SUBCOMMITTEE ON FINANCE AND TAX FIELD HEARING ON ACCESS TO CAPITAL FOR SMALL BUSINESSES

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SUBCOMMITTEE ON FINANCE AND TAX FIELD HEARING ON ACCESS TO CAPITAL FOR SMALL BUSINESSES

Monday, April 19, 2010

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:30 a.m., in Selby Auditorium, University of South Florida, 8350 North Tamiami Trail, Sarasota, Florida, Hon. Kurt Schrader [chairman of the Subcommittee] presiding.

Present: Representatives Schrader and Buchanan.

Chairman SCHRADER. Good morning and welcome to Vern's and I hosting of the Committee on Small Business Issues. This is a hearing on the Subcommittee of Tax and Finance of the Small Business Committee of the House of Representatives. We're trying to get out in the real world and solicit some interesting conversation, give you all a chance to listen and hopefully give us some feedback over time.

We'll probably give a lot of the testimony to our witnesses, but both Congressman Buchanan and I are very interested in hearing about your responses to the—to the hearing today.

My name is Kurt Schrader. I'm a Congressman from Oregon and chairman of the Committee. Mr. Buchanan, of course, is the ranking member of the Committee. We actually are in the eye of the storm when it comes to lending and access to capital for small businesses.

I really appreciate the opportunity to be here in Sarasota. Thank you for the weather. A lot nicer than it is in Oregon right now, I'll tell you that.

There's a reason we call small businesses the backbone of our economy. Throughout our history small businesses have generated enormous wealth in this country and often led us out of the toughest and darkest times. They've also unlocked innovation and powered our markets like no other business.

We also know that the entrepreneurship of the small business is the driving force in our economy. But at the same time, small businesses can't operate on good ideas alone; it takes money to get a start-up off the ground. It takes capital to keep a business running. It takes investment to build a small firm into an economic powerhouse.

During past economic downturns small businesses have actually managed to grow and flourish, like companies like Microsoft, FedEx, Hewlett-Packard, big companies in my part of the world, and 45 percent of Fortune 500 companies have all been founded during recessions.

Many Americans who have lost their jobs are not looking to unlock their own hidden potential as small businessmen and women by starting small businesses right now. And as the next generation of entrepreneurs step up to the plate, we need to make sure that they have the same opportunities to succeed that I had when I got my small business going.

I'm a veterinarian, started a small business there. Also a farmer, started a small farm in the valley of Oregon.

This hearing is very important. In our conversation this morning we're going to be talking about financing options of America's small firms, looking for ways to improve those choices, choices both here in Florida and hopefully my home state of Oregon.

As a small business owner myself, I understand the impact that lending declines can have on small ventures. I've seen firsthand in previous recessions as well as this one the role that capital plays in all phases of small businesses. In my veterinary practice I could have used some of the programs we're talking about right now when we had the last recession. We've been through some tough times.

Vern and I, along with some of the rest of our colleagues, were able to introduce a bill that is sitting in the Senate right now: H.R. 3854, The Small Business Financing and Investment Act, passed bipartisanly out of the House, out of our Committee, our Subcommittee and the Committee and the House of Representatives. And it actually has the opportunity to deliver $44 billion in lending and investment for small businessmen and women.

Mr. Buchanan played a critical role in those efforts. He particularly sought to modernize the Certified Development Company Program, helping established businesses secure capital for fixed-asset purchases.

Meanwhile, his continuing work to enhance SBA's SCORE Program would also go a long way to supporting new companies, training them in the areas like credit repair and loan package preparation.

Whether we're talking about small companies starting up in the valley in Oregon or real estate—real estate developers here in Florida, one thing is pretty clear: These entrepreneurs are struggling for the capital for the reasons we've talked about.

We're frustrated. We want to know, at least my guys want to know why, with a sound credit score and good payment history, why they can't access more capital or why their credit cards are being terminated, why their lines of credit are being stopped.

So we're hoping that all options will be put on the table as we discuss them here today. That includes policies to empower creditworthy borrowers over banks, greasing the wheels for equity investment, and otherwise deliver the widest array of choices for our small business innovators that we can do.

These are the avenues that Congressman Buchanan and I are working on to open and are just some of the issues we'll be exploring here today.

So I'm looking forward to hearing from all of the witnesses as we discuss ways to ensure that your small firms have the tools they need to be successful.

And with that, I'm going to yield to the ranking member for his opening remarks.

Mr. BUCHANAN. Thank you, Mr. Chairman.

I want to first thank our audience and thank everybody for coming. I know I did a seminar probably on small business access to capital myself about a year ago, seven months ago. We probably had 150 people show up.

And the first question I asked is how many people are having a challenge with banks and can't get lending. I thought maybe 20 percent of the room would raise their hand, and everybody in the room raised their hand up. So that's the reason that I've asked the Congressman to come.

I want to thank Congressman Schrader for his leadership as chairman. We've had a good working relationship. They always talk about Washington doesn't work, you can't get Republican and Democrat working together. But we've had a good friendship and his leadership has meant a lot to the Committee.

So I just want to thank him personally for being here today because congressional hearings are very unique and I don't know of the last time we've had a congressional hearing in Sarasota or Manatee County. Usually they're held up in Washington. And if you have one here, you have a member of the other party be a part of the process. So he was very willing to do this. Oregon is a long way. So I appreciate him being here in a bipartisan effort because he's interested, like I am, to do everything we can to help small businesses access capital.

The other thing I want to say is this Committee oversees about an $8 billion loan portfolio, the Committee that he chairs and I'm the ranking member of. So it's an important Subcommittee in Washington. I'm very proud. A lot of people have various committees. I do serve on other committees, like the Veterans Committee. We dedicated a new facility in Manatee County—very excited about that, a new veterans facility for our veterans. And I'm on Transportation, a big Committee and—in Florida.

But passion—these are—I'm passionate about the others, but my passion, and this is for 30 years, is really to work with small businesses.

When I think about our country, I think what makes it special and great and unique is entrepreneurs and small business. Being chairman of the Sarasota Chamber and the chairman of the chamber in Florida, one thing I realize, that 99 percent of all businesses registered in Tallahassee, Florida are small to medium-sized businesses.

They create 70—in communities like ours, probably 80 percent of the jobs. So capital is a very critical thing.

The national unemployment, I don't have to tell you, is hovering around 10 percent, 9.7. Florida is over 12 percent. I think in our region it's 13.

So again, when we look at any kind of legislation, you know, we're trying to find a way to help small businesses because they create 70 percent of the jobs.

Access to capital. I did a thing the other day. One of our witnesses that's a banker for, I think, 30 years. But I did a seminar or a little meeting the other day, I think with about 12 or 13 community banks. And most of them aren't lending today. And that's why the SBA is such an important aspect of that.

I look forward to hearing from our witnesses today. And I hope that we can identify ways to open up lines of credit for small businesses, things that work and change things that aren't working.

So the idea of our hearing today is to take back these ideas, formulate some policies, and see if we can't introduce, the chairman and myself, a bill maybe where we can get more access to businesses. And maybe that sunsets in a couple of years.

But I can just tell you you'll hear from our panel today, many— there are many good businesses in our region. If they had access to capital, they could grow from 15 to 30 employees. They can't get access to the money.

So I look forward to our witnesses. And I'll turn it back over to the chairman.

Chairman SCHRADER. I'm just going to explain the ground rules a little bit so everyone understands what's going on, hopefully.

The witnesses will basically have five minutes for their opening remarks. We'll probably be a little easier today than we would normally be in Washington, D.C. We're more casual in Florida. But try and get the witnesses to stay somewhat close to that because a lot of the better part of the hearing is, quite frankly, in the questions and responses going forward.

The green light will go on when they start. When they've got a minute left, the yellow light goes on. And when we'd like them to sort of wrap up the remarks would be when that red light is blazing away. So if witnesses could pay attention, that would be helpful.

Since we're in Mr. Buchanan's district, I just want to put a plug in for Mr. Buchanan. It's unusual for newer members to be in charge of committees and the fact that he's been selected as ranking member is pretty significant for Sarasota and Manatee County. It's a pretty big deal. So I— he's too modest to say that, but I'm saying he obviously has some cachet in Washington, DC.

With that, let's go ahead and I'll let the ranking member introduce our witnesses; we're in his district.

Mr. BUCHANAN. I'm excited. Our first witness today is Eric Zarnikow. He's an associate administrator at the SBA Office of Capital Access. He oversees and manages SBA lending, venture capital, international trade, a surety bond program. He's come to the SBA with 25 years of private sector experience. His latest corporation position was senior vice-president, chief officer and treasurer of ServiceMaster companies where they played a major role in the sale—he played a major role in the sale of the company to a private equity holder.

I welcome our witness today and look forward to your—your comments. And we'll proceed from there and ask you some questions and get your thoughts on various things.

Mr. Zarnikow.

STATEMENT OF ERIC ZARNIKOW

Mr. ZARNIKOW. Thank you, Subcommittee Chairman Schrader and Ranking Member Buchanan. I'm honored to be here today.

One of the missions of the Small Business Administration is to provide small business owners with access to much-needed capital. We do that primarily by providing a partial government guarantee on loans made by banks and on lending partners.

This guarantee helps provide access to capital for creditworthy small businesses who would otherwise be unable to get loans.

As a result, loans to women and minorities comprise a greater percentage of our portfolio than from the conventional lending market. Our programs are lifelines to many small businesses.

To address the disruptions in the credit markets the Recovery Act temporarily raised the maximum available guarantee on SBA loans to 90 percent and allowed us to reduce or eliminate most fees. The raised guarantees provided an extra incentive for risk-averse banks to lend to small businesses. And the fee reductions made loans more appealing to borrowers.

As a result of these actions and stabilization of the economy, SBA lending has increased by about 90 percent since the Recovery Act's enactment. It has turned about $600 million of taxpayer funds since the Recovery Act's enactment into support for over $25 billion in loans to small business owners.

We know that times are still tough for small business owners. While SBA's Recovery Act loans are helping, it is clear that many small business owners are still having a hard time getting access to credit.

Declines in home values have hurt small business owners as well because many entrepreneurs use home equity to help finance their business.

At SBA we understand how to use our program to address demand for credit, availability of capital, and risk tolerance. And with the President, we've proposed a jobs plan which targets gaps that still exist.

There's really five key components to that plan. First, to address the issue of banks that still have trouble taking risk, the Administration has asked for an extension through the end of fiscal 2010 of the increased 90 percent guarantee and reduced fees.

Second, for banks that don't have enough capital to lend, the Administration has asked Congress to establish a $30 billion small business lending fund to provide low-cost capital to community banks to allow them to lend more. This money would come with incentives to increase lending to small businesses.

Third, many small businesses need bigger SBA loans to create jobs. This could be franchisees, manufacturers, exporters, or other businesses. We want to increase our top loan limit for eligible 7(a) loans from $2 million to $5 million and from $4 million to five and a half million for 504 loans to manufacturers.

Fourth, for businesses that can't find access to working capital, we propose to temporarily raise SBA Express Loan limit from 350,000 to $1 million. These loans will help businesses restock shelves and fill orders that are coming in.

And fifth, we know that many small businesses have conventional owner-occupied commercial real estate mortgages that will need to be refinanced soon. As real estate values have declined, many banks will find that these businesses no longer qualify for conventional loans, regardless of the strength of the business.

As a result, even small businesses that are performing well and making their payments on time are going to have a hard time refinancing these loans and may face foreclosure. So we want to temporarily open up SBA's 504 program to commercial real estate refinancing.

It's critically important that we help creditworthy firms here in Florida and across the country avoid unnecessary foreclosure and lost jobs.

This plan is guided by basic principles: Build on what works, maximize limited taxpayer dollars, make targeted changes as quickly as possible. It addresses specific gaps in supply, availability of credit, and risk tolerance.

SBA is confident that this will allow us to better help small business in this tough economic environment.

Some people ask "Why doesn't SBA just make direct loans to small businesses?" Direct lending would require hiring a new work force and significantly expanding our reach. It would be much less efficient than the plan we've laid out. Moreover, we believe a partnership with private lenders is important for the sustainability of small business and to help target viable enterprises.

We want to build on the success of the Recovery Act by expanding points of credit access and bringing more small businesses into long-term banking relationships with an SBA lender. And we want to increase the number of banks that offer SBA products.

Let me close by saying that the SBA is here to help small businesses. Our field staff and resource partners are standing by to help small business owners and entrepreneurs as they start and grow their businesses.

And small business owners here in Florida have access to district offices, 35 small business development centers throughout the state, three women's business centers, a veterans' business center, and several chapters of SCORE, which is our executive mentoring services.

I thank you for your support of small businesses and for working with the SBA to get the support that they need. And I'm happy to discuss any of these proposals and answer any questions.

[The statement of Mr. Zarnikow is included in the appendix.]

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Chairman SCHRADER. Very good. You're experienced.

I appreciate you coming down. It must have been a tough deal coming from Washington, D.C. to beautiful Florida, but you have to sacrifice every now and then. So I appreciate you doing that.

Talking about some of the programs you were mentioning, back up first on the ARC. We chatted a little bit before the hearing. The ARC Program, for those in the audience that don't know, is $35,000, basically, line of credit that we've set up in the Recovery Act that small businesses were supposed to be able to access, provided they had a half decent balance sheet and plan to turn their business around, even if they were suffering a little bit in the recessionary economy.

With that, it's been a program that's been tough to get off the ground. In my own home state we've only had one bank making a number of loans and most of the other banks, in the year or so the program has been in existence, have only made like one loan.

What are some of the barriers you're hearing, Mr. Zarnikow? I've got some that I've heard, and I'm curious what you're hearing.

Mr. ZARNIKOW. Sure. The ARC Loan Program is attached as part of the Recovery Act. And it's a loan of up to $35,000 that's guaranteed 100 percent by SBA. And we actually pay the interest on behalf of the small business so the small business does not pay any interest on the loan.

The loan is to go to viable small businesses that are facing immediate financial hardship. And proceeds of the loan can only be used to make scheduled payments of principal and interest on all high end small business debt. It's— basically it's in essence a bridge loan to help a struggling small business that is still viable make payments on existing debt until economic times improve.

With the money that we got out of—out of the Recovery Act we have the ability to make about 10,000 ARC loans. So far we've made about 7,000—a little over 7,000 ARC loans. We've used about 70 percent of the money. We've seen loans in 49 of the 50 states plus the District of Columbia. And so far we have about 1200—over 1200 different lending institutions that have made at least one ARC loan.

