THE DODD-FRANK ACT: IMPACT ON SMALL BUSINESS LENDING

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GROWTH, CAPITAL ACCESS AND TAX

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

HEARING HELD
JUNE 16, 2011

Small Business Committee Document Number 112-022
Available via the GPO Website: www.fdsys.gov

U.S. GOVERNMENT PRINTING OFFICE

67–803 WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
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THURSDAY, JUNE 16, 2011

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX AND CAPITAL ACCESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Joe Walsh (chairman of the subcommittee) presiding.

Present: Representatives Walsh, Chabot, Coffman, Mulvaney, Schrader, Clarke, Cicilline, and Peters.

Chairman WALSH. Good morning. I call this hearing to order. Welcome.

I would like to start today's hearing by thanking everyone for attending. Specifically, I would like to thank our distinguished panel of witnesses for taking time out of their busy schedules to participate in what I believe to be a critical issue facing lenders as they work towards providing capital for our nation's small businesses.

On Wednesday, June 8, in response to a question from JP Morgan Chase CEO Jamie Diamond at the Bankers Conference in Atlanta, Federal Reserve Chairman Ben Bernanke stated that there has never been a study that examined the impact of the new financial regulatory structure on economic growth. For many of us in the room today and on this Subcommittee, this statement is very troubling. As we work to grow our economy and create jobs, it is critical that in everything we do we consider how policies made in Washington will impact small business owners that are struggling to make their businesses successful.

Regulations always require a careful balancing act, and here we have two very important concerns to worry about. First, we must make sure that the users of financial products are protected. Small business owners and consumers take advantage of a wide variety of financial products to fund their business. For business owners to succeed, they need to have faith that their financing options will continue to be available when they need them and that their money is secure. Customers also need financial products to purchase the goods and services that sustain small business.

On the other hand is the burden of regulation and compliance costs associated with oversight. A regulation that chokes off all economic activity is not meeting its purpose. If banks stop lending or cut back dramatically in response to regulators, the regulation itself must be reconsidered. While there is always going to be risk in the financial sector, we need to make sure to manage that risk responsibly so that banks are secure and small businesses have confidence that they can obtain the credit necessary to sustain or grow their business. We cannot afford a system where banks are afraid to take risks on small businesses for fear of regulatory reprisal.

Today we will discuss the new financial regulatory structure that was created by the Dodd-Frank Act. This new law responded to the perceived weakness in the former regulatory regime that left many lines of business without supervision, allowing systemic risk to develop. We know that the Dodd-Frank Act is over 2,300 pages. Within these pages are requirements for 243 new rulemaking actions and 60 studies. According to GAO, it will cost a billion dollars just to implement this new law. It will drain 27 billion job-creating funds from the economy over 10 years and require hiring more than 2,600 new, full-time government employees.

What we do not know, however, is the overall economic impact of this law and what it will do to small business job creation in this country. To help us grasp the impact of the new law we have a distinguished panel of witnesses who are on the ground dealing with the impact of this new law every day and working to prepare for the new rules coming down the pike. I am extremely interested to hear what these witnesses have to say about how they are dealing with this law and how it is impacting their small business lending.

With that, I happily yield to Ranking Member Schrader for his opening statement.

Mr. SCHRADER. Thank you, Mr. Chairman.

Less than three years ago our financial system was thrown into disarray with Lehman Brothers filing the largest bankruptcy in American history. In years since, our private and public sectors have taken unprecedented steps to pull us back from the brink and return our economy to a stable path. In the process we have learned a great deal about what caused the crisis and it appears that for decades I think, as we all know, regulators allowed an overabundance of high risk credit to grow unchecked. And in short, our entire financial system was flawed and the reprised regulatory framework definitely being called for and enacted in the Dodd-Frank bill.

While the legislation itself was directed primarily at the financial services industry, we are concerned about its impact and ramifications for all small businesses. It is imperative that as the statute is translated into meaningful regulations that we carefully consider how these changes might affect our small banks, our small credit unions, and the small business community in general. Community banks and credit unions comprise over 90 percent of our banking industry and significant efforts were made in the Dodd-Frank bill to mitigate the adverse effects this new regulation might have on them.

Indeed, I hope that in many respects small banks will benefit from the new law, with lower premiums for FDIC insurance, revised capital requirements, more freedom to open branches across state lines, community banks should see hopefully some reduced operating costs. You will correct me, of course, if that is not being achieved at this stage.

Nonetheless, small financial institutions will have their business models, I think, profoundly changed as a result of these regulations. We are hearing pushback already. We hear the higher compliance costs that are imposed on small firms that do not have the large capacity that bigger firms do to deal with those compliance costs. It is also undeniable that small lenders bear less responsibility, I think, for this financial crisis and should not bear the brunt of all these new regulations, so we want to make sure we get it right.

The new regulations created by the Consumer Financial Protection Bureau will be subject to the Regulatory Flexibility Act. This new regulator also becomes just the third agency to be subject to the Small Business Regulatory Enforcement Fairness Act. We are concerned about how it views its mission and how it will impact small businesses and small banks and small credit unions.

Businesses on Main Street also rely on the healthy functioning of our financial system. Perhaps no other group has been more affected by the collapse of Wall Street and the big investments banks and its trickledown effect to the smaller banks than small businesses on Main Street. We still find small firms at previous hearings struggling to find credit. Medium and larger firms are now able to access credit. We have to be careful that these new regulations do not exacerbate the current capital shortage that we already have out there.

Changes to our laws, I think, are overdue. There is this tendency, however, to overregulate and overrespond to the crisis. I need to hear feedback from our distinguished panel to make sure we do not go down an overcorrection path.

Both lenders and borrowers and small businesses have a lot at stake with this financial reform. The Dodd-Frank Act is going to affect every sector of American economy and I hope that if done properly as a result of your feedback and the work we will do to continue to improve the Dodd-Frank Act, that it will create more jobs and more credit will flow.

So I also want to thank the witnesses for being here and sharing their wisdom with us. I look forward to the hearing, Mr. Chairman.

Chairman WALSH. Thank you, Mr. Schrader.

A couple rules. If Committee members have an opening statement prepared, I ask that they be submitted for the record. I would like to take a moment to explain the timing lights for you. You will each have five minutes to deliver your testimony. The light will start out as green. When you have one minute remaining, the light will turn yellow. Finally, it will turn red at the end of your five minutes. If you go over your five minutes, someone will come in and escort you out of the room. I am just kidding.

I ask that you try to keep it to that time limit but will be as lenient as possible.

STATEMENTS OF THOMAS BOYLE, VICE CHAIRMAN, STATE BANK OF COUNTRYSIDE; MARK SEKULA, EXECUTIVE VICE PRESIDENT, CHIEF LENDING OFFICER, RANDOLPH-BROOKS FEDERAL CREDIT UNION; WILLIAM DALEY, LEGISLATION AND POLICY DIRECTOR, MAIN STREET ALLIANCE; GREG OHLENDORF, PRESIDENT AND CEO, FIRST COMMUNITY BANK AND TRUST

Chairman WALSH. Before we get to the witness introductions this morning I would like to first mention that there has been a great deal of interest in today's hearing from people who could not join us today as witnesses. So I would like to make sure that the hearing record reflects their views.

I received a letter from Peter Haleas as chairman of Bridgeview Bank Group. Peter is a constituent of mine from Illinois, so I am pleased that he wrote to share his view on this important issue. So I ask unanimous consent that this letter be made part of the record for this hearing.

Without objection, so ordered.

[The statement of Mr. Haleas follows on page 60.]

Chairman WALSH. Our first witness today is Thomas Boyle, vice chairman of State Bank of Countryside in Countryside, Illinois. I am very pleased to have someone from my home state of Illinois here today. Prior to Mr. Boyle's current role as vice chairman, he was the president/CEO of the bank from 1997 to 2009. State Bank of Countryside opened in 1975 and operates from six locations, including its main headquarters in Countryside, plus branches in Burbank, Darien, Orland Park, Chicago, and Homer Glen, Illinois. Mr. Boyle is testifying on behalf of the American Bankers Association where he has served a variety of leadership roles. Tom has also served as a director of the Illinois Bankers Association. Mr. Boyle, we look forward to your testimony.

STATEMENT OF THOMAS BOYLE

Mr. BOYLE. Thank you. Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee. My name is Thomas Boyle. I am the vice chairman of the State Bank of Countryside in Countryside, Illinois, and I thank you for the opportunity to testify on behalf of the ABA.

These are very important issues for thousands of community banks that work hard every day to serve small businesses and our communities. The health of the banks and the economic strength of our communities are closely interwoven. A bank's presence is a symbol of hope and a vote of confidence in the town's future. As a family business, State Bank of Countryside understands the concerns faced by our customers' personal and business lives, and we believe our success is tightly linked to their success. Our motto even reflects this, the family-owned bank for families and their businesses.

Banks are working very hard to make credit available in their communities. Efforts are made more difficult by hundreds of new regulations expected from the Dodd-Frank Act. Although these new regulations are inevitable, the sheer quantity will overwhelm many community banks who are already facing difficult times due to the economic conditions in many parts of the country. Second guessing by bank examiners makes this situation worse yet.

Let me give you a few examples of how Dodd-Frank will negatively impact small business lending. First, new regulations limit access to capital. Capital is the foundation upon which all lending is built. Having sufficient capital is crucial to lending and to absorb losses when loans are not repaid. In fact, $1 worth of capital supports $10 in loans.

In the past two years, bank regulators have requested greater levels of capital, taking away precious resources that could be used for lending. In conversations with fellow community bankers, I often hear how regulators are pressing banks to increase capital-to-asset ratios by as much as four to six percentage points above the minimum standard. Dodd-Frank limitations on capital sources have made access to capital even more difficult. The lack of access to capital has caused many banks to become smaller in order to maintain specific capital ratios. The result, loans become more expensive and harder to get, relieving the increased regulatory demands for more capital will help banks make loans needed for our nation's recovery.

Second, Dodd-Frank increases uncertainty for banks in the turn, raising credit risk, litigation risks and costs, and leading through less hiring or even a reduction in staff. The uncertainty makes hedging risks more costly and restricts new business outreach. All of this translates into a less willingness to make loans and worse, increases the likelihood of a massive consolidation.

Of particular concern is the additional compliance burden expected from the Bureau of Consumer Financial Protection. This bureaucracy will impose new obligations on community banks that have a long history of serving consumers fairly in a very competitive market. The Bureau should focus its energies on supervision and examination of nonbank financial providers. This lack of supervision of nonbanks contributed mightily to the financial crisis. We urge Congress to ensure that this focus on nonbanks is a priority of the Bureau.

Third, consequences for small businesses and the entire economy are severe. Costs are rising, access to capital is limited, and revenue sources have been severely cut. It is difficult to meet the needs of local businesses when we are dealing with regulatory overreaction, piles of new laws, and uncertainty about the government's role in the day-to-day business of banking. This will undoubtedly lead to a contraction of the banking industry. We must work together to ensure that banks meet the needs of small businesses and their communities.

Thank you for the opportunity to present the views of the ABA. And I am happy to answer any questions.

[The statement of Mr. Boyle follows on page 25.]

Chairman WALSH. Thank you, Mr. Boyle.

I would now like to introduce our next witness, Mark Sekula, executive vice president and chief lending officer at Randolph-Brooks Federal Credit Union. Mr. Sekula has 25 years of lending experience covering credit cards, mortgage, commercial, indirect lending, and collections. Mark and his team currently manage a $200 million commercial portfolio that includes SBA lending. In 2009, Randolph-Brooks was recognized as the SBA Credit Union Lender of the Year. Mr. Sekula is testifying on behalf of the National Association of Federal Credit Unions. Welcome. You have five minutes to present your testimony.

STATEMENT OF MARK SEKULA

Mr. SEKULA. Good morning, Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee. My name is Mark Sekula, and I am testifying today on behalf of NAFCU. I serve as the executive vice president and chief lending officer for Randolph-Brooks Federal Credit Union headquartered in Live Oak, Texas.

NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding the Dodd-Frank's impact on small business lending. Despite the fact that credit unions are already heavily regulated and were not the cause of the financial crisis, they are still within the regulatory reach of a number of provisions in the Dodd-Frank Act, including all credit unions being subject to the regulations and rulemaking of the Consumer Financial Protection Bureau (CFPB). This means that credit unions, like mine, are facing a host of new compliance burdens and costs.

As it relates to our business lending, the creation of the CFPB, the breadth of its power and the costly regulations it will undoubtedly prescribe will impact how we allocate our resources for our membership. For example, Section 1071, which has not received much attention, creates a data collection system for small business lending, similar to the Home Mortgage Disclosure Act for financial institutions. Under Section 1071, every financial institution will need to inquire whether the applicant is a small business or women- or minority-owned. While well intentioned in its own right, it is yet another compliance burden emerging from the Dodd-Frank.

Furthermore, given that credit unions serve a defined field of membership, individual credit unions' information in comparison to other lenders could be skewed.

Credit unions are chartered to serve their members. Thus, regulatory data collection that is intended for institutions that can serve anyone, should not be imposed on credit unions.

The financial institution must also maintain a record and report it to the CFPB. The information must be made public in accordance with the CFPB regulations. These provisions are effective on July 21, yet implementing regulations will not be issued until after that date, leaving financial institutions with no compliance guidance on the effective date. While the CFPB has indicated that compliance will not be mandatory on July 21, Congress should consider delaying the effective date of this provision until such time as implementing regulations take effect.

The Dodd-Frank Act also includes a section, Section 1100(G) that says the CFPB must evaluate the impact that its actions have on small entities. We believe that credit unions meet the definition of a small entity. We would urge Congress to ensure that the CFPB abides by this congressionally mandated standard and does not try to narrow the definition of small entity in the future. The environment around regulatory reform has led regulators to make changes that impact credit unions and may cause them to tighten their lending to small business.

At Randolph-Brooks, our SBA loan volume has diminished in recent years, partly due to the economic downturn but also because of the inconsistent nature of SBA examinations. On one hand the SBA encourages granting small loans to qualifying businesses, yet on the other, the agency states that a lender's status with the SBA can be rescinded if these higher risk loans default. The SBA provides a lender portal and a lender score from the SBA's credit risk assessment model. Our score is derived by averaging other lenders, mostly large 7A loans with our small SBA express loans.

The blending of all lenders with varying portfolios to arrive at a score dilutes the true picture as one cannot compare a small SBA, unsecured working capital line of credit with a large SBA loan secured with commercial real estate. The two loans should not have the same evaluation process. If this does not change, it may eventually drive all small loans from the lenders' portfolios.

