Testimony of Robert James II
Chairman of the National Bankers Association

Before the House Small Business Subcommittee on Consumer Protection and Financial Institutions

"Examining the role of Community Development Financial Institutions and Minority Depository Institutions in Small Business Lending."

May 18, 2021

Chairwoman Davids, Ranking Member Meuser, Chairwoman Velazquez and members of the Subcommittee, good morning and thank you for this opportunity to testify on the role of CDFIs and MDIs in small business lending. It gives me great hope that one of this Subcommittee's first hearings of the 117th Congress is aimed at shining a light on the critical issue of access to credit for small businesses.

My name is Robert James II, and I am President of Carver Development CDE in Savannah, GA and Chairman of the National Bankers Association (NBA). The NBA is the leading trade association for the country's Minority Depository Institutions ("MDIs"). Our mission is to serve as an advocate for the nation's MDIs on all legislative and regulatory matters concerning and affecting our member institutions as well as the communities they serve.

Many of our member institutions are also Community Development Financial Institutions ("CDFIs"), and many have become banks of last resort for consumers and businesses who are underserved by traditional banks and financial service providers. Members of our association are on the front lines, trying to reduce the economic hardship in minority communities, which are historically the most vulnerable during any slowdown.

The House Small Business Committee and Chairwoman Velazquez have been instrumental in the inclusion of several provisions in multiple relief packages adopted during the course of the pandemic that ensure that MDIs and the small businesses and individuals they serve are not forgotten during this national emergency.

The creation of the Emergency Capital Investment Program and the $3 billion plus up of the CDFI Fund will make real transformational changes to institutions like those within the NBA and allow for more access to credit for individuals and small businesses in LMI communities. The NBA applauds the Congress for the adoption of these two important measures and very much look forward to continuing to work with you on measures to ensure that the resulting changes will transcend the pandemic and lead to material changes in the communities our members serve.

The situation is dire in our communities and we all need to do our part to ensure individuals in the middle of the health crisis, principally minority communities that have accounted for ~50% of the deaths, have equal access to credit and funding that can ensure a smooth recovery.

It is important to note that an average of 70 percent of minorities do not have a bank branch in their neighborhood, coupled with 94% of Black small businesses being sole proprietors that are typically unbanked or underbanked. Given the challenges faced by small businesses, especially minority-owned small businesses, it is imperative to assess which type of banks are best placed to provide access to capital for minority communities. National banks may not be fastest in reaching this constituency.

Minority-owned small businesses are the lifeblood of their communities. The pre-pandemic 1.1 million minority-owned small businesses employed more than 8.7 million workers and annually generating more than $1 trillion in economic output. Women own nearly 300,000 of them, employing 2.4 million workers. Despite their significance, these businesses face underlying challenges that make them vulnerable during normal times. In an assessment of the financial health of companies, the Federal Reserve Banks reported that minority-owned small businesses were significantly more likely to show signs of limited financial health—by factors such as profitability, credit scores, and propensity to use retained earnings as a primary funding source.

These companies were approximately twice as likely to be classified as "at risk" or "distressed" than nonminority-owned small businesses. That is particularly concerning, since the US Federal Reserve also indicates that distressed companies are three times as likely as healthy businesses to close because of a two-month revenue shock.

Limited access to credit is a compounding factor that hurts the underlying health of minority-owned small businesses. Based on data from the 2018 Small Business Credit Survey, the Brookings Institution found that large banks approve around 60 percent of loans sought by white small-business owners, 50 percent of those sought by Hispanic or Latinx small-business owners, and just 29 percent of those sought by Black small-business owners. Research has found that Black small-business owners were significantly more likely to be asked to provide more information about their personal financials—including personal financial statements and personal W-2 forms—when applying for small-business loans than white small-business owners were, even when controlling for credit score and business characteristics.

Black-owned businesses, overall, also tend to start out with far less capital, whether from investments or bank loans, than white-owned businesses do. And only 1 percent of Black business owners get a bank loan in their first year of business, compared with 7 percent of white business owners. Twice as many white business owners—30 percent of the total—use business credit cards during their first year compared with 15 percent of Black business owners. The COVID-19 crisis has compounded this issue: 42 percent of minority-owned small businesses responding to McKinsey's US Small Business Pulse Survey reported that obtaining credit was becoming increasingly difficult, compared with 29 percent of all respondents.