So we've seen pretty good acceptance of it. The program was started up in June of last year so we got it out very quickly after passage of the Recovery Act. We've seen a ramp-up in the program and it's really—we've seen sort of a stabilization of the number of loans that are being made.

I think that some of the challenges that we've seen in it is some of the—in many cases what the business is looking for is not just a loan to make payments of principal and interest on existing debt; in many cases people are working—looking for working capital or ability to either start up or expand a business. And ARC loans don't fit that.

We also found that the level of documentation that's required to show that the business is viable and is facing immediate financial hardship has been challenging for some of the lenders.

In addition, there is a requirement that the lender take as much collateral as possible or they follow their existing collateral policy. And that's been a challenge, I think, for some of the lenders.

So the level of paperwork that's required has been a bit of an issue in order to meet the requirements of the loan program.

Chairman SCHRADER. In follow-up on that then, is SBA looking at ways to reduce that paperwork?

I hear from the bank side that it's not, a lot of times, worth their effort to get into that book of business. Frankly, you're not going to make much money on a $35,000 loan and you have to do all—go through all the bells and whistles and documentation you do for a much bigger loan.

Is SBA working on ameliorating or streamlining that to like a one-page application and look at freeing up some of the paperwork that banks usually have to do?

Mr. ZARNIKOW. I think there are several challenges to the program, and you reference one of them, which is for a temporary program, in some cases banks are unwilling to commit the resources that they need to train people, develop the infrastructure they need to be able to make the loans for what's a temporary program.

I think that one of the challenges we have is making sure that the lenders are following the requirements of the law: It's got to be a viable small business facing immediate financial hardship. The payment of the loan proceeds can only be used to make payments on existing qualifying small business debt. So there's a set of definitions that we have around that to ensure that the borrower is actually eligible for the loan and if the loan goes bad, that we're able to pay on the guarantee that we've made.

So we try to balance the oversight and responsibilities that we have as an agency with the goal of getting the capital out.

After the rollout of the program in June of last year we did— prior to the rollout we did a lot of conversations with banks to try and understand how they would utilize the product, how we could make it as desirable as possible for them to make loans. We got a lot of feedback.

When we rolled the program out in June, we continued to have a lot of dialogue with our lending partners. That's one of the things we do a lot is listen to small businesses, listen to lenders to try to understand how we can better— have programs that better fit or better meet the needs that are out there.

And we did make some changes to the program to simplify some of the documentation requirements, particularly around loans that were being used to pay credit cards. So we tried to narrow it down but at the same time also meet the statutory requirements of the program.

Chairman SCHRADER. Mr. Zarnikow, you reference the Administration's interest in beefing up the Express Loan Program. On one hand that makes sense because it's a program with a little less onerous paperwork; banks like those apparently. But they've had traditionally a pretty high default rate.

So how do we juxtapose increasing the amounts and putting more taxpayer money at risk and at the same time trying to get money out the door but not have that default rate issue?

Mr. ZARNIKOW. Sure. Our SBA Express product is a product that—it has a 50 percent guarantee, which is a lower guarantee than the rest of our loan programs.

That program is really targeted and focused primarily around working capital and providing working capital to small businesses and we have seen historically that that program has a higher default.

As Administration, we've proposed increasing the maximum loan size in that program. It's currently $350,000. We propose increasing it up to a million dollars. And the hope there really is to try and help small businesses that are now emerging from the recession, so they've survived the downturn.

We're hearing more and more that business is beginning to pick up. But when lenders look at my historical results, they're not as good and they have a hard time supporting a higher loan dollar amount, even when I have orders or I've gotten a new contract.

So we think that increasing the SBA Express Loan limit up to a million dollars will help provide access to capital.

To address the concern about taxpayers and taxpayer risk, we have seen historically that that program overall has a higher loss rate or default rate than our other programs.

However, when we parse the data and really drill into it, we find that that higher loss rate is really for loans of a hundred thousand dollars or less and that the default rate is actually much lower than our other programs when you get to loan sizes that are over a hundred thousand dollars.

So we think that increasing the maximum loan limit from 350,000 up to a million dollars on a temporary basis would help small businesses get access to working capital that they need as the economy is recovering without taking on undue risk for the taxpayers and providing that appropriate balance.

Chairman SCHRADER. Just a note of cautionary concern. The fact that the larger loans don't have as great a default rate, I understand. But I don't think there have been that many loans made of high magnitude to really justify statistically, you know, a lot of the information there.

And to be honest, I'm concerned most—most of the small business and stuff that I talk to are a much smaller nature. I'm a little concerned that the limited money set aside for the program go to these bigger concerns and be all eaten up and then a lot of smaller businesses wouldn't have any money at all to access. So just as a note of caution, I think for the SBA going forward.

Similarly, in the 7(a) program there's a push to increase the loan amount from $2 million to five. I believe in 3854, Mr. Buchanan's and my bill, we went up to three.

Again, trying to figure out, my understanding and Vern can correct me, but the average 7(a) loan in the state of Florida is about $290,000. So we're jumping it up to five.

I'm wondering again like in the Express Loans, are we catering to the bigger smaller businesses as opposed to the small—the 70 percent that are mom, pop with just a few employees, small businesses that I think need more help than some of the larger firms.

So if you could comment on why five.

Mr. ZARNIKOW. Sure. What we've tried to do at SBA is really serve all small businesses, whether you're a tiny small business, micro small business, or a little bit larger small business.

And what we've found is as the credit crunch has hit, a little bit larger small businesses typically have had better access to capital than the very small businesses.

With the upset in the credit markets, little reduced or increased risk tolerance, reduced risk tolerance from the banks, we hear more and more from a little bit larger small businesses and from their lending partners that they're having a harder time getting access to capital for what I would call a little bit larger small business.

The $2 million maximum loan limit hasn't been changed for a number of years. What we find is particularly in certain industries, franchise markets, exporting manufacturers, that there is a need for a little bit larger loan size. And those larger small businesses also provide a lot of job growth and job opportunity.

We do find and it would seem historically over the last several years that there's been more of a bunching in our loans, loans in the one and a half to two million dollar range, which is right up against our $2 million maximum; that the percentage of loans in our portfolio that are being made each year, there's an increasing percentage that's in that one and a half to the two million dollar range.

So we're seeing in our own lending that people are bumping up against that maximum.

When we talk with small businesses, when we talk with our lending partners, we hear a lot more of a concern that "I could help these businesses; they don't meet my conventional standard but I'm maxed out by the $2 million limit."

So our proposal is to increase the limit from two million up to five million.

We also have found that historically in our portfolio the larger size loans perform better and they actually provide a positive subsidy which helps support smaller dollar loans that are made in the portfolio as well.

Chairman SCHRADER. Just as a follow-up comment, again, most of these loans are smaller. I guess I want to make sure that, again, the limited dollars in these programs, these are not mandatory programs where just anybody comes in and gets it; if the money runs out, then someone wouldn't be able to get a loan.

So I would urge the SBA, if they haven't already, to look at some sort of set-aside, some, you know, information or—or an account where there is a certain amount allocated to smaller businesses, perhaps under the two million and then a certain amount of the money that would go to those over that to make sure that, again, the small businesses have that— that access and don't get crowded out.

With that, I'm going to turn it over to the ranking member for his series of questions. Thank you.

Mr. BUCHANAN. Thank you, Mr. Chairman.

I want to mention a couple of things. SCORE is out front if anybody—SCORE is a national organization. We've got a good chapter in our area, a very active chapter, a lot of our seniors, executives in big companies that want to help small businesses get off to a faster start. They've got a lot of expertise. And one of the big things I like about them is business planning.

The other thing I wanted to mention, again, the administrator will be available after all of our witnesses today, and I think he would really like the opportunity to visit a little bit. If it runs a little later, I'll buy you lunch or something. But we need to keep you here for this.

Let me mention I talked to your boss, the lady that's—the SBA administrator and we spent, you know, probably a half hour on the phone. We identified a lot of things.

But the President agrees on many things. I mean, he agrees in terms of capital gains taking zero for a year or two. That's one of the things that he agrees with the idea of 30 billion.

She was talking to me about getting access to community banks, $30 billion for those who qualify. It just seems like we're very good about watching—getting money out to the big banks. We're not getting it out to the little guys, the little banks. The little banks are dying. They provide a lot of capital for, you know, this area.

That's why the SBA really in this kind of environment, which doesn't come along very often, happened in the early 1990s and now—Florida has had a great run, I'd say, from 1993 to 2006, 13 years. But now we need some help. And the SBA is someone who is a provider and can really make a difference.

So I want to just—you know, listen: We need to get action because people are dying out there on the vine; they don't have any access to loans. So I want to run through—you know, I've got quite a few different questions, but I want to keep it—so if you keep your answers a little bit more concise. They're fine, but I just want to get to some things and get your point on a couple of things. And these are things that people in the audience have asked me if I wouldn't mind asking.

First thing: Is there, in your opinion, a segment of lenders, big banks, community banks, or other lending partners that, in the environment in the last year or so, that are lending or doing anything particularly well in the past year to year and a half? Do you see any segment?

What's your—and I'm sure Arizona, California, our area in Florida has been hit harder than most. Some areas aren't quite as bad, but we've been hit real hard because we're so heavy in terms of housing.

But what's your thoughts in terms of your sense of whether banks are lending or not?

Mr. ZARNIKOW. What we've seen is that there's been a real focus in small business lending around smaller or regional or community banks.

One of the things we have is strategic goals to increase the number of banks that participate in our program. We really want to increase the points of access.

And in fiscal 2009 we had about a 15 percent increase in the number of banks that made at least one SBA loan. And the vast majority of those were really focused around regional, you know, smaller regional and community banks, banks with less than $10 billion assets or community less than $1 billion of assets.

And we've seen a shifting in our portfolio over the last years where a much increasing percentage of SBA loans are being made by smaller community banks.

Mr. BUCHANAN. Let me ask—I just want to make a quick note here. SBA, the default rate in the last ten years, what has that been? Do you know offhand?

Mr. ZARNIKOW. Now—

Mr. BUCHANAN. Just an overall portfolio.

Mr. ZARNIKOW. I'd say the overall portfolio has varied depending on economic conditions. But when you look at the overall default rate, it's probably in the 6, 7, 8 percent range.

Mr. BUCHANAN. Because I heard it was—are you talking about lately or are you talking about the last ten years?

Mr. ZARNIKOW. I'd say for the last ten years it's probably lower, lower than that, and we've seen an increase in the last few years.

Mr. BUCHANAN. Okay.

Mr. ZARNIKOW. There's also a difference between the default rate and our loss rate because we do have recoveries on loans that are—

Mr. BUCHANAN. What is the loss rate?

Mr. ZARNIKOW. The loss rate is more like 4 percent.

Mr. BUCHANAN. Okay. So 4 percent. So the taxpayer's helping small business, and we've got about a 4 percent loss rate. I think that's important for people to know.

Also you suggested that the Administration supports increasing loan size for the SBA loans. My question is: If the banks are hesitant to do the $2 million loan now in the current system, why are we suggesting up to five million?

I'd like to see it go up to five million. But, you know, what's your thoughts on that?

Mr. ZARNIKOW. What we've seen is: an increasing percentage of our loans that are made each year are in that one and a half to two million dollar range, which tells us there's kind of a bunching, that the two million dollar cap is sort of an artificial limitation on expanding access to capital.

We would say that, you know, we would expect that banks would make larger loans with the SBA guarantee up to the $5 million level. We're not saying that the volume would be enormous, but we do see that there is a big, you know, access or loss of access to capital as businesses get a little bit larger. I think these businesses have been successful and want to expand. They want to add a location. We want to be able to grow with those small businesses and continue to support their needs.

Mr. BUCHANAN. Why is the general feeling with the SBA with a lot of banks you provide 80, 90 percent guarantees, some of these small loans maybe a hundred percent guarantee, we can't get more banks to access SBA?

It seems like it's a no-brainer for banks and something banks should do or want—because we need that capital in our communities, whether it's here or in the Chairman's district.

Why is it in such a tough time that we can't find a way to either cut the fees a little bit or be more accommodating to small banks? Small banks in general, you know, like it takes forever to issue a loan or something like that.

I think it's gotten better, but we need to make it—find a way where banks will actually access and use you guys more.

Mr. ZARNIKOW. You know, we, as an agency, have been very focused on how do we be better business partners. You don't often hear a government agency talk about being a business partner, but that's how we really think about it.

I mean, our programs, ultimately we're supporting small businesses. But our programs, our lending programs, are all delivered through lending partners.

Our programs are voluntary, so if the lending partners don't find them attractive, they're not going to participate in them. So we try very much to be more and more business friendly while also making sure that we have appropriate oversight to protect the interest of taxpayers.

We have seen last year, fiscal 2009, about a 15 percent increase in the number of lenders who made at least one SBA loan. And that was about 2800 different lending partners.

We're on pace in fiscal 2010 to actually exceed that goal. One of our strategic goals really is to increase points of access and add additional lenders into our lending, you know, programs. So we're very focused on trying to simplify our programs, be better partners, and have commitment to our lending partners as far as turnaround times and other things while at the same time making sure we're appropriately protecting taxpayer dollars.

Mr. BUCHANAN. The other thing, you have offices in Florida; one in Tampa and the one in Jacksonville, one in Miami. Where do you have other—human employees, if someone has a question and wants to—what office would they use? They'd use the Tampa office, wouldn't they?

Mr. ZARNIKOW. You know, here in Florida?

Mr. BUCHANAN. Yeah.

Mr. ZARNIKOW. I would say for this area they would use the Tampa office primarily. And we actually have a couple of people here from this area who are also—would be glad to help answer questions afterwards as well.

Mr. BUCHANAN. Okay. Where are they at, just out of curiosity? Do you want to stand up just so everybody can see you, if anybody wants to see you after the program?

Thanks for coming. Thank you.

Mr. ZARNIKOW. I would say too, very quickly, if you go to our website, which is www.SBA.gov, you can get through—off the Internet, access to all of our resource partners across the state of Florida or across the country are available on website. You can see the address and contact information as well.

Mr. BUCHANAN. Okay. I have a few more questions. I want to kind of run through these.

