Committee Meeting

of

JOINT LEGISLATIVE COMMITTEE ON ECONOMIC RECOVERY

"The Committee will receive testimony on the problems small and medium-sized businesses are currently experiencing with respect to access to capital and termination of lines of credit."

LOCATION: Municipal Building
South Brunswick, New Jersey

DATE: June 16, 1993
10:00 a.m.

MEMBERS OF JOINT COMMITTEE PRESENT:

Senator Jack Sinagra, Chairperson
Assemblywoman Harriet Derman, Vice-Chairperson
Senator Peter Inverso

ALSO PRESENT:

Assemblyman Paul Kramer
Christopher R. Berry
Office of Legislative Services
Aide, Joint Legislative Committee
on Economic Recovery

Hearing Recorded and Transcribed by
The Office of Legislative Services, Public Information Office,
Hearing Unit, State House Annex, CN 068, Trenton, New Jersey 08625

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New Jersey State Legislature
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C O M M I T T E E   N O T I C E

TO: MEMBERS OF THE JOINT LEGISLATIVE COMMITTEE ON ECONOMIC RECOVERY

FROM: SENATOR JACK SINAGRA, CHAIRPERSON
ASSEMBLYWOMAN HARRIET DERMAN, VICE-CHAIRPERSON

SUBJECT: **COMMITTEE MEETING - June 16, 1993**

The public may address comments and questions to Christopher R. Berry, Committee Aide, or make bill status and scheduling inquiries to Sharon Constantini, secretary, at (609) 984-7381.

The Joint Legislative Committee on Economic Recovery will meet on **Wednesday, June 16, 1993 at 10:00 AM at the Township of South Brunswick's Municipal Building Meeting Room, South Brunswick, New Jersey.** The committee will receive testimony on the problems small and medium-sized businesses are currently experiencing with respect to access to capital and termination of lines of credit from: Mr. Jeff Connor, Commissioner, N.J. Department of Banking; the CEO's or other senior executives of Midlantic National Bank, First Fidelity Bank, Chemical Bank and Core States Bank; senior officials from the Federal Reserve Bank; and from small and medium-sized business owners and operators currently experiencing this problem.

Directions to Township of South Brunswick Municipal Building: From the New Jersey Turnpike, take Exit 8A(Cranbury/Jamesburg); after toll, stay right at fork for Rt. 32W (Cranbury); continue on Rt. 32 about 1/2 mile and take right fork to Rt. 130 North; get in left lane and look for sign for Dayton, making a left turn here (across southbound Rt. 130) to Georges Rd. Continue on Georges Rd. to traffic light, where there will be five corners. Take left at second corner onto Rt. 522, and follow approximately 2 miles to Municipal Complex on right side. If lost, call (908) 329-4000.

OR

From Rt. 1, take Major Road (on northbound side at large water tower across from McDonald's) to right turn onto Kingston Lane; continue 1/2 mile to Rt. 522. The Municipal Complex is here.

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SENATOR JACK SINAGRA (Chairperson): Good morning, everyone. This Committee has gone all over the State and had numerous meetings on economic recovery. One of the things that has come up at numerous of the meetings -- one at the Port Authority, one at Rowan College, and the others -- is how the continued economic recovery appears to be hampered to a great degree, as it pertains to small and medium sized firms, by the banking industry itself, and the difficulty of obtaining loans and continuing on credit lines. So the Committee decided that why don't we get to hear from the Commissioner of Banking and the banking industry today, to see if there is anything that we can do to fully understand what the problem is as it pertains to credit, particularly among small and medium sized firms. With that, we've asked the Commissioner to start off.

Good morning.

COMMISSIONER GEOFFREY M. CONNOR: Good morning. Thank you, Senator Sinagra, and members of the Committee. I'm Jeff Connor, Commissioner of Banking of the State of New Jersey. I'm here to offer our Department's testimony as to the difficulties small and mid-sized businesses are experiencing gaining access to credit in New Jersey.

I'd like to point out that at the Governor's direction our Department formed a Credit Crunch Task Force, and we had a hearing just last Thursday on June 10. The purpose of that Task Force is similar to the purpose of your Committee, and that's to get banks back to the business of lending again, particularly to small businesses, because all experience shows us that small businesses are what create jobs, as opposed to the Fortune 500, which tend to be downsizing at this time.

Our Task Force has a nice cross section of representation on it. We have Ron Berman, who is Chairman of DKM Properties in Lawrenceville; Charles Bertsch, who is President of Marketing Communications in Westfield; Joseph Burke, a partner with Peat Marwick in Short Hills; Beatrice

D'Agostino, President of New Jersey Savings Bank in Somerville; Geloma Persson, who is President of Business Dynamics Associates in Farmingdale; John Thurber, Executive Director of the Trenton Office of Policy Studies; Joseph Yewasis, who is President of First Savings Bank in Perth Amboy; and former Commerce Commissioner George Zoffinger, who is President of the National State Bank in Elizabeth.

