Testimony of

Fred Green

before the

Subcommittee on Economic Growth, Tax and Capital Access

of the

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Chairman Rice, Ranking Member Chu, and members of the Committee, my name is Fred Green. I am President and Chief Executive Officer of the South Carolina Bankers Association. We are the professional trade association that has represented South Carolinaꞌs banks for over 110 years. Our members are both large and small and collectively have over 99% of the deposit market share in our state.

I am pleased to share the banking industryꞌs perspective on the state of the small business lending environment.

It is well-documented how crucial small businesses are to the national economy. Studies produced by the Small Business Administration demonstrate that small businesses account for over half of all jobs in the U.S. and this share of total employment has been fairly stable over the past few decades. More importantly, small businesses account for as much as 65 percent of net new jobs created over the past 15 years and most new job growth during economic recoveries occurs at new and small firms. Small firms and start-ups promote innovation because they are more flexible and often more daring than larger businesses.

Banks are the primary lender to small businesses and their presence in local communities throughout our nation is critical to meeting the unique needs of new and developing companies. There is a symbiotic relationship between the health of a community and the health of the banks located there. It is why small business lending is an important part of every bankꞌs strategy and why banks today provide more than 20 million small business loans.

Loan demand has improved since the recession, however remains at relatively weak levels, held back by tremendous uncertainty about the future. Concerns over changes to taxes, employment costs and regulation make small business owners less interested in expanding and incurring new debt. Businesses simply are not willing to take on additional debt with so much uncertainty about the economic future they face.

Despite the low loan demand, banks continue to meet the needs of their customers. In every community, banks are actively lending and continually looking for lending opportunities. After declines in loan portfolios since the pre-recession peak, recent FDIC call report data shows that outstanding loans have been growing over the last 12 months. The presence of banks in communities throughout our nation is critical to meeting the unique needs of small businesses.

Historically, small business loans have been more risky than other loan types. Small business loan portfoliosô credit metrics are improving but are still below pre-recession levels. Underwriting standards have forced banks to secure more of these loans with collateral. The smaller loans, generally $250,000 and less, are underwritten primarily on the ownerõs financial strength and personal assets. Since real estate is the primary personal asset for many small business owners, and real estate has decreased in value, this presents another challenge for banks.

Banks also face another challenge in providing loans to meet their customerõs needs with the most recent wave of regulations. The cumulative impact of hundreds of new or revised regulations may be a weight too great for many small banks to bear. Congress must be vigilant in its oversight of the efforts to implement the Dodd-Frank Act to ensure that rules are adopted only if they result in a benefit that clearly outweighs the burden. Some rules under Dodd-Frank, if done improperly, will literally drive banks out of lines of business.

This last point is very important. It is not that these regulations will just increase compliance costs for banks, but banks are now, in their strategic planning, being forced to consider the elimination of certain products to which customers have grown accustomed. In South Carolina we recognized this growing concern and held a special conference for top bank executives recently to address significantly stricter mortgage regulations and capital standards banks will find themselves facing beginning next year. Some community banks have already told us they will most likely have to stop offering residential mortgage products because of these new lending regulations. And as we all know, fewer participants in the market means fewer options for consumers. For many, these community banks are the only option. In fact, community banks are the only physical banking presence in one fifth of the counties in the U.S. The calculus is fairly simple: More regulation means more resources devoted to regulatory compliance, and the more resources devoted to regulatory compliance, the fewer resources are dedicated to doing what banks do best ï meeting the credit needs of local communities. Every dollar spent on regulatory compliance means as many as ten fewer dollars available for creditworthy borrowers. Less credit in turn means businesses canôt grow and create new jobs. As a result, local economies suffer and the national economy suffers along with them.

In my testimony today, Iôd like to make three key points:

- **Demand for Business Loans Remains Weak Due to Uncertainty.**
- **Banks are Making New Loans, Meeting Demand.**
- **New Regulations Threaten Banks' Ability to Meet Customer Demand.**

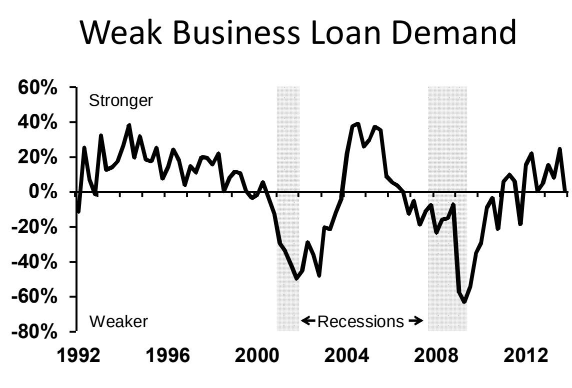
I will discuss each of these in detail in the remainder of my testimony.