You touched on the idea of the Express Loan, the SBA Express Loan, raising that up to a million dollars. Is the Express Loan more attractive to lenders, do you find? Because that's important. When I'm thinking express, I used to go to the SBA in the 1980s and Express was like a year later. But the point is is there—what is—how long does it take to get an Express Loan that's a million dollars? Raising that up, have you found more lenders open to that?

Mr. ZARNIKOW. No, the—there's a trade-off for lenders in our Express products. Our regular, our 7(a) product carries either a 75 or 85 percent guarantee depending on the size of the loan.

The Express product carries a 50 percent guarantee, but essentially we allow the banks to use their own paperwork to process the loan. So there's a trade-off for a bank. They get a lower guarantee but they're allowed to use their own paperwork.

SBA Express is really used by our most experienced lenders. They have delegated authority so they're actually allowed to put the guarantee on behalf of SBA.

So to the lender it's really a trade-off on "how much risk am I willing to take? Would I prefer to do more paperwork and have the higher guarantee or am I okay with the lower guarantee and the express paperwork?"

Mr. BUCHANAN. Another thing—again, I can't tell you how many businesspeople I talk to; been to six banks, seven banks, been turned down.

Why isn't the SBA open-minded towards direct lending for these economic times for a year or two where we can get money out quicker? Because you're really at the mercy of the bank if you have no banks in the region that are enthusiastic about it or might do it or might not do it.

I mean, you're guaranteeing 90 percent. Why don't we, you know, make some funding available for small business on a more direct basis? I know you touched on this in your opening remarks. But I—that's something I've been pushing for, the idea, sunset in a period of time.

What's your thoughts? Anything additional on that?

Mr. ZARNIKOW. Sure. The concern we have in trying to do direct lending, we really work through lending partners. We provide a partial government guarantee that—of the loan that's made by a bank or a credit union or a non-depository institution.

When you look at the reach out there, we have 68 district offices around the country. Our lending partners literally have tens of thousands, if not a hundred thousand branches.

What we're trying to do is make sure that when a small business needs capital, they go to a bank. Our programs have credit elsewhere attached, so we're not trying to replace the conventional market.

If a loan can be made by a bank on a conventional basis, they do it conventionally. If it doesn't qualify for a conventional loan, they can look at doing an SBA product. And obviously there are some small businesses that are out there that aren't creditworthy and are going to be unable to get access.

When we look at the infrastructure that would be needed to set up a direct loan program, there would be an enormous amount of hiring, and we would have to do training and we'd have to do—we would also be redirecting small businesses to now come to the government and apply for loans, go to those 68 district offices rather than go to the lending partners.

And we just feel that it's a very costly process to do. It would take a long time to hire up that level of people. And then we would have these loans on our books for a long period of time we'd have to continue to have to service and liquidate.

We also look at and have a concern that it is a small—if a bank is unwilling to make the loan at a 90 percent guarantee, should we, as the government and as taxpayers, in essence doing the loan—be doing the loan at 100 percent guarantee.

Mr. BUCHANAN. I don't think the bank is—they like the guarantee, but I think that they—many banks just feel like it may—you know, to get that guarantee, it takes too long to get the money back if someone defaults on a loan.

Let me mention—someone just dropped me a note— because we do have hurricanes and coming into hurricane season, you do do some SBA lending for national disasters, don't you? Is that true—

Mr. ZARNIKOW. Our disaster group, which is a whole 'nother area within SBA, we do do lending for disaster. Their mission is really focused on lending in areas there's been a disaster, whether it's a hurricane or an earthquake or flooding. And the focus there is primarily on homeowners and it's primarily on property damage.

So if you look at the number of loans that they do, 95-plus percent of the number of loans would be to homeowners and it would be for property damage.

They do do a limited amount of business disaster lending, once again, primarily focused on damage, replacement or damage loans that are—have caught—businesses had.

So when you look at their expertise, they do a wonderful job. They really do a great job in responding to disasters, but their focus is on property damage loans for homeowners.

Mr. BUCHANAN. The last question, I think maybe the Chairman touched on a little bit, but what are you doing to develop relationships with community banks, with banks, you know, local regions?

You mentioned—touched on it a little bit, but it just seems like we need to do a lot more. I want to bring SBA down here with our banks, I know, and I'm sure the Chairman does, just to make sure that our banks have complete access and they understand the pluses and—ideally pluses and some minuses with SBA—

Are you—do you have an aggressive reach-out program with banks or do you kind of let the banks come to you? Are you marketing it in this period, in this time frame?

Mr. ZARNIKOW.—I would say we have a very aggressive reach-out program primarily through our district office network in that you have 68 district offices around the country. And we're very aggressive about reaching out to lending partners who are—can potentially do SBA loans.

I mentioned we've seen 15 percent increase in the number of lending partners who made at least one SBA loan in fiscal 2009. And we have a goal to increase that even more.

We're also reaching out through some of the trade associations, the American Bankers Association, Independent Community Bankers Association to try and get the word out through the trade associations as well about SBA programs. So I would say we have a very aggressive program to try and increase the number of lending partners that participate in our programs.

Mr. BUCHANAN. I appreciate your comments. And I yield back to the Chairman.

Chairman SCHRADER. Thank you very much. Just a few follow-ups if I may. We don't have others to ask the questions so we can ask a little longer period of time than usually in Washington, D.C. here.

You talked about aggressive outreach and I would agree with that. I see that in my district back in Oregon.

What about the follow-up? Getting one more bank to sign up is considered a victory, but it's not really a victory for a small business that can't get a loan from that individual.

What sort of follow-up—do you have the manpower, I guess is the basic question, to actually follow up and, you know, encourage these banks to sign up? You know, what are your barriers? How can I help you follow through and make sure, you know, Schrader's Veterinary Clinic gets a loan?

Mr. ZARNIKOW. I'll tell you a couple of things. One is what we really measure is the number of partners who make at least one loan. So it's not enough to get them to sign up and say I'm open for—

Chairman SCHRADER. Could we expand that to three loans maybe?

Mr. ZARNIKOW. We'd be glad to do that. You know, our focus really is points of access for—you know, points of access to capital for small businesses.

We also are continuing to try and make our products easier to do. A little over a year, year and a half ago we rolled out what we call Small Rural Lender Advantage product, which is a simplified processing method that's really focused on the smaller community banks that basically do less than 20 SBA loans per year. They have a simplified method.

We have a process to really kind of hold their hand through the whole process because our processes and paperwork can be a little bit intimidating. So we have a simplified processing method that really helps the community banks get through the process.

Chairman SCHRADER. I think both the ranking member and I would like to see data on how that works—

Mr. ZARNIKOW. Sure.

Chairman SCHRADER.—as soon as possible.

You mentioned with the ranking member along this line of questioning about letting—some of these progressive banks are allowed to use their own paperwork. Why not allow that as a routine at least temporarily for the 7(a) program, the 504 program, some of the others, you know, besides the Express Loan program? Why not do that with some of the ARC loan program? Why not allow the banks to do their own thing and not have to jump through another—another hoop for the SBA?

Mr. ZARNIKOW. The balancing we have there is making sure we have programs that do protect taxpayers' dollars but also help support and expand access to capital.

Chairman SCHRADER. I just would be cautionary because—because we've heard, at least our communities, the banks are being pretty tough already. So I think not only are they protecting their shareholders, they're trying to protect the taxpayers too. They do not want to make a bad loan. I've yet to come across a banker or credit union individual that's making frivolous loans, at least in this day and age.

I just urge SBA to think about that.

What other elements—the other big thing I hear all the time is, Well, the SBA talks a good game, but they really can't—you can't get guarantees paid, they're difficult to work with, et cetera.

What has happened in the last year, year and a half that SBA has changed how they're doing business to make it more friendly for banks?

Mr. ZARNIKOW. Sure. We have focused very hard on our guaranteed purchase process. That's when a loan goes bad and the bank comes to ask money on our guarantee. So we put in about two years ago now what we call a brand promise where if the bank submits a package, a guaranteed purchase package, and it's complete, it's all the information we need to evaluate the guarantee to ensure that the loan was eligible, that the bank followed the rules around servicing and liquidation, we have committed that we will decision that case and get the guarantee paid within 49 days. And so far we have not missed a brand promise. We've been very focused on making sure that we paid a guarantee timely as long as the bank submits the information that's required.

Chairman SCHRADER. Last question and I'll turn it back to the ranking member for any additional questions here.

One of the things that was identified in my neck of the woods and in Washington, D.C. in some of our hearings was, you know, some of the carve-out programs and some of the abuses.

We have a pretty robust veterans small business assistance program trying to encourage entrepreneurship among our fighting men and women that come back and want to start a business. They're, unfortunately, 45 to 50 percent underemployed or facing no job.

But there have been horrible abuses in that program so the veterans aren't really getting help; there's the charlatan companies that are actually getting help.

What's SBA doing to fix some of those problems that we've seen particularly—I know Vern has met with veterans here in Florida. So how are we helping our fighting men and women?

Mr. ZARNIKOW. You know, from the loan side, and I don't know if you're talking about government contracting or the lending side. My area is really the loan side.

You know, we do focus on and have specific outreach to the veterans community because we find that a lot of the veterans want to be entrepreneurs, they want to start small businesses. You know, our loan volume, somewhere between 5 and 10 percent of our loan volume each year goes to veteran-owned businesses.

We do have also our Patriot Express product, which is really focused on the veteran community and their families. Once again, it's an express product with a higher guarantee to try and make sure that they have access to capital. We're supporting the veterans community.

Chairman SCHRADER. Thank you very much.

Mr. BUCHANAN. Yeah, I just—one other question. You know, one of the things that, you know, anybody that's looking for a loan, they want a quick yes or no; I'm sure that banks are the same way.

What is the process time? I mean, even—people say, Look, if I get a no, I don't want it but that's fine. But give it to me. Don't drag out it for three months and then find out I can't get my, you know, $75,000 loan.

Have we done anything to expedite decision-making to get a quicker yes or no? I know some of the programs that have a little less money attached to them, they're quicker.

But just in general, are we doing anything to expedite that? Because, you know, people are usually at their wit's end to try to get a loan and you wait three months and they're all frustrated.

And that's true of banks a lot of times too. They don't give a quick yes or no. It's a slow no.

But what's the mentality on that today? What are we doing to try to get a quick yes or no?

Mr. ZARNIKOW. Sure. Our process—there are several things that we've done. One is we have what we call preferred lending programs where for our largest, most experienced lenders we actually delegate authority with them to put the government guarantee on the loan. So they can have the ability without coming to SBA for pre-approval; they can actually put the guarantee on a loan.

And through delegated authority for the loans that come to SBA for approval we generally have a five- to seven-day turnaround while we decision that loan and give either a yes or no once we have a complete package.

The thing that I would highly encourage anybody, a small business who's looking at getting a loan, make sure you're well prepared, you know, through our small business development centers or SCORE volunteers or women's business centers. They can help you get prepared to go to a bank to get a loan. Make sure that you have a business plan, that it's well thought out.

Make sure you have the basic information that the bank's going to ask for. They're going to want to see tax returns, they're going to want to see financial statements. They're going to want to see information about your business and what your road map is, which is basically your business plan.

So I really encourage any small business who's thinking about getting a loan, make sure you're well prepared when you walk into the bank. And please access SBA resource partners to help you get it.

Mr. BUCHANAN. If you're prepared and you give them a complete package or maybe most of it, how long should it take between whether they're going to get a loan or not in terms of the bank making a decision and then getting your commitment towards the guarantee from the SBA? What do you think is a reasonable period of time in your mind for that time frame?

Mr. ZARNIKOW. You know, for the—it's hard to speak for each bank because each bank has their own internal process that they have to go through, the credit approval.

Smaller dollar loans tend to get decisions pretty quickly. A lot of times those are done on credit scores and some basic analysis.

A much larger dollar loan that's complicated can take longer. Once again, once—you know, we do have delegated authority, so once the bank decides, if it's a delegated lender, they can make the decision right away. Or if it comes to SBA, generally we have five- to seven-days turnaround time.

So it really depends on the size of the loan and the complexity of the situation.

Chairman SCHRADER. Okay. I'd like to thank our witness. He will be available later. And if we can get our four other witnesses to come forward, we'll take a quick break.

[Recess.]

Chairman SCHRADER. Let's resume. And the ranking member will introduce our first witness.

Mr. BUCHANAN. We've got a great panel. I appreciate all of our panelists for being here today.

Our first witness is Brian Hall, who is president/CEO of Sabal Palm Bank; has 26 years in the Air Force as an officer and pilot. Mr. Hall received his degree in finance from Indiana University, an MBA from University of Cincinnati. He's been a leader and very active in the Sarasota and Manatee community.

And I personally have known him and he's been a great banker, as well. I met him when he was actually at South Trust Bank. But he started his own bank, I would say, about 2005, I guess, 2006 he started a bank from scratch and they've done well.

We look forward to Mr. Hall and your testimony.

STATEMENT OF BRIAN HALL

Mr. HALL. Good morning. Thank you for the opportunity to participate in today's hearing.

In June of 2009 there were 53 FDIC-insured banks with locations in Sarasota and Manatee counties with approximately $18 billion in deposits.

This market has three banks, Bank of America, Wachovia, and SunTrust that have a combined 48 percent share of the market.

The nationwide and regional banks typically control 80 to 85 percent of banking in this area and the community banks around 15 to 20 percent of the market.

With the exception of a few banks that are focused only on consumer lending, private banking and/or wealth management, most banks in this market consider small business lending to be an important target segment.

Banks can play an important role in helping our economy recover. Our industry is needed to supply loans to small businesses that want to buy, build, expand, or support something that creates commerce and job growth.

Banking is a highly regulated business and banks are required to maintain certain leverage and risk-based capital ratios by their primary regulators based on the financial condition of the bank and the composition of the bank's loan portfolio.

For every dollar of capital that a bank has, it can leverage this about ten times into loans, again based on the type of loan and overall condition of the bank.

Many bankers will tell you that the number one consideration for determining the volume and the type of lending that they can do is their level of capital.

The key considerations for a bank's capital are as follows:

First, do banks have enough capital to deal with the loan risk that's inherent in their current loan portfolio?

Almost all small businesses—small business borrowers, unless they're in the business of providing a highly essential product, have experienced declining trends for the past two or three years. The cumulative impact of declining revenues, margins and liquidity has left small businesses in a very fragile condition and with reduced ability to pay their loans.