During our hearing we heard from many small-business persons, and also other people in the banking industry and other industries in the State. We heard stories of inability to obtain credit or to maintain credit for existing businesses, and also for new ventures. Our Task Force will prepare a formal report, but certainly one conclusion that everybody agreed with is that one of the problems that we're suffering from is overregulation at the Federal level, particularly this new law called FDICIA -- the Federal Deposit Insurance Corporation Improvement Act of 1991.

What that law was a reaction to was the savings and loan crisis. But savings and loans are really different from banks for many reasons. For one thing, the savings and loans went into the crisis period with no net worth -- no capital. The banking industry is very well capitalized. You also have many banks, if not most banks, that are well run and really don't need to be micromanaged by the Federal government, which is what FDICIA did.

Our final recommendation will be, undoubtedly, to recommend to our congressmen -- Roukema and Klein are both on the House Banking Committee, but to our whole delegation, both in the House of Representatives and in the Senate -- to cut back on FDICIA in terms of its micromanagement of the well run banks. If, certainly, there is a risk of failure, it is appropriate for the regulators to get more involved. But for the well run bank that knows what it's doing, don't try to remove all risk out of banking. Because if you remove all risk out of banking, you remove lending out of banking. Lending by definition involves some risk, but that is, after all, why we charter banks so that they'll lend. And that is why their deposits enjoy Federal insurance so that the consumers feel comfortable putting their money in a bank. We certainly want them to lend.

So that, I think, will be the main recommendation of the Task Force, but we're still drafting our report.

I'd like to give some of our thoughts as to what has gone into this credit crunch, and some other solutions as well. We have seen the failure of 35 savings and loans and 11 banks in New Jersey in the last four years. The savings and loans had assets of $23.8 billion. The banks, which included one savings bank -- Howard Savings Bank -- had assets of $6.5 billion. So there are 46 institutions that are no longer lending money. And many of them, no doubt, were making loans they shouldn't have made, but those were loans that were going into the economy. They have been pulled out of the economy, and I think that that not only had an effect on them directly, but on the survivors who saw the failures -- saw the reasons for the failures, which included in large part speculative commercial construction loans. So they backed out of that kind of lending as well so that they wouldn't be on the list of failures.

The statistics point out, or demonstrate that, in fact, loans outstanding have gone down in New Jersey quite dramatically. On September 30, 1989 loans outstanding in New Jersey from all our depositories -- Federal and State chartered, commercial banks, savings banks, and savings and loans -- totaled $105 billion. Three years later that figure was down to $80 billion. So loans outstanding in New Jersey in this period have declined by $25 billion. Now, that's all loans, including home mortgages, etc. If you just focus in on commercial and industrial loans, which is I think more what this Committee is interested in, that figure has also declined from $17.6 billion in June of 1990, to $12.5 billion on March 30, 1993. So that is really what we're talking about when we're talking about the credit crunch -- is that decline in the loans outstanding, particularly the commercial and industrial loans.

That's the bad news. The good news is that it is turning around. Last year the banks and thrifts in New Jersey made $859 million. The savings and loans -- and I'll say even the savings and loans -- made money, $259 million. The first quarter of 1993, the profits are up by 44 percent. So the bankers have adjusted to the crisis; they have spreads; they're making money. That's good news for them, and hopefully that will now start translating into good news for everybody else who is looking for the loan from the bank

First, on the Federal level, President Clinton is well aware of this problem. He has persuaded the four bank regulators on the Federal level to loosen the regulations to some extent. They have now all promulgated regulation allowing for the so-called character loan. Banks can lend up to 20 percent of their equity in what's called a character-loan basket. The idea being, if you have a customer and a history of repayment, and this is a reliable person, you don't have to wait for the appraisals, the certified accounts, and all the other documentation to make the loan. If you're comfortable making the loan within the basket so that there is not too much risk, go ahead and make it.

Certainly, that's crucial to lending in the business sense. When you're making a loan on a house, it's pretty much according to formulas, appraisals, and income stream. But business lending really does involve an assessment of character and taking a risk on the character of the businessperson to whom you're lending.

So it's certainly a very positive fact that the President and the Federal regulators understand that and are moving in that direction.

There are some other ideas at the Federal level that are also being proposed. Both President Clinton and Senator Bradley are talking about community development banks. They're talking about a program that would get lending into economically depressed neighborhoods to loan moderate-income individuals. This is a section of the economy that is basically in permanent recession. Whether we generally come out of the recession, we have certain areas that are depressed during good times and bad. They're trying to think about the credit crunch in terms of those urban areas, and they have proposed $400 million over four years for that program, which is relatively modest. If you divide $400 million by 50 states and then by four years, you're not coming up with that much money.

But I've spoken to Senator Bradley's office, and what they imagine is basically a trust in Washington, and each state will apply to get funds from the $400 million for programs with community development in mind. New Jersey could well get more than its share if we decide what we want and apply for it, and our application makes sense.

