



Credit Union National Association

cuna.org

BILL CHENEY
President & CEO

601 Pennsylvania Ave., NW | South Building, Suite 600 | Washington, DC 20004-2601 | **PHONE:** 202-508-6745 | **FAX:** 202-638-3389

October 26, 2011

The Honorable Shelley Moore Capito
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Capito:

On behalf of the Credit Union National Association (CUNA), I wanted to thank you for holding the hearing earlier this month on H.R. 1418, the Small Business Lending Enhancement Act. This legislation is critical job creation legislation which would permit credit unions to lend an additional \$13 billion to small businesses in the first year, helping them create over 140,000 new jobs. We appreciated the opportunity to present testimony in support of this legislation and look forward to working with you to move the bill through the legislative process.

At the hearing, several Members, including you, raised questions related to the demand for this legislation. These questions focused both on whether there was enough available small business credit as well as whether there was a need to increase the credit union business lending cap in order to make additional credit available. Some also expressed concern that increasing the member business lending cap would lead to a reduction of bank business lending. I wanted to take the opportunity to address these questions.

Demand for and Availability of Small Business Credit

There is no doubt that there has been a reduction in the demand for business credit as a result of the recession. However, unlike the consumer sector, there is no indication that the small business sector is (or has been) engaged in a process of systemic deleveraging. On the contrary, there is a large body of evidence that confirms a healthy demand for loans as discussed in more detail below.

At the same time, there also is considerable evidence that a significant contraction in the supply of bank business credit has contributed to a reduction in business credit outstanding. Small businesses want credit but far too many cannot obtain the capital they need from the nation's banks. The record is clear: a lack of more robust small business borrowing, business expansion and job growth can be traced in large part to ongoing reductions in lending activity among the nation's commercial banks.

Since mid-2009, no fewer than 25 Congressional hearings have been held to discuss issues related to small business access to credit. Further, credit availability was a major driver behind the enactment of the Small Business Jobs Act of 2010, which



PO Box 431 | Madison, WI 53701-0431 | 5710 Mineral Point Road | Madison, WI 53705-4454 | **PHONE:** 608-231-4000

created the Small Business Lending Fund (SBLF), a \$30 billion taxpayer funded incentive to community banks to lend to small businesses.¹

The importance of access to credit for small businesses was clearly articulated by a witness advocating for the enactment of the SBLF in 2010.

“The Wall Street meltdown of fall 2008 and the ensuing credit crisis and recession hit small businesses harder than medium and large-size businesses because they have faced greater challenges in obtaining credit. Boosting the flow of credit will help the small business sector to lead the recovery of economic growth and employment... small businesses responded to the recession by laying off more workers than medium and large size businesses. The difference lies in access to credit. Small businesses are more dependent on bank credit than medium and large businesses. Medium and large businesses regained access to credit through the corporate bond market, while small businesses continue to suffer from lack of credit... The greatest potential for job creation is among small business with restored access to credit.”²

There is considerable evidence suggesting not only that there is unmet demand for small business lending, but also that small businesses that would otherwise be interested in pursuing credit are not doing so because of the perception that credit is difficult to get in this economic environment.

In testimony before the House Small Business Committee earlier this year, the International Franchise Association, whose membership, according to their website, employs 6% of Americans, stated:

“While we estimate that franchise businesses will be able to access \$8.4 billion in lending this year, this analysis also shows that we will face a \$2 billion shortfall in available loans. This shortfall will result in the loss of nearly 8,000 franchise unit transactions, both new business development and transfers, and a loss of more than 82,000 jobs and \$10.7 billion in annual economic output.”³

The National Association of the Self-Employed testified before the Senate Small Business Committee in May that, “Access to capital also continues to be a large

¹ Credit unions did not need and did not seek access to this fund because the chief impediment to credit union small business lending is neither liquidity nor capital. It is the statutory cap on business lending.

² Testimony of James D. MacPhee on behalf of the Independent Community Bankers of America before the House Committee on Financial Services Hearing on “Initiatives to Promote Small Business Lending, Jobs and Economic Growth.” May 18, 2010. 2.

