INITIATIVES TO PROMOTE SMALL BUSINESS LENDING, JOBS, AND ECONOMIC GROWTH

HEARING

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INITIATIVES TO PROMOTE SMALL BUSINESS LENDING, JOBS, AND ECONOMIC GROWTH

Tuesday, May 18, 2010

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 1 p.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Waters, Maloney, Velazquez, Watt, Sherman, Moore of Kansas, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Bean, Moore of Wisconsin, Perlmutter, Donnelly, Foster, Carson, Minnick, Adler, Kilroy, Himes, Peters; Bachus, Royce, Biggert, Hensarling, Posey, Lee, and Lance.

The CHAIRMAN. The hearing will come to order.

We are here today to discuss a very important program which has been forwarded to us by the Administration. The lack of credit available to smaller businesses has been a serious problem in the economy and has concerned the Members here. We have had previous hearings on the subject, one in which blame for that situation was somewhat passed around. We have had arguments that the regulators have been too tough, that the banks have not been willing to lend, and that the demand is not there on behalf of the small businesses.

We will continue to deal with this. But today, we will hear a proposal that should alleviate the situation from all accounts by making more funding available to the small banks in a way that includes some serious effort to ensure that money is in turn lent. Clearly, getting more funding for small businesses that are ready to expand or that need funding to even stay where they are is a critical part of our number one job right now, which is to continue the recovery.

We are seeing the beginnings of a recovery. There have been very encouraging signs, including very good job numbers last week, somewhat obliterated 2 weeks ago by the stock market gyrations. But that is an argument for doing more, not less. I believe the economy has been responding to a variety of public policy initiatives, in addition of course to the dynamism of the economy itself and the natural countercyclical efforts; as inventory is drained, inventory gets restocked.

But it is important for us to build on initial successes and not in any way be complacent because there are very serious needs in the economy and we believe this is a very thoughtful approach. I should say at the outset that there is one thing which we understand is not here in the bill, and that this is how this will be paid for. There is a CBO score, it is an interesting situation, which CBO tells us I believe that this will cost some money in the first 5 years, but over 10 years, will make money for the Federal Government. That is a factor that we will be keeping in mind.

But the bill that we have before us today, which will be marked-up tomorrow and could go to the Floor next week, is, for that reason, an authorization. If this bill were to pass unanimously in the House tomorrow or next week, it would not lead to the spending of money until the House says, and the Senate and the President subscribe to a way to pay for it. So, yes, we understand this is a very important program that should be paid for. We will be dealing as a legislative body with the mechanism for paying for it.

I will say this: One proposal early on had been to pay for it in the TARP. Nobody likes the TARP at this point. And if you were to use TARP funds for this program, you wouldn't have a program unless you reinstated the draft. But since we are not likely to draft people to be in this program, it is not going to be in the TARP. And there will be no TARP trappings, no TARP restrictions, and, I believe, no TARP oversight. There will be oversight. There will be other requirements, but it will be entirely separate from the TARP because we want to get people involved.

With that, I now recognize the ranking member for 4 minutes.

Mr. BACHUS. Thank you, Mr. Chairman, for calling today's hearing to consider these two recently introduced bills designed to jump start lending in small businesses.

While Republicans share the goal of promoting credit availability for small businesses, many of us in the Minority disagree that the best method for achieving the goal is to create a new $30 billion program that is not paid for and that follows a model of government investment in private businesses that most Americans want to see brought to an end, and that is the bailouts. I count myself as one of those who wants to see all bailouts come to an end.

We are told that this new program is not TARP and that no TARP funds will be used to pay for it. But the reality is considerably more complicated than that. Indeed, Neil Barofsky, the Special Inspector General for the TARP, wrote in a letter to the Appropriations Committee yesterday that, "in terms of its basic design, its participants, its application process, and perhaps its funding source, from an oversight perspective, the small business lending fund would essentially be an extension of TARP's Capital Purchase Program."

While I take Chairman Frank at his word that he has rejected the Administration's original proposal to pay for the new initiative from repaid TARP funds, the fact that no funding source has yet to be identified gives rise to legitimate questions about taxpayer accountability that must be answered before this committee votes to authorize another $30 billion in new spending, particularly on the heels of what we have witnessed in Europe over the past 2 weeks, as we call on the Greek people and the Greek government to act in a responsible manner. We must not ask others to do what we are not willing to do ourselves.

The sponsors of this legislation also assure us that any taxpayer losses from new investments in financial institutions are likely to be minimal, but it is worth noting that some 90 institutions that received money under the Capital Purchase Program still owe more than $182 million in missed dividend payments to American taxpayers, and that some institutions like Citigroup have gone bankrupt and will never repay their government funds. Why should we have any confidence that Treasury can manage TARP II any better than TARP I?

Additionally, in a report issued just last week, the TARP Congressional Oversight Panel chaired by Elizabeth Warren raised serious questions about the prospects for success in this program. Former SEC Commissioner Paul Atkins, a member of that panel, is here with us today at the invitation of committee Republicans, and I look forward to hearing his insights.

While I support the Majority's decision to finally focus on one of the driving causes of the Nation's 10 percent unemployment crisis, lending to small businesses and lack of lending to those institutions, I cannot support ill-conceived proposals that likely will do little to help the economy but continue to drive up the national debt and crowd out funding in the private market for small businesses.

Thank you, again, Mr. Chairman, for holding today's hearing.

I yield back the balance of my time.

The CHAIRMAN. The gentleman has 15 additional seconds, which can be added to the time on that side.

And the gentleman from Kansas, Mr. Moore, is recognized for 3 minutes.

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

I am proud to be an original sponsor of H.R. 5297, the Small Business Lending Fund Act, and the role that our Oversight Subcommittee played in in laying the groundwork for this legislation.

Representative Gary Peters invited our subcommittee to visit Michigan last November to hear directly from local business leaders, community banks, and credit unions about the severe credit crunch facing small businesses, especially in a time and a place that desperately needs an economic turnaround.

I am pleased to co-sponsor a bill Representatives Peters, Dingell, and Levin drafted to create a State credit program modeled on a successful Michigan program which we learned about at the hearing. And we just held a field hearing yesterday in Chicago requested by Ranking Member Biggert to focus on the problems in commercial real estate. We were joined by Luis Gutierrez as well as Representatives Melissa Bean and Bill Foster, and we again heard from local businesses and financial institutions on the overlapping challenges they face with respect to CRE and small business credit.

As the evidence and facts from these hearings showed, restoring responsible credit availability to small businesses is crucial if we want a strong economic recovery. I look forward to working with my colleagues on this needed legislation, ensuring the bill is fiscally responsible by the time the full House votes on the measure.

And let me stress that we will have much more flexibility to find offsets after our committee reports out the bill as other committees have jurisdiction over a broader array of options to pay for the bill. So there is no reason we can't move this bill quickly out of committee and work together to ensure it is fiscally responsibly before the full House considers the measure.

I yield back my time. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman has used 1½ minutes. We have another half minute here.

So now the gentleman from Texas, Mr. Hensarling, is recognized for 3 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

It is another day and another opportunity to borrow $30 billion we do not have, to borrow it from the Chinese and send a bill to our children and our grandchildren.

The American people are increasingly asking, what part of broke doesn't this Congress understand? In just the last 2 years, the deficit has exploded, increased tenfold. The national debt is tripling before our very eyes. By the end of the decade, under CBO's score, we will be paying almost $1 trillion in year in interest alone on the national debt.

We have to go back to World War II to find such debt-to-GDP ratios as what we are soon to see in the United States of America. By the end of the decade, they will be wider than those of Greece, and we know what is occurring in Greece.

Moody's, not generally known for their pessimism, has stated that the United States could soon lose its AAA bond rating. In a first, recently the bond markets, during a debt offering, seemingly showed that they had greater confidence in Warren Buffett's Berkshire Hathaway repaying their debt than the United States Government repaying theirs.

So after a $700 billion dollar TARP program, which has now morphed into little more than a revolving bailout fund for the Administration; after a $1.2 trillion stimulus plan, which has stimulated our national debt but otherwise leaves us mired in almost double-digit unemployment, the highest in a generation; we have the next idea of the same philosophy that seemingly you can borrow, spend, and bail out your way into economic prosperity.

Although the $30 billion proposal is called SBLF, it reads like TARP to me. Now, this is TARP's Capital Purchase Program without the accountability and with an incentive to lend. But we have to look carefully at the incentive. Will taxpayers end up subsidizing banks to lend to businesses that they are soon to lend to anyway? Or perhaps more ominously, reminiscent of the Government-Sponsored Enterprises, is this an incentive to lend taxpayer money to marginal borrowers who may not be creditworthy?

The preponderance of the evidence points to a lack of creditworthy small business demand, not a lack of community bank capital supply, as the primary challenge that we face in our Nation. And until the Congress ceases its spending spree, its bailouts, its threatened higher healthcare costs, its threatened higher energy costs, more small business taxes, regulatory uncertainty, and the list goes on, that is unlikely to change.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from Massachusetts, Mr. Lynch, for 2 minutes.

Mr. LYNCH. Thank you, Mr. Chairman, for holding this hearing.

And I want to thank our panelists for helping the committee with its work. I think we all understand the urgency of this issue. Small businesses across the country have struggled since the financial crisis began. Banks have retracted lending and credit even for otherwise healthy businesses, and many businesses have been forced to cut jobs, reducing the size of their workforce.

I believe further efforts are necessary to assist small businesses, but they need to be targeted to those small businesses which are the backbone of our economy. They are the key to a successful economic recovery. Tax credits for job creation and improving access to credit for small businesses, two main components of the legislation before us will, I think, help put more Americans back to work, and that should be our number one priority.

Obviously, we have to be careful and deliberate about how we plan to pay for this program. Just 2 weeks ago, in this same hearing room, we heard from the Peterson Foundation about our ever-increasing national debt and that continuous spending outlays with no revenue stream to offset their costs are simply not sustainable. Our projected Federal deficit of $1.368 trillion no doubt is alarming, but also our structural deficit and escalating debt levels are even a greater concern.

We must get our economy back on track while simultaneously taking steps to address our Federal budget problems. The small business lending program is just one example of how we can begin. I look forward to hearing the testimony from our witnesses.

Mr. Chairman, I thank you and I yield back.

The CHAIRMAN. The gentleman from California, Mr. Royce, is recognized for 3 minutes.

Mr. ROYCE. Thank you, Mr. Chairman.

Albert Einstein once said, the definition of insanity is doing the same thing over and over again and expecting a different result.

We have tried this command-and-control, borrow-and-spend approach before, and it has failed us. The more our Nation borrows and spends, the closer we get in terms of our policies to that of Greece and the less economic growth we will see in the future.

Our Nation does not have $30 billion to give out. Just a couple of weeks ago, the Federal budget deficit at $92.7 billion for the month hit an all-time high for April, and that was $53 billion higher than economists had predicted just for that month. We will have to borrow that money from China and elsewhere, just as we will have to borrow this $30 billion if we go forward here elsewhere. And as Chairman Bernanke has repeatedly said, this path is simply unsustainable.

Businesses around the country understand that the wealth creators in the economy will be burdened with picking up the tab. They see the coming spike in capital gains and dividends taxes. They see the potential for a value-added tax increasing by the day.

They also see the new mandates and taxes that were just enacted in the health care bill.

They understand that the cap-and-trade legislation will increase the cost of doing business. It will certainly restrict future growth.

They see, throughout the financial system, businesses are facing these new hurdles. The Consumer Financial Protection Agency is coming down the pike with broad undefined powers.

And they see the 230 co-sponsors on legislation to abolish secret ballot elections for unionization.

So it is no wonder business confidence is at an all-time low. And the NFIB just released the study from last month noting that the prolonged pessimism found among business owners is unprecedented in survey history.

Real economic growth will not come from another program run out of the Treasury Department, but from Washington providing a modicum of certainty for businesses going forward.

I think we would be well served to take a step back and reassess the message coming from Washington, D.C.

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

The CHAIRMAN. The gentleman from Indiana, Mr. Donnelly, for 2 minutes.

Mr. DONNELLY. Thank you, Mr. Chairman.

There are few things more important than enabling small business to obtain credit. What I have consistently heard from the small businesses throughout Indiana is that to create additional jobs, their ability to obtain credit is critical. If they can have the credit, they can create the jobs and put the people of this country back to work.

Their biggest challenge remains; they are good companies with good credit ratings who still are not able to get credit. My commitment will be to continue to work nonstop so that these small businesses with good credit ratings who have struggled so hard to get the credit to run their businesses, that they can obtain this credit and that they, these small businesses, the engine of our economy, can succeed into the future.

Thank you, Mr. Chairman.

The CHAIRMAN. I now recognize—and let me be clear that this is an allocation that I do not make; I simply take what the Minority tells me—for 30 seconds the gentlewoman from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman. I just wanted to concur in what Representative Moore talked about, the oversight hearing that we had in Chicago yesterday and just a couple of things that we learned.

Number one is that there really is not the demand for loans at the community banks, because there is not enough businesses that are applying for the loans because of the trouble that they are all in. And in addition, we learned that a tax increase on income—

The CHAIRMAN. The gentlewoman's time has expired.

As I said, this is the allocation I was asked to give.

The gentleman from Michigan is recognized for 2 minutes.

Mr. PETERS. Thank you, Mr. Chairman.

We all know how important small businesses are to our economy. They have generated 64 percent of new jobs over the past 15 years. They create more than half of the non-farm private gross national product and hire 40 percent of all high-tech workers.

As our economy continues to recover, it is critical that small businesses have access to credit so that they can grow, add jobs in our communities, and create the innovative technologies of the future. I am pleased that today we are meeting to discuss two bills that have been introduced with the support of the Administration: the Small Business Lending Fund Act; and legislation that I introduced, called the State Small Business Credit Initiative Act.

Last November, Chairman Moore traveled with me to Oakland County, Michigan, where we held a field hearing to hear from representatives of small businesses, particularly small manufacturing companies, about the need for increased lending. We also heard from community banks and credit unions about their ideas of how to increase access to capital for small businesses. One of the ideas discussed at the hearing was to promote Federal funding for State lending support programs, such as the Michigan Supplier Diversification Fund. And since that hearing, I have worked with my colleagues from Michigan—Chairman Levin and Chairman Dingell and our Governor—to turn this idea into one of the proposals that we are debating today.

I am happy that Paul Brown from the Michigan Economic Development Corporation can be with us today to discuss how successful this program has been in our State and the support that it has received from both the business community and the financial industry.

I am also pleased that James MacPhee can be with us today on behalf of the ICBA. He is also a Michigan community banker who can speak to the need for this legislation from a community banker's perspective.

I am also pleased that another native Michigander, Gene Sperling, could be with us. His work over the last few months to turn this idea into a legislative proposal with such broad support has been incredible.

Chairman Frank, I would also like to thank you for holding this hearing today and for your continued leadership, and I yield back the balance of my time.

The CHAIRMAN. All time has expired.

I ask unanimous consent to introduce into the record statements in support of this bill from the American Bankers Association, the Financial Services Roundtable, the International Franchising Association, the National Association of Federal Credit Unions, the National Association of Home Builders, and the Associated Builders and Contractors.

Hearing no objection, we will enter these into the record.

We will now begin the testimony. And I also appreciate that Mr. Sperling is with us.

We have one panel that includes the Administration, but with this large committee, by the time we go around twice, everybody went to dinner, so we will try to get this in, in a reasonable time.

And let me say I appreciate the members showing up today. And I just want to address for a minute a question I had, which was, why are you having an important hearing on a day when there aren't votes?

And the answer is, this committee has a business agenda. Members on both sides frequently ask for hearings. We simply cannot accommodate them on 2 days a week. So there will be from time to time hearings during times when we don't have votes because the alternative is to have hearings 2 days a week, and that is why this day is different from all other days, a little out of season.

The first witness is Gene Sperling, Counselor to the Secretary of the Treasury, who has been working very hard and very cooperatively with us on this bill. Mr. Sperling?

STATEMENT OF GENE B. SPERLING, COUNSELOR TO THE SECRETARY OF THE TREASURY, U.S. DEPARTMENT OF THE TREASURY

Mr. SPERLING. Thank you very much, Chairman Frank, Ranking Member Bachus, and members of the committee.

I appreciate the opportunity to discuss the topic of small business lending and small business job creation today. I think it is safe to say that small businesses who have been responsible have been very deeply hurt in this financial crisis by those who were not responsible in their actions, and that this has been damaging, not only to those small business owners but to our economy, because we need small business job creation to help make this recovery a strong job-creation recovery.

And at this point, small businesses have taken greater hits in job loss and have had less recovery jobs-wise, optimism-wise, than larger companies, and this is of concern to our Administration, and we think it should be of concern to this Congress as well.

We do not believe there is a single silver bullet to respond to a single problem on small business lending. Rather, we think there are multiple barriers that we need to attack on all fronts. So, is it demand? Is it supply? It is all of these things. And if we care about getting small business lending and job creation going, we need a comprehensive strategy.

Of course, this Congress, this President, have focused on increasing overall demand in the economy through the Recovery Act through the financial crisis. As difficult and painful as this economy still is, the movement from a contraction of 6.4 percent in the first quarter of 2009 to averaging 4.4 percent growth over the last half year is one of the greatest swings we have probably seen in a century.

This Congress, and this President, have encouraged demand in investment by expensing net operating loss, tax cuts, bonus depreciation, 75 percent exclusions on capital gains, and a new HIRE Act to encourage hiring those who are unemployed.

We have seen success in the Recovery Act measures that have been done by SBA, under Karen Mills, working jointly with Treasury to free up secondary markets and see SBA lending rebound by 90 percent. These have all made a difference. They are all not enough: not enough when unemployment is at 9.9 percent; not enough when there is a record number of the unemployed who have been unemployed for longer than 6 months; and not enough when there are 5 unemployed people looking for every available job.

But it is wrong to think that it is just about hitting the demand side. The NFIB survey in February 2010 showed that 45 percent, nearly half of small business borrowers trying to get lending, could not access the full credit they wanted, 45 percent. The last time that study was done, in 2006, it was 11 percent. That means 4 times more small business owners cannot get the full amount of credit that they want.

So, yes, this is a multi-faceted problem. And that is why we are hitting on different levels, and that is why we support the efforts to have a strong small business job package, to go to zero capital gains for small business investment, to extend the Recovery Act SBA provisions, to work with Chairwoman Velazquez, as we are right now, on additional measures you could do through the SBA to help the early financing of companies and to try to bring good borrowers back into the picture who might be on the sidelines now. And that is why we are also making special efforts to go after programs that are for CDFI and new markets.

I want to stress very clearly on our $30 billion lending initiative here a few things. One, despite things I have heard already today, these are your community banks. These are your neighborhood banks. These are the banks of Main Street, not Wall Street. These are not the banks that led the financial crisis. They are not the banks doing synthetic CDOs. They are not the banks which paid multibillion dollar bonuses. These are your small community banks on Main Street that are the ones that predominantly lend to small businesses. They were the ones that kept lending during the crisis when larger banks pulled back. These are the banks we are trying to help in this initiative.

This should be labeled the small business lending fund because that is what it is. It will not cost the taxpayers a penny, as Chairman Frank said. CBO may estimate that it actually raises taxpayer money. But whether it costs or not, like every other measure, it will be offset, it will be deficit neutral when it is passed, and it will be a very strong bang for the buck.

It is for private sector lending, for private sector banks, for the private sector small businesses that will drive our recovery. And we are also happy that we are supporting and have worked together on this State Small Business Capital Initiative. This will help Democrat and Republican Governors in States across the country who have programs that are up and going, that are being cut back at a time of increased demand because of budget constraints. This program we think could spur almost $20 billion in additional lending at the State level in programs that are up and running.

There have to be answers. Can our answer really be to just criticize any program that is trying to address credit needs for small business lending? Haven't we seen the pain? Haven't we all gotten enough mail to know we have to put forward a constructive program? It is high bang for the buck. It would help community banks, and it would help successful State programs. It would be deficit neutral, and it would help the community and local banks that are at the core of Main Street and the core of lending to the small businesses who need credit so that they can lend, expand, and create the jobs our economy desperately needs.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Sperling can be found on page 111 of the appendix.]

The CHAIRMAN. The time has expired.

Next, we have Christian Johansson, who is the secretary of the Maryland Department of Business and Economic Development.

And he is here at the strong suggestion of Representative Van Hollen and other members of the Maryland delegation.

STATEMENT OF THE HONORABLE CHRISTIAN S. JOHANSSON, SECRETARY, MARYLAND DEPARTMENT OF BUSINESS & ECONOMIC DEVELOPMENT

Mr. JOHANSSON. Chairman Frank, Ranking Member Bachus, and distinguished members of the Financial Services Committee, good afternoon.

My name is Christian Johansson, and I am the secretary of the Maryland Department of Business and Economic Development. On behalf of Martin O'Malley, I want to thank you for inviting me to testify in support of the State Small Business Credit Initiative Act of 2010.

I am here today to endorse a key component of this Act, using existing State loan guarantee programs to extend credit to worthy small businesses. While the lifeblood of every American is a paycheck and a job, the lifeblood of every small business is access to credit. This piece of legislation helps accomplish both.

Loan guarantee programs are one of the single most effective tools we have to restore the economy. By expanding the capacity of existing guarantee programs, we truly have a shovel-ready solution to restore the flow of credit to small businesses crippled by tougher lending standards and devalued collateral.

In Maryland, we have established a loan guarantee program that helps banks and businesses bridge the collateral gap and address the issue that even if banks have the money, the playing field has changed, and many of our borrowers simply do not qualify.

But we are not alone. A nationwide network of 34 States and territories have existing loan guarantee programs. These programs have the infrastructure and the expertise to immediately put operating capital in the hands of business owners to hire new employees, to restock shelves, to expand locations. Federal support to guaranteed programs will significantly leverage multiples of bank lending to spur economic recovery.

You have the power to unlock billions of dollars of private bank lending by funding these existing guarantee programs. As the State economic development director, I can assure you that this legislation offers me and my colleagues sufficient flexibility to use our existing, often more nimble, grassroots programs to have the quickest, most meaningful impact in our communities. Strengthening these programs also serves as an important complement to the SBA.

Let me tell you a little bit about our program. It was established 45 years ago to increase capital to small- and medium-sized companies. In the first decade, we have done 823 loans, and in loans and bonds, we total $2.1 billion in credit that we have been able to extend. In the last 5 years, we have not had a single credit loss.

This year, we guaranteed $40 million in private sector loans, and we have over $150 million in our pipeline. These loans represent direct investments in businesses which ultimately create jobs, moving our economy from recovery to prosperity.

And while MIDFA historically operated in the $5 million to $15 million range, we amended the program this year to be able to do guarantees at $100,000 and below. The MIDFA small business guarantee would unlock $10 in private sector lending for every dollar of Federal funds you inject into the program.

Even in one of the toughest fiscal environments, Governor O'Malley demonstrated his commitment to this program by increasing funding and dedicating an additional $10 million to small business loan guarantees this past year.

Mr. Chairman, allow me to introduce Darius Davis, who is sitting behind me. He is the executive vice president of Harbor Bank, one of the Nation's largest minority-owned community banks. And I want to tell you the story of one of his customers, Bass Machining, a growing metal fabricator in Baltimore. These two businesses, Harbor Bank and Bass, embody the success of our guarantee program. To date, their stories intertwine.

Bass Machining was established almost 30 years ago. The company recently tripled their factory space and received a major contract to build power tools. He needed a line of credit support to fulfill his new contract. Harbor Bank was willing to fulfill that line of contract if they received support for their collateral position. MIDFA's $87,000 guarantee made it possible for Bass to obtain $350,000 in financing to fuel their expansion.

Mr. Chairman, Mr. Ranking Member, members of the committee, there are many opportunities for States to assist small businesses. And as Mr. Sperling said, there is no silver bullet to solving the effects of our prolonged recession. But loan guarantees are a proven and effective tool. They work. They are shovel-ready. And they have an immediate impact.

We urge this committee and Congress as a whole to pass this legislation quickly so our Nation's small businesses can access the capital they need to grow and create much-needed jobs. Thank you for your time.

[The prepared statement of Mr. Johansson can be found on page 78 of the appendix.]

The CHAIRMAN. Next, is Mr. Paul Brown, the manager of capital markets development in the Michigan Economic Development Corporation.

Mr. Brown.

STATEMENT OF PAUL BROWN, MANAGER, CAPITAL MARKETS DEVELOPMENT, MICHIGAN ECONOMIC DEVELOPMENT CORPORATION

Mr. BROWN. Thank you, Mr. Chairman, Ranking Member Bachus, and members of the committee. I appreciate the opportunity to discuss the topic of small business lending and job creation, and specifically the programs we have created in Michigan.

It is humbling to testify before those who are so dedicated to ensuring the opportunities for our small businesses and banks.

I especially would like to thank the Administration, specifically Mr. Sperling, and members of our congressional delegation, specifically Representatives Peters, Levin, and Dingell.

Unfortunately, Michigan has been dealing with the effects of the so-called "Great Recession" longer than most. But it is because of this long and severe experience that we have been able to develop programs which effectively tackle the difficulties our small businesses have in accessing capital.

I want to give you one example of a business in Michigan that demonstrates the typical stresses in the banking and small business field. Laurie Moncrieff is a third-generation owner of Adaptive Manufacturing Solutions. It was founded in 1948 by her grandfather. AMS lost their financing because they were in technical default of their loan, a term you have probably heard a lot of in the last 18 months. Because of this, they had to lay off some of their employees, going from 14 to 12 employees.

But the resilient Ms. Moncrieff has been able to keep her business alive by moving out, moving herself and her family out of her family home and renting it, and moving her family into the small apartment above the shop. Laurie is typical of small businesses in Michigan, especially manufacturers. And it is because of stories like hers that Governor Jennifer Granholm charged the MEDC with investigating and implementing a program that would assist companies like Laurie's.

We spoke to dozens of banks and dozens of borrowers, small businesses, and manufacturers, to understand what they were facing in the credit markets. There are two main factors a bank uses to determine the creditworthiness of a borrower. And these factors are getting particular scrutiny in this environment by the Feds.

The first is free cash flow. Typically, banks require 1.25 free cash flow to debt service. And they do that calculation based on a 3-year average. With the "Great Recession" hopefully behind us, there is a large portion of that average which is artificially low. So the 3-year average does not necessarily represent the ability of a business to pay now or in the future on an individual loan.

We designed what we call the Loan Participation Program to attack this issue. The Michigan Economic Development Corporation will work with the banks, and that is an important factor because the banks are the decision-makers, and they perform the due diligence and the administration of the loan. We will work with these banks to purchase a portion of that loan that is out of formula. And we will give a grace period in principal and/or interest for up to 36 months for that borrower.

In theory, they are traditional, in many cases revenue will increase during the grace period, as well as their diversification plan will come on-line and become profitable.

The second program attacks the collateral problem in Michigan. Many of our manufacturers rely on their property plan equipment value to borrow. Banks, in looking at a property plan equipment loan, like your typical home mortgage, will loan 80 percent to value. With many of our small businesses losing a huge portion of the value in their assets, they are unable to qualify for the current loans, let alone eligible for a loan diversification or an increase in their capital needs.

In this situation, we will work with the banks to determine what the gap is. And so as long as the bank has the majority of the loan, we will deposit the collateral gap in the bank. We get interest on the loan. We get points from the borrower. The bank gets a fully collateralized loan so that they can then make loans and make money on those loans. They also get increased deposits, which is very important in this strict regulatory environment.

One of the greatest examples of the success of our program is Mark One Corporation, a company in a small town in northern Michigan. Mark One developed a product that cleans metal in a green fashion, preparing it for manufacturing. They had purchase orders from companies around the world, including China, but they were unable to access the capital they needed to fill these purchase orders. Because of our loan and our loan guarantee in the form of collateral support—I am sorry, my time is up—Mark One was able to get a loan from Huntington Bank and hire up to 230 workers.

This is just one example of our State's programs that has been successful and we urge this committee and this Congress—

[The prepared statement of Mr. Brown can be found on page 66 of the appendix.]

The CHAIRMAN. Thank you, Mr. Brown. We got to the meat of it.

Mr. BROWN. We did. Thank you, sir.

The CHAIRMAN. Next, is Paul Atkins, a member of the Congressional Oversight Panel on the TARP. He is also a former SEC Commissioner.

And Mr. Atkins, to even out my lapse from before, you are going to get 6 minutes and 15 seconds, so, please, go ahead.

STATEMENT OF THE HONORABLE PAUL ATKINS, MEMBER OF THE CONGRESSIONAL OVERSIGHT PANEL, AND FORMER SECURITIES AND EXCHANGE COMMISSIONER

Mr. ATKINS. Thank you, Mr. Chairman. Chairman Frank, Ranking Member Bachus, and distinguished members of the committee, I am Paul Atkins, a member of the Congressional Oversight Panel for the TARP.

I appreciate this opportunity to testify about the Panel's recent work assessing small business lending initiatives. I should note that the views expressed in my testimony here today are my own.

I will do my best to convey the Panel's views, but my statements cannot always reflect the opinions of five very diverse thinkers on our Panel. I should also emphasize that the Congressional Oversight Panel has taken no position on whether any of the programs discussed today, including the Small Business Lending Fund or the State Small Business Credit Initiative, should be implemented.

During the Panel's recent field hearing in Arizona, a local bank president laid out the problem in stark terms, "We could grow the bank by $100 million in new assets and not need any new capital. Our lack of loan growth is a reflection of the impact of the recession on the small businesses in this State. We will do more, but it is difficult to find anyone who is not being impacted and remains creditworthy."

Another concern is that the current regulatory climate may make it extremely difficult for banks to increase their small business lending. There have been anecdotal reports that bank examiners have become more conservative and have required increasing levels of capital in the last year.

The balance between sufficient regulation and overregulation is a fine one. In an overly permissive regulatory environment, banks may tend to make riskier loans. In an overly restrictive regulatory environment, however, banks may become too conservative, and there will be insufficient credit available to help pull the economy out of the recession.

The SBLF's prospects, we think, are far from certain. Even if it is established by Congress immediately, it may not become fully operational for some time. It could arrive too late to contribute meaningfully to economic recovery.

Moreover, banks may shun the program in order to avoid the stigma of government funding. As Assistant Secretary Allison recently acknowledged before this committee, the TARP recipient label in negative advertising resonates with the public.

I recently took a photograph of this billboard held up behind me in Winchester, Virginia, which I think really says it all.

Even if the SBLF's incentive is sufficiently strong, the program may produce one key unintended consequence. A capital infusion program that provides financial institutions with cheap capital, along with penalties for failing to increase lending, runs the risk of creating moral hazard by encouraging banks to make loans to borrowers who are not creditworthy. The stronger the incentive, the greater the likelihood that the program will spur some amount of imprudent lending activity.

In my personal view, the Administration's proposal appears to share much of its design and business model with those adopted by Fannie Mae and Freddie Mac. Treasury should have learned from Fannie and Freddie that the combination of easily accessible below-market credit, matched with pressure to lend, regardless of credible demand or the employment of prudent underwriting standards, serves as the perfect recipe for extension of problematic loans and the creation and implosion of asset bubbles. That was the essential cause of the recent financial crisis.

Through my years in public service, I have been a big advocate of easing regulatory burdens on small businesses which get hurt in a one-size-fits-all regulatory scheme, such as the Sarbanes-Oxley internal control provisions. Because small businesses play such a critical role in the American economy, there is little doubt that they must be part of any sustainable recovery. It remains unclear however whether Treasury's programs can or will play a major role in putting small businesses on the path to growth.

In my opinion, the Administration and Congress could encourage the robust recovery of commercial credit and small business lending markets, as well as the overall U.S. economy, by sending an unambiguous message that the government will not directly or indirectly raise taxes or increase the regulatory burden of commercial credit in small business market participants and other business enterprises. Without that action, the recovery of the commercial credit and small business lending markets will most likely proceed at a sluggish and costly pace.

Thank you very much.

[The prepared statement of Mr. Atkins can be found on page 58 of the appendix.]

The CHAIRMAN. Next, we will hear from a former colleague, and the departing, very able chief executive of the Credit Union National Association, Dan Mica.

STATEMENT OF THE HONORABLE DANIEL A. MICA, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Mr. MICA. Thank you, Mr. Chairman, and Ranking-Member-in-attendance Hensarling.

It is good to be with you, and I will try to make this very brief to get straight to questions here, but there is a need for the Congress to act, absolutely, without a doubt. And you heard it from this committee to my right just last week.

Something has to be done. We will follow the judgment and leadership of this committee on some parts of the legislation you have here before you today. But I would tell you that credit unions want to be a part of the solution. Credit unions, for 100 years, have been a part of the solution, and we want to continue that fine tradition.

All we need to do, as far as credit unions are concerned, is change a statutory limit on lending, and we can participate in this recovery. We are not asking for a government agency. We are not asking for a penny of U.S. Government dollars. All we are saying is, raise the limit on our lending from 12¼ percent to 25 percent or so, and we can put $10 billion into the economy, and we can create 100,000 jobs, and we can do it with safety and soundness. And we have a track record of 100 years to prove it. More recently, going through the last few years of this financial crisis, not only have we done it, but our default losses were one-sixth the rate of commercial banks. So we can do it. We are looking for that. I will come back to that in a second.

The State Small Business Initiative, as we understand it, 34 States have this initiative. It is aimed at those States that are hurt the worst in the recession, need help, have high unemployment, and we support that. We support trying to help in any way you can. Each State has a little different program, a little different approach, but any way that you can put the guidelines in place to help, and this is a loan, a loan guarantee fund, we think would be helpful.

With regard to the Administration proposal before you, a $30 billion bailout fund, credit unions are not eligible for that. Credit unions were not technically eligible for TARP. And frankly, we are not asking to be eligible. We are simply saying, give us that other opportunity by giving us some regulatory relief with zero cost to the taxpayers. We don't need $30 billion to make us do what we are already chartered to do and what we have a great track record to do.

We do understand this is a difficult decision for the committee. We understand that the committee has some very tough questions to answer about funding and so on. But we will support the committee on this, whatever decision they make. We are asking the committee to look a step beyond it and do something for 93 million Americans that doesn't cost the taxpayers a dime, doesn't create a government agency, and puts $10 billion in new loans out there. And generally, these loans average less than $200,000. Our loan portfolio, when others in the commercial sector were saying it was drying up in the last year, our increase in net portfolio was 20 percent.

There is a need. It is not drying up, and we can meet that need. We have 26 percent of our assets in cash and investments, so we could do it without even hurting the bottom line on credit unions.

So the only group in America to oppose it is the group that is about to get $30 billion. And we find that a little ironic in that we don't come up here, and we haven't for 100 years, to oppose what they want. But they have come up here and opposed every single thing we have ever asked for, and now we are asking for some relief to help America, to help credit unions, and we hope we can get some attention here.

In closing, Mr. Chairman, I would just say this: We have had tremendous support on that proposal, both on the House and the Senate side, working with you and your staff, with Mr. Kanjorski, with Mr. Royce, with Mr. Udall, with Mr. Schumer, with Mr. Reid, and with dozens of other Members. We think we have an agreement with the other body to get this thing moving if we get something from this committee. And I would just like to thank you all for this opportunity.

