

U.S. Senate Committee on Small Business and Entrepreneurship
Roundtable on
“The State of Small Business Lending: Identifying Obstacles and Exploring Solutions”

Opening Statement of
William Loving
Executive Vice President & CEO, Pendleton Community Bank
On behalf of the
Independent Community Bankers of America

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Chairman Landrieu, Ranking Member Snowe, and Members of the Committee, I am William Loving, executive vice president and CEO of Pendleton Community Bank in Franklin, West Virginia. I am pleased to join today’s roundtable on the State of Small Business Lending, representing the nearly 5,000 members of the Independent Community Bankers of America (ICBA).¹ Restoring robust credit to the small businesses of this nation is a key condition for sustaining and accelerating the economic recovery, and community banks will play the lead role in providing that credit. We’re pleased to have this opportunity to provide our perspective on “obstacles and solutions” to small business lending.

ICBA favors a number of approaches and solutions. There are numerous supply and demand reasons why the flow of small business credit is not where it should be to foster stronger economic growth. No one solution in isolation will do the job. We strongly support the Administration’s proposed \$30 billion Small Business Lending Fund and other proactive programs like SBA lending incentives to restore credit, but they may not reach their full potential in the current, restrictive regulatory environment. Below, I discuss some ICBA-backed solutions.

¹ *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than \$908 billion in assets, \$726 billion in deposits, and more than \$619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA’s website at www.icba.org.

Small Business Lending Fund

The Small Business Lending Fund is a bold, fresh new program that will help restore credit to small businesses, and ICBA is pleased to strongly support it. Too many resources were directed to the nation's giant "too-big-to-fail" institutions that fostered the financial crisis and have little connection to Main Street lending. This SBLF is directed to banks with \$10 billion or less in assets that are in the best position to lend to local small businesses.

With the economic recovery underway and the return of consumer confidence and consumer spending, I believe that demand for small business credit will begin to pick up rapidly, and we need to have a program in place to capitalize on that demand. Small businesses shed jobs more quickly than mid- and large-sized businesses during the downturn, and they are poised to add jobs more quickly – provided they have access to credit. The quickest way to add jobs is to fuel small business growth. It makes sense to use the nation's 8,000 community banks, who are expert in small business lending, to boost credit to small businesses. However capital markets have not fully recovered from the financial crisis, and many community banks often do not have readily available sources of capital to support more lending. The SBLF can help supply that capital.

Notably, the structure of the SBLF program will also create a powerful incentive for recipients to lend. Banks that increase their small business lending will get a lower dividend rate, as low as 1 percent for banks that increase their lending by 10 percent or more. Banks that do not increase their lending will pay a higher dividend rate, as high as 7 percent. After 4 and one half 1/2 years, the dividend rate jumps to 9 percent, ensuring that recipients will repay any remaining capital injection. Frankly, banks won't take the capital unless they can put it to good use.

The \$30 billion SBLF can be leveraged to provide as much as \$300 billion of credit to small business. I expect this credit to have a strong impact on the recovery and job growth and to provide greater tax revenues flowing back to the federal, state and local governments.

With unemployment still near 10 percent, we must be willing to advance these different approaches to spur private sector job growth. I believe that the SBLF is one such promising approach.

Key Features of a Successful Small Business Lending Fund

We must ensure that the potential of the Fund is not undermined in its implementation. Specifically ICBA recommends:

- The Fund must completely avoid the onerous restrictions that were placed on TARP recipients, such as warrants, compensation restrictions, bank dividend restrictions, or restrictions on the 5-year NOL carryback. Such punitive conditions would only discourage participation.
- Oversight should not be so overbearing that it would discourage participation. We support appropriate Treasury oversight of the plan, which will give the public confidence that the funds are being well used.
- No applicant should be denied based solely on its CAMELS 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. Interested community banks should be evaluated with the *inclusion* of capital provided by the program. This will give a fuller picture of the banks' capital position under the plan and their lending capacity.
- Agricultural loans must be eligible. Farms are an important component of the small business sector.