So with that in mind, we have a Community Financial Services Advisory Board, which was established by statute. We're going to hold a hearing on July 20 and hear from people as to what they think New Jersey ought to apply for. No doubt we'll apply for funds to build on success, rather than start a whole new network of community banks with directors, administrative costs, etc. We'll find out what's successful. We know we have community loan funds like that that are successful, so I think our thrust will be to try to build on the success which we have.

My own feeling on community development is that you have to start small. You can't start with General Motors; you have to build one car, and if it's successful, you build 10 cars, and eventually you get to the large scale.

With that in mind, we have just chartered a community development credit union in Camden. This is built around a Hispanic group called LAEDA. Core States, New Jersey National Bank, is going to be on the second floor as a community development gesture. They're going to do the bookkeeping and the underwriting and help make sure that this is a success. I think it will be with their help.

If that model works, and I think it will, we've already talked to groups in Paterson and other areas in the State which could benefit from a community development credit union, which is a much smaller scale than a bank. The Community Reinvestment Act specifically gives banks credit for assisting low-income credit unions. So it's a nice mix, and it's a nice way to get a bank helping with the redevelopment.

I have another idea which I have been propounding, and here is an opportunity to talk about it again, and that is the RTC. The RTC, as you know, owns savings and loans. They bid them out, and if there is no buyer, they close them. We had, right in Paterson, a $240 million institution called United Savings. Its customers were all low- and moderate-income individuals. You talk about a community development bank, we had one. And they paid everybody out. Everyone stood in line and got their deposits, and now if you go to downtown Paterson, this building is shuttered up, it's closed. And within sight of City Hall, you also have the office of Alexander Hamilton Savings and Loan, and Irving Savings and Loan -- they're both closed.

What happened with those other two is that there was a buyer for those institutions, but they didn't want those branches. So those branches were closed and the deposits were moved out to suburban locations.

In Trenton you see the same thing. United Savings of Trenton: There was a buyer for the suburban locations. The deposits in Trenton were moved to a suburban location. The depositors in Trenton were told, "You can take a bus out to Hamilton or Lawrenceville, and visit your money that way." You end up with an eyesore created, basically, by the RTC and their policy of closing where they don't find a bidder.

It seems to me -- we have eight institutions left in RTC -- that we could take those branches that nobody wants, keep the deposits there, use this $400 million we're talking about and put some capital -- you need 6 percent capital -- and there is your community development bank. You've got your deposits; RTC can keep the bad loans. The Bradley/Clinton fund can give them the capital, and then they can make new loans. You talk about community empowerment, etc-- A savings and loan is mutual; it's owned by the depositors, so what could be more community empowerment than that. The very people who have their deposits there own the place.

So this is an idea that I've been pushing, particularly with Senator Bradley's office, because he's working on this bill for the community development of funding. Maybe we'll have an opportunity that we can take advantage of, but this is kind of our last chance. I'll just read you the names of the institutions in RTC: Carteret Savings Bank, Newark; Hansen Savings, Hammonton; Marine View Savings, Middletown; Prospect Park Savings, West Paterson; Polifly Savings, New Milford; Security Savings, Vineland; Volunteer Savings, Little Ferry; and White Horse Savings, Trenton.

Their suburban branches will probably be bought. Their urban branches will probably be closed. That's a disaster that I think we should try to avert.

Banks are not the only source of credit. Another way that we have been addressing the credit crunch is with alternate sources of credit, particularly in New Jersey from the HMFA, with the Welcome Home Program for the first-time home buyers; in the State EDA fund, which is lending in record numbers, although they tell me that they really don't want to be in the business. They want to have the banks come back and they'll step back in their program. And also, SBA programs are available from the Federal level.

Now, there are some causes of the credit crunch that are New Jersey's fault, and not the Federal government's fault. I would just like to touch on them, because it may be that your Committee can help us address these.

One is foreclosure delay. This is particularly a problem in the commercial lending area, although in the home residential area it's a problem too. It takes two years to foreclose in New Jersey, and according to the American Bankers, we have the distinction of being the worst state in the country in terms of foreclosure delay. Now, if you're going to make a loan, you're looking to the collateral, and if you aren't repaid, you want the collateral the day after the default. If you have to wait for two years, that's two years you have a nonearning asset, no income, and all the other problems that go into a delay. The property can deteriorate. The owner tends to still occupy the place and may even destroy the place during that period of time. It's a--

SENATOR SINAGRA: May I just interrupt you? I think the Committee would like to-- Can you explain, for our knowledge, what you have to go through in New Jersey that you don't have to go through in another state as far as commercial foreclosure.

COMMISSIONER CONNOR: Well, some states are deed of trust. Basically, you the lender already own the place. You have a deed, and if it's in default, you just go and wave your deed of trust on the courthouse steps someplace, and you own the place within three months.