As you said, Mr. Chairman, I spent 40 years on Capitol Hill; I have done every job in the congressional office, from intern to legislative assistant to Congressman to chairman of the committee, so I know this. I love this institution, but I love credit unions. They need an opportunity to help lead this country, and they are not asking for any kind of a bailout. So I appreciate your attention, your support, and we hope you can help us. Thank you.

[The prepared statement of Mr. Mica can be found on page 94 of the appendix.]

The CHAIRMAN. Next, will be Mr. Determan from Hord Coplan Macht on behalf of the American Institute of Architects. And I should note that he was the witness suggested by our colleague, the gentlewoman from New York, Ms. Velazquez, who chairs the Small Business Committee. So he is here at the particular urging of the Small Business Committee.

Mr. Determan.

STATEMENT OF JIM DETERMAN, HORD COPLAN MACHT, INC., ON BEHALF OF THE AMERICAN INSTITUTE OF ARCHITECTS (AIA)

Mr. DETERMAN. Chairman Frank, Ranking Member Bachus, and members of the committee, I am Jim Determan, an architect at Hord Coplan Macht of Baltimore, Maryland. I want to thank you for the opportunity to testify today on behalf of my firm and the American Institute of Architects.

I want to use my 5 minutes to make a few key points that I raise in my written statement. The design and construction industry accounts for $1 in $9 of gross domestic product and created over $1 trillion in economic activity in 2008.

But today, my industry is suffering to a degree we have not seen since the Great Depression. According to the Labor Department, the unemployment rate in the construction industry in March was 24.9 percent; that is 1 out of 4 workers out of a job. And that is not counting those of my colleagues who are underemployed or who have been working without pay for as long as 18 months.

If you ask architects across the country today why conditions are so bad, you will inevitably hear the same two responses: One, firms are unable to secure credit to keep operations going; and two, clients are unable to secure the financing needed to get construction projects started.

Architecture firms in general, and in particular smaller firms, rely heavily on short-term lines of credit to finance their operations. However, lending to small businesses has dropped severely. As banks restrict lending it has become increasingly difficult for firms to continue to make payroll and fulfill benefit obligations for employees, let alone expand and pursue new projects.

More problematic is the lack of access to capital for design and construction projects, which has depressed demand for our services to historically low levels. The pendulum has swung so far in the direction of restricted credit, that even worthy, well-secured projects are being denied access to financing. The mentality appears to be, since financing everything didn't work, let's finance nothing.

Last year, this reduction in work forced my partners and me to close the doors on our firm, a firm that had weathered previous recessions for over 60 years. A significant contributing factor was the lack of credit available to our clients to finance their projects. Projects stopped dead in the water. We couldn't move fast enough to shed employees or office space. And near the end, the bank called in our credit line.

Over 100 people lost their jobs, some of whom had been with the firm for 30 years. My story is hardly unique. No region in the country and no sector of our industry is immune from crisis. That is why I am pleased that this committee is considering legislation that would help small businesses weather the economic storm.

The Small Business Lending Fund Act and the State Small Business Credit Initiative both would inject billions of dollars into the small business market, thus providing vital relief for millions of small entrepreneurs who are struggling to make ends meet. I would urge the committee to ensure that the funds provided to small community banks under this legislation are lent to small businesses at rates and under conditions that make them attractive and useable.

These proposals will address some of the main causes of small business failure we are facing. However, I urge the committee to address the second problem I raised, the lack of demand for design and construction services caused by a lack of access to financing for our clients. Members of this committee have introduced numerous bills to address this issue, and they deserve serious consideration.

The bottom line is this: Until we find a way to get financial institutions to move the pendulum back to the center and begin to providing credit for worthy and vital projects, we are not going to see a broadbased recovery. Every idle construction site represents jobs lost and our Nation's competitive edge weakened. I call on Congress and the Administration to use every tool at its disposal to address the profound challenges that the lack of credit is presenting to our communities and our Nation.

I wish to thank the committee for its hard work in addressing these complex issues, and I look forward to answering any questions committee members may have.

[The prepared statement of Mr. Determan can be found on page 71 of the appendix.]

The CHAIRMAN. Thank you.

And finally, Mr. James MacPhee, the chief executive officer of the Kalamazoo County State Bank, and he is here on behalf of the Independent Community Bankers of America.

STATEMENT OF JAMES D. MacPhee, CHIEF EXECUTIVE OFFICER, KALAMAZOO COUNTY STATE BANK, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. MACPHEE. Thank you. Mr. Chairman, Ranking Member Bachus, and members of the committee, I am James MacPhee, CEO of Kalamazoo County State Bank in Schoolcraft, Michigan, and chairman of the Independent Community Bankers of America.

I am pleased to represent community bankers and ICBA's nearly 5,000 members holding $1.1 trillion in assets at this important hearing on initiatives to promote small business lending.

Small businesses create jobs when they have access to credit, and they will play a leading role in the economic recovery. In my State of Michigan, we face the Nation's highest unemployment at 14.1 percent. For me, this discussion is not in the least abstract. It is personal and close to home. My customers, friends, and neighbors have felt the full impact of the recession. The need for resolution is urgent.

ICBA strongly supports the proposed Small Business Lending Fund Act because it will help community banks do what they do best, support small business lending. Community banks are prolific lenders to small businesses. We continued to lend during the economic crisis, while the megabanks cut back most dramatically. Our business model is built on longstanding relationships with our customers, and we stand by them in good times and bad.

My bank survived the Great Depression and many recessions in its more than 100-year history. We are proud to continue serving our community through this difficult economic climate.

The SBLF is a fresh, bold program with the incentives needed to get credit flowing to many thousands of businesses, using community banks as conduits. TARP and other emergency capital programs were enacted in the urgency of the crisis and were used primarily by the mega banks. The SBLF would target community banks and is structured to incentivize small business lending.

ICBA is pleased to see that the proposal has many of the features we have recommended, features that will make the program attractive to community banks and successful increasing lending.

First, it appears to completely avoid the onerous TARP restrictions such as warrants, compensation restrictions, bank dividend restrictions or restrictions on net operating loss carryback. Such punitive conditions would only discourage participation.

Second, we support appropriate Treasury oversight of the plan which will give the public confidence of the funds being well used.

However, oversight should not be so overbearing that it would discharge participation.

Third, we are pleased that no applicant will be denied based solely on its CAMELS rating. This will ensure that the broadest possible number of community banks can participate and the small business customers of these banks will have access to SBLF-financed loans. Interest at community banks should be evaluated with the inclusion of capital provided by the program. This will give a fuller picture of the bank's position under the plan.

And, fourth, we are pleased that agricultural loans are explicitly eligible. Farms are an important component of this small business sector.

Though we await the final legislative outcome on various aspects of the program, we believe that it could attract broad participation by banks and result in more lending to small businesses. Notably, $30 billion in SBLF capital can be leveraged by community banks to support $300 billion in new lending. The plan would have tremendous bang for the buck.

In addition, Mr. Chairman, no one program in isolation is going to do the job of restoring credit to small businesses. To maximize its impact, the SBLF should be considered with other initiatives. These include: one, restoring the value of GSE preferred shares. The banking sector, including many community banks, lost an estimated $15 billion to $20 billion when the Treasury Department took Fannie and Freddie into conservatorship in September of 2008 and destroyed the value of their preferred shares.

Two, moderating an aggressive exam environment. Overreaching exams are exacerbating the conditions, the contraction, and credit for small businesses. The SBLF program will only work if bank regulators do not choke off lending with overly aggressive bank regulation.

Three, extending the FDIC's Transaction Account Guarantee Program, TAG, gives the assurance to small businesses that the payroll accounts are guaranteed and provides community banks with liquidity to make additional loans.

Lastly, recognizing State programs that have been successful in increasing credit to small businesses.

In conclusion, ICBA strongly supports the SBLF proposal, which has the potential to increase the flow of credit to small businesses. We look forward to working with the committee to make the program a success. Thank you very much.

[The prepared statement of Mr. MacPhee can be found on page 85 of the appendix.]

The CHAIRMAN. I have a couple of quick questions, and then I will give some time to the gentlewoman from New York, who has an important role here.

Mr. Sperling, as you said, you talked to Mr. Kanjorski, who is very interested in this. I am told that the Administration is essentially supportive of the provision that Mr. Mica talked about to increase the possibility of credit union lending; is that correct?

Mr. SPERLING. The Administration, having worked with Congressman Kanjorski in the House, and Senator Udall and Senator Schumer in the Senate, believe that we could support—

The CHAIRMAN. No, not could you, would you? Do you?

Mr. SPERLING. We do support—

The CHAIRMAN. Thank you.

Mr. SPERLING. —a compromise expansion of the credit union business loan program.

The CHAIRMAN. All right. I wanted to get that on the record. It is not germane to this bill, but I have talked—I gather there is a proposal, but I did want to clear that up.

Mr. SPERLING. Mr. Chairman, I just want to make clear so there is no confusion, we do support an expansion on the member business loan limit, but we do have stronger safety and soundness safeguards we believe that are in—

The CHAIRMAN. So will there be a proposal coming forward with your support?

Mr. SPERLING. We have been working with Congressman Kanjorski.

The CHAIRMAN. That is not what I asked you, Gene. Come on. Are you going to be giving us a proposal that you support?

Mr. SPERLING. Yes, we have a—

The CHAIRMAN. Thank you.

Mr. SPERLING. I am willing to discuss it now and willing to send it up to you, Mr. Chairman.

The CHAIRMAN. Five minutes are up. I thought that ought to be clear so everyone would know where we are.

One more question, for Mr. Determan, people have said, no, the problem is not that there isn't enough lending capacity in the banks, but that there is no demand by small businesses. Your answer to that?

Mr. DETERMAN. Not accurate. There are a lot of laid-off architects these days who are starting their own businesses.

The CHAIRMAN. To speed this up, as I heard you, you said you are aware of people who have projects they could do if they could get the lending, the loans; is that correct?

Mr. DETERMAN. Correct.

The CHAIRMAN. Thank you.

Let me ask Mr. MacPhee, the characterization from your members, is it a lack of demand or is there also—is there a demand that could be better met if you had more capital?

Mr. MACPHEE. There is definitely starting to—we are showing demand in the marketplace right now.

The CHAIRMAN. I think that is important, both from the lender and the borrower, we have an acknowledgement that there is a demand out there that is not being met at the current level of available funds.

I yield back the balance of my time to the gentlewoman from New York.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Sperling, the proposal from Treasury at this point does not specify how a small business loan should be defined; is that correct?

Mr. SPERLING. What it does, chairwoman, is that—

Ms. VELAZQUEZ. Just tell me yes or no.

Mr. SPERLING. It uses what we believe is the single-best proxy that we can for whether a small bank is increasing their lending to small businesses.

Ms. VELAZQUEZ. What is that?

Mr. SPERLING. We rely on four criteria: CNI loans; owner-occupied CRE loans; loans that support agriculture production; and loans secured by farmland, of which, in small banks, 80 percent—70, 80 percent of those tend to be small loans to small businesses. So that is the baseline.

Ms. VELAZQUEZ. My question to you now is, how can we make sure that large businesses do not benefit from this program and that banks are not provided with incentives for making loans that they are no relation to small businesses?

Mr. SPERLING. I think if you look at small banks, community banks, first of all, they have concentration limits, limits of how much they can give on a single loan as a percentage of their assets or a percentage of their capital. I think it is definitely the case that people may be giving loans to over a million or to companies that employ a couple of hundred people. But we still think that these are the type of small- and medium-sized businesses that are very important—

Ms. VELAZQUEZ. What about if banks participate in making loans that are syndicated loans?

Mr. SPERLING. I think that we would be open to discussion on that. Right now, what we are doing is looking at what their baseline is for 2009 in those four areas. If they are expanding above that, then they would be meeting the test.

Ms. VELAZQUEZ. So why is it so difficult to include in the proposal that loans will be made that fit the definition under the Small Business Act?

Mr. SPERLING. Well, I think Mr. MacPhee would back me up on this as well, that if you are doing a proposal that is performance-based, in other words, it is showing the increase from 1 year to the next, you have to use what is the existing data. You are stuck with the existing data. So we couldn't go back and tell a bank, small community banks, which average $200 million in assets, that they have to reconstruct a new baseline.

Now, going forward, maybe we should have better data to do that. But I think if we want to focus on performance, which so many people do, we have to use the data that exist right now and do the best proxy for small businesses.

Ms. VELAZQUEZ. Which is not the best data.

The CHAIRMAN. The gentlewoman will have her 5 minutes in turn.

The gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman.

During your time I heard earlier, I listened carefully to the various banking organizations and financial institutions that have endorsed this particular bill. I am not sure that you needed unanimous consent to enter it into the record. I would be very happy to stipulate that most people, if they had an opportunity to get a taxpayer subsidy with few if any strings attached, would probably sign up for that deal. So, in the future, I am not sure that we need unanimous consent to enter that into the record. I think it is a great deal for everyone except perhaps for the taxpayer.

Now, we are having a debate somewhat on whether or not when we look at small business lending, is the greatest challenge from a bank capital insufficiency or from a lack of creditworthy loan demand. Mr. Atkins, I think I read in the Congressional Oversight Panel—and, again, I congratulate you for your service and I am personally happy I don't have to do it anymore, but I believe I read in the Congressional Oversight Panel, you alluded to a report from the Fed, I think dated in February, that said the ratio of cash on bank balance sheets to corporate loans outstanding has more than quadrupled since mid-2008. And I think this was in your report—if not, it was in a press report—that in an April survey of the Federal Reserve, a senior loan officer says that loan demand has generally weakened further. Is that correct, and is that what the panel has observed?

Mr. ATKINS. Yes. In fact, sir, we have a couple of charges here that I think have been taken from our report that demonstrate this. The first one shows cash as a percentage of total assets, and you can see how here during the last few years since 2007, 2008, they have really—it spiked as a percentage approaching 8 percent from down at a low of 4, you know, and a half or so.

Secondly, the second chart here shows the outstanding commercial industrial loans at commercial banks since 1980. And so you can see in the various recessions that we have had here, first in the 1987 one and then also in the 1990's, the early 1990's and then now, you can see how in each instance, CNI loans have decreased at the commercial banks. So I think the data does support what you are saying, and that has been in our report.

Mr. HENSARLING. I have another question for you. In the time that I served on the Congressional Oversight Panel, which consists of three Democrats and two Republicans, frankly, getting a unanimous report was greatly the exception and not the rule, although it did happen from time to time. As I understand it, your most recent report was a unanimous decision, although I don't have the language right in front of me, or perhaps this is it: "After a thorough review, we found little evidence that these programs—referring to the TARP programs dealing with small business lending—have had a noticeable effect on small business credit availability." Is that correct? Is that what the Congressional Oversight Panel reported unanimously?

Mr. ATKINS. Officially, we found that the Capital Purchase Plan and the other programs have not had any discernible effect. Part of it is there is just hardly any information out there, and Treasury could do a lot better job of keeping information. But there is a real dearth.

But you are right. We found hardly any evidence of that.

Mr. HENSARLING. Mr. MacPhee, I have a question for you about bank capital. If I have this correct—and correct me if I am wrong—that based on the call report for the first quarter of 2010, your bank reported a Tier I capital ratio over 23 percent, and to be well capitalized I believe you need capital over 6 percent. Doesn't that suggest that your particular bank is sitting on a lot of untapped lending capacity?

Mr. MACPHEE. Actually, our Tier I capital is 13.1 percent. That is total risk base, I think you are looking at. But we are well capitalized. We saved our money during the good times so we could withstand this downturn. So we are one of the fortunate ones.

Mr. HENSARLING. Ostensibly, a number of banks are in that condition. Some aren't.

My time's running out, but, Mr. Sperling, you recently had a number of bank failures, as you are aware of. Just recently, Midwest Bank and Trust on May 14th; Southwest Community Bank, May 14th; New Liberty Bank. These are in Illinois, Missouri, and Michigan. Is there anything in this proposal, in the underlying legislation that would have prevented these banks from accessing SBLF funds?

Mr. SPERLING. Congressman, I think that the record on the overall Capital Purchase Plan so far is that it has actually been profitable for the American taxpayer. Whatever the wisdom that you—our support for the program is, we still support the idea that they have to apply to the regulators. You have to—

Mr. HENSARLING. Is that a yes or a no?

The CHAIRMAN. The gentleman's time has expired.

Mr. SPERLING. I'm sorry. I don't know what the yes or no question was.

The CHAIRMAN. The gentleman's time has expired.

The gentlewoman from California. But I will ask her for 10 seconds in order to—I think my colleague said that the TARP Small Business Lending Program had not worked. It had not worked because it doesn't exist. I am not aware of any TARP Small Business Lending Program. There was a TARP program. This is the first effort I have seen to focus on small business.

The gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

Let me thank the panelists for being here today, and it is good to see Mr. Gene Sperling. He has been around working on these issues for a long time. I am very pleased about the two initiatives that we are talking about today.

I don't know, Mr. Sperling, whether or not you are aware that this committee worked very hard on the Wall Street reform bill that left here and passed out on the Floor, now being discussed, its counterpart, on the Senate side, that the costs we discovered and we know that only 2.4 percent of all minority-owned firms and 2.6 percent of women-owned firms are in the finance and insurance industry.

So we also know that, according to a 2006 GAO report, minority-owned businesses have a higher rate of having their loans denied or paying higher interest rates even after controlling for creditworthiness and other factors and on and on and on, that we need to do something, and we need to stop lamenting this year in and year out. So we created in that legislation the offices of—minority and women-owned offices minority assistance, and we are not getting any help from the Administration.

The Congressional Black Caucus and, I believe, the Latino Caucus, we are focused on trying to create some real opportunities for minorities in funding and finance. And so I want to know what you know about it and whether or not the Administration is going to help us on the Senate side.

Also, I would like to basically know, we talked about eligible banks. What we find is, oftentimes, the eligibility is such that it denies the very institutions that need help—the small banks, the community banks, the CDFIs.

For example, in one initiative, the President's Community Development Capital Initiative does not include the nonprofit CDFIs, which make up 50 percent of the CDFIs. So quickly, your response on the offices of minority assistance and women-owned business assistance; and, secondly, on the Community Development Capital Initiative that cuts out the nonprofits; and, thirdly, the criteria for eligibility. We really want to understand it. Can you help me?

Mr. SPERLING. Congresswoman, on the first issue, I guess I would get back to you, just in that we have a team who is working on the Senate side. The amendments are fluid right now. I would rather to get back to you later today than inadvertently interfere with any negotiations going on.

On the CDFI initiative, I want to stress that was an issue we were able to do through TARP, because the CDFIs, unlike the community banks, were willing to partake in this program. This was, I think, a very strong program in that it allows them to get capital for 8 years at 2 percent, a low rate. It also allows them to get—

Ms. WATERS. What about the nonprofits?

Mr. SPERLING. You are referring to, I think, the CDFI loan funds; and I think it is true that, while our initiative deals with the CDFI credit unions and the CDFI banks that make up 80 percent of the assets in the CDFI community, it was not something that could be used for the CDFI loan funds. I think that is a shortcoming, and I am not sure what the best vehicle is for that. But we think there are excellent CDFI loan funds. We are trying to do more just through the appropriation process, but that is something we would be very interested in working with you on, because we do think CDFI loan funds—

Ms. WATERS. That is very good.

Let me just say, before you try even to attempt to talk about the criteria, my time is up, that we want to send a serious message, a serious message about the recovery bill that the African American, Black Caucus, Latino Caucus, we are going to seriously take a look at what the Administration is doing to give some assistance to us; and we are not poised to support that unless we do.

And, thirdly, these minority—these small banks, these community banks, we have to make sure that you don't have criteria that is going to prevent them. They should not have to jump through a lot of hoops. We want them to have the money. If they put the money out there, it will help to stimulate the economy. The small businesses need it. How are you going to expedite it and make sure it happens?

Mr. SPERLING. Well, I want you to know that one of the first groups that we did consult with in doing this was the National Banking Association. Michael Grant brought in banks; and they were very supportive of the fact that having an initiative that was supported just on smaller banks, where the focus was just for banks under a billion with somewhat less from a billion to $10 billion, would very much target the minority banks around the country. And several of them are also—a few of them are trying to apply to be CDFIs now, additional CDFIs, to access the more generous terms because they fit the criteria of lending 60 percent below moderate-income communities. So I do think we have made some process, although not enough.

Ms. WATERS. All small banks, all.

The CHAIRMAN. The gentleman from Florida, Mr. Posey.

Mr. POSEY. Thank you, Mr. Chairman.

Now, Mr. Sperling—you seem to be the popular one today, so I will ask you—when discussing how they arrived at the decision to request $700 billion from the American taxpayers—and Secretary Paulson, as you may remember, made the infamous statement: "It is not based on any particular data point; we just wanted to choose a really large number." At least for some of us on this committee, $30 billion is also a pretty large number. Would you please describe in detail for us how you arrived at the $30 billion number you are asking us to authorize?

Mr. SPERLING. I think that $30 billion reflected the best efforts of the people at Domestic Finance in Treasury having consulted with different community banks as to what we thought the maximum amount of participation would be. You try to get the best amount.

I think the important—

Mr. POSEY. Okay, okay, that is good. So, in other words, it is another "Hail Mary."

Mr. SPERLING. No, I didn't say that, sir.

Mr. POSEY. All right, I said it. That is what we have done so far. What gives the Administration confidence that the $30 billion will succeed where $700 billion failed?

Mr. SPERLING. So here are some very, very important differences. One, this is targeted just to small banks. You can only get the 5 percent of risk-rated assets if you are a community bank under $1 billion. Those are banks that average about $200 million in assets. They are the Main Street banks, the community banks, the neighborhood banks, the banks that do relationship lending to small businesses that I think many people in this body have asked us repeatedly to focus on.

Secondly, this is performance-based; a lot of what people were upset about was the idea of a perception of benefit without proof of an increase in lending. So we have an initiative where it only costs the taxpayers, only a benefit going—in the dividend if you are increasing your small business lending over the past year. And, in fact, if you don't, the rate actually goes higher, making it even that much more performance-based. So I think it is very different in that it is for small businesses and performance-based.

Mr. POSEY. So you are trying to get some more money out there. Mr. Mica has a proposal to get some more money there without the Federal Government pouring it out of their bucket. What you do think of that?

Mr. SPERLING. I think that—as I said, I think we have been working with Mr. Mica, with Congressman Kanjorski, Senator Udall, and others and think that we can support going to a higher member business loan limit. In fact, we are willing to go as high as 27½ percent for some banks, credit unions which are approved by their regulator. However, we want to make sure they have been doing at least 5 years of member business lending. We want to make sure they have 7 percent capital, equivalent ratios.

Mr. POSEY. I am surprised that wasn't part of this plan. I mean, here we have money already out there without throwing any more taxpayer money at it. They want to help solve the problem, but you apparently don't think that is a good idea, where at least that is on the back burner right now. Why don't we put some of the public money up, some of the people who want to help solve this thing without more taxpayer help? Why don't we give them a little bit more priority?

Mr. SPERLING. We actually believe that the terms of the Small Business Lending Fund that we put down, as Chairman Frank said, may not cost the taxpayers a penny, may even raise potential money, and they address 8,000 community banks in our country. And if we do not make an effort on the community banks—

Let me say something about community banks. Community banks may make up 20 percent of the assets. They probably hold 60 percent of the small business loans. An average community bank, 80 percent of their lending is in either agricultural—

Mr. POSEY. We know most of that. That is why we wonder why you excluded them previously from funding. If they are so important, why weren't they given any help before?

Mr. SPERLING. This is a very important point: They were eligible, and more than 600 of them who applied backed off because they felt that the TARP stigma discouraged them from doing that. Even though in this context, it is not a bailout; it is not to bail out the bank. It is to encourage more small business lending because we want small businesses to expand, get credit, and create jobs.

So by taking away the TARP stigma and offering them an opportunity to get more capital performance-based for the purpose of increasing small business lending and creating small business jobs that this was a cost-efficient, high-bang-for-the-buck method to do that.

But we support—as I said in my testimony, this is a multifaceted problem. It needs a multifaceted answer on the demand side, the credit union side, the community bank side.

Mr. POSEY. This is TARP with lipstick.

The CHAIRMAN. The gentleman's time has expired.

The gentlewoman from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you very much, Mr. Chairman, for having this very important hearing.

On the Joint Economic Committee, some of the studies that are coming forward from the Treasury Department, and the Labor Department are showing that, unlike prior recessions, small businesses usually hire very quickly, but we are not seeing that. They are very steady, and the hiring that is taking place is taking place with larger and middle-sized banks. When you talk to small businesses, they inevitably say it has been lack of access to capital. So I strongly support the chairman's bill that would target lending and that these dollars would get into lending, into the pipeline to help small businesses.

If we were able to do this, how quickly could we expect increased capital to flow through to hiring, to be realized in hiring in small businesses with this $30 billion bank working through the community banks and the regional banks? Anyone?

Mr. SPERLING. Our belief is that we could get this up and running very quickly, within a couple of months. And that we also do believe that—I know this committee has focused a lot on the strain from commercial real estate loans on community banks. And one of the things you don't want is for community banks to respond to that by conserving capital by pulling back on their small business lending. So our hope is, as soon as this passes, community banks would understand that they do have a potential capital cushion that would be an alternative to restricting their small business lending.

Mrs. MALONEY. Would anyone else like to comment on it?

Mr. ATKINS. I think we are a bit more sanguine about that. I think we have doubts that programmers can get up and running very quickly or that it would be effective once it is.

Mr. MICA. I would like to say our program is up and running. A recent NFIB study said that, right now, 40 percent of all lending needs are unmet; and it was—they couldn't make loans to 40 percent—I am sorry—40 percent were not getting the loans. But throughout the 2000's up until now, 90 percent were getting loans. So there is a disparity in those who need loans, and we are ready to do it. Our program is up and running, wouldn't cost a penny, and we are ready to go.

The CHAIRMAN. Would the gentlewoman yield to me for a minute?

You strongly disagree with those who say the problem is simply a lack of loan demand.

Mr. MICA. Now, I would say it is both. There is a lack of—loan demand has gone down, but meeting the loan needs of those who want it has also restricted tremendously.

The CHAIRMAN. I thank the gentlewoman.

Mrs. MALONEY. There has really not been a lot of data compiled on small businesses, but it is certainly something that all of my colleagues are talking about in their districts across the country. People cannot get access to capital. And how fast do you think conditions would improve if we could get this out to the small businesses so that they are hiring and moving forward?

Mr. JOHANSSON. I was going to say we have $150 million in backlog right now for our loan guarantee program. We can put this money to work tomorrow, and those are thousands of jobs that the State of Maryland would retain and create. There is a network of 34 other States and territories that have these. So there are active programs in place that have backlogs that can use the money right now.

Mrs. MALONEY. Okay. Any other comments?

Mr. MACPHEE. On the eastern side of the State of Michigan, we have a lot of small community banks that are financing Tier II and III auto suppliers that make about 3,000 parts for the auto industry that aren't made at the factory. Many of those small companies are out of capital; and many of the small banks, due to the tremendous deflation in property values, have had to write down property. On the margin, these banks are making money. They are second- and third-generation banks, well-managed, 30-year CEOs, but they can't track private capital. And this program would go a long way towards helping them reestablish, get these suppliers back into good shape and get things moving for the State of Michigan.

Mr. BROWN. I would like to point out the demand letter is somewhat misleading in that it represents those who are eligible under the current criteria, and it is precisely those loans that are just outside the margins that the State programs aim to support and, therefore, make eligible.

The CHAIRMAN. The gentleman from New York, Mr. Lee. Mr. Royce, I'm sorry. Mr. Royce, the gentleman from California.

Mr. ROYCE. Thank you, Mr. Chairman.

I was going to ask a question of Mr. MacPhee, and this goes to a concern that we often hear out in California from our banking community. The basic gist of it is there is $3 trillion in commercial real estate loans out there that are on banks' balance sheets or they are securitized through NBS, and we are going have $1.4 trillion of that roll over between now and 2013.

This is what banks communicate to me. They say, we have to go out there and get a new appraisal on property value. These are performing loans. In many cases, they are performing loans. But we can't roll these loans over because even though the revenue coming from the property remains strong, we have overzealous regulators leaning on us. And so we cut off the credit, and we are creating in that process—according to any number of bankers that I have talked to, we are creating something of a vicious circle. Because the more we close down access, the more we refuse to roll over these loans that are performing, the more we are impacting these communities; and it will become a self-fulfilling prophecy if we continue to do enough of this.

And so the question they have is, do we have to be so doctrinaire in terms of this concept that—we know the value of the property. There is no market out there for the property. So, by definition, we can't meet that test.

Now, we have had a number of discussions back here with regulators in Washington, but their point is the discussions we have with regulators in Washington never seem to reach the front, never seem to reach out in at least the Southwest where they are dealing with very overzealous regulators telling them that this is the way they have to do business.

Again, their point is, let us be bankers. Let us make these judgments on our own. You are creating this lack of liquidity in the system. And I was wondering, Mr. MacPhee, have you heard a certain number of these complaints? I would suspect you might have.

Mr. MACPHEE. Yes, sir. Being a community banker in any one of these States like Michigan, California, Georgia, or Florida is like being a candle in a hurricane. It has been a difficult process to keep the flame lit.

I only point back to the farm crisis, and I lived through that farm crisis. When the income stream was steady, payments were on time, but property values had dropped drastically, and there was forbearance. And through that forbearance, rather than write down property values to some ridiculous level that we were never going to get back, we were able to hang in there with our customers, accept payments on a timely basis; and, sure enough, property values came back over time. I think that is a really important lesson during this critical time.

Mr. ROYCE. Well, I would hope, in my frame of reference here, instead of putting more taxpayers' dollars at risk, if we would first pursue efforts to have field examiners implement their authority maybe in a more balanced manner, that would, I think, address part of the problem.

Another part of the problem—and this goes to legislation that I and the ranking member have on—Mr. Kanjorski and I have on the issue of trying to expand the 12.25 percent cap, it seems—and I was going to ask Mr. Mica this question. It seems that we could also provide some liquidity by raising the statutory limit on credit unions for member business lending at this time; and, again, that would have no cost to the American taxpayers.

I was going to ask you, Mr. Mica, considering that getting into the business of lending into the market requires quite a bit of capital expenditure. For one thing, it requires hiring and training personnel. So many credit unions probably don't believe it is a worthwhile endeavor if they are going to quickly hit that 12.25 percent cap. Whereas if that is raised, it might be worth making the investment rather than—you know, if you are just going to handle five or eight loans in your portfolio for your local business, for your small credit union, that is one thing. If you know that cap is going to be raised. I was going to ask you, do you agree with that?

The CHAIRMAN. The gentleman's time has expired, but the question has been thoroughly discussed, so I don't think we have lost anything. Mr. Mica and Mr. Sperling have talked about it significantly.

Mr. ROYCE. I appreciate it, Mr. Chairman. Thank you.

The CHAIRMAN. The gentlewoman from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Sperling, last week, the Congressional Oversight Panel released a report where, basically, they criticized Treasury's proposal, saying that he raised a question about whether the capital infusion program that focused on the supply side solution is good enough or do we need more to incentivize small businesses to get them off the sideline to spur demand on loans? And are you considering any incentives?

Mr. SPERLING. Yes. As I think I said at the beginning, and as I think we have discussed, I think you have to look at the demand and the supply side. As we said, we are seeing 45 percent of small businesses who want lending can't get the lending they need.

The Congressional Oversight Panel, I will also mention, in May put out a report in which they stressed that raising capital has been difficult in the last year even for healthy banks. It went on to say that uncertainty which is making raising capital difficult can also lead banks to conserve capital instead of making loans. So we want to make sure the banks have the loans, the capital, and the incentive.

But I think, as you have discussed with us, we also could face an issue where there are creditworthy borrowers who are just a little uncertain about the economy at this moment; and I do think, as you have suggested to us, that there may be ways that we could have a temporary program that would help get some good borrowers who are uncertain about the economy to increase their demand going forward. That is something we look forward to working with you on, not just in the long term but in the next several days as to whether that could be part of this small business jobs bill.

Ms. VELAZQUEZ. Thank you.

Mr. Determan, in your opinion, what will encourage a creditworthy business person to get off the sidelines and apply for loans?

Mr. DETERMAN. Very simply, growth. We have a lot of architects, for example, right now, who have been laid off because of the economy, and are starting up their own businesses. You have to have money to start that business, to get office space, to hire employees, to pay payroll for the first 3 months before you get your first dollar in. So you have to have the loans to support that. At the same time, you have to have the projects to do. The biggest problem we are seeing is that there is no financing for construction.

Ms. VELAZQUEZ. Thank you.

Mr. Atkins, we have heard repeatedly here today and in previous hearings conducted by this committee and the Small Business Committee especially from small banks that an overly restrictive regulatory environment is a significant factor in the credit crunch that is affecting small businesses. Does the data reviewed by the Congressional Oversight Panel bear out this perspective? And I would like to ask you, you are a former regulator, in your opinion, how should we address this issue?

Mr. ATKINS. Well, first of all, the data is mixed. I think there are a lot of anecdotes about how bank examiners are tightening down a lot, just like they did back in previous recessions as well. After you have had an asset bubble and there is a lot of scrutiny being paid—

For example, with respect to architects, we just came through a huge real estate housing and we still have a significant commercial real estate overhang. So there just is not the demand for new projects. And even if you had money you have to have revenue to support these projects from rent and everything else. I mean, that is a big—sorry to say, unfortunately, for architects, that is a big problem right now.

Ms. VELAZQUEZ. Mr. Atkins, in previous recessions we saw that people who were laid off created the startups. They created new businesses. We are not seeing that now. How can we get the startups and small businesses that are struggling to cope with the consequences of this economic downturn to be able to get credit?

Mr. ATKINS. Well, in order to have credit and to be able to pass the scrutiny of bank regulators and everything else, you have to have the anticipation of being able to have that loan pay off, so that you are going to be able to sell services or products or whatever once you make that loan. That is the crucial thing when you have a economic downturn, whether or not you have the consumer demand out there to support the business. That is why, again, you have a structural situation here in the economy to look at taxation, regulation, and those other sorts of things that inhibit businesses.

The CHAIRMAN. The gentlewoman from California is recognized to make a unanimous consent request.

Ms. WATERS. Thank you very much, Mr. Chairman.

I am requesting unanimous consent to insert into the record for purpose of disclosure the fact that my husband, Ambassador Sidney Williams, is an investor in OneUnited Bank, a small minority community bank in Los Angeles.

The CHAIRMAN. The gentleman from New York is now recognized for 5 minutes.

Mr. LEE. Thank you, Mr. Chairman.

I appreciate everyone coming in today. This is an important issue.

In fact, I just had—the President of the United States was in Buffalo, New York, this past week, and it was nice to have him there. What I wanted to have him do was to sit and listen. The people who are going to get us out of this recession are the people outside of Washington, D.C. In my mind, it is bringing back a level of certainty to this economy.

