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THE STATE OF SMALL BUSINESS LENDING: IDENTIFYING OBSTACLES AND EXPLORING SOLUTIONS

ROUNDTABLE

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

JUNE 8, 2010

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THE STATE OF SMALL BUSINESS LENDING: IDENTIFYING OBSTACLES AND EXPLORING SOLUTIONS

TUESDAY, JUNE 8, 2010

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Washington, DC.

The committee met, pursuant to notice, at 10:03 a.m., in Room SR–428A, Russell Senate Office Building, Hon. Mary L. Landrieu, Chairman of the Committee, presiding.

Present: Senator Landrieu.

Staff Present: David Gillers, Chris Lucas, and Matt Walker.

OPENING STATEMENT OF HON. MARY L. LANDRIEU, CHAIR, AND A U.S. SENATOR FROM LOUISIANA

Chair LANDRIEU. Good morning, everyone, and thank you so much for joining us today for this roundtable on a very, very important and timely subject.

This is probably the sixth one that we have conducted this year since I assumed chairmanship of this Committee, and we are pleased to have such a distinguished group gathered today. The purpose is to assess the current lending environment for small businesses in America today to try to identify the obstacles that continue to constrict credit and to explore the proposed legislative solutions we are considering in a small business jobs package which will hopefully be enacted by Congress in the upcoming weeks.

As you may know, since I assumed the Chair of this Committee in January, lending in the small business sector was at a historical low. Since then, the numbers have improved significantly, but not to the satisfactory level of this Committee, or many others. We passed the American Recovery and Reinvestment Act, which, in the opinion of many, helped jump-start hundreds, if not thousands of small businesses on Main Streets throughout our country and provided increased SBA lending. This act is widely viewed by economists and policy professionals as having succeeded to a great extent; however, we continue to hear that credit in the small business sector is nowhere near sufficient.

Congress has held countless hearings on this issue, including six in this Committee alone. The borrowers claim that they cannot obtain financing despite being creditworthy. The lenders respond by saying that the borrowers are, in fact, not as creditworthy as they think they are. Three years ago the banks would have, without a doubt, extended a loan, but really, they say, it is the regulators that are being unnecessarily strict.

The regulators, of course, say the borrowers are not creditworthy, and the banks are using the regulators as a convenient excuse. In recent months, some regulators have, in fact, confirmed that there are likely cases of overregulation, but they have not been able to definitively confirm such overregulation. So it is this back-and-forth blame game that small businesses are tired of hearing and, frankly, many members of my Committee, from both the Republican and the Democratic side of the aisle.

I thought that convening this roundtable this morning would move us past the fingerpointing and would like to walk away from this conversation this morning knowing that all relevant parties are participating in a productive dialogue to try to solve this very important challenge before our Nation today. We will try to clarify what the current obstacles are so that we can adequately address them and not to unnecessarily assign blame.

I am encouraged that the Federal regulatory agencies and the Conference of State Bank Supervisors issued the interagency statement on meeting the credit needs of creditworthy small business borrowers in February. However, it is unfortunately not seeming to get at the root cause of the problem.

I would like to thank Federal Reserve Chairman Ben Bernanke for his good work conducting meetings across the country to determine how best to respond to small business lending needs. I would also like to thank TARP's Congressional Oversight Panel who has produced a thorough and thoughtful report on this subject. And I want to also thank the other regulators who are sincerely trying to do their best job to maintain stability in our banking system. I am aware of those painful challenges as well.

However, some have expressed doubts about the demand for small business lending. I can assure you from my seat on this chair there are hundreds and thousands of small businesses, some of whom have sat right where you all are sitting today, desperate for money to continue their operations, to weather the storm, the economic storm, and in some instances, which is quite exciting, to take advantage of opportunities out there to grow their businesses. They have sat right where you are, and they just cannot seem to get their hands on the money to do so.

According to the National Federation of Independent Businesses, in the last 3 months only 36 percent of small businesses who applied for financing received the full amount requested. Compare that to 70 percent as reported in 2008 and 67 percent in 2007. Again, that is 36 percent today compared to 70 and 67 percent, respectively. Clearly, there is a level of demand that is not being met, and when this demand is not being met, jobs are not being produced, and this recession is not coming to an end. You know, the growth is stagnating, will continue to stagnate. Jobs will continue to go without being crafted and filled as long as we are restricting the flow of capital to the small businesses who are indeed the engines of growth in this country.

In our overall effort in Congress to get this economy moving in an upward direction, to expand and to grow, to bring hope and opportunity for Americans, it is imperative that we drill down on this issue. What is the disconnect here? There are businesses out there that are creditworthy, that need the money. There are regulators that have an obligation to make sure the banking system is stable and is trustworthy and fail-proof. But there is a disconnect, and the banks are really on the front line trying to get money out the door. Obviously, they make money when they make good loans. I would believe it would be in their interest to do so, yet they are feeling somewhat restricted.

That is the purpose of this roundtable. This format is much more informal than our regulation hearings. I am going to open it up by asking a few questions. I would like to start off by asking everyone, starting with you, Mark, to introduce yourself. When you want to be recognized or to respond to a question, just put your placard up this way with your name facing towards us so we can call on you—it is going to be very informal, really a back-and-forth exchange. Do not be embarrassed about jumping in if you want to take a question or disagree with something that has been said. We hope that you all will be very forthright in this conversation because, again, our purpose is to get to this issue.

Mark, why don't we start off with you? Please introduce yourself briefly, and we will go around the table.

Mr. WILLS. Thank you. My name is Mark Wills——

Chair LANDRIEU. You have got to press your "talk" button. I am sorry. And perhaps lean into your mic a little bit as well.

Mr. WILLS. Thank you. My name is Mark Wills. I am with Georgia Bank and Trust in Augusta, Georgia, and I am pleased to be here, and I hope I can add to it.

Chair LANDRIEU. Thank you.

Mr. LOVING. Good morning, Senator. I am Bill Loving with Pendleton Community Bank in Franklin, West Virginia, representing the Independent Community Bankers of America. As well, I am happy to be here and help in any way we can.

Chair LANDRIEU. Thank you very much.

Tim.

Mr. LONG. My name is Tim Long. I am with the OCC. I have been with the agency for 31 years. I have run the large bank program, I have run the mid-size community bank program, and I am now running the bank supervision policy for the agency. Glad to be here.

Chair LANDRIEU. Thank you, Tim.

Christine.

Ms. KORONIDES. Christine Koronides from the Small Business Administration. I am a senior policy adviser. I have done a lot of work on the Recovery Act measures and the jobs bill efforts that are currently being discussed to address this lending gap in the economy.

Chair LANDRIEU. Jon.

Mr. GREENLEE. I am Jon Greenlee. I am an associate director in the Division of Banking Supervision at the Federal Reserve Board. I have been spending quite a bit of time on policy-related matters concerning credit availability.

Chair LANDRIEU. Thank you.

Mr. FRITTS. Yes, good morning, Chairman. I am Steve Fritts of the FDIC. I am a 33-year veteran of the FDIC, commission bank examiner. I have worked in seven States throughout the country in my career, and I am currently associate director for risk management policy with the FDIC.

Chair LANDRIEU. Thank you, Steve.

Tom.

Mr. DAMMRICH. Good morning, Senator. My name is Tom Dammrich. I am president of the National Marine Manufacturers Association. We are based in Chicago, Illinois. We have about 1,500 members who manufacture recreational boats, engines, and accessories. There are actually over 30,000 small businesses in the recreational boating industry.

Ms. WALKER. Good morning, Senator. My name is Carolyn Walker. I am the proud owner and founder of a small business located in the D.C. Metropolitan Area. We provide services primarily to the Federal Government, but also to commercial industry.

Chair LANDRIEU. Thank you all very much. So we have our regulators, we have our banks, and we have representatives of small business, and I thank you all for making yourselves available and for sharing your experience today.

What I would like to do is start off with asking just a couple of questions. I am going to stay with you all as long as I can. I have got another meeting. I am going to leave you in the able hands of our senior staff person when I have to slip out, but I am going to try to stay as long as I can.

Just to get things started, let me get the staff to introduce themselves. Go ahead, if you would, Chris.

Mr. LUCAS. My name is Chris Lucas, and I work for Senator Snowe on the Committee.

Chair LANDRIEU. Who is the Ranking Member.

Mr. WALKER. I am Matt Walker, and I am the Deputy Staff Director for the Republicans on the Committee. I work for Senator Snowe, and I want to thank you for having this roundtable and for all of your hard work on this issue.

Chair LANDRIEU. Thank you very much.

David.

Mr. GILLERS. I am David Gillers from the Senator's Committee staff working on banking and finance issues.

