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Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of J. Mark McWatters

Congressional Oversight Panel Field Hearing on Small Business Lending

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Thank you Professor Warren.

I very much appreciate the attendance of the distinguished witnesses and I look forward to hearing their views.

In order to suggest a solution to the challenges currently facing the commercial credit and small business lending markets it is critical that we thoughtfully identify the sources of the underlying difficulties. Without a proper diagnosis it is likely that we may craft an inappropriately targeted remedy with adverse unintended consequences.

The problems presented by today's commercial credit and small business lending markets would be easier to address if they were solely based upon the mere undersupply of commercial and small business credit in certain well defined regions of the country. Unfortunately, the commercial credit and small business lending markets must also assimilate a remarkable drop in demand from borrowers who have suffered a reversal in their business operations and prospects over the past two years. In my view, there has been a material decrease in demand for commercial and small business credit and many potential borrowers have withdrawn from the markets due to, among other reasons (i) their desire to de-leverage, (ii) the introduction of enhanced underwriting standards by lenders and their regulators, (iii) the diminishing opportunity for prudent business expansion, (iv) the crippling effects of the recession, and (v) the increasing tax and regulatory burdens facing small and large businesses.

Conversely, the Administration has focused on the undersupply of commercial and small business credit and has, not surprisingly, proposed a government-sponsored program to remedy the problem. If enacted as proposed, the Small Business Lending Fund (SBLF) will permit a subset of commercial and small business lenders to obtain capital from the Federal government at very favorable rates provided the lenders agree to use the proceeds to extend credit to small business borrowers. In addition to serving as arguably the first step in a program to nationalize small business lending, I am troubled that providing financial institutions with capital at below market rates will lead to imprudent lending activity and the inflation of a series of government sanctioned and subsidized asset bubbles. If the government convinces—or pressures—financial institutions to accept cheap credit based on the condition that the recipients off-lend the proceeds then I suspect the government will accomplish just that. Yet, isn't this what we have recently experienced in the sub-prime credit bubble—too much money chasing transactions of diminishing credit quality?

The Administration's proposal appears to share much of its business model with those adopted by Fannie Mae and Freddie Mac. Treasury should have learned from Fannie and Freddie that the combination of below market credit together with a single-minded mandate to lend—regardless of credible demand—serves as the perfect recipe for the creation and implosion of asset bubbles. In addition, the Administration's program seems at cross-purposes with the recent actions of Federal banking regulators who have become increasing cautious—perhaps overly cautious—regarding extensions and renewals of credit by regulated financial institutions. It is indeed ironic for the Administration to propose a program of cheap credit driven lending while at the same time Federal and state banking regulators are attempting to reign in the excesses that inevitably followed from the government's last experiment with cheap credit.

Instead of requiring the taxpayers to subsidize another round of imprudent short-term credit expansion, commercial and small business lenders—in consultation with their regulators where appropriate—should adopt long-term business models and strategies that incorporate objective and transparent due diligence standards that permit well run borrowers to receive credit on reasonable terms and the lenders to earn an appropriate risk adjusted rate of return. Regrettably, some potential borrowers will fail the heightened underwriting standards and will not receive their requested extensions of credit. This should not necessarily serve as a sign of angst but should indicate that the credit markets have moved away from an "anything-goes" mentality where borrowers frequently over-extended their leverage and financial institutions survived through the clever interpretation of accounting rules and the implicit guarantee of their obligations by the American taxpayers.

Any suggested solution to the challenges facing commercial credit and small business lenders and borrowers that focuses only on the undersupply of credit to the exclusion of the economic difficulties facing prospective borrowers appears unlikely to succeed. The challenges confronting the commercial credit and small business lending markets are not unique to that industry, but, instead, are indicative of the systemic uncertainties manifest throughout the larger economy. Until small and large businesses regain the confidence to hire new employees and expand their business operations it is doubtful that the demand for properly underwritten commercial and small business credit will sustain a meaningful recovery. As long as businesspersons are faced with the multiple challenges of rising taxes, increasing regulatory burdens, enhanced political risk associated with unpredictable governmental interventions in the private sector as well as uncertain health care and energy costs, it is unlikely that they will enthusiastically assume the entrepreneurial risk necessary for protracted economic expansion and a recovery of the commercial credit and small business lending markets. With the ever expanding array of less than friendly rules, regulations and taxes facing businesspersons and consumers we should not be surprised if businesses remain reluctant to hire new employees, consumers remain cautious about spending, and the commercial credit and small business lending markets continue to struggle.

In my view, the Administration could jump start the prompt and robust recovery of the commercial credit and small business lending markets--as well as the overall U.S. economy--by sending an unambiguous message to the private sector that it will not directly or indirectly raise the taxes or increase the regulatory burden of commercial credit and small business market participants and other business enterprises. Without such express action, the recovery of the commercial credit and small business lending markets will most likely proceed at a sluggish and costly pace.

Thank you for joining us today and I look forward to our discussion.