You talk to people throughout my district—it is a very Midwestern-type community; and what I hear, loud and clear, is people are tired of the taxpayers' subsidies, tired of it. We are fortunate that the local banks and community banks have actually flourished during this period. They were responsible lenders. We had people who didn't overreach. But what they are tired of—and we talk about in this case another $30 billion. I hate to tell you the revenue of Microsoft Corporation last year was about $60 billion. We are just going to throw another $30 billion—we throw numbers around with no regard when we are criticizing countries like Greece. We have to get our fiscal house back in order.

What I have seen—I am a new Member to Congress, having been here about 16 months, and I came out of the private sector. Certainty into the marketplace is what is going to get investors back in there. But all I have seen in 16 months is we have a health care legislation we are still trying to understand, small business owners are afraid to go out and reinvest until they know the repercussions of that. We have tax cuts from 2001 and 2003 that are sitting out there. We have potential with a cap and trade. We have the President's Debt Commission. We have issues on carried interest. There are dividends, capital gains.

These are what—to my mind, these are the issues that are helping to keep people off in investing. But surely I can tell you people in my district only want bankers to lend to those who are creditworthy. They are tired of the bailouts.

With that being said, maybe I can go over to Mr. MacPhee. As I said, many people believe the issue is a lack of demand from creditworthy borrowers brought on by the adverse economic conditions. To what percent do you think that is versus this issue and the lack of demand right now?

Mr. MACPHEE. Let me just say this, community bankers are commonsense lenders. We have to live with our decisions every day because these people are our neighbors. We didn't create this mess. We have always been steady lenders to our communities. And if we don't loan within our communities, we don't have a market.

For anyone to insinuate that we are going to take this money and just go out and gamble it after what just happened, I just can't believe that would ever happen in a community bank environment. That is not how we work. That is not how we function. We are part of our communities. We have to do the right thing by our customer or we are out of business.

Mr. LEE. Well, let me shift gears and go back to Mr. Sperling.

Elizabeth Warren has criticized TARP for not requiring banks to lend the capital they received from the taxpayer. I am still trying to understand this. Maybe you can help clarify it in terms of what provision of this bill requires banks to lend the funds that they are receiving?

Mr. SPERLING. What it does is it builds in a very strong incentive. So when you get—if you are a bank—

Mr. LEE. There is an incentive, not a requirement.

Mr. SPERLING. That is right. And if you were to do a requirement—

Mr. LEE. I appreciate that.

Mr. SPERLING. —then you would be in danger of—

Mr. LEE. Mr. Sperling, I only have a minute—

The CHAIRMAN. The gentleman from New York's time—

Mr. LEE. Thank you, Mr. Sperling.

Understand, again, I am getting back to the point that it is a nice thing to do potentially, but there is not a requirement for them to lend and taxpayers surely have had enough.

Last question, I would love to go back to—where am I here—sorry. One more to Mr. Brown. What are you hearing from local businessmen? I know you have from your—based on your background, given that commercial banks—as the reasons given by the commercial banks for this denial of credit.

Mr. BROWN. I think it goes back to the temporary downturn in the economy which affects their 3-year average of free cash flow, which, frankly, we at the MEDC don't believe is a true measure of their ability to pay going forward, as well as the decrease in the collateral value.

As I said, I think the demand numbers are misleading, because many borrowers are not looking for capital, merely because they have been turned down so many times they have just shrunk and almost browned out their businesses. And the ones that we are lending to are putting them to work.

Mr. LEE. Thank you.

The CHAIRMAN. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman.

I was here for the testimony on both of these legislative proposals, H.R. 5297 and H.R. 5302, proposals of the Administration. So I presume Mr. Sperling is here in support of these; and it sounded to me like everybody else on the panel, with the exception of Mr. Atkins, thought that both of those legislative proposals were good ideas. If I have misread that, please raise your hand if you disagree with what I just said.

Okay, then I want to focus on the two pieces of legislation for everybody other than Mr. Sperling and Mr. Atkins. Mr. Atkins, I understand, disagrees with the proposals, but, for the other people on the panel, are there things in either of these proposals that need—specific things that need to be tweaked to make the proposal stronger? Does anybody have any suggestions to make the proposal stronger or more effective?

I am not talking to you, Mr. Atkins. You already told me you disagree with the proposal.

Mr. ATKINS. I could suggest something.

Mr. WATT. Okay. Mr. MacPhee?

Mr. MACPHEE. Yes, sir.

Well, I think the key to this proposal is that it is different in purpose and structure than TARP was. This is not a bailout bill. This is a bill to help create lending by small banks for small business. That is what we do best. And I think if we can not overregulate this, it can certainly go a long way towards freeing up this capital and getting—

Mr. WATT. Are there things in either of these pieces of legislation that you believe to be overregulating it?

Mr. MACPHEE. Not at this point, not that I am aware.

Mr. WATT. All right, I am just—I guess I am just baffled at the amount of opposition. I think a number of my colleagues on the other side have just reached a conclusion that it is more prudent for them politically to just say no to everything, rather than trying to be constructive in trying to evaluate what is being proposed. They say they support small businesses, they say they support community banks, they say they trust community banks, and we come with a proposal that seemingly would be the exact kind of thing that they would be supporting and they say no, no, no, no, no, this is terrible. I just don't understand.

Now, Mr. Atkins, maybe you can explain that to me. If you want to try to explain how somebody can tell me out of one side of their mouth that they trust community banks and they trust people in the community to be responsible lenders and then when you try to provide funds to them to do exactly that, if you can explain that to me, I would love to hear your answer to that.

Mr. ATKINS. I think part of the disagreement here is we are talking about—

Mr. WATT. I just want an answer, if you could explain that particular disconnect to me. I don't really need you to describe part of the problem again. I am just looking for what the disconnect is, other than this is a political year and it is politically expedient for some of my colleagues to say no to everything.

Mr. ATKINS. I think it comes down to looking at the data. And I think when you look at whether a capital infusion program actually will result in increased lending, I think that is where we part ways. You are talking about using $30 billion of taxpayer funds where there are not very—to disagree with Mr. Sperling, there are not huge incentives for banks to lend this out. There are a lot of incentives to keep it in.

Mr. WATT. You were getting ready to tell us why there is not a requirement. I thought I understood that if you required a bank to loan—

Mr. SPERLING. I have to—

Mr. WATT. —you would do exactly what Mr. MacPhee said was detrimental. You would create a situation that required people to make bad loans. So—

Okay, I yield back. Thank you.

The CHAIRMAN. The time has expired.

Members on the panel who have other things they want to say, somebody asked a question, at some point later on, you will be able to get it in there.

The gentlewoman from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman.

I would like to commend Chairman Moore for the hearing that we had yesterday in Chicago on commercial real estate. We spent a lot of time talking about a lot of things that are here today, and I was really sorry that Treasury could not find one staff member to be there for that hearing. We had most of the other regulators—the SEC, the Federal Reserve, the OCC, the FDIC, and a couple others.

What we heard was—and, as you know, this was to be the regional regulator, so we got to those that were on the ground to compare with what we are hearing in Washington. And one of the things that troubled me was that—obviously, Chicago and the surrounding area has a very high deficiency and default rate for these banks; and one of the things that came up was the Federal Reserve talked about how they had been really looking at for almost 16 years—looking at the fact that there was a severe concentration in commercial real estate by many of the banks there and all over the country.

Just recently, last week, we had—one Midwest bank failed in Chicago, and the week before there were seven banks that failed, including the Broadway Bank, which was owned by our State Treasurer; and all of these involved overconcentration of real estate.

Now, you are talking about putting money into these banks to be able to loan to small businesses; and, in the hearing, we found that there wasn't an overabundance or plea for loans because—for the small businesses was because they are really looking for certainty in the market. If there is no certainty, they don't know whether they can have the ability if they do get a loan to do what they want to do.

And they talked about how what they need are expanding ideas for more than 1 year. It doesn't help if you increase section 179, expanding amounts that only last until the end of 2010. And having the 5-year net operating loss carrybacks, and that is going to expire. The accelerated depreciation, I think that is expired. These would immediately inject small businesses with the money to expand and create the jobs, not looking at just what—the loan they can get. There is no certainty in what is going to expire and what is going to be available to them.

And the high concentration of these real estate loans that are going to come due, does this mean—and I was looking at page 11 of one of the bills, that it says that the Secretary may not deny an application for a capital investment of the program solely on the basis of composite rating of the eligible institution and the uniform financial institution rating system. So I don't know where, if you have a 1 or a 5, if they are going to be able to get these loans and is this a basis for disqualification.

So I think we really need to look more in—rather than just saying here is another $30 million—$30 billion that we are going to give to those banks and yet the small businesses don't have that certainty. If anybody would like to speak to that?

Mr. ATKINS. I could add one thing. I think we have to remember these loans are not pennies from heaven. Basically, you have to have a business person who has a business plan that he thinks is going to make money. Then you are going to have the flinty-eyed banker looking at that business plan to see is that going to yield any money. And that flinty-eyed banker needs to know that there is a flinty-eyed regulator in back of him to look and see if this loan is going to pay off or not. Because, ultimately, we are talking about capital infused into a bank and it is not otherwise a subsidized loan.

Mrs. BIGGERT. Do you think that if it is infused and yet this might keep that bank just barely qualifying, while if they didn't have that money they would go under as so many banks are?

Mr. ATKINS. There is a huge incentive in this program—because the incentives are so weak, there is a huge incentive for the banks to hold this capital in, to bolster—especially for poorly rated CAMEL rated banks to hold this in as capital and not lend it out.

The CHAIRMAN. The gentlewoman's time has expired.

The gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you.

Mr. Sperling, it is good to see you again.

One approach is that we buy the stock and subordinated debt of healthy insured financial institutions. The second approach is that we buy the toxic assets gathering mildew in the back of bank safes. The third approach is that we just give the Administration total authority to do either. Would we achieve the intended purpose if this bill required that we—it is limited to the purchase of stock and subordinated debt of healthy insured financial institutions on terms that represent fair value?

Mr. SPERLING. Congressman, all I can do is comment on the proposal that we have before us. We think—and this goes to the point just being made—this would be capital for—in the form of preferred stock—for banks that were viable, where the regulators stated they were viable, that they had enough capital without the government assistance and that this would provide a cushion that could allow for them to increase their small business lending, to give them an incentive and only get the incentive if they are actually lending more than they were in 2009.

Mr. SHERMAN. So, if I can interrupt, your plan is to buy preferred stock in healthy financial institutions. Does your plan involve doing this only on terms that represent fair value or does the Administration want to be free to overpay for the securities received?

Mr. SPERLING. Again, we are offering people capital in terms of preferred stock. They would pay back at 5 percent. If they increased the small business lending, that dividend rate could go down as low as 1 percent. If after 2 years they had not increased the lending, it would go to 7 percent. We think that provides a strong incentive structure to lend. I completely disagree with Mr. Atkins. It does not in any way encourage somebody to get involved—

Mr. SHERMAN. If I could interrupt, I want to thank you—

Mr. SPERLING. —not be sound and credible—

Mr. SHERMAN. Reclaiming my time.

Mr. SPERLING. —to have a loan—

Mr. SHERMAN. Reclaiming my time.

The CHAIRMAN. Mr. Sperling, it is the member's time. There was nothing in our oath of office that says we have to let other people talk.

Mr. SHERMAN. I want to thank you for your answer; and if you want to comment on someone else, you can do that on another member's time.

Now Republican friends have rejected the idea—and it is a controversial idea—that we put public cash, public capital into private institutions. Mr. Mica, is there a way for credit unions to help the small business credit crunch without us having to take that highly controversial step of putting Federal capital at risk? What impediments do you see for increasing small business lending by credit unions?

Mr. MICA. There is only one impediment right now, and that is that one group of financial institutions is opposing raising our limit on the amount of money that we can put into these loans. For 100 years, we have made these loans, for 90 years with zero restriction. And for the last 10 years, we have outshined them one-sixth of the default rate of banks. We are often told we are not sophisticated enough; you don't know how to do it. We know how to do it. We have done it for 100 years. We only had artificial restrictions for about a decade. We can put $10 billion into the economy right now, create 108,000 jobs, and we will not impact safety and soundness. Our records shows that. We are willing to work that compromise that Mr. Sperling said, and we can do it tomorrow.

Mr. SHERMAN. So you are not looking for Federal dollars to be placed at risk or you are just looking for us to take the handcuffs off at least partially off?

Mr. MICA. No government money, no new agency, nothing is needed, and our regulatory is ready to go.

Mr. SHERMAN. Now, the Administration bill involves boosting bank capital by putting in Federal dollars. Are there steps Congress could encourage that would boost credit union capital without our having to put in any Federal dollars, and with this additional capital, could you do even more for small businesses?

Mr. MICA. For the last 5 years, we have been asking for the opportunity to have alternative capital, get additional capital from our members with full disclosure so that we can grow and do a better job. It wouldn't cost the taxpayers. It would be fully disclosed, and our regulator supports that plan. That is the other—one of the two items we have asked for, for 5 years, that have been totally opposed by that group.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Kansas Mr. Moore.

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

Mr. MacPhee, as Mrs. Biggert mentioned yesterday, we had a field hearing in Chicago. We heard from Greg Ohlendorf, who represents the Community Bankers Association. Something you both stress is that community banks support the proposed Small Business Lending Fund as long as it is free from TARP restrictions that may have been more helpful in keeping a tight leash on large banks who received TARP funds. Would you please elaborate on why keeping this proposed fund TARP-free is important to ensure participation by community banks?

Mr. MACPHEE. Yes, sir, I will try. Community banks—this fund for community banks is not TARP. This fund for community banks is about creating small business loans to help get this economy rolling, and I think there is a distinct difference in how community banks run on a local board versus large institutions that run international corporations and what they have done.

I don't think it's going to take the type of—well, we want oversight. Don't make any mistake about that. We don't want to do anything that we shouldn't be doing here, and we won't. Community banks by and large have been the commonsense lenders, and we will continue to be.

Mr. MOORE OF KANSAS. Thank you.

Mr. Sperling, as we have heard from Mr. MacPhee, I think it is important that this new fund be TARP-free, but we also need to ensure the bill is fully paid for by the time the House considers the measure. Do you believe there are modifications or offsets that can be identified by the time the full House considers the bill to ensure that we are being fiscally responsible?

Mr. SPERLING. Not only can we, it is the only condition we should go forward. We are completely, 100 percent committed, as is the leadership in the House, that this will be deficit neutral. And, indeed, it may be that the Small Business Lending Fund as constructed would actually over 10 years save taxpayers money. The State initiative will leverage, we believe, $10 of lending for each dollar.

We already believe there are measures that have passed through the Ways and Means Committee, others that could be used to afford the small costs that this bill would cause for the bang for the buck it would create. But, one, again I repeat I do not believe this program, the Small Business Lending Fund, will have a long-term cost at all to the taxpayer, and whatever costs that will happen will be offset. It will be deficit neutral.

And I just want to say that while people have tried to suggest why capital, the reason why you support a capital plan is the capital plan paying dividends is capable of getting 20-, $30 billion from capital. That is leveraged to create multiples of that in lending. If you told the average American taxpayer you had a plan where you could provide capital that would basically be paid back in a way that wouldn't cost the taxpayer a penny, but could allow community banks to increase their lending to the small businesses that they are relying on for job growth and might not cost the taxpayer a penny, and any small cost would be paid for so it didn't cost the deficit a penny, I think, correctly described that way, which is the correct description, it would have very broad support.

Mr. MOORE OF KANSAS. So is there any legitimate reason in your estimation to oppose this bill if other committees would be able to help ensure the final bill of the House is fiscally responsible?

Mr. SPERLING. No. I think there is every reason to support these measures and additional measures that might be packaged together to support small business job growth in our country right now. It is desperately important.

Mr. MOORE OF KANSAS. Thank you. I yield back.

The CHAIRMAN. I will take the gentleman's time briefly if I can, if he would yield to me.

Mr. MacPhee, I heard your answer regarding the TARP. The Inspector General of the TARP, who has done a very good job over there, has asked that this bill be amended to put it under the jurisdiction of the TARP Inspector General. Would your comment about the problems that would cause apply to that?

Mr. MACPHEE. I am not sure of the answer, Mr. Chairman, but I would be willing to find out and get back to you.

The CHAIRMAN. All right. Because I would say that I think there are ways to provide oversight, and I understand the TARP issue, and I would not want to see this in any way compromised. So I am skeptical.

The gentleman from California, Mr. Baca.

Mr. BACA. Thank you very much, Mr. Chairman, and Mr. Ranking Member, for having this hearing, and I thank the witnesses for being here.

The first question is to Mr. MacPhee, you stated earlier that we did not create this mess. What do you mean by that, and who created this mess?

Mr. MACPHEE. I was speaking of the subprime debacle and the economic crisis that we are in today.

Mr. BACA. So who created that?

Mr. MACPHEE. Well, in my opinion, it was the nonregulated and Wall Street.

Mr. BACA. Because we weren't regulated, we didn't have oversight; is that correct, that caused some of the problems?

Mr. MACPHEE. That is correct.

Mr. BACA. And now we are trying to do the right thing in creating jobs and creating opportunities and creating incentives for businesses to operate, especially to provide small business loans to individuals. This bill is creating incentives for banks to level, but even with these, little is done to break down the barriers of credit and capital that banks require of borrowers to make the loans. How does this bill work to alter the landscape of eligible borrowers and in turn increase eligibility for small businesses? I would leave it to any one of you to answer.

Mr. ATKINS. I think you hit the nail on the head that this is looking at the supposed supply side, but as we were talking before, the demand coming from small businesses, we think, because of all the other aspects of the current situation in the economy, inhibits that demand from banks.

Mr. BACA. Mr. Sperling?

Mr. SPERLING. I don't understand why there is this constant desire to determine whether there is a single solution to the lack of small business loans. There is clearly a demand side. And I should point out that a program like ours encourages a bank to actually lower interest rates, which could help increase the demand for lending.

But, again, I am going to go back and say the NFIB study in February 2010 of this year showed that 45 percent of small businesses that sought credit could not get the full amount of credit that they needed. The last time that survey had been done, in

2006, it was 11 percent. It is 4 times greater the number of small businesses, and I would expect that most of the members here, like the President, could rely on their mail alone to know that there are creditworthy small businesses who cannot get the credit they need to expand, meet payroll, create jobs—

Mr. BACA. And that seems to be an ongoing program. I know in the Inland Empire where I come from, the hub for major industry is the small businesses, but they are unable to obtain loans, and that seems to be a major problem where we have to break down the barriers and provide them an opportunity for them to exist, as all of you indicated, that jobs could be created immediately.

One of the other areas that I want to address in doing something, we recently saw what happened with the dealers, the auto dealers. Where do the auto dealers fit into this bill? A lot of small dealers have been forced to close their doors, not because of their own actions, but because of the mistakes of corporate parents like Chrysler and GM; they were once part of a thriving auto industry, and now little thought has been given to them to survive, and yet the majority of them provided a lot of jobs, and they were the last to be hired. Minority dealers, Black and Brown, were the last to be hired, first to be fired, and yet a lot of these have lost their dealerships. They created a lot of jobs, created a lot of philanthropy, gave a lot back to their communities. But what is this bill doing to help small businesses, especially the automobile industry?

Mr. SPERLING. I might defer to Mr. Brown, who has been someone we have talked to often, and part of the inspiration for the State option that Congressman Peters, Congressman Levin and others have inspired is not only the manufacturers, but the credit issues for auto suppliers. So—

Mr. BROWN. Yes. If your question refers to the auto suppliers, they have been the major recipients of our program, and I think, to Mr. Atkins' point, it is the—

Mr. BACA. We want to make sure that it gets down to minority dealers, though, because the auto dealers are getting them up at the top, but the minority dealers, who were the last to receive their ownership, were the first to be closed. And we want to make sure that these minority dealers—and they are the ones that are actually selling a lot more vehicles than some of the others as well.

Mr. BROWN. I think what we have found in Michigan is that dealers, like suppliers, it is particularly the minority business owners who don't have the capital and have built that business over the years to act as a borrowing base, and it is often those minority business owners who are most in need of these types of support.

Mr. BACA. So will this be able to provide assistance to them?

Mr. BROWN. Absolutely, which in turn attacks the demand issue.

Mr. BACA. Okay. Good.

One of the other areas, because I know my time is running out, but I also wanted to talk about the minority underserved communities and the impact of this bill. It has been well documented that these communities and minority-owned businesses were struggling before the economic crisis, and from what it looks like, they will be the last to recover.

The CHAIRMAN. The gentleman's time has expired.

Mr. BACA. Hopefully, we can address that, too, as well.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from North Carolina.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

I have agreed with some of the observations of my colleague, Mr. Watt, that the criticisms of this program are so mind-bogglingly inconsistent from the other side that it is hard to imagine that the real objection is not that it is a proposal of the Obama Administration: There are too many strings attached.

There are no strings attached. It is designed to subsidize failing banks; it won't keep banks from failing. The purpose that I understand is behind the bill I support is to encourage small business lending, to put money in the hands of community banks that will in turn lend it out to creditworthy borrowers. I agree with Mr. Sperling that the incentives to do that for a bank not worried about its solvency are strong. There is a strong incentive to lend. There is a strong disincentive for not lending. But Mr. Atkins points out for those banks that are perhaps on shaky ground, the incentives aren't strong enough, and they will hold onto their capital.

The FDIC—I know the legislation says that there is supposed to be consultation with the regulator, they are supposed to have small business lending, but why should we lend this money to shaky banks? It seems like there is a lot that could go wrong. They might not lend it out. We might not get our money back. They might not make the kind of sensible loans we want them to make. They might make loans that have higher interest rates if they are trying to get back in the game that might, in fact, be more likely to go into default.

There is a list—the FDIC maintains a list, a private list, the problem bank list, those who score 4 or 5 on their scale. Why should those banks on double secret probation be eligible for this lending at all? Mr. MacPhee, I know you were just consulted, but why should this not be limited to those banks that the FDIC feels very confident are solvent and will make sensible lending decisions and will lend it?

Mr. MACPHEE. My understanding of the procedure for this draw on this program is that Treasury would consult with the prudential regulator for that bank and get approval before they would be allowed to take a draw on this fund. So I think there is a safeguard in place for those banks that have not been running well on the margin and maybe had some history. Those banks that have always been strong community banks, well-run community banks, again, maybe have taken some hits on property values and have drawn down their capital because of it, should be able to work through the regulator to be—

Mr. MILLER OF NORTH CAROLINA. It appears to be about 1 of 11 are on this double secret probation list, problem list. Why not simply limit this program to the 10 out of 11 banks that are not, that we know will not feel a need to hold onto capital rather than lend it out? Why not limit it to those banks that the FDIC is not worried about?

Mr. Sperling, time yielded to you has proved to be a black hole, but go ahead.

Mr. SPERLING. We agree with you. That is the way the legislation is drafted. The bank would have to apply to the regulator, who would have to determine that they were viable, thus they had enough capital at that time on their own to be sustainable. That would be the conditions. We would not imagine that a bank with a CAMEL 4 rating would be eligible for this. So I think that we believe the legislation is written in support of what you are suggesting here.

Mr. MILLER OF NORTH CAROLINA. Is there an outright prohibition or just a general kind of viability standard?

Mr. SPERLING. It is a viability. And one of the few—one of the suggestions that we have refused to incorporate that has come from some people is for us to somehow mandate to the regulators that they lower their viability standard. We think that would be a bad idea. It would drive the costs of this program up. So that is why we are keeping the stance with the regulator to recommend to us that the bank is viable, meaning they have enough capital without the government assistance to be viable going forward, and this is providing additional capital that would be fully to support lending. The increment would all be there to support additional lending to small businesses.

Mr. MILLER OF NORTH CAROLINA. Why not an outright prohibition if they have a CAMEL 4 or 5 that they not be eligible for this lending program?

Mr. SPERLING. I think that is—as written, I believe it is an effective prohibition on a CAMEL 4 or a CAMEL 5, so I am not sure that it would be necessary to intrude on the regulators by doing that. But I think what we have is the equivalent of an outright ban on a 4 or 5.

The CHAIRMAN. I just want to congratulate all of us for making no obvious camel metaphors.

The gentleman from Texas.

Mr. GREEN. Thank you, Mr. Chairman.

Mr. Atkins, you spoke of a moral hazard, and rather than state your position, tell me what your position is again with reference to the moral hazard.

Mr. ATKINS. Well, just that by providing very cheap credit, and that is what this essentially is to banks, cheap capital, that they will be—and then just spurring them to go out to lend maybe to less than ideal credits, that that will create some of the same sorts of situations that we have seen in the past that led to this financial crisis.

Mr. GREEN. And, Mr. Sperling, I would like to ask you to respond, please, to Mr. Atkins' contention with reference to the moral hazard.

Mr. SPERLING. I simply don't agree. In fact, I am having a hard time knowing which way he is criticizing it. At one point, he has said the incentive is not strong enough. Then he has said it is so strong, there will be moral hazard.

The fact is that the economics of this, which is that it would never make sense for a bank to do a loan that they thought was going to fail under this—what would make more sense, the more economic logic of this program, is since that you would get a lower dividend rate by increasing your lending, you would have an incentive to seek out creditworthy borrowers and perhaps offer them lower interest rates to encourage them to take lending. So this plan is actually designed to pass on some of the benefit.

And I can't understand how this could be analogized to Fannie and Freddie, which is about the implied subsidy and "too-big-to-fail." These are small banks, as Mr. MacPhee will tell you, that do not—that are never considered "too-big-to-fail," don't have an implied subsidy, and this provides a reasonable benefit for them to increase their small business lending with—without, I think, any economic logic that would suggest there would be moral hazard.

Mr. GREEN. Mr. MacPhee, would you kindly respond to the moral hazard argument?

Mr. MACPHEE. Yes, sir. I have been a community banker for 41 years. I can honestly look anyone in the eye and say I have never made a bad loan. Now, loans have gone bad after I have made them, but I have never made a bad loan. We don't do that on purpose, squinty-eyed or not, and I can tell you that from the standpoint of any banker that—I think it is pretty much a standard in this industry that community bankers have skin in the game. Most of us are shareholders. Many are second- and third-generation family-owned banks. They don't make bad loans in good or bad times. They always try to make good loans. So they don't—to suggest that the moral hazard is that it gives us incentive to make loans that will go bad just isn't reasonable.

Mr. GREEN. Mr. Mica, I want to thank you for your testimony as well, and I do look forward to working with the credit unions to see if we can reach some sort of amiable, amicable conclusion. I think that Mr. Sperling has indicated a willingness to work with you. Obviously, the ranking member, Mr. Kanjorski, and the others have indicated such, so I look forward to working with you as well.

My final comment is simply this: I do understand the moral hazard argument, but there is also the moral hazard associated with doing nothing and simply allowing things to unfold at a time of crisis. Things have gotten better, but they are not where we have to ultimately try to get, and until we get there, we do have to try as best as we can to help this economy turn around.

I marvel at how people say, we want you to do something, and then they can never agree with anything that you try to do. There has to be some way for us to reach across and come to some consensus on some of these things.

I clearly believe that this is a good piece of legislation. Maybe we have to tweak it, but I think it is a good piece of legislation, and I am honored to support it. My hope is that it will help those small businesses in communities where we have high levels of unemployment, help those capable, competent, and qualified businesses, because that is what bankers, the bankers that I have dealt with, do. They look for capable, competent, qualified businesses to do business with. And hopefully, this will help us to create some jobs and turn this economy around. It is not a panacea, but it is another step in the right direction, and I want to compliment the President for following through on this commitment that he made, and I believe it was in his State of the Union Address he announced this. Is that right, Mr. Sperling?

Mr. SPERLING. Yes.

Mr. GREEN. Thank you, Mr. Chairman. And I thank the President.

The CHAIRMAN. Your time has expired.

I am going to ask unanimous consent to make a statement. I think it is important for people to know this. The credit union issue has come up. I had been made aware that there were conversations going on, negotiations with Mr. Kanjorski and Mr. Royce, the credit unions and the Administration. I have heard what Mr. Sperling has repeated. I know—let us be clear. People in my line of work hate to have to choose between their friends when they are fighting. This is the classic case where Members of Congress have friends on both sides, but I can, as chairman of the committee, suppress this.

The Administration supports this. And I just wanted to put people on notice. Sometime soon, this committee is going to be dealing with this issue in a markup. Members will be free to do what they want, and I just put everybody on notice. There apparently is a revised version of this that is coming forward, and I just want to put everybody on notice that sometime fairly soon we will be dealing with this issue of an expansion of credit union business lending, and I just want to put everybody on fair notice of this. And that is about as neutral as I am capable of stating anything, and I am not going to say any more.

The gentlewoman from Wisconsin.

Ms. MOORE OF WISCONSIN. Thank you, Mr. Chairman.

I would like to address my first question to Mr. Sperling with regard to something the Honorable Paul Atkins and Representative Velazquez and others have talked about. They have talked about the regulatory climate as being one that perhaps is overly restrictive, and in such an environment it is impossible to pull out of this recession. And you also talked about the regulatory framework in response to, I believe it was Mr. Green's questions.

Do you think that we are in an overly restrictive regulatory environment? The anecdotal evidence out there is perhaps that as a result of some things that the "too-big-to-fail" companies have done, that this has fallen mighty heavily on community banks, and that these restrictions are arbitrary, and they have caused a great deal of havoc.

Mr. SPERLING. It is certainly the opinion of many community bank CEOs that we have spoken to that their examiners have been overly rigorous. It is—I think, as Secretary Geithner says, it is always a bit of human nature when you have had a financial crisis that you go from taking way too little risk to perhaps becoming too restrictive.

Ms. MOORE OF WISCONSIN. Can I ask this, then: Is it inappropriate for the Treasury Department to make some sort of audit, examination, guidance as to what is scientifically or reasonably appropriate? Because what I am hearing is this is rather arbitrary, and it is more than just a failure of human nature. It is really causing the collapse of many businesses and the loss of jobs.

Mr. SPERLING. One area where we have spoken with the regulators, and it is related to some of the State programs we have, is the idea that you do not want—when you are coming out of a recession into recovery, you do not want people to discourage lending to a small business that has positive cash-flow prospects simply because their collateral has deteriorated. We have tried with regulators to pass that message down. In other words, if you are a good business, and your commercial real estate has gone down in Michigan or Ohio just because of the property values or the economy is weak, but your business would be good, you want that loan to take place.

It does not always work, and one of the reasons, for example, the program in Michigan is important or other Midwestern States are interested in it is that in the absence of that happening, they provide collateral support. They provide a bit of a guarantee. The SBA loans that do the 90 percent guarantee do the same thing. They say to that bank, even if the collateral is deteriorated, we will protect you.

Ms. MOORE OF WISCONSIN. Mr. Sperling, I get the point, but it is also with regard to the capital requirements of the banks. Do you feel they are being too stringent?

Mr. SPERLING. No—

Ms. MOORE OF WISCONSIN. And can Treasury do anything other than just sort of nudge them and beg them to be less human and be a little bit more scientific and businesslike about it, not arbitrary?

Mr. SPERLING. It is actually very hard for us to control the bank examiner of—

Ms. MOORE OF WISCONSIN. Thank you.

I would like to ask the Honorable Paul Atkins a couple of questions.

I enjoyed listening to your testimony and reading it as well. I just was a little bit confused about your conclusions. You say that the CPP, which, of course, took $205 billion and gave it to the largest banks, had a very poor performance in lending to small businesses, but you also acknowledge that small businesses, in fact, historically were provided loans—that small banks provided loans to small businesses. So your conclusion that there was no evidence that this program would be helpful in terms of getting that money to small businesses based on the model of the big banks not doing it, I didn't quite understand how you reached that conclusion.

Mr. ATKINS. Well, you have to remember the CPP didn't just go to big banks; it also went to hundreds of small banks, including in my neighborhood a bank of maybe $500 million of assets, a community bank. So it is a broad-based program, but a lot of people, of course, decided not to—

Ms. MOORE OF WISCONSIN. Okay. But then they also had these increased capital requirements that we just discussed, Mr. Sperling just discussed. So I think—Mr. Chairman—

Mr. MILLER OF NORTH CAROLINA. [presiding] I am sorry.

Ms. MOORE OF WISCONSIN. Okay. I had time. I had about 10 seconds left.

Mr. MILLER OF NORTH CAROLINA. Go ahead.

Ms. MOORE OF WISCONSIN. Thank you.

I just wanted to talk about something that my colleague talked about with respect to the moral hazard. Is it your view, Mr. Atkins, that—we have talked about a whole lot of these small businesses really being very creditworthy, and because the capital requirements and collateral requirements have increased arbitrarily, that there are plenty of creditworthy businesses that are going under for lack of capital? And so how did you reach the conclusion that this, not being a permanent program, but a short, temporary program, could create moral hazard when there is, in fact, plenty of evidence that there are very worthy, credible businesses that have been run very well but for the fact that they have not been able to get the short-term credit that they rely upon to conduct their business?

Mr. ATKINS. Well, from my testimony and also from our study, the Oversight Panel—and I disagree with Mr. Sperling, the NFIB survey actually did say that small businesses have not found that they have had a lack of credit. It seems like banks do have capital out there to lend, but the real question is, why are they not lending it? Is it because of regulatory reasons? Is it because of lack of the underwriting aspects of these particular people who are searching for loans, and do they need them?

Getting to the moral hazard like with the SBA before you all here on this panel, you had an SBA official who said, "an extra incentive for risk-averse lenders to lend to small businesses is provided by the SBA guarantee." That is what we are talking about with respect to moral hazard, that they have to bolster it to—

Ms. MOORE OF WISCONSIN. I yield back.

Mr. MILLER OF NORTH CAROLINA. The gentlelady's time has expired. Because the Chair almost shortchanged Ms. Moore 3 seconds, she got 2 minutes extra. I will not make that mistake again.

The Chair yields 5 minutes to Mr. Lance.

Mr. LANCE. Thank you very much, Mr. Chairman.

Good afternoon, gentlemen. I think we are entering an interesting time in the congressional year between now and Memorial Day, or perhaps between now and the Fourth of July. It seems to me we ought to address some of the budgetary issues. We do not yet have a budget, and there is a debate as to whether or not we are going to have a budget act, and as I understand it, if we don't have one, it would be the first time since the 1974 act that we do not pass a budget. In the next several weeks, we are supposed to consider unemployment benefits, money to continue funding for our troops in Afghanistan, etc.

Mr. Sperling, regarding the $30 billion that would be the basis of this program, does the Administration yet have an indication of where the money would be identified to pay for the program?

Mr. SPERLING. Congressman, as you know, what is required to meet the PAYGO scorecard is what CBO will say the cost is. So we will be looking for the score of this proposal both over the 5-year and the 10-year level. We think that over 10 years, as Chairman Frank said, the $30 billion initiative will actually not cost the taxpayer any money. There could be a small cost in the 5-year window. It will be a small fraction. And if that is the case, then when we are putting together the offsets for the overall small business jobs package, we will have to ensure that it is deficit neutral over 5 years and deficit neutral over 10 years.