Chair LANDRIEU. Okay. Let us start, if we could, with the small businesses, representatives of small business. What has been your experience in the recent 12 months, 24 months, basically, which has been a tough time? What are you hearing at the conferences that you are attending or any specific information or questions that you would like to ask either the regulators or the banks in terms of the difficulties of either you getting the credit or lines of credit being constricted, difficulty—and I know it has been a tough time for everyone, but I do not know if, Carolyn, you want to start, or Tom?

Ms. WALKER. I would be happy to. Thank you. And I would like to share anecdotally my personal experience over the past 24 months, which I think is a clear indicator of what many of my colleagues as small business owners have also experienced.

Our company provides services. We do not have our assets in capital. We are a labor-intensive business. We have been successfully delivering these services since 2002 and have had, thankfully, a very steady increase in growth for the first 5 years of our business. We hit a little decline in 2007–08 primarily due to some budget reductions from one of our major clients, one of the Federal agencies.

However, in 2009, we had an opportunity and won a competitive bid to provide services for the U.S. Census. So unlike many of my colleagues, 2009 proved to be a record revenue-generating year for our company.

Although we were excited and elated, it also provided one of the most difficult challenges. We had an opportunity to increase our payroll from our existing six employees to hire an additional 25 employees over the 18 months, which, of course, our key issue was financing that payroll.

My first reaction, of course, was to go to my local bank. I had been banking with them for 7 years. They knew me. I had had consistent cash flows coming through those accounts there. There is nothing more assuring to a small business owner or a banker than to see invoices paid by direct deposits from the U.S. Treasury. To my surprise, we were declined. The reason given, not that we were not paying our debts. We were making our payments on time. But the reason we were given was that we were overleveraged.

Why? Over the past 6 months, my personal credit lines as well as the business credit lines had been unilaterally reduced. So even though we were paying on time, I felt we should have been creditworthy, we were told that we were not.

Meanwhile, back at the ranch, I am required to deliver on this contract. I have got a signed contract in hand, a multi-million-dollar contract, which is a huge accomplishment for a small business, and I am struggling to hire these people, bring them on board, and meet my payroll.

For those of you who are not familiar with how the service industry works, you invoice and get paid once you have delivered the services. You hire people initially to do the work. Once it is delivered, your client is happy, then you get paid. So the end result is I am looking at a payment cycle of approximately 75 days that I now have to figure out how to finance a payroll that was running around $25,000 to $30,000 a month, which was going to peak at $199 a month—$199,000 a month, excuse me.

So being declined by my small bank, I was advised to try a larger bank, “Clients like to see you working with big national banks. They have got money available to them. Go to a big bank.” So I took my application, paid my $1,500, updated all my financials. This process of applying for loans is pretty tedious, and you have to dot all your i’s and cross all your t’s. But I was refused by the large bank, the reason being, “Well, we would like to see you operate at this increased level of revenue through the end of the year to prove that you can successfully do this.”

Now, mind you, we had been performing on this contract now for 90 days, and I was fronting this payroll through my personal assets and resources.

So then I was steered towards a special program that is funded by the county in which my business resides, a program designed specifically to provide financing for small businesses, emerging small businesses like myself. Well, you go through the same process. They were happy to have me as one of their clients. I was proving to be one of the largest clients that they had. Unfortunately, this program was designed for what they called emerging small businesses, so their assets were limited, and they were not able to provide the level of credit that I needed to fund my payroll.

So I took what little they were able to offer, and being an entrepreneur and very creative, I said, "Okay, fine. Now what are you going to do?" So, fortunately, having the confidence and respect of colleagues and other small business owners, I was offered personal financing from one of my colleagues who had a line of credit as a small business owner but was concerned that because she had not had to use that line of credit for the past 24 months, her bank was also threatening to reduce her credit line. So I was in need of credit; and she was in need of needing to use the credit. So, fortunately, there was a synergy there, and I was able to secure private funding and financing from her, another small business owner, to meet my payroll needs and perform on this contract.

Meanwhile, we have been doing very well. Twelve months have gone by. I have closed a year-end book with increased revenues, performed well; clients are happy. Interestingly enough, my original local bank has been bought out by a larger national bank who is now approaching me and asking me if I would please apply for a line of credit. I figured, "Aha, problem solved." Everything is looking good. I have demonstrated that I can perform. I have got a large national bank who is actually wooing me to come and apply for a line of credit, which I did. They approved the line—however, for such a small amount that it did not come near to meeting the needs that I had on a monthly basis. So I now have this small line of credit from a large traditional bank. I have got another line of credit from a non-traditional receivables-based program from my county. And I have got personal financing from a colleague, another business owner.

Needless to say, the costs of this hybrid solution far exceeded what was budgeted initially for this program and is cutting severely into my profit margins on the work that I am performing.

I am still working with the bank to try to get an increased line. I recently reapplied to get the small line that my now large bank offered. I went through the process, applied, paid for the application. Just last week, I received a nice letter saying, "Thank you very much. However, you have not fully utilized the line that we have given you, so why should we give you more?"

I say all this to say clearly there is a disconnect between the availability of capital and really, I believe, an understanding of the banking industry of what small businesses really need on a day-to-day basis in order to function.

Chair LANDRIEU. Well, thank you very much. I am going to ask anybody that wants to to respond. It is very typical of the stories and personal testimony that we have heard now in front of this Committee for over a year and a half. What I heard was if lines of credit by small businesses are not used, they are at risk of being withdrawn. But if you do use your line of credit and you overextend yourself, you cannot then get additional loans when you need it.

I also heard that even with a Government contract in hand, this borrower was still unable to access the credit that she needed. So from our perspective, as we are pushing the Federal Government from this committee and other committees to contract with minority-owned businesses, small businesses, emerging businesses, the Federal Government has goals that every department has to meet at about 23 percent. What I am hearing is even if we are successful pushing those goals out to get contracts from Federal agencies to small businesses like Ms. Walker's, even with that contract in hand, she is still having difficulty getting the financing she needs.

What that tells me is we have got millions of small businesses out here that do not do business with the Federal Government, do not have contracts in hand like this. What is their story? How depressing is their story?

Does anybody want to respond? Maybe start with the banks to see if this is familiar to you. Could you understand? Maybe this was a mistake. Mark, you must have customers like this that come in.

Mr. WILLS. Well, I do have a customer that I have had in the past that does Government contract work through the military. Please understand that with a community bank, you know, our bread and butter has been real estate lending, and community banks—and our community bank has grown through that.

Understanding and having the expertise for lines of credit are a little more difficult, and the larger the line of credit, the more difficult it is. Dealing with borrowing-based certificates and agings and understanding a company's agings and how they are paid is a little more difficult for us because we do not have the expertise.

Chair LANDRIEU. Well, let me ask this question, because that is a very good point. You said your particular bank makes its bread and butter, most of its profits off of real estate lending. That would be raw land or commercial development, residential?

Mr. WILLS. Owner-occupied real estate.

Chair LANDRIEU. Owner-occupied real estate.

Mr. WILLS. Our bank is pretty well diverse with a good portion of owner-occupied, some non-owner-occupied. We do one to four residential.

Chair LANDRIEU. Okay. So you are not used to doing the small business lending necessarily in your community. You do mostly real estate lending.

Mr. WILLS. No. Small business lending through owner-occupied real estate, and we do have lines of credit. I would say our lines of credit are probably going to be below $1 million.

Chair LANDRIEU. So what you are saying is when you do the small business lending, you require the collateral or the equity from a home loan to back it up? That is the way you are most familiar with lending? I am not——

Mr. WILLS. Not necessarily. We may use real estate—we will use accounts receivable and inventory. We will use a borrowing-based certificate that will have advance rates based on what their receivables are. But the risk is going to be less the smaller the line of credit is. And if you do not have the expertise to manage and look at borrowing-based certificates that the borrower is going to provide you on their accounts receivable and their inventory on a monthly basis and the ability to monitor the agings of the receivables, you need to shore that loan up the best you can. Sometimes we shore it up with equity in their office building or whatever they may have. We have even, you know, used liquid collateral that they may have. But, I mean, we do it all different ways.

Now, my understanding is that Government contracts are a little different. It is much more difficult for a bank to take a lien against a Government contract. It is much easier to do a UCC filing on someone's receivables and inventory if it is non-governmental. If it is governmental, it is a little more difficult—really a good bit more difficult, and, you know, if it is not done properly, you have got an unsecured loan. If you have got a $2 or $3 million line of credit and it is unsecured, I do not know that that is prudent from the bank's perspective if you cannot protect that lien.

Chair LANDRIEU. Right, that is an interesting point, and I am going to get to the regulators on that in a minute. But, Bill, can you respond?

Mr. LOVING. Yes, I would reiterate what Mark said. You know, lines of credit are a unique type of financing, and receivable-based in itself creates its own problems, and as Mark alluded to, the nature of the contract itself creates problems.