In New Jersey, first you have to get the sheriff to serve process. That can take six weeks because they have other things to do. But it has to be the sheriff, and it's only after the sheriff cannot find the person that you're allowed, eventually, to hire your own process server. Then you're put on a court docket, and of course, there can be counter claims. The borrower will say -- you know, lender liability -- "You should never have lent money to me. It's your fault. It's not my fault I'm in default." So you go through your whole court case. Eventually you get judgment. Maybe they go bankrupt; there's more delay. But then the judgment has to be executed, so you're back in line at the sheriff's office. Then maybe they do two a week on a Tuesday. They always adjourn it twice, and you with your $10 million industrial site are sitting there with a $100,000 house waiting for this foreclosure process.

I think there may be an attitude in terms of, "We're doing people a favor by delaying foreclosures." In the individual case, you may be doing them a favor, but in terms of the overall credit crunch you're not doing the economy a favor, because if you can't foreclose, you're not going to lend. That's a problem we see.

New Jersey is so slow that the Federal regulators have instruction to be more severe in their criticism of loans in New Jersey because of foreclosure delay. Your collateral-- You may be 100 percent collateralized, but if it takes two years to get it, you're not 100 percent collateralized. So it's a very real problem.

Now, the Governor has met with me and the Attorney General, and we've met with Al Griffith and the New Jersey Bankers. We have an ongoing task force, but you have to attack different branches in government. Sheriffs don't report to the Governor; they're not on the State payroll and they're elected. That means they are independent. You can't simply order them to make this go faster; you have to try to work with them. The judges, obviously, are a separate branch of government, and you have to work with them too. What we try to do is impress upon the Chancery judges and the sheriffs that they're causing the credit crunch. It has sunk in to some extent.

You then have Judge Kimmelman, who came up with this idea of a special referee to bypass the sheriff. He has done this in Hudson County to the point where the sheriff is nervous, because they get a percentage of the foreclosure cost, etc., and he has pushed them along with that incentive.

We've worked on a draft of a standing order, statewide, where in commercial foreclosures the bank can apply for the special referee. The Judiciary is hesitant to have a statewide order, but they have this model, if you will, so that in a specific case a bank can apply for a special referee to basically bypass the sheriff.

These may be fruitful areas for your Committee to explore. In terms of commercial foreclosure delay, you have none of the emotional situations you might have with a residential foreclosure, and we certainly should look into it.

The other distinction New Jersey has, of course, is in the environmental area. There, again, you have the problem of: You're the bank; you make the loan. If you foreclose, you own the property. Basically, 100 percent of our industrial properties have some kind of a spill problem or a pollution problem. Even our suburban properties, I'm told that one out of eight have some kind of a pollution problem. Up until now the owner had to clean it up, whether or not they were responsible for the spill. So the banks were very hesitant to lend in industrial areas because their collateral had no value. It may be a property worth a couple of million, but if you have a $30 million Superfund bill, obviously it has negative value to you.

The Senate, the Assembly, and the Governor have all responded with a bill, S-577, which was just signed into law. We had a seminar just yesterday that New Jersey Bankers put on. We had several hundred bankers. The purpose was educational, to explain to them about the risks involved and the lessening of the risks with S-577. Now also we have 1070, which has passed both Houses and renamed our ECRA law ISRA, and is supposedly less onerous. And it is, but it's also 70 pages instead of six paragraphs. It's a lawyer's dream, I'd guess you'd say, in terms of going through the very complicated statute.

So if you're a banker, you have a choice of making a loan in an industrial area and facing a 70-page statute you deal with if you take title, or you can just buy a Treasury Bill, get yourself 7 percent, and there's no risk at all. That's a problem, particularly in our industrial State, but at least we are finally addressing it. I think the end result has got to be some kind of common sense. We have an industrial area, and that's just not going to be as clean as the Jersey Shore or the Pinelands, but that's where the jobs are. We've got to think in terms of the economy as well as the environment.

What we've been doing is calling the bankers and saying-- The Governor didn't like signing S-577. I mean, he's the author of the Superfund. He said to me-- He signed the laws on a Friday. The next Tuesday he said to me, "Where are the loans? They said they'd make loans if I signed this bill." So we are gathering information from the bankers about loans. You know, they said they'd make loans if you signed the bill, so where are the loans? Hopefully, we're going to see some progress.

There is another bill that I just want to mention in passing, and then I'll finish my remarks. That's Leanna Brown's bill, Senate Bill No. 1599. The bankers are adamantly opposed to this bill. However, it would allow foreign banks to open loan production offices in New Jersey, and that's a source of credit. It may be a niche that is not being filled completely by our bankers in terms of import/export trade. One of the growth areas for New Jersey, because of our location on the coast with ports and closer to Europe than the rest of the country, is in import/export. Foreign companies particularly complain that New Jersey banks don't seem to know how to deal with foreign currency, bills of lading, and letters of credit and all of the financing that goes into foreign trade; whereas, these foreign banks are equipped to do that. If they were allowed to open loan production offices it might help stimulate the economy and bring in more tenants for empty real estate.

