TESTIMONY OF

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On

SEEKING SOLUTIONS:

FINDING CREDIT FOR SMALL AND MID-SIZE BUSINESSES IN MASSACHUSETTS

Before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

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Good morning, Chairman Frank, Congressmen Capuano and Lynch. My name is Steven L. Antonakes and I serve as the Commissioner of Banks for the Commonwealth of Massachusetts. The Division of Banks is the primary regulator of nearly 250 state-chartered banks and credit unions with total combined assets in excess of $350 billion. The Division is also charged with the licensing and examination of over 1,000 non-bank mortgage lenders and brokers, over 4,000 individuals engaged in mortgage lending and brokering, as well as an additional 3,500 non-bank financial entities, including check cashers, money transmitters, finance companies, and debt collectors.

I commend you, Mr. Chairman for scheduling this timely hearing on the credit needs of small and mid-sized businesses during these difficult economic times. The ongoing success of our private-sector businesses is critically important to the Massachusetts economy. According to the United States Small Business Administration ("SBA"), there were an estimated 26.8 million small businesses in the United States in the year 2006. These small businesses created nearly 80% of the new jobs in the last 10 years and employ over 50% of the nation's private sector workforce.

Small businesses continue to play an instrumental role in the Commonwealth's economy as well. As of 2006, there were nearly 600,000 small businesses in Massachusetts employing over 2.8 million people. Our smallest businesses, those employing 20 individuals or less, employ 25 percent of the Massachusetts workforce. The continued emergence of new small businesses as well as the healthy growth of existing small businesses is critical to our economy and is also a significant source of new jobs.

Access to credit is essential to fuel the growth which will produce new jobs. Job creation will play a critical role in allowing our Commonwealth and our nation to emerge from our current economic downturn. Similarly, any significant curtailing of business credit will further hinder our overall economic recovery. Restrictions in financing could result in small businesses needing to increasingly rely on more expensive credit card financing, savings, or non-traditional forms of financing. This would significantly increase operating costs and curtail expansion opportunities.

During my testimony today, I would like to address two issues. First, the experience and challenges of Massachusetts state-chartered community banks in the current environment to continue to help to meet local business credit needs. Second, a series of Massachusetts initiatives designed to establish strategic partnerships between businesses, lenders, and Massachusetts government as a means of embracing and nurturing businesses in the Commonwealth. Finally, I will conclude with some thoughts on how future regulatory restructuring can continue to promote the diversity of our financial services industry.

Challenges for Community Banks

Media reports have continuously focused on diminished consumer and business credit opportunities. Certainly the well chronicled difficulties being experienced by some of our large nationwide money center banks have resulted in the deleveraging of large balance sheets and therefore, the restriction of credit. However, the experience of community banks and credit unions has been strikingly different. I have just completed a series of roundtable discussions across the Commonwealth and have heard from hundreds of bank and credit union officers on their perspectives of what is happening on Main Street. Many Massachusetts state-chartered institutions report increased lending as a result of reduced competition from some of their largest bank competitors. This is yet another example of how our diversified and decentralized system of banking continues to serve our nation well. This contention is supported by our analysis of FDIC Call Report Data which shows that Massachusetts state-chartered community banks' balances for commercial real estate loans and commercial loans to businesses increased 14.5 percent from 2007 to 2008 and nearly 26.9 percent from 2006 to 2008. Please See Exhibit A, *Massachusetts State-Chartered Community Banks' Business Loan Balances 2006 – 2008.* While years of consolidation among some of our nation's largest financial institutions has had the effect of increasing systemic risk to our banking system, the community banking system and credit union movement remain fundamentally sound and continue to serve as sources of strength during our existing economic difficulties by providing credit to consumer and business customers and positively impacting the local communities where they are based.

Despite their ability and willingness to lend, some community bankers are frustrated that business loan demand has diminished due to the same media reports that credit is unattainable. Moreover, some businesses are likely delaying expansion opportunities given poor economic forecasts. While some community banks have tightened underwriting criteria, many others report that businesses seeking credit have significantly weaker financial positions than before our economic decline took hold. These banks would argue that they have not tightened underwriting standards, but rather they have maintained them.

Many community banks in stock form are also frustrated by the broad application of criticism stemming from the bad acts of some of the largest financial institutions and former Wall Street firms. Acceptance of TARP funds, in the eyes of many, has now become untenable given many banks' experience of having to defend the need for so-called government "bailout" funds despite running well capitalized and well managed institutions. The opportunity for the U.S. Treasury to deploy TARP funds to Massachusetts banks has also been significantly restricted. Massachusetts has the largest percentage of mutual banks in the country. Mutuality is quite likely the reason Massachusetts remains so well banked today despite years of bank consolidation. More than five months after the first banks were provided TARP funds, the United States Treasury Department has still not released a term sheet for mutual banks. Accordingly, TARP funds are still not an option for the majority of community banks operating in the Commonwealth. This has certainly had the effect of unnecessarily restricting increased lending opportunities that might otherwise be available through the use of TARP funds.