Now, I have a customer that is doing some Government financing—or doing financing with Government contracts, and it has worked well. But based upon their particular cash flow, they have not drawn against their lines to a significant basis. Now, I have not used that as a reason to decrease the size of the line because there could be a time when there would be a delay from a subcontractor that they receive payment from as well, that they may need that line. But receivable-based financing creates its own unique challenges, and like many community banks, we find that we can shore that up with other collateral such as real estate or even participating in the Small Business Administration—they have a cap program for accounts receivable financing that may be an opportunity as well.

Chair LANDRIEU. And how does that program work? Either Christine or Bill, do you want to talk about the cap program? Or do you know?

Ms. KORONIDES. Right now the cap program is a small fraction of our 7(a) lending program that specializes in helping small businesses with seasonal needs or receivables financing needs. It is not fully utilized. I think as Mark and Bill were describing receivables financing, different banks specialize in performing those functions, and our program has not been leveraged that broadly, but we are certainly taking a look at how to get that more out there.

Chair LANDRIEU. But just briefly describe the parameters of the program as it exists today. What is it?

Ms. KORONIDES. It is a regular 7(a) guaranteed lending program, so 75, 85 percent guaranteed, depending on the size of the loan.

Chair LANDRIEU. It is a 95-percent guarantee.

Ms. KORONIDES. Right now a 90-percent——

Chair LANDRIEU. Right now? What is the limit? And what is the limit you can borrow or access?

Ms. KORONIDES. I believe the limit is $750,000, but I would need to get back to you on that.

Chair LANDRIEU. So with a 90-percent guarantee on——

Ms. KORONIDES. We do not have a 90-percent guarantee rate, no. That authority expired.

Chair LANDRIEU. Okay, it expired, but you had it.

Ms. KORONIDES. Yes, we did have it.

Chair LANDRIEU. So you did have a 90-percent guarantee, and you could lend up to $750,000. It still was not utilized very much, you say?

Ms. KORONIDES. No. I think we see from SBA more of the working capital loans being financed through the SBA Express program. It is a little bit of a streamlined paperwork process, a little easier for our lending partners to work with. And as we have seen the different issues in the current economy, one of the proposals that the Administration has made is to increase the available size of an SBA Express loan from its current limit of $350,000 up to $1 million to meet the needs that different small businesses have currently for working capital and to help extend that 50-percent guarantee on those Express loans to additional lenders.

Chair LANDRIEU. Well, hopefully that will help.

Mr. Dammrich, let me ask you, what is your experience? Do you mind sharing it?

Mr. DAMMRICH. Thank you. I would love to. When you mentioned that small business is the engine of job growth, credit is the lubricant of that engine, and it has been sorely missing, certainly for the marine industry and other industries that depend on credit to finance inventory. Boat dealers buy inventory from the manufacturers to have on display, to sell when consumers come to the showroom. When a consumer is ready to buy a boat—and in most parts of this country, the boating season is 3 or 4 months—if you do not have the boat available and have to order it and wait 6 or 8 weeks for delivery, you have likely lost that sale.

So the inventory financing is critical to our industry, and it has dried up almost entirely. At one point there were probably a half a dozen national lenders that were doing inventory financing for the marine industry, the RV industry, the pool and spa industry, and a variety of other industries that depend on inventory financing. Today in the marine industry, there is one national lender who at this point probably serves less than half of the dealers in the industry. And the rest have a serious problem with their ability to get credit.

We have stories from many dealers. One dealer who visited 22 banks, was turned down by 22 banks, before he found a bank that would lend him 85 percent on the inventory that he purchased.

One of the things to understand, too, about the recreational boating industry is that 95 percent of all the boats sold each year are under 26 feet in length. They are trailerable boats. They are, you know, purchased by middle-class families. They are manufactured by middle-class workers. And if the dealer cannot buy the inventory, the manufacturer cannot produce the inventory, so there are no jobs.

We were very encouraged when the SBA initiated the dealer floor plan lending program under the 7(a) program, but it has been extremely disappointing in terms of the number of loans that have actually been made through that program.

We are now seeing a little bit of an upturn in boat sales. Certainly things have bottomed for the manufacturers, and manufacturing is picking up. But the manufacturers have two problems: one, a problem with credit, there are dealers not being able to give credit to buy the boats; and, two, as they begin to ramp—as demand begins to ramp up for their product, they have needs for working capital to buy the supplies that they need to manufacture the boats and are finding that difficult to get on that side of the equation as well.

We have seen credit lines reduced, credit lines withdrawn, interest rates doubled, which puts additional stress on these small businesses whose cost of carrying whatever little credit they have has just skyrocketed, providing further stress on them.

So I know that there has been some suggestions that there is a lack of demand for credit by small business. I will tell you that in the marine industry and the RV industry and other recreational industries, there is no lack of demand. There is clearly a lack of lenders.

Chair LANDRIEU. Thank you. That is my experience as well, and I am reading as many surveys as I can and listening to as many different areas of the country, and that is overall—even though you see some contradictory information coming across this dais, everywhere I go what I hear is there are small businesses out there that want to grow, that can grow, but just cannot get access to the money necessary to allow them to do so.

Let us hear from the regulators. I do not know who wants to start, Tim or Jon or Steve, about the small business lending activity you are observing in the banks that you supervise, what the difference is now as opposed to maybe a few years ago. Any thoughts that you might have on what has been shared? We will start with you, Mr. Long.

Mr. LONG. Sure, let me hit a couple things. What you are hearing is——

Chair LANDRIEU. Did you press your button?

Mr. LONG. Yes. Can you not hear me?

Chair LANDRIEU. Could you speak a little bit—just lean a little bit into it, if you would.

Mr. LONG. You know, some of what you are hearing is really what you see in a normal recessionary cycle. You know, we went through 15 years of peacetime where, you know, credit was flowing and credit was pretty easy to get. And, unfortunately, when you get into an economic downturn, you know, you have a couple things happen. Demand in many cases does decrease, so, you know, there is an issue there, and we can come back to that. But to Ms. Walker's and Mr. Dammrich's issue, what banks will do, what we see normally in a situation like this, there is a natural tendency for banks to tighten underwriting standards. And a good example on the receivable and inventory financing, you were looking for 85-percent financing on the inventory. You know, during times where credit is abundant, that is a number you may see. But as banks tighten up, you will see them tighten covenants. Maybe they will want to pull that back to 75, 70 percent on inventory. You know, 85 percent may be something you would normally see on a receivable. So you will see banks tighten up underwriting and ask for more equity, for, you know, different borrowing-based covenants, whatever. But it is unfortunate at times, but that is what we see during a recession. You see decreased demand, you see tightened underwriting, and you have some banks who are in a situation where they are just simply trying to protect balance sheet, protect liquidity, protect capital, and survive. So, you know, you have got a number of factors going on right now.

Chair LANDRIEU. Jon.

Mr. GREENLEE. I agree with a lot of what Tim just said. We have been following this matter since, you know, early 2008, late 2007, and trying to understand what is going on with lending and the economy in general at the Fed.

I would note our senior loan officer opinion survey we do periodically, we have seen a significant tightening in late 2008 in small business lending. I think 90 percent of the respondents said they had tightened their underwriting standards.

Chair LANDRIEU. But did they say why?

Mr. GREENLEE. I think it is a combination of what Tim said. It is a combination of their view of the economy, their view of their own financial situation in terms of trying to preserve capital, maintain earnings, maintain liquidity, and ensure that they operate a safe and sound bank. And when we have had these discussions—and we have had a lot of them at the Fed through our outreach efforts—you know, these are a lot of the dynamics we hear about, that credit is not as available on the same terms and in the same quantity as it was in, say, 2006 before we started to go into the recession. And some of that is what we would want to see as bank regulators as well, is, you know, I think part of the problem we had observed, there was too much leverage in the system in terms of people being overextended, and when we hit a recession, then there was a lot of negative fallout from that. And it is a natural tightening that the banks do.

Now, our most recent survey that we have gotten shows that there is no more new tightening of small business lending, so it is not getting tighter, but definitely the banks have tightened over this period.

Chair LANDRIEU. Well, Steve, I may want you to comment, but let us talk for just a minute about the fallout. How many community banks failed in the country—does anybody know—in the last 2 years? Or how many have been maybe put on a list subject to fail? I do not know who keeps that list, but how many are we talking about?

Mr. FRITTS. We keep that list.

Chair LANDRIEU. Okay. How many do we have on the list?

Mr. FRITTS. It is right at 800.

Chair LANDRIEU. Eight hundred?

Mr. FRITTS. Right at 800.

Chair LANDRIEU. There are 800 out of how many?

Mr. FRITTS. About 8,000.

Chair LANDRIEU. Okay. So it is about 10 percent that are on a list that are sort of subject to "if you do not get your business together, you may fail" list?