Demand for Business Loans Remains Weak Due to Uncertainty

Loan demand has steadily improved since the recession, however remains at relatively weak levels. Although the economy continues its slow recovery, there remains tremendous uncertainty about the future. This uncertainty, particularly relating to potential changes to taxes and regulation makes borrowers less interested in adding new debt.

Small business sentiment has yet to recover from the recession. The National Federation of Independent Businessôs (NFIB) Small Business Optimism Index remains at depressed levels, and has yet to surpass pre-recessionary lows going as far back as 1980. Moreover, optimism has not seen any significant improvement in the past two years.

As a result, businesses are not looking to expand. In the NFIBôs October survey, just 6 percent of small businesses see now as a good time to expand. In fact, 59 percent of the respondents cited the economic conditions and political climate alone as the reason not to expand. If businesses are not expanding, they are not taking out loans to fund expansion.



Source: Federal Reserve, Senior Loan Officer Survey

In South Carolina, our bankers are reporting the same ï that there is some demand, but economic uncertainty and the political climate are holding businesses back from making capital investments to grow their businesses.

Most bankers state that demand is low particularly from companies with stronger credit profiles. Financially strong companies are holding back because of the uncertainty generated by the debate on the budget and the debt ceiling; and over healthcare cost concerns.

Higher employment costs such as healthcare, taxation and labor are bigger issues than most realize, especially for the small-business owner. Our bankers repeatedly report speaking to companies that are cutting employees to get below the 50-worker threshold. For these businesses, that means no expansion and therefore a limited need for bank funding for expansion. One banker reported a common example. This banker had banked the local owners of seven fast-food restaurants. The owners recently refinanced all term debt and extended amortization to provide better debt coverage in preparation for the impact of increased healthcare costs. They currently have approximately 150 full time employees and 50 part time employees. They plan to cut full time employment by at least 50 percent and offset that by increasing their part time staff. In addition, they have put all expansion plans on hold. Another business owner is outsourcing instead of expanding and hiring new employees. He cites concerns over the rising cost of healthcare as one thing that keeps him from growing his employment base.

Due to this uncertainty and apprehension about the future, small business ownersô loan levels have decreased. This leaves bankers to aggressively seek what little business is available, often taking business from one another; rather than seeing an expansion of the business market to pre-recession levels due to increased borrowing. Even though the resulting pricing and terms from this competition are very favorable to borrowers, lending levels remain low due to the lack of confidence on the part of small business owners, not banksô unwillingness to lend.

Business thrives when there is a level of stability in the economy. The unknowns associated with providing health care to employees is just one of many concerns in what business owners see as a confusing and convoluted environment.

Businesses simply are not willing to take on additional debt with so much uncertainty about the economic future they face. In fact, utilization of existing line commitments remains low at around 50 percent. Said differently, business owners are using only 50 percent of the dollar loan commitments already in place.

Banks are Making New Loans, Meeting Demand.

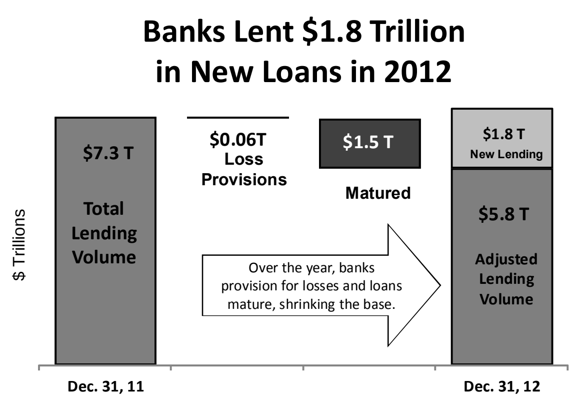
In every community, banks are actively lending and continually looking for lending opportunities. In spite of the slowly recovering pace of the economy, recent FDIC call report data shows that outstanding loans have been growing over the last 12 months and that after several years of contraction, the overall portfolio of small business loans has stabilized. The presence of banks in communities throughout our nation is critical to meeting the unique needs of small businesses.

Financing Least Cited Concern For Small Businesses

Single Most Important Problem	Share of Respondents
Government Requirements & Red Tape	21
Taxes	20
Poor Sales	17
Cost/Avail. Of Insurance	8
Quality of Labor	8
Competition From Large Business	8
Other	8
Cost of Labor	5
Inflation	3
Financing & Interest Rates	2

Source: National Federations of Independent Business, as of October 2013

In fact, banks are meeting the majority of loan demand of small businesses. In the NFIBôs October 2013 Small Business Optimism Index, financing and interest rates were the least cited concern facing small businesses. In fact, just two percent of respondents identified this as their chief concern, a survey low. On the other hand a combined 41 percent of respondents cited government requirements or taxes as their greatest concern.



