Small business owners. Small business values.

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

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

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

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

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

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

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

Credit dried up because of the financial crisis itself, which could have been averted or at least mitigated had the stabilizing measures contained in Dodd-Frank been in effect before the crisis. To blame Dodd-Frank for the crisis-induced credit crunch confuses cause and effect, especially as the new law is not yet even fully implemented. A proper reckoning of cause and effect is

needed in order to move forward with pragmatic policies that clear the path for small businesses to flourish.

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

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

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

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

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

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

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

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

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

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

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

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

The Dodd-Frank Law's Benefits for Small Businesses

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

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

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

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

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

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

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