Mr. FRITTS. I would say typically they have exhibited some fairly significant problems. Sometimes it is credit. Most of the time it is. It would not always be credit problems. And they are generally on a corrective program with a regulator to get themselves back to financial health.

Chair LANDRIEU. And what would you say—how do you judge a bank's size? By its assets? What is the average size of this 10 percent of the banks that are on this list?

Mr. FRITTS. I do not have that stratification, but I think common parlance is banks that are under $1 billion in asset size are generally considered——

Chair LANDRIEU. Considered small banks?

Mr. FRITTS. Considered community banks. And we basically—the FDIC is the supervisor of the great majority of community banks. We supervise about—both of the banks here today are community banks that the FDIC——

Chair LANDRIEU. Because I would be very interested in this actually, and I am going to ask the staff to get the details of the banks that are on this list and what their average size is, because maybe there are some near $1 billion banks that are on this list, but if this list is comprised of very, very small banks in certain geographic areas or something like that that you could identify they are having, you know, problems—maybe some of them are in Detroit, Michigan, or Ohio and some areas.

My problem is that if regulators regulate for that list as opposed to regulating for the list of healthy community banks, we are not going to get out of this situation. This is what I am starting to think about.

Now, I know that you have to have one set of regulations, but you also have to apply common sense that if we do not get lending up through banks to these small businesses, we are not going to come out of this recession. It is about as simple as that, unless we can give them some other access to capital. But go ahead. I am going to be very interested in who is on this 10-percent list.

Mr. FRITTS. Well, I think it is a mix. Of course, the majority of banks are community banks, so they are going to be a majority on the problem list, too. It is just statistically probable. And I do not think there is any question, you know, we have been concerned about credit available at the FDIC for some time, and, in fact, we and the other agencies started to track—historically, we just got small business credit semi-annually, and we have started tracking that quarterly now, and we just got the March data. And, yes, credit has retrenched. For the 9-month period from June to March was the first quarterly report we got small business credit, which we measure by the size of the loans to business. It retrenched not quite 4 percent. But for community banks, it was essentially static, and community banks, by and large, have kept up their pace of lending to small business. And, in fact, they disproportion—of all bank lending to businesses, even though community banks make only about 10 percent of the assets of the industry, they make up almost 40 percent of the lending to small business.

So the community banks are small business lenders. That is what they do. That is their niche. And, by and large, they have hung in there. For the banks that have serious problems, obviously they may be constrained, and you do see some cases there. But keep in mind 90 percent of banks are still well rated, are well capitalized, and are healthy, and so——

Chair LANDRIEU. Steve, how does your testimony gibe with what Ms. Walker said? She had a 7-year experience with her community bank. She went in, she had a contract. You say they hang in there and they continue to lend. They did not seem to hang in too much with these two businesses.

Mr. FRITTS. Well, the statistics, those are the statistics I quoted you in the aggregate. Obviously, I cannot address individual—I would say a couple of things.

I would say Ms. Walker's example of having sort of a variety of financing vehicles that she used—family, personal credit cards—that is not atypical for small and emerging businesses.

Chair LANDRIEU. No. We know that is very typical.

Mr. FRITTS. And the other thing to remember is that commercial banks are secured lenders, like these gentlemen said, and typically they want hard collateral. That is what commercial banks do. They are lending on—accounts receivable factoring is a fairly specialized business that not that many commercial banks do.

Chair LANDRIEU. Ms. Walker.

Ms. WALKER. Yes, thank you. I just wanted to make a comment and ask a question. In everything that I have read and what I see, in this economy business growth and growth of the economy has moved from traditional manufacturing, where you would have assets, hard assets, and collateral. And I think moving forward this country's success is going to be in the space of technology and service providers. That is where the innovation is. That is where the growth is. That is where the opportunity is, not only within the United States but also globally.

My question and my concern is it seems that the banking industry, the banks and the regulators have not moved to understand how this service-based business operates and how to properly assess the viability of a business that is service-based and does not have traditional assets. As a service provider, I am not interested in buying brick and mortar to have as collateral for a loan. My investment is in the expertise and the technology of the people that I hire and the service that I deliver.

So how does the industry look at a business that has a successful track record of providing services and opportunities for growth and do what needs to be a good financial evaluation to see how secure is this business and how probable will it be that the loans are repaid.

Chair LANDRIEU. That is an excellent question, very well put. I would love to hear some response to that, either Mark or Bill. And how about the regulators commenting on that as well? But, Bill, as the independent banker representative, what do you think about that? Do you think that is an accurate assessment or do you think that banks are evolving to make better—you know, I would not say better or worse. It is not a matter of good or bad or better or worse. It is just adapting to new environments, you know, the different kinds of changes and the types of businesses that are emerging in our country today. What do you think about that?

Mr. LOVING. Well, again, small business lending is the bread and butter of the community bank model, and so I would say that while community banks historically have been secured lenders and we are the first secured lending arrangements, we always look at new opportunities and ways to approach a customer or a client in their line of business. Different lines carry different risk factors, and, yes, we have to evaluate all those risk factors in the equation because, in fact, what we are doing, we are extending credit of funds that are our depositors' and which we have to protect those funds. And so we have a fine line that we have to walk to try to satisfy the credit needs of the community as well as satisfying the needs for safety and soundness issues as well.

So in answer to your question, our banks are changing. I think we are, I think we are looking at new ways to approach this new industry that is coming about, because I agree, you know, we are seeing more service-based industries. But, you know, back to the model of the community bank, we historically have been secured lenders and need to look for ways to maintain that balance going forward.

Chair LANDRIEU. Tom.

Mr. DAMMRICH. Just a couple of comments that have been made. The normal advance rates on wholesale boat purchases by dealers historically has been 100 percent. And banks like hard collateral, and new boats are hard collateral.

Our issue has been the exiting of this inventory lending by larger national banks, not by community banks, which, frankly, I think probably most community banks do not have a great deal of experience with this type of inventory financing, which is why we thought that the SBA program might be a good way to encourage more community banks to take a look at this type of lending.

But there are several issues with the SBA dealer floor plan financing program that we think need to be addressed. One is that the program was announced as a 1-year pilot, and it is very difficult, I think, to entice a bank or a lender into a business for a 1-year program.

Chair LANDRIEU. It has to be longer.

Mr. DAMMRICH. You know, we really think that we need a 5-year program at a minimum. We think the loan limits need to be increased. They are currently capped at $2 million. We would like to see that increased to at least $5 million, which I believe your Committee has recommended.

There is a restriction on less experienced floor plan lenders in the program, so that if a lender has less than $15 million in floor plan lines or less than 5 years of experience in floor plan lending, they can only lend to current customers, which to us seems completely contrary to the goal of attracting new lenders to this floor plan space.

We would like to see increases in the size standards for the businesses, increased and made permanent so that, you know, boat dealers up to $14 million in sales could qualify for the program. And we would like to see the process streamlined significantly. We have had a few boat dealers that have been successful in getting loans through the SBA dealer floor plan program, but the amount of time and paperwork it has taken is an impediment, I think, to banks' participation in the program. But those who have been successful, few as they are, the program has been a godsend, and we think with some of these changes the program would provide more credit to more dealers.

Chair LANDRIEU. Well, thank you, Tom. It is very timely because we are going to be—hopefully on this third jobs bill, some of these ideas that you have just presented will be strongly considered by me.

Christine, I do not know if you want to comment, and then I will get back to you, Steve.

Ms. KORONIDES. Sure. We have definitely heard these concerns before around the dealer floor plan program, and the pre's as well, where this is a pilot program that we were able to flexibly put together very quickly in response to a number of lenders exiting that type of financing market. And it is a brand-new program. We stood it up less than a year ago. We have been working very hard to get the different lenders, our lending partners engaged. As, you know, a start-up pilot program, we had to control the risks around the program by concentrating on bringing in some more experienced lenders first. As we look to evaluate the success of the program and make a decision about its extension, we are definitely taking these factors into consideration and seeing what types of changes might be helpful to make it more broadly available.

Chair LANDRIEU. Okay. Mr. Fritts, you had something?

Mr. FRITTS. Yes. I think Ms. Walker's point is a good one, and I think the banking industry and financing, there is probably some evolution that is probably appropriate there where businesses—their primary assets are human capital and intellectual property as opposed to hard assets. And there are some things going on there relative to credit scoring for small businesses that are sort of evolving us toward that, because community banks are very comfortable making loans to their local doctors and lawyers and vets, taking their office building and all of their assets and tracking their predictable cash flows, whereas businesses like Ms. Walker's where it is not that traditional set of circumstances.

I would say this, though, a little note of caution as we evolve towards that. I use the example of the residential mortgage arena where some would say that the lending evolved very heavily towards credit scoring, discounting traditional underwriting and documentation, and I think some would observe that maybe there is always that balancing of making sure you have sufficient documentation and underwriting, and credit scoring has some limitations.