In addition to the SBA's scoring problem, practices by other regulators have had an impact as well. Last year the National Credit Union Administration (NCUA), issued a rule to amend the agency's Regulatory Flexibility program known as RegFlex as it relates to business lending. The new rule requires a personal guarantee for all credit union member business loans (MBLs). Unfortunately, this proposal will make credit union MBLs significantly less attractive to members.

NAFCU believes and has told the NCUA that requiring a personal guarantee for all MBLs is unnecessary given the underwriting policies that RegFlex credit unions already have in place. Currently, there is a divide between Congress, the administration, and other policymakers that wish to spur lending and the regulators that oversee financial institutions. On the one hand, we sit in this hearing today discussing ways to encourage small business lending. On the other hand, regulators explicitly create barriers to new lending by regulation, the exam process, and implicitly warn credit unions against making any loans that may be deemed risky. Forced to choose between these two conflicting objectives, Randolph-Brooks must, of course, follow the directive of our regulators. In short, any congressional goal to promote lending will never be successful when the regulators are not on the same page.

I thank you for the opportunity to appear before you today on behalf of NAFCU and would welcome any questions that you may have.

[The statement of Mr. Sekula followson page 35.]

Chairman WALSH. Thank you. I would again like to recognize Ranking Member Schrader, who is going to introduce our next witness.

Mr. SCHRADER. Very good. Thank you, Mr. Chairman.

Bill Daley is a legislative and policy director for Main Street Alliance, a national network of state small business coalitions that give, hopefully, small business owners a voice in all this discussion, particularly those small businesses that are busy trying to put food on the table and create jobs and unable to come to Washington, D.C. to testify.

Prior to joining Alliance, Mr. Daley worked on the staff of the Washington State legislature, numerous state agencies and served two years as mayor of Olympia. So you have been in the trenches, sir. Thanks for coming, Mr. Daley. I look forward to your testimony.

STATEMENT OF WILLIAM DALEY

Chairman WALSH. Congressman Schrader, members of the Committee, thank you very much for the opportunity to testify on behalf of our small business owners. We represent organizations in 14 states.

Our members supported the passing of Dodd-Frank, particularly some provisions of it were very important to us. Our interest is essentially economic. When the Great Recession hit, small businesses were among its major victims. As of late 2009, small business job losses are responsible for about two-thirds of the employment decline that occurred as the recession came, and small business bankruptcies nearly doubled in March to March 2008–2009. We are still suffering from a significant loss of our customer base held down by high unemployment rates and the foreclosure crisis. We do not want to go through this again. It is important that this law be implemented and we do not want to see it undermined as the effort to make it work goes forward.

We commented on a couple of specific issues about Dodd-Frank. First, whether or not the Act causes a credit crisis. Our small businesses hear a statement like that and they kind of bristle. We do have a credit crunch in small businesses. Credit dried up well before Dodd-Frank, and credit dried up because Dodd-Frank was not in place. We had a meltdown that could have been mitigated or prevented.

Blaming the act for a crisis-induced credit crunch confuses cause and effect. We lost our customer base, and until those customers begin to return, there will be a credit crisis for small businesses.

Second, Dodd-Frank is a source of uncertainty in the economy. Surely the implementation of any act of Congress causes some uncertainty and something this big and complex will cause uncertainty. But we think that a period of uncertainty is important to go through in order to have certainty in the future about the credit that we can obtain. And Dodd-Frank provides protections for that. So we are tolerant of a little uncertainty in the short-term to get certainty in the long-term.

Will the Act's new reserving requirements limit small business capital? I think it remains to be seen whether that will be the case, although you have heard some concern about that from the testimony so far. The improvements in the requirements to protect against risk that are associated, however, with these new reserving limits are important.

Let me parenthetically comment about the availability of capital. The financial institutions' reserves now are at levels even the Wall Street Journal calls eye-popping. There was last year 1.2 trillion in excess reserves beyond amounts required by law. That increased in the first quarter of this year by $225 billion. And the money is sitting in the Fed gaining interest at a .25 interest rate. Putting that investment back into the economy would help us tremendously.

And then, are new data requirements a benefit to small businesses? Again, I think I have to be real clear about it. Our folks do not like paperwork. Thank you for getting rid of the 1099 provision. There is a considerable flexibility in the Act about how the rules are imposed with regard to this requirement and we think it remains to be seen just how much of the burden will fall on the small business, how much will fall on the lending institution.

And then I want to close by noting some features of the Dodd-Frank that our members find especially attractive. Swipe fever forms are a benefit to our small businesses. They will help save us some money. We like the Consumer Protection Bureau. We are all financial customers ourselves and our members have been harmed by attractive but risky products.

Dodd-Frank helps restore focus on traditional lending through limits on proprietary trading. In short, Dodd-Frank is a good thing for small businesses, and we hope that its progress will not be hindered.

[The statement of Mr. Daley follows on page 48.]

Chairman WALSH. Thank you, Mr. Daley.

The final witness that I have the pleasure of introducing is also from Illinois, Mr. Greg Ohlendorf. Greg is president and CEO of First Community Bank and Trust in Beecher, Illinois. First Community Bank and Trust specializes in small business lending, including commercial real estate. Mr. Ohlendorf is testifying on behalf of the Independent Community Bankers of America where he serves as chairman of their Policy Development Committee.

Mr. Ohlendorf, you have five minutes to present your testimony.

STATEMENT OF GREG OHLENDORF

Mr. OHLENDORF. Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee. I am Greg Ohlendorf, president and CEO of First Community Bank and Trust, a $147 million asset community bank in Beecher, Illinois.

I am pleased to be here today to represent the nearly 5,000 members of the Independent Community Bankers of America. Thank you for convening this hearing on the Dodd-Frank Act and its impact on small business lending.

Community banks are prodigious small business lenders. In his recent speech before the ICBA Annual Convention, Federal Reserve Chairman Ben Bernanke shared new research that shows while overall small business lending contracted during the recent recession, lending by a majority of small community banks, those of less than $250 million in assets, actually increased. By contrast, small business lending by the largest banks dropped off sharply. The viability of community banks is linked to the success of our small business customers and we do not walk away from them when the economy tightens.

Community banks have little in common with Wall Street firms, mega banks, or shadow banks. We have a much different risk profile because our business model is built on long-term customer relationships. We cannot succeed without a reputation for fair treatment. We make quality small business loans often passed over by the large banks with their statistical models because our personal knowledge of the borrower gives us first-hand insight into the true credit quality of a loan. These localized credit decisions made one by one by thousands of community bankers will restore our economic strength.

The Dodd-Frank Act is a generational law and will permanently alter the landscape for financial services. It has proven to be a mixed outcome for community banks, combining both punitive and helpful provisions. Every provider of financial services, including every single community bank, will feel the effects of this new law to some extent.

While there are many provisions of the law I could discuss at length, I will focus my comments on the new CFPB. Community banks are already required to spend significant resources complying with consumer protection rules. This compliance burden is a distraction from our small business lending. Every hour I spend on compliance is an hour that could be spent with a small business customer. CFPB rules should not contribute to this distraction. The CFPB should use its authority to grant broad relief to community banks where appropriate. ICBA also supports legislation recently passed by the Financial Services Committee to reform the CFPB to make it more balanced and accountable in its governance and rule writing.

Probably the most frustrating aspect of the current regulatory environment is the trend toward oppressive exams. The misplaced zeal and arbitrary demands of examiners are having a chilling effect on small business lending. Good loan opportunities are passed over for fear of examiner write-downs. I am fortunate in my bank to enjoy a cooperative and constructive working relationship with my regulator, the Federal Reserve Bank of Chicago. Examiners perform a difficult job and the stakes were raised sharply after the financial crisis, but I believe many examiners have overreacted to the crisis. I have met with hundreds of community bankers from every part of the country in recent years and I can tell you there is an unmistakable trend toward arbitrary, micromanaged, unreasonably harsh examinations that have the effect of suffocating small business lending.

ICBA supports legislation to bring more consistency to the examination process. Arbitrary loan classifications are a particular source of frustration for community bankers. Representative Bill Posey's commonsense Economic Recovery Act, H.R. 1723, would establish conservative, commonsense criteria for determining when a loan is performing and provide more consistent classification guidance. This bill would give bankers flexibility to work with struggling but viable small business borrowers and help them maintain the capital they need to support their communities.

The ICBA-backed Communities First Act or CFA, H.R. 1697, introduced by Representative Blaine Luetkemeyer contains many reforms that would improve the regulatory environment and community bank viability to the benefit of our customers and our communities. To cite just a few examples, CFA would raise the threshold number of bank shareholders that triggers SEC regulation from 500 to 2,000. SEC compliance costs are a significant expense for listed banks. Another provision would extend the five-year net operating loss carryback provision to free up community bank capital now when it is needed most. We are very pleased that CFA has bipartisan co-sponsorship and look forward to its advancement in the House.

Given the state of the private capital markets for small- and mid-sized banks which are largely still frozen since the financial crisis, ICBA supports the Small Business Lending Fund as an alternative source of capital for interested healthy banks structured to incentivize increased lending. We hope that the first round of capital will be disbursed soon.

Thank you again for your commitment to small businesses and your interest in the institutions that partner with them. I have outlined some of the more significant regulatory challenges we face in the months ahead.

Thank you for hearing our concerns. We look forward to working with you.

[The statement of Mr. Ohlendorf follows on page 52.]

Chairman WALSH. Thank you. And thank you all for your testimony.

Let me begin my series of just a couple of brief questions. And this first one will directed toward each member of the panel. Try to be brief and specific with your answer.

Dodd-Frank. An appropriate reaction to the financial crisis? An overreaction? Or a reaction that was not strong enough to the financial crisis? How would you answer that? Brief and specific. An appropriate reaction, an overreaction, or not a strong enough reaction. Let us start our way here and we will work our way down.

Mr. OHLENDORF. Dodd-Frank is a mixed bag. There are many provisions that are, I think, an overreach and there are some provisions that I think are very helpful, including deposit assessment reform and the assessment base that community banks and other banks are able to take advantage of which are going to save us a whole lot of money and put the burden more appropriately where it needs to be. There are other provisions of Dodd-Frank that frankly scare us tremendously.

The CFPB, while we have a bit of an exemption or a carve out in community banks, we are still subject to their rule writing. Today what we have to understand is we are already overburdened with regulation. We have a significant number of regs that we need to comply with today and it seems like just one more is not going to change the deck a whole lot. But the piling on and the consistent piling on of additional regulation is very, very stunning.

In the good old days I had a part-time person that did 10 percent of their job in the area of compliance and we complied with all the rules of the land. Today, we have got six or eight people, all senior officers that sit on a compliance committee, attempting to deal with these reforms as they come along. And it is punishing and it is very difficult for small institutions.

Chairman WALSH. Mr. Daley, an appropriate reaction? An overreaction?

Mr. DALEY. Thank you. I think our members would say it is largely appropriate. The process in the Congress was fascinating to watch for us. And the balance that came through the debate and exchange really served the country well we think. There are a couple of areas where we would like to see things stronger. The proprietary trading provisions we thought could be strengthened. We would have liked to see the swipe fee rules applied to credit cards as well as debit cards. But overall the work of the Congress seemed appropriate.

I also think it is appropriate for you to continue your work now. Congressional oversight of the implementation of this act is important. It is good that you are holding a hearing here and there are other hearings because that balance that we think was achieved in the Congress needs to be achieved in the implementation of the act.

Chairman WALSH. Mr. Sekula.

Mr. SEKULA. NAFCU does not blame Dodd-Frank for the credit crunch, but we do believe that it overreaches and is an overreaction as all credit unions are under the CFPB's rulemaking authority. A couple of items that we do like, we feel positive about the Dodd-Frank, of course, as mentioned earlier, the permanent increase in the Federal Deposit Insurance from $100,000 to $250,000, and consumers do need protection from predatory lenders. And we understand and we support that view. We are just hopeful that more time will be spent on unregulated entities, such as payday lenders that should be the focus of the CFPB.

Chairman WALSH. Mr. Boyle.

Mr. BOYLE. I feel that it is an overreaction. In our shop of $800 million bank, we have two full-time compliance officers and we also outsource to a third party to make sure we remain in compliance. We are anticipating with the uncertainty that the Dodd-Frank bill is going to bring that we are actually interviewing additional consulting firms that could cost us anywhere from $75,000 to $125,000 going forward to make sure we maintain our good standing in the compliance arena. So we feel that it is an overreaction.

Chairman WALSH. Thanks. Mr. Daley, quick question, and I am confused. And I apologize for that.

Briefly describe your members to me because I think if I took you by the hand and you and I walked around my district for a day and we talked to 50 small businessmen and women, you would hear the same refrain. They are scared to death. There is so much uncertainty out there and there is a lot of angst about the additional regulations and the regulatory climate that they believe Dodd-Frank is going to lead to. Your members are fine with what is coming?

Mr. DALEY. May I describe our members? They are small businesses. We have about 10,000 members. Our members are the owners and they own and operate their businesses. I talk to them a lot, we are in fairly constant communication. And they come a lot to testify to Congress and go to meetings. They are more concerned about the long-term return to practices that put them in the bank. And when I have these conversations, because I remember, they said that is their greatest concern. The problems that were caused by these practices as having harmed them, as having destroyed their customer base, and the law that is being put in place to prevent that from happening in the future is important.

Chairman WALSH. Did they feel overregulated before Dodd-Frank?

Mr. DALEY. When I talked to them about the operation of their businesses, they do not talk to me about regulation. They talk to me about what is going on in my community. My community is— the quality of life and the quality of the local economy is what is important to them. They do not draw their business from around the state or around the country or internationally. They do all their business from their community. And their community is in trouble now and their business is in trouble as a consequence. So they do not talk to me about regulation. They do not talk about taxes. They talk about getting investment into the community. Getting jobs into the community so that my business can continue to thrive.

Chairman WALSH. You and I are talking to different folks. That is fascinating. It actually is.

One final quick question. Mr. Ohlendorf, are you getting consistent information from regulators about your portfolio?

Mr. OHLENDORF. I talk to a lot of bankers around the country and we feel like there is some very inconsistent data. I talked to a banker on the way to the airport yesterday from one of our neighboring states who was dealing with an appraisal and they had gotten the appraisal, you know, it is supposed to be the be-all, end-all. This is the value of the property. And they were concerned about some of the assumptions. So they shared some of their thoughts on those assumptions with the appraiser or with the examiner. And the examiner came back and said that the bank had no business making any changes to the assumptions to the appraisal. Okay, fine.