Second, are banks confident that they can get additional capital when they need it in a timely manner and a fair price to support future growth or use as a cushion for the risk of losses?

For most community banks, even mature banks that are profitable and have relatively clean balance sheets, it is very difficult to raise additional capital today, even at 50 percent book value per share.

The President's announcement a few months ago about a Small Business Lending Initiative that would make capital available to community banks under reasonable terms and conditions has many of us eagerly waiting for more details.

And third, how confident are banks about the results of their next regulatory exam, especially as it applies to the review of their loan portfolios and capital expectations by regulators?

There have been many well publicized comments by our political leaders and banking association leaders calling for regulators to show restraint, consistency, and provide more time for banks to work through problem loans and complete capital raises.

The only microwaved solution for a problem loan today is just to charge it off or set aside reserves which reduces capital, which reduces—which results in less lending that banks can do, which results in less commerce and job creation.

So what can be done to help small businesses get more access to bank loans for building, buying, supporting something?

I have a few suggestions:

First as it applies to bank capital, as I previously mentioned, the level of bank capital is the key driver for how much lending and what type of lending a bank can do.

There are a number of initiatives being discussed to strengthen bank capital which will lead to more lending.

Number one, the President's Small Business Lending Initiative proposed $30 billion to be provided to banks with $10 billion or less in assets as recommended by their primary regulator.

The details of this program have not been announced. But it's critical that the applying bank be evaluated based on their condition and ability to repay after receiving the capital, not on the bank's current condition. This wouldn't be a bailout or a handout, but it would be a capital investment required to be repaid with dividends.

Banks should be encouraged to use these funds for small business lending and receive a reduction in the dividend or interest rate based on their lending results.

The program should encourage but not require banks to do SBA lending if they participate. Many banks are SBA lenders, as we heard this morning, but many are not.

Gearing up to do SBA lending does take a lot of time and expertise that many banks don't have today. We just don't have that time to spend.

Currently banks are limited on the amount of their allowance for loan loss that can be counted as part of their capital. These limits didn't anticipate the type of economic challenges that we're facing today and the limited access to new bank capital.

Accordingly, a bank's entire allowance for loan loss should be treated as a form of capital. And really that's what it is. It's funds to be set aside to help support the future risk of loss in a loan portfolio. This would increase bank capital which could be leveraged into increased small business lending.

Third, very few banks have been profitable over the last two or three years. Current accounting for deferred tax assets, which are basically treated as reductions from capital for capital adequacy measurement, needs to change.

Current treatment of deferred tax assets is very destructive to capital and the U.S. has among the most outdated accounting treatment for deferred tax assets of any modern country.

Our leading trade association, American Bankers Association, recently announced this issue as a key initiative. But frankly, with so many other things gong on in our industry it's really not received the attention that it deserves.

Modifying the treatment of deferred tax assets for capital adequacy would increase capital for banks which would—could be used for additional small business lending.

Second, as part of the American Recovery and Reinvestment Act—we heard a lot about it this morning from our first speaker, I agree and applaud the SBA's efforts to reduce fees and increase the amount of guarantees. I think as Mr. Zarnikow said, that has been helpful. Our bank is a relatively young bank. But we have been an active participant with the SBA.

And finally, regulators need to provide some relief as it applies to commercial real estate lending. Not all commercial real estate loans are alike. Most bankers agree that loans for land, development and other speculative purposes are very high risk, especially in the current economy.

However, if conservatively underwritten, other types of commercial real estate loans such as office, medical, anchored retail, and multifamily are not necessarily higher risk than traditional commercial loans.

To summarize, in order for our economy to recover, qualifying small businesses need access to capital from banks for loans to buy, build, expand or support their businesses. Banks are motivated to find ways to make loans; that is what they do. However, bank capital is the key.

These are solutions that I mention that are available to increase capital for banks which will allow for more lending which will advance the volume of commerce and job growth in our economy.

Thank you again for the opportunity to speak for you today.

[The statement of Mr. Hall is included in the appendix.]

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Mr. BUCHANAN. Our next witness is Bill Miller. Bill is Senior Vice-President for Political Affairs and Federation Relations, which means—when I was chairman of the Florida chamber, we had 137,000 businesses in the federation. A lot of chambers are part of the state federation. And they are, all of those chambers, tied into the national. I think there's over three million small business and businesses that tie in, in terms of the U.S. Chamber; Bill Miller oversees that.

In his capacity he's responsible for directing and implementing the Chamber's political grassroots and elected-related activities. You know, his job is to find members of Congress and the House or Senate that are pro-business, Democrats or Republicans.

His biggest issues in terms of his portfolio, in terms of legislation pertain to keeping taxes low, trade, legal reform, govern—corporate governance and election reform.

He serves as spokesman and has appeared on many numerous shows including CNN, Inside Politics, Bloomberg, ABC Nightly News, PBS as well as the Wall Street Journal—he's written articles, published articles in the Wall Street Journal, New York Times, Fortune.

I want to thank you for being here today, Bill.

STATEMENT OF BILL MILLER

Mr. MILLER. Thank you.

Good morning. Again, my name is Bill Miller. I'm here proudly representing the United States Chamber of Commerce.

Thank you, Chairman Schrader. Thank you, Member Buchanan. I greatly appreciate the opportunity to offer the perspective of the business community on the important discussion of issues today.

In addition to representing the chamber, I'm also a small business owner myself; over the years starting and selling an entertainment company, starting a—starting and running a small community bank. And today I'm a part owner of two restaurants in Washington, D.C.

The nation is clearly emerging from trying economic times. With the unwinding of the housing market, severe liquidity crisis, and the general deleveraging of financial markets, the economic downturn was severe.

Not surprisingly, many small businesses are still in that survival mentality, making defensive operational decisions in an attempt to protect assets.

As economic activity gains momentum, credit markets will need to respond by providing robust avenues of capital for Main Street to replenish those inventories, purchase equipment, and make investments in new opportunities.

The following are a couple of policy initiatives that the U.S. Chamber of Commerce feels are warranted to help small businesses grow and create those new jobs.

First, with regard to federal income tax rates, many small business are organized as Subchapter S Corporations, limited liability partnerships, or LLC for federal income tax purposes.

This means the profits are not taxed at the corporate level but instead passed through to the individual income tax returns.

While small business owners pay personal income tax on the profits, the reality is only a portion of the income generated by the businesses actually make their way back to the personal bank accounts. Much of the income small business owners are being taxed on is actually reinvested in the companies in the form of expansion and new equipment.

The chamber recommends that Congress lower all marginal tax rates or, at the very least, keep those rates at present levels. By lowering or keeping the rates at present levels, Congress would enable small business owners of all size to invest more in their businesses. Allowing these rates to increase would increase the cost of capital and diminish the investment opportunities.

Secondly, repealing the 3 percent withholding tax, Section 511 of PL 1009-22, requires a 3 percent tax withholding on all government payments, which affects all government contracts as all as other payments, such as Medicare, grants, and farm payments.

While this requirement is not set to go into effect until January 1, 2012, there are many companies that are already expending funds to prepare for the implementation of this. These are needless preparation expenses for a requirement that most believe should have never been enacted.

The chamber supports repealing the 3 percent tax withholding law which will have tremendous impact on working capital for those companies that are local, state and federal government contractors.

Three, access to capital provisions. As was discussed by the previous two witnesses, access to capital is a critical component for small businesses for them to fully unleash the job-creating engine that will be vital to igniting the economic turnaround for our country.

In order to have capital available for small businesses they need to revive the economy, the chamber supports the following legislative efforts: Extend and fund through the current calendar year the reduced borrowing and lending fees for SBA 7(a) and 504 programs. These fee reductions will continue to incentivize financial institutions to lend and will make funds more affordable for small businesses to borrow.

Extend—number 2, extend fund—extend and fund through the calendar year the 90 percent government guarantee percentage of the SBA 7(a) loans. Appropriate increases in the federal government guaranteed portion of the loan reduce risk to the financial institutions and provide additional incentives for the industry to underwrite small business loans.

Make improvement in the SBA Express Loan provisions increasing the maximum Express Loan value to $1 million and temporarily increase that Express guarantee for 75 percent for the next two years. This was discussed in some detail in the last presentation.

Number 4, increase the maximum loan size and maximum guaranteed portion of the SBA loans. This was discussed also. And the Chairman and Ranking Member have a proposal. There's also one in the Senate by Senators Landrieu and Snowe on the Senate Small Business and Entrepreneurship Committee that has introduced increasing the size of the maximum size of the SBA 7(a) and 504 loans from two million to five million.

And then finally, Small Business Innovation Research and Small Business Technology Transfer programs, these were established by the Congress in 1982 to use innovative talents of small businesses to help meet the government's research and development needs at a time when there was a significant concern that the United States was falling behind its global competitors in developing innovative technologies.

SBIR and STTR currently do not enjoy long-term reauthorization. In order to make sure that these small businesses are fully involved in advancing the nation's innovation and technology, we need to expeditiously get the Senate to get a comprehensive reauthorization of these two programs.

In conclusion, I appreciate the opportunity to submit these comments on proposals that will be helpful to small businesses. I look forward to working with you and the Committee to champion the policies to unleash the innovative abilities and the entrepreneurial spirit of American job creators, our small and medium-size businesses.

[The statement of Mr. Miller is included in the appendix.]

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Mr. BUCHANAN. Thank you, Mr. Miller. I just want to say the U.S. Chamber, as well as the state Chamber, will lobby in terms of small business or pro-business in Tallahassee with members of the House and Senate. The U.S. Chamber weighs in aggressively with Democrats and Republicans in the House and Senate in Washington.

And I say that because it's just not a Republican-based thing. Aggressively with Democrats, anybody that's going to be pro-small business policies in terms of less tax, less regulations, less frivolous lawsuits. They do a heck of a job, and I appreciate Mr. Miller being here today.

The next gentleman I just met a week or so ago, but he represents why I want to have this access to capital. This whole thing is about jobs and working families.

And he—I got introduced to him by a mutual friend. And he was talking about if he had access to capital, he's got a company that's grown quickly. He's got a company that's profitable; just that he's a newer business, he can't get—he can't get money from banks or anything else locally, as many small businesses can't.

Mr. Orr is the founder and CEO in Sarasota of Creative Agency Service Team, Inc. or CAST. CAST provides retailer and manufacturers with creative manpower and virtual interactive services.

His company currently supports an average of over 25,000 retail locations a month, brands like American Express, Macy's, Wal-Mart, CVS, and many others.

Mr. Orr has over 30 years of retail and marketing experience and serves in a—he did serve in a senior leadership position for three different Fortune 500 companies prior to starting the company three years ago, CAST.

After initial investment of 175,000 from private investors less than two and a half years ago, CAST is projected to deliver top-line revenue of $6 million this year in 2010 in downtown Sarasota.

The company currently employs about 450 employees, not all full-time, some of them are part-time, and employs opportunities for over 18,000 independent contractors in the country.

I'm glad to have Mr. Orr with us today.

STATEMENT OF JOHN PAUL ORR

Mr. ORR. Thank you.

Well, before I begin, I think I'd like to start by introducing my wife Kelly who's—stand up, Kelly. Kelly is my wife for 28 years and the last two years she's been my business partner. She left her nursing career as an RN and she's joined me in business.

So I said to someone as we were preparing for this that now that we've learned to work together in business, that if you should need some help with settling peace in the Middle East, Kelly and I would be glad to step up.

So what I want to do today is just really give a personal experience here in Sarasota, how it's related. It's related to our need to raise capital and some of the challenges that we face.

I'd like to first just repeat some of the things that Vern has already said. As founders of a small company that's experienced fairly significant growth since its inception, I'm honored today to discuss the opportunities that we believe could be created if small businesses are afforded more sufficient and reliable access to capital.

Like many small business owners, our American Dream actually began as a nightmare. Without notice, we received a phone call informing us that the job we thought our entire future depended on was being eliminated.

Fortunately, we were armed with over 30 years of corporate experience, an extremely generous group of friends and family who believed in us, many of those are here today, and a healthy dose of entrepreneurial naivety; in other words, we didn't know what we were getting ourselves into.

I'm here today to provide evidence though also of society's return on investment when small businesses do succeed.

The name of our company is Creative Agency Services Team, Inc. or CAST for short. Our mission is to support major retailers and their suppliers in over 100,000 retail store locations across the country.

And CAST's model requires us to train and deploy thousands of agents to do work in all 50 states. This means that our success is hinged greatly on our ability to make investments in state-of-the-art technology, to establish scalable infrastructures, and to create sufficient cash flow to floor plan our payables.

CAST was started, as Vern said, with an initial investment of $175,000 from private investors just a little over two years ago when the company started and is projected this year to deliver top-line revenues of 6 million. It's a testament to the American economy that a company started by a husband and wife and one employee in the worst economy since the Great Depression currently provides jobs to over 450 employees and deploys opportunities to 18,000 independent contractors.

Naturally we are proud of these accomplishments and grateful for the support that has got us to this point. But it's important that I use the opportunity today to point out to the Committee that with better access to capital, we believe that CAST could have grown at twice that rate and employed a much larger work force at a time when America desperately needs jobs.

Small business investment is not only a great deal for savvy investors, it also yields significant returns for society at large. In contrast to the rhetoric we hear about corporate America and big labor and big government, small business continues to embody the true spirit of America. By definition, no small business is too large to fail; and, therefore, company politics and hidden agendas and wasteful spending are better left to those who can afford to fail.

We've been thrilled to find that in small business it's still very personal. Loyalty to customers and to employees and to deep-rooted principles is still very much in vogue.

Small businesses literally bloom from the roots of the community. Friends and relatives offer unconditional support and encouragement. Employees bring their experience and their ambition, while investors add a sense of confidence and responsibility to the organization by betting that success is within reach.

If you think about it, all great American institutions can ultimately be traced back to their small business DNA. That's why I submit to you today that placing too much of our nation's priority on businesses thought too large to fail at the expense of small business is like frantically gathering fruit from a burning vineyard while allowing the roots to die.

At the end of the day, small business gives birth to our future economies. It makes a major contribution toward the culture that most Americans long to restore and it truly represents the most powerful mechanism at our disposal for stimulating economic growth and job creation.

I'm honored to be part of the panel, and I look forward to learning, as I've already learned some things today, and sharing ideas that can help us maximize the potential of our small business economy. Thank you.