Chair LANDRIEU. Thank you very much. I am going to have to slip out. I am going to leave you in the able hands of David and the staff here to continue this line of questioning, and I really appreciate it. This has been very, very helpful. It is very, very timely. And this Committee is just staying focused like a laser on this issue until we can break through, you know, strengthen our programs, build strong partnerships with the community banks, which this Committee is very, very proud of the community banks in our country that have been trying to do good work in difficult times. But, you know, we continue to hear from small business owners everywhere, and unless we get, you know, Ms. Walker and Mr.

Dammrich the money they need, this recession is not going to end. I mean, it is about as simple as that. There is no magic here. There is really no magic. You know, you do not wave a magic wand and jobs are created. You get money, capital, in the hands of small business in America. They create the jobs. The numbers go up. Everybody goes back to work. It is just as simple as that. Big business is not going to lead us out of this recession. It is not going to be GE, it is not going to be IBM, it is not going to be Microsoft, it is not good morning be McDonald's. It is going to be the small businesses, the boat manufacturers, the marine operators, the technical companies out there. And this country, I will just say, has invested a huge amount of money in brain power, and if America cannot figure out a way to lend on brain power, which the taxpayers of this country—I am going to add up what this number is. Just over the last 20 years, if you add up what we invest from Pell grants to State taxes to local taxes educating our population, if we cannot figure out how to lend on that intellect and move this country to another place, we are never going to get out of the box we are in.

So this is sort of a paradigm shift that I see and many of my colleagues see as well. So we will keep plugging along.

I am going to turn it over to David. Thank you all very much.

Mr. GILLERS [presiding]. We will now turn it over to Chris and Matt for questions.

Mr. LUCAS. Thank you. I want to open this up to the regulators. Chair Landrieu talked about what may happen in the future, and I know that it is tough to look ahead 6 months let alone 6 years. But a few years down the line, if there is a slow economic recovery, what activity levels will you see in access to capital? Do you think that it will be back to where we were at pre-recession? Is it going to be a different environment? We talked about new business models and banks learning to adapt to lend to them. What sort of growth and change do you see in the community banking industry? How are they going to become more responsive—or are they going to become more responsive to small businesses?

Ms. KORONIDES. I am not exactly a regulator, but I can start us off. We have seen at SBA that—we have had a long history of great partnerships with community banks, but we have also seen community banks increasing as a share of our active lenders in the past year or year and a half, and we believe the tools that the Committee has equipped us with—through the Recovery Act and through a number of additional measures being discussed for the jobs bill, we will be able to work even more closely with community banks to help them continue to meet the needs and the growing and changing needs of small businesses.

Mr. LONG. I will add a couple things, I guess. You have got a couple things going on here. From one aspect, I think with one of the small businesses here, you have got the issue of underwriting got pretty loose. There is a natural tendency to pull it back. It needs to be pulled back. It should have been pulled back earlier. And, you know, clearly in terms of how they evaluate credit, I mean, every bank is different, and, you know, they do their thing.

You have got another situation where the business model, you know, there are banks exiting. You are right, Mr. Dammrich. On the marine industry, there is not a lot of lenders doing this right now. And in an effort to meet credit demands, some of our—a lot of our banks, particularly the large and mid-size banks, have moved that into a true asset-based lending unit to where they can meet those credit demands, and there are greater controls over that type of lending, receivable and inventory, because it is a high-touch, high-cost, high-overhead type of business. So that is an issue of where is that credit supply going, and clearly I think there is a space there, I think, that I would agree the SBA could significantly help with.

More to your question, maybe long term, look, there are a lot of things going on right now that the industry is facing, both community banks and large banks, with legislation, with FASB, trying to go to mark to market, with the accounting pronouncements, with 6667, everything coming back on balance sheet. Ms. Walker talked about one of the problems that she had accessing her loan was her credit lines. I mean, small business, when you look at small business lending, eight out of ten small business loans as defined on the Call Report, loans under $1 million, are funded by large banks. But that is not really where the small business lending activity is. It is in credit card lines, and it is in home equity lines.

And, you know, part of the problem with the credit card lines is the recent legislation that was passed a year ago. There has been $1.5 trillion cut in credit lines, in credit cards in the last probably 18 months, 24 months, and it is a direct result that the business model does not work as well under this new legislation. And these banks are going to have to find out how do they make the business model work, can they, and, you know, what do they have to do.

So I would tell you there are a lot of things facing the banking industry right now. In some cases, the old models are not going to work, and in many cases, you may have, you may very well have a very restricted access to credit going forward.

Mr. LUCAS. So you are saying that this is sort of the new normal, that it is a very real concern.

Mr. LONG. I actually said a lot of things.

Mr. LUCAS. I know you did.

[Laughter.]

Mr. LONG. I do not know what the new normal is. I do not think anybody does. I think we are in a very tenuous time right now. I think there is a lot of uncertainty out there. I think there is a lot of nervousness. You have got to get the securitization market opened back up. You have got to get credit flowing again. And, you know, there are just a lot of balls in the air right now that have to land.

Mr. LUCAS. Mr. Fritts.

Mr. FRITTS. Thank you. I would echo—there are a lot of things going on in the credit arena and financial services, obviously, as you are aware. And I do not predict the future. I would say, though, history has shown that the credit cycle almost invariably mirrors and trails the economic cycle. It really does not drive the economic cycle. It is a reflection of it. So history has shown that the credit cycle mirrors the economic cycle and trails it by generally about a year. So if that proves to be the case, as the economy picks up, the credit cycle will pick up.

And I just want to say a few things about the FDIC, what we have tried to do. We have tried to recognize this issue because I lived through the 1980s when it was, quote-unquote, the regulator-induced credit crunch, which we were very attuned to that, we and the other regulators, as we saw the credit cycle turning. And we have tried to get the message out there about fair and really a balanced approach to our supervision and understanding of what banks have to do. And we have done some very specific things relative to policy guidance to the industry about that balanced supervision and understanding what banks and customers are going throughout their as to credibility. And a couple other things that we specifically at FDIC have done, when we have had failed banks, whereas in the past you have had a lot of disruption to the community and the customers, we very heavily use loss share programs which are the least disruptive option to those communities and the customers at those failed banks. And the other things that we have done is we have engaged in and sponsored a lot of small business roundtables around the country. We have done in the last year and a half I think four or five in Louisiana and a lot of other States. So we are out there in the marketplace, in the communities, talking about this issue. We bring community groups and lenders together to discuss these issues. We saw this coming. We cannot change the economic cycle. We cannot necessarily change the credit cycle, but we are attuned to the issues here.

Mr. GREENLEE. Just to follow up a little bit, I think, from the Fed's perspective, as I mentioned earlier, we started getting concerned about what was happening with lending, you know, late 2007, early 2008, primarily to recognize the exact question you have raised about the economy, job growth, the concerns there.

We have done a number of things on the supervision side, as Steve had mentioned interagency, to, you know, reinforce the message to our examiners as well as industry, take a balanced approach, look at a borrower's ability to repay, do not treat everybody the same, you know, look at the facts and circumstances.

In addition to that, you know, we have set up the TALF program that provided a lot of financing to a lot of individuals as well as small businesses. And I think the most important thing, as our Chairman and our other Governors have mentioned, is, you know, the accommodative monetary policy we have in place, improving the economy, trying to get, you know, the economic growth to come back is going to be a key to this whole thing.

Mr. GILLERS. Thank you. I would like to turn now, if I could, to trying to get a sense of the bigger picture. Mr. Long, you mentioned that there really is a question of demand and there is a decrease in demand out there. We are obviously hearing from the small businesses that, despite whatever decrease in demand there is in general terms, in very specific case, obviously, there is still a real need. And the Senator mentioned in her opening statement that, independent of whatever general drop in demand there was, 36 percent of those who have actually applied for credit have gotten what they have applied for. So there is, in fact, a real need that is not being met.

What I would like to do and to take advantage of everyone we have in this room—and, Christine, I would actually like to start with you to get a sense of this big picture—but to go around and to give your own—or the institutions your represent—your perspective on this question of drop in demand, because this ultimately is, we think, one of the more important issues to really clarify.

Ms. KORONIDES. Sure, thanks. I think what we have seen as we look and talk to all of our small business and our lending partners and our Federal partners is that there really is not just one problem going on. I think that is consistent with what we have heard today. There is a documented decline in demand, according to the senior loan officer survey, and I think that part of that comes from businesses that are sitting on the sidelines that could be—you know, they are doing fine, they are paying back their loans, they are not growing and expanding at a rate that they could be right now in order to add jobs to the economy, and they are uncertain of the economy and uncertain of the outlook. So there is, on the one hand, a part of the market that has a lower demand than previously seen.