There are 100,000 people in America who work for foreign banks. Delaware has been very successful with a foreign bank initiative. New York, of course -- it's a very vital part of New York's economy, the foreign banks. We've let them in through the back door with our back-office bill, which allows their back offices in New Jersey. We've created 2000 jobs with that bill. Maybe it's time now to look at Leanna Brown's initiative -- probably not this year, but next year -- in terms of whether or not we want to let loan production offices of foreign banks into New Jersey.

That concludes my remarks. I think we all agree that we share the problem on a bipartisan basis, and that we want to work together to solve it. I'll be happy to answer any questions.

SENATOR SINAGRA: Okay. Senator Inverso?

SENATOR INVERSO: First of all, I want to thank you for appearing here today. We know there's a lot of activity going on in Trenton today with a public hearing on the budget, so you're presence here is certainly appreciated. I want to thank you for what I think is a very comprehensive review of the activities of your Department and the State in general with regard to alleviating this -- and I'll call it a credit crunch, because indeed, it has been a crunch.

I appreciated hearing some of those initiatives that you have on the drawing board, some that are on the way and some that we have to work together to achieve.

I was wondering, with regard to the deed of trust: Is that not something in our arsenal that we could put into place in this State, a deed of trust? Would we need legislation to do that?

COMMISSIONER CONNOR: I think we need enabling legislation. There has been talk about having it as an alternative -- more than one way to do it. But I think you need enabling legislation for a nonjudicial foreclosure that, importantly, wipes out the other liens. One thing that you do when you foreclose is, you want to own the property free of any liens. I believe in New Jersey it requires a judicial foreclosure to eliminate those other liens.

SENATOR INVERSO: Does your Department contemplate drafting legislative--

COMMISSIONER CONNOR: We've worked with Vice Chairwoman Vandervalk on a bill in the residential area. But unfortunately the bill got dragged down with the Public Advocate wanting to go in one direction, and the banks wanting to go in another direction. It's my impression that that bill isn't going to make it.

SENATOR INVERSO: There have been no hearings on this? The bill has not been introduced in Committee?

COMMISSIONER CONNOR: I don't think there have been hearings on it. It's in the Assembly Financial Services Committee.

SENATOR INVERSO: Well, this doesn't relate specifically to anything under your domain, but there have been a lot of lender suits -- lender liability suits initiated as a tactic in warding off banks approaching their collateral. What do you think needs to be done in that area? Do you have any thoughts on that? Is there anything we can do to constrain--

We certainly can't abridge anyone's legal rights and remedies. But on the other hand, it seems to me many of these suits are based on a rather frivolous basis. People come in, provide representation to a bank, documentation to a bank about their abilities and so on and so forth, and then when the market goes against them or businesses fail, they counter with, "The bank should not have lent me the money, because they should have known." Now, the bank certainly can't be put into a posture of being the sole liability and responsible party for a transaction involving two parties. Is there anything that we can do in that area?

COMMISSIONER CONNOR: Well, I think we did pass a law that basically says that the whole contract has to be in writing so that the borrower can't say, "Well, the banker promised he'd lend me another $500,000, and I could have completed the building," -- or whatever -- "if only he'd done that."

I don't know if it's possible, but there should be a way to transfer title right away. You get the property owned by somebody who is going to operate, and then to keep the lawsuit about the lender liability going without it standing in the way of title transferring. So let the bank get title; let the bank sell it to someone else, and then they can continue for the next 15 years with their lender liability suit. In fact, if the bank was at fault, the bank would have the money to pay a money claim, but the property wouldn't be tied up. Don't tie up the property. Is there some way to do that?

SENATOR INVERSO: Yes, we ought to take a look at that. Also of concern to me are situations where a bank will commit under, say, a line to provide "X" dollars, and in assessing the specific situation can come to a reasonable determination that this whole thing is going south quickly and therefore it would be imprudent to lend additional dollars. My understanding is that many times they are required to lend additional dollars and immediately provide 50 percent as a DOFO, (phonetic spelling) maybe even 100 percent as a loan-loss situation. Is there anything we can do there to help in that situation, without a bank taking it on its own and then being subject again to this lender liability where they say, "Well you promised me this money. If I had the additional money, I could have been, perhaps, successful."? On the other hand, anyone with any sense and expertise in the business of banking could determine that that would not have occurred.

COMMISSIONER CONNOR: That obviously is a problem. If you have a written commitment to advance a certain amount of money, that is a contract subject to litigation if you don't advance it. In many of these cases there is a line of credit, and it expires and there is an expectation of renewal because it always is renewed. It's very hard for the bank to terminate that when there is an ongoing relationship. You really do have to be careful, and that's one of the main areas of this lender liability. If you could have a law saying there is no obligation to renew a line of credit, I'm not quite sure how you would do it.