[The statement of Mr. Orr is included in the appendix.]

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Mr. BUCHANAN. Thank you, Mr. Orr. I—you know, I—that's the American dream. You start out a business. My wife and I started ours in 1976, we put in a few dollars and grew it over the years. In fact, the two of you are doing that.

We're going to find in this recession, a deep recession, you're going to see a lot of successful entrepreneurs come out of this. But even if they didn't want to necessarily be an entrepreneur but always had some interest in maybe being one, it's forced them into that position.

So I'm excited about your company. I'm excited it's based in Sarasota. And I think the American Dream, as long as we've got access to some capital, is alive and well.

Our fourth witness, Mr. Herbert Brill, is a private business consultant who advises small business clients on a host of activities including access to capital. We're excited about him being here today. He's a member of several professional associations such as the New York and Florida Bar Association. Mr. Brill has held a variety of jobs throughout his career, I believe managing partner of a law firm in Miami. He's also general counsel to a bank in Miami so he understands a lot of things that we're talking about today in terms of access to capital.

In addition to his professional experience, Mr. Brill has also taught at several universities throughout the United States including locally in this region the University of Florida, University of Miami. He has a law degree from Columbia University Law School. He currently resides in Lakewood Ranch.

We're excited to hear your testimony today, Mr. Brill.

STATEMENT OF HERBERT BRILL

Mr. BRILL. Thank you. Before I begin, I'm very happy to be here today, but it did cause me some distress this morning. And that distress was how do you make a tie? It's been so long since I had to put on a shirt and tie that I'm thinking, Well, wait a minute, they are only members of Congress. What do I need a tie for? So I figured, Well, what the hell.

So I put a tie on and I did remarkably. Thank you for jogging my memory.

I look at what I am here today to say and what I've heard from the bank's point of view. I was general counsel for Bank of Miami, Banco Popular, and counsel to Key Credit, et cetera, et cetera, et cetera. So I look at it from a lender's point of view, having sat in on executive Committee meetings, board of directors meetings, that said yes or no over a long period of time.

We all know we're in a recession. And the cause of it, you know, that's for another time. But we do know that the Secretary of the Treasury went to the President in the fall of seventy—2007 and said, "Mr. President, the sky is falling, we're out of credit, the banks are frozen, the credit is frozen. What do you want to do?"

Well, historians ten years from now will probably tell us what he really thought or really said. I don't know and I don't really care.

But at that point that Administration, the prior Administration, said, "We have got to do something", and went to Congress. And in Congress and it was Congress that said, "Okay, we approve all this lending and borrowing, et cetera, et cetera".

Was it good? Was it bad? Was it done well? We'll see. But it did do one thing: It did stop the bank panic. It did stop the credit flow from increasing and at least put a stop to it. It is now progressing on the right side.

I don't think anybody can argue about that. You can argue about means, methods, and long-term effect, but we did stop it.

Okay. One of the specific things that came out of that, among many others, and that is that credit to small business like Mr. Orr dried up. It just isn't there.

Personal experience, first let me just say that the SBA—the SBA is wonderful. They do a good job. They've increased their lending. They've modified their ability to do it quickly because they've eliminated cost. They're doing a terrific job.

Congress has hampered them by saying this increased authority is month to month. Now it's only until April 30th. After April 30th, you can't continue to do what you've been doing, which is the right thing.

And the President has asked that they extend it to September 30th. And there's a bill pending and I spoke to Congressman Schrader, I think it's 3854, that would extend that until the end of fiscal year 2011.

So it's not a question of fault. But one of the answers to keep SBA going—and I love SBA, they're very effective, especially today—is to get that extension. Banks are not going to want to loan on a month-to-month basis and set up a program, hire people, train them, and then say, Oh, it's over next month. You've got to get real about these things.

I do most of my work pro bono for the Manatee Chamber of Commerce. And I think the chambers of commerce are terrific locally. And they do a great job. And I agree with everything that Mr. Miller said about taxes on small business.

I do not agree on the national policies of the U.S. Chamber on national tax policies. But that's for another time.

But as far as the SBA and as far as local tax and tax on small business, I'm in total accord.

I was retained and paid a nice fee, thank you, for getting a loan on a business, a local business, manufacturing, that hired people, that I helped streamline, got their balance sheet in shape, et cetera. And I personally wrote the proposal, business plan, everything.

I know what banks want. I've reviewed them for banks. I've been with banks. And I said to my client, It's a 90 percent shot.

This is January of 2008. Okay? 2009. I'm sorry, 2009. I spent six months and went to six banks, three major, three local, one small community. I was turned down by all six.

And I was almost insulted. I said, "I know what you want. This is a good loan."

"Oh, yeah, but it's based on collateral, the major collateral" which is the building in which he operates.

And I said, "Fine. But that's $175,000 on a building that was assessed today, now, in the middle of recession at $800,000, and we want four and a quarter."

They said, "Sorry."

It just didn't make sense. So I got this answer from virtually every bank.

But knowing bankers, I then said to two or three or four of them, "Let's go to coffee". So we went to Starbuck's. I drank Starbuck's coffee, and I don't like Starbuck's coffee; it's too bitter. But we went.

And I said, "Guys, what's going on?"

They said, "Herb, we've raised our lending standards to the extent where if you come in and before all this happened you were triple A, we were delighted to give you the money, to keep you on our books. But now those loans are going to the SBA."

So I said, "Well, the effect of that is to eliminate all these good-credit people over a standard and your triple -- AAA". And he says, "That's right."

I said, "Why?" He said, "Because we have got to get our balance sheets in order or I'm going to lose my job. I will not make a loan or approve a loan or even set up a loan, I don't care how good it is, unless I know the bank examiners are not going to come in and say it's questionable because—not because it's SBA, but it's SBA, or it may go into default because we have to get our balance sheets.

Why do they have to get our balance sheets? Because the Secretary of the Treasury and the government has said, 'Clean up your balance sheets'."

How many times have you heard that?

Mr. Hall said balance sheet. Mr. Orr was talking about balance sheet. Most clients don't know what a balance sheet is, by the way. That's another problem.

And they said, "Because you must do that."

And that problem stems from the federal government's left hand saying, Clean up your balance sheet, and the right hand saying to the banks, Loan money.

They're not going to loan money. If I—if Mr. Orr came to me today and said, "Get me a start-up loan", I'd say, "Thank you. Buy me a cup of coffee and let's go home because there's no way; no way, any start-up is going to get a loan. Absolutely not. I don't care what it is or how it's collateralized."

So it doesn't happen even with the 90 percent bank guarantee.

The big problem there—and again, this gets somewhat technical—it's GAAP, generally accepted accounting principles, which are formulated, that all banks must look at because the major accounting firms will look at it that way.

And I could go into what—what—the games that have been played, Lehman Brothers made assets disappear, they disappear off their balance sheet. They weren't just sold and put on as assets, which is what they did; they disappeared because GAAP said you could do that. And we could spend a— you know, a whole day talking about GAAP.

The problem with GAAP is because it was so loose and so flexible, that banks can do whatever they want.

But when it comes to the balance sheet now, if you come back to the balance sheet, as everybody on this panel has said, the problem lies in having enough equity.

Sabal Bank—I've never done business with them, but they've got a good reputation, has basically said, "We must protect our balance sheet."

The three items or three of the four or five that he listed are capital, additional capital, and bank examiners.

That means capital. That means keeping your balance sheet clean.

I can only tell you that you can say what you want and do what you want, have all the great programs like SBA, which is a great program, but it starts with the banks.

The SBA doesn't lend money. I have clients that think, Oh, let's go to the SBA. You don't go to the SBA. You've got to go to a bank.

So why are the banks not lending? They're scared. They're frightened of their jobs. They've seen what's helping.

The last two years friends of mine in the banking business call me and say, Herb, do you know anybody who's looking? I lost my job.

What do you mean you lost your job?

Well, it's the industry. That happened to Mr. Orr. He went out on his own.

So what is the answer? There's no one answer. But certainly GAAP and the Accounting Standards Board that sets the rules for GAAP are a major, major problem. We get left hand to know what the right hand is doing, we're going to be fine.

I could go into the history like everyone has written government intervention. And government intervention started in 1933, and that was the year I was born, not that that's particularly noteworthy. But when I got out of law school and went into law and into business, the FHA and the alphabet people, all government regulation, the FCC were there and doing what they were supposed to be doing.

That ended when the Glass-Siegel Act was—was canceled by Congress. When they canceled Glass-Siegel, which was the law that said the banks shall only lend; they should not invest; and Wall Street, you invest, you don't lend. And you don't mix the two.

Well, we've got Citibank which became 300,000 employees around the world. And they became everything. And you've got the—I think I know a little, and I don't begin to understand them, but they're bets on bets on bets. There's five hundred million dollars worth—trillion, trillion dollars out there, and guess who controls 95 percent of them? Right. The five big banks.

There's a lot to do. But my bottom line is we can do what we want with SBA, we can have all these things going that are great.

But unless Congress, and I mean Congress, steps up—and I don't want bipartisanship, I want nonpartisanship—and get this thing solved.

Thank you.

[The statement of Mr. Brill is included in the appendix.]

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Mr. BUCHANAN. Mr. Brill, I agree with you. And that's reason I'm holding this hearing today.

I've met with banks, they're not lending. And they're—it's all about—I ask them where they're at. One key word: Capital, capital, capital. That's it. Most of them don't have enough capital.

Mr. Hall knows if you lend ten to one your capital is not there, you're going to shrink the size of the bank. That's what's going on a lot in our region and all over the country.

I'll turn it back over to the chairman. We are a little bit on a time frame here. People have got flights and things. So we're going to—I ask you to be fairly concise. Our witnesses will be around for few minutes right after. Mr. Chairman.

Chairman SCHRADER. Well, I guess the obvious question—well, a comment first. I agree with Mr. Brill that we need to put some certainty in the marketplace. And frankly, it would be nice if the Senate would pass our bill, and hopefully that will happen. It would be nice to have that, to do what he was talking about. And hopefully that will happen. We'll get back and use his testimony, might light a little bit of a fire.

I'd like Mr. Hall to respond a little bit to Mr. Brill. Obviously you guys aren't lending at all. You're not doing anything right. And you're hamstrung by all these evil regulators. Respond, please.

Mr. HALL. Well, it is interesting. If you had a group of bankers, I think you'd hear them say the two toughest challenges for banks today—and I'm talking about local community banks here— number one is just managing through the loans that are already on their books.

But number two and maybe it's 1, 1A, is ″we've got to grow our own portfolios. Do you know of any good loan opportunities? Do you have any that you could participate with me?″

Now, there are a few banks that really are not doing that. They're trying to manage to their current capital levels. And it's clear they're on the sidelines.

But I think if you got most banks together they'd say, ″We've got to find a way to grow our loan portfolio.″

But yes, I would say lending standards having tightened; there is no doubt about that. The economy is very, very uncertain right now. As my directors say, Brian, let's look at the business; the last three years key indicators have gone from here to here to here. Where is it going next? Well, that's a very hard thing to know.

Chairman SCHRADER. So if I can interrupt you guys, just for the sake of moving things along, not to be disrespectful. So how do we untighten standards and still protect investors and taxpayers?

Let's do several things. GAAP is one I've heard again.

Mr. BRILL. Let me add to GAAP, get rid of mark-to-market. GAAP is scoring the balance sheet. And that makes people like—

Chairman SCHRADER. But on a temporary basis. Not doing mark-to-market, some people have argued, is what got us into this mess.

Mr. BRILL. I think it's the worst thing that can happen to keep credit—to keep banks from lending.

Chairman SCHRADER. Mr. Hall?

Mr. HALL. Well, I think the SBA is doing a much better job. They are being good business partners. We're a young bank; we're three and a half years old. We've done six ARC loans. We have two more that are pending. I'd like to see that keep going and make it a little more streamlined but raise the dollar amount, to at least $50,000. That would be helpful.

But I think that really in the current environment banks are going to be looking at what's the primary source of repayment and what's the secondary source of repayment. And if there's a heavy speculative element to that, those kinds of loans are going to be very, very hard to get done.

Chairman SCHRADER. The ARC loans we are trying to increase. That's in our bill actually. So we agree with you and hopefully that will come to fruition.

Mr. Orr, you mentioned some things that—well, obviously you're successful. You could have been more successful. What things in the lending environment got you to be successful briefly? And then what are the things in the lending environment that are hindering you from being as successful as you think you should be?

Mr. ORR. Well, the thing that I think helped us with our capital getting started up is angel investors. And with the current unemployment rate, a lot of very qualified people are being in the market considering starting businesses.

These programs may exist and they just don't know about them. But I think one of the things that would be powerful in our nation is I think it's high time that angel investors are given tax breaks or given some of the benefits that banks are given for backing loans, even though it may not be at the same rate.

These people are actually stepping up and taking huge risks, believing in people like myself who have given us an opportunity and absolutely given no—none of these programs or none of them the benefit—

Chairman SCHRADER. Are you aware of the new market venture program that—okay. We've got to get more information out on that.

Mr. ORR. So I think that—

Chairman SCHRADER. What's holding you back? What should we do?

Mr. ORR. At this point, I think it's kind of like a conventional loan for an individual: Once you get to the point where you don't need the money as much, obviously you can get a loan.

So I think that some of those things will be behind us. But I think a lot of it—as I've learned today, a lot of it's education. When you're—when you're starting a new business, you're very busy. You're scrambling. You're trying to find out where you can get capital and get it quickly.

And, you know, I think it's—a lot of it's just educate yourself. So some of that is not—you know, not up to Congress. It's not up to society. It's up to the business owner themself.

But I do think that programs that motivate people who have previously been in the real estate market made a lot of investments, there's quite a bit of capital out there with investors who are willing to bring capital to the table for the—for the right business plan.

I just think that emphasis in not only educating business owners but educating those potential investors of the programs that you're—that are out there can be very powerful.

Chairman SCHRADER. Last comment and I'll turn it over to the ranking member. I'd ask Mr. Hall, you reference in your testimony the allowance for loan loss and accounting. If you could give my office, our offices some more elaborate information on that, that would be very helpful as we go back.

Mr. HALL. I'll be glad to.

Mr. BUCHANAN. Thank you, Mr. Chairman.

Mr. Hall, there's been discussion with the Administration and the administrator called me about capital, access to capital for community banks. Big banks got the money; we're talking 30 billion.

