Michigan Association of
Community Bankers

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On behalf of the
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Before the

United States House Financial Services Committee
Subcommittee on Oversight and Investigations

Field Hearing on

"Improving Responsible Lending to Small Businesses"

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Congressman Peters, Members of the House Financial Services Committee Subcommittee on Oversight and Investigations, my name is Michael A. Kus. I am legal counsel for the Michigan Association of Community Bankers ("MACB"), a full service trade association exclusively serving community banks, and their financial services partners, throughout Michigan. I am pleased to provide testimony on behalf of the MACB and its members.

Critical Economic Role of Small Business and Community Banks
Small businesses represent 99% of all employer firms and employ approximately 50% of private sector workers in the United States. The majority of new job creation in the past 10 years has been the result of the 26 million small businesses in America. It is clear that for any meaningful economic recovery to occur in America, America's small businesses must have access to credit to operate and grow.

And small businesses rely heavily on community banks for the credit they need to operate their businesses. Even though community banks represent only about 12% of all bank assets in the U.S., they make up 31% of the dollar amount of all small business loans that are less than $1 million, and 50% of all small business loans under $100,000 in the U.S.

As recently as May 29, 2009, at the establishment of the FDIC Advisory Committee on Community Banking, FDIC Chairman Sheila C. Bair recognized that "community banks are the lifeblood of our nation's financial system, supplying much-needed credit to countless individuals, small businesses, nonprofit organizations and other entities in large and small towns around the country."

Access to Capital for Community Banks = Access to Capital for Small Business
While the majority of community banks have money to lend, some federal regulatory agencies have taken an aggressive stance toward community banks, forcing the banks to write down their assets, which are largely secured by commercial real estate, at an unprecedented pace, thereby destroying capital and severely curtailing community banks' abilities to fulfill the vital role they can play in revitalizing the country's ailing economy.

Some federal regulatory agencies have insisted that banks purge their balance sheets at fire sale prices and are requiring community banks to make enormous infusions of capital – even when the bank's capital levels far exceed the statutory levels needed to be considered "well capitalized." And the capital markets have not responded positively by infusing capital into community banks on the scale necessary to restore the robust flow of credit to small businesses vital to the economic recovery of this country.

The recent joint Policy Statement on Prudent Commercial Real Estate Loan Workouts ("Guidance") issued on October 30, 2009 is a step in the right direction by the federal banking regulators and the FFIEC. It is also in keeping with the type of suggestions made by the MACB in its Executive Summary of August 2009, a copy of which was provided to Governor Jennifer Granholm, OFIR Commissioner Ken Ross, Senate Majority Leader Mike Bishop, Senator Randy Richardville, Speaker of the House Andy Dillon and Representative Andy Coulouris.

More initiatives like this on the part of the federal banking regulators are needed to provide immediate assistance to community banks. The Guidance states that the federal regulators recognize prudent commercial real estate ("CRE") loan workouts are often in the best interest of the banks and creditworthy CRE borrowers. The tone of the Guidance would suggest that the federal bank regulators understand the need to assist banks in working through the current economic environment.

However, as any community bank in Michigan who has recently been examined can tell you, instead of working with community banks to help both banks and their customers overcome current economic stress, some federal examiners have become extremely harsh in their assessment of the value of CRE loans and their collateral. This extreme examination environment is adding to the credit contraction for small businesses. Community banks are effectively being forced to avoid making good loans out of fear of examination criticism, forced write-downs and the resulting loss of income and capital.

More aggressive measures are needed to direct capital assistance toward the banks who play the most central role in small business lending – community banks.

Administration Efforts to Help Small Businesses Access Credit
The President recognizes this need to support economic recovery and job creation by improving access to credit for small businesses and on October 21, 2009 announced further initiatives toward that goal. The MACB supports the central concept of the Administration's initiative of making lower-cost capital available to community banks under $1 billion in assets, however we have serious concerns about how such an initiative will ultimately look.