A banker 30 minutes from that bank had a set of examiners in and had a piece of commercial real estate that was worth, on their books, $4 million. It had just been appraised at $4 million and the regulators came in and asked that bank to charge that loan down to $2 million because the appraisal was not worth anything.

As a banker, in trying to work in this economy, how am I supposed to take those two stories that are both very current with banks that are 30 minutes apart in a neighboring state and gel that together to understand what I am supposed to do to help, you know, make small business loans. I cannot have arbitrary 50 percent write-downs to my portfolio when the appraisal just indicated that the value is what I said it was. And on the other hand, I cannot look at another appraisal and try to, you know, say well, maybe some of those assumptions are not accurate and try to massage it because they were told they did not have the credentials and the expertise.

Chairman WALSH. Thank you. I now turn to Ranking Member Schrader.

Mr. SCHRADER. Thank you, Mr. Chairman.

As I listen to the panel, it would appear that the biggest problem seems to be the regulators maybe more than Dodd-Frank itself. And I hear that same song and verse back at home with my local banks and credit unions. You get that inconsistent regulation.

Question for Mr. Ohlendorf and Mr. Boyle, in particular. In Dodd-Frank, they talked about a five percent capital requirement holdback that was going to be mandated and maybe even some flexibility for mortgage-based loans. But when I talked to some of my folks at home they are saying, well, actually, we are getting rules that are talking about a 20 percent downpayment and stuff. Could you comment on are you hearing that also? That would seem to be in contravention to what was put out there. Mr. Ohlendorf and then Mr. Boyle.

Mr. OHLENDORF. We heard that discussion. We are concerned that the horse is out of the barn. Back in the days when I started in banking, a 20 percent downpayment may have been traditional and you saved up money and you tried to buy your first house. The rules somewhere along the line were changed significantly and obviously lower downpayments were allowed, which fueled tremendous boom in the housing industry and a lot of first-time homebuyers were able to buy homes that were not. And we can argue the political policy of that for all it is worth for a long time and that is not probably what you want to do.

The problem that we have today is to go backward to that is going to have significant additional downward pressure on real estate. There is a lot of real estate out there and if only people with 20 percent downpayments are eligible to be able to buy a home, it is going to be very difficult to take and handle the slack and the supply.

Mr. SCHRADER. Are your regulators mandating that right now?

Mr. OHLENDORF. We are not seeing it mandated right now but we have seen it talked about in a variety of a number of places within some of the proposed regulations. You know, a limit at some level of a required downpayment may be appropriate. Twenty percent, I believe, and the ICBA believes is too high.

Mr. SCHRADER. Okay. Mr. Boyle.

Mr. BOYLE. We also believe that the 20 percent is excessive, but we do believe that the borrower should have some skin in the game. And maybe the right answer might be 10 percent. But in our marketplace, and Greg's as, well, you know, we are in a relatively upscale-type of product and if it is very difficult for someone to save $80,000 to $100,000 as a downpayment, so there needs to be some adjustment from the 20 percent down to a more manageable number to allow younger people to move into communities.

Mr. SCHRADER. Okay. Yeah, I would hope that would be the case. I mean, 20—I had to do that way back when but times have changed and I believe we got way too lax. Prior to Dodd-Frank we are making lots of mistakes, so some intermediate area and hopefully our Committee and others will talk to FDIC and some of our friends, comptroller, to make sure that they get this right.

I guess, Mr. Daley, it would appear to me that from your testimony you feel that access to credit has been a long-term issue for small businessmen and irrespective, I guess, Dodd-Frank came last year. And prior to Dodd-Frank, if I look at the graphs, it looked like small business credit was inaccessible long before Dodd-Frank came into being. Would that be your assessment also?

Mr. DALEY. The difficulty our members expressed to me about access to credit has to do with the idea that they are reluctant to borrow and lenders are reluctant to lend if their business is not thriving. The key question for them is customers. We need people coming in the door with money in their pocket. And when that happens, it is easier for us to borrow.

Let me mention one borrowing phenomena for small businesses that is important, and that is a lot of small business start-ups are financed by equity in their homes. You can see the people will start up a small business by borrowing against the equity in their home. And the housing crisis, the drop in housing value throughout the company has had an impact on that as well. And I think as you evaluate the credit problem for really small businesses, you need to think of that as well.

Mr. SCHRADER. So it is a longstanding, ongoing issue irrespective I think of the new regulations.

Mr. DALEY. It came well before the passage of this bill or the introduction of it even.

Mr. SCHRADER. I guess I had a question regarding small business lending. Small businesses come in all sizes apparently. They are not just small-small, you know, under 500 employees under a certain gross retail volume, you fit into a small business category. Get I a comment from you, Mr. Sekula and Mr. Boyle on which small businesses are now getting credit? Because anecdotally I hear back home that for some of my larger small businesses it is okay; for some of my smaller small business, not so much. What are you seeing? Do you see that differentiation? Or is lending improving slowly but surely for all those businesses?

Mr. SEKULA. Well, for lending at Randolph-Brooks, our members, our small business owners are still able to get loans. We have realized continued growth through our portfolio for the last three years in a row. Where we are running into a problem is that, as an SBA lender, we have had problems being able to maintain. See, our membership is specific. I mean, they are military or Air Force. We support the Patriot Express SBA program. And as a result, we are the fifth largest Patriot Express lender in the country for a credit union. So that is our membership. That is who we are serving. They are coming to us for these business express lines of credit under $50,000, and we are granting them. I think probably close to 75 percent of our portfolio is made up of those type of loans. Our average loan size on the SBA size is only $44,000. So those are the members who are coming to us that we are trying to serve.

The problem that we have is that we just completed an SBA exam and it was cited as a finding that we needed to improve our delinquency rate, our past due rate. If not, we run the risk of losing our preferred lender status and access to these funds. Well, as we look at the lender portal that the SBA puts out, our numbers, as we view it, are great. We think that they are good. So we do not know if SBA added this as a finding as the shot across the bow as a warning maybe for all financial institutions, but as a result and by listing it as a finding I have to address and explain what our actions are going to be to make sure that delinquency in those losses do not go up, yet we are a well-capitalized organization. Our underwriting standards are top-notch. Our performance is great. And here we are, we think that we are doing things right. Our numbers show that we are doing things right, but yet the SBA is now telling us that I have got to put a plan in action to improve those numbers, which means then now instead of me focusing on these loans that are for the $35,000 to $50,000 range that our membership is asking for; now I need to focus on maybe a larger 7A loan or a 504 loan just so I can make my numbers look better. That is not my membership. That is not what they are asking for. And so as a result, that is the biggest problem I have.

Now, in defense of the SBA, we have had a great relationship working with them since we have been offering SBA loans. And also in their defense, we just got our write-up, our finding two weeks ago. So as a result, I have not had an opportunity to respond back to them about my concerns. But since the timing of this hearing was right now, I felt it was important to share it because I feel that we are not the only institution experiencing these type of experiences with the SBA.

Mr. SCHRADER. Thank you. Mr. Boyle.

Mr. BOYLE. We believe that each individual credit request is unique in and of itself. And we are a relationship lender by nature. And we always have viewed our business is to make loans. We are not profitable unless we make loans. I will admit to the fact that over the last two years the underwriting has significantly increased and that the scrutiny and the requirements from the businesses, the additional information that we request is probably more than we have in the past. But it is our goal to continue to make small business loans going forward because without it we are not profitable.

Mr. SCHRADER. I will yield back, Mr. Chairman, and let the others.

Chairman WALSH. Thank you, Mr. Schrader.

I now turn to my colleague from Colorado, Mr. Coffman.

Mr. COFFMAN. Thank you, Mr. Chairman.

You know, I want to say, first of all, one of the stunning things that is lacking in Dodd-Frank, and I think it is part due to the fact that—well, part largely due to the fact that government never wants to point the fingers at itself. But if we look at the catalyst of the financial crisis it is subprime lending. And who mandated subprime lending? Who was the one who came forward with this policy that said let us take people that really cannot afford these homes and let us put them in these homes. You know, and then, of course, we will securitize it and bundle it up and credit rating agencies missed it. So therein lies the catalyst of this crisis. And it was government.

And guess what is not included in Dodd-Frank? Fannie Mae, Freddie Mac, the very catalysts that drove us into the ditch is nowhere mentioned because the very politicians who wrote it had their fingerprints on it. And so I just think it is stunning that we have not dealt with that issue that is the basis of really the problem that we have today.

But let me just ask this question to the three bankers, and that is are regulators communicating with each other? Or are you answering duplicative questions from various regulators?

Mr. Boyle.

Mr. BOYLE. In our situation we are of a size where most of our or all of our examinations are a joint examination between the FDIC and the state. And we have not seen a duplication of questions. In Chicago, the FDIC is very well organized and getting the requirements ahead of time makes the examination as last burdensome as possible even though it takes four weeks.

Mr. SEKULA. In regards to the National Credit Union Association, communication with them has been very good in regards to some of their expectations coming down and giving us an opportunity to prepare. Whether they coordinate with the SBA on any of their exams or audits, that is information I am not aware of. So I am sorry, I am not able to add much more information to that.

Mr. OHLENDORF. We are federally regulated by the Federal Reserve in the state and we have experienced very little difficulty in communication. Where there have been overlaps, we have brought it to their attention where they have asked us to do things twice and in general sense they have been able to work that out amongst themselves. So I do not think it is the nature of them doing duplicative things. I think we have other issues that need to be addressed.

Mr. COFFMAN. Great. Thank you, Mr. Chairman. I yield back.

Chairman WALSH. Thank you. I will now turn to my colleague from Michigan, Mr. Peters.

Mr. PETERS. Thank you, Mr. Chairman.

You know, much of the testimony that we have been hearing today has been kind of focused on some of the potential negative aspects of Dodd-Frank. And I say potential because most of the bill has not gone into effect. And so the criticism that we are hearing is speculative in nature at this point. And yet we have already seen numerous attempts from the Republican majority to delay, to weaken, and even to kill this new bill. Community banks and credit unions certainly did not cause the financial crisis. In fact, in many respects I believe that you are among the worst victims of the crisis. There have been hundreds of bank failures since the 2008 financial crisis and each time one of these banks fails, another community lender is not in a position to make critical, small business loans. As was mentioned, where most of the small business come from are credit unions and small community banks.

But now that the worst of the crisis is over, there seems to be a tendency to forget what caused it and how it affected Americans all across the country who lost their jobs, their homes, and saw their retirement savings vanish. I want to work certainly with the industry to make sure that this bill is implemented in ways that work, but I also believe it is very shortsighted to lose focus of the fact that the bill was passed in the face of the worst financial crisis in generations that absolutely destroyed our economy. A crisis that was caused for a variety of reasons that caused it but it was excessive speculation and risk taking particularly by some of the very large, systemically risky institutions that are in our country. And so I think that needs to be the focus of what we are looking at for reforms. Folks here before us on the panel are not part of those large, systemically risky institutions but we need to address that so we do not ever have a situation where we are put into a catastrophe like we had.

So with that kind of premise, Mr. Boyle, I want to direct this question to you. When small banks get into trouble now, the FDIC will come in and will unwind them through an orderly dissolution process. As you know, that did not exist for some of these very large institutions. That caused a significant problem for our economy as we were going off the cliff. The Dodd-Frank bill did create a new dissolution process for these large, systemically risky institutions. You know, what is your assessment of that? Is that helpful to small banks and does it help put smaller banks on the same footing that these large institutions will be under?

Mr. BOYLE. The Dodd-Frank Act and its treatment of the too big to fail concept was probably one of the better aspects of the bill. With regards to leveling the playing field, the Chases and Bank of Americas are not my competitors. My competitors are my local community banks within the metropolitan area of Chicago. So I do not think that it leveled the playing field. We each carve out our own niche and we do not view the Bank of America as our competitor.

Mr. PETERS. But now you talked about the too big to fail as probably the best part of the bill. Would you just elaborate on that, please?

Mr. BOYLE. Well, I think the way that they would deal with the orderly liquidation or the solving or a problem of too big to fail, you know. Having a system in place that does not exist currently.

Mr. PETERS. Do others share that opinion?

Mr. OHLENDORF. I think one of the obvious benefits was the whole change in the FDIC Act and the assessment base and so on. But also one of the other major provisions that we have yet to see how it is going to work out is bringing the shadow banks and the mortgage brokers and the nonregulated financial institutions into the fold. Our consumers do not understand the difference. When they hear someone can make them a mortgage loan, they do not understand, Congressman, that that person may be or may not be from a regulated financial institution. They assume that they may be getting a better rate or it looks like a better rate but they are not sure we are playing by all the same rules. Their assumption is we are all playing by the same rules. And in fact, we are not. And if in part of this crisis we can reign that in, find out who those folks are and bring them under the same type of regulation that we have long been under and have successfully operated under those types of rules, I think it is going to make a major change. That has yet to be seen.

Mr. PETERS. Again, a lot of this still has to be implemented going forward so we are in the very beginning stages, which is why it seems to be premature to try to unwind this because I agree with you that we had a system prior to Dodd-Frank that had heavily regulated institutions like yourself and everybody at this panel here. We had silos of regulation but between those silos there was a lot of open area where people would compete. And they were your competitors, whether they were paid A lenders or other folks that are in that shadowy area that is significant competition to you. And they are playing in an unregulated environment and they are using tactics that often are predatory on customers. You know, you are trying to do what is right for your customers. You are playing by all the rules, you believe in having a long-term relation with those customers. And yet you have folks out there who have a whole different business model and it is disruptive to your ability to raise funds, raise capital, investment in small businesses if you have got to compete with these shadowy organizations. So Dodd-Frank is a move forward to try to reign in that practice and those unsavory type business practices. And so I look forward to working with you so that we can continue to do what is right for the American consumers and the American taxpayers and stand up to some of these very large, systemically risky financial institutions as well that caused so much trouble in our economy. So with that I will yield back my time.

Chairman WALSH. Thank you. Now it is my pleasure to hear from my colleague from South Carolina, Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman.

Gentlemen, I have run a couple of small businesses. I have started three or four of them myself. I have served on this Committee now for about six months with the rest of these gentlemen. And I have to admit that I have never heard anybody come in and talk about the things Mr. Daley has. Mr. Daley, you heard the Chairman say that he might be speaking to people who are different than the people you are talking to. Is that at all possible?