SENATOR INVERSO: Yes, I don't know either. It's just something that seems to be a pragmatic problem. I understand the contractual nature of some things. But we had situations with the bank that I'm associated with where when assessing the credibility and the hedge to cover the loan, we had come to the conclusion there is no way it is going to happen, and had to advance an additional sum of money, which immediately was put into the loss category and 100 percent reserve, and never got the money back. There has got to be some remedy somewhere, because obviously this influences the future relationship of banks with customers and perspective customers.

COMMISSIONER CONNOR: Maybe if you have a law saying that the liability can't exceed the loan. I mean, one reason in that situation you might advance them the $100,000 is for fear they are going to counterclaim, "You destroyed my $10 million business." Your liability exceeds the loan, so you're better off making the loan. Maybe there would be some way to limit the liability to the amount of the loan, which is awesome if you're in the environmental area. Your exposure exceeds-- Banks are conservative. They want to know what the risk is. If the risk is the loan, fine. But if the risk is unquantifiable, then they're not going to make the loan.

SENATOR INVERSO: Is there any way that the Banking Department, in evaluating the fiscal integrity of a bank, and they're looking at its loan loss provisions and its capital needs -- lightening up on some of the loan provisions requirements going forward at this point in time? You know, we've been through a very bad period here in New Jersey with regard to the real estate market, and of course the capital position of banks has been jeopardized by that. We see that banks seem to be returning to health. They seem to be doing it basically on investments as opposed to the lending you alluded to so well.

Part of the problem is that, you know, many loans -- even if you do this character loan -- immediately there is a piece of that loan that may have to go into loan-loss provision. I understand that there are ranges and that there is judgment there, but it seems to me that part of the problem is that when loans are reviewed for approval, and if a loan falls into a substandard category -- even slightly, even though the ability to pay seems to be there, but for some reason substandard -- immediately there is a provision required against that. I know that's prudent.

You know, I'm an accountant, and I believe in conservativeness, but it does seem to me also to hamstring banks, particularly when they have to look at that capital-ratio requirement. Is there any consideration given to perhaps lightening up a bit on the loan-loss provisions that are required in assessing the loan to -- or structuring the assessment of a loan, the categorization of a loan a little differently?

COMMISSIONER CONNOR: Going into this crisis our banks tended to be underreserved, and the reason they lost money in the last few years is because they were adding that to their reserves. They weren't truly losing the money; they were moving it from one account to another.

Now, as we come out it may be that some banks are overreserved. As they analyze, the reserves are more than they have to be. They can bring those reserves, some of them, back into income. They are permitted to reduce the size of their--

SENATOR INVERSO: Their provision?

COMMISSIONER CONNOR: Their provision, right.

In terms of the nonperforming or the loan in default: There is a rule which says, if you are fully collateralized -- and that means really well overcollateralized, so that there is no possibility that you are going to lose money; that eventually you will collect on this collateral; that loan does not have to be classified substandard. That rule, basically, was ignored for the last few years, but I understand that it is now being looked at again and will allow some standard loans, at least, to move into the special mention category, which has a much lower reserve assigned to it. But there has to be no expectation of a loss when the loan is finally liquidated. If there is any expectation of a loss, then it does have to be classified.

SENATOR INVERSO: To get back to the community development banks-- Is that how you refer to them, the community development banks?

COMMISSIONER CONNOR: Yes.

SENATOR INVERSO: You have been in contact, you said, with Senator Bradley's office with regard to--

COMMISSIONER CONNOR: Yes.

SENATOR INVERSO: Does that initiative involve requiring perhaps, the RTC -- through affirmative changes, requiring the RTC to cause to be created the capital for the community development banks to be in place, or is it just a matter of a separate initiative to take some of those properties with the RTC and capitalize them separately?

COMMISSIONER CONNOR: It would have to be a separate initiative. The capital would have to come out of this other fund.

SENATOR INVERSO: The $400 million.

COMMISSIONER CONNOR: The $400 million fund. And then there would be a directive, basically, to the RTC that if there is no bidder-- If there is a bidder, they will award it to the bidder. But if there is no bidder that they would work with the Community Development Program, which would supply the capital, and then transfer title of the institution -- or more likely, the branch, because most of these institutions will sell most of their branches -- to form a new mutual savings and loan.

That would be the initiative, but you would have to have separate funding. The RTC really shouldn't be expected, I don't think, from their own funds, to capitalize these institutions, because they are a liquidating agency.

SENATOR INVERSO: You mentioned that banks can get credit against their CRA requirements--

COMMISSIONER CONNOR: Yes.

SENATOR INVERSO: --if they provide capital for community development banks. Is that true if they do it outside of their lending area?

COMMISSIONER CONNOR: As I understand it, the way the law is written it says, specifically, if you assist a community -- low-income credit union. But this is a point of contention in: What is your community and is it outside of your community? In the case of Core States, which is assisting the

Camden development, it didn't come up because Camden was part of their community by any definition. But it could maybe come up in a different part of the State. I think the banks that we would get to help us would be a local bank.

This is another law that could be changed, but it's a Federal law.