ICBA is pleased that all of these features are considered in the House-advanced version of the Small Business Lending Fund Act (H.R. 5297). We believe that the SBLF could attract broad participation by interested banks and result in more lending to small businesses. ICBA hopes to work with Congress to refine the proposal and implement it as quickly as possible.

A Harsh Regulatory Environment Will Undermine the Lending

In order for the SBLF and other lending incentives to work as intended, we must also have a regulatory environment that supports increased small business lending. Bank regulators perform a critical function. But they must strike the appropriate balance between regulating safety and soundness and allowing the flow of properly underwritten credit. Many believe the bank regulatory pendulum has swung too far in the direction of discouraging lending. Below I outline some of the common concerns bankers nationwide have raised regarding the current regulatory environment.

Improve the exam environment for community banks

An aggressive exam environment is making it harder for many banks 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. Many bankers report that examiners are second guessing bankers and demanding aggressive write-downs and reclassifications of viable and performing commercial real estate loans and other assets. In particular, field examiners often are:

- Focusing on the value of collateral irrespective of the income or cash flow of the borrowers (despite guidance from Washington to look beyond collateral values);
- Placing loans on non-accrual even though the borrower is current on payments;
- Discounting entirely the value of guarantors;
- Substituting their judgment for that of the appraiser;
- Downgrading otherwise sound loans simply because they are located in a state with a high mortgage foreclosure rate, which is tantamount to statewide redlining.
- Imposing higher capital standards, beyond what's called for in regulation, in order for a bank to be classified as "well capitalized." Banks that don't meet this standard – that are classified as merely "adequately capitalized" – are restricted in their ability to accept brokered deposits or pay above market interest rates in order to raise capital.
- Discouraging sound new CRE loans because of existing CRE concentrations.
- Requiring excessive loan loss reserves.

This examination environment has a chilling effect on the extension of credit to creditworthy borrowers, as many community bankers fear examiner criticism, write-downs, and the resulting loss of income and capital.

Additional Initiatives

ICBA recommends additional initiatives that would work well in conjunction with the SBLF in providing more credit to small businesses. These include:

Restore the value of GSE preferred shares. The banking sector, including many community banks, lost an estimated \$15 to \$20 billion when the Treasury Department took Fannie Mae and Freddie Mac into conservatorship in September 2008 and destroyed the value of their preferred shares. We urge Congress to help restore community bank capital and lending by supporting the value of dividend payments of GSE preferred stock.

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

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 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 support the extension of the key incentives for SBA 7(a) and 504 lending programs, 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 help many 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, support more lending, and ride out this difficult business environment as the economy recovers. Losses can be carried forward for tax purposes for 20 years already, but it makes great sense to allow the use of these losses now when the economy is struggling to recover.

The Wall Street Reform Act

Finally, I would like to say a word about the anticipated effect of the Wall Street Reform Act on small business lending. Both the House and the Senate versions of the legislation still contain many new unwarranted regulatory requirements that will obstruct community bank lending. ICBA has detailed its concerns in a recently letter to the conferees. But I will take this opportunity to highlight just one of the provisions with unintended consequences for community bank capital that is particularly troublesome and must be fixed in conference. An amendment to the Senate bill would have the unintended effect of disallowing the inclusion of capital raised by issuing trust preferred securities in Tier 1, a practice regulators have long allowed and supported, subject to limitations. While ICBA fully supports the intent of the amendment -- to ensure that large banks and bank holding companies meet capital standards at least as strict as those that apply to small banks and bank holding companies -- the change to the capital treatment of trust preferred securities would have a disproportionate impact on community banks, for whom trust preferred securities were allowed by bank regulators as a principal means of raising capital, since issuing equity is not a practical option. Changing the rules now would pull the rug out from under many community banks. It would force banks to reduce their lending in order to restore their capital ratios, which would reduce credit to small businesses. ICBA urges the conferees to preserve community banks' Tier 1 capital treatment of trust-preferred securities.

Conclusion

Thank you again for the opportunity to participate 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 lawmakers' action as well. We look forward to working with Congress on these issues.