Research Paper Session 1
Small Business Lending

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**Views and opinions expressed do not necessarily reflect those of the FDIC.*

Common Themes

- **Impact of regulation on small business lending**
  - Does business lending change in aggregate?
  - Do banks change what kinds of loans they make?
  - Are there downstream impacts on local economic activity?
- **Both targeted and broad regulatory levers may produce effects**
- **Comparing policies that differ between relatively small and relatively large banks**
  - How careful do researchers need to be when employing this strategy?
- **Links to CSBS survey and the FDIC's Small Business Lending Survey (SBLS)**

(I) Black and Hackney – Overview

Main Question: Do banks facing different incentives use different strategies to comply with CRA?

- **Regulation: Loans reviewed for CRA exams**
  - Large bank – all loans originated before exam announcement
  - Small bank – up to 2 quarters of loans originated after announcement
  - Compare lending by small and large banks in the same county during exam years and off-exam years
- **Findings: Under scrutiny, small business lending increases and shifts towards SBA**
  - Small banks increase volume and number of very small business loans by 19% in year of exam
  - Large banks do not
  - Evidence that small SBA eligible lenders use SBA 7(a) program

(I) Black and Hackney – Questions

- **Outstanding questions for best policy response**
  - Are these additional loans that need to be made to comply with CRA or are they made over and above what is necessary?
  - Are the results driven by SBA lenders?
  - What are the economic effects on LMI areas?

- **Outstanding questions from survey evidence**
  - SBLS and CSBS Survey suggest that small banks do not heavily rely on SBA for their small business lending programs – are CRA loans different?

(II) Degryse et al. – Overview

Main Question: What is the effect of increased regulatory capital requirements on collateralized lending?

- **Regulation: Sudden increase in capital requirements for some larger Portuguese banks in October 2011**
  - Affected banks needed to quickly increase risk-weighted capital ratio
  - Risk-weighting meant uncollateralized loans required more capital than collateralized loans
- **Findings: Collateralized lending increases for borrowers without prior banking relationship**
  - Loans from affected banks to new borrowers are roughly 3 percentage points more likely to be collateralized
  - Effect dissipates for loans to borrowers in longer relationships
  - Collateral required has lower regulatory risk-weight – shift towards real estate and state guarantees (safer) from movable assets and personal guarantees (riskier)

(II) Degryse et al. – Questions

- **Outstanding questions for best policy response**
  - Are uncollateralized loans going down, collateralized loans going up, or both? Are there effects downstream on firms?
  - Do findings imply regulation decreases banks' incentives to invest in relationships?
  - Does this make it harder for firms without relationships or collateral (such as start-ups) to get credit?
- **Outstanding questions from survey evidence**
  - 2018 CSBS: Banks "rarely" compete for small business borrowers through collateral
  - SBLS: Banks that use relationship practices more likely to lend without collateral

(III) Srivastav and Vallascas – Overview

Main Question: Does deregulation increase small business lending?

- **Regulation: Asset threshold for being a ‘small’ BHC increased from \$500M to \$1B in June 2015**
  - Small BHCs exempt from Basel III capital rules and have fewer reporting requirements
  - Affected banks – those in the \$500M to \$1B range – can now take on more debt at BHC level and inject into subsidiaries as equity
- **Findings: Increased share of small business lending, equity injections, higher deposits, and deposit rates among affected banks**
  - Small loans to businesses as share of assets increase by around 5 percent (0.5 percentage points)

(III) Srivastav and Vallascas – Questions

- **Outstanding questions for best policy response**
  - Is the policy change really what's driving the pre/post-2015 divergence between banks above and below the threshold?
  - If so, which part of deregulation is driving it?
  - Why small business lending? What are affected banks shifting away from?
- **Outstanding questions from survey evidence**
  - CSBS 2019 shows that deposit costs have surpassed regulatory compliance as top concern of community bankers
  - SBLS shows that small loans to businesses are not the same as small business loans, with big changes around $1 billion threshold – so it's good to supplement with SBA data!

Digging Deeper

- **Effect on employment and economic growth are of great interest to policy-makers – more like this, with more emphasis please!**
  - Lower-hanging fruit: Absolute changes in lending rather than proportional changes
- **What are the underlying mechanisms proposed for the bank's changes in behavior?**
- **Bankers: Do these tests and theories pass the 'smell test'?**
  - Do you think about CRA exam timing when you make small business lending decisions?
  - Do you think about capital requirements when deciding what kinds of collateral you will take?
  - Does small BHC designation guide your decision-making?