SENATOR INVERSO: A Federal law, right.

COMMISSIONER CONNOR: We have this with the Thrift Institutions Community Development Corporation -- I think is what it is called -- they're building low-income housing in Newark. They go to a savings and loan in Millburn and say, "Help us." And they say, "We can't. We don't get any credit." You can see-- If you stand in the right place in Millburn, you can see Newark, but it's not in their "community."

That doesn't make any sense in a little State like New Jersey. The whole State is our community.

SENATOR INVERSO: Agreed, agreed.

That's all I have at this point, Mr. Chairman. I want to thank the Commissioner again. I think he's done a great job in reviewing exactly where we are and what needs to be done. Hopefully, together with the committee that will be releasing its report in September -- the Governor's Committee in September--

COMMISSIONER CONNOR: Yes.

SENATOR INVERSO: If there is any opportunity for our Committee and that group to join forces and resources to accomplish what needs to be done, whatever it is you have in the pipeline with regard to recommendations, I know I can speak for the Chairman that we stand ready to work with you on that. It is an important issue, and September is a few months down the road, but we have to move quickly on some of these. Whatever legislative initiatives are necessary, we've got to move quickly on.

COMMISSIONER CONNOR: That's right. That's very helpful, particularly as we lobby the Federal government and our Federal legislators, to have more than one source making a similar recommendation would be very helpful.

SENATOR INVERSO: Right.

COMMISSIONER CONNOR: I think that when they passed some of these laws they really didn't consider the impact it would have on lending. To hear back from the communities and the states that they are strangling the lending should have a real impact, and if they hear from more than one source, that would be helpful.

COMMISSIONER CONNOR: Assemblyman?

ASSEMBLYMAN KRAMER: It appeared when you said New Jersey was really a community in itself, have you lobbied the Federal government on changing the regulation where a bank can assist another community?

COMMISSIONER CONNOR: I've written Senator Bradley on that point.

ASSEMBLYMAN KRAMER: Yes, because it really makes a lot of sense.

COMMISSIONER CONNOR: It really does, particularly if you look historically. A lot of the institutions used to be in the city that they no longer are in.

ASSEMBLYMAN KRAMER: By the way, White Horse Savings and Loan is in Hamilton Township, not in Trenton.

COMMISSIONER CONNOR: Well, the mailing address is.

ASSEMBLYMAN KRAMER: But we can leave it in Trenton if-- Well, it's not there anymore anyway.

Do you feel strongly that some of the changes you talked about, easier foreclosures for example, some of the other things would really make a bank be more willing to lend money? Or is it just it makes it easier for them to foreclose?

COMMISSIONER CONNOR: It would. Not only New Jersey banks, but out-of-state banks are hesitant to lend to New

Jersey because of the foreclosure delay. You know, why not lend into some of the southern states where it moves so quickly.

ASSEMBLYMAN KRAMER: So the bill that you spoke of, that Vandervalk had before the Financial Institutions Committee, hasn't gone anywhere because of some opposition by the Public Advocate? I didn't understand that.

COMMISSIONER CONNOR: Well, it was going in two directions at once. It was trying to help people prevent foreclosures and it was trying to speed up foreclosures, and you can't do both.

ASSEMBLYMAN KRAMER: Okay. Is that bill still around?

COMMISSIONER CONNOR: It exists, yes. It's in-- It's almost mutually contradictory at this point, because it's trying to please everybody.

ASSEMBLYMAN KRAMER: Okay. I just wondered if, in fact, that would-- I guess the argument would be, those who would oppose it would say, "No, it's just going to help the banks foreclose. It's really not going to--"

Nothing in what you've said, nothing in what I've heard-- It isn't that there is a lack of money to lend?

COMMISSIONER CONNOR: There is plenty of money. Our banks are 40 percent liquid -- 45 percent liquid. In other words, half the money they have is just sitting there in Treasury Bills. It could be lent. Now, they have rules, so they really shouldn't lend more than 80 percent, but there is a wide margin of funds that could be lent in New Jersey if the demand was there and if these other factors were addressed.

So it is there. It's not a shortage of available money. It's the fact that the loans just aren't being made.

ASSEMBLYMAN KRAMER: How much of what's happened with the savings and loans that have been closed and given-- I'm sure you've heard from former boards of directors, what's happened to them, sometimes personally. I mean, questions about their personal finances, etc., etc., make other boards more hesitant in lending money and in taking risks.

COMMISSIONER CONNOR: It has to have an effect. There are two kinds of savings and loan failures. There are the people who lined their pockets and lent money to themselves, etc., or took it. They obviously should be liable. But there is the other group who were just directors and had no personal stake, but approved loans that went bad. They're being sued on the general negligence theory. Now, if you're a director, and most of our directors have fairly substantial net worth, that is going to make you hesitant to approve a loan.

ASSEMBLYMAN KRAMER: Sure.