At the same time, there is a huge issue of risk aversion on the part of the banks, and those are things that the SBA guarantees can definitely help with. There are credit qualification issues as people see their assets declining in value and their collateral declining in value, and at the same time a pressure to shore up collateral on lending.

At the same time, there is another issue we heard about today with capital availability in community banks and issues about making sure that they are prepared to expand and grow and ready to lend more to small businesses.

So those are the three problems we have seen, and I think that kind of sets the framework for looking at—there is not going to be one solution to the availability of credit at this point. There are a number of different problems out there. There are a number of different proposals that have been made to address these different market issues.

Mr. GILLERS. And I would also be interested in what the banks are experiencing just on the ground. Are you seeing, in fact, as the senior loan officer survey suggests, a real drop in demand?

Mr. WILLS. I would say demand is very weak. At our bank in Augusta, Georgia, the demand is very weak. We do see our pipeline is growing a little bit. You know, I want you to understand. We are a bank that is very pro-small business. It is the backbone of our bank. We work very closely with the SBA, with SBA 504 loans, and we are seeing some of it come back.

But just to give you some of my experience with the clients that I deal with, I try to build a good relationship with my clients, and I try to understand their business. And I work with them, I work with their accountants. You know, a lot of these business owners have kind of gone over to the sideline. They are fairly debt averse. They are not ready to bring on additional debt at this point. They are waiting on making equipment purchases. They are waiting on expanding their buildings.

At the same time, you know, as their revenues are going down a little bit, they are looking at what expenses they can cut. They are learning that they are working with less and doing just as well.

So I think there is going to be some—we are going to get the equipment purchases. We are going to get expansions in buildings. I think you are also going to see, with the way that property values have gone, you may see them moving into other buildings. There are a lot of vacant buildings out there in our market that are great opportunities for businesses. And I think you are starting to see some recognize it, because I am starting to get those questions.

But they are learning to work with less and doing it well, and that is going to be a challenge going forward. But we are seeing demand going up a little bit, but it is way down.

Mr. GILLERS. And so this leads then to the solution section, that the Treasury Department and the administration have obviously proposed a $30 billion small business lending fund. But it is premised on the idea that capital purchases or capital infusion for the banks will, in fact, help small businesses. And I guess the question, in light of what we are now saying, that there really is a drop in demand by small businesses, the question that I would be curious to know responses, both from the banks and from the regulators, if, in fact, there is a drop in demand, will a—and we do not have to discuss the real specifics of the proposal. But, you know, in its essence, will a capital purchase program, will a capital infusion for small banks really help bring demand back to the small business sector? Christine, go ahead.

Ms. KORONIDES. Sure. As I mentioned before, I think there are a number of different problems. There is demand, there is capital availability, and there is risk aversion, and there are different solutions that address those problems.

Now, the Treasury proposal really does focus on infusing community banks with capital that gives them an incentive to make more small business loans. That program works on the general premise of providing low-cost capital based on the increase in small business lending that community banks do.

Now, that interest savings for the community banks can be passed on to borrowers, and that is where we really see an increase in demand, almost a sale on loans. The interest rates can come down, but the capital is available at a lower cost. We have seen that be very successful in the Recovery Act SBA programs. The fee relief that given to borrowers kind of puts the SBA loan on sale, and that helped. As you know, our Recovery Act lending has increased from the weeks before the Recovery Act was passed, has increased by over 90 percent. So it is a combination of addressing the different factors. There is an issue with capital availability that the Treasury proposal addresses. It can be translated into increased demand from businesses. The other measures that your Committee has discussed, that the President has discussed, like extending the 90-percent guarantee on 7(a) loans, extending the fee relief, go to address demand; they go to address risk aversion. Increasing the loan sizes, which the Committee has taken a great leadership role in, will help address risk aversion for part of the market that currently SBA cannot serve, so borrowers that might have qualified for conventional non-SBA credit previously might be good candidates for guaranteed loans now that they are sized out of the market.

Thanks.

Mr. GILLERS. Bill.

Mr. LOVING. As we said earlier, credit usually follows the increase in an economic cycle, and while credit demand may be down at the present time, the availability of this capital for many community banks will be a stimulus to increase small business lending. And as we noted, you know, there are incentives to use a fund with a reduced cost. If you participate and you do not increase your small business lending, then there is a disincentive to do so.

So as it is structured, and not getting into specifics, but as it is structured, I think it would be a great opportunity to provide capital to community banks who many of them need it today with the challenges they have been facing, with the GSE issues on the stock, and other issues that have decreased the capital that is available to them.

So I think it would be a good program. Once demand does increase, there is going to be a need for additional capital.

Mr. GILLERS. And I am curious to get the regulator input here, knowing, of course, that you are not going to make an official statement on the proposal, but in general terms, you know, again, in its essence, is a capital infusion program what is needed at this point? Is that going to address one of the three issues that Christine has pointed out?

Mr. GREENLEE. I think from our perspective, to the extent that capital constraints are, you know, causing banks not to lend, this was a possible option that could be considered to alleviate that. Does it spur demand? I think improving the economy is what really is going to be the key to improving demand for credit.

Mr. LONG. Our position is we are fine with the program. We have testified to that, but I agree it is not going to—you are talking about $30 billion. If you look at the five banks that we had in the TARP program in the fourth quarter of 2009, during that quarter they put out $420 billion in loans. That is $32 billion a week, those five banks alone. And we had $4 trillion in unused commitments on our national banks' balance sheets.

So, you know, it is an issue of there is increased demand. There is no question about that, and that is what happens during a recession. The spot that businesses need help are the businesses that were probably on the margin during good times, and we clearly—we were up testifying on this, and I think all of us have spent time on the Hill of you have got constituents who have been with the bank for 5 or 6 years, and then they go into the recession and they do not get their loan renewed. Well, maybe that loan was on the margin during good times, and that banker looked at that loan and said, "You know, we are going into a recession. I do not know if this borrower is going to do very well inside this recession, and I do not want to bank them." That is the piece that appears very unfair to the borrowers. They have been borrowing there. They have been paying. But, you know, if their balance sheet is not strong enough to survive a recession, they are not going to get a loan in a recession.

So, you know, if this will maybe help with that, I mean, we are on record as fine with the program, we support it. But as Jon said, you know, demand and the economy have got to turn around before this gets fixed.

Mr. GILLERS. If I could just do a quick follow-up to that, the issue that Jon also spoke about is that the Fed has tried other measures to actually deal specifically with the economy, monetary policy, and I guess it is another question. If we are skeptical or if one is skeptical that this $30 billion fund is not going to be a cure-all, then from a regulator's perspective, looking at this issue of demand, what else should we be looking at? Setting aside, of course, your understanding that the Fed has already mentioned some suggestions.

Mr. LONG. Well, I will just say this—because I talk to hundreds of bankers, and I have asked them, specifically groups of bankers I talk to, Are you willing—are you open for business? Are you willing to make loans to creditworthy borrowers? And the answer is resoundingly yes. But the issue is the creditworthy borrower, you know, on the risk scale, you know, where do they want to be.

There are two ways to juice loan demand. One is to reduce rates, and, you know, you are obviously not really able to do that in this environment. And the other is to relax your underwriting standards, and that is really the last thing that needs to be. That is why we are where we are at, is because underwriting standards got too loose.

So those are the only two ways to juice loan demand artificially, so I would say again that I agree with my colleague from the Federal Reserve, you have got to get the economy to turn around, and you have got to get things working.

Mr. GREENLEE. I would again just come back to I think the main thing is the economy. We are trying to understand this in more depth all the time. We are doing these outreach—public and private outreach efforts to try to understand what are the issues here and thinking are there other tools. But I think it is a balance here between preserving the safety and soundness of the banking system and individual institutions and promoting the economic growth. And I think Tim is absolutely right. I think you could reduce underwriting standards, you could do things to make a lot more loans, but in the long run, that may not be the best thing for the economy more broadly, because I think we came out of the—we are coming out of a situation where we had very liberal lending standards in certain aspects of the economy that we are now working our way through. And so this is very painful at this point, and we do not want to go back, you know, and have to go through that again in a few years.

Mr. DAMMRICH. Thank you. Everybody talks about the demand for credit is documented to be down, and I would say even in the marine industry, probably the demand for credit is down. But there is still a significant unmet demand. And no one has said it but I seems to be implied in some of the comments that there is plenty of supply, there just is not enough demand. And knowing that there is a significant unmet demand, at least in recreational boating, the RV industry, and some other industries that require inventory financing, how do we get this excess availability to where the unmet demand is?