As an additional consideration, research suggests that the average minority-owned mature small business is 30 percent smaller than the average nonminority-owned mature small business. Our own analysis of the data provided by Minority Business Development Agency found that only 11 percent of minority-owned small businesses had employees, compared with 22 percent of nonminority-owned small businesses. And, when looking exclusively at small businesses that have employees—excluding sole proprietorships—we found that, on average, minority-owned small businesses had 32 percent fewer employees and 47 percent lower receipts than nonminority-owned ones did.

Traditionally, MDIs and CDFIs can be economic development engines due to their relative concentration in minority and low-income communities, and established relationships, especially in African American communities. Unfortunately, MDIs' small scale does not allow them to move fast enough, especially in times like these. With African Americans overrepresented by the health and economic crisis, but potentially underrepresented by the relief efforts, a more customize solution is required.

We saw this play out during all rounds of the Paycheck Protection Program (PPP). Congress devised the program as a mechanism to aid small businesses who suddenly found themselves forced to close during stay-at-home orders. A set of conditions that have favored larger businesses, including many banks only approving loans for existing customers, delaying the application of sole proprietorships, and not allowing enough time for institutions like ours to work through the application process with very small, under-resourced businesses, shut out many minority-owned businesses.

MDIs themselves have experienced a period of significant decline. Since 2009, nationally, the number of MDIs has dropped from 215 to 155 at the end of the second quarter of 2018. In addition, MDIs are far smaller than the average non-MDI bank. Compared to commercial banking institutions on average, they are very small; the largest institution has only $38 billion in total assets. Black and Hispanic MDIs have average assets of $245 million and $2.7 billion, respectively, compared to an average of $3.1 billion for all US banks.

A critical component of the resilience of the banking sector and its ability to assist minority businesses is the amount of Tier 1 Capital it has. Without sufficient Tier 1 Capital, not only are banks limited in the amount of deposits they can take in, but they are limited in their ability to weather loan losses. In this unprecedented economic shock, many financial institutions, especially those in underserved communities, will have increased delinquent loans. Although federal government efforts to stand up new loan loss reserves are important, standing up a new federal program with significant red tape will create a bottleneck when speed is necessary.

The NBA has recommended several potential solutions to the Congress and Administration including the following:

Passage of the Ensuring Diversity in Community Banking Act

The bill is a historic and important first step by Congress to more fully embrace its role in supporting MDIs and creating a regulatory and operating environment that will help to ensure that MDIs continue to play a vital role in meeting the banking and credit needs of communities of color throughout the country. The bill also provides a mechanism to ensure MDIs can better capitalize and in turn provide services in LMI communities.

Consumer Credit Enhancements

As you know, the vast majority of U.S. economic activity is ultimately driven by consumer spending, and this activity is severely threatened by protocols to protect the public health and slow the progression of the virus. As a result, wage earners in the service sector across many industries are losing their livelihoods. Many our banks' customers live from "check-to-check". These are hard-working, low- to moderate-income wage earners, who typically have low balance ($1,000 or less), high-transaction checking accounts. While we fully support policy proposals to immediately transmit cash to consumers and offer our banks as vehicles to efficiently and effectively deliver that cash to our customers, we also recommend additional support in the form of a Treasury-backed consumer loan loss pool or other credit enhancement mechanism for MDIs that would allow us to offer our customers small-dollar loans that would essentially look like overdraft protection, allowing them to continue to afford essentials like food, shelter, and medicine, without having to resort to expensive, predatory lenders.

Small Business, Faith-Based, Non-Profit Institution Credit Enhancements

The NBA supports proposals to stabilize and protect small businesses during this crisis, in particular streamlined, U.S. government guaranteed loans or lines of credit that will allow small businesses to continue to make payroll. Our member banks are perfectly positioned to get this funding into the most vulnerable small businesses, but we need to cut through the SBA red tape to ensure we can make households available to our bank customers. The Treasury's State Small Business Credit Initiative has the potential to serve this purpose. Our Association strongly supports any initiatives that will require states that receive SSBCI funding to directly involve MDIs in the deployment of these resources to small businesses.