Many community banks either did not or could not take advantage of the Troubled Asset Relief Plan, Capital Purchase Program ("CPP"). Those who did not were concerned about the onerous requirements and restrictions required of CPP participants. If the new initiative incorporates those same onerous requirements and restrictions, it is unlikely the initiative will have any appreciable impact on community bank lending to small businesses. In addition, if the initiative is administered like CPP, only "viable" banks will be able to participate – effectively shutting out the very banks who would benefit most from the initiative.

Alternative Capital Resources for Community Banks
Another concept that Congress should consider is the creation of a program where community banks could obtain long term stock loans from the Federal Reserve Bank under a program by the Small Business Administration ("SBA"). Banks are comfortable borrowing from the Federal Reserve Bank and the operational structure for such borrowings are already in place.

A long term borrowing program would permit community banks to leverage new capital immediately and provide banks with longer term financing that could be supported and repaid with future bank earnings. If community banks could get an exemption or other concession on the amount of leveraged CRE or small business loans created by new capital obtained under such a loan program, the banks would have the ability to continuing lending to small businesses whose loans are largely secured by commercial real estate.

Other considerations to boost community bank capital include:

- Allow banks to include in their capital all (or a significantly higher portion than the 1.25% of assets currently allowed) of the amount currently carried in their allowance for loan and lease losses (ALLL).

- Allow banks to include as part of their capital the face amount, rather than the market price, of Government Sponsored Enterprises (GSE)[i] securities that are held to maturity in their investment portfolios.

- Allow banks to amortize losses over a 7 to 10 year period, instead of the current requirement to realize the loss in the quarter in which it is experienced, thereby preserving capital.

Proposed Small Business Administration Reforms to Stimulate Small Business Lending
Proposed reforms of the SBA loan programs are also a step in the right direction to stimulate the flow of credit to small businesses. The MACB strongly supports reforms that would make SBA lending more "user friendly" for community banks. Before the financial crisis began, nearly 60% of all SBA loans were made by 10 banks.

As noted earlier in my testimony, if Congress wants to get credit into the hands of small business, it must start with community banks who have largely built their banks on relationships with America's small businesses. The SBA loan program should be able accessible to all lenders, and the elimination of the SBA's "LowDoc" program effectively removed many community banks from the SBA lending arena.

The more than 8,000 community banks across America can support a large number of SBA loans if community banks can more easily access SBA lending programs. The traditional "one-size-fits-all" type program is tailored to large bank lenders and does not fit the community bank model. If Congress wants to supply small businesses with the capital they need to operate and grow, the SBA needs to do a better job of reaching out to community banks so that all lenders can more easily participate. Enabling non-preferred lender program community banks to use their own underwriting paperwork and to submit a short, simple and streamlined SBA 9(a) application would result in a significant increase in SBA lending by community banks to their small business customers.

The MACB also supports the proposed increases in SBA 7(a) and 504 loan sizes. Many small businesses need bigger loans to grow or start their businesses. MACB also supports the proposal to allow alternative SBA loan size standards for determining eligible small business borrowers. These measures will enable more small businesses access to the capital they so desperately need to operate and grow their business.

In conclusion, the MACB encourages Congress to continue to work with community bank groups and small business groups to focus on ways to assist community banks obtain and retain the capital they need to increase the flow of credit to the small businesses in America who are so vital to any hope of economic recovery for our country.

We hope Congress will be receptive to "outside the box" proposals from business and industry groups such as those testifying today that will enable small businesses to grow and be successful. The recovery of the U.S. economy is dependent on innovative solutions to the current economic crisis.

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[i] GSEs include: Federal Home Loan Banks, Fannie Mae, Freddie Mac, Federal Agricultural Mortgage Corporation, Farm Credit System, the Financing Corporation and the Resolution Funding Corporation *(see Federal Reserve Statistical Release Z.1 Flow of Funds of Accounts of the United States, Schedule F.124 Government Sponsored Enterprises.)*