Mr. DALEY. I do not know. How would I assess that? I do talk—I actually have a business myself. It is very small. And have in the past operated small businesses. I have worked, as was mentioned, as a mayor in a small town, small-time mayor actually. Small town, Olympia, Washington, where I lived for many years. And worked with the businesses community closely as we tried to bring back our downtown, revitalize the core of the city.

I find the values that I experience when I interact with small businesses to be close to what I have described here. They are very concerned about the quality of their communities. They choose to do business with banks like the ones that are—financial institutions like the ones that are represented here because they have a relationship to the communities. And they do that when they can and appreciate them.

Mr. MULVANEY. And let us talk about those businesses for a second if we can, because I admit when I came into prep for this meeting, I know who the American Bankers Association is, I know who the federal credit unions are, and I know who the community bankers of America are. In fact, all of those organizations are very active in my state of South Carolina.

I had not been familiar with the Main Street Alliance, but was surprised to find out that it is also active in my home state of South Carolina through an organization called the South Carolina Small Business Chamber of Commerce. And as I was sitting here, I just learned that, Mr. Daley, as I was going through the internet while you were testifying. I am familiar with this organization, and I think it would be of value to those of you who have heard testimony today and to this Subcommittee to recognize who that group is in South Carolina, if it is representative, Mr. Daley, of who your organizations are. It is an organization that exists only on paper. Its core group is a liberal talk show host, a Democrat lobbyist, a Democratic political consultant, and a Democrat public relations specialist. They supported Obama Care, including the public option. They supported cap-and-trade, and they actually got very active in South Carolina in encouraging the state government to create a new agency to oversee small business. In fact, the quote that they had that was much talked about in my state was let us acknowledge that small businesses are a pillar of success in the state and are just as deserving of a new state agency to lead them. I have never heard of a small business group talk about creating new state agencies to oversee them.

Actually, in South Carolina they claim to have 5,000 members, just as you heard Mr. Daley claim that nationwide they have about 10,000 members. The only way they get to 5,000 members in the state of South Carolina is by using the lists of the South Carolina Association of Trial Lawyers and the South Carolina Association of Claimants Attorneys.

I heard Mr. Daley testify earlier today that he actually likes the uncertainty that comes with Dodd-Frank, which would surprise me none as trial lawyers love uncertainty. Mr. Daley, I used to—before I was a small businessperson, I was actually a trial lawyer, so I have been down that road as well. The NFIB has spoken out against South Carolina Small Business Chamber of Commerce, another organization that I am a little bit familiar with, as have our two largest Chambers of Commerce in the state of South Carolina, decrying it as nothing more than a front for the trial lawyers in our state. It does not surprise me then, sir, that you have come in here today to defend Dodd-Frank, and in all fairness, probably just reaffirms my position that the bill is a complete travesty to begin with and should be repealed in its entirety.

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

Mr. DALEY. Mr. Chairman, may I for the record point out that we do not have an affiliate in South Carolina, and we are not affiliated with the Small Business Chamber of Commerce.

Mr. MULVANEY. To that point, if I may reclaim my time, Mr. Chairman, your website identifies 14 agencies, 14 state agencies that make up your base, essentially your affiliate agencies. They include the Idaho Main Street Alliance, the Colorado Main Street Alliance, the Iowa Main Street Alliance, the Maine Main Street Alliance, something called the Keystone, which I assume is Pennsylvania, and then very clearly on your website, the South Carolina Small Business Chamber of Commerce.

Thank you, Mr. Chairman. I yield back.

Chairman WALSH. Thank you. I now turn to Ms. Clarke, my colleague from New York.

Ms. CLARKE. Thank you very much, Mr. Chairman. And thank you Ranking Member Schrader.

I have a statement that I would like to insert for the record, Mr. Chairman.

Chairman WALSH. Yes, without objection.

Ms. CLARKE. Thank you very much.

Let me just start by recognizing the support in my district in Brooklyn, New York, for the work of community banks and the credit unions and acknowledge that as all of America knows, your entities were not a part of what took down our economic system. And so we want to thank you for your steadfast work and your commitment to the growth and development of communities across this nation and the businesses they are in.

Let me ask my question to Mr. DALEY. And let me say that, you know, we recognize how much small businesses have suffered during the downturn and that you welcome any of the provisions of Dodd-Frank. One of the number one issues that I hear when talking to small business owners and entrepreneurs in my district is the lack of access to capital. I think, you know, it is almost a mantra at this point. So my question is given that small businesses, we all recognize as the engines of our economy, and recognize that Dodd-Frank is the law of the land, what else can be done to get lenders to free up the over one trillion in reserves that they are holding so that small businesses can hire again and power our economy toward a full recovery? Or is the business model of lenders so inflexible at this stage that it simply cannot adjust to the current regulatory environment.

[The information follows on page 62.]

Mr. DALEY. During the meltdown, Congress passed a law allowing the Fed to pay interest on surpluses. They are currently paying interest on surpluses that are way in excess of the required financial holdings. And we raised the question as to why? Why is that money not being invested back into the economy rather than sitting in the Fed gaining interest? And I hope you will take a look at that question.

There are some other things that might help our customers that are related to lending that are not related to the lack of capital. And one of them is the foreclosure crisis. It is a tremendous drag on the neighborhood economies. And efforts by the government to try to get these underwater loans drawn down have not proven very successful and have not been very aggressive. And we have a continuing drop in the value of housing, a continued lack of construction industry would help us tremendously if that crisis could be closed. So two answers. Take a look at why we are sitting on all this money for one, and please take a look at that foreclosure crisis.

Ms. CLARKE. Thank you. Do any of you gentlemen want to add your perspective to that question? I am trying to figure out, you know, what is it? Is it that it is hard to adjust to the current regulatory environment? Or what would you say? Yes.

Mr. BOYLE. One way for us to increase our lending would be for a reduction in the stringent capital requirements put on us by the FDIC. We are currently holding nine percent capital. If we could get that reduced to just eight and a half percent, we could make as much as $10 million in new loans. So the joke around our institution is the accountants are running the bank because everything we do is dedicated towards the achievement of the nine percent capital ratio.

Mr. OHLENDORF. One of the other things that I would like to mention is in the days gone by we were able to show sources of liquidity to the regulators as lines of credit with our correspondent banks, lines of credit with the Federal Home Loan bank, the discount window authorization, our relationships with maybe brokered CD providers. Today the regulators are asking us for on-balance sheet liquidity. They do not trust that we are going to be able to draw on those lines because some of those organizations have withdrawn lines from banks that show some signs of weakness. So instead now I need to hold on my balance sheet levels of liquidity that were prior unheard of in dollars and cents. So part of it again is going back to what I am being required to hold on my balance sheet which looks like substantial loanable funds and I would love to loan those funds out.

Ms. CLARKE. Thank you very much, gentlemen. I yield back, Mr. Chairman.

Chairman WALSH. Thank you. I have just a couple quick final questions.

Mr. Daley, you state or stated that "some small curtailment of available credit over the long term is favorably outweighed by the certainty that sensible requirements to mitigate risk will stabilize credit markets over the long term and less the like likelihood of another financial collapse." What data can you point to to show that the current regulations are merely sensible and not burdensome and that they will prevent another financial crisis?

Mr. DALEY. I am not going to point that I do not have data that would make a prediction like that. And I must be clear that the provisions related to reserving in Dodd-Frank are very complex. And I believe that there is a legitimate debate about whether they need to be uniformly applied or is there some way that different institutions with different circumstances should have different applicability of those reserving requirements. But the underlying idea of there being those reserving requirements in place and being applied throughout lending institutions is important to the long-term stability of credit. And that is what I am trying to express here. That having some base requirement there. I do think there is a reasonable debate about how exactly to apply those provisions of the law. But that there be provisions like that is important to the long-term stability of credit.

Chairman WALSH. Your members are small business owners. Did they support the repeal of the 1099 aspect of Obama Care?

Mr. DALEY. Yes.

Chairman WALSH. Overwhelmingly?

Mr. DALEY. There was one sense of hesitation. It was the pay-for. The original proposals to pay for the repeal of the 1099 provision undermined aspects of the ACA, or the Affordable Care Act, of which they supported passage.

Chairman WALSH. In describing your membership briefly, this is a real short answer, the small business owners, do they feel overregulated and overtaxed?

Mr. DALEY. To the degree I have had conversations with them about these things, they are not—they do not say they are overregulated and they are overtaxed. They are much more concerned about what happens to the money that they pay? Where is it invested? They are much more concerned about what impact the general quality of life in their community has on them than anything else.

Chairman WALSH. You and I need to take a day. We will go and randomly find 100 small business owners around the country. We will ask them that question. Thank you.

One final question for the three bankers. In essence, you are all small businessmen. What, to your estimation, and be brief, is, as small businessman, your greatest fear right now for the small business community?

Mr. OHLENDORF. My greatest fear is where does this regulation stop. Every time we have to comply with a new regulation we are just having to spend that much more time on the regulation and that much less time supporting small business people. We completely understand their need for capital. We completely understand our role in that. We are in business to make loans. We are in business to support our communities. There does not need to be a regulation to tell us how to support our communities because if we do not do that our communities will not do business with us. So it is not complicated in a community bank. We just need to find a way to be able to get out from under the burden of oppressive regulation.

Chairman WALSH. Mr. Sekula.

Mr. SEKULA. The concern definitely is about the overreaching, regulation. Right now we are talking about investing and taking care of our members, their needs right now. That is all they can think of right now. So some of them are not investing and growing their business or seeking loans because of the fear and uncertainty, but when they come to us we want to make sure that they feel comfortable and that we are going to be there to take care of their needs, whatever it may be. When we have our regulators, whether it be the National Credit Union Association or the SBA hindering and preventing us from getting in the way, especially for a well-positioned financial institution to be able to take care of them, what kind of message does that send?

And that is my biggest fear, is that we think that we have done everything right to take care of our business the way we operate and our members, and now being possibly restricted from being able to get them access. That concerns me because we think we are doing everything right but now I am being told you need to be careful.

Chairman WALSH. Mr. Boyle, your greatest concern for this small business community?

Mr. BOYLE. I have been a banker for 34 years and I started off as a regulator and moved into the banking environment. And in those 34 years I could not recall a regulation being retracted. Every time they put a new layer of regulation on us it costs us money. This new regulation for Dodd-Frank, as I mentioned earlier, could cost us as much as an extra $150,000 a year. The debit change effect last week where we lost, those are $200,000 a year. That is $300,000 in profits I do not know how I am going to make up. And if I had those dollars as capital I could make as much as $30 million in new loans. So the leveraging aspect worries me. The over-regulation is only going to hamper my ability to become more profitable.

Chairman WALSH. Thank you. I am done. Mr. Schrader, any follow-up?

Mr. SCHRADER. No, sir.

Chairman WALSH. Great. Thanks. Now that the questions are complete, I would like to again thank our witnesses for being here today to discuss this important issue for small business. We know that small businesses will lead any economic recovery and jobs recovery. So today was a step in the right direction towards focusing our efforts on determining the impact of the law and resulting regulations on small business. As we move forward with the implementation of this law, I would like to encourage the participants here today to keep us informed about the issues discussed. It is important that we know the exact impact of policies for those who are working every day to grow business and create jobs.

With that I ask unanimous consent that members have five days, legislative days, to submit statements and supporting materials for the record. Without objection, so ordered.

The hearing is now adjourned. Thank you.

[Whereupon, at 11:19 a.m., the Subcommittee hearing was adjourned.]

June 16, 2011

Testimony of

Thomas P. Boyle

On behalf of the

American Bankers Association

before the

Subcommittee on Economic Growth, Tax and Capital Access

of the

Committee on Small Business

United States House of Representatives

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Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee, my name is Thomas Boyle, Vice Chairman of State Bank of Countryside, Countryside, IL. State Bank of Countryside was chartered in 1975 to meet the needs of local families and their businesses. We are an $800 million commercial bank with 6 offices and 105 employees. We serve the Chicago area market, with a population of approximately 4 million people. I appreciate the opportunity to present the views of the American Bankers Association (ABA) on the state of community banking and our ability to meet the needs of small businesses in our communities. ABA represents banks of all sizes and charters and is the voice of the nation's $13 trillion banking industry and its two million employees.

At my bank, as is true of my banker colleagues around the country, we are intensely focused on building and maintaining long-term relationships with our customers. In fact, State Bank of Countryside was founded with the motto "The Family Owned Bank for Families and Their Businesses," to convey the relationship the Bank has with our customers. We view our customers not as numbers but as individuals and business owners. As a family business, we understand the financial needs and concerns faced in our customer's personal and business lives, and we believe that the success of State Bank of Countryside is inextricably linked to the success of the communities we serve. They are, after all, our friends and neighbors.

Let me give you just a glimpse of the State Bank of Countryside's close ties with our communities. Over the years the Bank has specialized in lending to in-fill builders and small, family-owned businesses ranging from plastic injection molding to the local insurance agent. We have also participated in the SBA 504 Program and continue to do so under the new refinancing guidelines. In the Spring of 2011 we used this program to finance a restaurant acquisition ($3 million).

Not only do we provide the funding to meet the credit needs for our communities, our people are truly a part of these communities. A good example of this is our relationship with Christ the King Jesuit College Prepartory Schools, which serves young men and women from Chicago's Austin neighborhood and its surrounding communities on the west side of the city. The school has a corporate work study program designed to introduce inner city students to the business world under the guidance of a professional and designated staff. The program partners with Chicago area businesses to fill one or more full time entry-level jobs, while modifying the academic schedules of the students so that they do not miss class. The students who participate in the program earn up to 65% of their tuition, which not only allows them to take ownership of their education but also builds their professional skills. Our bank has participated in this program for the past three years, and has four students who job-share a full-time teller position.

Another good example is our Small Dollar Loan Program. We launched this program in 2008 in conjunction with the Citizenship Micro-loan, which is offered to individuals applying for United States citizenship. No application fee or credit history is required, so it brings new opportunities to a potentially challenged subset of our community.

In January 2011, we partnered with Operation Hope, using their curriculum to reach children in low income schools in Chicago's inner city neighborhoods. Operation Hope provides the school contacts and our employees provide the "teaching" component that brings the students the concept of Save, Spend and Share and helps them understand the difference between "needs" and "wants." In addition, for the past decade, our employees have participated in the ABA's "Teach Children to Save" program. Each spring our employees provide 18-20 hours of classroom instruction.