So I think everybody who has spoken on this bill so far, whatever their philosophy, whatever their differences, agrees this must be passed in a way that does not add 1 penny to the Federal deficit.

And, of course, your goal is if you can do something deficit neutral that is creating jobs and activity and revenue, that it will actually have a positive impact.

Mr. LANCE. And if I might continue, Mr. Sperling, what would be the timeframe for a determination that would be deficit neutral?

Mr. SPERLING. I think we have already gotten a preliminary report that it would be deficit neutral, the $30 billion fund over 10 years. I think we are looking at the design timing over the 5-year amount. But I think, you know, as you think about the extenders bill, you obviously are, I am sure, for extending the R&E tax credit, but you want to pay for that overall package when it comes through in the extenders.

In this case, a bill will come together that pays for an overall jobs tax credit bill—I mean, jobs bill, which will include the tax cuts as well as this measure, and I think what Chairman Frank and the leadership has made a commitment to is that that package as a whole will be deficit neutral, and we will be working with the committees, including House Ways and Means, to make sure—

Mr. LANCE. Our staff indicates to me that the CBO indicates that the cost would be $10 billion over 5 years and a savings of $1 billion over 10 years. At least, those are the current figures.

Mr. SPERLING. That is because the program as initially put forward lasted 5 years until a lot of people would pay back the capital right after the 5-year window. So we have sent that back to the Congressional Budget Office at 4½ years. It is our understanding that would bring the 5-year costs down to just $1 billion or $2 billion, but that is what I don't know for certain at this time, Congressman.

Mr. LANCE. Thank you.

I raise this in the context that the CBO has recently indicated the additional costs in part of the health care proposal. This is an ongoing debate, and obviously we are concerned on our side of the aisle related to whether or not there will be a budget act this year. I know that is not specific to the discussion today, but there is an overall theme that is of great concern to our side of the aisle.

Very briefly, as I understand it, the legislation says that for each eligible institution that applies to receive a capital investment under the program, the Secretary shall consult with the appropriate Federal banking agency for the eligible institution to determine whether the eligible institution may receive such capital investment. That impresses me as being broad language, and perhaps that is appropriate. But, Mr. Sperling, could you indicate what your views are regarding that legislation and whether that is specific enough? Does it need to be that broad given that we are trying to help the economic situation?

Mr. SPERLING. I think Congressman Moore has asked the same thing. I think we believe it is, because we believe that the process of going through the regulator, they are the ones with the expertise, access confidential information to make the judgment that that firm is viable without existing capital. Therefore, the new capital would be simply additional capital to increase lending.

So it is our understanding that language is strong enough, but if there were concerns about that, that would certainly—you know, that would certainly be the type of thing we would be willing to discuss.

Mr. LANCE. Thank you, Mr. Sperling.

I believe my time is up.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Lance.

The gentleman from Missouri, Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. Sperling, I want to follow up, if I might, on the exchange you had with Ms. Waters regarding—as she talked about the CDFIs. Is there a reason we aren't doing more to assist the community development loan funds, who are actually doing some of the most difficult work in disadvantaged communities, and do you think that we should make them eligible under the Small Business Lending Fund? For example, this would be a way for them to meet increased demands they are facing with regard to the small business loans in lower-income communities all across the country.

Mr. SPERLING. I think we should—we are actually at this point still trying to see if, through the existing TARP authority, there is a way that we could help the CDFI loan funds as we have done an initiative to help CDFI banks and CDFI credit unions.

We agree with you. The question is finding the right vehicle. The Small Business Lending Fund is obviously designed more to bring capital to a regulated financial institution. CDFI loan funds, which we strongly support and agree with you, don't fit that description.

So I think the short answer is, we ought to be doing more, and we ought to work on that. And this may not be the best vehicle, but it doesn't mean we shouldn't find a vehicle to do more for CDFI loan funds. Certainly, having strong appropriations for our CDFI program is the most certain way of doing that, but there could be others.

Mr. CLEAVER. Does anybody differ with that?

Thank you. I have no further questions, Mr. Chairman.

Mr. MILLER OF NORTH CAROLINA. The gentlewoman from Illinois Ms. Bean.

Ms. BEAN. Thank you, Mr. Chairman.

And thank you all for your testimony today and for sharing your expertise with us on this important subject.

I happen to be a vice chair of the New Dems, which is a 70-member coalition that very much sees themselves as a voice for small businesses, which are so important to our economic growth. We were very involved in some of the stimulus provisions that made sure that we went further than just providing tax cuts to 95 percent of Americans on the consumer spending side, but to make sure the B2B space was addressed by including the NOL carryback. Over $9 billion has gone back into the hands of small businesses, taxes they had paid in previous profitable years, to help them weather through unprofitable ones. We encouraged the SBA loan guarantees, which have allowed $23 billion to go into the hands of small businesses when they need it, recognizing access to capital is important. We fought to include health IT initiatives, smart grid technology, the first-time homebuyer tax credit to bring 700,000 new buyers into the market at an important time. I think that is why the Chamber and the National Association of Manufacturers endorsed that important stimulus to our economy.

But we recognized more needed to be done. So that was done in February of last year. In March, we came to the White House. We met with the President. The number one issue we raised with him at the time was access to capital for small businesses. He committed at that time to putting $18 billion into the secondary market should it be necessary so that small community banks that were lending to small businesses could recycle those loans. It turns out we didn't have to do that because the guarantees in the stimulus had already helped create a secondary market.

But there is certainly more to do since then. We had the ARC loans, which had the smaller loans that allowed companies to restructure debt. There is a proposal to expand the 504 program, which would allow refinancing for the commercial real estate market, which right now is hampering the balance sheets of so many of our community banks. They want to lend in many cases, but they can't because they have an examiner over their shoulder saying, your balance sheet is just not going to allow that given your exposure.

So my question is, I guess, for Mr. Sperling. The Administration is proposing to increase both the SBA and 504 loan sizes to $5 million. There are a number of measures in Congress, some of them bipartisan, to support that; but some also expressed concerns that increasing those loans obviously increases taxpayer exposure. Why do you feel that is a sound approach?

Mr. SPERLING. Actually, the experience on the SBA side has been that the larger loans have actually performed better. So by going to the $5 million, we believe that will be very strong for the economy.

It was interesting, if you were to ask—I know they aren't represented here—the franchisers, they would consider that to perhaps be their number one agenda item, and the reason why is because some of the most promising people who had opened new franchises often want to open several at one time, or they don't go in. Those are obviously clear job-creating, small business-owning-type situations. So we feel that it is a good complement to what we have now to offer those loans up to $5 million, and that they actually perform well and have low subsidy costs.

I know Chairwoman Velazquez has also been concerned that that doesn't take away focus on the smaller loans, and that is why I think we could also imagine including in a jobs package something that made loans under $250,000 more attractive in this period as well.

Ms. BEAN. How quickly do you think, assuming these proposals move forward, would the moneys from the Treasury be available to those community banks?

Mr. SPERLING. Well, in the SBA program, that would just happen—that would just be part of the SBA's relationship with the banks forward. In terms of the programs we have here, one is that the good part about the State option, and we have two representatives here, is that these are programs that are up and going. We know what has been frustrating is when there has been a Recovery Act, we had to start brand new. This is trying to get funding to programs that are up and going and having higher demand as they are getting budget cuts.

So I think on the State programs, money could go very quickly. And then on the capital program, it is our opinion that we could get this up in a couple of months at most. So we feel that we have learned some lessons in the Recovery Act, and one of the focuses we have had is on being able to implement quickly under these initiatives.

Ms. BEAN. I thank you, and I thank you for your efforts on behalf of our small businesses. We feel the Administration has been working closely with those of us who don't want to just talk about supporting small businesses, but actually act to do so. Thank you.

Mr. SPERLING. Thank you.

Mr. MILLER OF NORTH CAROLINA. The gentleman from Colorado, Mr. Perlmutter.

Mr. PERLMUTTER. Thank you, Mr. Chairman.

I am going to hold up a couple of charts for you all, but basically from 2008 to the beginning of 2009, we had a falloff like we have never seen, none of you sitting at that table or anybody sitting up here has seen. Since President Obama took office, with the Recovery Act, we finally have crossed the axis to the point we are adding 290,000. We had been losing 780,000 jobs. The area in the middle of this "V" is 8 million jobs. So I think everybody, Democrat or Republican, wants to put those people back to work, and the question is, how do we do it?

Our principle is that small business, once it is back on its feet, is going to be the primary generator of those jobs. And as we put people back to work, then the budget deficit solves—there are a lot of problems solved by an improving economy and a reduction of people on the unemployment rolls.

So, Mr. Determan, I want to start with you. You talked about one of the things that I think we have to address in any of these bills, and you said you all lost your line of credit. So—and a number of the Members have talked about this, but as part of this process, we have the old borrowers; we have, we hope, new borrowers; and I personally want to see competition so that we maintain community banks. Maybe we add credit unions to that mix. So in your situation, would some of the people for whom you did business, if there had been the opportunity for them to keep their lines of credit or you to keep your line of credit until you see the light at the end of the tunnel, which is coming here—go ahead, if you could respond to my sort of general statement.

Mr. DETERMAN. Yes. Thank you for the question.

We closed our business in October of 2009. We were waiting for a project to begin, and it went for years without being financed, and our fees were deferred until the project closed. We were expecting $1.8 million. Our credit line was finally called in. We had to pull the plug on the firm. In November of 2009, that project closed, a month after we ended the firm.

Mr. PERLMUTTER. Okay. So that is my point here. As we get to the light at the end of the tunnel, I want people to be able to get there, to maintain competition, to maintain good borrowers. I have a bill I am going to raise either tomorrow or at some point that does, Mr. MacPhee, one of the things you were talking about, which is to take a loss now and amortize it over 7 years so that you don't have to take the entire loss to capital—the bank doesn't have to take the entire loss to capital—right now it is H.R. 5249—and spread it out over 7 years, which is what we did in Colorado so that the agricultural banks could stay in business. And we didn't close everybody, because as you close those banks, you are going to dry up credit.

I agree with my friend from North Carolina, you don't want the bad banks staying in business, but I want to have competition when we get to the end of this thing. And that may be that we do some—we have new lending money, but we give some opportunity to amortize, because I don't want the architectural firms, the small businesses that are going to put all those people back to work, I don't want them going out of business.

Now, Mr. Atkins, I have to quarrel with you for a second. You used the word "anecdote" twice, that it is anecdotal that the regulators have been harsher. We have had about a million hearings in here. It is no longer anecdotal for me. We have heard from too many people. And it is natural; Secretary Geithner says it is human nature where the regulators tighten up because they don't want to lose a bank or a credit union on their watch, and the bankers tighten up. So in Congress, we need to do some things to tell them we want to be countercyclical. We want small businesses to survive and then thrive and put people back to work. So I will give you a chance to respond to my quarreling with you about anecdotes.

Mr. ATKINS. I agree. All I meant was that there is no real survey data to support it, but we hear the same sort of thing as you that you are hearing in the hearings as well, and it frankly has existed in past recessions as well. We heard it when I was a staffer at the SEC back in the early 1990's, basically that bank examiners are being, you know, much too particular.

Mr. PERLMUTTER. And I think the bankers are, too.

And I will make just this last point. We had a company, a little restaurant, that wanted to franchise, that had two little barbecue franchises. They wanted a $250,000 operating line, not much. They went to 18 banks and were denied at all 18 banks. We intervened a little bit and said to some bankers, check this out. But 18 banks for a $250,000 line of credit? That is not right.

The CHAIRMAN. Time has expired.

The gentleman from Indiana.

Mr. CARSON. Thank you, Mr. Chairman.

Mr. Mica, what did you mean when you earlier stated that your regulator is prepared to take on the Member business lending efforts that we have discussed today? Does it support these efforts?

Mr. MICA. Yes, absolutely. Our regulator has sent a letter to Treasury and to the Congress indicating they would support this. They, too, want to make sure, and we agree with that, that there are proper safety and soundness guidelines, that they continue to have proper oversight. We have no problem with that. Our record is very strong.

Mr. CARSON. Thank you.

Mr. MacPhee, while the size gap is narrowing between men- and women-owned businesses, it is clear we still have a long way to go in terms of the current number of women-owned businesses. With regards to the banks that will receive funds pursuant to the Small

Business Lending Fund, will they be required to report how they plan to increase lending opportunities for women and minority-owned businesses and aspiring entrepreneurs?

Mr. MACPHEE. I do not know the answer to that. I can get back to you on it, though.

Mr. CARSON. Thank you.

And, lastly, Mr. Atkins, for those States that apply for funds made available by the State Small Business Credit Initiative program, will they be required to submit a business strategy for how they plan to allocate funding to lending institutions that are most in need?

Mr. ATKINS. That is a good question. I don't think that the legislative language necessarily covers that, but I can get back to you on that as well.

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

Mr. PETERS. [presiding] The Chair recognizes the gentlewoman from Ohio, Ms. Kilroy.

Ms. KILROY. Thank you, Mr. Chairman.

Thank you to all the panelists for joining us this afternoon.

As my colleagues have indicated, I have heard also from people from central Ohio about their issues with access to credit, and many small business people tell me that they could expand, they could hire, they could invest in a building opportunity or a commercial opportunity if they had access to capital. And at the same time I hear from the small community banks that they are lending, that capital is going out there. And from some of them I am also hearing the issue that has also been raised here this afternoon that the regulators are holding them back from making those loans or requiring them to call in even loans that are productive.

So given all the allegedly anecdotal reporting, are there going to be provisions that will require data be kept so that we actually know who is trying to access capital, and who is getting access to the loans, and who is being turned down for those loans, and also how many jobs are being created?

Mr. SPERLING. I don't know that—you know, right now on the Small Business Lending Fund, we are relying on the existing data sets that are out there, so we look at the—we look basically at the C&I loans, and the owner-occupied real estate loans, and the agriculture loans of small banks, which obviously are small and go to small businesses, and we are looking at how much they are increasing.

You are asking another question, which is a good question, which is do we have a way of getting data as who is applying? And I don't know that there is anything in this legislation that would be asking for kind of a new data set. I think the issue that anybody dealing with this deals with, that there is not perfect information at all. I think Chairwoman Velazquez was getting to that, too, on small business lending, and you are forced to use the best proxies that you can.

The only thing I would just want to say is that, you know, while the examiner issue is controversial, it is difficult, when they classify a loan and make you give more capital or they worry about your collateral, some of these programs we are dealing with now do directly deal with that. If you can get more capital through the

Small Business Lending Fund, that could give you—puts you in a stronger position to keep lending, even if you feel your examiner is unfairly classifying one or two loans. If you have things like the collateral support program that the Michigan and others are doing, those are things that could more directly affect you and allow you to give a loan even if you felt a bank examiner was mischaracterizing a loan you are giving.

Ms. KILROY. And yet, though, to be devil's advocate here, there is a value in having underwriting standards so that bad loans aren't being made, so that the program is being productive, and that the taxpayers are being protected. So should we have some minimum underwriting standards that are required in this bill?

Mr. SPERLING. Well, I don't think—and I think—as Mr. MacPhee said, I don't think there is anything here that would encourage anybody to loosen their underwriting standards, nor should they, not just for the taxpayer, but to be honest, bad loans, like subprime loans that shouldn't have been given, can make people lose everything and go into bankruptcy. We wouldn't want to encourage those bad loans not only—

Ms. KILROY. But aren't we putting in incentives to provide loans here?

Mr. SPERLING. But the incentive is—what you really want is a combination of things that will make banks who have maybe pulled back categorically from small business lending go back into lending. You know, the Recovery Act that many of you voted for encouraged 1,300 banks who hadn't been doing SBA lending to come back, to set up shops and hire people to start doing small business lending. So by offering an incentive, you give an encouragement to do more in that area, and you make the lending performance-based, which was one of the big complaints about CPP.

But, again, I don't see any economic incentive that would make you actually give a bad loan. The loss you would suffer would be much greater than any incentive you would get if you had a loan that completely failed.

Ms. KILROY. We have all been very interested in helping small business, as you suggest, the Recovery Act; and the HIRE Act; the Worker, Homeownership, and Business Assistance Act; tax credits for small business for health care. But how do we make sure that this is targeted towards those small businesses? The definition of lending seems pretty broad there to me, but I am deferring to you as the expert here.

Mr. SPERLING. Well, again, the President is supporting a comprehensive approach. So we are supporting the expansion of the SBA recovery provisions which go—which, by definition, go only to certain small businesses of certain sizes. The expansions on the SBA program go to the small businesses. The State program also is there. This one program goes to small banks and uses the best possible proxy that exists that we could possibly use today to measure whether a small bank has increased their lending to small businesses and farmers.

Mr. PETERS. [presiding] The gentlewoman's time has expired.

Ms. KILROY. Thank you, Mr. Chairman.

Mr. PETERS. Thank you.

I am the last questioner for you, and you will be on your way shortly. We certainly appreciate all of you being here and giving this testimony on a very, very important topic, one that we had been dealing with for quite some time here.

Before I ask a few questions, I want to make a unanimous consent request to those of us who are still here. I have two items to put into the record: I have a letter in support of the State Small Business Credit Initiative, signed by 13 Governors; and a letter of support from the Motor & Equipment Manufacturers Association. I would like to enter them into the record, with unanimous consent.

Before I ask some questions, it certainly has been interesting in hearing the comments of some of our colleagues here on the other side that there is a lack of demand for this lending. Certainly, that is not what I hear. We have certainly been hearing from many folks on this side of the committee room as well. That is not what we are hearing from our small business owners. In fact, I had a meeting just yesterday with small business owners, and I had a gentleman who has the top credit rating, an outstanding entrepreneur in my area, who was attempting to expand his business in the local town, and he said he has been to eight banks and has not been able to get the loan, and he is now on his ninth bank, and he thinks that hopefully he will be able to get it. And he said he wouldn't have gotten it except for incredible perseverance to do it. It is a job that can immediately lead to the creation of additional jobs.

So we definitely have an issue out there. We definitely have to be working on that. And I think that perhaps maybe the definition of "demand" is one in which demand is not there from what is considered creditworthy, because the standards have changed as to what is creditworthy, which I think is why it is so important that we have these State programs. And I want—Mr. Brown, if you could just comment on that. Is it lack of demand from creditworthy? It is not that we have good companies that can immediately put people to work, it is that the goalposts have changed basically, and that is why these State programs are necessary? Is that an accurate statement?

Mr. BROWN. I think that is a perfectly accurate statement. And, in fact, the existence of our program has created a huge pool of demand, basically pulling in loans that would otherwise have not been considered eligible. So its very existence is now bringing people back to the credit markets and encouraging them to expand their businesses.

Mr. PETERS. Mr. Johansson, you are also heading a State program. Is that an accurate statement for your organization as well in Maryland and what you are doing?

Mr. JOHANSSON. Congressman, I think your statement is right on. And the evidence we have in the State of Maryland is that last fiscal year, we did $40 million in loan guarantees. At this point in time, we have $40 million already done, and we have $150 million in the pipeline. If that is not a signal of an uptick in demand, I don't know what is.

Mr. PETERS. And what sort of jobs would be created by that? Do you have any idea?

Mr. JOHANSSON. Well, it would be everyday businesses. We were talking a company that manufactures tools, Bass Manufacturing, and we gave them an $87,000 guarantee. They got a $350,000 loan as a result.

These are small businesses that are throughout the State of Maryland, and we are talking about thousands and thousands of jobs that can be impacted by this.

Mr. PETERS. The other complaint that I have heard, or I should say criticism of the potential, is the cost to the taxpayers. If I recall in your testimony, you mentioned that there has not been a loss. What would we expect the cost to the taxpayers would be from additional resources from your fund in Maryland?

Mr. JOHANSSON. Well, we haven't had a single loss in the last 5 years, and we expect that record to continue.

Mr. PETERS. And the resources that would be put into your program, how would that be leveraged with private resources?

Mr. JOHANSSON. We are estimating a minimum of 10 to 1. So for every dollar that you inject into a fund like the MTFA fund, you get $10 of private sector lending.

And I think what you brought up before about the goalposts being changed, the fact is you are dealing with stricter lending standards. And the collateral, people's houses, people's equipment, the commercial land that they own, and so forth, the commercial real estate, all of that has been reassessed, and so that gap even when they are creditworthy, that is a gap that we need to help plug, and we can do it.

Mr. PETERS. Mr. Brown, is that a similar experience in Michigan?

Mr. BROWN. Yes, it is quite a coincidence that actually our hard pipeline in terms of deals that have already been brought to us and our already under underwriting and due diligence by the banks is also $150 million. And our program right now has also, although it has only been in existence about a year, has never had a default. We expect that the portfolio theory will prevail, and there will be some defaults, but overall, we expect our fund to return 5 percent on invested public dollars.

The PETERS. Mr. Atkins mentioned in his testimony that we should not have a one-size-fits-all plan with this legislation. But it seems to me the small credit business initiative is exactly the opposite. It is not a one-size-fits-all plan, but really is tailored to the unique needs of States, and they are going to be different. We have two for Michigan and Maryland. Your plans are going to be different, but you have different States and different needs. Is that an accurate assessment, Mr. Johansson?

Mr. JOHANSSON. Most definitely. If you look at loan guarantees, there are 34 States that have these. These are shovel-ready solutions that are ready to go, not tomorrow, but are ready to go today if they have the necessary capital to put to work. And this isn't capital that will sit on the sidelines. For a loan guarantee, by its very nature it has to unlock private sector lending. So every dollar that someone puts in it effectively unlocks private sector lending.

Mr. BROWN. I think one of the particularly elegant parts of this plan is that it relies on the States to develop their own programs. Michigan, I think it is not surprising that our program right now is reserved for Tier II, III, and IV auto suppliers who are diversifying into four of our targeted industries. We have identified that manufacturing is something that we have a core competency in. We would like to continue it. We risk losing it and losing it permanently if we don't get the capital to these companies. And every State may be different. It both allows, this program both allows the States to tailor theirs to their specific need as well as allows a diffuse pipeline to get those moneys out on the streets quicker.

Mr. PETERS. I know my time has expired, but it is rare that I can have a chairman's prerogative and take a little extra time. I will just ask one question, and that is, we are in 34 States. Are these programs that it is not just about those 34 States, these are State programs that can be replicated fairly easily? Based on the success of those 34 States, would you expect any problems for the other States?

Mr. BROWN. Not at all. In fact, we have looked at this issue and have spoken to some States that currently don't have a loan support program. Most of their economic development agencies, whether it is the Department of Commerce or something more similar to the Michigan Economic Development Corporation, are able to do that administratively.

Mr. PETERS. Great. Thank you.

Are there any other members who wish to be recognized?

With that, the Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

This hearing is now adjourned.

[Whereupon, at 4:05 p.m., the hearing was adjourned.]

A P P E N D I X

May 18, 2010

Testimony of Paul Atkins

Member, Congressional Oversight Panel

before the

House Financial Services Committee

May 18, 2010

Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee, I am Paul Atkins, a member of the Congressional Oversight Panel. I appreciate this opportunity to testify about the Panel's work assessing initiatives to promote small business lending, jobs, and economic growth. I should note that the views expressed in this testimony are my own. I will do my best to convey the Panel's views, but my statements cannot always reflect the opinions of our five diverse thinkers.

The Secretary of the Treasury recently designated small business credit access as a primary focus of the Troubled Asset Relief Program (TARP), and he pledged TARP funds "for additional efforts to facilitate small business lending." Because the Panel is mandated to review the Secretary's use of his TARP authority, oversight in this area is an important statutory role of the Panel.

Although the legislation that the Committee is now considering would establish a Small Business Lending Fund (SBLF) outside of the TARP, the SBLF is intended to complement the TARP, and it is a close relative of TARP initiatives such as the Capital Purchase Program. As such, I believe that the Panel's perspective may be valuable.

The Congressional Oversight Panel has taken no position on whether any of the programs discussed in this testimony, including the SBLF, should be implemented.

Introduction

Small businesses have long been an engine of economic growth and job creation in America. More than 99 percent of American businesses employ 500 or fewer employees, and together these companies employ half of the private workforce and create two out of every three new jobs.

Credit is critical to the ability of most small businesses to purchase new equipment or new properties, expand their workforce, and fund their day-to-day operations. If credit is unavailable, small businesses may be unable to meet current business demands or to take advantage of opportunities for growth. This could choke off any incipient economic recovery.

Unfortunately, small business credit remains severely constricted. Data from the Federal Reserve shows that lending plummeted during the 2008 financial crisis and remained sharply restricted throughout 2009. Although Wall Street banks had been increasing their share of small business lending over the last decade, between 2008 and 2009 their small business loan portfolios fell by 9.0 percent, more than double the 4.1 percent decline in their entire lending portfolios. Some borrowers looked to community banks to pick up the slack, but smaller banks remain strained by their exposure to commercial real estate and other liabilities. Many small businesses have had to shut their doors, and some of the survivors are still struggling to find adequate financing.

Although the small business credit crunch is partly caused by the reluctance of banks to lend, it is exacerbated by the reluctance of businesses to borrow. A small business loan is, at its heart, a contract between two parties: a bank that is willing and able to lend, and a business that is creditworthy and in need of a loan. Due to the recession, relatively few small businesses now fit that description.

During the Panel's recent field hearing in Arizona, a local bank president laid out the problem in stark terms:

> "We could grow the bank by $100,000,000 in new assets and not need any new capital.... Our lack of loan growth is a reflection of the impact of the recession on the small businesses in this state.... We would do more, but it is difficult to find anyone who has not been impacted and remains creditworthy."

Another concern is that the current regulatory climate may make it extremely difficult for banks to increase their small business lending. There have been anecdotal reports that bank examiners have become more conservative and have required increasing levels of capital in the last year. The balance between sufficient regulation and over-regulation is a fine one. In an overly permissive regulatory environment, banks may tend to make riskier loans, exacerbating the economy's precarious position. In an overly restrictive regulatory environment, however, banks may become too conservative, and there will be insufficient credit available to help pull the economy out of the recession.

The TARP and the Capital Purchase Program

Treasury has launched several TARP initiatives aimed at restoring health to the financial system, and the Panel evaluated the impact of these programs on small business lending in our most recent oversight report, "The Small Business Credit Crunch and the Impact of the TARP." After a thorough review, we found little evidence that these programs have had a noticeable effect on small business credit availability.

Among the TARP initiatives announced to date, the program that most closely resembles the proposed SBLF is the Capital Purchase Program (CPP), which provided a total of $204.9 billion in capital infusions to banks. In exchange, the government received preferred stock paying a 5 percent dividend, as well as warrants for the purchase of common stock. The bulk of CPP funding, about 81 percent, went to large banks with over $100 billion in assets.

The impact of the CPP on small business lending is extremely difficult to measure. One issue is that the definition of "small business" varies widely, meaning that different data sources on small business lending are often not directly comparable. Further, Treasury required only the top 22 CPP recipients to report on their lending activity. Even for these institutions, relevant data is available only from April 2009, when Treasury first required reporting of small business lending, until January 2010, when the institutions began to exit from Treasury reporting requirements upon repaying their CPP funds.

Within this narrow window, it is clear that small business lending was on the decline. The average small business loan balance for these institutions decreased 4.6 percent from April 2009 to November 2009. Total small business originations for these institutions decreased by 7.4 percent for this same period. Although it is possible to question whether lending levels might have decreased further absent the CPP, there are no data to support or challenge this assertion.

The lack of data available to evaluate the CPP illuminates a broader problem: the absence of high-quality data about current lending practices. The Panel believes that Treasury's currently limited data collection is at best regrettable. Such poor data have made it far more difficult to pinpoint the causes of today's problems and, as a result, to find effective solutions.

The Small Business Lending Fund

As presently proposed, the SBLF would provide $30 billion in low-cost capital to small- and mid-sized banks. Banks would be eligible for the SBLF only if they hold less than $10 billion in assets. The goal is to reach the relatively small financial institutions that provide a disproportionately large share of small business credit.

The core of the SBLF program is an incentive for banks to increase lending. The SBLF would, like the CPP, require recipients to pay a dividend on their borrowed money – but unlike the CPP, the SBLF would link the dividend rate to the recipient's lending activity. Participating institutions would pay a dividend of 5 percent, which could drop as low as 1 percent if the bank "demonstrates increased small business lending relative to a baseline set in 2009." On the other hand, if the bank's lending rate decreases or plateaus after two years, the dividend rate would rise to 7 percent. At the end of this five-year period, the dividend rate would increase to 9 percent, which would provide an incentive for banks to repay the funds. This dividend structure is intended to ensure that SBLF recipients, unlike CPP recipients, actually increase their lending to small businesses.

The SBLF's prospects are far from certain. Even if it is established by Congress immediately, it may not be fully operational for some time. It could arrive too late to contribute meaningfully to economic recovery.

Moreover, banks may shun the program in order to avoid the stigma of government funding. Assistant Secretary Allison recently testified to this committee that small banks have faced pressure from competitors that use the "'TARP recipient' label in negative advertising." In addition, industry sources have told the Panel that restrictions that were applied after banks accepted TARP funds have made banks hesitant to participate in the TARP, as they have no guarantee that the restrictions in place will remain constant. It is possible that concerns over these issues could carry over to the SBLF.

Banks may also avoid the SBLF if they are unwilling to take on new liabilities during troubled economic times. In particular, the Panel recently reported that 2,988 banks nationwide were classified by their regulators as having a potentially risky concentration in commercial real estate (CRE) as of March 2010. As long as CRE and other assets remain in jeopardy, banks may be unwilling to increase their small business lending, notwithstanding the SBLF.

The SBLF also raises questions about whether, in light of the CPP's poor performance in improving credit access, any capital infusion program can successfully jump-start small business lending. The SBLF rests on the assumption that the key factor constraining lending is that banks do not have enough money to lend. However, another major constraint is the unwillingness of small businesses to borrow. In the fourth quarter of 2008, net 57.7 percent of the respondents to the Federal Reserve Board's Survey of Senior Loan Officers reported that demand had fallen for small business loans – a figure that rose to 63.5 percent the following quarter. Even now, net 9.3 percent of the survey respondents continue to report falling demand. To the extent that contraction in small business lending reflects a shortfall of demand for credit rather than of supply, any supply-side solution that relies on improving bank balance sheets, such as the SBLF, will fail to gain traction.

An additional risk is that the SBLF may reward banks that would have increased their lending even in the absence of government support. The SBLF's incentive structure is calculated in reference to 2009 lending levels, which were low by historical standards. If a bank increases its lending – not as a result of receiving the SBLF funds but simply to return to a more normal lending level commensurate with its long-term business model – then it will receive a reduced cost of funds. The low lending levels in 2009 also make it unlikely that the penalty provision will be triggered. In effect, a bank may receive a government reward and avoid a penalty simply for acting in its normal course of business.

Even if the SBLF's incentive is sufficiently strong, the program may produce one key unintended consequence. A capital infusion program that provides financial institutions with cheap capital along with penalties for failing to increase lending runs the risk of creating moral hazard by encouraging banks to make loans to borrowers who are not creditworthy. The stronger the incentive, the greater the likelihood that the program will spur some amount of imprudent lending activity. Treasury maintains that this concern is minimal, as the SBLF was designed to minimize the chances that banks will use the capital to make risky bets. The program does not shift risk away from the banks that receive the capital: any institution that receives funds under the SBLF is obligated to repay that money to Treasury and therefore will lose money if it makes a bad loan. The dividend and repayment requirements are likely to decrease the chances that banks squander the capital on imprudent lending.

Alternatives to the SBLF

One alternative to the SBLF that the Panel explored in our most recent oversight report would be to permit banks to fund state lending consortia, such as those that exist in New York and South Carolina. The New York Business Development Corporation (NYBDC), for example, uses funding from member banks to make loans to small businesses, "many of which do not meet the requirements for traditional financing." Because of the single-purpose nature of consortium lending, this approach may be effective for deploying capital directly into new small business loans, rather than using it to shore up a bank's balance sheet. A consortium could also leverage contributed capital several times over.

This option would be most effective if it included an incentive that encourages banks to provide funds to consortia. For example, just as the SBLF's lending incentive primarily rewards banks based on the loans they make, a consortium-oriented approach could employ an incentive that rewards banks for their contributions to a consortium.

Any effort to spur small business lending through consortia would, however, face several obstacles. Lending consortia are currently active in only a handful of states, and starting programs from scratch in other states might take a substantial amount of time. As a result, any consortia-based approach might have limited reach, especially in its early stages. Today's witnesses from Michigan will, no doubt, be able to shed more light on this subject.

Conclusion

Treasury has stated that it believes that providing cheap capital to the smaller banks will unlock the credit that CPP did not. It is true that the SBLF, unlike the CPP, provides incentives for banks to lend, which may result in a different outcome. In many ways, however, the SBLF substantially resembles the CPP: it is a bank-focused capital infusion program that is being contemplated despite little, if any, evidence that such programs increase lending. Had Treasury gathered more consistent data, including ongoing data from the top 22 CPP recipients, it might have been possible to have a complete basis of comparison for lending by these institutions since EESA was enacted. In the absence of that data, the Panel is skeptical that Treasury has the grounds on which to make such an assumption. After all, the largest CPP recipients did not lend more. Further, the SBLF imposes only a mild penalty on banks that take the funds but fail to increase lending, and there is nothing in the SBLF to create accountability or linkages between the receipt of funds and loans, something that even some small banks have said that they would welcome.

The Panel recommends that Treasury and the relevant federal regulators:

- Establish a rigorous data collection system or survey that examines small business finance in the aftermath of the credit crunch and going forward. The Federal Reserve Bank of Atlanta has commenced a demand-side survey, for example, that could potentially be expanded to other Federal Reserve banks. Such a survey should include demand- and supply-side data and include data from banks of different sizes (both TARP recipients and non-TARP recipients), because the lack of timely and consistent data has significantly hampered efforts to approach and address the crisis;

- Require, as part of any future capital infusion program, reporting obligations that would make it easier to evaluate whether the support provided by the program actually has the capacity to achieve the hoped-for results;
- As part of its consideration of small business lending, evaluate whether a capital infusion program is likely to have the effect of increasing lending, and is therefore worth pursuing;
- Consider specifying minimum standards for underwriting SBLF loans in order to be sure that the incentives embedded in any program do not spur imprudent lending; and
- If the SBLF is to be pursued, evaluate whether the SBLF can be implemented quickly enough to make any difference at all, particularly given that announcements followed by inaction may negatively affect the market.

Because small businesses play such a critical role in the American economy, there is little doubt that they must be a part of any sustainable recovery. It remains unclear, however, whether Treasury's programs can or will play a major role in putting small businesses on the path to growth.

House Committee on Financial Services

"Initiatives to Promote Small Business Lending, Jobs and Economic Growth"

Tuesday, May 18, 2010 1:00pm

Testimony of Paul Brown of the Michigan Economic Development Corporation

The efforts of this administration and this congress over the last year can only be described as having saved our economy. The bill you are considering today is not designed to save our economy, but to save our economy as we know it. This country's true economic strength has always been in its small businesses, especially small manufacturers. The vast majority of workers are employed by small and medium size firms. We have to rely on small businesses for job growth if we hope to quickly recover the millions of jobs lost during the Great Recession. This administration and Congress had to save Wall Street. Now we should save Main Street.