³ Testimony of William G. Hall on behalf of the International Franchise Association before the House Committee on Small Business Hearing on “Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs?” June 1, 2011. 4.

problem for the self-employed and microbusinesses, despite efforts by the federal government to spur lending to small businesses.”⁴

As noted in our written testimony, the Pepperdine Capital Markets Project conducts an ongoing, twice-yearly survey of U.S. small businesses in conjunction with Dunn and Bradstreet. While the second 2011 full report has not yet been published data collected during the week of August 29, 2011 (from a sample of over 5,500 U.S. small business owners) finds that nearly one-quarter of small businesses sought a bank loan in the preceding 12 month period. Among those that sought bank financing fully 57% indicated that they were not successful in obtaining financing. This is a clear indication that a substantial number of small businesses continue to need more access to capital.⁵

The most-recently published full report from the Pepperdine Project (Survey Report V – Summer 2011) is attached.⁶ The Report – summarizes views of 1,221 privately-held businesses that responded to the survey. Among these, 24% had businesses that involved manufacturing and 11% were in the engineering and construction industry. Approximately 59% of respondents have between 11 and 100 employees.

One of the report’s key findings was: “**Business owners enthusiastic about growing, but lack resources.** Nearly 95% of privately-held businesses owners report having the enthusiasm to execute growth strategies, yet just 53% report having the necessary financial resources to successfully execute growth strategies.”⁷

Given this reported enthusiasm for growing it is not surprising that the report also finds substantial demand for financing on the part of small businesses: Overall, 38% of businesses indicated that they are “currently” seeking financing, with about one-half (48%) of these seeking bank loans.⁸ In fact, bankers tell the Pepperdine researchers the same story being told by small business- and one that is disturbingly at odds with what banks been telling policy makers: Overall, 65% of banks responding to the Capital Markets Project Survey tell researchers that they have seen an increase in demand for small business loans compared to six months ago.⁹

On the supply side of the equation, the bank lobby has been telling policymakers that there is an ample supply of business credit. But they provide a starkly contrasting view in the Pepperdine Survey. Indeed the Report states: “Currently, lenders see economic uncertainty (48.6%) and access to capital (25.7%) as the top issues facing privately-held businesses”.¹⁰ Yet, despite their public claims to the contrary, bankers reveal to the Pepperdine researchers that they are restricting the supply of credit.

⁴ Testimony of Kristie Arslan on behalf of the National Association for Self-Employed before the Senate Committee on Small Business and Entrepreneurship Hearing on “Small Business Recovery: Progress Report on Small Business Jobs Act of 2010 Implementation.” May 19, 2011. 5.

⁵ See: <http://bschool.pepperdine.edu/appliedresearch/research/pcmsurvey>. Survey of firms with less than \$5 million in annual revenues.

⁶ Pepperdine Private Capital Markets Project Survey Report V. Summer 2011.

⁷ Ibid. p.8

⁸ Ibid. p.19.

⁹ Ibid. p. 119.

¹⁰ Ibid. p.111.

Overall, bank survey respondents indicate they are declining 60% of small business loan applications.¹¹

Importantly, bank credit restriction in the face of healthy demand has been an ongoing problem. A 2010 Business Week article, *Why Small Business Can't Get Financing*, contains an extensive interview with John Paglia, senior researcher for the Pepperdine Private Capital Markets Survey. In the course of the interview Paglia states: "The No. 1 concern for private companies is access to capital. Nearly 31 percent cited that..." and "The companies also reported, by 71 percent, that if they had additional growth capital they believed they would see an increase in revenue growth."¹²

During the course of the interview, Business Week reporter Karen Klein states "Many bankers say they aren't lending, at least in part, because demand for loans is down. But your survey seems to contradict that assertion." Paglia's response is noteworthy: "Generally speaking, we found more demand for loans among business owners. And among the banks that responded to our survey, 72 percent indicated that the number of loan applications they received had increased during the last six months. So there's demand for capital. Something's not quite sitting right when we hear from the banks that there's no demand."¹³

The National Small Business Association's 2011 Mid-Year Economic Report found that lack of available capital was a concern for 22% of those responding to their survey of small business owners.¹⁴

According to the National Association of Realtors®, 87% of Realtors® said that lack of financing impacted their clients decisions in 2011; nearly 60% said that they failed to complete a transaction due to financing; and lack of available financing was the most frequent response of Realtors® when asked what were the major obstacles to commercial real estate this year. Sixty-five percent report significantly or somewhat significantly tightening of lending conditions; none reported a significant easing of lending conditions. The Realtors® report further states, "While large corporations do not have difficulties securing capital, small businesses have been struggling to find access to financing."¹⁵

Some small business owners may have simply given up on the credit market. Multifunding.com, a small business finance consulting organization, conducted a survey of 1200 small businesses in July 2011 and found that 73% of small business owners who say they are in need of a loan have not applied for a loan. Twenty-one

¹¹ Ibid. p.118.