I believe that these initiatives demonstrate that when a bank sets down roots, communities thrive. A bank's presence is a symbol of hope, a vote of confidence in a town's future. The health of the banking industry and the economic strength of the nation's communities are closely interwoven. We strongly believe that our communities cannot reach their full potential without the local presence of a bank – a bank that understands the financial and credit needs of its citizens, businesses, and government. However, I am deeply concerned that this model will collapse under the massive weight of new rules and regulations. The vast majority of banks never made an exotic mortgage loan or took on excessive risks. They had nothing to do with the events that led to the financial crisis and are as much victims of the devastation as the rest of the economy. We are the survivors of the problems, yet we are the ones that pay the price for the mess that others created.

Banks are working every day to make credit and financial services available. Those efforts, however, are made more difficult by regulatory costs and second-guessing by bank examiners. Combined with hundreds of new regulations expected from the Dodd-Frank Act, these pressures are slowly but surely strangling traditional community banks, handicapping our ability to meet the credit needs of our communities.

Managing this mountain of regulation will be a significant challenge for a bank of any size. The median-sized bank has only 37 employees – for them, and even for banks like mine with 105 full time employees, this burden will be overwhelming. Right now, our bank is seeking proposals from three outside compliance consulting firms to enhance what we believe to be an existing robust compliance program. But the new regulatory obligations mean more regulatory scrutiny, which can include penalties and fines. All of these expenditures take away precious resources that could be better used serving the community.

The consequences are real. Costs are rising, access to capital is limited, and revenue sources have been severely cut. It means that fewer loans get made. It means a weaker economy. It means slower job growth. With the regulatory over-reaction, piles of new laws, and uncertainty about government's role in the day-to-day business of banking, meeting local community needs is difficult at best.

Without quick and bold action to ***relieve regulatory burden*** we will witness an appalling contraction of the banking industry. Each bank that disappears from the community makes that community poorer.

In my testimony today, I'd like to focus on three key themes:

➢ ***New regulations increase the costs of doing business while limiting access to capital***
Each new regulation, or change in an existing one, adds another layer of complexity and cost of doing business. The Dodd-Frank Act will add an additional, enormous burden, has stimulated an environment of uncertainty, and has added new risks that will inevitably translate into fewer loans to small businesses.

- ***New rules substitute Washington bureaucratic judgment for that of local bankers***
  Increasingly, the government has inserted itself in the day-to-day business of banking. The government should not be in the business of micro-managing private industry. Traditional banks tailor products to borrowers' needs in local communities, and prescriptive rules inevitably translate into less access to credit and banking services.

- ***The consequences for consumers, small businesses, and the economy are severe***
  The Dodd-Frank Act will raise costs, reduce income, and limit potential growth, all of which drives capital away from banking, restricts access to credit for individuals and business, reduces financial resources that create new jobs, and retards growth in the economy.

I will discuss each of these in detail in the remainder of my testimony.

I. New Regulations Limit Access to Capital While Increasing the Costs of Doing Business

Capital is the foundation upon which all lending is built. Having sufficient capital is critical to support lending and to absorb losses when loans are not repaid. In fact, $1 worth of capital supports up to $10 in loans. Most banks entered this economic downturn with a great deal of capital, but the downward spiral of the economy has created losses and stressed capital levels. Not surprisingly, when the economy is weak, new sources of capital are scarce.

The timing of the Dodd-Frank limitations on sources of capital could not have been worse, as banks struggle to replace capital used to absorb losses brought on by the recession. While the market for trust preferred securities (which had been an important source of capital for many community banks) is moribund at the moment, the industry needs the flexibility to raise capital through various means in order to meet increasing demands for capital. Moreover, the lack of readily available capital comes at a time when restrictions on interchange and higher operating expenses from Dodd-Frank have already made building capital through retained earnings more difficult.

These limitations are bad enough on their own, but the consequences are exacerbated by bank regulators piling on new requests for even greater levels of capital. In conversations with fellow community bankers, I often hear how regulators are pressing many banks to increase capital-to-assets ratios by as much as 4 to 6 percentage points – 50 to 75 percent – above minimum standards.

For many banks, it seems like whatever level of capital they have, it is not enough to satisfy the regulators. This is excess capital not able to be redeployed into the market for economic growth.

Thus, to maintain or increase capital-to-assets levels demanded by the regulators, these ***banks have been forced to limit, or even reduce, their lending.*** The lack of access to capital has caused many banks to become smaller in order to ensure the banks maintain specific capital ratios. The result: loans become more expensive and harder to get.

Ever-increasing demand for more capital puts a drag on the economy at the worst possible time for our nation's recovery. Moreover, it works at cross-purposes with banks' need for the strong and sustainable earnings that will be the key to addressing asset quality challenges. ***Therefore, anything that relieves the increasing regulatory demands for more capital will help banks make the loans that are needed for our nation's recovery.***

At the same time the Dodd-Frank Act decreases access to capital, it increases compliance burdens. The Dodd-Frank Act will have an enormous and negative impact on all community banks and their ability to make small business loans. Already there are nearly ***2,000 pages*** of new proposed rules and there will be many thousands more as the 200+ rules under the Act are promulgated. This is on top of the 50 new or expanded regulations affecting banks over the two years leading up to the enactment of the Dodd-Frank Act. This flood of new regulations is so large that regulators are urging banks to add new compliance officers to handle it.

State Bank of Countryside is typical of many community banks in the U.S., and I know how demanding the crush of paperwork is for my staff. It is hard enough to deal with one new regulation or a change in an old one, but with reams of new proposals and reams of final regulations, it is overwhelming. We used to close many of our loans internally with our loan officers assuring compliance with all the requirements. Now, we are very likely to seek outside help to ensure that we are in compliance through increased testing of the loan portfolio.

Managing compliance with these new requirements adds time and costs – all of which makes it more difficult and costly to make loans to our customers. It is a sad commentary when our investment dollars this year and next – and probably longer – will be spent on compliance with the Dodd-Frank Act rather than making new loans, products and services available. There are many community banks smaller than mine, and I cannot imagine the pressure they face with fewer employees. The cumulative burden of hundreds of new or revised regulations may be a weight too great for many smaller banks to bear.

Businesses – including banks – cannot operate in an environment of uncertainty. Unfortunately, Dodd-Frank increases uncertainty for banks, and as a consequence, raises credit risks, raises litigation risks and costs (for even minor compliance issues), leads to less hiring or even a reduction in staff, makes hedging risks more difficult and costly, and restricts new business outreach. All of this translates into less willingness to make loans.

One major uncertainty is the additional regulatory requirements that will be expected once the Bureau of Consumer Financial Protection (CFPB) becomes fully operational. One of the claims was that small banks would be exempt from the new CFPB. ***But small banks are not exempt.*** All banks – ***large and small*** – will be required to comply with rules and regulations set by the CFPB, including rules that identify what the CFPB considers to be "unfair, deceptive, or abusive." Moreover, the CFPB can require community banks to submit whatever information it decides it "needs." There are also many other new regulatory burdens flowing from the Dodd-Frank Act empowerment of the CFPB which will add considerable compliance costs to every bank's bottom line. Adding such a burden on banks that had nothing to do with the financial crisis constitutes massive overkill. In the end, this cumulative burden will only impede fair competition among trusted providers seeking to serve responsible customers.

Much needs to be done to reverse the burdens Dodd-Frank threatens to impose through the CFPB. We support the efforts of the House Financial Services Committee, which passed three bills that would help:

- ***H.R. 1121***, which establishes a five-member, bipartisan commission to lead the CFPB, instead of a single director.
- ***H.R. 1315***, which clarifies that the Financial Stability Oversight Council (FSOC) must set aside any CFPB regulation that is inconsistent with the safe and sound operations of U.S. financial institutions. In addition, the bill would change the vote required to set aside regulations from two-thirds of the FSOC's voting members to a simple majority.
- ***H.R. 1667***, which delays the transfer date to for the CFPB until a Senate-approved director is in place.

In addition to these important initiatives, ABA recommends the following steps as only a beginning:

- Eliminate the expansive definition of "abusive" practices since appropriate use of existing unfair and deceptive practices authority is more than adequate;

- Prohibit Attorneys General from enforcing federal standards subject to federal supervision, or at least limit such actions to remedy only conduct occurring after the last CFPB or prudential regulator examination; and
- Prevent States and prudential regulators from augmenting or interfering with consumer protections otherwise covered by CFPB rules.

II. Individual Rules Substitute Washington Bureaucratic Judgment for That of Bankers in Local Communities

Increasingly, the government has inserted itself in the day-to-day business of banking. Micro-managing private industry should not be the role of government. Inevitably it leads to negative unintended consequences. The most egregious example is the price-controls for interchange fees being promulgated by the Federal Reserve under the Durbin Amendment.

The loss of interchange income will certainly mean higher costs of using debit cards. Greater mortgage restrictions and the lack of certainty on safe harbors for qualified mortgages means that community banks may no longer make mortgage loans or certainly not as many. Higher compliance costs mean more time and effort devoted to government regulations and less time for our communities. Increased expenses often translate into layoffs within the bank, and although we have not had any layoffs, our full time employees are down by 7 due to a hiring freeze.

Banks have always accepted the operational, reputational, and financial risk associated with developing new products and services and making them available to millions of consumers. Now financial institutions risk losing their investments of billions of dollars into improvements of existing products and services, and the creation of new ones, through government price controls. Why would any business invest in an innovative product knowing the government ex post facto will interfere and completely dismantle its free-market business model by imposing price controls? The Durbin Amendment serves as a strong ***disincentive*** for innovation and investment by financial institutions in other emerging payment systems and financial products and services. In the end, it is the American public who suffers.

III. The Consequences for Consumers, Small Businesses, and the Economy are Severe

Banks have to be profitable and provide a reasonable return to investors. If they do not, capital quickly flows to other industries that have higher returns. The Dodd-Frank Act, in combination with intense regulatory over-reaction, has increased expenses, decreased potential revenue, and limited community bank access to capital. Added to greater uncertainty about new regulatory and legal risks, these pressures directly take resources away from the true business of banking – making loans in local communities – the loans that should be going to families in my community and their family businesses.

Certainly, I want my bank to be successful, as do all of my fellow bankers throughout the country. Every day, we are facing new challenges that threaten our very existence. But for community banks, it goes beyond just our parochial interests. We are very much a part of our community. It is why every bank in this country volunteers time and resources to make their communities better. If the relentless pressures on our small banks are not relieved, the loss will be felt far beyond the impact on any bank and its employees. It will mean something significant has been lost in the community once served by that bank.

Thus, jobs and local economic growth will slow as impediments inevitably reduce the credit that can be provided and the cost of credit that is supplied. Fewer loans mean fewer jobs. Access to credit will be limited, leaving many promising ideas from entrepreneurs without funding. Capital moves to other industries, further limiting the ability of banks to grow. Since banks and communities grow together, the restrictions that limit one necessarily limit the other.

Lack of earning potential, regulatory fatigue, lack of access to capital, limited resources to compete, inability to enhance shareholder value and return on investment, all push community banks to sell. The Dodd-Frank Act drives all of these in the wrong direction and is leading to consolidations. The consequences for local communities are real.

State Bank of Countryside will survive these changes. I fear that many other community banks may not. I have spoken to many bankers throughout the country who describe themselves as simply miserable. Some have already sold their banks; others plan to do so once the economic environment improves. The Dodd-Frank Act was intended to stop the problem of too-big-to-fail, yet now we have even bigger institutions; ironically, the result may be that some banks will be too-small-to-survive the onslaught of the Dodd-Frank rules.

Conclusion

An individual regulation may not seem very oppressive, but the cumulative impact of all the new rules plus the revisions of existing regulations is oppressive. The regulatory burden from Dodd-Frank and the excessive regulatory second-guessing must be addressed in order to give all banks a fighting chance to maintain long-term viability and meet the needs of local communities everywhere.

It is important to understand that our bank – indeed, any small business – can only bear so much. Most small banks do not have the resources to easily manage the flood of new rules. Higher costs, restrictions on sources of income, limits on new sources of capital, regulatory pressure to limit or reduce lending in certain sectors, all make it harder to meet the needs of our communities. Ultimately, it is the customers and community that suffer along with the fabric of our free market system.

NAFCU

National Association of Federal Credit Unions

Testimony of

Mark Sekula
Executive Vice President, Chief Lending Officer
Randolph-Brooks Federal Credit Union

on Behalf of

The National Association of Federal Credit Unions

"The Dodd-Frank Act: Impact on Small Business Lending"

Before the

House Small Business Committee
Subcommittee on Economic Growth, Capital Access and Tax

United States House of Representatives

June 16, 2011

Introduction

Good morning, Chairman Walsh, Ranking Member Schrader and members of the Subcommittee. My name is Mark Sekula and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the Executive Vice President, and Chief Lending Officer for Randolph-Brooks Federal Credit Union (Randolph Brooks), headquartered in Live Oak, Texas.

NAFCU is the only national organization exclusively representing the interests of the nation's federally-chartered credit unions. NAFCU–member credit unions collectively account for approximately 65.4 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding the Dodd-Frank Act's impact on small business lending.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for nearly 93 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 § USC 1752(1)). While over 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 7,800 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed, with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided, but also—more importantly—to quality and cost.

Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

Randolph-Brooks FCU and Business Lending

In line with it's mission to 'improve the economic well-being of those within its field of membership', Randolph-Brooks began offering government backed SBA loans in 2006. We were recognized by the SBA as the 7(a) Small Lender of the Year in 2009. We are a Preferred Lender with delegated authority and an Express lender which aids in quicker than normal loan turnaround. Since our program's inception, the portfolio has grown to $23.7 million in total loan amounts (as of 5/31/11) and has $18.4 million in outstanding principal. Randolph Brooks participates in the SBA 7(a) and SBA 504 loan programs. 7(a) eligible use of funds include purchasing commercial real estate, equipment, inventory, working capital, etc., while the 504 loan program is limited to the purchase of real estate and heavy equipment.

Utilizing any SBA loan guaranty program requires meeting stringent government regulations. Determining overall applicant eligibility to participate in an SBA program is nearly as important as determining the applicant's creditworthiness. Failing to meet certain eligibility criteria may preclude the applicant from participating in an SBA guaranteed loan program. Eligibility criteria includes among other things: size restrictions, eligible and ineligible types of business, use of proceeds, credit standards, and meeting a 'credit elsewhere' test.