Small businesses, particularly manufacturers, have faced a perfect storm in the Great Recession decreasing their revenue, collapse in the real-estate market decreasing the appraised value of their property, plant and equipment (PP&E), and frozen credit markets decreasing their ability to borrow the capital they need to hire and expand. The effects of these challenges continue to pose a serious threat to our small businesses, our country's industrial capacity, employment and GDP. The effects of these threats could be long lasting, even permanent, if you don't act soon to make capital available to our small businesses.

Michigan and the upper Midwest have been particularly hard hit by these factors because of our high manufacturing concentration and real-estate value. Unemployment in the state is still over 14%[1]. A recent University of Michigan report projected the state will continue to shed jobs in 2010, before a gradual recovery in 2011[2]. Many of those losses will likely come from small manufacturers, which is troubling given the large economic multiplier of the sector[3].

Michigan entered a recession earlier than most states therefore we have been grappling with these challenges longer than most. Governor Granholm, working with the Michigan Economic Development Corporation, has put in place programs to diversify our economy. These programs coordinated the state's colleges and universities, local economic development organizations, the business community and local governments to leverage our strengths to diversify and create jobs. A year and a half ago at the depth of the recession Governor Granholm had the foresight to recognize that once these seeds for growth had been planted our businesses would need capital to take advantage of the inevitable upturn in the economy. The Governor charged the MEDC with coming up with a program that would help businesses get the capital they need to survive and grow. We subsequently created and funded the Michigan Supplier Diversification Fund, with the leadership of our CEO Greg Main. This two part program supports banks in financing the strongest small businesses.

We spoke with hundreds of banks and manufacturers in order to understand the problem and design a solution. We recognized that businesses would need increased capital in order to compete for new business. Unfortunately, what we were seeing were firms failing, not for a lack of customers, but for a lack of capital. Companies were "browning out" for lack of financing. The small businesses were closing and holding asset sales on their doorsteps. Many of our manufacturers are being forced to sell their equipment at cents on the dollar. The resellers of this

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[1] "Labor Market Information". Michigan Department of Labor, Energy, and Economic Growth. March, 2010.
[2] George A. Fulton. "RSQE Forecasts". University of Michigan Seminar in Quantitative Economics. April 6, 2010.
[3] David Cole. "The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers". Center for Automotive Research. November 4, 2008.

equipment are reporting that the best of this equipment is not being reused by domestic manufacturers but carted of to countries like China and India.

Our solution recognizes that small businesses finance their operation with bank financing. Their ability to obtain financing is determined by their available free cash flow and value of their collateral. Banks are under increasing pressure from regulators to require a historic three year average of free cash flow levels over 1.25 times loan service and collateral values of at least 120% of loan value. Healthy firms are finding it impossible to get the capital they need to grow or even survive because of the temporary drop in revenue and asset values.

Focusing on these factors, the MEDC launched the Michigan Supplier Diversification Fund ("MSDF" or the "Fund"), which has been highly successful at inducing new loans that were otherwise disqualified from the bank's perspective. Many of the projects induced by the Fund have garnered financing for diversification into emerging industries like alternative energy.

The Fund accomplishes this via two mechanisms designed to address the financial impediments of the borrower given current market conditions. One: Companies' three-year average of free cash flow is artificially low because of the devastating hole in revenue created by the recession. Small businesses with strong free cash flow today are penalized by the use of this three-year average. To alleviate this problem MEDC purchases the portion of the loan not justified by the three-year average, but which the borrower can pay using the more relevant current free cash flow data. The banks work us out of the loan once the three year average improves. Two: Small businesses, especially manufacturers, rely on being able to borrow up to 80% of the value of their PP&E. Even healthy companies' PP&E has dropped as much at 80% in 18 months, decreasing the amount they can borrow. MEDC assists banks and borrowers by supplementing the collateral value on loan requests by depositing cash pledged to the bank. MEDC gets interest and fees on both of these programs making it profitable for the state.

Both of these mechanisms also improve the health of banks. The cash flow mechanism helps limit default risk exposure and supports debt service coverage. The collateral support mechanism, in addition to increasing collateral coverage for borrowers, also increases the banks' core deposit base improving its capitalization ratio.

Another positive of the Fund's design is that loans are made at the time public dollars are deployed. Loan closing is required for public funds transfer. In this way, the program self-regulates by ensuring that public dollars are contingent on each individual loan actually being made, in contrast to TARP, where follow-up lending has either severely lagged or failed to occur.

MSDF relies on the market expertise, prudent risk management, and financial capacity of private lenders, who source, underwrite, lead, and service the deals, while injecting targeted public dollars at the level of individual loan requests. So far, every $1 in public funds has leveraged $4 in private funds.

MSDF has been well received by the lending and manufacturing communities in Michigan. In less than six months from inception, the initial $13.3 million fund was fully committed. It resulted in twelve loans, leveraging a total of $41 million in private dollars.

Unfortunately the rest of the country is now experiencing the same effects as Michigan. Demand is increasing as economic activity increases, as evidenced by the Institute for Supply Management reported increases in the ISM Manufacturing Index.[4] Commercial real estate values continue to plummet, as indicated by the Moody's/REAL Commercial Property Price Index[5], without a recovery in sight. In addition, industrial machinery and equipment continues to sell at fire sale prices, reflecting the overall devaluation of hard assets. In other words, manufacturing production is outpacing the recovery of asset values, which significantly limits the borrowing base of manufacturers and their ability to sustain growth.

The constant demand from banks and borrowers for our loan enhancement programs at the Michigan Economic Development Corporation demonstrates the need for additional action to stimulate lending rapidly. While the recovery plan helped to capitalize the banks, it did little to stimulate new lending. In Michigan, commercial and industrial lending declined by over 10.5%[6] in 2009.

This moment is critical for small businesses especially manufacturers. In this tenuous environment, a failure to support new financing to allow businesses to accelerate production may actually cause them to suffocate on their own growth, a potentially insidious side effect of the recovery. Even stable companies that have 'right-sized' are finding it difficult to finance growth opportunities. In addition, businesses need capital to reorganize and consolidate efficiently and in an orderly manner to improve their financial health. Finally, those businesses seeking to utilize their core competencies in new economy sectors like wind and solar energy, medical device, and homeland defense are often unable to finance this transition.

We agree that the health of banks took precedence during the Great Recession, and access to cheaper capital was critical. But to grow our struggling small business sector, we must focus our attention to the health of borrowers. Lowering the cost of capital to small banks, increasing guarantees, and reducing fees and bureaucracy will save our critical small banking industry. But it does change the fundamental process of banks: making loans to borrowers with sufficient three-year cash flows and sufficient collateral values. We don't believe the banks should change their model. Their underwriting standards and expertise are essential to proper risk management and a healthy economy.

In our view, perhaps the only way to quickly stimulate new lending to small businesses and manufacturers in this environment, and without warping the banks' model, is to provide temporary support to borrowers such as those offered by Michigan and other states. These are the only mechanism to offset the effects of current market conditions, in order to make deals bankable from a commercial underwriter's point of view.

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[4] "Manufacturing ISM Report". Institute for Supply Management. April, 2010.
[5] "Moody's/REAL CPPI". REAL Capital Analytics. April, 2010.
[6] Michigan Bankers Association.

Unfortunately the resources available are insufficient. There is an estimated need of at least $1 billion in Michigan, and approximately $8-10 billion nationally[7]. This gap represents untapped growth potential that threatens to disappear should the necessary financing fail to materialize. A chain of bankruptcies remains a real possibility. The beneficiaries of such an outcome would be China and India, who would exploit our best machinery and equipment, which they will have purchased at cents on the dollar.

The economy has begun to improve, due in large part to your and the administration's efforts. Our small businesses, especially manufacturers, are the key ingredient for sustained growth, and they are falling behind. As we speak, China, Germany, and other nations are seizing the opportunity by supporting programs that assist their businesses' ability to get capital, and will take the lead in economic strength unless we act soon.

The Obama administration's proposed Small Business Lending Fund, which is being introduced and supported by many in our Michigan delegation, including Congressman Sandy Levin and Gary Peters, is a bold and necessary step to support our small businesses, save our manufacturers and create jobs quickly. Allowing states to use a portion of these monies to support targeted loan enhancement programs will leverage dollars ten to one and have the potential to create millions of jobs. I believe loan enhancement programs like these will be the spark to our economic recovery and the cornerstone of a successful national manufacturing policy.

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[7] Robert E. McKenna. "Emergency Financial Assistance Request". Motor & Equipment Manufacturers Association. June, 2009.

AIA

THE AMERICAN INSTITUTE OF ARCHITECTS

TESTIMONY OF
JIM DETERMAN, AIA

"Initiatives to Promote Small Business Lending, Jobs and Economic Growth"

United States House of Representatives
Committee on Financial Services

-

May 18, 2010
2128 Rayburn House Office Building

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Chairman Frank, Ranking Member Bachus, and members of the Committee, I am Jim Determan, AIA, an architect at Hord Coplan Macht of Baltimore, MD; a former member of the American Institute of Architects (AIA) National Board of Directors; and, until recently, a principal of CSD Architects, a small architecture firm in Baltimore. I want to thank you for the opportunity to testify today on behalf of my firm and the AIA.

The current economic crisis has affected every American, but it has hit small businesses particularly hard. Moreover, the impact of this recession on the design and construction industry has been simply devastating. According to the U.S. Department of Labor, the unemployment rate in the construction industry in March 2010 was 24.9 percent, the highest by far in any industry.[1] The Associated General Contractors of America report that in the last year, 48 out of 50 states and the District of Columbia lost jobs in the construction industry.[2]

In my profession, the Labor Department reports that employment at architectural firms has dropped by 18 percent between 2008 and 2009.[3] And that is only counting those who have applied for unemployment insurance. Many of my colleagues report being underemployed or working without pay for as long as 18 months. That is an enormous burden for skilled workers who have families to feed and mortgage bills to pay. Worse, many young architects are simply leaving the profession, looking for opportunities elsewhere. Once economic conditions improve, a dearth of young talent will hamper the ability of our country to design and construct high-quality buildings for years.

Architects are, by and large, small businesspeople. In fact, 95 percent of architecture firms employ 50 or fewer people.[4] They are truly the engine that drives the design and construction industry. Architects are job catalysts – they are the first workers to be involved in the construction process when they develop designs. Hiring an architect leads to employment in other construction-related fields, from engineers and manufacturers, to steel and electrical contractors. In fact, one architectural service worker, on average, begets 34 additional construction industry workers in this country.[5] Our industry created over $1 trillion in economic activity in 2008,[6] and

[1] http://www.bls.gov/news.release/pdf/empsit.pdf
[2] http://www.agc.org/cs/news_media/press_room/press_release?pressrelease.id=568
[3] Bureau of Labor Statistics
[4] http://info.aia.org/aiarchitect/thisweek09/1009/1009b_firmsurvey.cfm
[5] U.S. Department of Labor
[6] www.census.gov/const/C30/total.pdf

a recent study by the George Mason University Center for Regional Analysis found that every $1 million invested in design and construction creates 28.5 new full-time jobs.[7]

Architectural activity is a harbinger of construction work: the AIA Architecture Billings Index (ABI), which surveys work on the drawing boards, is a leading indicator of construction activity nine to 12 months down the line.[8] The most recent ABI, although showing more encouraging results than in recent months, still indicates less demand for architectural work than the month before. Indeed, the most recent issue of *Bloomberg/Business Week* magazine notes that the index has been contracting for 26 consecutive months. In other words, the decline in the industry has not turned around, but is merely slowing. This means that the construction industry should expect soft demand for its service for the next nine to 12 months. Clearly, the green shoots of economic recovery are not bearing fruit in this important sector.

If you ask architects across the country today why conditions are so bad, you will inevitably hear the same two responses: one, firms are unable to secure credit to keep operations going; and two, clients are unable to secure the financing needed to get construction and renovation projects started.

Architecture firms in general – and, in particular, smaller firms – rely heavily on short-term lines of credit to finance their operations. However, lending to small businesses has dropped severely during this economic crisis. According to the Congressional Oversight Panel, "Although Wall Street banks had been increasing their share of small business lending over the last decade, between 2008 and 2009 their small business loan portfolios fell by 9 percent, more than double the 4 percent decline in their overall lending portfolios."[9]

As banks have restricted lending, it has become increasingly difficult for firms to continue to make payroll and fulfill benefit obligations for their employees, let alone expand and pursue new projects. I have heard from many of my colleagues who have reported banks either restricting draws on their lines of credit or, in some extreme cases, calling in those lines. Although some have argued that the recued level of lending to small business is due to a lack of demand for

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[7] www.naiop.org/foundation/contdev.pdf
[8] www.aia.org/aiaucmp/ groups/aia/documents/pdf/aias076074.pdf
[9] http://cop.senate.gov/press/releases/release-051310-smallbusiness.cfm

loans, I can tell you that in my experience there are numerous architecture firms that rely upon short-term lending to stay afloat, but have been denied access because of the lack of supply.

More problematic is the lack of access to capital for design and construction projects, which has depressed demand for our services to historically low levels. The January ABI survey questioned firms about the reasons for a lack of work in the design and construction industry. The response was overwhelming: more than 90 percent of architecture firms participating in the survey rated construction project financing as at least a somewhat serious problem, while almost half (44 percent) rated it as an extremely serious problem. Half of firms surveyed indicated that the availability of credit for construction financing had become much more restrictive over the previous year, while an additional 30 percent indicated that it had gotten somewhat more restrictive.[10]

It is both inevitable and understandable that, following the economic collapse in 2008, credit would be tighter than it was in the middle part of the last decade. However, the pendulum has swung so far in the direction of restricted credit that even worthy, well-secured projects by clients with impeccable credentials and proven track records are being denied access to financing. The mentality appears to be, since financing everything didn't work, let's finance nothing.

Last year, the reduction in work due to a lack of financing forced my partners and me to close the doors on our firm – a firm that had weathered previous recessions for over 60 years. A significant contributing factor causing the demise of our business was the lack of credit available to our clients to finance their projects. Projects stopped dead in the water. We could not move fast enough to shed employees or office space. And near the end, the bank called in our credit line. One hundred twenty good people lost their jobs, some of whom had been with the firm more than 30 years.

What is striking about my story is that, if a well-established firm with a six-decade record of achievement can fail, then small firms just starting out have an even more difficult time surviving

[10] http://www.aia.org/practicing/AIAB082315; the most frequently mentioned categories where construction financing is an issue were commercial projects (71%), new construction projects (68%), and large projects (54%). Projects where financing was less likely to be mentioned as a concern were health care (10%), industrial (17%), and education (18%).

in this economic climate – and yet it is precisely the ability of entrepreneurs to form new ventures and strike out on their own that is vital to driving economic recovery.

That is why the AIA and its partners in the design and construction industry have worked hard to call on Congress and the Administration to enact polices that will stimulate and restore confidence in the United States economy. The AIA's *Rebuild and Renew Plan for Long-Term Prosperity* identifies policy objectives that will put architects and their allied professionals back to work designing and building our communities and laying the groundwork for future economic growth.[11]

Congress has taken some important steps over recent years to address these challenges. The American Recovery and Reinvestment Act of 2009 (ARRA), though by no means a panacea, is providing opportunities for work for a number of architects; in fact, the AIA's research shows that, as of March, one in four architecture firms have recorded billable hours from stimulus-funded projects.[12]

However there is much more to be done. As I mentioned, the ABI figures indicate that we are still at least a year away from having a healthy business environment in the design and construction industry. With that in mind, I am pleased that this Committee is considering two pieces of legislation that would help small businesses weather the economic storm.

H.R. 5297, the Small Business Lending Fund Act of 2010, introduced by Chairman Barney Frank (D-MA); and H.R. 5302, the State Small Business Credit Initiative Act of 2010, introduced by Representative Gary Peters (D-MI), both would inject billions of dollars into the small business market, thus providing vital relief for millions of small entrepreneurs who are struggling to make ends meet. I am particularly pleased that H.R. 5297 would allow for the provision of "owner-occupied nonfarm, nonresidential real estate loans." This has a double benefit: not only does it provide a means for small businesses to grow and expand their operations, but it would provide financing for new projects, therefore creating jobs in the design and construction industry.

I would urge the Committee to ensure that the funds provided to small community banks under this legislation are lent to small businesses at rates and under conditions that make them attractive

[11] www.aia.org/advocacy/federal/AIAB081324
[12] www.aia.org/advocacy/AIAB082671

and usable. I also would like to suggest that the Committee resolve to review and evaluate the results of these programs once they are completed to determine which strategies worked best.

These proposals will address some of the main causes of small business failure and job loss we are facing. However, I would like to urge the Committee to work to address the second problem I raised as well, namely the lack of demand for design and construction services caused by a lack of access to financing for our clients. Although there are many ways to solve this problem, I understand that members of this Committee have introduced bills to address this issue.

For example, Representatives Ed Perlmutter (D-CO) and Mike Coffman (R-CO) have introduced H.R. 5249, the Capital Access for Main Street Act of 2010. Over the next three years, it is estimated that $1.4 trillion in commercial real estate debt will come due. Much of this property has been significantly devalued in the recession, and the borrowers are under water. This legislation would help lenders and borrowers as they attempt to work out their loans under terms that are mutually acceptable, avoid large sums of commercial foreclosures, and free up credit that can be used more constructively.

Second, Representatives Scott Garrett (R-NJ) and Paul Kanjorski (D-PA) have introduced H.R. 4884, the United States Covered Bond Act of 2010. According to the Congressmen, covered bonds are a type of bond that is far less risky than other kinds of investments. Covered bonds are not new; they have been successfully employed in many European economies for decades. Hopefully, this legislation will attract investors back into the real-estate market and worthwhile projects can find the financing they so desperately need.

I believe that the efforts to increase the supply of credit for small businesses, as is envisioned in the Small Business Lending Fund Act and the State Small Business Credit Initiative Act – *combined* with initiatives to increase demand for small business services, such as the Capital Access for Main Street Act and the United States Covered Bond Act – will go a long way to address the challenges that small businesses across the country face in a sensible and coordinated manner.

Having said that, none of these bills are a silver bullet, nor are they meant to be. Until we find a way to get financial institutions to move the pendulum back to the center and begin providing credit for worthy and vital projects, we are not going to see a broad-based recovery. Every idled construction site represents jobs lost and our nation's competitive edge weakened. I call on Congress and the Administration to use every tool at its disposal to address the profound challenges that the lack of credit is presenting to our communities and our nation. America's architects stand ready to work with you to help rebuild and renew our country.

In conclusion, I wish to thank the Committee for its hard work in addressing these complex issues, and I look forward to answering any questions the Committee members may have.

MARYLAND
Department of Business &
Economic Development

Martin O'Malley Governor
Anthony G. Brown Lt. Governor
Christian S. Johansson Secretary
Dominick E. Murray Deputy Secretary

State Small Business Credit Initiative Act of 2010

Small Business Lending Fund Act

Christian S. Johansson, Secretary
Maryland Department of Business & Economic Development

Testimony before the
House Committee on Financial Services

May 18, 2010

Introduction

Chairman Frank and Ranking member Bachus, and distinguished members of the Financial Services Committee, good afternoon. My name is Christian Johansson and I am the Secretary of the Maryland Department of Business & Economic Development. On behalf of Governor Martin O'Malley, I appreciate the invitation to bring my perspective on small business access to credit and support the provisions contained in the State Small Business Credit Initiative Act of 2010.

As all of us are painfully aware, as the American economy is recovering from this global recession, one of the lingering challenges continues to be access to credit, especially for our small businesses. Last week, the Congressional Oversight Panel released its May report stating that "if the Troubled Asset Relief Program (TARP) is to meet its Congressional mandate to promote growth and create jobs, then it clearly must address the needs of small businesses."

Small businesses have long been an engine of economic growth and job creation in America. More than 99% of American businesses employ 500 or fewer employees and together, these companies employ half of the private workforce. Maryland is home to 156,000 businesses with fewer than 100 employees, or 98% of all our businesses.

In the aftermath of Wall Street excesses, banks have been forced to adopt significantly stricter banking practices, which have reduced the flow of credit to their Main Street clients. In Maryland, Governor O'Malley recognized that it is not sufficient to address to only address Wall Street's credit crisis, but equally important, we must also address the credit tsunami affecting Main Street. As Wall Street Banks repay the federal government on time and with interest, we have a unique moment in history to continue our recovery further and faster – taking advantage of a nationwide network of loan guarantee programs and extending a very specific, safe and successful practice to main street lending – helping stabilize and expand small businesses to recapitalize, regain revenue, hire new employees, purchase or renovate property, acquire needed equipment and return to economic prosperity.

Maryland Takes a Leadership Role

This past February, Governor Martin O'Malley outlined a bold but simple proposal to his colleagues at the 2009 annual meeting of the National Governor's Association: Re-use a percentage of the TARP repayment funds to support state loan guaranty programs. A loan guaranty program would give banks the additional "push" to allow them to make loans to credit worthy businesses that are short on collateral. In less than 24 hours, 28 States and US Territories joined the Governor and signed a bi-partisan letter to President Barack Obama urging the Administration to work with the Congress to extend a partial payment of the TARP funds using existing loan guaranty programs. The letter demonstrated the bipartisan support for an initiative that can get Main Street businesses moving forward again. Getting capital to small business is critical to sustaining the country's recovery and continued job growth. Access to capital is key to America's sustained economic recovery.

We strongly urge favorable consideration of the State Small Business Credit Initiative Act of 2010 and support consideration for funding to be made available to state small business guaranty and loan programs. Many state programs are already in place and can have an immediate impact – putting operating capital into the hands of business owners in order to hire full and part time employees, restock their shelves and expand operating hours. These programs are "shovel ready." Unfortunately, given fiscal constraints at the state level, these programs are for the most part woefully under-capitalized.

Maryland is well poised to speak to best practices of model programs that unfreeze credit for the nation's small businesses and manufacturers and encourage small and medium sized banks to increase lending to small businesses. As Maryland's economic development (and jobs) chief - I am honored to join you today and explain how this "Main Street" approach has worked to strengthen small businesses in Maryland, and how banks and businesses have used the program model successfully, and why this is an effective federal investment.

Background & Rationale

Small Business Credit Crunch & New Stricter Lending Guidelines

Despite signs of an economic turnaround, small businesses continue to struggle with access to capital due to overall more conservative banking practices. Credit conditions are particularly troublesome for small businesses because their finances are more closely intertwined with the personal finances and assets of their owners. As a result, many businesses are reluctant to make new investments until they are confident that a recovery in sales can be sustained.

As you know, the Congressional Oversight Panel just released its report on the small business credit crunch showing that small business credit remains severely constricted. It cites data from the Federal Reserve that shows lending plummeted during the 2008 financial crisis and remained sharply restricted throughout 2009. Between 2008 and 2009, the small business loan portfolios of Wall Street banks **fell by 9%**, more than double the 4.1% decline in their entire lending portfolios. During this time period the smallest banks small business lending portfolios fell by almost 3%, while their entire lending portfolios fell 0.2 percent.

While steps were taken to insure that community banks have sufficient capital to lend, it is also important to recognize that even fully capitalized, many of these banks still did not extend credit to small businesses. Right now, given the impact of the recession on businesses and "new" stricter lending criteria, many previously credit worthy small business customers no longer qualify for a loan or a line of credit.

Devalued Equity

The recession's lingering impact and the greatest challenge that remains has been the devaluation of assets of individuals, homeowners and business owners. As far too many Americans have lost value in their homes and are "upside down" on their mortgages, far too many businesses have also lost value in their assets. Their lines of credit have been exhausted, not because their businesses are unsuccessful or unstable but because the value of real estate, durable goods and equipment has dropped precipitously. Along with the devaluation, America's banking crisis resulted in new, stricter lending criteria. Previously credit-worthy lending customers were no longer able to qualify for loans or lines of credit.

In essence, the convergence of stricter lending standards with collateral shortfall created a perfect storm to shut out small businesses from our economic recovery plan.

Loan Guarantee Programs Work - America Has a "Shovel Ready" Opportunity

We believe that guaranty programs can directly address the issue of otherwise credit worthy businesses not receiving access to credit by lowering the perceived credit risk through small guaranties that cover any perceived collateral shortfall. In this way, state guaranty programs facilitate small business lending by community banks – a marriage of the two legislative proposals that are before us today.

While it is difficult for individual states or territories to directly lend to small businesses on a large scale, it is possible to unlock multiple dollars of private bank lending and unleash additional funding for business owners through loan guaranty programs. The State Small Business Credit Initiative Act, H.R. 5302, offers sufficient flexibility for each state to use these existing, often more nimble, grassroots programs and to determine, based on their own circumstances, how to have the quickest and most meaningful impact. According to the Council of Development Finance Agencies, 34 states have some form of existing loan guaranty program. However, in today's economic environment, many of these programs are challenged in terms of available funding. That is why the State Small Business Credit Initiative Act is necessary.

Successful State Examples

- In Massachusetts, the state's Small Business Capital Access Program (CAP) uses cash collateral guaranties from a loan loss reserve fund to enable banks to make loans they might otherwise be unable to grant. The program was created by the Massachusetts Business Development Corporation (MBDC) in 1993 and over the past 17 years, CAP has been one of the most successful economic development tools in Massachusetts, making 4,285 loans to community-based, small businesses.
- The Indiana Loan Guaranty Program provides loan guarantees for rural development and value-added agricultural projects and for high-growth/high-

skilled companies and manufacturing projects. The program has funded more than 83 loans providing over $84 million in guaranteed loans to Indiana businesses.

- The New Jersey Economic Development Authority (EDA) provides loan guarantees to creditworthy businesses operating in New Jersey that need additional security to obtain financing, up to 50% of the loan amount up to $1.5 million. To be eligible, companies must create one job for every $50,000 of EDA assistance. Funding can be used for fixed assets and working capital to meet operating needs, with term financing for a maximum guarantee term of five years.

Based on the leverage ratio of ten-to-one in the State Small Business Credit Initiative Act, $3 billion in funding invested into states' loan guaranty programs could unlock as much as $30 billion in small business lending. The funding of a guaranty program is more effective than direct lending since the investment can be leveraged multiple times as a guaranty, the cash is only expended in the event of a default deficiency, and guaranties leverage multiples of bank loan dollars. Strengthening state guaranty programs would also serve as an important complement to the on-going efforts to support small businesses through a variety of programs at the Small Business Administration (SBA).

<u>The Maryland Model</u>

Maryland Industrial Development Financing Authority

The Maryland Industrial Development Financing Authority (MIDFA) was established in 1965 as the State's principal credit enhancement program to increase access to capital for small and mid-sized companies. MIDFA stimulates bank loans and bonds by providing a credit deficiency guaranty that reduces credit risk and facilitates better terms. In the past 45 years, MIDFA has participated in 823 loans and bonds totaling over $2.1 billion. Currently, 58 transactions remain active with principal balances totaling $427 million. Early signs of economic recovery coupled with aggressive program marketing resulted in a burgeoning interest from banks and borrowers. Over the last five years, the program has not experienced any loan deficiency losses.

Recently Modified to Address Small Business Loans

Because of its statutory guaranty maximums of $2.5 million for loans and $7.5 million for bonds, MIDFA typically has been used for larger transactions.

However, to address the current credit crisis, MIDFA implemented two streamlined capabilities, referred to collectively as our "Rapid Response Program," that expedite small business lending by providing approvals in 48 hours or less for: (a) a 50% guaranty up to $50,000 for loans not exceeding $100,000, and (b) a 25% guaranty up to $250,000 for loans not exceeding $1,000,000.

This enhancement of MIDFA was developed after significant outreach with regional and community banks as to what programs they perceived had the highest value in stimulating small business lending. Since Governor O'Malley announced this new program earlier this year, the State has committed $10 million to guaranty small business loans and has already unlocked in excess of $5 million of small business lending. More than $3 million was used to expand certified minority business enterprises. This is especially important because many of the banks that do not have relationships with the SBA are community banks, many of whom are owned by and do business with small and minority businesses.

For example, Kayden Premier Enterprises and Harbor Bank of Maryland are two Maryland companies who have benefited from MIDFA since the State modified the program. Kayden experienced significant growth over the past three years. The company grew from approximately $42,000 in revenues in 2007 to projected $4.5 million in the first six months of this year. The company needed a line of credit to support its cash flow due to its growing pipeline of projects including a large contract with Clark/Bank, a construction company joint venture. Harbor Bank was willing to provide the line of credit contingent upon receiving some type of credit enhancement to support its collateral position due to the inherent risk in the construction industry and the relatively young age of the company. MIDFA provided $50,000 insurance (50%) on the $100,000 line of credit, making it possible for Kayden to receive the financing needed to support its growth while doing so under an acceptable risk profile for Harbor Bank.

Very Effective in Leveraging Federal Dollars

MIDFA's small business guaranty can unlock a minimum of $10 of private sector lending for every $1 of federal funds injected into the program. This would yield an average 10+:1 loan to fund ratio. This number would easily exceed 10: 1 if the guaranty funds are allowed to revolve in the MIDFA program rather than being subject to repayment.

Conclusion

Mr. Chairman, Mr. Ranking Member, and members of the Committee, there are many opportunities for states - in cooperation with regional banks, community banks and regional revolving loan funds, and the SBA - to assist small businesses. We strongly urge Members to swiftly pass the State Small Business Credit Initiative Act of 2010 and to make funding available to state small business guaranty and loan programs. While it is critical to recapitalize our community banks, it is also important to complement this with appropriately capitalized loan guaranty programs – which is a "shovel-ready" asset waiting to be unlocked on a larger scale.

There is no silver bullet to solving the lingering effects of a prolonged economic recession. As part of your efforts to spur small business lending – and on behalf of Maryland Governor Martin O'Malley - we urge you to consider loan guaranty programs such as MIDFA.

Thank you for your time and consideration.

INDEPENDENT COMMUNITY BANKERS *of* AMERICA

Testimony of

James D. MacPhee

Chief Executive Office, Kalamazoo County State Bank

Schoolcraft, Michigan

On behalf of the

Independent Community Bankers of America

Before the

Congress of the United States

House of Representatives

Committee on Financial Services

Hearing on

"Initiatives to Promote Small Business Lending, Jobs and Economic Growth"

May 18, 2010

Washington, D.C.

Chairman Frank, Ranking Member Bachus, and Members of the Committee, I am James MacPhee, CEO of Kalamazoo County State Bank in Schoolcraft Michigan and chairman of the Independent Community Bankers of America. Kalamazoo County State Bank is a state-chartered community bank with $77 million in assets. I am pleased to represent community bankers and ICBA's nearly 5,000 members at this important hearing on "Initiatives to Promote Small Business Lending, Jobs and Economic Growth." My community banker colleagues and I work day-in and day-out to serve our small business customers because our viability is intertwined with theirs in the communities we serve. I am pleased to have the opportunity to offer our perspective.

Small businesses create jobs when they have access to credit, and small businesses will play a leading role in the economic recovery. In my state of Michigan, we face the nation's highest unemployment rate of 14.1 percent. While the country at large added jobs in March, Michigan shed another 9,500 payroll jobs. For me, this discussion is not in the least abstract. It is personal and close to home. My customers, friends, and neighbors have felt the full impact of the recession. The need for solutions is urgent. ICBA and its community bank members nationwide will continue to play a constructive role in identifying and implementing solutions.

Small Businesses Continue to Struggle

An economy in which small businesses thrive is a rich, diverse and competitive economy, offering personalized customer service and broad consumer choice. Support for small business is support for the entrepreneurialism and innovation that have always been the strength of the American economy. Small businesses are struggling today and deserve continued attention from policy makers.

The Wall Street meltdown of fall 2008 and the ensuing credit crisis and recession hit small businesses harder than medium and large-size businesses because they have faced greater challenges in obtaining credit. Boosting the flow of credit will help the small business sector to lead the recovery of economic growth and employment. That is why the ICBA strongly supports the proposed Small Business Lending Fund Act (H.R. 5297) among other measures that will bring more credit to small businesses.

Two weeks ago, Treasury Assistant Secretary for Economic Policy Alan Krueger testified that small businesses responded to the recession by laying off more workers than medium and large size businesses. The difference lies in access to credit. Small businesses are more dependent on bank credit than medium and large businesses. Medium and large businesses regained access to credit through the corporate bond market, while small businesses continue to suffer from lack of credit. "The segment of employers that are lagging most behind in hiring are small businesses," said Assistant Secretary Krueger. The greatest potential for job creation is among small business with restored access to credit. ICBA agrees.

Community Banks Stand Ready to Help

Community banks are prolific lenders to small businesses. While community banks represent only about 12 percent of all bank assets, they support nearly 40 percent of small business bank loans under $1 million and nearly half of all small business loans under $100,000. During the economic crisis, small business lending by the mega-banks fell more dramatically than lending by community banks, which held steady or declined only modestly. The community bank business model is built on longstanding relationships with our small business customers and we stand by them in good times and bad. My bank survived the Great Depression and many recessions in its more than 100-year history. We're proud to continue serving our community through this difficult economic climate.

The Small Business Lending Fund

As unemployment has remained high, policy makers have rightly turned their focus to small businesses as the most promising source of job creation. ICBA has endorsed a series of proposals that would spur more small business lending, and I'm pleased to have the opportunity to discuss some of them with you today.

Let me first address the "Small Business Lending Fund Act" (H.R. 5297) (SBLF). We applaud the President and this committee for proposing a fresh, bold program with the incentives needed to get credit flowing to many thousands of businesses, using community banks as conduits. The SBLF would allow banks with less than $1 billion in assets to receive capital investments up to 5 percent of their risk-weighted assets; those with between $1 billion and $10 billion in assets could receive up to 3 percent.

The SBLF is not another TARP program. TARP and other emergency capital programs were enacted in the urgency of the crisis and were used primarily by the mega-banks. Many banks have stabilized and paid the capital back at a profit to the taxpayers. The SBLF would target community banks and – this is a crucial distinction from TARP – it is structured to incentivize increased small business lending. Lenders who increase their small business lending over a baseline will pay discounted dividends to the government, as low as 1 percent. Lenders who decrease their small business lending will pay a dividend premium, as much as 7 percent. This structure could provide a powerful incentive for a bank to increase its small business lending.

ICBA is pleased to see that the proposal has many of the features we have sought and believe will make the program attractive to community banks and successful in increasing lending. In particular:

- It appears, from the legislative detail that we have, to completely avoid the onerous TARP restrictions for SBLF participants. In particular, warrants, compensation restrictions, bank dividend restrictions, or any restrictions on using generally available tax measures such as the net operating loss rules would be avoided. Such punitive conditions would only discourage participation.

- We note that the proposal would allow any participant in the program to repay the investment without impediment following any retroactive change in law that modifies the terms of the program in a materially adverse respect. However, attention should be given to recipient institutions that have already lent their funds. Retroactive changes could have the effect of jeopardizing outstanding small business loans as lenders seek to repay the government in order avoid the change in law. We believe that a participant that has received funds should be able to carry out the program according to the original terms, immune from any harmful change in law.

