Insight

Dodd-Frank Will Reduce Small Businesses' Access to Credit

PAUL GESSING | MARCH 15, 2012

The devil is always in the details. Nowhere is this statement truer than in the area of federal legislation. Nowhere are those details more devilish than in the Dodd-Frank legislation that was passed in the wake of the 2008 banking and financial crisis. This law holds a ticking time bomb that, if not addressed, will destroy a large swath of the U.S. economy while further concentrating the banking business in the hands of those few behemoth banks that did so much to cause the economic crisis from which our nation is still emerging.

Small banks did not cause the economic crisis. They were not engaged in the risky behaviors that caused the economy to tank and they were not bailed out by trillions of taxpayer dollars. But when it came time to "reform" the banking system, it was the big banks, not the small ones, that had the lobbying power to get what they wanted on Capitol Hill.

Specifically, I'm referring to Section 1071 of the Dodd-Frank Act. Section 1071 amends the Equal Credit Opportunity Act to require that financial institutions collect and report information concerning credit applications made by women- or minority-owned businesses and by small businesses.

The stated goal of this section of Dodd-Frank — "to facilitate the enforcement of fair lending laws" — is laudable. Unfair lending practices are abhorrent and are something that reputable banks should not engage in. Still, Section 1071 is problematic. In order to ensure that lenders aren't discriminating against minority groups on price, it will take away lenders' ability to flex with borrowers, to custom-make loans. This will make it impossible for lenders to make the loans their customers need.

Flexibility is the small banks' main selling point. Big banks already loan in ways that ensure that each loan is similar to another. They are big, ponderous and don't "need" to tailor loans to small businesses.

One banker at a locally owned bank that I interviewed for this article says that no two small business loans are exactly alike and that Section 1071 will destroy small bankers' competitive edge in small business lending relative to the big banks.

Small businesses rely on flexible lending from small banks to grow. This growth spurs economic growth and new business development, but will suffer incalculable harm if Section 1071 of Dodd-Frank becomes effective. Small banks (banks with under $1 billion in total assets) make up only about 10% of the banking deposit market, but they make approximately 40% of loans to small businesses, which employ 80 million Americans.

The intent of Section 1071 is to make more credit available to small businesses, but its effect will, in fact, be just the opposite. And since economic recoveries are led by entrepreneurial small businesses, Section 1071 will endanger our nation's economic recovery.

Lastly, by hurting small banks, Section 1071 will increase the big banks' market share, exacerbating the "too

big to fail" problem that caused this mess in the first place.

Because it has not been implemented yet, Section 1071 is, as they say, "below the radar." But, once it does go into effect, it won't be long before lenders and small business owners are affected by it. It is up to Congress and the Obama administration to recognize the problem and get rid of Section 1071 entirely, before it strangles our economic recovery.

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