¹² Klein, Karen E., "Why Business Can't Get Financing." Business Week. August 31, 2010.

¹³ Ibid.

¹⁴ National Small Business Association. "2011 Mid-Year Economic Report". Page 8. August 3, 2011.

See: <http://nsba.biz/surveys.shtml>.)

¹⁵ National Association of Realtors® Research. August 2011. 1.

percent said they were afraid of application rejection; 18% said they were not willing to pay high interest rates.¹⁶

According to Gallup, 30% of small business owners say it is difficult for them to obtain credit – two to three times more difficult than it was in 2006 and 2007; 21% say credit is easy to get, which is about half the number from 2006 and 2007.¹⁷

The demand for small business loans is present in the market and the data suggest that banks continue to constrict credit availability while credit unions are expanding their business loan portfolios. Since the beginning of the recession three and a half years ago, total bank business loan portfolios have declined by almost 14%, while credit union business loan portfolios grew at a healthy rate of over 40% – a very stark difference. If indeed the contraction in business credit outstanding was due solely to reduced demand, credit union business lending would have declined as it has at banks. That is obviously not the case.

Why Increasing the Credit Union Member Business Lending Cap Is Necessary

Another question that you and other members of the subcommittee raised at the hearing was whether it is necessary for Congress to permit qualifying credit unions to lend to business owning members in excess of the statutory cap in order for credit unions to continue to meet the business lending needs of their members. We believe that it is.

The recently strong growth of credit union business lending is slowing as an increasing number of credit unions approach the cap, and the support credit unions have provided to America's small businesses cannot continue into the future unless Congress raises the credit union business lending cap.

The bank lobby claims that only a "handful" of credit unions are actually capped, but a total of more than 500 credit unions will be bumping up against the cap in the next three years. Contrary to the bank lobby claims that the credit unions constrained by the cap are a "new breed" of large credit unions, it is worth noting that a credit union seeking to offer business services to its members is not engaging in activity that is "new" to credit unions – credit unions have been offering business services to their members since they were founded in the United States over 100 years ago. In addition, roughly 75% of the over 500 credit unions that are constrained by or at the cap have total assets of \$500 million or less, rendering the bank lobby's assertion that these are only large credit unions false.

Most of these credit unions are already looking for ways to moderate their business loan growth.

¹⁶ Multifunding.com. August 11, 2011. (see: <http://www.multifunding.com/uncategorized/multifunding%e2%80%99s-second-quarterly-small-small-businesses-arent-applying-for-loans/> .)

¹⁷ Testimony of Dennis Jacobs before the House Committee on Small Business Hearing on "Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs." June 1, 2011. 3.

- A total of 227 credit unions hold business loans between 5% and 7.5% of assets. These credit unions will be capped within 2.7 years at recent growth rates. They held \$6.5 billion in business loans at mid-year 2011 and their business loans grew by \$3.9 billion over the preceding three years. Their business lending will have to slow dramatically in the coming few years without an increase in the cap.
- Another 149 credit unions hold business loans between 7.5% and 10% of assets. These credit unions will be capped within 2.5 years at recent growth rates. They held \$7.0 billion in business loans at mid-year 2011, and their business loans grew by \$2.1 billion over the preceding three years. Their business lending will have to slow dramatically in the coming few years without an increase in the cap.
- 148 credit unions, with \$7.1 billion in business loans outstanding, had business loans of more than 10% of assets. These credit unions are essentially capped or will reach the cap in the next twelve months. In the three years ending June 2011, business loans outstanding at these credit unions rose by only \$137 million. They will be able to contribute very little to future business loan growth without an increase in the cap.

Taken together these 524 credit unions now account for 75% of all business loans subject to the 12.25% cap. These credit unions have been the major contributors to credit union business loan growth over the past few years – accounting for 83% of total growth in non-grandfathered credit unions.

When the business lending growth in these credit unions is contrasted, the cap limitations are clearly reflected in slower growth rates among credit unions that are closer to the cap. In fact, the aggregate data shows:

- Credit unions with 5% to 7.5% MBL/Asset ratios saw portfolios increase by 36% in the year ending June 2011;
- Credit unions with 7.5% to 10% MBL/Asset ratios experienced an increase of 23%;
- Credit unions with more than 10% MBL/Asset ratios actually saw their loan portfolios decline. These credit unions will be able to contribute very little to future business loan growth without an increase in the cap.