- We support appropriate Treasury oversight of the SBLF. However, oversight should not be so overbearing that it would discourage participation.

- We support the provision stating that no applicant shall be denied based solely on its composite rating. This will ensure that the broadest possible number of community banks can participate and that the small business customers of these banks will have access to SBLF-financed loans. Participating banks should have the benefit of the capital provided by the program in determining their capitalization at the outset of the program.
- We're pleased that agricultural loans are explicitly eligible. Farms are an important component of the small business sector.

Though we await final legislative language on various aspects of the program, we believe that the SBLF could attract broad participation by banks and result in more lending to small businesses. Notably, $30 billion in SBLF capital can be leveraged by community banks to support $300 billion in new lending. So the SBLF would have tremendous "bang for the buck." ICBA hopes to work with this committee and Congress to refine the proposal and implement it as quickly as possible. ICBA has attached at the end of this statement our letter to the committee highlighting our recommended program structure.

The Administration is also supporting other proposals, such as the State Small Business Credit Initiative, which would provide federal funding for state initiatives. ICBA is pleased to support a broad array of initiatives that have the potential to spur small business lending. Many states have had local success with different approaches, and the federal government should encourage and support successful small business lending efforts using local banks.

Additional Initiatives

GSE preferred share losses continue to pose a challenge to community bank capitalization

Capital levels are critical to support banks lending. As you know, when the government took Fannie Mae and Freddie Mac into conservatorship in September 2008 they destroyed the value of their preferred shares, costing the banking sector, including many community banks, an estimated $15 to $20 billion. This was an unprecedented breach of faith. Community banks were encouraged by their regulators to purchase these shares as a safe investment and with the incentive of special regulatory capital treatment. Nearly two years later, many community banks continue to struggle to cope with this abrupt loss of capital. We urge you to require the Treasury to restore the value of Fannie and Freddie preferred shares to what it was prior to conservatorship both to remedy an injustice and to boost community bank capital and spur lending.

Providing capital through the SBLF is a good idea. Restoring the value of preferred share losses would support the same goal. We urge you to help restore community bank capital and lending by supporting the value of dividend payments of GSE preferred stock.

Improve the exam environment for community banks

While community bankers are coping with the challenges of the economic downturn, an aggressive exam environment is making it harder for us to continue the flow of credit to small businesses. The SBLF program will only work if bank regulators do not choke off lending with overly aggressive bank regulation. Community bankers nationwide continue to report to ICBA about zealous, overreaching examiners second guessing bankers and appraisers and demanding aggressive write-downs and reclassifications of viable and performing commercial real estate loans and other assets. Examiners are focusing on the value of collateral irrespective of the income or cash flow of the borrowers; placing loans on non-accrual even though the borrower is current on payments; discounting entirely the value of guarantors; criticizing long-standing practices and processes that have never been questioned before; and substituting their judgment for that of the appraiser. All of this has the effect of smothering small business lending.

Other bankers are concerned that otherwise solid loans are being downgraded simply because they are located in a state with a high mortgage foreclosure rate. This is tantamount to statewide redlining, and in today's economic climate it could ultimately lead to capital problems at otherwise healthy banks. *This examination environment is exacerbating the contraction in credit for small businesses*, as community bankers must avoid making good loans for fear of examiner criticism, write-downs, and the resulting loss of income and capital. While it is expected and understandable that examiners will be more thorough and cautious during a credit downturn, excessively tough exams that result in potentially unnecessary loss of earnings and capital can have a dramatic adverse impact on the ability of community banks to make small business loans and support economic growth.

Extend the FDIC TAG Program to 2013

The FDIC Transaction Account Guaranty (TAG) Program, which guarantees noninterest bearing transaction accounts, certain NOW accounts and IOLTA accounts, has been an important tool for protecting and promoting the interests of small businesses by guaranteeing payroll accounts and providing community banks additional liquidity to make loans to creditworthy borrowers. Banks pay a separate fee to the FDIC for this additional coverage. Accounts guaranteed under the TAG are not considered in determining the deficit in the FDIC's Deposit Insurance Fund, so continuing the TAG would not increase the deficit in the DIF or affect the FDIC's regular insurance premiums.

We are very pleased that the FDIC recently decided to extend TAG, which was scheduled to expire on June 30, till the end of the year, with the option for an additional 12 month extension. In order to provide enough time to restore and maintain liquidity and customer confidence in the banking system, we urge that the program be extended yet further, until 2013. In certain areas of the country, such as Georgia, Florida, California and the Southwest, it is very important that this program continue long enough to bring about stability.

The TAG program ensures that community banks can continue serving their small business customers and are not at a competitive disadvantage in this fragile economy. The safety of transaction accounts continues to be a significant concern for customers. The public perceives that too-big-to-fail institutions can provide unlimited protection because they will ultimately be bailed out if they become financially unstable. Extension of the TAG program would give community bank customers the same assurance.

Extend Small Business Changes in the ARRA

The severe economic recession justified a sizable economic stimulus, including tax relief measures for individuals and small businesses. ICBA was pleased the American Recovery and Reinvestment Act (ARRA) enacted in February 2009 contained several tax relief and SBA reform measures to help boost small businesses. Specifically, the major SBA loan program enhancements enacted are all helping many small businesses ride out this deep recession. These programs have been extremely successful in doubling SBA lending levels in the past year and have been a bright spot in a difficult small business lending environment. We also support the extension of the key incentives for SBA 7(a) and 504 lending programs.

ICBA also supports extension of the beneficial SBA enhancements included in ARRA. Specifically:

• Extending the SBA fee reductions through fiscal year 2011;
• Extending the higher guarantee levels through fiscal year 2011; and
• Making permanent the SBA secondary market facility authority.

If enacted, these measures would all help community banks expand their SBA lending to small businesses and would stimulate much-needed economic activity and job creation.

Extend the 5-Year NOL Carryback Through 2010

ICBA applauds the expansion of the NOL carryback for 2008 or 2009 signed into law by President Obama. The FDIC reports that 30 percent of banks had a net loss for 2009. ICBA recommends extending this beneficial NOL reform through 2010. This would allow many more small businesses to preserve their cash flow and ride out this difficult business environment as the economy recovers.

Specifically, ICBA recommends allowing community banks and small businesses with $10 billion in assets or less to spread out their current losses with a five-year carryback allowed through tax year 2010. This extension would help increase small business lending. TARP-CPP participants should not be excluded. It makes little sense for Congress to encourage community banks to lend more to small businesses by participating in the TARP program and then to punish them by not allowing the potential use of the NOL five-year carryback. Public policies to promote lending should not offset one another.

The expanded NOL carryback simply allows businesses to accelerate allowable NOL deductions that would otherwise be claimed in future years. Businesses should have access to these deductions when they are needed most for capital and lending.

A May 27, 2009 Congressional Research Service report notes that most economists agree that U.S. companies would benefit from a longer net operating loss carryback than the current two-year period. The CRS report says the carryback period should last through the typical business cycle (six years) to help smooth the peaks and valleys in income.

Conclusion

Thank you again for the opportunity to testify today. ICBA strongly supports the new SBLF proposal and we'll do our part to make it a success. Our economy won't truly thrive again until the environment for small businesses improves. Community banks' special relationship with small businesses gives us a special responsibility to pursue practical solutions to the challenges they face. The SBLF holds promise; other initiatives I've discussed warrant your attention as well. We look forward to working with the committee on these issues.

ICBA Letter on SBLF Recommendations:

INDEPENDENT COMMUNITY BANKERS of AMERICA®

May 17, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Spencer T. Bachus III
Ranking Member
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus,

On behalf of the 5,000 members of the Independent Community Bankers of America, we strongly support the proposed Small Business Lending Fund Act of 2010 (H.R. 5297). The Act would offer capital to interested community banks to use to increase small business credit. The Nation's 8,000-strong community banks are well-positioned to leverage this fund and have established relationships with small businesses in their communities to get credit flowing.

Under the proposed $30 billion fund, banks with less than $1 billion in assets could receive capital investments up to 5 percent of their risk-weighted assets, and those with between $1 and $10 billion in assets could receive up to 3 percent.

ICBA firmly supports the central purpose of the program to spur further lending to small businesses by means of community banks. ICBA believes the programs goals will be accomplished with a properly structured plan with incentives to participate and increase lending.

Notably, leveraging the $30 billion fund with community banks would potentially support many times that amount in loan volume to small businesses -- as much as $300 billion in additional lending. By reducing the dividend cost on the capital investment as lending increases, this program helps ensure more community banks have both the incentive and greater capacity to increase total loans to small businesses.

To make sure that the program achieves wide participation and its intended goals as it moves through Congress, ICBA strongly recommends *any final legislation* maintains these recommendations:

- There should be no counterproductive, TARP-like restrictions to receiving the investment, otherwise participation will be minimal and small business lending will suffer. For instance, there should be no warrants, no compensation

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restrictions, no bank dividend restrictions, and no restriction on generally available tax measures such as the net operation loss (NOL) carryback for tax years 2009 and beyond.

- The government should not have the right to change the contract or add onerous conditions unilaterally. Participants should have certainty that the rules of the contract will not change once they have agreed to participate the program. Therefore, banks should be able to return the investment at any time without penalty and should be able to keep the investment for at least five years or more to better facilitate small business loan durations.

- Dividend payments on the capital should be suspended for one year until the small business loans can be underwritten and put in place.

- The broadest number of community banks possible should be eligible to participate. For instance, banks with composite CAMELS ratings of 3 or higher should be automatically eligible and banks with composite CAMELS ratings of 4 should be eligible to participate after approval. Banks with CAMELS ratings of 1 and 2 generally have enough liquidity and capital to make small business loans without investment from the proposed fund. The fact that a community bank is subject to a supervisory order should not disqualify it from participating.

- If a bank's financial position is to be considered, the status should be based on the bank's <u>post-investment capital position</u>, i.e., include the impact of the capital injection from this proposal.

- In addition, special consideration should be given to minority banks given their roles in promoting the economic viability of minority communities and their financial service in often difficult economic environments.

- Furthermore, all types of banks should be able to participate, including Subchapter S, mutual banks and holding companies on equally fair terms.

- Treasury should have the ability to make the final capital injection decision after consultation with the bank regulators. The application eligibility and approval process must be well-defined and transparent so bank access to the program will be fair and consistent.

- Existing TARP CPP recipients should be able to easily transfer from the CPP program into the new program and be subject to the new program rules and released from their existing TARP restrictions and have their warrants cancelled.

- All community banks that participate should be able to treat the investment as Tier 1 capital.

- The definition of small business loans should be broad enough to include agriculture loans.

- Treasury should implement a relatively easy way to report an institution's small business lending using existing financial reporting banks are already mandated to produce.

- Finally, credit unions should not be eligible to participate in the program since they are subject to statutory restrictions on commercial lending and are tax-exempt. Many federal, state, and local governments are struggling to manage difficult budgets and should not forfeit even more tax revenue by displacing taxpaying activity to the tax-exempt credit union sector.

ICBA believes the proposed Small Business Lending Fund Act supports these recommendations and this fresh program approach will attract a broader spectrum of community banks to boost small business lending and job growth. We applaud the new program focused on getting funds to Main Street small businesses using Main Street community banks.

Thank you again for advancing this positive plan. The ICBA looks forward to working with the House Financial Services Committee and all of Congress to help advance this effort so that community banks can continue to aid in our nations' economic recovery.

Sincerely,
/s/
Camden R. Fine
President and CEO

cc: Members of the House Financial Services Committee

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Written Testimony of

Dan Mica
President and Chief Executive Officer
Credit Union National Association

Before the Committee on Financial Services

Hearing on
"Initiatives to Promote Small Business Lending, Jobs and Economic Growth"

May 18, 2010

Mr. Chairman, Ranking Member Bachus, and Members of the Committee: thank you very much for the opportunity to express the views of the Credit Union National Association (CUNA)[1] regarding the Obama Administration's "Initiatives to Promote Small Business Lending, Jobs and Economic Growth." My testimony will focus on the two proposals that the Administration transmitted to the Committee recently, the Small Business Lending Fund Act (H.R. 5297) and the State Small Business Credit Initiative Act (H.R. 5302), as well as legislation which key members of the Senate along with CUNA have recently negotiated with the Department of Treasury and other supporters of legislation in both chambers to increase the credit union member business lending cap and facilitate the ability of credit union to help small businesses and further support the economic recovery.

The need for legislation to address the credit crunch facing small businesses is indisputable. As the Congressional Oversight Panel reported last week,

> "Although Wall Street banks had been increasing their share of small business lending over the last decade, between 2008 and 2009 their small business loan portfolios fell by 9.0 percent, more than double the 4.1 percent decline in their entire lending portfolios. Some borrowers looked to community banks to pick up the slack, but smaller banks remain strained by their exposure to commercial real estate and other liabilities. Unable to find credit, many small businesses have had to shut their doors, and some of the survivors are still struggling to find adequate financing."[2]

Credit unions are well aware of the demand for business loans because credit union business lending portfolios have expanded by 10% as business owners are turned away by large and small banks unwilling, or unable, to extend credit. As the financial crisis deepened and the small business credit crunch intensified, credit unions were a part of the solution for many small businesses, and credit unions have the financial capacity to do more to help these

[1] CUNA is the nation's largest credit union advocacy organization representing nearly 90% of America's 7,800 state and federally chartered credit unions and their 92 million members.

borrowers; however, there are statutory limits that inhibit credit unions from providing more small business loans.

Small Business Lending Fund Act

The Small Business Lending Fund (SBLF) Act would establish a $30 billion temporary small business lending fund for banks having total assets of $10 billion or less. Under the proposal, the Department of Treasury would be authorized to purchase preferred stock and other financial instruments from eligible institutions under certain conditions. The legislation is intended to provide community banks with an incentive to lend to small businesses. Further, the legislation makes it clear that recipients of funds made available under this legislation are not considered recipients of Troubled Asset Relief Program (TARP) funds.

Credit unions are not eligible to participate in the SBLF; and, quite frankly, credit unions do not seek to be eligible for this fund. The fact of the matter is that credit unions remain generally well-capitalized and have continued to lend throughout the financial crisis. Credit unions do not need taxpayer money to encourage them to do what they were chartered to do, which is to serve their members' financial needs. What restricts their lending to small businesses is NOT a lack of capital; rather, it is instead an arbitrary provision of the law that limits the amount of capital credit unions can provide to small businesses. Therefore, notwithstanding the proposed investment $30 billion of taxpayer money in the nation's community banks to spur lending, we believe Congress should increase the credit union member business lending cap, permitting credit unions to serve their business-owning members in a greater capacity.

In contrast to the administration's $30 billion proposal, increasing the credit union member business lending cap could be done without cost to the taxpayers and without an increase to the size of government. Further, credit unions have a long history of engaging in business lending to their members, and they have demonstrated that they can lend to these members safely and soundly; when credit union business loan charge-off and delinquency

[2] Congressional Oversight Panel. "The Small Business Credit Crunch and the Impact of TARP," May 13, 2010. 4.

numbers are side-by-side with the banks', this is made crystal clear. Indeed, since 1997, the loss rate on credit union MBLs has averaged only 0.15% compared to 0.82% at banks.

Credit Union Business Lending: Safe & Sound
Business Loan Asset Quality Comparison

	Net Charge Offs	
	Credit Union MBLs	Commerical Bank Commerical & Industrial Loans
1997	0.18%	0.28%
1998	0.08%	0.43%
1999	0.12%	0.57%
2000	0.05%	0.01%
2001	0.10%	1.43%
2002	0.09%	1.76%
2003	0.08%	1.26%
2004	0.10%	0.50%
2005	0.05%	0.27%
2006	0.08%	0.30%
2007	0.09%	0.52%
2008	0.33%	1.01%
2009	0.59%	2.36%
Avg. Since 1997	0.15%	0.82%

Source: FDIC, NCUA and CUNA E&S.

The only groups that actively oppose additional credit union business lending are representing those to whom Congress is considering giving $30 billion to do precisely what credit unions are willing to do at zero cost to the taxpayers. These groups put forward many reasons why they believe credit unions should not be able to help small business-owning credit union members; but their reasons are not supported by facts. Attached to this statement is a document that rebuts the banking lobby's unsubstantiated reasons for opposing credit union business lending.

Credit unions are not asking for a bailout and they have not needed bailout money throughout the crisis. They too have been hurt by the severity of the recent financial crisis, but they remain on a sound footing and have capital to lend, but the law limits their ability to do so. If Congress intends to give the community banks $30 billion in taxpayer money as an incentive to lend, why would Congress not also increase the credit union business lending cap and permit credit unions to use existing resources to lend to their business-owning members? This is the question that small businesses, credit union employees and volunteers ask me every day. "The banks oppose it," is not a good enough answer for them especially when that is the only answer available. There is no sound public policy reason not to allow credit unions with the demonstrated capacity to do so to increase their lending to small businesses. That answer also certainly does not satisfy the small business owner who has been turned down by a dozen banks; it should not satisfy anyone. Failure to expand the credit union member business lending cap would literally leave money on the table – and, I think we can all agree that small businesses need as much help as possible.

The bankers say business lending is not a part of the credit union mission; but the facts show that credit unions have been doing this business from day one.

They say increased business lending would undermine credit union safety and soundness; but the facts show that we do this safer and sounder than the banks.

They say increasing the cap will only affect a small number of credit unions while at the same time claiming that increasing the cap will hurt community banks. It is a contradiction – and they are wrong on both accounts. The cap affects every credit union that has a member who looks to them for financing a new or existing small business. Some have active business lending programs; others do not engage in business lending because they view the cap an impediment that does not justify the cost of establishing a sound business lending program in the first place. Increasing the cap will have a profound effect on the hundreds of credit unions that will reach the cap in the next few years, but it should not adversely affect the banker dominance of the commercial lending market. Credit unions hold just under 5% of the small business loans at all depository institutions, and even less, about 1%, of the total business loan market at depositories. If the cap is increased, that market share might increase slightly – but banks would still have over 90% of the small business loan market. How much market share is enough for the banks that the Administration is proposing to give $30 billion to lend? And more important for small business, even with the banks' dominance in the marketplace, small business lending needs are still unmet.

They say that increased credit union business lending will lead to a reduction of other types of credit union lending, but that fact is that the average credit union has about 26% of its assets in cash and investments, which means if they are permitted to do more lending, they would most likely fund this increase out of excess investment holdings, and not a reduction in consumer lending.

They talk about the credit union tax status and that credit unions should not be granted an expansion of powers. However, this specious and sidetracking argument ignores the fact that roughly 2,500 banks are Subchapter S institutions, and, like credit unions, have been afford special federal income tax treatment by Congress. It is more than a little disingenuous for the bankers to use the credit union tax status as an argument against increasing the credit union member business lending cap when one-third of all banks are exempt from federal income tax, these banks would be eligible to receive funds under H.R. 5972, credit unions have not cost the taxpayer a dime, credit unions fund their own share insurance fund and no credit union member has ever lost a dollar of insured deposits in a federally insured credit union.

The bankers say that increased business lending will distract credit unions from serving the underserved. There are many in this country who are underserved and the credit union record on serving these populations is solid. But, as we recover from the Great Recession, our small businesses are underserved. Bank business lending portfolios have shrunk while credit unions' have increased. Credit unions want to meet the needs of their business-owning members, and a Treasury study has found that credit union loans to small businesses go disproportionately to business owners on the lower end of the income scale.[3]

The need for more small business lending is evident; the time for Congress to act is now. Investing $30 billion of taxpayer money in community banks may be part of the solution – CUNA does not oppose this aid because it may help small business. However, there is at least $10 billion of capital in well capitalized credit unions with business lending experience ready to be loaned if the credit union member business lending cap is increased, and it will cost the taxpayers nothing.

Increasing the Credit Union Member Business Lending Cap

Representatives Kanjorski and Royce have introduced legislation (H.R. 3380) which, if enacted, would increase the credit union member business lending cap from the current

[3] United States Department of the Treasury, *Credit Union Member Business Lending,* January 2001. 3.

level of 12.25% of total assets to 25% of total assets. The House bill has 113 cosponsors, including many members of this Committee. Similar legislation (S. 2919) has been introduced in the Senate by Senator Mark Udall, where it has 11 cosponsors, including Majority Leader Reid.

We appreciate the support of these and other Members of Congress. As a result of the momentum created in support of increasing the credit union business lending cap in both chambers, Senator Udall and others have negotiated modifications to this legislation with the Department of Treasury over the course of the last several months. We now believe that there is a proposal to increase the MBL cap which the Administration will support, and we urge you to include it in the small business lending package you will soon introduce.

The proposal that Treasury has told us they would support establishes a two-tier structure for the credit union member business lending cap. Tier One credit unions would be eligible to engage in business lending to the current cap of 12.25% of total assets. Tier Two credit unions would have to meet certain criteria and be approved by NCUA, but would then be permitted to engage in business lending to 27.5% of total assets. In order for a credit union to be considered for Tier Two status, the credit union would have to:

- be well capitalized (currently, at least 7% net worth ratio);
- be at or above 80% of the Tier One cap for one year prior to applying for approval;
- have engaged in member business lending for five years prior to applying; and
- be able to demonstrate sound underwriting and servicing based on historical performance; strong management, adequate capacity to lend, and policies to manage increased business lending.

The proposal calls for Tier Two credit unions to phase in additional business lending by limiting a Tier Two credit union's business lending portfolio growth to no more than 30% per year.

NCUA would approve a credit union for Tier Two status using statutory standards, set by Congress, not the regulator. In addition, the proposal states that a credit union that drops below the well capitalized level would have to stop making new business loans until such time as NCUA determines they are again well-capitalized.

The proposal makes no change to the definition of a business loan, preserving, but not increasing, the current $50,000 de minimus threshold. Finally, the proposal directs the NCUA and the GAO to conduct separate studies of credit union business lending and report to Congress three years after enactment.

We believe that this proposal would permit credit unions to help small businesses in need of credit while at the same time ensuring that credit unions engaging in additional business lending are continuing to do so safely and soundly. Many of the new features of this proposal address safety and soundness, and will safeguard the National Credit Union Share Insurance Fund against increased exposure.

We estimate that if this proposal were enacted into law, credit unions could lend an additional $10 billion to small businesses in the first year after implementation, helping small businesses create as many as 108,000 new jobs. **This is a job creation proposal that would not cost the taxpayers a dime and would not increase the size of government.**

We urge Congress to permit credit unions to do what they were established to do – serve their members, including those who own small businesses. We have the willingness to help. We have the capacity to help. But, we need Congress to act.

State Small Business Credit Initiative

We have also reviewed H.R. 5302, the State Small Business Credit Initiative Act, which has been introduced by Representative Gary Peters (D-MI) and cosponsored by 25 Members of the House of Representatives. This legislation authorizes Federal support for two types of State business lending programs: capital access programs and other innovative loan programs. The idea behind both of these types of programs is to use small amounts of public resources to generate private financing of small business loans.

State Capital Access Programs have been successful in 34 states. States create a loan-loss reserve fund for small business loans, funded by fees paid by participating banks and credit unions, the borrowers and the state. The federal program seeks to assist states that have seen the most significant increases in unemployment over the last two years. This helps spread default risk and encourage credit unions and banks to lend more to small businesses.

The federal support to state programs in H.R. 5302 would be particularly helpful in that it would be targeted to those states that have been the worst hit by the recession. It is in these very states that banks and credit unions have been hardest hit by rising losses on both their consumer and business loan portfolios. Faced with recent losses, these institutions require support and the incentive to expand loans to small businesses. Credit unions participate in capital access programs in a number of states, including Michigan. CUNA supports the legislation because we believe this will help spur small business lending and help create jobs, especially in those states hit the hardest by the recession. Coupled with an increase in the MBL cap for credit unions, the legislation would take a big step toward addressing the need for additional capital for small businesses in the nation's most economically troubled regions.

Conclusion

Mr. Chairman, thank you very much for the opportunity to testify today. I am happy to answer any questions the members of the Committee may have.

CUNA's Response to Objections to Raising the Credit Union Member Business Loan Cap

CUNA Research and Policy Analysis
May 18, 2010

Banking trade associations object to the expansion of credit union business lending authority. This paper provides a summary of the objections made by those opposed to lifting the business lending cap, and responds to those claims with facts.

By way of background, as of December 2009, credit unions held $36 billion in loans to small businesses. This represents 4.5% of all small business loans at depository institutions.[4] Were a doubling of the business lending cap at credit unions to eventually lead to a doubling of credit union business lending, that would leave at least 91% of the market to banking institutions. To the extent the additional credit union loans were made to borrowers whose credit demands would not have been met by banking institutions, the reduction in the banks' share would be less.

Most credit unions are currently under a business lending cap of 12.25% of assets, established by law in 1998. (There are statutory exemptions that some credit unions meet.) Prior to that date, there was no business lending cap at credit unions. Although the majority of credit union lending has always been in loans to consumers, credit unions have engaged in business lending since their inception in the US in 1908. The cap is expressed as 1.75 times net worth, but only net worth up to the level required to be well-capitalized (7%) can be counted. Thus, credit unions with excess capital are not permitted to hold additional business loans. Approximately 100 business lending credit unions were grandfathered by Congress because they exceeded the cap at the time of its imposition.

Banker Claim: Raising the cap would undermine credit union safety & soundness.

Facts: Credit unions have a long history of engaging in safe and sound business lending. Business lending at credit unions is much safer than at other institutions. According to data collected by NCUA and FDIC:

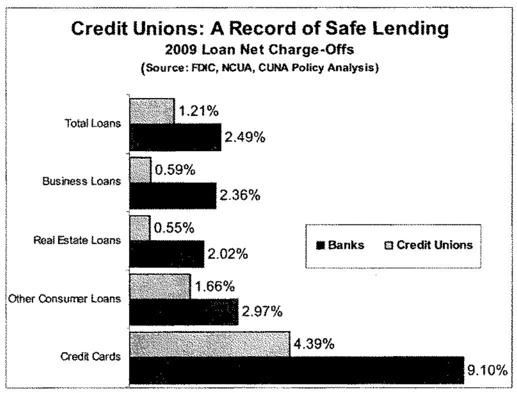
- Credit union member business loan net charge-off rates have been significantly lower than bank rates year-in and year-out for over a decade. Since 1997, credit union member business loan net charge-off rates have averaged 0.15%, a figure that is roughly **one-sixth** the 0.82% bank average over the same period.[5]
- More recently, the financial crisis and recession have increased losses at all lenders. However, the increase in loss rates at credit unions pales in comparison to bank results.

[4] NCUA Call Reports and FDIC Statistics on Depository Institutions.
[5] Ibid.

During 2009, credit unions charged off business loans at a 0.59% rate – about one-fourth the 2.36% rate reported by banks over the same period.[6]

- Compared to other loans at credit unions, business loan net charge-off rates are lower than net charge-off rates on credit union consumer loans and essentially identical to the net charge-off rates in credit union real estate loan portfolios.[7]

As shown in the following graph, relatively low charge-offs are NOT confined to credit union business lending portfolios. Credit union net charge-offs are substantially lower than bank net charge-offs in each loan category. This lower loss experience at credit unions is the result of their operation under a cooperative structure, which provides much lower incentives to take on risk than a for-profit structure.[8]



Further, most credit unions have excess liquidity today which is depressing their overall earnings. Moving assets from low-yielding investments into higher-yielding member business loans, even after accounting for credit losses on those loans, will increase credit union earnings, capital contributions, and overall safety and soundness.

Finally, the federal credit union regulator, the National Credit Union Association (NCUA), has full authority to supervise credit union business lending. That regulation is no doubt an important reason behind the very low loss rates experienced on credit union business loans over the past

[6] Ibid.
[7] NCUA Call Reports.
[8] Edward J. Kane and Robert J. Hendershott, *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S. Taxpayers*, Journal of Banking and Finance, 20(September, 1996), pp. 1305-1327. Kane and Hendershott describe how the cooperative structure of credit unions presents credit union decision makers with incentives that are strikingly different from those faced by a for-profit financial institution, making it less feasible for credit union managers to benefit from high-risk strategies.

decade. Recently, NCUA Chairman Matz emphasized in a February 24, 2010 letter to Treasury Secretary Geithner[9]: "If legislative changes increase or eliminate the aggregate MBL cap, NCUA would promptly revise our regulation to ensure that additional capacity in the credit union system would not result in unintended safety and soundness concerns."

<u>Banker Claim</u>: Raising the cap would not create jobs or reduce unemployment. However, even if it did do so, the CUNA-produced estimate of job creation is too high.

<u>Facts</u>: Relaxation of artificial statutory lending restrictions will increase the efficiency of capital allocation in the economy. This will promote more lending, more spending, more job creation and higher economic growth. Recent bank business loan contraction suggests that, at least to some degree, credit unions will be making loans that banks are not making.

CUNA estimates that raising the business lending cap would allow credit unions to increase business lending by up to $10 billion in the first year after the cap is lifted. This estimate is based on three conservative assumptions, and is described below:

1. We assume that "grandfathered" credit unions (i.e., the approximately 100 credit unions that are currently above the 12.25% cap) do not increase their lending when the cap is raised.
2. We assume that credit unions that are not currently engaged in business lending would enter the market in an amount equal to 1% of total assets on average under the new authority. We further assume that only 40% of the increased activity would occur in the first year.
3. We assume that all other business lending credit unions lend in an amount equal to their current "use" rate, i.e., all non-grandfathered current business lending credit unions would eventually just over double their business lending. Our conservative estimate assumes that only 40% of the increased lending would occur in the first year.

Applying these assumptions produces an estimate of a $10.8 billion first-year increase in lending, which we have rounded down to $10 billion. That would represent an approximately 30% increase in credit union business lending. This is certainly plausible considering that credit union business loan portfolios increased by 30% or more in four of the past eight years. That growth has slowed recently as an increasing number of credit unions have begun to approach their caps.

Because bank business loan portfolios are shrinking we assume that the new loans would largely be loans that would not otherwise be made by banks. We further assume that the $10 billion increase in lending would be a "new normal" - that the first-year addition would represent a permanent addition to loan volume in credit union portfolios. In this regard, the increase in lending can be viewed as ARRA-like stimulus similar to direct spending. Thus, we assume that the additional lending would produce jobs at a rate that is similar to the estimates published by the Council of Economic Advisors (CEA) in its May 2009 estimates of job creation.[10]

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[9] http://www.ncua.gov/news/press_releases/2010/MA10-0225MatzLending.pdf

[10] See: http://www.whitehouse.gov/administration/eop/cea/Estimate-of-Job-Creation/. Note: Use of Small Business Administration survey data would produce a much larger estimate of job creation. Since CUNA's aim was to produce a conservative estimate we chose not to use the SBA job creation data.

Using these assumptions and rounding, each $92,000 in additional MBL lending on the part of the nation's credit unions will create one additional job. Therefore expanded credit union MBL authority will result in an estimated first-year increase of 108,000 new jobs nationally.

Banker Claim: There is no evidence to support the contention that credit for small businesses is in short supply, as community banks have been lending to small businesses in their communities throughout the economic crisis.

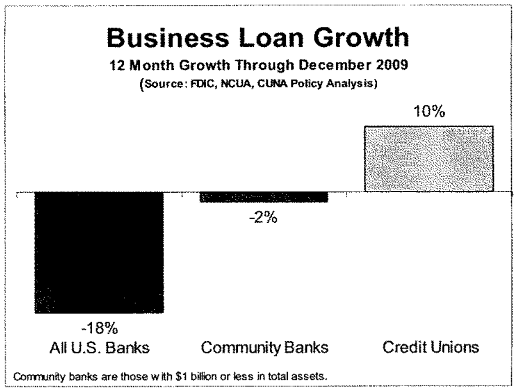
Facts: There is no doubt that there has been a reduction in the demand for business credit as a result of the recession. However, there is also considerable evidence that a significant contraction in the supply of business credit has contributed to the reduction in credit outstanding.

In a recent study, the NFIB reported that only . . . "Forty (40) percent of small business owners attempting to borrow in 2009 had all of their credit needs met. . . The current level of borrowing success is significantly lower than in the mid-2000s when up to 90 percent had their most recent credit request approved."[11] As the NFIB points out, for many businesses, the recessionary lack of sales is a more basic problem than lack of access to credit, but their findings are strong evidence that low credit availability is exacerbating the effects of the recession.

Not surprisingly, a large number of small business owners are telling policy makers that they are being turned away by their banks. That is the primary reason that Congress has held several hearings on this subject (most recently on February 26, 2010).

Moreover, recent data from financial institution regulatory reports supports this view. Call Report data suggests that banks – both large and small – are turning away many business borrowers. As shown in the following graph, bank business loan portfolios are shrinking, while credit union business loan portfolios are growing. If indeed the contraction in business credit outstanding were due solely to reduced demand, credit union lending would have declined as it did at banks, rather than registering a 10% increase in 2009.

[11] William J. Dennis, Jr. *Small Business Credit in a Deep Recession,* NFIB Research Foundation, February 2010, p 1. Available at www.nfib.com/Portals/0/PDF/AllUsers/research/studies/Small-Business-Credit-In-a-Deep-Recession-February-2010-NFIB.pdf



Allowing credit unions to extend loans to businesses that need credit will add fuel to a self-sustaining economic expansion. Increasing competition in the small business loan market will increase the efficiency of capital allocation. Businesses will choose credit union loans over community bank loans only if credit unions provide a product that provides an overall better value. And credit union competition will ensure that banks are treating their small business customers more fairly.

Banker Claim: Raising the cap is unnecessary because relatively few credit unions are now near the 12.25% member business lending cap.

Facts: For the past several years, business loans have been the fastest growing component of credit union lending (the other two sectors being residential mortgage loans and non-residential consumer loans.) From 2000 to 2009, business loans at credit unions grew at an annual rate of 25.1%, over three times faster than the 7.4% annual growth rate of all credit union loans.

However, that growth is now slowing as more and more credit unions approach their caps. The closer a credit union gets to its cap, the less accommodative it can be in granting business loans. As of December, 2009 the following conditions held with respect to credit union proximity to the cap (excluding grandfathered credit unions):

- 174 credit unions, with $8.8 billion in business loans outstanding, had business loans of more than 10% of assets. These credit unions are essentially capped; they are either at the cap or will be there within a little more than a year or less. In the three years ending December 2009, their business loans outstanding rose by $4.5 billion. They will be able to contribute very little to future business loan growth without an increase in the cap.
- Another 163 credit unions hold business loans between 7.5% and 10% of assets. Most of these credit unions will be capped within three years. They held $5.6 billion in business loans at year-end 2009, and their business loans grew by $1.9 billion over the preceding

three years. Their business lending will have to slow dramatically in the coming few years without an increase in the cap.

Taken together these nearly 350 credit unions account for approximately 60% of all business loans subject to the 12.25% cap. These credit unions have been the major contributors to credit union business loan growth over the past few years. Over the next few years, their business loan growth will dry up without an increase in the cap.