Finally, events beyond the control of community banks have and will continue to affect the ability of community banks to lend in the future. The conservatorship of Fannie Mae and Freddie Mac as well as proposed significant deposit insurance assessment increases will significantly impact the earnings of state-chartered community banks and, in the case of the recapitalization of the corporate credit union system, state-chartered credit unions as well. The initially proposed 20 basis points special assessment by the FDIC will cost 36 Massachusetts state-chartered banks over one million dollars each and an additional 73 state-chartered banks over half a million dollars in increased premium payments. The NCUA's planned capital restoration plan for the corporate credit union system could eliminate up to two years of earnings for most state-chartered credit unions. It is important to note that these actions will not threaten the capital base of any Massachusetts state-chartered bank or credit union. However, the availability of credit to consumers and businesses alike will most certainly be reduced across the board as a result of these increased operating costs. In sum, the ability of local institutions to continue to lend is not being impacted by their bad acts, but by the bad acts and aggressive risk taking of others.

Massachusetts Innovations to Support the Financing of Small Business

Massachusetts has a proud history of attempting to leverage partnerships to increase opportunities for small businesses to flourish. Access to credit and other banking services remains paramount to the success of small businesses. Massachusetts banks have historically played a significant and vital role in providing such financial services to numerous small businesses located throughout their communities. Nevertheless, it is estimated that nearly 10 percent of the nation's population at this time remains unbanked. Accordingly, many of our smallest and emerging new businesses are likely to be owned and operated by individuals that are indeed unbanked.

Individuals without traditional banking relationships are predominantly low income and minorities. As a result of being outside the financial mainstream, unbanked individuals are typically dependent upon non-traditional, more expensive providers of both credit and other money management services. In the case of small businesses, the reliance on these higher cost financial services directly impacts profitability and prospects for growth. Massachusetts has developed two programs designed to make financing easier for our smallest businesses.

Massachusetts Small Business Capital Access Program ("CAP Program")

In the early 1990s, Massachusetts was also facing a credit crunch. The ongoing recession and the New England banking crisis resulted in a substantial reduction in credit availability especially for small and new businesses. Recognizing that most new jobs are created by small businesses and that the creation of new jobs would be vital to the Commonwealth's ability to emerge from the economic downturn at the time, Massachusetts policymakers sought new innovative solutions to encourage increased small business lending. The result was the highly successful Massachusetts Small Business Capital Access Program, or CAP Program.

In an effort to encourage bank lending, $5 million in state funding was initially appropriated to provide a cash collateral guarantee or credit enhancement to small business loans made under the CAP Program. This allowed banks to originate loans they might not otherwise have been able to make.

Today, over 100 banks participate in the CAP Program. Since banks utilize their own underwriting criteria and directly provide the funding, the loans are simpler to originate than loans made through the SBA. Banks also receive credit under the Massachusetts Community Reinvestment Act for participating in the CAP Program.

The CAP Program is designed to assist small businesses with annual revenues of $5 million or less to obtain financing from participating banks. CAP Program loans may be used to start or expand businesses, or to provide permanent working capital to ensure continued profitable operations. Typical uses are equipment purchases, start-up costs, and real estate acquisitions. The CAP Program can also be used for working capital lines of credit.

In 15 years, a total of $10 million in state funding has been leveraged into $241 million in loans to 3,828 small businesses. With an average loan amount of $51,000 and loans as small as $1,000, CAP Program loans have helped create or retain 26,000 Massachusetts jobs and brought in over $100 million in payroll taxes to the Commonwealth. The CAP Program has also been instrumental in providing financing to small businesses in inner city neighborhoods with more than $20 million in loans to 275 businesses in Boston's Roxbury and Dorchester neighborhoods. Finally, $34 million in CAP Program loans have gone to start up businesses. An additional $22 million in loans have been provided to firms with annual revenues of less than $100,000.

Massachusetts Banking Partners Small Business Loan Program ("Banking Partners")

The charge of the Massachusetts Banking Partners Small Business Loan Program, or Banking Partners program, is also to provide greater access to reasonably priced credit and banking services to small businesses as well as access to vital business assistance services. The program recognizes that many start-up and small business owners need help with recordkeeping, general management, and in preparing a business plan and financial statements. Specifically intended for very small businesses located in low- or moderate-income census tracts needing small dollar loans, the Banking Partners Program matches small business owners receiving technical assistance and training from small business assistance providers with participating banks.