What's your thought? Is that something—because what I hear from banks, you know, a lot of them, if they don't get it, they're going to be out of business, and they can't get it anywhere else; it's too expensive or nobody wants to invest in this period of time.

Isn't that 90 percent—I hear from banks, community banks, all of them, many of the banks that have gone out of business in our communities here came to see me a week or two before they got taken over, taken out. Isn't that 80 percent of the issue?

Mr. HALL. I think capital is top shelf for all bankers right now. And the details are important of this program, kind of headline news. But I think having something where banks could apply for up to 5 percent of the risk-weighted assets. A bank like ours, we're three years old, that would amount to somewhere around two and half, $3 million.

It's very, very difficult to go out in the private market and raise bank capital today. If you can, the price is extremely low.

So, yeah, I think that—I think that would be an outstanding program. It would help, I think, banks quite a bit in terms of, maybe being more bullish towards small business lending.

You can't give it to every bank. There are some banks that probably wouldn't qualify. But the banks that are well run, well managed we could look at ...

Chairman SCHRADER. So like if we did the program, how do we make sure it goes out to small businesses? You said you didn't want to tie up SBA necessarily. How do we make sure—would the banks be open to some requirement that that be loaned out to small businesses?

Mr. HALL. I think so. I think most banks, that's what they would want to do is to put it in small business loans.

And as I've heard discussed, there would actually be some, incentives for banks based on their small business lending performance; the more they do, the lower the cost of the program is to the bank. So I think something like that would be very good.

Mr. BUCHANAN. Thank you.

Mr. Miller, I know one of the big things I always hear is mark-to-market. We're in an area, region, where somebody might have a piece of land, you know it's worth five million three years ago. And today, you know, you could put it almost zero, 20 percent or some number. So the regulators come in, make them break that down. And if they've got ten million in capital, all of a sudden they've got to write down four million or something else.

Why—you know, everybody talks about adjusting the accounting on that, the GAAP, in terms of mark-to-market, the original market. How come they don't make a concession for a year or two? Are you up to speed on that?

Mr. MILLER. Well, to a degree. And one of the things that we do often is poll our membership with regard to, you know, the major issues that they're facing, particularly small business.

One of the things that has been discussed today is what is collateral. And as—with the problems with regard mark-to-market and the lack of identifying, because of the downturn in the housing market and the ability to actually identify from the bank's perspective what collateral is, and at the end of the day when a loan goes bad, what is the banker going to be able to hold is a very difficult issue.

And so while there are—the SBA programs help out a lot of the banks that are not just trying to manage current loan portfolios but actually moving forward, it's—the real issue is the issue of collateralization and as—making the final determination, as a loan committee or others are making those determinations on good versus bad loans, the lack of ability on mark-to-market collateralization is a huge issue.

Mr. BUCHANAN. Someone says, "Are the banks lending?" Yeah, they'll lend. If you want to borrow a million, put up a million-dollar CD; they'll loan it back to you.

Mr. Orr, let me ask you, because we're talking about SBA today, and I know you talked about access to capital, have you looked at SBA? If you have, great. If you haven't, why not?

Mr. ORR. Well, we looked at SBA early on. And actually we did participate in an Express Loan, you know, early on in our business, a small loan.

But after that it's basically every banker we talked to before we even filled out an application, within two minutes they could tell you if you haven't been in business for two years, you need not apply.

So it doesn't matter really how well you're doing. It doesn't really matter what your balance sheet says. If you haven't been in business for two years, then you need to survive another year.

So that's been our experience, and we've survived it. But at this point I'm fairly confident we would qualify for an SBA loan.

Mr. BUCHANAN. I want to say, Mr. Brill, a little bit on the SBA thing because you sound like you've had some experience with it. You said, "Well, the banks aren't lending." And I agree with you totally. But then if the banks aren't doing SBA, can't we look at—are there banks in the region—I would say ideally Sarasota/Manatee County, but if you go up to Tampa, aren't there some banks that are open-minded to SBA?

Part of the concern I don't understand is if a bank can get a 90 percent guarantee from the federal government, it seems like a regulator is not going to come in and pop them on it. I mean, they might write it down 10 percent, but you've got a 90 percent guarantee.

Why don't banks do a lot more lending under some of these programs? They have a guarantee. Why not? It's just crazy. If I was a bank, whether I liked to do it or not is one thing, but I'd want to do it as a community service, especially in these tough times.

It might take a little longer, but you still have the guarantee of 90 percent; where you've got a piece of real estate, God only knows what that might be worth in a couple of years. What's your thoughts on that?

Mr. BRILL. Well, when you say banks, lending, community service, that's an oxymoron. No way.

Mr. BUCHANAN. Trying to give Brian the benefit of the doubt here.

Mr. BRILL. Like it or not, over the last 25, 30 years banks have become the primary source of capital for small business and big business, of course. Well, they become the source of capital for small business and they have ability and did make loans with a certain amount of community access because they do have the SBA.

But things changed two and a half years ago. And when the bank examiners come in, having an SBA loan doesn't necessarily make them, Oh, my goodness, we don't really care, you can keep that as a full asset on your balance sheet, at least up to the 90 percent. That's not the way that works in the real world.

The trauma, the absolute trauma, that the bank officers, their people, have felt in the last two, two and a half years when they see their friends losing their jobs— one guy I know very well; I visited him in Miami and he said, "Come look at our office."

We looked at the office. He said, "This is my desk. Look at those other empty cubicles." He says, "I survived; they didn't. I'm not making any loans, period."

That's one thing. Now you've got to get the banks themselves, and I don't mean the local banks, Sabal Bank; I mean the major banks to say, "Okay, we've got to get the balance sheet working. But we've got to get the examiners and GAAP to coordinate. Otherwise, it'll be there a year from now and it'll be a little bit better, but it isn't going to change."

Mr. BUCHANAN. I want to thank you, Mr. Brill, and all our witnesses today. We're on a time frame. We have a big thing on Port Manatee down the street. I'm speaking at 12:30 or 12:45. And I want to especially thank our Chairman of the Finance and Tax Committee, who came all the way here from Oregon.

I appreciate that, Mr. Chairman. And I yield back.

Chairman SCHRADER. Thank you very much. It's been a great hearing and a great outpouring of interest, which I think we both appreciate. We thank the witnesses very much.

The members will have five days to submit statements and supporting material for the record. Without objection, so ordered. The hearing is now adjourned. Thank you all very much.

[Whereupon, at 12:12 p.m., the Subcommittee was adjourned.]

KURT SCHRADER, OREGON
CHAIRMAN

VERN BUCHANAN, FLORIDA
RANKING MINORITY MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
Subcommittee on Finance and Tax
2361 Rayburn House Office Building
Washington, DC 20515–0515

STATEMENT
of the
Honorable Kurt Schrader, Chair
Subcommittee on Finance and Tax of the
House Committee on Small Business
Field Hearing on:
"*Access to Capital for Small Businesses*."

It is great to be in Sarasota today. I want to thank my colleague and Ranking Member of the Small Business Subcommittee on Finance and Tax Vern Buchanan for inviting me to this important field hearing for our subcommittee.

There is a reason we call small businesses the "backbone of our economy." Throughout our history, they have generated enormous wealth for our country, created jobs, unlocked new markets and, most importantly, powered innovation. But while we know that entrepreneurship is the driving force in our economy, we also know this--a small business cannot run on good ideas alone.

It takes money to get a startup off the ground, it takes capital to keep a business running, and it takes investment to build a fledgling firm into an economic powerhouse. During past economic downturns, small businesses have managed to grow regardless. Companies like Microsoft, FedEx, and Hewlett-Packard, along with 45% of the Fortune 500, were all founded during recessions.

As the next generation of entrepreneurs step up to the plate, we need to make sure that they have the same opportunities to succeed. That is why today's hearing is so important. In our conversation this morning, we'll discuss the financing options of America's small firms, and look for ways to improve those choices—in Florida, Oregon, and nationwide.

As a small business owner myself, I understand the impact lending declines can have on a small venture. I've seen, first-hand, the role that capital plays at all phases of a small business' lifecycle. Armed with that insight, my colleagues and I were able to introduce H.R. 3854, *The Small Business Financing and Investment Act*, which passed the House last October and promised to deliver $44 billion in lending and investment. I'm proud to say Mr. Buchanan played a key role in those bipartisan efforts. His contributions sought to modernize the Certified Development Company Program---helping established businesses secure capital for fixed-asset purchases. Meanwhile, his work to enhance SBA's SCORE program would go a long way in supporting new companies, training them in areas like credit repair and loan package preparation.

These are critical resources. Because whether we're talking about a software startup in Salem, Oregon, or a small real estate developer in Sarasota, Florida, one thing is clear--entrepreneurs everywhere are struggling to access capital, and they are frustrated. They want to know why it is that, even with sound credit and a solid business plan, they can't get a loan. I've heard from entrepreneurs who want nothing more than to expand their operations and, yes, create a few new jobs. Yet they can't access the credit necessary to do so. That's why all options must be on the table for small firms. That includes policies to empower creditworthy borrowers over banks, grease the wheels for equity investment, and otherwise deliver the widest array of choices to our small business innovators. These are the avenues that Congressman Buchanan and I are working to open, and they are just some of the issues we will be exploring today. I look forward to hearing from today's witnesses as we discuss ways to ensure small firms have the tools and resources they need to do that very thing. I'm pleased they could join us today, and am interested in hearing their thoughts on this pressing issue.

U.S SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Testimony of Eric R. Zarnikow
Associate Administrator for Capital Access
U.S. Small Business Administration
U.S. House of Representatives Committee on Small Business
Subcommittee on Finance and Tax
"Access to Capital for Small Businesses"
April 19, 2010

Thank you, Subcommittee Chairman Schrader and Ranking Member Buchanan. I'm honored to be here, and I'm glad to see so many small business owners in the audience.

One of the missions of the Small Business Administration is to provide small business owners with access to much needed capital. We do that primarily by providing a partial government guarantees on loans given by banks and other lending partners.

This guarantee helps provide access to capital for creditworthy small businesses that would otherwise be unable to get loans. As a result, loans to women and minorities comprise a greater percentage of our portfolio than the conventional lending market. Additionally, SBA has specialty programs for some small business owners, such as our Patriot Express program, for Veterans; Community Express, for businesses in distressed and underserved communities; and the 7(j) program that provides technical assistance to socially and economically disadvantaged contractors that participate in our 8(a) program. In addition, we are also using Recovery Act funds to provide working capital to small automotive dealers. SBA also offers surety bond guarantee programs that can aid contractors in getting bonding support. In addition to these programs, which are administered by my office, SBA has extensive technical assistance programs – including Small Business Development Centers, Women's Business Centers, and SCORE chapters – and procurement assistance programs, like 8(a) and HUBZones, that can assist small and disadvantaged businesses in accessing business opportunities with the Federal government as contractors and suppliers.

Our programs are lifelines to many small businesses. As someone who has started and owned several businesses, Representative Buchanan, I'm sure you understand the difficulties small businesses face with access to credit in today's economic climate. Our programs in this area will be the focus of my testimony today.

To address the disruptions in the credit market that came to a head last year, the Recovery Act temporarily raised the maximum available guarantee on some SBA loans to 90% and allowed us to reduce or eliminate most of our fees.

The raised guarantee provided an extra incentive for risk-averse banks to lend to small businesses. The fee reductions made the loans more appealing to borrowers, and put more money in the hands of small business owners who need it.

As a result of these actions and the stabilization of the economy SBA lending has increased by about 90% since the Recovery Act's enactment.

We've turned about 530 million dollars in taxpayer funds since the Recovery Act's enactment into support for over 23 billion dollars in loans to small business owners. This includes over 285 million dollars in lending in Representative Schrader's home state of Oregon, and over 1 billion dollars here in Florida.

I know that times are still tough for small business owners. While SBA's Recovery loans are helping, it's clear that many small business owners are still having a hard time getting access to credit. Declines in home values have hurt small business owner as well, because many entrepreneurs use home equity to finance their business. We know that there is still more work to do.

At the SBA, we have examined how to use our programs to address demand for credit, availability of capital, and risk tolerance, and with the President we have proposed a jobs plan which targets gaps that still exist.

There are 5 key components.

1. First, to address the issue of banks that still have trouble taking risk, the Administration has asked for an extension through to the end of fiscal 2010 of the increased 90% guarantee and reduced fees.

2. Second, for banks that don't have the capital to lend, the Administration has asked that Congress establish a 30 billion dollar Small Business Lending Fund, to provide low-cost capital to community banks to allow them to lend more. This money would come with incentives to increase lending to small businesses.

3. Third, many small businesses need bigger SBA loans to create jobs – franchisees, manufacturers, exporters, others. We want to increase our top loan limits for our eligible 7(a) and 504 loans from $2 million to $5 million and from $4 million to $5.5 million for 504 loans to manufacturers.

4. Fourth, for businesses that can't find access to working capital, we have proposed to temporarily raise SBA Express loan limit from $350,000 to $1 million through FY 2011. These loans will help businesses restock shelves and fill orders coming in.

5. Fifth, we know that many small businesses have conventional, owner-occupied commercial real estate mortgages that will need to be refinanced soon. As real estate values have declined, many banks will find that these businesses no longer qualify for adequately sized conventional loans, regardless of the strength of the businesses. As a result, even small businesses that are performing well and making their payments on time can have a hard time refinancing these loans and may face foreclosure.

   So, we want to temporarily open up SBA's 504 program to commercial real estate refinancing through FY 2011 with an option to extend through FY 2012, if economic conditions warrant it. It's critically important that we help creditworthy firms here in Florida and across the country avoid unnecessary foreclosure and lost jobs. 504 refinancing will allow them to lock-in stable, long-term financing, while freeing up banks to make even more small business loans.

This plan is guided by basic principles: build on what works, maximize limited taxpayer dollars, and make targeted changes as quickly as possible. It addresses specific gaps in supply, availability of credit, and risk tolerance. SBA is confident that this will allow us to better help small businesses in this tough economic climate.

Some people have asked about why SBA doesn't make loans directly to small businesses. Direct lending would require hiring a new workforce and significantly expanding our reach. It would be less efficient than the plan I have laid out, and SBA would not be able to make its first loan for a year or more. Moreover, we believe the partnership with private lenders is important for the sustainability of small businesses and to help target viable enterprises.