Finally, the cap also has a chilling effect on credit union entry into the business lending arena: For many credit unions even capped portfolios are not large enough to justify the sizeable up-front investment necessary provide this service.

<u>Banker Claim</u>: Raising the cap is undesirable because member business lending is incompatible with credit unions' statutory mission of serving only consumers.

<u>Facts</u>: Credit unions have been making business loans since their inception in the early 1900's. In the first 90 years of their existence, there was no business lending cap at credit unions. The current 12.25% of assets cap was an arbitrary limit imposed by Congress in the Credit Union Membership Access Act in 1998 (CUMAA).

The credit union tax exemption arises from their unique structure as not-for-profit, democratically-controlled cooperatives – and that structure is unchanged over the past 100 years. The tax exemption has absolutely nothing to do with the breadth or volume of credit union product and service offerings – a fact clearly spelled-out by Congress in CUMAA.

<u>Banker Claim</u>: Raising the cap is undesirable because increased member business lending will force credit unions to reduce their lending to consumers.

<u>Facts:</u> The average loan-to-asset ratio at credit unions that offer business loans is 69%. Accounting for the roughly 5% of assets in fixed and other assets, that leaves about 26% of assets in cash and investments. If an additional 12% of assets were eventually devoted to business lending as a result of lifting the cap, credit unions could fund the increase almost exclusively out of investment holdings.

<u>Banker Claim</u>: Tax-subsidized institutions like credit unions should not be granted expansion of powers – this is especially true now because the credit union tax subsidy is contributing to the national debt during a time of extreme budgetary pressure.

<u>Facts</u>: Having credit unions pay federal income taxes will have no discernable effect on the federal budget deficit. The Administration's current estimate of the value of the credit union tax exemption was $650 million in 2009, whereas the federal budget deficit was over $1.4 trillion in 2009.

Because credit union taxation would have an indiscernible effect on the deficit it would have no impact on interest rates in the economy. With no effect on interest rates, borrowing, spending, job creation and economic activity would be unaffected. However, credit union small business lending does in fact produce greater capital expenditures, greater economic activity and ultimately more job creation. The multiplier effect means that these new jobs lead to new spending which then sets in motion support to a self-sustaining economic recovery.

<u>Banker Claim</u>: Raising the cap will harm community banks.

<u>Facts</u>: As of December 2009, credit unions held a total of $36 billion in loans to small businesses. This represents 4.5% of all small business loans at depository institutions. It took credit unions 100 years to reach this share of market. Even if credit unions were to double their market share in the future that would still leave banks with an overwhelming 91% share.

The Treasury Department has found that credit unions do not have a competitive advantage over banks, and that credit union business lending does not harm community banks. In a 2001 report on credit union business lending, the Treasury Department concludes:

> Credit unions have advantages over other depository institutions in that some receive sponsor subsidies, while all are exempt from the federal corporate income tax. However, credit unions do face certain constraints, in the form of limitations on the eligibility to receive such loans and on the loans themselves, that banks and thrifts do not have. Overall, we cannot discern whether credit unions have a competitive advantage.[12]

and,

> Overall, credit unions are not a threat to the viability and profitability of other insured depository institutions.[13]

These Treasury conclusions were admittedly based on the existence of a 12.25% cap and a lower level of credit union business lending than pertains today. However, as mentioned above, doubling current credit union business lending would still leave over 90% of the market to banks. Under those circumstances, it is unlikely that Treasury would need to dramatically alter its conclusions.

<u>Banker Claim</u>: Pursuit of expanded commercial lending powers calls into question the credit union industry's commitment and ability to serve the needs of lower-income and unbanked populations.

<u>Facts</u>: It is true that part of the credit union mission is to serve those of modest means, along with others. It also is true that many modest means individuals run small businesses and need credit. This is especially true in economic downturns because unemployed and discouraged job seekers are more likely to form businesses during these events.

Treasury's 2001 comprehensive analysis of credit union business lending showed that credit unions do a very good job of serving the business credit needs of low and moderate income business owners. Treasury found that 25 percent of member business loans were made to members with household income of less than $30,000 -- and that these loans totaled 13 percent of the outstanding member business lending balances. Another 20 percent of the loans (with 15 percent of the outstanding loan balance) went to households with incomes reported to be between $30,000 and $50,000.[14]

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[12] United States Department of the Treasury, *Credit Union Member Business Lending,* January 2001. p 5.
[13] Ibid. p.5.
[14] Ibid. p. 3.

Beyond business lending, credit unions do an outstanding job of serving those of modest means. For instance, Home Mortgage Disclosure Act (HMDA) data – the primary data source in CRA examinations - clearly and consistently show that compared to banks, credit unions make a greater percentage of their loans to lower income individuals. HMDA data also reveal that lower income households are substantially more likely to be approved for loans at credit unions and substantially less likely to be denied a loan at credit unions.

For example, analysis of HMDA data shows that, since 2005, credit unions have approved an average of 68% of applications from low/mod income borrowers, whereas other lenders approved an average of only 51% of these applications. Moreover, since 2005, an average of 26% of total credit union mortgage originations were to low/mod income borrowers while low/mod income originations represented only 23% of total originations at other lenders.

It is worth noting that credit unions have repeatedly attempted to reach out to serve more individuals in lower-income households. However, bankers have used the courts to bar those efforts. This tactic of claiming that credit unions are not "doing enough" on the one hand while simultaneously erecting obstacles to the provision of credit union service does nothing to help these communities.

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Written Testimony Submitted By
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Counselor to the Secretary of the Treasury
U.S. Department of the Treasury
Before the Committee on Financial Services
U.S. House of Representatives
Hearing on "Initiatives to Promote Small Business Lending, Jobs and Economic Growth"

Chairman Frank, Ranking Member Bachus, Members of the Committee, I appreciate the opportunity to discuss the topic of small business lending and job creation today.

There are few things as important for a strong recovery as ensuring that small businesses have the ability to access credit, make investments and create new jobs. One of the brutal facts of the financial crisis is that the actions of the irresponsible have hurt so many innocent Americans who did act responsibly– including hundreds of thousands of small business owners across the country. As Secretary Geithner wrote last year, the decisions that led to the financial crisis "have caused enormous suffering, and much of the damage has fallen on ordinary Americans and small-business owners who were careful and responsible. This is fundamentally unfair, and Americans are justifiably angry and frustrated." Secretary Geithner and the Administration recognize that the continued challenges small businesses face in accessing the credit they need to keep their businesses afloat or expand as the economy improves are not only unjust, but also work against the kind of recovery we need to create jobs again.

Indeed, during the past recession, small business employment went down less than employment at larger firms, and then began growing faster during the recovery. In this recession, however, smaller firms have struggled more than larger firms to gain jobs. Data analyzed by Treasury's Assistant Secretary for Economic Policy and Chief Economist Alan Krueger reveals that between July 2009 and February 2010, establishments with fewer than 50 employees lost, on average, 158,000 jobs a month, while establishments with more than 250 employees gained about 32,000 jobs a month.

As the National Federation of Independent Business' monthly survey of small businesses shows, the number one economic concern facing small businesses is poor sales stemming from a lack of demand from consumers – with 29 percent reporting in April that it was their most important problem. But beneath this headline is the clear fact that many small businesses – including many of those who are also struggling due to poor sales – want to borrow, but cannot. According to a special NFIB supplement on credit published this February, among small businesses that sought to borrow last year, 45 percent were unable to get all the credit they wanted. Similarly, the National Small Business Association reported that 39 percent of small businesses were not able to get adequate financing. This suggests that even as the recovery emerges and sales pick up, creditworthy small businesses may struggle to expand and create jobs because they are unable to borrow.

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Since before the day the President took office – at a point when the alarming extent of the credit crunch for small businesses had become very clear – this Administration has sought to put forward a comprehensive agenda to ensure small businesses could borrow, expand and create jobs. We started with tax cuts, including provisions in the Recovery Act that allowed small businesses to write off up to $250,000 in investments, carry back their net operating losses five years, use "bonus depreciation" to accelerate the rate at which they can deduct the cost of capital expenditures, and have 75 percent of capital gains on qualified small business investments excluded from taxation. In addition, through the Making Work Pay tax credit, the vast majority of small business owners received a tax cut.

At the beginning of this Administration, Treasury and SBA also worked together to address a severe decline in SBA lending. While annual SBA loan volume in recent years had been about $20 billion per year, at the beginning of 2009, SBA lending was on pace to potentially fall below $10 billion. The secondary market on which SBA loans are bought and sold had frozen, removing a key source of liquidity that allowed banks to extend new credit. As a result, we recognized we would need a coordinated response of strong measures to jumpstart SBA lending through the Recovery Act, combined with a commitment to unfreeze the secondary market—which many banks rely on for liquidity to make new 7(a) loans. Treasury worked with the Small Business Administration to secure passage of higher guarantees for qualifying 7(a) loans and reduced fees for both 7(a) and 504 loans under the Recovery Act, while announcing an effort to directly purchase securities backed by SBA loans and improving the terms under the Term Asset-Backed Securities Loan Facility to help unlock the secondary market.

These efforts had their intended effect. By creating confidence that there would be a buyer of last resort, the improved terms for securities backed by SBA loans under TALF, combined with the March 2009 announcement of the SBA securities purchase program, helped to unfreeze the secondary market. Indeed, some market participants noted that the simple announcement of these efforts had a positive impact in restarting the market. In January and February 2009, the volume of loans settled from lenders to broker-dealers on the secondary market for SBA loans averaged $112 million – about one-third of the 2008 pre-crisis average of $328 million. By May 2009, activity had returned to $325 million, and monthly volume since has averaged $336 million. Combined with the Recovery Act provisions increasing guarantees and reducing fees – implemented under the leadership of SBA Administrator Karen Mills –these improvements have helped SBA weekly loan volumes increase by over 90 percent relative to the weeks before the Recovery Act passed and encouraged nearly 1,300 lenders that had not made a SBA loan since 2007 to do so.

In the months since, we have continued to take action to support small business job creation. The comprehensive health reform that passed as part of the Affordable Care Act included a Small Business Health Care Tax Credit – effective immediately – that will help small businesses afford the cost of covering their workers, saving smaller firms $40 billion by 2019. At the same time, health care reform will, by 2014, allow firms with 100 or fewer workers to pool their purchasing power. These policies will also reduce the unfair burdens these employers face in the small group market and lower administrative costs by allowing them to buy insurance through an exchange, while bringing down the cost of treating the uninsured that adds a "hidden tax" of over $1,000 to every family's health care premium.

We have also worked with Congress to pass additional tax relief for small businesses to encourage job creation and investment. As part of the HIRE Act signed into law earlier this year, the Administration extended Recovery Act expensing provisions for small businesses that increased the amount of capital expenditures small businesses could write off to $250,000, while creating a new tax credit for businesses that hire and retain workers that were previously unemployed.

More broadly, by stabilizing the financial system, the efforts taken under TARP prevented what might otherwise have been a more severe contraction in credit to small businesses and a much deeper recession. Among smaller banks – which have generally maintained lending to a much greater degree than their larger counterparts, and are the most focused on small business lending – those that participated in the Capital Purchase Program (CPP) outperformed those that did not with respect to lending. Treasury's analysis of Call Report data finds that for banks with assets less than $1 billion, the median growth of total loans for CPP banks from the third quarter of 2008 to the fourth quarter of 2009 was 4.1 percent, compared to a median rate of 2.3 percent among non-CPP banks. Likewise, the efforts to stabilize the financial system and stimulate a recovery – which helped an economy that had contracted at an average annual rate of -5.9 percent in Q42008/Q12009 shift to an average annual growth rate of 4.4 percent during the past two quarters – prevented what would have been a much steeper decline in lending and in sales for small businesses.

Yet while these measures have certainly made conditions for small business significantly better than they would have been in their absence, the President and his economic team believe that credit availability remains a serious problem requiring significantly more to be done. According to the Federal Reserve Senior Loan Officer Opinion Survey, lenders reported 13 straight quarters of net tightening loan standards for small firms prior to last quarter, when they reported no net tightening or loosening – an improvement, but one that suggests that lending remains constrained given the prolonged tightening over the course of the crisis. The pullback in lending among larger banks has been particularly disappointing – especially, as the President said in December, since "given the difficulty businesspeople are having as lending has declined, and given the exceptional assistance banks received to get them through a difficult time, we expect them to explore every responsible way to help get our economy moving again."And while large businesses have also been impaired by these credit constraints, this tightening has had a more significant impact on small businesses. Large businesses rely on banks for only 30 percent of their financing. Many have been able to access other sources of credit and benefit from the recovery in the corporate bond market. Small businesses, on the other hand, rely on banks for 90 percent of their financing, leaving them with few alternatives as lenders tighten their standards. Indeed, the combination of constrained credit conditions, reduced sales and declines in the value of real estate collateral has led many small businesses to face a "perfect storm" that continues to hinder their ability to grow and create new jobs.

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Throughout 2009, the Administration continued to explore additional ways to use Treasury's authority under TARP to support lending to small businesses. Unfortunately, we found that fear of stigma and retroactive punitive measures made community and smaller banks increasingly unwilling to take part in any TARP program. Indeed, we started seeing this trend even earlier in 2009, when over 600 banks withdrew their applications to participate in the CPP – many citing these concerns about TARP stigma or retroactive restrictions. This fear of becoming a TARP recipient became even more pronounced last November when Congress chose to disqualify any bank that had participated in TARP from receiving the benefits of net operating loss carrybacks.

The sole exception appeared to be Community Development Financial Institutions. Because they alone stressed to us that they were willing to participate in a TARP facility, Treasury moved forward with the new Community Development Capital Initiative (CDCI). The results so far have been very encouraging, as we understand well over 100 banks, thrifts and credit unions have applied to their regulators to participate in the CDCI program since it was launched earlier this year.

We have also put serious work into exploring whether there would be a way to use TARP funds to help small businesses – outside of CDFIs – without requiring that small banks be labeled "TARP recipients." However, after much effort and consideration, we determined we had no choice but to seek new legislation to enable us to help the flow of small business credit — and in turn, small business expansion and job creation — through efforts completely outside of and separate from TARP. In that light, the Administration has sought to work with Congress to pursue a comprehensive small business jobs package that would include the following elements:

1) Additional tax incentives to encourage small business investment, including a 100% elimination of capital gains taxes on certain small business investments

2) A temporary extension of successful Recovery Act provisions that increased SBA guarantees and eliminated fees

3) An expansion of SBA loan products, including an increase in the maximum loan size of loans under the 7(a), 504 and microloan programs and an expansion of refinancing of owner-occupied commercial real estate under the 504 program

4) New proposals we are discussing with Chairwoman Nydia Velazquez to strengthen programs at the SBA that bring creditworthy small business borrowers off the sidelines and support financing for small businesses, including those in their earliest stages of growth

5) An expansion and improvement of the New Markets Tax Credit (NMTC) to support lending in the hardest-hit communities as proposed in the Administration's budget – by extending the NMTC through 2011 with $5 billion in authority, allowing the NMTC to offset the Alternative Minimum Tax (AMT) to put it on equal footing with other similar credits, and enhancing the credit so it works better for small businesses

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6) The creation of a new Small Business Lending Fund that would invest capital in community and smaller banks with strong built-in incentives to increase lending

7) A new State Small Business Credit Initiative that would strengthen innovative state programs, supporting $10 in small business lending for every $1 in Federal funding

Today, I'd like to discuss these last two provisions at greater length.

First, the Administration earlier this year put forward a proposal to create a new $30 billion Small Business Lending Fund. This fund – which would be established entirely separate from TARP – would provide capital to community and smaller banks whose commercial lending is already concentrated among smaller loans, structured with incentives to increase that lending. By providing $30 billion in capital to these banks, the fund could support several multiples of that amount in new lending. However, I want to focus in particular on five key features of the fund and its design that we believe will make it a cost-effective means of supporting small business lending:

1) ***The Program Is Limited to Smaller Banks That Traditionally Focus Their Business Lending on Small Businesses:*** As designed, the program would be open only for banks with less than $10 billion in total assets – with the fund providing up to 5 percent of risk-weighted assets to banks smaller than $1 billion in total assets, and up to 3 percent of risk-weighted assets to banks between $1 billion and $10 billion in total assets. These banks are the lenders most focused on small business lending: among their commercial and industrial (C&I), owner-occupied commercial real estate and farm lending, about two-thirds of their loan volume is extended through the smallest loans.[1]

2) ***The Smaller Banks Targeted By This Program Have Dramatically Outperformed Larger Banks in Maintaining Lending to Small Businesses:*** While smaller banks have unquestionably been challenged by the financial crisis, they have also dramatically outperformed larger banks in maintaining lending to small businesses during the crisis. For instance, as the chart below illustrates, commercial and industrial (C&I) and commercial real estate lending at banks with less than $1 billion in assets grew at an average annual rate of 3.5 percent for the eight quarters ending with the 4th quarter of 2009, while lending at banks with more than $10 billion in assets contracted at an average annual rate of 8.1 percent:

[1] Here, the smallest loans are defined – using Call Report data – as C&I loans under $1 million, CRE loans under $1 million, and farm loans under $500,000, loans secured by farmland under $500,000, and agricultural production loans under $500,000.

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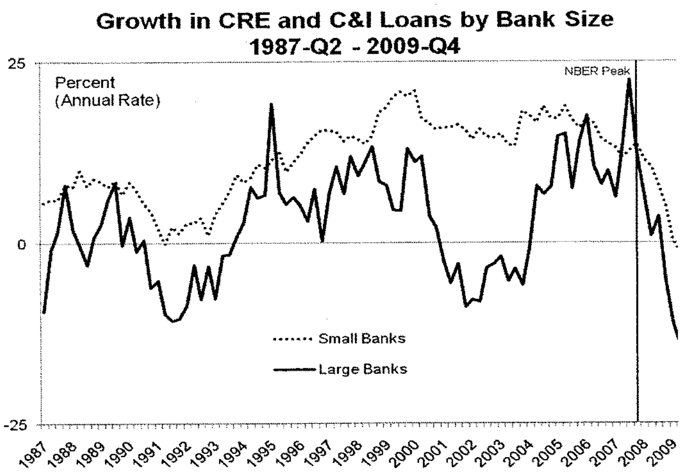

3) ***Performance-Based Incentives Target Benefits Only to Those Banks That Increase Lending Over 2009 Levels:*** The dividend rates banks pay on SBLF capital would start at 5 percent, but would be set to provide an incentive to increase lending over a baseline set using 2009 data. This baseline would not only include standard C&I and owner-occupied real estate loans, but also encourage banks to increase lending to farmers and agricultural businesses as well. Lenders could reduce their dividend rate to as low as 1 percent – but only if they increased lending by at least 10 percent over that baseline. This design establishes a clear, reliable metric of measuring changes in lending before and after banks enter the program, while ensuring that the incentives only go to those banks that use capital to extend more credit. At the same time, lenders that receive the lower dividend rate will be able to "pass through" the lower cost of funds to their borrowers by offering reduced rates on new loans – potentially bringing new borrowers off the sidelines so that they can expand and hire new workers.

4) ***In Response to Discussions With Congress, We Have Added A Higher Rate for Institutions That Do Not Increase Lending:*** After consultations with Congress, the proposed Small Business Lending Fund now includes a provision that would increase the dividend rate from 5 percent to 7 percent after two years for any participating bank that

[2] Data are from the FDIC Call Reports. The chart shows the quarterly change in loan balances at an annual rate. Data have been adjusted for mergers and acquisitions. For purposes of this chart, small banks are defined as less than $1 billion in assets, while large banks have greater than $10 billion in assets.

does not increase its lending. This new provision increases the "performance-based" nature of the program, offering a further incentive for participants to extend more credit.

5) ***Capital Designed to Ensure Small Banks Do Not Pull Back Lending In Light of Commercial Real Estate Concerns:*** With some community banks anxious about continued challenges in the commercial real estate market, the Small Business Lending Fund is designed to reduce the risk that viable institutions would react to such fears by pulling back indiscriminately on small business lending. By accessing additional capital under the SBLF, institutions can be confident that they can continue to lend and still have a buffer against future CRE losses.

We believe that as designed, the Small Business Lending Fund can attract smaller and community banks to participate in a program that will help them extend more credit. Indeed, we are pleased that this proposal has drawn the support of the Independent Community Bankers of America – represented here today by its chairman James MacPhee – as well as groups like the National Small Business Association, Small Business Majority, the National Bankers Association, the Conference of State Bank Supervisors, as well as the 19 Members who have chosen to sponsor or co-sponsor the legislation.

Secondly, as a new component of our Small Business Lending Fund, we have worked with Congress to put forward a new State Small Business Credit Initiative, which would support state programs that help make credit more available for small businesses and manufacturers.

This new initiative would provide grants to state small business programs – programs that are facing increased demand, even as strained state budgets have reduced their ability to meet that need. Funding would go to state programs that enable private lenders to extend credit to creditworthy small businesses, ensuring that loans are made with sufficient underwriting standards. At the same time, the program would operate with a significant "bang for the buck," as states would be required to support at least $10 of lending across all programs for every Federal dollar received. Congressman Gary Peters and Ways and Means Chairman Sandy Levin have proposed to fund this program at $2 billion – an amount that the Administration supports as part of an overall package that is paid for – and we believe that with such funding, the program could support over $20 billion in lending.

Through this initiative, states could expand a range of innovative small business programs. States could use funds for programs that provide collateral support to small businesses and manufacturers. These programs help support viable businesses that have seen the value of their collateral fall, a problem that has made credit more difficult to get, particularly for small manufacturers in some of the communities hardest-hit by the financial crisis. States like Michigan under Governor Jennifer Granholm and Ohio under Governor Ted Strickland have looked to devote funds to augment collateral the borrower holds, providing banks with a greater confidence to lend to small businesses. The experience of Michigan's collateral support program – which I know Paul Brown of the Michigan Economic Development Corporation will be

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discussing today – offers a promising example of the kind of program states could support under the State Small Business Credit Initiative.

The State Small Business Credit Initiative could also support Capital Access Programs (CAPs). CAPs, which are already up and running in about 30 states and cities, offer matching contributions to loan loss reserves when lenders extend credit to qualified small businesses. These reserves serve as a form of insurance on a lender's loan portfolio, with the matching contribution from the state allowing lenders to take on slightly more risk in lending to creditworthy borrowers. Past Treasury evaluations of Capital Access Programs have suggested that they offer a promising means of expanding availability of credit to small businesses, and their track record in states across the country has encouraged members of both the House and the Senate, like Sen. Mark Warner, to promote these programs.

Finally, the State Small Business Credit Initiative would support other efforts like state loan guarantee programs, in keeping with a request made to the President and Secretary Geithner earlier this year in a letter signed by 28 governors across the country – including Governor Martin O'Malley of Maryland, who is represented here today by Christian Johansson of the Maryland Department of Business and Economic Development. This initiative would provide funds immediately to these state programs and would not require states to appropriate matching funds or take other measures that would slow down the urgent need to get funding to small businesses.

We believe these two programs can be established quickly to make credit more available to small businesses so that they can create new jobs. We are eager to work with this Committee and the Congress – including the House and Senate Small Business Committees – to swiftly pass these measures into law as part of a small business jobs package that will support new lending, provide small businesses with tax incentives to grow, and expand the SBA's ability to make credit more available to firms looking to expand and hire new workers.

Thank you for your efforts in working to make credit more available to small businesses across the country. I look forward to taking your questions.

May 18, 2010

Statement for the Record

By the

AMERICAN BANKERS ASSOCIATION

For the Hearing Before the

Committee on Financial Services

United States House of Representatives

American
Bankers
Association

Statement for the Record
by the
American Bankers Association
for the hearing before the
Committee on Financial Services
of the
United States House of Representatives
May 18, 2010

Chairman Frank, Ranking Member Bachus, members of the Committee, the American Bankers Association (ABA) is pleased to submit for the record this statement in support of the proposed Small Business Lending Fund and proposals for state small business credit initiatives . The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees.

ABA supports H.R. 5297, the Small Business Lending Fund Act of 2010, which was recently proposed to stimulate small business lending. This bill can help community banks meet the needs of small businesses across America. As Congress considers efforts to help small businesses, it is important to keep in mind that most banks are small businesses in their own right. In fact, over 3,400 banks (41 percent) have fewer than 30 employees. Small steps taken by the government now can make a huge difference to small banks, their customers, and their communities – keeping capital and resources focused where they are needed most.

The success of the Small Business Lending Fund will depend in part on whether those banks that can benefit the most will be allowed to participate. In particular, viable banks that are located in the hardest-hit parts of this country should be allowed to participate. It is these banks in economically-challenged areas that are the ones likely to have the greatest interest in this new fund. Since banks are a reflection of their communities, they are suffering right along with the communities they serve. Business failures and unemployment have impaired credit quality and increased loan losses. As a result, capital – which underpins every loan made by banks – has been stressed.

Moreover, in hard-hit areas, meeting the needs of borrowers has been made more difficult by regulatory pressure on banks to maintain (and even increase) capital-to-asset ratios. Given the severity of the downturn, it is very difficult if not impossible for community banks to find new sources of capital. Thus, for some banks, reducing the size of the bank often becomes the only viable alternative for maintaining regulatory capital-to-assets ratios.

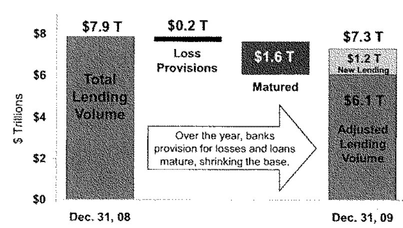
The proposed new fund can help reverse this need to downsize and help stimulate lending to small businesses. With a comparatively small investment from Treasury, these banks will be in a better position to provide credit where it is needed the most, and hard-hit areas will recover faster. ***It is critical that Treasury judge a bank's application by how strong the bank would be <u>with</u> the Treasury investment.*** In this way, taxpayers would be protected while the program's reach is expanded.

The fund also would be more effective if it recognized the dynamic nature of a bank's loan portfolio. H.R. 5297 would reduce the required dividend payable to Treasury (providing an incentive to lend) based upon the degree to which the volume of outstanding small business loans each quarter is greater than volume of lending at the end of 2009. In determining the base lending volume, the bill subtracts out loan losses that the bank has charged off. This is appropriate because the bank would have to ***more than replace these loan losses*** to show an increase in loan volume.

What is ***not*** recognized, however, is that ***roughly 20 percent of a bank's loan portfolio is repaid each year. Under H.R. 5297, a bank would not be viewed as increasing its small business lending until it made enough loans to replace that 20 percent.***

To illustrate this, at the start of 2009, total loans across all business lines on the books of banks totaled $7.9 trillion. Over the course of the year, banks set aside $248 billion in provisions for anticipated loan losses. In addition, a rough estimate is that at least $1.6 trillion of loans matured or were paid off. If banks had initiated no new lending, the year-end loan volume would have been $6.1 trillion.

Banks Lent $1.2 Trillion in New Loans in 2009



Assumes 20% of the loan base matures each year.
Source: FDIC, ABA analysis

Just to stay even with last year, banks would have to originate over $1.8 trillion of new loans. In normal times of economic growth, with strong loan demand and low loan losses, this is possible. But it is impossible today with the many economic challenges, such as 61,000 business failures, 4.7 million jobs lost, and a 10 percent reduction in business inventories. It is remarkable, in this context, that banks were able to originate about $1.2 trillion in new loans, for a total of $7.3 trillion at year-end 2009.

In regions where the economy has yet to emerge from this recession, replacing loans that are maturing with new loans would be a monumental feat – let alone lending beyond that level as the program requires. Simply looking at loan volume from one period to the next misses a large part of the lending that banks are doing every single day. Thus, H.R. 5297 should recognize ***all*** of a bank's small business lending. By doing so, it would make the program far more attractive, particularly in economically hard-hit areas.

It is vitally important that the new program be removed from TARP, both in form and in substance. The statement in H.R. 5297 regarding the distinction between TARP and this program is helpful, and we urge Congress and the regulators to communicate clearly that the small business lending program is in no way a bailout.

Another idea that we also find very promising is the state small business lending initiatives. Efforts like this in Michigan, for example, have shown great promise over the years they have been in place. Under the Michigan Strategic Fund (MSF), the MSF deposits the cash into an interest bearing account with that lender and this account will then be pledged as collateral on behalf of the borrower. Based on an amortization schedule, the MSF will draw down the account as the loan principal is paid. In the event of full default, the lender will have rights to the account less a liquidation fee. Loan-flow in Michigan's pilot program has been high, with close to 300 inquiries and at least $150 million in requests in the first two months of the program. The loans in which Michigan banks have participated have created or saved jobs at a "cost" of approximately $6000 per job. That is particularly exciting when you consider that the $6000 is in the form of a loan/deposit which we are confident will be repaid with interest. This creates a real negative cost per job.

The proposed State Small Business Credit Initiative would function in a similar manner and, we believe, could provide much needed support for loans made by participating banks. As with the Small Business Lending Fund, ABA recommends that Congress and the Administration create criteria for participation in the state credit initiatives that allow all viable community banks to participate. The state credit initiative is to be available to a bank that "has sufficient commercial lending expertise and financial and managerial capital to participate in the approved State capital access program." We propose that all banks that meet those criteria, but particularly banks that did not qualify for Capital Purchase Program (CPP), be permitted to participate. Otherwise, Congress will miss an opportunity to help the customers and communities of many banks across the country.

In conclusion, the Small Business Lending Fund can provide a needed boost to assist viable community banks weather the economic storm and lend to small businesses as the economy gains momentum. ABA would be pleased to work with this Committee in this important program.

Associated Builders and Contractors, Inc.

May 18, 2010

The Honorable Barney Frank
Chairman, Committee on Financial Services
2129 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20510

The Honorable Spencer Bachus
Ranking Member, Committee on Financial Services
B-371a Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20510

Dear Chairman Frank and Ranking Member Bachus:

On behalf of Associated Builders and Contractors (ABC), a national association with 77 chapters representing 25,000 merit shop construction and construction-related firms with 2 million employees, I am writing in regard to the full-committee hearing, "Initiatives to Promote Small Business Lending, Jobs and Economic Growth."

Access to capital is a major concern within the construction industry, which has been severely impacted by the economic downturn. The national unemployment rate for the construction industry is 21.8 percent, and the nonresidential construction industry has lost 51,200 jobs (6.9 percent) since April 2009. The construction industry simply cannot continue to endure the limited access to capital in this economy.

In order to break out of this dire situation, ABC developed a 2010 Job Creation Proposal--a wide-ranging package of recommendations that will help stimulate the construction industry and put Americans back to work. ABC recommends immediately addressing the near freeze on lending for private sector construction projects. Many ABC members have viable low-risk projects/contracts that simply need funding in order for work to commence. In the construction industry, small businesses provide valuable jobs and play an integral role in building communities. An increase in small business lending will encourage small construction firms to hire additional employees or invest in equipment or facilities, thus expanding the economy.

In addition to increasing access to capital, ABC's Job Creation Proposal recommends: eliminating uncertainty in the business environment by focusing on free enterprise initiatives and open competition instead of anti-business legislative and regulatory proposals; providing meaningful tax relief and reducing the tax burden on hardworking Americans and small businesses; enacting a national comprehensive energy plan that includes new construction and upgrades to the nation's insufficient and crumbling infrastructure; allowing the entire construction workforce to participate in federally funded or assisted projects; and supporting construction training programs that attract new skilled workers.

ABC members large and small are eager to take the lead in stimulating economic growth and spurring job creation. Implementing ABC's recommendations will help revive the economy and increase jobs for the men and women in the construction industry. We look forward to working with you as you develop initiatives to promote small business lending, jobs and economic growth.

Sincerely,

Brewster B. Bevis

Brewster B. Bevis
Senior Director, Legislative Affairs

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ACCION USA

Statement for the Record – Financial Services Committee Hearing, May 18, 2010

While the US economy is gathering strength, the main drivers of upbeat news are large corporations that are announcing growth in both profit and revenue. This is not the case for small businesses, the historical engine of US expansion. These businesses continue to be constrained by access to capital and the House Financial Services Committee is right to support increased lending to America's small businesses, the most important private employers in our economy.

Through various Small Business Association guarantee programs, traditional banks provide capital to small businesses. However, there is a large group of entrepreneurs whose businesses are too small to be addressed by these traditional banks. Microfinance Institutions (MFIs) serve this gap in small business lending. **The Committee should ensure existing microfinance programs stay fully funded and the new Small Business Lending Facility includes MFIs in their scope.**

Role of Microfinance

Microfinance is often thought of as an international success, recently highlighted by Muhammad Yunus' receipt of the Nobel Peace Prize in 2006. Domestically, microfinance institutions fill a gap in the US financial system and assist entrepreneurs who are not supported by the formal financial sector. Non-profit microfinance intermediaries, such as ACCION USA (AUSA) provide economic opportunity to those aspiring business owners – and future employers – who are too small to be cost effectively assisted by community banks. These MFIs operate as non-profits in the US receive government support, funding from donors, and financing from commercial banks and other traditional lenders that cannot focus on the small size loans of America's smallest businesses.

Traditional bank loans to small businesses are usually upward of $100k, and capital availability to entrepreneurs is limited. On the other hand, loans made by AUSA generate, on average, 255 jobs for every $1 million lent. Based on an average credit size of just $6,649, this is clearly high-impact financing. Equally important is the technical assistance provided to entrepreneurs, which helps them manage and grow their businesses successfully and responsibly - and which is materially funded by the SBA Microloan Program.

Federal support for American Microfinance

Since 1991, the SBA micro loan program has been influential in supporting the growth of this nascent industry. The program has supported 35,000 microloans made for a total of $420 million, at an average size of $12,000. Just last year, despite the limited flow of credit in the economy, the program supported 3,000 loans and $34.5 million of lending. The economic impact of this program, per dollar loaned, is one of the most powerful drivers of job creation in the country.

The Administration has proposed to cut the program by 46%. In the current economic environment – where job creation is one of the Administration's top priorities and capital for small businesses is scarce – we believe this cut will negatively impact job creation and thwart sustainable economic recovery.

Request on behalf of American Microfinance

In its effort to strengthen the economy and grow employment via support for small business lending, the Committee should lend explicit support to the microfinance institutions that play such an important role in financing America's smallest entrepreneurs.

- **Maintain FY1010 allocation for SBA microloan program at $26 million**. Credit for small business remains severely constrained and now, more than ever, federal support for lending is required. By preventing cuts from 2010 levels and updating various provisions, the SBA Microloan Program will continue to be a success.
- **Provide incentives for lending to MFIs by Eligible Institutions**. The proposed Small Business Lending Fund Act should provide incentives for Eligible Institutions to lend to MFIs, including explicit qualification of loans to MFIs as "small business lending."
- **Ensure MFI eligibility for State Small Business Credit Initiative**. It should be made explicit that MFIs qualify as eligible beneficiaries of State Capital Access Programs and other credit support programs supported by the Act. "Collateral Support and Other Innovative Credit Access and Guarantee Initiatives" should support lenders' credit to microfinance institutions in addition to small businesses and manufacturers, as MFIs provide pass along that credit to employers that would otherwise be left behind.
- **Consider a specific MFI loan guarantee program**. The financial sector has evolved significantly since 1991, and during that time, the Community Reinvestment Act has been put into place. Given these changes, the cost effectiveness of providing loan guarantees to microfinance intermediaries, who in turn use them to obtain CRA eligible lending, would magnify the impact on federal assistance.