Source: Federal Deposit Insurance Corporation, ABA Analysis

Banks still continue to make loans to creditworthy borrowers, constantly assessing whether some businesses can reasonably take on more debt in this economy. In 2012 alone, banks made $1.8 trillion in new loans and business loan volumes have grown by 10 percent in the past year alone.

The pace of business lending is affected by many things, most importantly being the demand from borrowers. The state of the local economy ï including business confidence, business failures, and unemployment ï and regulatory pressures to be conservative plays important roles too. The rise in new credit means that businesses are borrowing more from banks and using that money to grow and improve the economy.

New Regulations Threaten Banks' Ability to Meet Customer Demand.

Banks are currently contending with a wave of new regulations. During the last decade, the regulatory burden for community banks has multiplied tenfold, with more than 50 new rules in the two years before Dodd-Frank. And with Dodd-Frank alone, there are more than 5,500 pages of proposed regulations and 6,700 pages of final regulations (as of November 19, 2013). What is frightening to consider is that we are not even half way through Dodd-Frankœs 398 rules that must be promulgated under this new law.

In many cases, the cumulative impact of the last few years of new regulations threatens to undermine the community bank model. Banks certainly appreciate the importance of regulations that are designed to protect the safety and soundness of our institutions and the interests of our customers. We recognize that there will always be regulations that control our business. But the reaction to the financial crisis has layered regulation upon regulation, doing little to improve safety and soundness and, instead, increasing our operating costs and handicapping our ability to serve our communities.

Community banks pride themselves on being agile and quick to adapt to changing environments. During the recession, banks tightened lending standards. Even though underwriting has loosened some, it is still tighter than before. Yet what will discourage loosening underwriting standards even further are the regulatory pressures on smaller community banks, the banks that make the majority of the small business loans. New laws or regulations might be manageable in isolation, but wave after wave, one on top of another, will undoubtedly overwhelm many community banks. Given that the cost of compliance has a disproportionate impact on small banks as opposed to large banks, it is reasonable to expect this gap to widen even more as Dodd-Frank is fully implemented.

The cumulative impact of hundreds of new or revised regulations may be a weight too great for many small banks to bear. Congress must be vigilant in its oversight of the efforts to implement the Dodd-Frank Act to ensure that rules are adopted only if they result in a benefit that clearly outweighs the burden. As mentioned earlier, some rules under Dodd-Frank, if done improperly, will cause many banks to eliminate or drastically limit products and services many businesses have used for years. New rules on mortgage lending, for example, are particularly problematic.

In dramatic illustration of this point, a 2011 ABA survey of bank compliance officers found that compliance burdens have caused almost 45 percent of the banks to stop offering some loan or deposit products. In addition, almost 43 percent of the banks decided to not launch a new product, delivery channel or enter a geographic market because of the expected compliance cost or risk.

The bottom line is this - additional regulations mean more resources devoted to compliance, and dollars directed toward compliance are dollars that canôt be directed toward meeting the credit needs of local communities. Banks understand regulation is necessary, but they also understand that burdensome regulation ultimately means they have fewer dollars to lend, which means less opportunity for businesses to grow and create new jobs. As a result local economies suffer and the national economy suffers along with them.

Conclusion

Banks in South Carolina and across the nation are eager to serve the financing needs of small businesses. They understand they play a critical role in their local economies and no bank has or wants to stop pursuing small-business lending. Yet, small businesses remain very hesitant on the whole to embrace expansion due to economic uncertainty, concerns over healthcare and the political climate. Businesses that are ready to expand, hire and invest find themselves increasingly apprehensive as a result of the external turmoil and, as a result, have held off significantly from enacting growth plans.

This does not mean that banks are not making loans. Our economy is growing and banks are addressing financing needs. But these loans are being made to creditworthy borrowers with vanilla financials; businesses with financials that vary from norm, sometimes even in small measures, often finding themselves unable to secure financing.

Finally, regulatory pressures on banks have slowed banksô ability to provide their communities the economic financing they need. Regulations restrict what loans can be made and the amount of regulations greatly increase compliance costs, thus reducing the ability to lend. The bottom line is that while banks may be eager to lend, and business may be eager to grow, the environment that exists at present is hindering efforts by both to make transactions a reality. As such, itôs not only banks and small businesses that are hurt, but communities as a whole.

Healthy, properly financed small businesses are absolutely critical to our communitiesô economies. Banks understand their role in this and continue to make every good loan they can, despite an increasingly difficult lending environment.

Thank you once again for the opportunity to testify.