses, which often lag the overall economy, will also continue to impact banks. Thus, realistically, the level of lending outstanding to all businesses will continue to decline for the rest of this year. 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.

We recognize that there are some consumers and businesses in the current situation that believe they deserve credit that is not being made available. In some cases, 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.

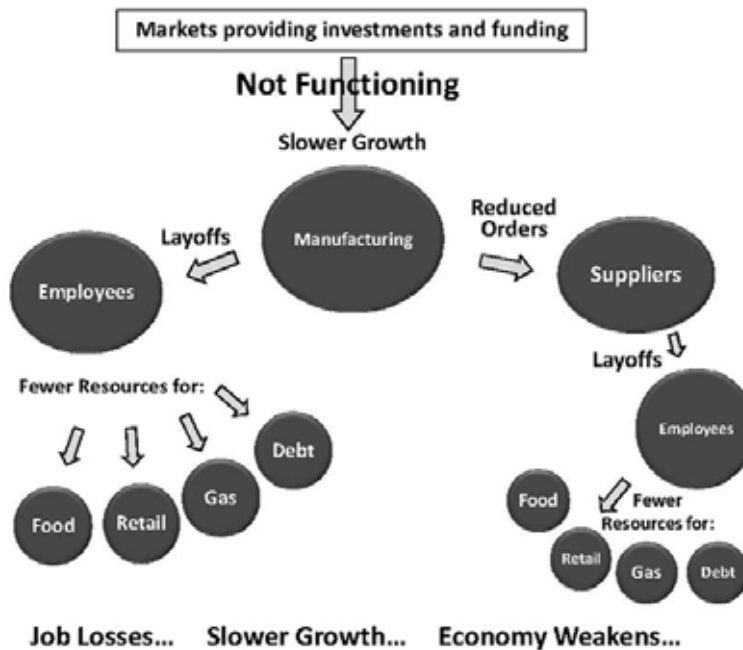
I have an example that illustrates this. We had a customer who we turned down on an application for a loan. The customer was frustrated and angry, and left our bank. Recently, he e-mailed me to say he should not have been granted that loan and that he is coming back to our bank. He said that if he would have accepted our response instead of looking elsewhere, he would have been in better financial stature now. He moved back to our bank, he said, because he appreciates the fact that when we underwrite loans, we are concerned about the success of our customers and whether the loan makes sense for them.

We do not turn down loan applications because we do not want to lend—lending is what banks do. When banks consider an individual loan application, we have to place it in the context of the economic environment. For small local businesses, banks will consider local economic conditions in addition to any specific issues that may affect the business.



The July Senior Loan Officer Opinion Survey by the Federal Reserve bears this out. The survey found that the number one reason for a more conservative approach to underwriting was the poor outlook for the economy. Of that segment of the banks that had tightened lending, more than 70 percent said that the “less favorable or more uncertain economic outlook” was a “very important” reason for tightening credit standards or loan terms (and 30 percent said it was “somewhat important”). Concerns with the outlook in individual business sectors was also noted as a problem. “Worsening of industry-specific problems” was cited by 43 percent as a “very important” driver of these changes (with another 49 percent saying it was “somewhat important”). This is the context that banks must consider when evaluating a loan application. For example, if a developer came into our office wanting to build spec homes, we would be very hesitant to make this kind of loan in today’s housing environment.

The current credit markets have tightened largely because of problems outside the traditional banking sector. Many large manufacturing companies, like the auto companies, relied on funding that came directly from investors, not banks. However, when those funding sources dried up, the impact cascaded down the supply chain.



In fact, because of the funding problems associated with individual investors, the traditional banking sector will have to play an even larger role in providing credit to get the economy growing again. Banks are anxious to meet the credit needs of businesses and consumers, and we know that such lending is vital to an economic recovery in communities large and small across the country.

### 3. 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. Here are a couple of the factors that are impeding greater bank lending:

- *FDIC premium payments are impacting banks' ability to make new loans:* Perhaps the most immediate threat hampering banks' ability to make new loans is the very high premiums being paid by banks to the FDIC. This year alone, the banking industry will be paying at least \$17 billion to the FDIC. The recent proposal by the FDIC to pay expenses over a longer period of time, rather than having a huge payment all at once, is promising. Banks have paid the full cost of the FDIC for 75 years now, and banks will assure the financial health of the FDIC during this difficult period. It is absolutely critical how those obligations are repaid so as not to further exacerbate the poor economic conditions.
- *Supervisory responses to the crisis threaten to stifle new lending:* 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 also have heard complaints from other banks about examiners being inappropriately tougher in their analysis of asset quality and 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. Commendably, the bank regulators are publicly encouraging lenders to work with their borrowers who are doing the right thing in good faith during these challenging times. But the current regulatory environment essentially precludes banks from being able to do that. 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 Brown, for the opportunity to present the views of the ABA on the challenges ahead for the banks that serve small businesses and manufacturers. These are difficult times and the challenges are significant. In the face of a severe recession, 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.