STATEMENT FOR THE RECORD

THE FINANCIAL SERVICES ROUNDTABLE

On

The U.S. House Committee on Financial Services Hearing on "Initiatives to Promote Small Business Lending, Jobs and Economic Growth"

May 18, 2010

The Financial Services Roundtable ("Roundtable") respectfully offers this statement for the record to the U.S. House Committee on Financial Services Hearing on "Initiatives to Promote Small Business Lending, Jobs and Economic Growth."

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Roundtable member companies provide fuel for America's economic engine, accounting directly for $74.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

The Roundtable Supports Small Business:
The federal government plays a key role in helping small businesses obtain the capital they need to meet their financial potential. Small businesses are a vital component of the nation's economic growth and well-being. Small businesses have led job formation during previous economic recoveries.

Access to capital and credit is a critical issue facing small business today. As a nation, we must ensure that viable small businesses have access to financing so that entrepreneurs can again play a prominent role in leading our country's economic recovery. Whether its establishing new programs within the United States Treasury Department, or enhancing existing Small Business Administration (SBA) lending programs, the Roundtable encourages Congress and the Executive Branch to consider not only traditional programs, but also innovative initiatives that will increase opportunities for small businesses to access needed capital, maintain and expand operations, increase inventory, and most importantly, recruit, train, employ and retain quality employees.

The Roundtable also supports the coordinating effort among stakeholders between all levels of government to help small business. This includes state-run programs such as the capital access program (CAP). Currently, there are numerous states that are operating successful CAP programs, including, California, Colorado, Michigan, North Carolina, Maryland, and Virginia. Stakeholders in these states benefit from CAP (and CAP-like programs) by the extension of credit to businesses that may not meet conventional loan requirements. CAP programs are known for their minimal administrative costs, streamlined applications, and important job creation.

As Congress reviews proposals which aim to increase lending to small businesses, the Roundtable respectfully requests that Congress also consider enhancing programs operated by the SBA. The Roundtable believes the following recommendations, if implemented, will help strengthen SBA programs by encouraging more people to start small businesses, increase the flow of capital small businesses, and reduce the administrative burden facing small business by providing the necessary flexibility to respond to current market conditions.

- Increase and make permanent the SBA Express loans to $1 million and increase the guaranty to 75%;
- Support funding and extending the SBA fee waiver and the 90% loan guarantee program thru December 31, 2010;
- Decrease capital requirements for loan guaranteed by the SBA;
- Allow debt refinancing of conventional real estate loans through 504 program to enhance credit support for the 504 program;

- Raise the caps on both 7(a) and 504 programs to loan amounts of $5 million; and increase the loan guarantee to 75%;
- Increase lending limits on the Microloan program from $35,000 to $50,000;
- Allow preferred lenders to approve SBA Capital Access Program (CAP) loans and allow for multi-year approvals rather than year to year;
- Reduce turnaround time and increase resources to the Certified Lenders Program (CLP);
- Update CAP line program to reflect current asset lending guidelines and pricing;
- Request more flexibility in allowing Preferred Lender Program (PLP) lenders to refinance their own debt.
- Maintain the traditional role of banks in existing SBA programs
- Increase lending limits on the Microloan program from $35,000 to $50,000;
- Extend Dealer Floor Plan (DFP) and increase the $2 million loan cap to $5,000,000 with a maximum $3,750,000 guarantee or 75%.

Conclusion:
The Roundtable encourages the House Financial Services Committee, and Congress as a whole, to review and consider traditional and alternative avenues to help create business lending opportunities through innovative policy solutions that will help create a foundation to build a strong and prosperous economy.

IFA INTERNATIONAL FRANCHISE ASSOCIATION | Franchising Building local businesses one opportunity at a time | 50 YEARS

May 17, 2010

The Honorable Barney Frank
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Spencer Bachus
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

On behalf of the International Franchise Association (IFA), I write today regarding the committee hearing on "Initiatives to Promote Small Business Lending, Jobs and Economic Growth." Thank you for your attention to this important issue, and we are hopeful that Congress will shortly advance legislation that addresses the credit crisis facing small franchised businesses, specifically the Small Business Job Creation and Access to Capital Act (H.R. 4302/S. 2869).

As the largest and oldest franchising trade group, the International Franchise Association's (IFA) mission is to safeguard the business environment for franchising worldwide. IFA represents more than 85 industries, including more than 12,000 franchisee, 1,100 franchisor and 500 supplier members nationwide. According to a 2008 study conducted by PricewaterhouseCoopers, there are more than 900,000 franchised establishments in the U.S. that are responsible for creating 21 million American jobs and generating $2.3 trillion in economic output.

We commend the Administration for its proposals aimed at spurring small business lending, and we strongly support H.R. 4302/S. 2869, which will increase the maximum loan amounts for the 7(a) programs to $5 million and for the 504 program to $5.5 million. It will extend the 90 percent loan guarantee rate through the end of FY2010. Given the extreme difficulty many aspiring entrepreneurs are facing in this economy, this increase will allow more individuals to get off the sidelines and access to the start-up capital they seek. This legislation is bipartisan and has been endorsed by the Administration.

Franchising can play an essential role in helping lead us out of recession if policymakers give franchised businesses the tools they need to succeed. During previous economic downturns, franchising has led the economy toward recovery. Our data shows that between 2001 and 2005, the franchising sector expanded by over 18 percent, adding more than 140,000 new establishments and creating more than 1.2 million new jobs. The direct economic output of franchised businesses increased by more than 40 percent during that period of time compared with 26 percent for all U.S. businesses. In fact, by virtually every measure, franchising recovered more quickly and more strongly than other sectors of the economy.

We strongly encourage Congress to find solutions that do not worsen our federal budget outlook and rising deficits. Instead, policies should be enacted that lead to increased lending and less government spending. Based on the experience of franchising, we firmly believe that policies to encourage lending will lead to more sustainable long-term job growth. In fact, according to IFA's recently updated *Small Business Lending Matrix and Analysis,* for every incremental $1 billion in lending, franchised businesses can create 40,400 jobs and $4.2 billion in economic output.

The IFA looks forward to working with the committee on initiatives that will improve the conditions for small business lending. Investors and entrepreneurs alike are sitting on the sidelines, unable to purchase or expand their business and create economic opportunity and jobs. We need to update and improve existing SBA loan programs so that more franchise business owners can obtain the necessary capital to help lead our economy on a road to recovery.

Please do not hesitate to contact me should you have any questions. Thank you for your continued leadership on behalf of our nation's small businesses.

Sincerely,

David French
Vice President, Government Relations

1501 K Street, N.W. Suite 350 Washington, DC 20005
Telephone: 202/628-8000 Fax: 202/628-0812 E-Mail: ifa@franchise.org Internet: www.franchise.org

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B. Dan Berger
Executive Vice President
Government Affairs

May 17, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Frank and Ranking Member Bachus:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions, I am writing to you regarding tomorrow's hearing on "Initiatives to Support Small Business Lending, Jobs and Economic Growth." NAFCU urges action on legislation modifying the arbitrary credit union member business lending cap, such as H.R. 3380, the *Promoting Lending to America's Small Businesses Act*, in conjunction with any Committee action on H.R. 5297, the *Small Business Lending Fund Act*, or any other legislation put forward.

NAFCU believes that the strength of the economy and labor force is strongly influenced by the health and well being of the small business community. Unfortunately, due to an antiquated arbitrary cap (12.25% of total assets) on their member business lending, credit unions' business lending ability is restricted. While there are a number of credit unions at or approaching the arbitrary cap, many more have capital to lend but have not fully developed their business lending programs because of this artificial and arbitrary limitation on these programs.

Eliminating or raising the arbitrary credit union member business lending cap would help take an important step in the recovery of the small business community and the overall economy. H.R. 3380 would raise the member business lending cap to 25%, while also allowing credit unions to supply much needed capital to small businesses. Unlike our banking counterparts, NAFCU believes we must do everything possible to extend credit to small businesses from as many resources as possible.

E-mail: dberger@nafcu.org • **Web site:** www.nafcu.org

The Honorable Barney Frank
The Honorable Spencer Bachus
May 17, 2010
Page 2 of 2

We also note that President Obama has stated that he would like job creation measures that would not impose a burden on taxpayers. Unlike some other ideas, this approach to helping small businesses could be done without costing the American taxpayer a cent. It is with this in mind that NAFCU strongly supports Committee action to raise the arbitrary credit union member business lending cap in conjunction with action on H.R. 5297 or any other job creation legislation.

Thank you for your attention to this matter. If my staff or I can be of assistance to you, or if you have any questions regarding this issue, please feel free to contact myself, or NAFCU's Director of Legislative Affairs, Brad Thaler, at (703) 842-2204.

Sincerely,

B. Dan Berger
Executive Vice President, Government Affairs

cc: Members of the House Financial Services Committee

Statement of the National Association of Home Builders

Initiatives to Promote Small Business Lending, Jobs and Economic Growth

Hearing before the Financial Services Committee
Of the U.S. House of Representatives

May 18, 2010

The National Association of Home Builders (NAHB) appreciates the opportunity to submit this statement to the Financial Services Committee on lending conditions in the home building industry. While there are several signs that the housing market may now be at or near bottom, the acquisition, development and construction (AD&C) lending crisis that has choked off credit for home builders threatens to prolong the current housing and economic downturn. Lack of production credit is placing enormous pressure on home builders' bottom lines and, for many, endangering their ability to survive the economic downturn. Housing was the first sector hit by the current economic crisis and no sustainable recovery can be achieved until the housing industry revives.

The housing sector is an industry made up of mostly small businesses. Over 85 percent of NAHB's builder members reported building fewer than 25 homes per year in both 2008 and 2009. Over 85 percent of them have less than $5 million in annual receipts, and over 95 percent have less than $15 million. In comparison, the U.S. Small Business Administration classifies construction businesses as small if they have average annual receipts under $33.5 million. Thus, the typical home builder easily qualifies as a small business, and these small businesses depend almost entirely upon commercial banks and thrifts for housing production credit. Each year, NAHB's members construct about 80 percent of new housing in America.

This statement addresses the following areas:

1. Current conditions in the housing market and the long term outlook.
2. Acquisition, Development and Construction (AD&C) credit problems.
3. Economic impact of the AD&C credit crunch.
4. Policy solutions for directing credit to small businesses.

Housing Conditions and Outlook

The current housing recession is the worst since World War II. Total housing starts fell 79% from their peak in January 2006 – from 2.3 million starts to a low point of 479,000 starts in April of 2009. Virtually every housing indicator (starts, permits and sales) reached all time record lows in the first half of 2009. The drop in single family construction alone resulted in more than 3 million lost jobs in construction and the related industries supplying materials and goods to housing construction.

Glimmers of hope, however, suggest that the three-plus-year decline in housing may have stabilized, but momentum and sustained recovery are far from guaranteed. Existing and new home sales appear to have bottomed, but remain well below historical norms. Existing single-family home sales hit a low of 4.08 million in January 2009, improved to 5.71 million sales at a seasonally adjusted, annual rate in November (presumably due to the $8,000 first-time home buyer tax credit enacted as part of the American Recovery and Reinvestment Act of 2009 (ARRA)), but then the annualized sales rate fell by almost 1 million units in December. Meanwhile, new home sales bottomed in January 2009 at 329,000. New home sales saw increases to an annualized rate of 400,000 in October 2009 and 411,000 in March 2010 due to the various iterations of the home buyer tax credit, but these levels remain far below historical norms and long-run demand based on population growth. For example, the average volume of new home sales in the 1990's was 700,000.

The inventory of unsold new homes continues to fall from a peak of 572,000 in July 2006 to 228,000 in March 2010, roughly 100,000 homes fewer than the average from 1980 to 2000. The decline has reduced the months' supply of unsold homes but not as dramatically because sales continue at a very slow pace. The NAHB Housing Market Index (HMI) languished at a single digit rate for five straight months from late 2008 through the first quarter 2009, picked up in the summer months of 2009, but remains at a level indicating considerable builder pessimism. The most recent reading in May 2010 was a level of 22, with levels below 50 indicating poor market conditions. Single family housing starts have risen from their abysmal trough of 357,000 early in 2009, but seem to have plateaued at a pace around 500,000 annually (the most recent reporting was of a seasonally adjusted, annual rate of 543,000 for April 2010). Multifamily starts have fallen over the same period and will likely continue to fall in the face of a large excess inventory of apartments.

In addition to this mix of signals, a number of housing specific headwinds will continue to buffet any significant housing recovery:

- A large inventory of vacant homes and apartments on the market
- A pipeline of foreclosures feeding the inventory
- Continuous downward price pressures from too much supply and not enough demand
- Tight mortgage underwriting and low appraisals making it difficult for a willing buyer to complete the sale
- Extremely difficult financing terms and availability for builder AD&C credit

All these data suggest that residential construction is now bouncing along a bottom. NAHB forecasts that housing starts face a long, slow recovery that will take several years. At present, NAHB is forecasting 646,000 total housing starts for 2010 and 991,000 for 2011. By comparison, NAHB believes that 1.8 million annual starts will be required to meet future housing demand.

Builder AD&C Financing Issues

A critical problem facing home builders is the lack of credit for land acquisition, development and residential construction (AD&C). Residential AD&C loans are used to purchase land;

develop lots; build a project's infrastructure such as streets, curbs, sidewalks, lighting, and sewer and utility connections; and construct homes. Loans extended to builders/developers are short-term obligations lent as progress payments, i.e., portions of the loan commitment are advanced as stages of the construction project are completed. The advances, or draws, are generally made over a six-to-18 month period. While interest payments are made during the development and construction period, the principal on the loan is not repaid to the lender until the home or lot is sold. In addition to the collateral represented by the project under construction, builders may also secure this financing through personal guarantees and/or offering other assets as collateral.

We continue to hear from NAHB members that it is extremely difficult, if not impossible to get AD&C loans and builders with outstanding loans are facing mounting challenges. This is a major impediment to the housing recovery and an increasing threat to the ability of many home builders to survive the economic downturn.

Current AD&C Financing Conditions

Home builders are having extreme difficulty in obtaining credit for viable projects. Builders with outstanding construction and development loans are experiencing intense pressure as the result of requirements for significant additional equity, denials on loan extensions, and demands for immediate repayment. The credit window seems to have been slammed shut for builders all over the country.

In many instances, the construction projects are solid projects that simply need to be built out for completion. Even builders who are current on their AD&C loan payments are facing bank demands for additional capital. Most builders have no alternative financing sources, and thus those who would otherwise be able to complete and sell their project under the original terms of the loans, are being bankrupted because they lack the additional money the banks suddenly demand. Performing loans are therefore rendered non-performing as a result of these actions.

These trends are supported by NAHB's member surveys of the availability and cost of AD&C credit. Our latest survey shows that conditions continued to deteriorate through the first quarter of 2010:

- Well over half of respondents to this survey have reported that the availability of credit for AD&C loans has worsened every quarter for ten quarters in a row, from the fourth quarter of 2007 through the first quarter of 2010.

- The ten consecutive quarters of continuing decline in loan availability has been true for all types of AD&C loans: land acquisition, land development, single-family construction, and multifamily construction.

- More than three quarters of the respondents who reported that conditions had become even worse in the first quarter of 2010 stated that lenders are simply not making new AD&C loans.

Appraisals are a major contributing factor to the current AD&C credit crisis. Falling appraised values for land and subdivisions under development have led some financial institutions to stop lending to developers and builders, to demand additional equity, and even to call performing loans.

An increasing number of builders are being required to put up additional equity or collateral due to reappraisal of collateral or revaluation of their loan. AD&C loans are entirely dependent on collateral (the project being financed) for repayment of principal. In other words, sale of the lot or home is required to provide funds to retire the AD&C loan. Most home building companies are small businesses and do not have the capacity to meet significant equity calls. The result is often foreclosure on a loan that had been performing. Such actions can result in a cut-off of loans on other projects a builder is undertaking and can also have severe adverse consequences for other AD&C loans in the bank's portfolio. Foreclosure on such loans is not in the best interest of the lender, builder or the community.

Performing loans that have been extended routinely in the past are now being called. Banks are increasingly refusing to modify AD&C loans or to provide builders more time to complete their projects and pay off these loans. Some lenders are abandoning the construction lending business, without regard to a builder's ongoing projects, and some institutions are auctioning off loans without negotiating with the builder. These actions have increased foreclosures on AD&C projects which in turn have hurt communities by unnecessarily increasing the inventory of unsold or half-completed homes.

Regulatory Concerns

Of concern to NAHB is that lenders often cite regulatory requirements or examiner pressure that banks shrink their AD&C loan portfolios as the reasons for their actions. While the federal bank regulators maintain that they are not encouraging institutions to stop making loans or to indiscriminately liquidate outstanding loans, reports from NAHB members in a number of different geographies suggest that bank examiners in the field are adopting a significantly more aggressive posture. Moreover, some institutions appear to be overhauling and downsizing portfolios independent of regulator/examiner pressure.

In general, the federal banking regulators have been reminding financial institutions to adhere to the December 2006 bank regulatory Guidance on Understanding and Managing Commercial Real Estate (or CRE) Risks. (The CRE category includes residential AD&C loans.) The Guidance instructs financial institutions with "high" CRE concentrations to have both heightened risk management practices and levels of capital that are higher than the regulatory minimums and appropriate to the risk in their CRE lending portfolios. A financial institution is considered to have a high CRE concentration, and thus subject to the Guidance, if it exceeds or is rapidly approaching the following thresholds:

- Total reported loans for construction, land development, and other land represent 100% or more of the institution's total capital; or

- Total reported loans secured by multifamily and nonfarm nonresidential properties and loans for construction, land development, and other land represent 300% or more of the institution's total capital.

The guidance emphasized that the 100% and 300% thresholds are not to be considered as limits or caps on bank CRE lending but rather are intended as guideposts for banks and their examiners in determining appropriate loan underwriting and review systems, risk management practices and levels of reserves and capital.

More recently, federal banking regulators have taken note of tighter lending conditions. In November 2008 they issued a joint statement urging banks to lend to creditworthy borrowers. Further, they warned that excessively tight lending standards could exacerbate current market conditions leading to slower economic growth.

Building on the 2008 statement, on October 30, 2009, the regulators issued new guidance on *Prudent Commercial Real Estate Loan Workouts*. The objective of the new guidance is to encourage financial institutions to pursue workouts on troubled CRE loans, a category that includes residential AD&C loans. Their stated intent is to ensure that supervisory policies and actions do not impair the flow of credit to viable borrowers and projects. The statement says that financial institutions that implement prudent CRE workouts will not be subject to criticism for engaging in such efforts and loans should not be subject to adverse classification solely because the value of the underlying collateral has declined.

The policy statement is a positive step in encouraging workouts as a preferred course of action and in directing examiners to make balanced assessments of institutions' workout efforts. The direction provided on allowing institutions to avoid using liquidation values when assessing collateral and on bifurcation of loans should be helpful to builders and developers.

In general, however, the criteria specified for prudent loan workouts will allow institutions fairly limited ability to structure workouts for AD&C borrowers. Since AD&C loans are collateral-dependent with no internal cash flows to service principal and interest, borrowers on these loans will have to demonstrate other sources of loan repayment, provide additional collateral and/or make principal repayments in order to satisfy the criteria for prudent workouts. Many AD&C borrowers are not in a position to meet such requirements. In addition, the higher likelihood of a reclassification of a restructured AD&C loan as a troubled debt restructuring likely will discourage institutions from pursuing workouts on AD&C loans.

The most recent joint statement from the federal banking regulators, released on February 5, encouraged institutions to engage in prudent lending to creditworthy small business. The statement urged banking institutions to focus on the viability of the borrower's business, rather than the borrower's geographic location or industry sector. The regulators said they are working with the banking industry and supervisory staff to ensure that supervisory policies and actions do not inadvertently curtail the availability of credit to sound small businesses.

While the statements of the banking regulators seem to support a flexible and pragmatic approach to examination of bank AD&C and other lending activities, NAHB has seen no evidence that the problem of extreme regulatory pressures on lenders is abating. We hear daily from builders and bankers who are complaining of excessive actions from bank examiners. In particular, it appears that examiners are treating the loan-to-capital thresholds as hard limits and using those limits to discourage institutions from taking on viable new loans and forcing them to dispose of sound portfolio holdings. Such results leave the impression that bank examiners are very comfortable with the restrictive approach and are not exhibiting the flexibility necessary to facilitate reasonable and prudent lending practices.

Comptroller of the Currency John Dugan said recently that banking agencies plan to issue new tougher standards to rein in CRE lending and are considering hard limits on the amount of these holdings on bank ledgers as well as more stringent underwriting standards and increased capital requirements for CRE loans. While NAHB believes that banks should engage in sound, balanced underwriting standards when considering all types of loans, the pendulum has already swung too far on the restrictive side in the current regulatory climate.

At a time when financial institutions need to be engaged in responsible lending practices to spur job creation and economic growth, establishing overly harsh limitations on construction lending will do just the opposite by further stifling the flow of credit for housing production. With the housing market struggling to regain its footing, regulators need to be issuing more flexible guidelines that will encourage banks to maintain funding for residential AD&C loans in good standing that fall below their underlying value. Tightening the screws further could have a devastating impact on the housing market and jeopardize the budding economic recovery.

NAHB is anxious to work with Congress and the banking regulators to find a way to get the regulators' positive messages implemented in the field and to prevent the imposition of counterproductive additional restrictions on bank lending.

NAHB Recommendations

Financial institutions should be encouraged to fund viable new projects and to take steps to avoid foreclosure on AD&C loans by accommodating loan modifications and workouts. Regulators should issue more flexible guidelines that will encourage banks to maintain funding for residential AD&C loans in good standing that fall below their underlying value. While NAHB welcomes the new CRE guidance, the workout criteria is focused on income-producing properties which will help multifamily builders, but will only provide fairly limited ability to structure workouts for AD&C borrowers. For this policy to be truly effective, more flexibility in workouts for AD&C loans is needed.

In the vast majority of cases, lenders would be better off working with their builder/developer borrowers to modify or extend loans, rather than requiring additional equity or shutting off credit. This is a lesson that has been demonstrated by holders and servicers of home mortgages who now increasingly attempt to work out a mutually beneficial solution with struggling borrowers. The alternative is to incur foreclosure and real estate owned expenses, only to sell the property for cents on the dollar.

The same economic principles apply to banks that hold AD&C loans. Rather than calling loans or taking other damaging actions, banks would be acting in their own best interest by modifying or extending loans for borrowers who are not in default and have projects that are worthy of completion. This would allow borrowers to develop alternative repayment plans, adjust their finances or find other funding sources until they are able to complete and sell their homes.

NAHB urges Congress to direct financial institution regulators to encourage lenders to work with residential construction borrowers who have loans in good standing by providing flexibility on re-appraisals, loan modifications and perhaps forbearance. This would give builders sufficient time to complete projects and sell their inventory. Solutions could include allowing institutions to continue making and holding sound AD&C loans even if they are above the loan-to-capital thresholds and to permit institutions to write down troubled loans over an extended period of up to 10 years.

Economic Impact of the AD&C Credit Crunch

The credit crunch faced by home builders will exacerbate the current housing inventory problem, prolonging the downward spiral in home prices and the housing slump. Clearing out the excess inventory of unsold homes is a key factor toward stabilizing housing markets and prices. While the level of unsold homes varies significantly across markets, builders in depressed areas have slashed home production to levels well below that needed to meet longer-term demand. Lenders in these markets will not resume lending until a supply-demand balance is restored. The credit crunch is also contributing to slowing housing production in areas not impacted by excessive inventories.

The problems in the housing sector have had a significant impact on the nation's economy. The sharp decline in home building from the 2005 peak – a drop of one million units – has translated into 1.4 million lost jobs for construction workers and the loss of $70 billion in wages.

The housing plunge has also affected industries that provide materials and services to home builders. Over 560,000 jobs have been lost in the manufacturing sector due to the housing decline as makers of products such as lumber, concrete, windows, doors, plumbing, flooring and appliances have slashed their workforce in response to slumping demand. This has produced a loss of $25 billion in wages.

Further, jobs have been lost by lenders, architects, real estate agents, lawyers, support staff and others who provide services to home builders and home buyers. There has been a loss of over 580,000 jobs and $32 billion in wages for these service providers. The total impact of the housing slump has been the loss of over 3 million jobs and $145 billion in wages in all housing-related industries.

The ongoing credit problems for home builders will further inflate these totals. Home builders cannot keep their doors open and provide jobs in their communities if they cannot get credit to build even pre-sold homes. And builders in the middle of viable projects cannot pay subcontractors and other materials and services providers if lenders will not grant routine loan extensions or if banks require payment-in-full before homes can be finished and delivered.

The credit crunch also will cause longer-term economic damage. The development process is lengthy, taking years from the acquisition of land to the completion of homes. With lenders refusing to finance lot development, the pipeline of ready-to-build-on land will drain dry. This will result in a major delay in meeting demand for new homes when consumers return to the marketplace in more significant numbers. In cases where federal permits are also required, expirations of these permits will force builders to start the approval process anew, adding at least several years to the pipeline. The effect will be most severe in markets that have not suffered the boom-bust extremes and would otherwise be poised for more rapid recovery.

NAHB estimates that over the next decade there will be a need for at least 1.7 million additional homes per year. This translates into 5 million jobs and significant economic activity. Without increased AD&C lending, this future demand will not be met, job loss will occur and job creation will suffer.

Policy Solutions for Directing Credit to Small Businesses

The policy initiatives that have been undertaken to address credit problems of small businesses, for the most part, have not addressed the financing disruptions in the home building sector, which, as was noted earlier, is made up largely of small companies. The failure of these efforts to provide any relief to builders seeking financing for housing production stems from the fact that the initiatives generally utilize programs of the Small Business Administration (SBA), which have rules that impede borrowing for residential development and construction. Consequently, small home building companies have not seen any real improvement in financing prospects as a result of recent SBA program changes such as the increase in guarantee levels and elimination of certain loan fees.

Home Builders Ineligible for ARC Loans

A case in point is the SBA's America's Recovery Capital (ARC) Program, established in the American Recovery and Reinvestment Act of 2009 (ARRA). The ARC program guarantees interest free, deferred payment loans of up to $35,000 from participating lenders to help existing small businesses meet their current obligations. When the ARC program was rolled out in June 2009, NAHB was hopeful that this program would help many of NAHB's members to stay afloat through these tough economic times. Unfortunately, these hopes have been dampened as we received feedback from members who are being told by their bankers and SBA field staff that their businesses are not eligible for this assistance.

SBA's Standard Operating Procedures[1] separate home builders' activities into 1) building of a speculative nature, and 2) building under contract with an identified purchaser. SBA has long held the position that the business of home building is *always* speculative, a conclusion with which NAHB strongly disagrees. During times of strong home sales, many home builders constructed homes ahead of sales in order to have homes available on short notice to satisfy the demands of prospective home buyers. Few home builders have engaged in speculative building since the beginning of the current economic downturn. NAHB believes that home builder

[1] Small Business Administration SOP 50 10 5(A), Subpart 2, Chapter 2 (III)(D)(s)(2)(e), page 110

eligibility for SBA programs should be determined on a case-by-case basis, based on the nature of each builder's activities and the specifics of a particular building project, rather than excluding all builders through an across-the-board approach.

SBA's characterization of the nature of home builders' activities is greatly oversimplified and imprecise, and is inappropriately preventing small building companies from accessing SBA programs. The continuation of this approach is particularly disturbing in the case of the ARC program, which could provide valuable funding to cover costs that are associated with keeping a small company afloat, such as the need to pay utilities and other overhead necessary to maintain an office or vehicles or to safeguard tools and inventories of materials that are used in the normal course of business. These are the types of expenses that home builders, the vast majority of whom operate small businesses, could successfully carry if ARC loans were readily available.

We urge the committee to encourage the SBA to revisit that way it views home building business activities and to reconsider the eligibility requirements for ARC program loans as well as other SBA programs.

Small Business Lending Fund

Most recently, the Administration has proposed legislation to recycle $30 billion of Troubled Asset Relief Program (TARP) funds to establish a Small Business Lending Fund (SBLF). The SBLF is designed to support lending by community and other banks with assets under $10 billion through capital investments in those institutions under a variable cost of funds, where dividend payments to Treasury are reduced as small business loan activity increases. NAHB strongly supports the SBLF proposal, since most home builders rely extensively on community banks and thrifts for housing production funds and many of those institutions currently face severe capital constraints that are impairing their lending capacity. NAHB would like to work with the Administration and Congress to ensure that the SBLF program has a meaningful impact in improving the lending capacity of community based institutions and avoids any bias against small home building companies.

In this regard, NAHB feels it is essential to revise the definition of "Small Business Lending" that is currently contained in the proposed SBLF measure to specifically include commercial real estate loans, including residential AD&C loans. In addition, the SBLF should be run independently of the Small Business Administration (SBA) which has rules (discussed in detail earlier in this statement) that generally impede borrowing for residential development and construction.

NAHB also believes it is important that there is broad eligibility for the SBLF. NAHB is pleased to see that the proposed language for the SBLF states that applications may not be denied solely on the basis of the composite rating of an institution under the Uniform Financial Institutions Rating System.

Finally, in order for the SLBF to have a meaningful impact in improving credit availability for housing production, significant efforts are required to eliminate current regulatory and examination constraints on AD&C lending. Without such action, the program's capital investment will produce little or no change in credit availability for home builders. It would be helpful if the SLBF legislation directed the federal banking regulators to allow institutions to utilize the program's resources for AD&C lending even when an institution is above the loan-to-capital thresholds in the CRE guidance.

Conclusion

Thank you for the opportunity to submit this statement. NAHB stands ready to work constructively with the Committee to find prudent and workable solutions to the small business credit constraints that are currently retarding economic recovery. Please direct any questions on this statement to Scott Meyer at (202)266-8144 or smeyer@nahb.org.

Motor & Equipment Manufacturers Association
Your First Call for Global Intelligence on the Motor Vehicle Supplier Industry

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May 14, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
U.S. House of Representatives
B-371A Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

The Motor & Equipment Manufacturers Association (MEMA) represents more than 650 companies that manufacture motor vehicle parts for use in the light vehicle and heavy-duty original equipment and aftermarket industries[1]. MEMA represents its members through three affiliate associations: Automotive Aftermarket Suppliers Association (AASA), Heavy Duty Manufacturers Association (HDMA), and Original Equipment Suppliers Association (OESA).

Over the past year, significant and unprecedented government and industry actions have prevented a collapse of the automotive sector, which is now positioning itself for a recovery. However, future employment, capital investment, and economic growth of the supply base are dependent on increased access to credit. Continued coordinated action by industry, the financial community, and the government is required to effectively retool suppliers for new fuel efficient products and to facilitate the industry's production ramp-up.

For these reasons, MEMA strongly supports legislation to create a Small Business Credit Initiative Program at the Department of Treasury. We believe the credit support program particularly would be of significant assistance to smaller suppliers who are continuing to find it difficult to access the capital markets. Specifically, we believe this program could assist the industry's needs in order to:

- Invest in capital equipment related to new customer-specific programs;
- Support working capital requirements related to increased production volumes and material prices; and
- Expand into new manufacturing sectors and consolidate motor vehicle operations.

[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. Every supplier job creates another 4.8 jobs in local and state economies. Automotive suppliers are the largest manufacturing employer in eight states: Indiana; Kentucky; Michigan; Missouri; Ohio; Oklahoma; South Carolina; and, Tennessee. Furthermore, suppliers are responsible for two-thirds of the value of today's vehicles, 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.

Automotive Aftermarket Suppliers Association

Heavy Duty Manufacturers Association

Original Equipment Suppliers Association

Furthermore, this program could support the lending streams with the national banks that have large automotive lending exposure and assist regional and community bank expansion into the automotive sector. A small amount of federal resources will be needed to implement this program. More importantly, by targeting small companies, these funds will provide important new jobs and stable workplaces throughout the country.

We urge the Committee to move quickly and pass this legislation.

Sincerely,

Robert E. McKenna
President and CEO

Michigan Ohio Colorado Connecticut Illinois Massachusetts New Mexico New York North Carolina Oregon Washington West Virginia Wisconsin

May 18, 2010

The Honorable Nancy Pelosi
Speaker
U.S. House of Representatives
Washington, D.C.

The Honorable Harry Reid
Majority Leader
U.S. Senate
Washington, D.C.

The Honorable John Boehner
Minority Leader
U.S. House of Representatives
Washington, D.C.

The Honorable Mitch McConnell
Minority Leader
U.S. Senate
Washington, D.C.

Dear Speaker Pelosi, Majority Leader Reid, Minority Leader McConnell and Minority Leader Boehner:

We urge you to take immediate action to increase small business lending in the United States. While our nation's economy continues to recover from this great recession, small businesses in our states continue to struggle to gain access to the credit they need to create jobs. We believe federal action is necessary to remedy this issue.

We strongly support a comprehensive package being considered that would include expanding the size of Small Business Administration loans and temporarily extending successful Recovery Act provisions reducing fees and raising guarantees for SBA loans, enacting tax incentives for small business investment, and a proposal for a $30 billion Small Business Lending Fund that would provide community banks with capital and incentives to increase lending to small businesses.

In addition, we especially want to convey our support for a new proposal for a State Small Business Credit Initiative, which would strengthen innovative state programs that support small business lending. In our states, these programs are facing increased demand, yet the budgetary pressures we face have limited their ability to fill the credit gap left by the financial crisis. These innovative programs include those that augment collateral values for small businesses and manufacturers who have seen them decline as a result of the financial crisis, capital access programs that contribute to loan loss reserves that allow banks to expand credit to more businesses, and loan guarantee and other programs that help share risk with lenders that are willing to extend credit to viable small businesses, manufacturers and farms that are crucial to a strong recovery. By supporting these programs, the State Small Business Credit Initiative would leverage Federal funds several times over to enable billions in new lending to small businesses that can support new job creation.

We strongly encourage you to adopt these proposals. We applaud you for taking action on this urgent matter and look forward to partnering with you to ensure small businesses and manufacturers have the financing they need to create jobs and sustain our economic recovery.

Sincerely,

Governor Jennifer M. Granholm
Michigan

Governor Ted Strickland
Ohio

Governor Bill Ritter
Colorado

Governor M. Jodi Rell
Connecticut

Governor Pat Quinn
Illinois

Governor Deval Patrick
Massachusetts

Governor Bill Richardson
New Mexico

Governor David A. Paterson
New York

Governor Bev Perdue
North Carolina

Governor Theodore R. Kulongoski
Oregon

Governor Christine O. Gregoire
Washington

Governor Joe Manchin III
West Virginia

Governor Jim Doyle
Wisconsin