Mr. LUCAS. That is a good question. I want to refocus a little bit back to the small business lending fund. I think that one of the big questions that has been raised about it is whether banks actually use it, and that is the main question, because if banks do not use it, as well intentioned as it might be, it is going to be perceived as a failure. And since we have a couple community bankers here, one of the concerns with this program has been that although it is not being taken from TARP funds, it is TARP-like, and banks may suffer reputational damage if they take this in the future.

What are your perspectives on—I am not going to ask you whether your bank would take these funds, but what type of program would meet your needs?

Mr. LOVING. Well, as you stated, it is not TARP, and I think it needs to be clear that it is not TARP, because there are reputational issues surrounding the possibility of accepting it.

I think the guidelines have to be clear, concise, and permanent. The one thing that we all as consumers, and when we enter into a contract, we like to know what the rules of the game are going to be from the beginning to the end, and that was not the case with TARP, and so I think it has to be clear, concise, and a known set of rules for the banks to participate. And, yes, it has to be completely separate and apart from any semblance of a relationship to TARP because of the possibility of reputation.

Mr. LUCAS. Thank you.

Mr. WILLS. I think it is going to also be important what the requirements are going to be as far as the lending side. If we put benchmarks out there that banks have to meet, we are going to have another challenge with the type of loans you get. So we have got to be careful that it is done right and that there is the proper incentive for the banks to go out. I definitely think it is a good program.

It is going to be for the banks that do not have the liquidity or do not have the—or their capital has been stretched to a point that they are challenged right now in making loans. So it will depend on, you know, will it just be a funding isuse, or will it be Tier 1 capital to allow them to leverage that out for loans? You know, if you have got stretched capital already, you know, just having a funding source is not going to help you any. So it depends on how it comes.

Mr. WALKER. It is interesting you mention that. One of the criticisms that we have heard is that the benchmark being used is the amount of lending that took place in 2009 for the banks and that they would use that as a benchmark to determine the increase, the percentage increase. That begged the question, What if the banks would have increased lending anyway, not as a result of this program, but as the economy gets better and more lending takes place? Would it be somewhat of a windfall for banks? I am not taking that argument. I am not saying that argument is correct, but that is an argument that has been made.

So I guess my question to you is: What are your thoughts on that, number one? And, number two, do you have another idea for another benchmark or some type of benchmark that might be more relevant?

Mr. LOVING. Well, in response to your question, I think the banks that would participate in the program need the capital to increase their lending anyway, so if they did not participate in the program, they may not have the necessary capital to increase their lending beyond the base that was set for the 2009 cycle.

You know, I think, again, as a bank needs the capital for growth, as you said, included in Tier 1 so that it can be leveraged to expand the borrowing base, the banks that participate will need that capital. You know, the supply-demand side would not dictate taking the capital if you could not put it to use because there is a financial cost for doing so.

Mr. GILLERS. I just wanted to briefly share with the regulators and the banks—oh, excuse me. Christine, did you want to—sorry.

Ms. KORONIDES. I think that as these gentlemen covered it, it is a very important program, and there are a number of community banks that have stuck up to say that they would be willing and would need to take advantage of it. I believe the baseline that has been set out—one of the important things that I believe Mark just mentioned is making sure that it is data that everyone has already collected. So in order to establish a common baseline, we went to Call Report data on this. I know Treasury worked very hard to look through what does everyone already have, how can we measure from a common place. And the Call Report data on small business lending is the only common baseline that was out there that everyone could quickly and easily leverage.

Mr. GILLERS. I was about to share a glimmer of good news for the regulators. As you are probably aware better than we are, we have been in touch with a good number of banks recently in some conferences, and there have been some workout groups that bankers are getting together talking about issues of regulation. And the glimmer of hope or of good news is some bankers have come back and have just finished examinations, and they have said it is as if the regulators have been told to kind of calm down a little bit.

That said, we are still hearing reports from a good number of banks. The vast majority are still having a tough time with the examinations. And, again, as I am sure you all know better than we do, it breaks down into about three different categories of complaints.

Number one is the explicit message from the examiner to the bank that, despite whatever regulatory requirement of risk-weighted capital, say it is 10 percent, even though regulatorily that is what is required, I am telling you I am not going to accept anything less than 12 percent. So there is the explicit spoken message.

There is an implicit message that is often suggested to the banks—and, again, this is the reports that we are hearing. It is an implicit message that, you know, really you should shore up your capital.

And then the third issue that we are hearing from banks is even if there is no explicit or implicit message, there is a great fear. There is a great fear among the banks that at some point capital requirements will shift and the regulators will change their requirements. And the Senator mentioned the interagency statement on meeting the credit needs of creditworthy small business borrowers, which was a very strong step in the right direction. This, of course, is in addition to in the fall of 2009 the policy statement on prudent commercial real estate loan workouts, which we also appreciate. It seems, however, that these interagency statements are not necessarily having the intended effect.

And so the question is just assuming—we do not have to kind of get into the—but assuming that these three reports that we are hearing are still true, how do we as the Government, how do we as regulators deal with those complaints? And I think I am most interested in how do you deal with the real fear that bankers have that capital requirements will change.

Mr. LONG. I will start. You know, we have had this conversation a lot up here, and in the case of—you know, none of the regulators—I will speak for the OCC, but I think I can probably speak for my colleagues at the FDIC and the Fed, too. You know, we do not have a secret number that the old 10 is now 12. We go into every bank, and we look at it individually. We look at that loan portfolio. And in some cases, you know, if you have got a banker that has put 500 or 600 percent of their capital in commercial real estate, they have bet the farm. And in some cases, they may need that capital just to survive.

So this idea that the regulators are arbitrarily coming in and raising PCA minimums—and those are minimums. Those are for well-run, clean, well-managed banks. So, obviously, if it is not a well-run bank or they have taken on too much risk or they do not have good risk management practices, we are going to raise those minimums. And it is completely within our rights to do it, and that is what we do. But we do not have a standard across-the-board 6 is now 8, 8 is 10, and 10 is 12. We look at each bank individually. In some cases, they need the capital to survive. In other cases, we think what is coming at them—you know, maybe they have not realistically assessed the situation, and we want them to shore it up in a space where they can before it is too late. So, you know, it varies, but every bank is different. And we do not have examiners just out there arbitrarily raising capital on banks. It goes through layers of review, and it is signed off on at the highest levels of the organization.

So I am a little surprised at the comments we get, and when you have a conversation with the bankers, you know, for the most part they understand it. I will tell you, though, you know, in terms of an exam team going into a bank and that banker is in denial and they are not recognizing what is going on around them and they do not realize that the real estate values have fallen and that the loans are not paying and they are not funding their reserve and classifying their loans, that exam can be an unpleasant experience for them. There is no question about that.

Mr. GREENLEE. I will just echo what Tim said. We have not changed our minimum expectations for capital requirements. We expect banks to hold capital for the risks and the quality of their management. And as Tim alluded to, a number of smaller banks in particular have large commercial real estate concentrations that have proven to be problematic. We expect them to hold capital and manage those risks appropriately.

So we have not changed any of our standard requirements in this area, and similar to what they do at the OCC, we have a thorough review process, a vetting process. If we are here in Washington and we meet with bankers or others that have concerns about this, we do follow up and look into the situation as much as we can. And usually my experience is similar to Tim's. When we get down and then really talk about it, people understand the analysis we have done and why we have the expectations we do.

Mr. GILLERS. And I am not necessarily asking whether, in fact, you have changed your capital requirements. What I am curious about—and the message that we can bring back to bankers who have a very real concern that there will be a regulatory shift, I guess my question is: How do regulators address these fears that banks have? Again, I am staying away from whether or not you have technically made the decision. Obviously, you have not. But how do you address their fears aside from saying, "Well, we do not do it"?

Mr. GREENLEE. I think one of the key ways we do it, I mean, obviously we go through the examination process and explain ourselves and give them a chance to ask questions and iterate with us on these things.

The other thing we have done a lot of is outreach to the industry to explain the expectations. Part of that commercial real estate workout guidance is about, yes, working with borrowers, but the other key message in there is recognize your problems and deal with them in a timely manner. We have tried to get that message out to people that, you know, you need to be realistic about the quality of your assets so that your business, your environment you are operating in, make the appropriate plans and management actions to preserve the safety and soundness of the organization. So that is one of the key things we do.

Mr. FRITTS. On the capital issue, I think it is important, just as these business people understand, first and foremost capital is a business necessity. It is not a regulatory construct, you know, that we make up, except in those few cases where bankers are in denial, and I think most are not, the great majority are not. In fact, the great majority of banks are reasonably healthy and have weathered some hard economic times reasonably well. For those that are in most severe need of capital, those are the ones that are finding it the hardest to get.