These participating banks accept referrals of small business applicants who are receiving services from not-for-profit small business assistance providers. In exchange, participating banks offer small business loans at a rate below the lender's typical market rate; make smaller dollar loans than those generally available; and consider financing for early-stage businesses. Banks participating in the Banking Partners program also receive consideration under the Massachusetts Community Reinvestment Act.

Systemic Supervision and Regulatory Restructuring

In the weeks ahead as Congress evaluates our regulatory structure, I urge you to examine the linkages between the capital markets, the traditional banking sector, and other financial services providers. Our top priority for reform must be a better understanding of systemic risks. The federal government must facilitate the transparency of financial markets to create a financial system in which stakeholders can understand and manage their risks. Congress should establish clear expectations about which regulatory authority or authorities are responsible for assessing risk and for using the necessary regulatory tools to address and mitigate risk.

Congress, the Obama Administration, and federal regulators must also consider how the federal government itself may inadvertently contribute to systemic risk—either by promoting greater industry consolidation or through policies that increase risk to the system. Perhaps we should contemplate that there are some institutions whose size and complexity make their risks too large to effectively manage or regulate. Congress should aggressively address the sources of systemic risk to our financial system.

State bank regulators have long believed capital and leverage ratios are essential tools for managing risk. Federal regulation needs to prevent capital arbitrage among institutions that pose systemic risks, and should require systemic risk institutions to hold more capital to offset the grave risks their collapse would pose to our financial system. Perhaps most importantly, Congress must strive to prevent unintended consequences from doing irreparable harm to the community banking system in the United States. Federal policy to prevent the collapse of those institutions considered too big to fail should ultimately strengthen our system, not exacerbate the weaknesses of the system. Throughout the current recession, community banks have largely remained healthy and continue to provide much needed capital in the communities where they operate. The largest banks have received amazing sums of capital to remain solvent, while the community banks have continued to lend in this difficult environment with the added challenge of having to compete with federally subsidized entities.

Congress should consider creating a bifurcated system of supervision that is tailored to the size, scope, and complexity of financial institutions. The largest, most systemic institutions should be subject to much more stringent oversight that is comprehensive enough to account for the complexity of the institution. Community banks and credit unions, which operate in a much smaller market than the money center banks, should be subject to regulations that are tailored to the size and sophistication of the institutions. In financial supervision, one size should no longer fit all.

The Treasury Department and the Federal Reserve should be required to provide a plan for how to unwind the various programs established to provide liquidity and prevent systemic failure. Unfortunately, the attempts to avert crisis through liquidity programs have focused predominantly upon the needs of the nation's largest institutions, without consideration for the unintended consequences for our diverse financial industry as a whole, particularly community banks. Put simply, the government is now in the business of picking winners and losers. In the extreme, these decisions determine survival, but they also affect the overall competitive landscape and relative health and profitability of institutions. The federal government should develop a plan that promotes fair and equal competition, rather than sacrificing the diversity of our financial industry to save those deemed too big to fail.

Conclusion

Again, Mr. Chairman I thank you for calling today's hearing. As we continue to work our way through our current economic difficulties, small and medium-sized businesses will also face increasing challenges. It is these businesses, however, that can play a significant role in our economic recovery by adding new and sustainable jobs. I appreciate your efforts and the recent actions by the Obama Administration to strengthen SBA lending programs. But the federal government cannot do it alone. Innovative collaborations between state governments, non-profit entities, and local banks as I have described have also proven to be extremely effective in nurturing and supporting our small businesses and creating new and long lasting jobs.