We want build on the success of the Recovery Act by expanding points of credit access and bringing more small businesses into a long-term banking relationship with an SBA lender. And we want to increase the number of banks that offer SBA products. Our field staff, here in Florida and across the country, are working to sign up more lenders.

Let me close by saying that the SBA is here to help small businesses. Our field staff and resource partners are standing by to help small business owners and entrepreneurs as they start and grow their business. Small business owners here in Florida have access to:

- Two District Offices
- 35 Small Business Development Centers throughout the state
- 3 Women's Business Centers and a Veteran's Business Center, and

- Several chapters of SCORE, our executive mentoring service

I want to thank you for your support for small businesses, and for working with the SBA to get them the support they need. And I'm happy to discuss any of these proposals and answer any questions.

Statement
of the
U.S. Chamber
of Commerce

ON: **Access to Capital for Small Businesses**

TO: **U.S. House of Representatives Committee on Small Business, Subcommittee on Finance and Tax**

DATE: **April 19, 2010**

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Introduction

Thank you Chairman Schrader and Ranking Member Buchanan: I greatly appreciate the opportunity to offer the perspective of the business community on the important topics under discussion today. In addition to representing the Chamber, I am also a small business owner myself; over the years, I started and sold an entertainment company and founded a small community-based bank. Today, I am part-owner of two restaurants in Washington, D.C.

The nation is clearly emerging from trying economic times. With the unwinding of the housing market, a severe liquidity crisis, and the general deleveraging of the financial markets, the economic downturn was severe and widespread. Furthermore, the weakened economy has left Main Street businesses with slashed payrolls and reduced inventories. Not surprisingly many small businesses are still in a survival mentality, making defensive operational decisions in an attempt to protect assets in hopes of future increased economic activity.

Although this hearing is focused on access to capital and such access to capital is vital to small businesses returning to economic prosperity and job creation, we should not lose sight of the fact that more than capital is needed at this time. Small businesses need customers that are willing and able to spend if they are to survive, before they will be able to put capital to work growing and creating jobs.

According to a recent survey by the National Federation of Independent Businesses (NFIB), "the principal problem associated with the current economic condition for a majority (51%) of small business owners impacted by the year's economic changes remains slowing and/or lost sales".[1] To put this into perspective, in the same survey, access to capital was cited as a major problem for only 8% of those surveyed. This is not to suggest that capital isn't important but capital alone won't fix the current problems.

As economic activity gains momentum providing more widespread confidence for small businesses to assume additional risk, credit markets will need to respond by providing robust avenues of capital for Main Street to replenish inventories, purchase equipment and invest in new opportunities. The outcome of financial regulatory reform now being discussed in the Senate could have an impact on the appetite for financial institutions to extend the credit small business owners will need to help spur new job creation.

[1] NFIB, "Small Business Credit In A Deep Recession", February 2010

Additionally, fiscal policy decisions made by Congress can also play an important role in determining available capital for entrepreneurs. Lower marginal income tax rates, generous depreciation allowances, certainty in the estate tax rates and permanency in the R&E tax credit are just a few examples of how lawmakers can augment current cash flow and encourage and enable companies to invest in new machinery and equipment, increasing their productivity and providing a further boost to the economic sectors that produce and service those items.

The following are some policy initiatives that the U.S. Chamber of Commerce feels are clearly warranted to help small businesses grow and create new jobs as the economy rebounds:

Federal Individual Income Tax Rates

Many small businesses are organized as a Subchapter S Corporations, Limited Liability Partnerships, or Limited Liability Corporations for federal income tax purposes. This means that the profits are not taxed at the corporate level, but instead are passed through to shareholders who must then report the income (or loss) on their own individual income tax returns. While small business owners pay personal income taxes on the profits, the reality is that only a portion of the income generated by their businesses actually makes its way back to their personal bank accounts. Much of the income small business owners are being taxed on is actually reinvested in their companies in the form of expansion and new equipment.

Raising or lowering the individual federal income tax rates directly impacts the cost of capital for small and mid-size business formed as "pass through" entities. If Congress were to raise the individual income tax rates, capital would cost more and small business owners would have less money to invest in their companies. In contrast, by keeping taxes low, small and mid-size businesses can invest and grow and have greater ability to create jobs and help expand the economy.

As lawmakers look to addressing tax rates in the 111th Congress, the Chamber recommends that Congress lower all marginal tax rates, or, alternatively, at very least, keep those rates at present levels. By lowering or keeping rates at present levels Congress would enable small business owners of all sizes to invest more in their businesses. Allowing these rates to increase would increase the cost of capital, diminish investment opportunities, and ultimately make small businesses less competitive, thus hampering job creation and leaving our nation less prosperous.

Repeal of the 3% Witholding Tax

Section 511 of P.L. 109-222 requires a 3% tax withholding on all government payments, which affects all government contracts as well as other payments, such as Medicare, grants, and farm payments. While this requirement is not set to go into effect until January 1, 2012, companies, as well as federal, state, and local governments are already expending funds to prepare for implementation. These are needless preparation expenses, particularly during rough economic times, for a requirement that most believe should never have been enacted and should be repealed. The Department of Defense estimated that the costs to comply with the 3% withholding requirement will be in excess of $17 billion over the first five years, which is far more than any estimated revenue gains. While $17 billion is substantial, it is only a portion of the additional costs with which governments and the private sector will be burdened. Accordingly, the Chamber supports the repeal of the 3% tax withholding law that will have a tremendous impact on the working capital of our local, state and federal government contractors.

Access to Capital Provisions

Access to capital is a critical component for small enterprises if they are to fully unleash the job creating engine that will be vital in igniting an economic turnaround for the country. Regrettably, due to the turmoil in the financial markets, small business owners have reported to us that traditional avenues entrepreneurs use to finance their operations and grow businesses have been disrupted, limiting their ability to expand and in some cases even survive.

One source of funding, the Small Business Administration's (SBA) 7(a) and 504 government guaranteed loan programs, plays an important and essential role in providing an alternative means of obtaining capital for many small business owners where funding has not been available through conventional lending methods. Although SBA lending programs lending volume has dramatically rebounded over the past year due to incentives contained in the American Recovery and Reinvestment Act, loan volume is still at depressed levels, compared to pre-recessionary times.

In order to have capital available for small businesses so they can create jobs and help us revive the economy, the Chamber supports the following legislative efforts:

1. **Extend and fund through the current calendar year the reduced borrower and lender fees for the SBA 7(a) and 504 programs.** Significant fee reductions will continue to incentivize the existing financial institutions to lend and will make funds more affordable for small businesses to borrow for their enterprises. Many small business owners cannot wait for new untested programs to be developed, no matter how well intentioned, that are currently being discussed as part of House and Senate jobs related packages, in order to access funds to run their businesses. Additionally, new short-term programs may have the unintended consequence of further disrupting traditional channels of distribution.

2. **Extend and fund through the calendar year the 90 percent government guaranteed percentage of SBA 7(a) loans.** Appropriate increases in the federal government guaranteed portion of the loan reduce risk to financial institutions and provide additional incentives for the industry to underwrite small business lending during a time when increased business default risk exists.

3. **Make improvements to the SBA Express loan program.** Increase the maximum SBA Express loan value to $1 million and provide a temporary increase in the Express guarantee to 75 percent for two years.

4. **Increase the maximum loan size and maximum guaranteed portion of SBA loans.** Senators Landrieu and Snowe, the Chair and Ranking Member of the Senate Small Business and Entrepreneurship Committee, have introduced legislation that would increase the maximum size of SBA 7(a) and 504 loans from $2 million to $5 million. Importantly, their legislation would also provide a commensurate increase in the statutory maximum guaranteed portion of SBA 7(a) loans. These levels are recommended by the Administration, they have bi-partisan support, and we urge your support as well.

The Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs

Congress established the Small Business Innovation Research program in 1982 to use innovative talents of small businesses to help meet the government's research and development needs at a time when there was significant concern that the United States was falling behind its global competitors in developing innovative technologies. Our technological supremacy is again being challenged, yet SBIR and STTR currently do not enjoy a long-term reauthorization. In order to make sure that small businesses are fully involved in advancing the nation's innovation and technology we need to expeditiously negotiate with the Senate a comprehensive reauthorization of these two programs with the Senate. The series of short term reauthorizations have created an unstable environment for SBIR and STTR program managers to administer funding.

CONCLUSION

In conclusion, I appreciate the opportunity to submit these comments on proposals that will be helpful to small businesses. I look forward to working with you and the Committee to champion and put in place policies that unleash the innovative ability and entrepreneurial spirit of America's job creators – our small and mid-size businesses.

Thank you.

U.S. House of Representatives Committee on Small Business
Subcommittee on Finance and Tax
April 19, 2010
Submitted by Brian Hall

Good morning and thank you for the opportunity to participate in today's hearing. My name is Brian Hall and I am the President & CEO of Sabal Palm Bank, a locally owned and managed community bank that opened in 2006 primarily to serve the financial service needs of small to mid-sized businesses, business real estate owners and investors, non-profit organizations and consumers in Sarasota and Manatee counties. I have been a banker for 30 years and have been in the Sarasota/Manatee area for about ten years.

In June 2009 there were 53 FDIC insured banks with locations in Sarasota and Manatee counties with an approximate $18 billion of deposits. In June 2006, there were 45 FDIC insured banks doing business here and with a total of $16.5 billion in deposits. This market has three banks (Bank of America, Wachovia and SunTrust) that have a combined 48% share of the market. The nation-wide and regional banks typically control 80 to 85% of this market, and community banks have 15% to 20% of the market. With the exception of a few banks that are focused only on consumer lending, private banking and/or wealth management, most banks in this market consider small businesses to be an important target segment.

As we now know by looking at key demographic and economic data, in 2007 the economy in Sarasota and Manatee counties began to decline, and we have gone through nearly three years of extraordinary change. In late 2007 it certainly "felt" a lot better than it really was. New construction and development activity was strong, unemployment was low, the Dow hit 14,000 and the access to new capital for banks was in strong supply. Access to capital by small businesses wanting to buy, build, expand or support something was readily available through traditional small business and commercial real estate loans by all segments of the banking community in the Sarasota/Manatee MSA. You are well aware of the economic difficulties we have experienced since late 2007. There is no need to go into detail about our double digit unemployment, record number of residential and commercial real estate foreclosures, and reduced tax base that has put our schools in financial crisis.

Banks can play an important role in helping our economy recover. Our industry is needed to supply loans to fund small businesses that want to buy, build, expand or support something that creates commerce and job growth. However, the banking is a highly regulated business and banks are required to maintain certain leverage and risk based capital ratios by their primary regulators based on the financial condition of the bank and the composition of the banks loan portfolio. Many bankers will tell you that the number one consideration for determining the volume and type of lending they can do is their level of capital. Key considerations for banks about capital are:

- First, do they have enough capital to deal with the loan risk inherent in their current loan portfolio? Almost all small business borrowers, unless they are in the business of providing a highly essential service or product, have experienced declining trends for the past three years. The cumulative impact of declining revenues, margins and liquidity has left many small businesses in a fragile financial condition and reduced ability to repay their loans.
- Second, are they confident they can get additional capital in a timely manner and fair price to support future growth or use as a cushion for the risk of loan losses? For most community banks, even mature banks that are profitable and have relatively clean balance sheets, it is very difficult to raise additional capital even at 50% of book value per share. The President's announcement a few months ago about a Small Business Lending Initiative that would make capital available to community banks under reasonable terms and conditions has many of us eagerly waiting for more details.

- Third, how confident are bankers about the results of their next regulatory exam, especially as it applies to the review of their loan portfolio and capital expectations by regulators? There have been many well publicized comments by elected officials and banking association leaders calling for regulators to show restraint, consistency and provide more time for banks to work through loan problems and complete capital raises. The only micro-waved solution for a problem loan is to charge it off or set aside reserves, which reduces capital, which results in less lending that banks can do, which results in less commerce and job creation.

So what can be done to help small businesses get more access to bank loans for building, buying, expanding or supporting something? Here are a few suggestions:

1) As previously mentioned, the level of bank capital is the key driver for how much lending and what type of lending a bank can do. There are a number of initiatives being discussed to strengthen capital, which will lead to more lending:
   - The President's Small Business Lending Initiative proposed $30 billion to be provided to banks with $10 billion or less in total assets as recommended by their primary regulator. It is critical that the applying bank be evaluated based on their condition and ability to repay after receiving the capital, not on the bank's current condition. This is not a bailout or handout, but it would be an investment to be repaid with interest, yet treated as capital. Banks should be encouraged to use the funds for small business lending and receive a reduction in the dividend or interest rate based on their lending results. The program should encourage, but not\t require banks to do SBA lending if they participate in the Initiative. Many banks are SBA lenders, but gearing up to do SBA lending takes time and expertise that many banks do not have today.

- Currently banks are limited to the amount of their Allowance for Loan Loss that can be counted as part of their Total Risk Based Capital. These limits did not anticipate the type of economic challenges we are facing today and the limited access to new bank capital. Accordingly a bank's entire Allowance for Loan Loss should be treated as a form of capital – that's what it is; funds set aside to help support the future risk of loss in the loan portfolio.
- Very few banks have been profitable the last two or three years. The current accounting for deferred tax assets, which are basically treated as reductions from capital for capital adequacy measurement, needs to change. The current treatment of tax deferred assets is destructive to capital and the U.S. has among the most outdated accounting treatment for deferred tax assets of any modern country. The American Bankers Association recently announced this issue as a key initiative, but frankly with so many other things going on in our industry, it has not received the attention it deserves.

2) As part of the American Recovery and Reinvestment Act, continue to offer reduced or waived SBA fees and increased levels of loan guarantees.
3) Regulatory relief to recognize that not all commercial real estate loans are alike. Most bankers agree that commercial real estate loans made for land, development and other speculative purposes are high risk loans, especially in the current economy. However, if conservatively underwritten, other types of CRE loans, such are office, medical, anchored retail and multi-family, are not necessarily higher in risk than traditional commercial owner occupied real estate, equipment and line of credit lending.

To summarize, in order for our economy to recover, qualifying small businesses need access to capital from banks for loans to buy, build, expand or support their businesses. Banks are motivated to find ways to make loans – this is what they do. However, bank capital is the key variable in determining the extent to which a bank is lending and taking measured risks. There are solutions available to increase capital for banks, which will allow for more lending, which will advance the volume of commerce and job growth needed to lead us into sustained economic recovery.