I guess there are some positive signs that capital is starting to flow into banking, particularly the community banking sector. It is becoming a little bit more available, as I think the general investor community has started to think that maybe the economic and credit cycle have bottomed out. So we are seeing and hearing a little bit of good news, and the growth in problem loans and that sort of thing has sort of stalled out. Having lived through the 1980s in Texas, the late 1980s in Texas, I would say this: that, you know, we saw a lot of bankers in denial then. They were not recognizing their losses. They were not dealing with their problems. We are not seeing that nearly as much. I will give you a good example of the State of Georgia. The bankers there have had a very rough time. They are fighting through it, and I would say at least some there tend to be a little bit more optimistic at this point. That is not to say that we are out of the woods. We are not. But I think you are hearing more of optimistic.

But the reality is our exams do not create the economic reality. In most cases, we are validating the bankers' own credit ratings, their own financial statements. If they have had bad losses for 2 years and they need capital, that did not have anything to do with the regulators. That had to do with the economic circumstances.

Ms. KORONIDES. One of the things we have heard from our lending partners is during this time as they are looking at their capital reserves, the 90-percent guarantee and actually any guarantee on an SBA loan, the lenders do not need to reserve capital against. So one way that we have really helped the banks weather this uncertainty is by raising the SBA guarantee and allowing them to more comfortably use the capital that they have.

A proposal that addresses the coming risk, as Tim and John mentioned, the banks' exposure on commercial real estate, particularly owner-occupied small business commercial real estate, is a growing concern. One of the proposals your Committee has put forward and the President has put forward is to open up certain SBA lending products to allow banks to use a partial guarantee on those loans and in that market to help address some of their capital concerns.

Mr. GILLERS. And before you go ahead, if you do have comments on the 504 commercial real estate refinancing piece that Christine was referring to, we would love to hear them.

Mr. LOVING. I do not, but I have used the 504 program in the past, and it is a great program. But in answer to your question and comment, you know, how do you eliminate the fears of the bankers, capital is, as you said, a necessity in our business, and I and our institution have had an outstanding relationship with our regulator, with the FDIC, and we appreciate the job they do. And I think the way to eliminate the fear across the country—because there are parts of our country that are experiencing more problems than others. You mentioned the Georgia area. You have got Michigan, Illinois, California. There are various pockets of our country that are experiencing significant problems, and I would say a continued balanced approach from the regulatory environment, you know, the guidance that has come out, a continued balance of that approach of looking at the credits, you know, looking at credits that go beyond just the surface and look at the guarantors and, you know, what the supporting factors behind that are.

When we see that that is really taking place, then I think the capital fears will be eliminated to some degree.

Mr. DAMMRICH. I would just make a quick comment on the 504 program. A number of our members have suggested that if that program could be modified to allow refinancings under the 504 program, that would be very beneficial both for dealers and manufacturers.

Mr. GILLERS. Well, thank you very much, all of you, for your participation. As the Senator mentioned, the record will be help open for a week, so if any of the participants have suggestions on how to help get small businesses out of the crisis they are in, we would love to hear them. Thank you all.

Mr. LUCAS. Thank you very much.

Mr. WALKER. Thank you.

[Whereupon, at 11:40 a.m., the Committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

STATEMENT FOR ROUNDTABLE ON "The State of Small Business Lending: Identifying Obstacles and Exploring Solutions"
Senate Committee on Small Business and Entrepreneurship
Ranking Member Olympia J. Snowe
June 8, 2010

Thank you, Chair Landrieu for holding this roundtable on efforts to unlock the credit market for small businesses.

I thank all of our panelists for taking the time to join us today to discuss an issue that has far-reaching impacts for our constituents and for our efforts towards economic recovery. And I would note that Chair Landrieu and I have worked together hand-in-glove in a bipartisan fashion to support policies that would increase small business access to capital and I thank her for such constructive efforts in this area.

It is essential that we continue this work so that we can pass a small business jobs bill as soon as possible. To that end, I recently wrote President Obama advocating for passage of a comprehensive small business jobs bill before the July 4th recess. While last week's report on unemployment showed a slight drop in the unemployment rate from 9.9 percent to 9.7 percent, just 20,000 of the 431,000 jobs added were in the private sector. To fully drive this economy into recovery, we must begin to see small businesses start hiring workers again and giving these firms access to affordable capital is the first step in this process. A package that combines tax cuts with small business friendly policies such as increasing SBA 7(a) and 504 loans sizes from $2 to $5 million, as well as increasing microloans from $35,000 to $50,000 will help create jobs and reduce unemployment.

While small businesses are still in dire need of help, we have recently seen two pieces of good news. The April Federal Reserve Senior Loan Officer Opinion Survey finally shows banks starting to loosen credit standards for small businesses after either tightening or maintaining their credit standards for three

years. In addition, the SBA has continued to help fill the access to capital gap left by the reduction in conventional lending. The increase in guarantee rates and the fee reductions Chair Landrieu and I supported in the Stimulus led to an over 90 percent increase in SBA lending since the passage of the Recovery Act.

One concern I do have is that these provisions, after being repeatedly extended by Congress, expired at the end of last month. It is essential that we find budgetary offsets for these programs so that they can continue in a responsible manner. I, along with Chair Landrieu, will do everything within our power to continue to extend these programs so long as small business lending continues to be depressed.

To the regulators on our panel, I urge you to closely examine the plight of small businesses. As Chairman Bernanke said last week, "...while maintaining appropriate prudence, lenders should do all they can to meet the needs of legitimate, creditworthy borrowers." Bank regulators must work with bankers in a responsible and constructive manner to ensure that small firms continue to have access to capital. It is my hope that we can use this opportunity to elevate the needs of small businesses and amplify those needs so that entrepreneurs' voices are heard in Congress and with this Administration. Thank you, Madam Chair.

Questions for the Record for Mr. Jon Greenlee:

1. On February 10, 2010 the Federal Reserve issued guidance to federal and state bank regulators that was intended to assist banks in responsibly underwriting loans to small businesses.
   This guidance asks regulators to "...take a balanced approach in assessing the adequacy of an institution's risk management practices in its small business lending activities." In addition the Federal Reserve asks regulators not to, "...adversely classify loans solely due to a decline in the collateral value below the loan balance, provided the borrower has the willingness and ability to repay the loan according to reasonable terms."
   This was intended to both help banks facilitate loans to small businesses and still continue to be regulated in a sound and financially responsible manner. On paper, these regulations would seem to be a positive force, allowing bankers to extend credit to distressed, but viable, small business borrowers.
   As we all know though, the real effect of these regulations is in how they are enforced by bank regulators. Since the Federal Reserve made this announcement, have you seen any changes to the small business lending market?

Questions for the Record for Mr. W. A. Loving:

1. One term that has been raised quite frequently in media reports is the problem of "technical default." A technical default occurs when a borrower is in violation of one of the terms of his or her loan or line of credit, for example, the borrower has insufficient profits or revenues but continues to make payments.
   During better economic times, banks could ignore this "default" even though they have the right to consider it a breach of the terms of the loan or line of credit and demand immediate repayment. During the past recession though, banks often used the pretext of technical default to call small business loans.
   In March 2009, the Small Business Committee held a hearing that focused on credit lines. At the hearing a New Mexico car dealer, Mr. Bob Cockerham testified that, due to a technical default, his line of credit which he used to finance his inventory, had been pulled. In his case, a business that was still profitable and at one point had 80 employees, was forced to lay off workers and close down operations, despite his ability to still make payments on his loans.

Do you have a historic perspective on what attitude the banks have taken towards their borrowers in technical default prior to the current credit crisis? Have banks become quicker to pull lines of credit in order to reduce their loan exposure?

Questions for the Record for Mr. Mark Wills:

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   Do you have a historic perspective on what attitude the banks have taken towards their borrowers in technical default prior to the current credit crisis? Have banks become quicker to pull lines of credit in order to reduce their loan exposure?

Questions for the Record for Ms. Carolyn Walker:

1. There is a common misconception that a bank's extension of a loan to a borrower is a simple transaction. The borrower applies, the lender approves, and the borrower makes payments until such time as the debt is paid off.
   In reality, the extension of a loan marks the start of a partnership between borrower and lender, one which is hopefully profitable and mutually beneficial. Sometimes however, the relationship can turn exploitative, and this is one of my main concerns about the current difficulties small businesses are having with their credit.

Do you feel that your bankers have treated you fairly, as partners in a symbiotic relationship or do you feel that they have used the credit crisis as an excuse and pretext for reducing your access to capital?

Questions for the Record for Mr. Thomas Dammrich:

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   In reality, the extension of a loan marks the start of a partnership between borrower and lender, one which is hopefully profitable and mutually beneficial. Sometimes however, the relationship can turn exploitative, and this is one of my main concerns about the current difficulties small businesses are having with their credit.
   Do you feel that your bankers have treated your industry, as partners in a symbiotic relationship or do you feel that they have used the credit crisis as an excuse and pretext for reducing access to capital?