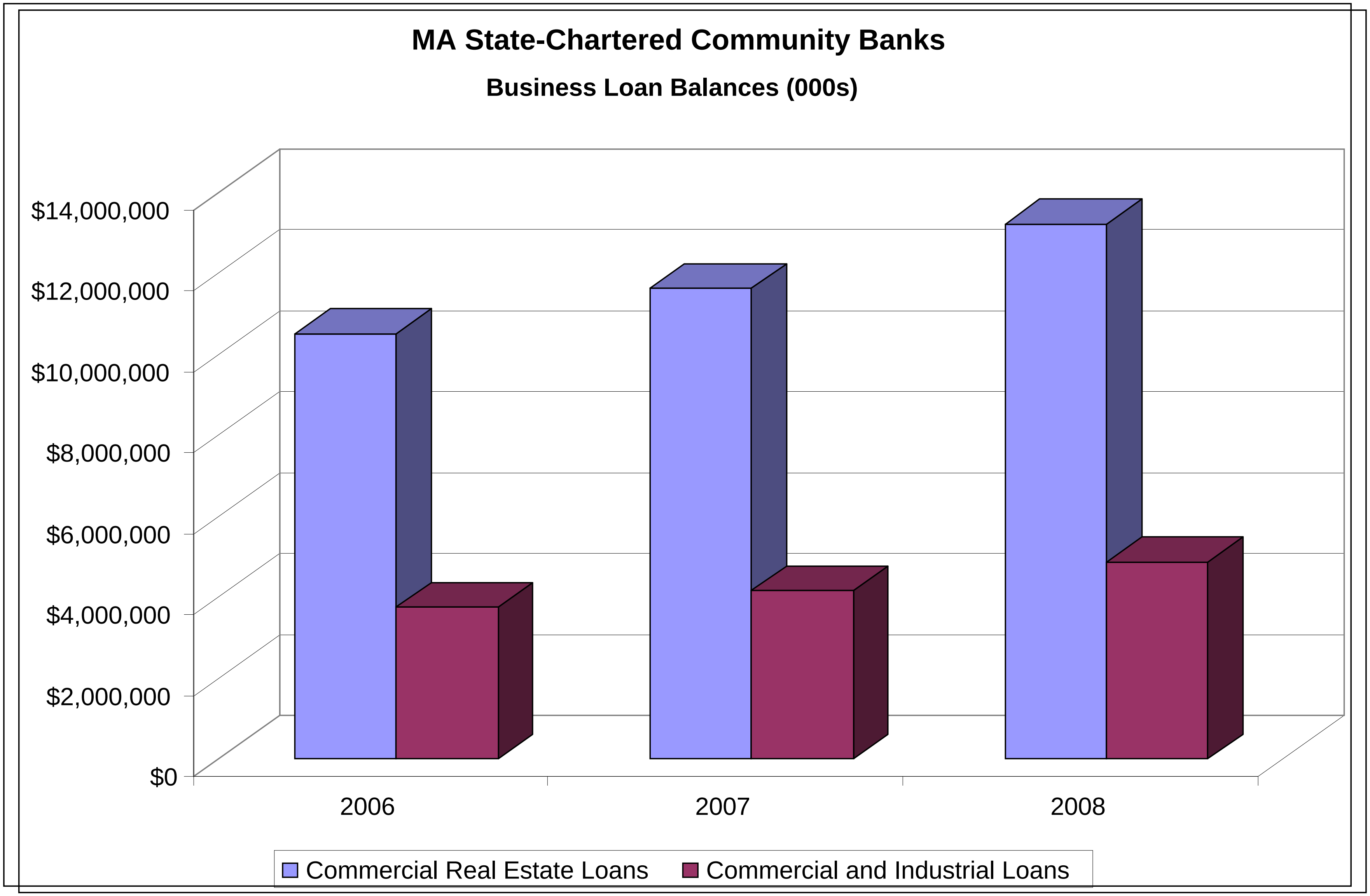
Our highly diverse financial system has been the envy of the world, allowing our markets to be flexible and responsive, and has survived booms and busts. Thanks to our decentralized regulatory system, our financial institutions are competitive internationally and locally. However regulators and legislators address the current market failings, it should be in a way that preserves the diversity of financial institutions and supervision that has made our economy nimble, resilient, and dynamic.

There is a need for improved coordination and cooperation among functional regulators. The Conference of State Bank Supervisors ("CSBS") has been actively engaged in efforts to enhance coordination as we work to develop a federalist system of supervision that ensures safety, soundness, and consumer protection, but still provides economic growth and innovation. As Congress reviews proposals to restructure our financial regulatory system, there are several principles that must be adhered to. Ultimately, CSBS believes the structure of the regulatory system should:

1. Usher in a new era of cooperative federalism, recognizing the rights of states to protect consumers and reaffirming the state role in chartering and supervising financial institutions.
2. Foster supervision that is tailored to the size, scope and complexity of the institution and the risk they pose to the financial system.
3. Assure the promulgation and enforcement of consumer protection standards that are applicable to both state and nationally chartered financial institutions and are enforceable by locally responsive state officials against all such institutions.
4. Encourage a diverse universe of financial institutions as a method of reducing risk to the system, encouraging competition, furthering innovation, ensuring access to financial markets and promoting efficient allocation of credit.
5. Support community and regional banks, which provide relationship lending and fuel local economic development.
6. Require financial institutions that are recipients of governmental assistance or pose systemic risk to be subject to enhanced safety and soundness and consumer protection oversight.

I thank you for the opportunity to testify and would be happy to answer any of the Committee’s questions.

EXHIBIT A



SOURCE: FDIC Call Reports