

May 18, 2010

Statement for the Record

By the

AMERICAN BANKERS ASSOCIATION

For the Hearing Before the

Committee on Financial Services

United States House of Representatives



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Chairman Frank, Ranking Member Bachus, members of the Committee, the American Bankers Association (ABA) is pleased to submit for the record this statement in support of the proposed Small Business Lending Fund and proposals for state small business credit initiatives . The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's \$13 trillion banking industry and its two million employees.

ABA supports H.R. 5297, the Small Business Lending Fund Act of 2010, which was recently proposed to stimulate small business lending. This bill can help community banks meet the needs of small businesses across America. As Congress considers efforts to help small businesses, it is important to keep in mind that most banks are small businesses in their own right. In fact, over 3,400 banks (41 percent) have fewer than 30 employees. Small steps taken by the government now can make a huge difference to small banks, their customers, and their communities – keeping capital and resources focused where they are needed most.

The success of the Small Business Lending Fund will depend in part on whether those banks that can benefit the most will be allowed to participate. In particular, viable banks that are located in the hardest-hit parts of this country should be allowed to participate. It is these banks in economically-challenged areas that are the ones likely to have the greatest interest in this new fund. Since banks are a reflection of their communities, they are suffering right along with the communities they serve. Business failures and unemployment have impaired credit quality and increased loan losses. As a result, capital – which underpins every loan made by banks – has been stressed.

Moreover, in hard-hit areas, meeting the needs of borrowers has been made more difficult by regulatory pressure on banks to maintain (and even increase) capital-to-asset ratios. Given the severity of the downturn, it is very difficult if not impossible for community banks to find new sources of capital. Thus, for some banks, reducing the size of the bank often becomes the only viable alternative for maintaining regulatory capital-to-assets ratios.

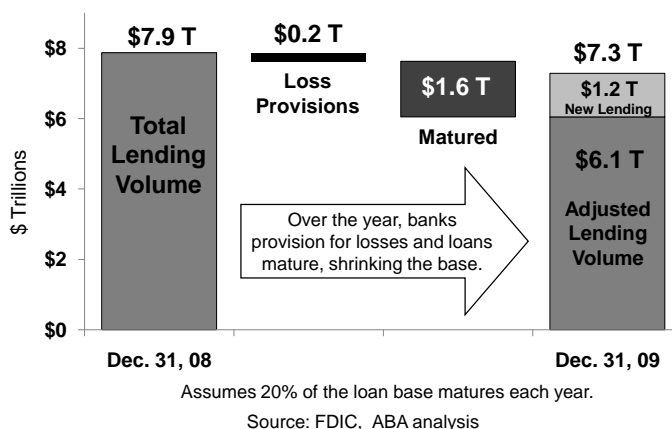
The proposed new fund can help reverse this need to downsize and help stimulate lending to small businesses. With a comparatively small investment from Treasury, these banks will be in a better position to provide credit where it is needed the most, and hard-hit areas will recover faster. ***It is critical that Treasury judge a bank's application by how strong the bank would be with the Treasury investment.*** In this way, taxpayers would be protected while the program's reach is expanded.

The fund also would be more effective if it recognized the dynamic nature of a bank's loan portfolio. H.R. 5297 would reduce the required dividend payable to Treasury (providing an incentive to lend) based upon the degree to which the volume of outstanding small business loans each quarter is greater than volume of lending at the end of 2009. In determining the base lending volume, the bill subtracts out loan losses that the bank has charged off. This is appropriate because the bank would have to ***more than replace these loan losses*** to show an increase in loan volume.

What is ***not*** recognized, however, is that ***roughly 20 percent of a bank's loan portfolio is repaid each year. Under H.R. 5297, a bank would not be viewed as increasing its small business lending until it made enough loans to replace that 20 percent.***

To illustrate this, at the start of 2009, total loans across all business lines on the books of banks totaled \$7.9 trillion. Over the course of the year, banks set aside \$248 billion in provisions for anticipated loan losses. In addition, a rough estimate is that at least \$1.6 trillion of loans matured or were paid off. If banks had initiated no new lending, the year-end loan volume would have been \$6.1 trillion.

Banks Lent \$1.2 Trillion in New Loans in 2009



Just to stay even with last year, banks would have to originate over \$1.8 trillion of new loans. In normal times of economic growth, with strong loan demand and low loan losses, this is possible. But it is impossible today with the many economic challenges, such as 61,000 business failures, 4.7 million jobs lost, and a 10 percent reduction in business inventories. It is remarkable, in this context, that banks were able to originate about \$1.2 trillion in new loans, for a total of \$7.3 trillion at year-end 2009.

In regions where the economy has yet to emerge from this recession, replacing loans that are maturing with new loans would be a monumental feat – let alone lending beyond that level as the program requires. Simply looking at loan volume from one period to the next misses a large part of the lending that banks are doing every single day. Thus, H.R. 5297 should recognize *all* of a bank's small business lending. By doing so, it would make the program far more attractive, particularly in economically hard-hit areas.

It is vitally important that the new program be removed from TARP, both in form and in substance. The statement in H.R. 5297 regarding the distinction between TARP and this program is helpful, and we urge Congress and the regulators to communicate clearly that the small business lending program is in no way a bailout.

Another idea that we also find very promising is the state small business lending initiatives. Efforts like this in Michigan, for example, have shown great promise over the years they have been in place. Under the Michigan Strategic Fund (MSF), the MSF deposits the cash into an interest bearing account with that lender and this account will then be pledged as collateral on behalf of the borrower. Based on an amortization schedule, the MSF will draw down the account as the loan principal is paid. In the event of full default, the lender will have rights to the account less a liquidation fee. Loan-flow in Michigan's pilot program has been high, with close to 300 inquiries and at least \$150 million in requests in the first two months of the program. The loans in which Michigan banks have participated have created or saved jobs at a "cost" of approximately \$6000 per job. That is particularly exciting when you consider that the \$6000 is in the form of a loan/deposit which we are confident will be repaid with interest. This creates a real negative cost per job.

The proposed State Small Business Credit Initiative would function in a similar manner and, we believe, could provide much needed support for loans made by participating banks. As with the Small Business Lending Fund, ABA recommends that Congress and the Administration create criteria for participation in the state credit initiatives that allow all viable community banks to participate. The state credit initiative is to be available to a bank that "has sufficient commercial lending expertise and financial and managerial capital to participate in the approved State capital access program." We propose that all banks that meet those criteria, but particularly banks that did not qualify for Capital Purchase Program (CPP), be permitted to participate. Otherwise, Congress will miss an opportunity to help the customers and communities of many banks across the country.

In conclusion, the Small Business Lending Fund can provide a needed boost to assist viable community banks weather the economic storm and lend to small businesses as the economy gains momentum. ABA would be pleased to work with this Committee in this important program.