As the economy hopefully recovers over the next few years, the business loan growth of this group of credit unions will disappear without an increase in the cap. In an environment where banks have constricted their lending, the credit constriction resulting from the statutory credit union business lending cap will mean that some members with existing business relationships may find it increasingly difficult to secure business credit from their credit union, and the credit unions which have contributed to business lending growth during the recession will be increasingly unable to serve new member business borrowers. All of this makes it critical that legislation to increase the business lending cap is enacted.

Increased Credit Union Business Lending is Not a Zero Sum Game for Banks

One of the more perplexing arguments made by the bank lobby is that Congress should not increase the cap because there is no excess demand for small business lending but that raising the cap would harm banks by allowing credit unions to take loans from them.

The bank lobby grossly misrepresents the impact of raising the credit union business lending cap on their own lending volumes. Research suggests that additional credit union business lending would not crowd out bank business lending. And certainly, with the banks controlling 95% of the commercial lending market, even a doubling of credit union market share would not significantly alter their dominance of this market.

During the hearing, one of the bank witnesses specifically claimed that that business lending is a “zero-sum game” – which, if true, would mean that every loan originated by a credit union is a loan that is not originated by a bank. This is simply not true.

Economic theory is revealing on the extent to which credit union lending may or may not “crowd out” bank business lending. Raising the credit union business lending cap is equivalent to an increase in the supply of business credit. Unless the demand for business loans were totally price inelastic, that increase in supply would lead to some increase in loans (i.e., the demand curve is not vertical.). Recently, researchers at the Federal Reserve Board estimated a semi-elasticity of demand for unsecured business loans to be -1.4, implying that a 100 basis point reduction in loan rate would be associated with a 1.4% increase in the amount of loans demanded.¹⁸

This suggests that an increase in credit union lending would not substantially come from reduced bank loans. Using their estimate, and considering that credit unions currently hold on average only about 5% of the small business loans held by depository institutions, and that H.R. 1418 would limit annual business loan growth above the old cap to 30%, if credit unions entered the market lowering interest rates by roughly 100 bp, the vast majority of that new lending could be accomplished without any reduction in bank loans.

In a recently published report for the Small Business Administration, Professor James A. Wilcox paper also dispels the zero-sum-game myth. While estimates in the Wilcox paper indicate that developments that boost small business loans at credit unions tended to reduce business loans at banks – the effect was very small. The evidence suggests that the offset was about \$0.20 per dollar of additional small business loans at credit unions. In other words, a reduction in business loans at banks implies that a \$1 increase in the supply of small business loans by credit unions would lead to a net increase in business loans of \$0.80.¹⁹ Put simply, on average, 80% of the increase in credit union lending is new capital that would otherwise not be available in the

¹⁸ Basset, William F., Chosak, Mary Beth, Driscoll, John C., and Egon Zakrajsek (All of the Division of Monetary Affairs, Federal Reserve Board.) “Identifying the Macroeconomic Effects of Bank Lending Supply Shocks.” December 2010. Page 18. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1758832.

¹⁹ James A. Wilcox. *The Increasing Importance of Credit Unions in Small Business Lending*. SBA Office of Advocacy. Release Date: September 2011.

marketplace. Thus, the vast majority of new credit union lending is not “siphoned” from banks that would otherwise make these loans.

Conclusion

Throughout our history, credit unions have existed to serve the credit needs of their members. From the very first days, this has included the business credit needs of members. During the recession, credit unions remained engaged in member service, and increased lending to small businesses when other lenders fled the market. The credit unions that contributed the most to this growth are or soon will be approaching the cap. In order for these credit unions to continue to serve their small business owning members, Congress must raise the statutory cap. Representatives Royce and McCarthy have put forward a thoughtful bill to achieve this that includes provisions designed to enhance safety and soundness. We urge you to strongly support this legislation, which would allow credit unions to lend an additional \$13 billion in the first year, helping small businesses create 140,000 new jobs.

Again, we appreciate your holding the hearing on H.R. 1418, the Small Business Lending Enhancement Act. We look forward to working with you and your staff as this legislation moves forward.

Best regards,

A handwritten signature in black ink, appearing to read "Bill Cheney", with a long, sweeping underline.

Bill Cheney
President & CEO

Attachment