Our SBA loan volume has diminished from the early years. It is noteworthy that we are still experiencing increases in net loans and net loan dollars. Much of the decrease can be associated with the overall economic downturn the nation as a whole has experienced. However, Randolph Brooks has also scaled back to some extent as a response to comments from the SBA and its examinations. On one hand the SBA vigorously encourages granting small loans to qualifying businesses, yet, on the other the agency matter-of-factly states that a lender's status with SBA can be rescinded or imperiled if these higher risk loans default. The SBA provides a Lender Portal and a lender 'score' derived from SBA's Credit Risk Assessment Model. While this information is useful, it would be more beneficial for a lender to see how they compare to other lenders with *similar* loan portfolios. Our 'score' is derived by averaging other lenders', mostly large 7a loans, with our small SBA Express loans. The blending of all lenders with varying portfolios to arrive at a 'score' dilutes the true picture as one cannot compare a small SBA unsecured working capital line of credit with a large SBA loan secured with commercial real estate. Clearly the two loans are different and should have different evaluation processes. If this evaluation process is not changed, it may eventually eliminate all small loans from lenders portfolios. We have requested that the SBA via the Office of Credit Risk Management address this deficiency so the playing field is leveled and more accurate information is dispensed to participating lenders so that they can more accurately determine the soundness of their respective SBA loan portfolios. We hope that the Small Business Committee will be able to help in this regard.

The Impact of Dodd-Frank on Credit Unions and Business Lending

It is widely recognized by leaders on Capitol Hill and in the Administration that credit unions did not cause the economic downturn. Still, credit unions continue to be some of the most highly regulated of all financial institutions, facing restrictions on who they can serve and their ability to raise capital. There are many consumer protections already built into the *Federal Credit Union Act*, such as the only federal usury ceiling on financial institutions and the prohibition on pre-payment penalties that other institutions have often used to bait and trap consumers into high cost products.

Despite the fact that credit unions are already heavily regulated, were not the cause of the financial crisis, and actually helped blunt the crisis by continuing to lend to credit worthy consumers during difficult times, they are still firmly within the regulatory reach of a number of provisions contained in the *Dodd-Frank Act*. While many may be well-intentioned, these additional requirements in the *Dodd-Frank Act* have created an overwhelming number of new compliance burdens, which will take credit unions considerable time, effort, and resources to resolve.

As not-for-profit cooperatives that cannot turn to capital markets to raise funds, the capital of a credit union comes from its members and is returned to them. Resources expended to comply with new burdens result in fewer resources available to make the next loan or offer a better rate.

We applaud recent efforts by the Obama Administration and the House of Representatives to tackle excessive regulations that hamper the ability of an industry to create jobs and aid in the economic recovery. With a slew of new regulation emerging from the *Dodd-Frank Act*, such relief from unnecessary or outdated regulation is needed now more than ever by credit unions.

Still, there are a number of provisions in Dodd-Frank that will have a direct or indirect impact on small business lending by credit unions.

One of the most direct impacts will likely come from Section 1071 of the *Dodd-Frank Act*. This provision creates a data collection system for small business lending similar to *Home Mortgage Disclosure Act* (HMDA) for financial institutions requiring them to collect and report information to the Consumer Financial Protection Bureau (CFPB). Section 1071 requires every financial institution (broadly defined as anyone who engages in a "financial activity") to inquire of any businesses applying for credit whether the business is a small business and women or minority-owned.

Given that credit unions serve a defined field of membership, individual credit unions' information, in comparison to other lenders, could be skewed when compared to others, as credit unions can only serve those in their field of membership. Credit unions are chartered to serve their members, thus regulatory data collection that is intended for institutions that can serve anyone that comes into the doors and would necessarily paint a broad brush should not be imposed on credit unions. Further, while we acknowledge that taken on its own, Section 1071 is a well-intentioned provision, when added with other laws and regulations, this new compliance burden is just another drop in the new and growing overall cost of compliance bucket emerging for credit unions from Dodd-Frank.

The financial institution must also maintain a record and report it to the CFPB (along with other related information about the application). The information must be made public in accordance with CFPB regulations. These provisions are effective on the CFPB transfer date (currently scheduled to be July 21, 2011), yet implementing regulations will not be issued until *after* that date, leaving financial institutions with no compliance guidance on the effective date. While the CFPB has indicated that compliance will not be mandatory on July 21, Congress should consider delaying the effective date of this provision until such time as implementing regulations take effect giving financial institutions the guidance that they need to carry out the goal of this provision. Moreover, Section 1071 gives the CFPB considerable discretion to establish the requirements, define the scope, provide for exemptions, and protect the privacy of individuals. We believe it is critical that Congress ensures that the CFPB narrowly interprets this discretionary authority.

The Dodd-Frank Act also includes a section (Section 1100G) that says the CFPB must evaluate as part of its regulatory flexibility analysis the impact that its actions have on "small entities" (which includes "small organizations"). We believe that credit unions meet the definition of a "small organization" as defined in Title 5, Section 601 of the U.S. Code as "any not-for-profit enterprise which is independently owned and operated and is not dominant in its field..."

We would urge Congress to ensure that the CFPB abides by this Congressionally-mandated standard, and does not try to narrow the definition of "small entity" in the future in order to strengthen its authority over credit unions. We believe this authority could be enhanced by Congress strengthening the cost-benefit analysis requirement for rule-writing that would allow institutions to rebut the need for rules based on cost thresholds.

Numerous Additional Provisions of Dodd-Frank will also Impact Credit Unions

While not the subject of this hearing, the biggest impact from the *Dodd-Frank Act* on credit unions will likely come from the new price controls on debit interchange, which will have a negative impact on the entire business model of credit unions. For credit unions with business lending programs, the price controls on debit interchange may force them to revise or even scale back their business lending because they would have to re-allocate resources to pay for costs associated with their debit card program.

In addition to the debit interchange price cap provision, the creation of the new Consumer Financial Protection Bureau (CFPB) is potentially problematic. The Bureau will have rule-writing authority over credit unions of all sizes, and examination and enforcement authority for those above an arbitrary threshold of $10 billion. NAFCU has consistently opposed efforts to include credit unions, regardless of size, under the new CFPB. As not-for-profit cooperatives owned by the people they serve – their members – credit unions have different motives in serving their members than for-profit financial service entities. Unfortunately, despite numerous hearings on regulatory reform in the last Congress, credit unions were ultimately included in the jurisdiction of the new CFPB without a single hearing to examine whether or not they should be covered by the CFPB.

While we were pleased to see the Financial Stability Oversight Council (FSOC) granted some "veto" authority over some proposed CFPB rules if they are found to create safety and soundness concerns, we believe the current veto authority does not go far enough. NAFCU supports legislation proposed by Representative Sean Duffy, H.R. 1315, to modify the threshold needed for the FSOC to veto a proposed CFPB rule, and that clarifies the standard of what can be considered in making the determination. We believe this approach to make it a majority of the FSOC (minus the CFPB Director) is a positive step that ensures safety and soundness concerns do not take a back seat in this new regulatory environment.

NAFCU is pleased to see H.R. 1121, legislation introduced by House Financial Services Committee Chairman Spencer Bachus to create a 5-person commission to govern the CFPB. We believe a 5-person Board has benefits over one single director. Moving forward under the law that is in place at this time, however, NAFCU believes that the CFPB must have a Senate confirmed director before the official transfer date. We support legislation (H.R. 1667) which would delay the transfer date until a confirmed director is in place. Lawmakers, their constituents, and every entity under the CFPB deserve a fair and open process in which candidates that may head the new agency are properly vetted.

While the ability to prevent unfair and deceptive practices is important, we are concerned that the CFPB's authority under Unfair and Deceptive Acts or Practices (UDAP) could amount to a blank check for it to delve into any number of areas that create new regulatory burdens or hurdles for credit unions that make it harder to lend. It may be prudent for Congress to require joint-rulemaking with functional regulators when the CFPB wishes to write new rules using its UDAP authority.

Additionally, while it is important for the CFPB to hear consumer complaints, we believe it is important that the CFPB create safeguards for ensuring that consumer complaints remain confidential and that institutions do not face reputation risk due to unsubstantiated claims.

The Regulatory Environment Impacting Credit Unions and Small Business Lending

The environment around regulatory reform has led regulators to make changes that impact credit unions and may cause them to tighten their lending to small business. As noted above, the SBA has told us to tighten up our lending practices despite an excellent track record. The net result of this "scoring" approach by the SBA discourages smaller SBA loans and encourages lenders to focus on bigger loans.

Practices by other regulators have had an impact as well. Last year, the National Credit Union Administration (NCUA) issued a rule to amend the agency's Regulatory Flexibility Program (RegFlex) as it relates to business lending. The new rule requires a personal guarantee for all credit union member business loans (MBLs). Unfortunately, this proposal will make credit union MBLs significantly less attractive to members and it will likely become more difficult to retain those members' deposits if credit unions cannot offer competitive loans.

NAFCU believes, and has told the NCUA, that requiring a personal guarantee for all MBLs is unnecessary given the underwriting policies that RegFlex credit unions already have in place. This is true for two reasons. First, RegFlex credit unions, as part of sound lending practices, still require personal guarantees in many situations. Second, other factors, most notably the borrower's equity may be more useful than a personal guarantee in predicting or ensuring repayment.

Neither the proposed rule, nor the final rule provided sufficient justification for the change in policy. At a time when the federal government is attempting to increase access to credit for small businesses, this decision is counterproductive.

The NCUA could have written a more narrow rule that addresses safety and soundness concerns without eliminating the exemption altogether. For example, NAFCU recommended a more narrow exemption that would have given credit unions a blanket waiver of the personal guarantee in situations where the borrower has invested a significant amount of its own money in a project. This recommendation is based on the simple fact that projects with a significant amount of investor equity are generally more likely to be repaid. The final rule, however, forces credit unions to treat all loans equally, which simply does not make sense. The purpose of underwriting is to determine the risk of the loan and offer a price and terms accordingly. A personal guarantee is an important term for the borrower and it is one which the credit union should have the ability to waive if certain standards are met. We urged the NCUA Board to reexamine this issue and consider some sort of sliding scale where safe loans that meet certain criteria can still be approved without a personal guarantee. We hope Congress will exercise its oversight in this regard as well.

The NCUA's changes to the RegFlex program and the SBA's directive to tighten lending standards are symptomatic of a much larger issue that Congress must address if it is serious about encouraging lending. Currently, there is a very strong disconnect between Congress, the administration and other policy makers that wish to spur lending and the functional regulators that oversee financial institutions. On the one hand, we sit in this hearing today discussing ways to encourage small business lending. On the other hand, the NCUA explicitly creates barriers to new lending – by regulation and the exam process – and implicitly warns credit unions against making any loans that the agency may deem as risky. Forced to choose between these two conflicting objectives, Randolph-Brooks must, of course, follow the directive of the NCUA. In short, any Congressional goal to promote lending will never be successful when the functional regulators are not on the same page.

Conclusion

In conclusion, the ink is barely dry and credit unions are already being negatively affected by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* [P.L. 111-203]. In addition to the debit interchange price caps, credit unions will feel a host of new compliance burdens from the CFPB, including data collection from small business loans as part of Section 1071. The costs of complying with these new requirements add up. Furthermore, regulators from the SBA to the NCUA have taken steps in this new environment that could serve to discourage aspects of business lending. We urge Congress to use its authority to find ways to help ease these burdens, including oversight of provisions found in Section 1100G, and enacting changes to improve the CFPB.

I thank you for the opportunity to appear before you today on behalf of NAFCU and would welcome any questions that you may have.

the MAIN STREET alliance

Small business owners. Small business values.

Statement of William Daley, Legislative and Policy Director for the Main Street Alliance
Hearing of the Subcommittee on Economic Growth, Capital Access, and Tax
Titled "The Impact of the Dodd-Frank Act on Small Business Lending"
On Thursday, June 16, 2011

Chairman Walsh, Ranking Member Schrader, and members of the Committee,

On behalf of the Main Street Alliance, I am grateful to have this opportunity to comment on the impact that the Dodd-Frank reform legislation has had on small business lending.

The Main Street Alliance is a national network of small business owners. Our network creates opportunities for small business owners to speak for themselves on matters of public policy that impact their businesses, their employees, and the communities they serve. We represent small business owners across the country and have active networks of small business leaders in 14 states.

Our membership comes from true Main Street small businesses. Jim Houser in Portland, Oregon is an auto mechanic. Melanie Collins in Falmouth, Maine runs a childcare business. Chris Petersen in Clear Lake, Iowa is a family farmer. For the most part, our members draw their customers from the communities and neighborhoods around them. So when the Great Recession came to devastate communities with high rates of unemployment and a deep foreclosure crisis, our businesses lost a significant share of our customer base – a customer base that has yet to return to full strength.

There is little question that access to credit is and has been a problem. The financial crisis and its aftermath have taken a serious toll on America's small businesses. According to a report by London-based Capital Economics, during this recession small business job losses were responsible for about two-thirds of the employment decline in the U.S. as of late 2009. Between March 2008 and March 2009, small business bankruptcies nearly doubled. While bailouts were being handed out on Wall Street, Main Street small businesses have continued to pay the price in a "double squeeze" of a decimated customer base on the one hand and nearly frozen credit markets on the other.

Yes, small businesses are in a credit crunch – the banks slashed their small business lending by $59 billion between June 2008 and June 2010. This is certainly a serious issue for owners who are positioned to expand, and for the nation's economic recovery. But to blame the Dodd-Frank law for this credit crunch makes little sense.

Credit dried up because of the financial crisis itself, which could have been averted or at least mitigated had the stabilizing measures contained in Dodd-Frank been in effect before the crisis. To blame Dodd-Frank for the crisis-induced credit crunch confuses cause and effect, especially as the new law is not yet even fully implemented. A proper reckoning of cause and effect is needed in order to move forward with pragmatic policies that clear the path for small businesses to flourish.

Is Dodd-Frank the Source of the Uncertainty in the Economy?

It would be impossible to assure you that the implementation of an Act as complex and far reaching will not create any uncertainty. Surely it does. But it is impossible to implement any Act of Congress without some element of uncertainty. What would solve this problem would be a clear path forward. It must be noted that efforts to re-write Dodd-Frank, even before it is implemented, actually add to the uncertainty and confusion about the direction of lending and financial sector practices. The efforts to repeal all or part of Dodd-Frank are doing more to create uncertain circumstances than any other factor related to the Act.

The real reasons why small institutions and small businesses are having difficulties with credit and lending are the underlying uncertainties in the economy – high unemployment, sluggish demand, and the lingering foreclosure crisis. The Great Recession cost the U.S. economy 8 million jobs and eroded the small business customer base severely. Those customers have not yet returned in sufficient numbers to restore lending to better terms. Uncertainty in the foreclosure market continues to hang like an albatross around the neck of consumer demand as the unwillingness of big lenders to write down foreclosures lingers as a drag on lending markets and economic growth.