In addition, we call your attention to the financial predicament that will be confronting many churches and other faith-based institutions and non-profits. Many of our banks, especially African American MDIs, have traditionally been the lenders of choice and necessity for many churches in their communities. We know from decades of experience that these churches face bleak financial times, as attendance at worship services becomes limited by public health realities, and donations rapidly decline due to financial hardship among their members. These church customers are not only centers of spiritual solace, but often provide vital community services such as daycare, feeding programs, and the like, so it is imperative that we assist them. As such, we ask that Treasury partner with us to create a loan loss reserve or guarantee pool for churches, other faith-based institutions and non-profits. This would allow us to work with these customers to restructure their loans in advance, extend working capital lines, or provide other assistance to ensure that they are able to survive the downturn, maintain their staffs, and continue to be beacons for their communities.

MDI Investment Tax Credit

The Association believes that a tax credit for equity investments in MDIs would further encourage all investors to make equity investments in our institutions. Given our institutions' track record of impact investments in the LMI communities we serve, we believe that our institutions' work confers enough of a benefit on LMI communities that an investment tax credit is warranted. We look forward to working with House and Senate sponsors to introduce MDI investment tax credit legislation this year.

Securing legislation to amend the Bank Holding Company Act to allow MDIs and CDFI banks under $3B to raise additional capital without triggering the BHCA's change-of-control provisions

The Bank Holding Company Act's change-of-control provisions are triggered when an investment exceeds 25% of the institution's equity. For smaller institutions like our member banks, relatively small equity investments implicate the BHCA, therefore limiting both the attractiveness of smaller banks for investors and the size of the investments that investors are willing to make in our member banks. The BHCA should be modified to allow for significant infusions of non-dilutive equity investments in our member banks. The Association supports legislative proposals that would exempt community banks under $3 billion from the 25% change-of-control provisions of the BHCA in an effort to both attract significant equity investments and to help protect the minority ownership status of our member banks.

Fully Supporting the Community Development Financial Institutions Fund

Establish a permanent set aside of 40 percent of CDFI Fund appropriations reserved for award, guarantee, and grant programs for minority lending institutions, and require reporting on such activities. Establish a new Office of Minority Community Development Financial Institutions to administer these funds led by a new Deputy Director of Minority Community Development Financial Institutions.

Federal Deposits in Minority Depository Institutions

Current rules require that federal agency deposits in MDIs must be fully collateralized, which has proven an insurmountable hurdle to implementation of the Minority Deposits Program, as doing so locks-up capital that could be mobilized for lending. Clarify that any such deposits may also be insured, including through reciprocal deposits. Doing so will ensure that any such deposits do not pose any financial risk to federal government, while also allowing the deposits to be mobilized for lending and therefore having a positive multiplier effect in the communities in which these banks operate.

Custodial Deposit Program for Covered Minority Depository Institutions

Establish a new program whereby the Treasury Department will deposit into MDIs and Impact Banks funds up to the FDIC insured amount, from Funds under management by the Treasury Department. The program is to be implemented by the Treasury Department, working via custodial banks, which can more easily and efficiently distribute the funds across covered MDIs and Impact Banks. This initiative will help mobilize stable deposits into MDIs and Impact Banks, which will have a multiplier effect on the communities they serve without creating any new exposures or loss risks for the Treasury Department.

Troubled Asset Relief Program Resolution

TARP effectively expired on October 3, 2010—two full years after its inception. After this date, funds could no longer be extended. In 2014, the U.S. government reported a $15.3 billion profit as a result of TARP. There are, however, MDIs who have not been able to exit the program. These institutions face significant hurdles in raising Tier 1 capital and are limited in their ability to participate in programs such as the Emergency Capital Investment Program created last year by Congress. The Treasury Department should work expeditiously to release these institutions from the program so they are able to raise capital and better serve the communities in which the operate.

Conclusion

The NBA again applauds the Subcommittee for holding this important hearing and for the full Committee's ongoing efforts to ensure equity for all businesses and communities in the country. While we commend Congress on its leadership to date in responding to the needs of our country's small businesses, we firmly believe much work remains to be done in supporting the MDI sector as we respond to the credit needs of the communities and small businesses that our member institutions serve that will disproportionately shoulder the burden of any economic downturn. In this regard, the NBA and its members banks look forward to working closely with the Committee and Subcommittee on workable solutions that ensures LMI communities and minority small business do not just simply survive but ultimately thrive. Thank you again for the opportunity to testify. I will be pleased to answer any questions.