Thank you for the opportunity to speak with you today and I would be glad to respond to any questions you have.

Sincerely,

Brian Hall

President & CEO

Sabal Palm Bank

Sarasota, FL

Mr. John Paul Orr

President & CEO

CAST, Inc.

Good Morning, my name is John Paul Orr. As the Founder of a small company that has experienced fairly significant growth since its inception, I'm honored to discuss the opportunities that could be created if small businesses are afforded more sufficient and reliable access to capital.

Like many Americans, our American Dream actually began as a nightmare. Without notice, we received a phone call informing us that the job we thought our future depended on was being eliminated. Fortunately, we were armed with over 30 years of Fortune 500 leadership experience, an extremely generous and trusting group of friends and family, and a healthy dose of entrepreneurial naivety.

The name of our company is Creative Agency Services Team or Cast. Our mission is to support major retailers and their suppliers in over 100,000 retail store locations across the country. Our business model requires us to train and deploy thousands of Cast agents to do work in retail stores in all 50 states. Like many companies, our business requires state-of-the art technology, a scalable organizational infrastructure, and sufficient cash flow to floor-plan our receivables in order to reach full potential.

I'm here today because our experience has taught us that investments in small business is not only a good deal for savvy investors, it also yields significant returns for society at large. After an initial investment of only $175,000 from private investors, Cast is projected to deliver top-line revenues of $6 million in 2010. A company that started with 3 employees in the worst economy since the great depression a little over two years ago, currently employs over 450 W2's and deploys opportunities to over 18,000 independent contractors serving over 25,000 store locations on a monthly basis. Naturally, we are proud of these accomplishment but one of the key points that we want to make to you today is that I'm convinced that with better access to funding, Cast could have grown at twice this rate and employed a much more significant work force at a time when America desperately needs job creation.

I'm also here today, because our experience has taught us that in contrast to the rhetoric we hear about Corporate America, Big Labor and Big Government, small business continues to embody the true Spirit of America. By design, no small business is too large to fail and therefore company politics and hidden agendas are better left to those who can afford failure. In contrast to my former career, I've been thrilled to find, that in small business, it's still personal, . . . loyalty to customers, to employees and to deep rooted principles is still very much in vogue. So at the end of the day, we've learned that an investment in small business is also a contribution toward the culture that most Americans long to restore.

I am honored to be part of this panel and I look forward to listening to and sharing ideas that can help us all maximize the potential of our small business economy.

Mr. Herbert L. Brill
Business Consultant
Lakewood Ranch, FL

Enhanced remarks by Herbert Brill testifying before The House of Representatives Committee on Small Business, Subcommittee on Finance and Tax, entitled "Access to Capital for Small Businesses." April 19, 2010.

Mr. Chairman and members of the Committee.

In the fall of 2007 the Secretary of the Treasury met the President of the United States in the oval office and essentially said:

"Mr. President the credit markets are frozen. The banking system is unable to function; banks do not have the liquidity to fund their depositors. The stock market is in a downward spiral and there is no end in sight. The entire banking system of the United States is on the brink of collapsing. The impact of what is happening to our financial system, unless it is stopped, is incalculable

It is not known exactly what the President said in response, but over the next few months a massive federal intervention into the entire economic structure of the country initiated by the Bush administration was continued and enhanced by the Obama administration.

It is generally acknowledged that this federal intervention prevented a catastrophic economic collapse more ruinous than the "Great Depression" of the 1930s. However, the long term implications for the economy are unknown. They will be subject to much debate and scholarly analysis for years to come

However, one of the discernable effects of the financial meltdown has been the virtual elimination of credit for small businesses.

In speaking to the staff of Representative Buchanan (very efficient and professional) I was advised the overriding question the committee was seeking to explore was:

"Why are banks (in this instance in Southwest Florida), reluctant to make loans to local businesses particularly when they are 90% backed by the Small Business Administration (SBA)?"

Good question! The answer is, of course, simple, but also very nuanced and complex.

Is the SBA there to provide banks with additional guaranty's sufficient to enable the bank to make secure loans? Yes!

NOTE: SBA lending for 7(a) loans is up 100% for the second fiscal quarter. Total lending representing $32.billion is up 100%.

Has the SBA lowered their fees, simplified their procedures and become more accessible for borrowers? Yes!

Note: The SBA loan adjustments which allow for higher levels on the backing of 7(a) loans and waives borrower fees on 504 and 7(a) loans has been extended by Congress on month to month basis, until April 30, 2010. Average weekly loan approvals are up 86% according to SBA.

The administration has requested these adjustments be extended through September 2010 (it should be longer); increase lending limits and add refinancing for commercial real estate.

Have these measures by the SBA convinced banks to increase their SBA backed lending to small business. NO!

A recent personal experience:

I recently concluded an effort to secure a well collateralized loan on behalf of a profitable local manufacturer from six local lending institutions. I was met by a denial from all six. In my experience, prior to 2008, banks would have been competing to put this loan on their books, especially with SBA backing

Faced with an urgent need for working capital, my client was forced to go to the "hard money" market. This market consists of private lenders who make loans at high interest rates. My client paid an eight point premium of $32,000 for a three year $400,000 loan with interest at 10%.

When I asked the reason for the denial, I was told by virtually every loan officer with whom I worked, "we have revised our lending criteria." I inferred this to mean they substantially raised the lending bar, eliminating otherwise credit worthy borrowers. I asked about those loans that qualify for SBA backing?

In private, usually over coffee at a Starbucks, they said: "Herb, we are under strict orders to accept only the highest quality applications. Loans we would normally keep on our books without SBA backing, i.e. doctors, companies with exceptionally strong cash flow, large compensating balances, etc, we make, but now only with the additional security of an SBA guaranty. Other applications, forget it. ***No risk is the rule, or I lose my job."***

Several loan officers went further: "The bank does not want any loan, even with SBA backing, that ***could*** be subject to examiners classifying it as "questionable," or ***could*** become classified as "non performing," even if the bank is eventually made whole. No loans***. We must, above all else, protect the balance sheet".***

These responses offer a clue as to the underlying cause of the shrinking of credit for local businesses, irrespective of the SBA.

To understand the thinking behind the bank's policy of "protect the balance sheet at all costs" look at the main thrust of the actions by the Treasury Department and the Federal Reserve. Over the past two years, the fundamental overriding direction from the Treasury Secretary and the Federal Reserve was two pronged:.

First, pump enough money into the system to create sufficient liquidity to prevent bank defaults. Confusing and somewhat loosely directed but, mission accomplished.

Second, require the banks to strengthen their balance sheets. There, in my judgment, lies the essence of the problem. ***The solution is not at the local level***. Strengthening the balance sheet is the banking industry's Holy Grail. Every business needs a strong balance sheet, especially a lending institution. Here we see the solution to one problem running into the law of unintended consequences. OOPS!

To create and maintain a strong balance sheet a bank (or any business) must have assets that exceed its liabilities. Pretty basic stuff. But, the assets must be such that a bank examiner, using GAAP (Generally Accepted Accounting Standards), must accept the value the bank assigns to its assets.

The "mark to market' concept which is vigorously applied by bank examiners, has had the unintended consequence of accelerating the downward spiral of the banks balance sheet. As the economy spiraled down (think real estate both commercial and single family houses) the weaker the banks balance sheets became, which in turn caused banks to withhold lending, which in turn weakened the economy, which in turn ...well, you get the picture.

This hearing is not the place to delve into the intricacies of GAAP or the Accounting Standards Board's rules. However, having worked as an attorney with major accounting firms over many years, I have been mystified by what appears to be the seemingly illogic of the rules, the "flexibility" in how the rules are applied and the unnecessary complexity of GAAP. Lehman Brothers made its assets not only disappear from their balance sheet by the use of off balance sheet accounting (remember Enron?), they literally made them disappear altogether (as did Lehman), all in conformity to with GAAP. For an informative description of the magical disappearing act of Lehman's troubled assets, please refer to a column in the NY Times Business Day section of Friday April 2, 2010 "Demystify The Lehman Shell Game" by Floyd Norris.

GAAP is at the core of the problem and its reform must be part of the solution!

A brief economic history lesson:

Voltaire said: "History is a bunch of lies on which we all agree"
Henry Ford said: "History is bunk".
Santana said: "If we do not learn from history we are doomed to repeat it,"

Take your pick.

If you examine the history of government intervention in the economy of the country, one only has to start with the reaction of the Congress to the economic chaos of 1933. Prior to the stock market crash of 1929, there was virtually no meaningful government regulation of the financial markets. Between the "Black Monday" collapse and the inauguration of a new administration, the Congress, responding to the admonitions of the Hoover administration refused to intervene in the economy. Beginning with the presidency of Franklin Roosevelt in 1933 and lasting until 1938, the actions taken by the federal government to end the depression, and of equal importance, to prevent it from happening again, was, and remains the most "radical" intervention in the economy by the federal government in history

From a policy of no intervention, the Congress: sanctioned a "bank holiday" ordered by the President that closed all the banks; expanded the authority of the Federal Reserve to regulate banks; established a plethora of federal agencies including, but not limited to; the SEC, FHA, FDIC, WPA, CCC, ICC and provided those agencies with the authority to create and enforce their rules and regulations.

In1938-1939, as the country was being prepared for a war, the beginning of what became a federal industrial policy was initiated. The federal government controlled and directed all production to building the armaments necessary to win a war. This apparatus was dismantled after WW11. The financial regulatory system remained. But not for long.

It was Congress that established the principal of government oversight, through federal regulation, to oversee virtually ever aspect of the financial system of the country. From a position of virtually no federal regulation of the economy these interventionist policies by the Congress created a climate of financial stability. They established clear definably standards for banks and all financial institutions, allowing for a huge expansion of the private business sector and an increase in the GDP.

Along the way, Congress established the Social Security System (a government mandated savings plan.) This was followed by Congress establishing Medicare (a government mandated heath insurance plan.) Later, Congress established Medicare Part D (a federally mandated prescription drug plan.) All of these federal mandates have a profound impact on the economy...

The over ridding act of Congress that set the "umbrella" over the regulation of the economy was the passage of the Glass-Siegel Act.

This legislation created a fire wall between the banks and Wall Street. Banks would stick to taking deposits and making loans. Investing and speculating by the banks was forbidden.

Savings and Loans aka S & Ls (remember them?) were lending institutions owned "mutually" by the depositors (no stockholders). The S & Ls were strictly regulated. They were created to essentially accept deposits (does anyone know what a Christmas Club was?) and make local, affordable interest rate mortgage loans. They were created to ensure a reliable flow of affordable interest rate mortgages for the local community in which they operated. They were structured so they could not compete with commercial banks.

Congress "deregulated" the S & Ls in the 1970's and allowed them to become "mini banks." They were permitted to compete with commercial banks, make car loans, have checking accounts and become "profit sharing lenders" with real estate developers. Bankers, who spent their entire careers reading balance sheets suddenly, became investors, developers and entrepreneurs. Congress sanctioned an "economic marriage" between mortgage bankers and real estate developers. The deregulation of the S & Ls by Congress became a financial debacle of historic proportions, requiring a massive "bank bail out" that cost taxpayer billions of dollars. The Savings and Loan industry no longer exists. A very costly divorce.

Congress repealed the Glass Siegel Act...

Over the years, Congress has systematically dismantled the wall between banks and Wall Street, brick by brick.

Clearly, Congress agrees with Henry Ford's definition of history.

The destruction of the regulatory wall appears to have allowed Lehman Brothers (and other financial institutions to us "legal" and approved GAAP classifications) to, among other accounting gimmicks, use "off balance sheet" accounting of its "repos" agreements to sell and buy back assets from affiliates and lie about its true net worth. They lied to the SEC. They lied to their clients. They lied to their investors. They lied to their shareholders. The federal regulators did nothing. And it was all according to GAAP. .

Why does GAAP legitimize the concept of "off balance sheet" accounting without full disclosure requiring where and how the assets disappeared from the real balance sheet. The very name "off balance sheet" is a classic accounting oxymoron

Goldman Sacks was permitted to become a bank holding company and remains one today. It has access to the Federal Reserve lending window from which it can borrow at minimal interest rates (just like a real bank) and has become an enormously profitable "bank". This should have provided business of all sizes with a cornucopia of working capital. Yes? Alas, no. According to its most recent report "72 percent of its profits came from investing on its own account." Along the way, Goldman provided a scheme of "off balance sheet" borrowing for the Greek government, which allowed the government to hide billions of dollars of debt from unsuspecting bond holders, lending institutions and the European Union. Their fee was in the millions of dollars. Way to go Goldman!

There are numerous other examples of individuals and companies gamming the system and leaving with a pile of dollars and in a few cases, a mea culpa, (but they kept the money).

The Solution(s)?

As you seek a solution to the questions surrounding the shrinking of the credit market for small businesses, it becomes apparent that the answer(s) are both simple and complex. The simple answer is " End mark to market valuations because banks are focusing on keeping their balance sheets free of any loans that would cause their balance sheets to appear weak." That, in of itself, is complex.

The more complex solutions(s) rest with the Congress. Congress must use its prerogative as the legislative branch of the federal government and pass and implement the legislation necessary to reset the federal government's regulatory clock and restore predictability to the financial markets.

As I prepare this testimony: the morning papers, internet blogs, TV news, virtually every economic commentator, Treasury Secretary Geithner, Chairman Bernecki, the majority and the minority leader of the House and Senate are all discussing one subject i.e. President Obama's submission of the most comprehensive overhaul of the government regulation of the financial system since the "New Deal"

Clearly, this is not the forum for a detailed discussion of the proposal(s).

However, until the role of commercial banks, investment banks, the credit rating agencies, GAAP, Wall Street and every financial institution in the country and the rules by which they are required to operate are established by the Congress, the credit freeze for small businesses throughout the country will remain.

The duty and the power to resolve these questions rest primarily in the hands of the Congress of the United States.

Is there the will for the Congress to rebuild the structure that served the economy so well for 35 year? Is the Congress prepared to make into law those reforms that will prevent another "great recession" and protect the economic future of the country? Will the Congress act in a non partisan manner and resolve these issues?

I surely hope so.

I conclude my remarks with a quote from my favorite philosopher Winnie the Poo:
"We have seen the enemy and it is us"

Thank you

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