Dodd-Frank and Reserve Requirements: Do They Limit Access to Capital for Small Businesses?

The answer here is that it remains to be seen. The current lack of access to capital is clearly caused by the general drag in the economy. Because of the economy, fewer small businesses (and lenders) will be able to enter into small business loans while the customer base is so depressed. Without a stronger customer base, neither lender nor borrower can be certain about how the loan can be repaid. Once we have customers again, then credit will flow more freely. Main Street Alliance leaders believe the possibility of some small curtailment of available credit over the long term is favorably outweighed by the certainty that sensible requirements to mitigate risk will stabilize credit markets over the long term and lessen the likelihood of another financial collapse.

It also is necessary to view the question of reserves in the context of the reserves presently held by lending institutions. The excess reserves the banks are sitting on could fill the small business lending gap 20 times over. Data on bank reserves reinforce the conclusion that the credit problem stems not from regulatory requirements (either current or pending), but from the lingering hangover that remains from the financial meltdown. According to the *Wall Street Journal*, U.S. bank reserves had swelled to $1.3 trillion earlier this year, a figure the *Journal* described as "eye-popping." That figure included $1.2 trillion in excess reserves – reserves beyond the amounts required by law – a number that swelled by at least $225 billion in the first quarter of this year.

Even focusing narrowly on small lending institutions, Fed data indicates that about $150 billion of the bank reserve figure comes from small institutions. That alone is more than two and a half times the amount that would be needed to restore small business lending to the level of summer 2008.

Furthermore, small lending institutions should readily benefit from the lower FDIC assessments and increases in deposit insurance that will come with Dodd-Frank implementation. They also should experience something of a leveling of the playing field with non-bank financial firms.

It seems likely, overall, that these lending institutions will easily be able to meet new risk retention requirements and still have plenty of capital available to lend to small businesses. Those excess reserves represent money that could be out circulating in the economy on productive loans, including loans to small businesses. Instead, those excess reserves are sitting at the Fed and the banks are collecting 0.25 percent interest for holding more money out of the economy.

New Data Collection Requirements: A Hindrance or a Benefit to Small Businesses?

To be sure, our small business members are no fans of paperwork. It does remain to be seen how much of the data collection burden will fall on lending institutions and how much on the businesses. Section 1071 of the Dodd-Frank Act amends the Equal Credit Opportunity Act (ECOA) to create a set of requirements for small business credit applications. In brief, every financial institution must inquire of any business applying for credit whether the business is a small business, or a women- or minority-owned business, maintain a record of the information separate from the application, and report the information along with related information about the application (location of business, action taken, amount of credit provided, etc.), to the Bureau of Consumer Financial Protection. The Bureau is given considerable flexibility to establish the requirements, define the scope, provide for exemptions, and protect the privacy of individuals.

We need to see the regulations in detail to be sure of their impact. However, the idea that there should be better information about small business available throughout the regulatory and lending communities is a good one. Our members often feel that there is a great deal of confusion about what small businesses actually are – and what they actually need – and the sharing of better information would help overcome a dearth of understanding about our characteristics and needs.

The Dodd-Frank Law's Benefits for Small Businesses

The Main Street Alliance supported the passage of the Dodd-Frank financial reforms. We did so in large measure because our businesses believed and still believe that the practices that put us into this recession need to be curbed. Here are some of the features of the Act that weigh in on the positive side of the ledger for small businesses:

Consumer Financial Protection Bureau
The new Consumer Financial Protection Bureau will benefit small businesses from three perspectives:

- First, small businesses are financial consumers, too – our members been harmed directly by deceptive financial products, and our members will benefit directly as abusive lending practices are curtailed.
- Second, people need to have money in their pockets to go out and spend in local small businesses. When people get trapped in bad mortgages or deceptive credit arrangements, it saps their disposable income. By guarding against this, the CFPB will help keep money in people's pockets to spend in the real economy.
- Third, the consumer bureau will promote a level playing field in lending by regulating shadow lenders, reining in abusive but profitable practices (propagated mostly by larger institutions), and allowing small banks and credit unions to compete on more equal terms.

In the *Main Street Policy Pulse* report the Main Street Alliance released in January 2010, based on a survey of over 1,200 small businesses across 13 states, 67 percent of responding business owners supported the creation of the consumer bureau, and only 12 percent opposed it.

Restoring the Focus on Traditional Lending Through Limits on Proprietary Trading
The Dodd-Frank law's limits on proprietary trading will also benefit small businesses. The basic function of banking – to pool deposits and offer loans to build and grow productive enterprises – should be reliable and predictable. With the boom in proprietary trading by banks, more and more attention and resources were turned toward casino-style trading and its big payouts, and less and less toward traditional lending. This was bad news for small businesses seeking loans. The Dodd-Frank law's proprietary trading limits will encourage banks to restore the focus on their traditional mission of economically productive lending.

Reforming Credit/Debit Contracts and Debit Interchange Fees
The Dodd-Frank law also included provisions that will restore some parity to credit and debit contracts and debit interchange fees. These include returning to business owners the freedom to make decisions about forms of payment, and ensuring that debit interchange fees are set at reasonable and proportional levels. While we would have liked to see a similar requirement for credit card interchange, these provisions represent important positive steps for small businesses, as reaffirmed last week when the Senate voted down an amendment to delay the new debit swipe fee limits that are set to take effect in July.

In addition to these specific measures, there remain the overarching benefits to small businesses and local economies of increasing overall economic stability as the Dodd-Frank framework seeks to do. Main Street Alliance small business leaders see the Act as necessary, as a clear plus for Main Street small businesses, as an insurance policy to make sure we don't have to pay for Wall Street's mistakes in the future. We urge the Congress to help, not hinder, its implementation.

ICBA
INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Testimony of

Greg M. Ohlendorf

President and Chief Executive Officer
First Community Bank and Trust
Beecher, Illinois

On behalf of the
Independent Community Bankers of America

Before the
U.S. House of Representatives
Committee on Small Business
Subcommittee on Economic Growth, Tax and Capital Access

Hearing on
"The Dodd-Frank Act: Impact on Small Business Lending"

June 16, 2011
Washington, D.C.

Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee, I am Greg Ohlendorf, and I am President and CEO of First Community Bank and Trust, a $147 million asset community bank in Beecher, Illinois. I am pleased to be here today to represent the nearly 5,000 members of the Independent Community Bankers of America. Thank you for convening this hearing on the Dodd-Frank Act and its impact on small business lending. Small business lending will play an essential role in the economic recovery and in creating desperately needed job growth.

Community banks are prodigious small business lenders. We provide small business credit in good times as well as challenging times – supporting the sector responsible for more job creation than any other. In his recent speech before the ICBA annual convention, Federal Reserve Chairman Ben Bernanke shared new Federal Reserve Bank research that shows that while overall small business lending contracted during the recent recession, lending by a majority of small community banks (those of less than $250 million in assets) actually increased, and small business lending by banks with asset sizes between $250 million and $1 billion declined only slightly. By contrast, small business lending by the largest banks dropped off sharply. The viability of community banks is linked to the success of our small business customers in the communities we serve, and we don't walk away from them when the economy tightens.

Community Banks Remain Strong

The past few years have been tumultuous for community banks, but the vast majority of them are well capitalized and are helping to lead the economic recovery. Still, community banks were affected by the financial collapse. Both businesses and consumers have struggled significantly during the recent economic downturn. But, despite the wave of bank failures and consolidations since the financial crisis, I fully expect the community bank business model will thrive in the future, to the benefit of consumers, small business, and the economy. Many ICBA members have been in business for more than 100 years (my bank celebrates its 95th anniversary this year) and our members have survived the Great Depression and numerous other recessions. While I believe the community banking sector will remain vibrant, policymakers must help by providing relief from overly-burdensome regulations.

Community banks have little in common with Wall Street firms, mega-banks, or shadow banks and did not cause the financial crisis or engage in abusive consumer practices. Community banks have a much different risk profile because their business model is built on long-term customer relationships, and we cannot succeed without a reputation for fair treatment. We make loans often passed over by the large banks because a community banker's personal knowledge of the borrower which gives us firsthand insight into the true credit quality of a loan, in stark contrast to a statistical model used by a large bank in another state or region of the country. These localized credit decisions, made one-by-one by thousands of community bankers, will restore our economic strength.

Tiered Regulation Needed

ICBA believes it is appropriate to tier regulation and supervision of the financial services industry. The Dodd-Frank Act has proven to be a mixed outcome for community banks, combining both punitive and helpful provisions, but it did recognize community banks as a separate category of financial services providers with a distinct business model, risk profile and mode of relating to customers. A number of provisions of the law make a separate accommodation for community banks. Notable examples include:

- An exemption for banks under $10 billion in assets from primary examination and enforcement by the Consumer Financial Protection Bureau.
- An exemption from the so-called "Collins Amendment," which will make it harder for bank holding companies to raise Tier 1 capital. Bank holding companies of less than $500 million in assets are exempt, and trust preferred securities (TRUPS) – an important source of capital for many banks – issued by bank holding companies of less than $15 billion in assets are grandfathered.
- Community banks are shielded from the impact of new regulation of derivatives. Community banks may continue to offer interest rate swaps to their customers and to hedge their own interest rate risks for proper financial risk management.

Yet much more must be done to address the large and growing regulatory burden on community banks. Overly prescriptive regulations and overly harsh exams only reduce community banks' flexibility in serving the unique needs of their customers. Moreover, regulation has a disproportionate impact on community banks as we have fewer resources to dedicate to compliance due to our smaller size.

Oppressive Examination Environment

You are correct, Mr. Chairman, in observing that the current oppressive exam environment is hampering small business lending. The misplaced zeal and arbitrary demands of examiners are having a chilling effect. Good loan opportunities are passed over for fear of examiner write downs and the resulting loss of income and capital. The contraction in credit is having a direct, adverse impact on the recovery. Exams could be greatly improved by being made more consistent and rational. This would encourage prudent lending without loosening standards. There needs to be more thoughtful and systematic ways to reduce risk without discouraging sound lending.

I'm fortunate to enjoy a cooperative and constructive working relationship with my regulator, the Federal Reserve Bank of Chicago. I value this relationship very highly. It is an important part of the success of my bank and has allowed me to weather the financial crisis. I understand that examiners have a difficult job with a great deal at stake. The stakes were raised sharply after the financial crisis, but I believe many examiners have overreacted and now the pendulum has swung too far in the direction of over-regulation. I've met with thousands of community bankers from every part of the country in recent years, and I can tell you there is an unmistakable trend toward arbitrary, micromanaged, and unreasonably harsh examinations that have the effect of suffocating lending.

This has not always been the case. Before the crisis, examiners frequently worked in partnership with the banks they examined. They were a resource in interpreting often ambiguous guidance. Where corrections were needed, opportunity was given to make them, and compliance was a mutual goal. This is the best means of achieving safety and soundness without interfering with the business of lending. Currently, these relationships are too often adversarial. Understandably, an examiner does not want to be blamed for the next crisis. Examiners are not evaluated on banks' contributions to the economy. At all costs, they want to avoid a bank failure that would put a black mark on their record. As a result, the examiner's incentive is to err on the side of writing down too many loans and demanding additional capital. The crisis was not caused by a failure to adequately examine community banks.

Disconnect Between Washington and Local Exams

A particularly frustrating aspect of the exam environment is the disconnect between the examiners in the field and the directives from Washington. A November 2008, Interagency Statement on Meeting the Needs of Creditworthy Borrowers established a national policy for banks to extend credit to creditworthy borrowers in order to help initiate and sustain an economic recovery. It stated, "The agencies expect all banking organizations to fulfill their fundamental role in the economy as intermediaries of credit to businesses, consumers, and other creditworthy borrowers." Unfortunately, this policy is often overlooked, especially in the regions most severely affected by the recession. Field examiners are second guessing bankers and independent professional appraisers and are demanding unreasonably aggressive write-downs and reclassifications of viable commercial real estate loans and other assets.

Furthermore, examiners are demanding capital levels higher than those required by regulation. To bankers, the process feels arbitrary and punitive. Many community banks complain that the required capital level goalpost is unpredictable and regulators simply keep moving it further, making it nearly impossible to satisfy capital demands in a difficult economy and capital marketplace. As a result, bankers are forced to pull in their horns and pass up sound loan opportunities in order to preserve capital. This is not helpful for their communities and for overall economic growth.

Additionally, bankers used to receive prompt feedback following their exams which they could act on immediately as part of the exam process. Today examination reports arrive months after the examiner's visit, with little opportunity for the banker to sit down with the examiner, go over the results, and respond to the examiner's concerns on the spot.

Legislative Help is Needed

ICBA supports legislation to bring more consistency to the examination process. With regard to loan classifications, for example, one of community bankers' greatest concerns, a bill recently introduced in the House would establish criteria for determining when a loan is performing and thereby provide for more consistent classifications. When loans become troubled often the best course for the borrower, the lender, and the community is a modification that will keep the loan out of foreclosure. But in recent years, many examiners have penalized loan modifications by aggressively placing loans on non-accrual status following a modification – even though the borrower has demonstrated a pattern of making contractual principal and interest payments under the loan's modified terms. This adverse regulatory classification results in the appearance of a weak capital position for the lender, which dampens further lending in the community and puts a drag on economic recovery. Rep. Bill Posey's Common Sense Economic Recovery Act of 2011 (H.R. 1723) would establish conservative commonsense criteria for loan classifications.

Community bankers enthusiastically support this bill because it resonates with their experience from examinations. If it becomes law, it will give bankers the flexibility to work with struggling but viable borrowers and help them maintain the capital they need to support their communities.

Communities First Act

The ICBA-backed Communities First Act (CFA, H.R. 1697) captures many reforms the community banking sector deems necessary to address the difficult regulatory burden they face, including a change to the FSOC veto standard for CFPB rules, which is nearly impossible to meet under the Dodd-Frank Act. This legislation was recently introduced in the House and cosponsored by members from both sides of the aisle. ICBA is working to introduce a similar bill in the Senate. Notably CFA would:

- Increase the threshold number of bank shareholders from 500 to 2,000 that trigger SEC registration. Annual SEC compliance costs are a significant expense for listed banks.
- Require the SEC to conduct a cost/benefit analysis for any proposed accounting change.
- Lower Small Business Administration origination and program fees for rural and small business borrowers.
- Provide relief from new Dodd-Frank data collection requirements in connection with loan applications from women-owned and minority-owned businesses.
- Extend the 5-year net operating loss (NOL) carryback provision to free up community banks capital now when it is most needed to boost local economies.

These and other provisions would improve the regulatory environment and community bank viability, to the benefit of their customers and communities.

The Communities First Act (CFA), a bill meeting the broad objectives outlined above, was introduced and advanced during the 109th and 110th Congresses with bi-partisan support. In the 110th Congress, CFA was introduced in the House by then-Small Business Committee Chairwoman Nydia Velazquez (D-NY).

Small Business Lending Fund

ICBA fully supports the $30 billion Small Business Lending Fund (SBLF) program. This program will provide capital for interested community banks to increase small business lending in their communities and boost economic growth. With the private capital markets for small and mid-sized banks still largely frozen since the financial crisis, SBLF can provide an important alternative source of capital for interested healthy banks, structured to incentivize increased lending. We're pleased that Treasury has now completed all the term sheets and hope that the first round of funding will be disbursed soon.

The Dodd-Frank Act

The Dodd-Frank Act was generational legislation and will permanently alter the landscape for financial services. Every provider of financial services – including every single community bank – will feel the effects of this new law to some extent. Undeniably, it will result in additional compliance burden for community banks and will be challenging for them. The full and ultimate impact won't be known for years, depending on how the law is implemented and how the market adjusts to it. There's still an opportunity to improve some negative provisions in the law – with the help of this committee and Congress – and provisions that could be helpful to community banks are still at risk of being weakened in the implementation.

Debit Interchange

The most troubling aspect of the Dodd-Frank Act, by a wide margin, is the debit interchange, or "Durbin," amendment. Despite the statutory exemption for institutions with less than $10 billion in assets, we believe small financial institutions cannot be effectively carved out. We were very disappointed by the failure of the Tester-Corker amendment in the Senate last week. The outcome was a blow to consumers and community bankers who, absent change, will bear a significant cost as a result of the flawed debit interchange rule. ICBA will continue to fight to improve the rule through every avenue available to us.

Consumer Financial Protection Bureau

While we are pleased the Dodd-Frank Act allows community banks with less than $10 billion in assets to continue to be examined by their primary regulators, ICBA remains concerned about CFPB regulations, to which community banks will be subject. ICBA strongly opposed provisions in the Dodd-Frank Act that excluded the prudential banking regulators from the CFPB rule-writing process. Bank regulators are in the best position to balance the safety and soundness of banking operation with the need to protect consumers from unfair and harmful practices and provide them with the information they need to make informed financial decisions.

There are different ways of strengthening the voice of the prudential regulators in CFPB rule writing. One example is a bill recently passed by the House Financial Services Committee. The Consumer Financial Protection Safety and Soundness Improvement Act, sponsored by Rep. Sean Duffy, would strengthen prudential regulatory review of CFPB rules, which is extremely limited under the Dodd-Frank Act. Prudential regulators have the ability to comment on CFPB proposals before they are released for comment and an extremely limited ability to veto regulations before they become final. This veto can only be exercised if, by a 2/3 vote, the Financial Stability Oversight Council (FSOC) determines that a rule "puts at risk safety and soundness of the banking system or the stability of the financial system," a standard that is nearly impossible to meet. A rule that doesn't meet this high standard could nevertheless do extraordinary harm to banks and consumers. H.R. 1315 would change the voting requirement for an FSOC veto to a simple majority, excluding the CFPB Director, and change the standard to allow for a veto of a rule that "is inconsistent with the safe and sound operations of United States financial institutions." While this change would improve CFPB rulemaking, ICBA has proposed language that would further broaden the standard to allow FSOC to veto a rule that could adversely impact a subset of the industry in a disproportionate way. We believe that this standard would give prudential regulators a more meaningful role in CFPB rule writing.

ICBA also supports additional legislation passed by the Financial Services Committee to strengthen the CFPB. Chairman Spencer Bachus's bill, the Responsible Consumer Financial Protection Regulations Act of 2011 (H.R. 1121) would change the governance of the CFPB from a single Director to a Commission. Commission governance would allow for a variety of views and expertise on issues before the CFPB and thus build in a system of checks and balances that would be absent in a single director form of governance. Congresswoman Shelley Moore Capito's Bureau of Consumer Financial Protection Transfer Clarification Act (H.R. 1667) would postpone transfer of functions to the CFPB until its Director is confirmed. The CFPB's impact on the financial sector, consumers, and the economy should be matched by the highest standard of accountability. Ultimately, accountability for the actions of the CFPB resides with its Director, appointed by the President and confirmed by the Senate. This basic mechanism of good governance would be undermined if the CFPB were to be operative before its Director is confirmed by the Senate.

Community banks are already required to spend significant resources complying with voluminous consumer protection statutes. CFPB rules should not add to these costs. The Dodd-Frank Act gives the CFPB authority to exempt any class of providers or any products or services from the rules it writes considering the size of the entity, the volume of its transactions and the extent to which existing law already has protections. ICBA urges the CFPB to use this authority to grant broad relief to community banks and/or community bank products where appropriate. The Dodd-Frank Act is a mixed outcome for community banks. I've noted some of our concerns, but the legislation also gave us an opportunity to advance long sought priorities which will improve our ability to serve small businesses.

Too Big To Fail

ICBA has long expressed concerns about too-big-to-fail banks and the moral hazard they pose, well before the financial crisis. Community banks are more finely tuned to these concerns because we and our customers feel the direct impact. It's challenging for us to compete against mega-banks whose too-big-to-fail status gives them funding advantages. For this reason, we're pleased the Act takes steps to mitigate too-big-to-fail.

ICBA supported the creation of the Financial Stability Oversight Council (FSOC) whose duties include identifying and responding to risks to financial stability that could arise from the failure of a large, interconnected bank or nonbank. We are pleased that Dodd-Frank provides for enhanced prudential standards for systemically risky firms, including higher capital, leverage, and liquidity standards, concentration limits and contingent resolution plans. Firms subject to these higher standards should include, but not necessarily be limited to, large investment banks, insurance companies, hedge funds, private equity funds, venture capital firms, mutual funds (particularly money market mutual funds), industrial loan companies, special purpose vehicles, and nonbank mortgage origination companies.

We also support the FDIC's new resolution authority to empower it to unwind large, systemically-risky financial firms. The government must never again be forced to choose between propping up a failing firm at taxpayer expense and allowing it to fail and wreak havoc on the financial system. Powerful interest groups are lobbying doggedly to undermine the too-big-to-fail provisions of Dodd-Frank, which are essential to creating a robust and competitive financial services sector to the benefit of consumers, businesses, and the economy. We urge this committee to ensure that these provisions are upheld and enforced.

Deposit Insurance

ICBA was a leading advocate for the deposit insurance provisions of the Act, including the change in the assessment base from domestic deposits to assets (minus tangible equity), which will better align premiums with a depository's true risk to the financial system and will save community banks $4.5 billion over the next 3 years. The deposit insurance limit increase to $250,000 per depositor and the two-year extension of the Transaction Account Guarantee (TAG) Program, which provides unlimited deposit insurance coverage for non-interest bearing transaction accounts, will help to offset the advantage enjoyed by the too-big-to-fail mega-banks in attracting deposits.

Closing

Thank you again for your commitment to small businesses and your interest in the institutions that partner with them and ensure they have the credit they need to grow, thrive, and create jobs. I've outlined some of the more significant regulatory challenges we face in the months ahead. Negotiating these challenges will help us to serve our communities and promote the economic recovery – a goal we share with this committee. Thank you for hearing our concerns. We look forward to working with you.

April 5, 2011

The Honorable Joe Walsh
United States House of Representatives
432 Cannon House Office Building
Washington D.C. 20515

Dear Congressman Walsh:

I believe that the overly aggressive nature of regulators today continues to threaten our country's economic recovery and forces unemployment to remain at unacceptable levels. Ultimately, the current direction of the regulatory agencies threatens the community banking system that funds small businesses and creates local jobs in our communities.

As community bankers, we recognize the need to provide strong regulatory oversight in order to stabilize the banking system and our economy. However, banks are not all the same. Banks are not all uniform. Meanwhile, the regulators continue to impose "big bank fixes" on community banks, while not regulating larger institutions with nearly the same degree of intensity.

There are any number of common sense solutions to these problems. One of them is the legislation that was proposed last year which would enable community banks to temporarily "amortize" over 10 years their marked-to-market losses on property securing impaired loans or acquired through foreclosures when calculating regulatory capital. While this proposal did not make it through the Dodd-Frank legislative process last year, it merits reconsideration by Congress (even if the 10 year period were to shrink to 5 or even 3 years).

Another suggestion that merits consideration would be to expressly address Troubled Debt Restructuring (TDR) in federal statutes. TDRs occur when a bank restructures the debt of a borrower who cannot afford to meet prior payment terms. The regulators write down TDRs so harshly that community banks have little incentive to work with borrowers in good faith in attempts to keep a business or project afloat, which is exactly what our economy needs right now. There is no doubt that a number of approaches could fix this problem, but the regulators won't consider them unless Congress tells them to do so.

It's worth noting that since Congress enacted "FDICIA" in 1991, the regulators have been required to apply "GAAP" accounting in every aspect of their examinations and supervision of banks, but there are many gaps in GAAP accounting – which is to say, GAAP accounting fails to address many circumstances that are unique to financial institutions. The regulators too often fill in these gaps on an *ad hoc* basis, without uniformity, often contrary to logic, and too often in ways that run counter to the goals shared by our industry and Congress for the banking industry to weather the storm of this economy and help our local businesses do likewise. Our regulators are preventing us from doing that in so many ways, and there are any number of things that Congress could do to correct this course, the above being just a couple of examples.

I hope that through further discussions we might provide the beginnings of a roadmap to a better regulatory process that will allow our economy to grow by creating jobs, rather than furthering this recession and small business stagnation. It is my experience that the vast majority of community bankers work well together with their regulators, and we simply want to ensure that we can have a supervisory climate that contributes to the economy rather than stymies it.

Please don't hesitate to contact me if you have any questions.

Very truly yours,

Peter J. Haleas
Chairman
Bridgeview Bank Group

NASBIC America's Small Business Partners

June 16, 2011

The Honorable Joe Walsh
Chairman
United States House of Representatives
Committee on Small Business
Subcommittee on Economic Growth, Tax and Capital Access
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Kurt Schrader
Ranking Member
United States House of Representatives
Committee on Small Business
Subcommittee on Economic Growth, Tax and Capital Access
2361 Rayburn House Office Building
Washington, DC 20515

Dear Representatives Walsh and Schrader,

As the trade association representing private equity firms that invest in domestic small businesses, we thank you for holding this subcommittee hearing on the "The Dodd-Frank Act: Impact on Small Business Lending." As the Subcommittee attempts to better understand the effect that the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) will have on the ability of small businesses to access capital, we encourage its members to examine the consequences resulting from a myriad of new regulations on small investment funds.

It is a basic fact of business that the smaller the company, the more difficulty it has securing capital. However, this problem has grown more acute. A recent study by Dr. John Paglia for Pepperdine University's Private Capital Markets Project found that 88.4% of companies with $1 million or less of earnings (EBITDA) reported difficulty securing senior debt, while 61% of companies with $5 million or less in EBITDA reported difficulty finding this capital.[1] While these small businesses struggle to acquire the financing they need to create jobs and grow the economy, a survey of larger businesses with $15 million in EBITDA or less found that only 30.8% are facing difficulty securing capital. This study also showed that when asked to name the top issues facing them today, 38% of businesses cited access to capital, 37% cited economic uncertainty, and 12% cited government regulations and taxes. These numbers highlight that financial regulatory reform is affecting small business. This is not to say that Dodd-Frank caused

[1] Paglia, Dr. John K. "The State of the Private Capital Markets" *Pepperdine Private Capital Markets Project* 10 June 2011.

all of these problems. It did not. However, it caused some of the problems, exacerbated some problems, and failed to correct others. When small businesses cannot access capital, their businesses cannot grow. A recent National Federation of Independent Businesses (NFIB) report finds that 63% of small business owners do not view this as a good time to expand.[2] Ironically, the Pepperdine study found that nearly 95% of small business owners surveyed said they had enthusiasm about executing growth strategies, but more than half thought that capital was out of reach. Clearly, access to capital issues are dashing the hopes of those seeking to expand.

Small businesses access capital from a range of sources, including private equity funds. New mandates requiring managers of small business investment funds to register with the Securities and Exchange Commission (SEC) add hundreds of thousands of dollars in costs without adding any additional public value. This registration system will be most harmful to the size funds that primarily invest in small businesses. This registration is not a simple process of listing names, addresses, and basic information. Registering with the SEC changes the way a fund is managed and shifts the focus away from growing businesses to complying with bureaucracies. These new burdens waste time and money that would otherwise be used to provide capital to America's job-creating entrepreneurs. The core question is do we want to create jobs by creating new compliance officers or do we want to create job growth via small businesses? Fund managers should be focusing on finding and growing American small businesses, not focusing on regulations that were meant for large, systemically risky institutions.

There appears to be bipartisan agreement on this point, as was illustrated at a recent House Financial Services Subcommittee hearing. At this hearing, Representative Jason Himes (D-CT) said, "I am not convinced, and I have not heard one single persuasive argument that private equity can generate systemic risk of any kind. They do not employ leverage at the fund level, they invest in companies...and those companies do assume some debt, just like any other company."[3] At the same hearing, Representative Robert Hurt (R-VA) said "Private equity funds did not cause the financial crisis and do not appear to be a source of systemic risk. These funds are not highly interconnected with other financial market participants, thus the failure of a private equity fund would be unlikely to trigger cascading losses that lead to similar financial crises."

It is important for members of the subcommittee to note that while these new requirements will create a burden that is de minimis for the multibillion-dollar funds which supported creating this barrier to entry, the cost is substantial for small business investment funds and has been estimated at hundreds of thousands of dollars per year, decreasing competition and the amount of capital available for small businesses. Since larger investment funds invest in larger companies, small businesses are the primary casualty of this loss of competition to provide them capital.

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[2] Dunkelberg, William C., Wade, Holly. "Small Business Economic Trends" *National Federation of Independent Businesses* June 2011: 7.

[3] Mark-up of H.R. 1082, the Small Business Capital Access and Job Preservation Act: Before the Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises of the House of Representatives. 112th Cong., (2011).

Thank you for taking the time to consider our concerns and recommendations, which we believe are vital to ensuring the continued ability of private equity to provide capital to small businesses.

Sincerely,

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President

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