COMMISSIONER CONNOR: Because you have to second guess the future. I think it's very unfair. The RTC has an unlimited legal budget; they can sue anyone they want to. I think it's very unfair in the cases of what we'll call the general negligence theory, as opposed to the actual personal enrichment, where they should definitely sue.

ASSEMBLYMAN KRAMER: But it seems to me that even the director that wasn't personally enriched is treated pretty shabbily in some cases. At least, those that I know--

COMMISSIONER CONNOR: They are.

ASSEMBLYMAN KRAMER: --that certainly are credible individuals in the communities that I represent. Is there any way that we can change that?

COMMISSIONER CONNOR: I don't know if the Committee knows it-- It is standard in the savings and loan failure to write every director and ask for a statement of his net worth. Now, that is a search of documents, and the Constitution says there is supposed to be a judicial order. You're supposed to know what the claim is against you. There is no claim against them; there is no judicial order. It probably is unconstitutional. But this is what they are subjected to, and it goes on for years. And finally, just when the statute of limitations is about to expire, they're sued for $200 million -- or some fantastic amount of money, as in the case of City Federal -- on the general negligence theory.

It's awful. Directors of other banks have got to read the papers and get kind of shy about approving loans.

ASSEMBLYMAN KRAMER: There isn't much we can do about that though, is there?

COMMISSIONER CONNOR: Well we could, and we should, have a State statute to limit the liability of directors. But you still have Federal law to deal with, and if there isn't a corresponding Federal law, it wouldn't go the whole way in terms of protecting people.

ASSEMBLYMAN KRAMER: Thank you very much, Commissioner.

COMMISSIONER CONNOR: Thank you, Assemblyman.

SENATOR INVERSO: Could I follow up on that?

COMMISSIONER CONNOR: Sure.

SENATOR INVERSO: I'm very close to an individual who is involved in one of those situations, and you're absolutely right. They are treated awfully and shabbily, almost without due process. The message it sends out is: Going forward, we're not going to get qualified, competent people who want to serve on bank boards, and in that case, maybe other boards too, where liability can way exceed what should be any reasonable measurement.

The people with the RTC, the way they have been handling some of these situations that are noncriminal, nondiversion of funds and that type of thing, are strictly making judgments based upon documentation available to them at the time. Seeing the market go sour on them and then having them be held accountable for penalties that far exceed what any one of us would think would be reasonable, I think is an unconscionable thing. There is no question that the full impact of the law should be brought to prevail on those who have done things with public funds -- depositor funds -- that were wrong. But when that is not the case, to have directors in the latter category treated the way directors in the former category are treated, to me is something that needs to be remedied.

I understand that it's not within our State purview to do anything. It's really the way the RTC brings to bear its responsibilities in this area. But it's sending shock waves through our community, certainly, in a couple of instances. You're dealing with people who are, in many respects, pillars of the community. This has been a very, very sour thing for them to have to absorb and the word is being spread. People will not be serving on community banks. It's not going to happen.

Maybe we're going to see the death knell of community banks in that regard. I don't know how we can-- Even the Fed, I guess, doesn't have any prerogatives in this area, but maybe together we can lobby our Federal legislators to do something. A lot of it's in the pipeline now. A lot of it will take years to unravel. The uncertainty hanging over the heads of the people involved is something that precludes them from getting involved in other business matters. It's just a terrible thing. Something has to be done. Even if it's an expeditious solution or resolution in those areas where there is no criminal involvement, there is no self-aggrandizement--

COMMISSIONER CONNOR: I've had accountants tell me that they have advised wealthy clients who are invited to join a board of a bank not to do it.

SENATOR INVERSO: Exactly, exactly.

SENATOR SINAGRA: First, I would like to compliment you, also, for the fine presentation that you made this morning.

COMMISSIONER CONNOR: Thank you.

SENATOR SINAGRA: Probably a question I'll ask everyone who speaks this morning is: What are other states doing. In your testimony you indicated that New Jersey has some particular problems that other states do not have; namely, length of time it takes to foreclose, ECRA, ISRA -- whatever term you want to put to it -- our environmental laws, certainly, in many cases are unique to New Jersey. Is there anything that you see other states doing that is a positive? This is not totally a unique situation to New Jersey, although we have our particular problems. What are other states doing?

COMMISSIONER CONNOR: Well, I don't really know that much about other states, but I think this alternate sources of credit idea is being pursued in other states in terms of state lending. Pennsylvania, as I understand it, has some program with people who are in foreclosure where they will assist them with their mortgage payments to get them through a period of unemployment. Those cah be very expensive programs naturally. It's certainly better to stimulate the private sources of credit.

But we seem to be harder hit than other states too. So we may have to come up with our own solutions that other states don't have.

The SBA is a great source of financing for small business. We've never been that active in New Jersey compared with some other states with SBA guaranteed loans, and that might be an area to explore. Because when you get the Federal government on 90 percent of your loan amount, it's obviously much less of a risk. And yet, we only have a few banks and finance companies that are SBA lenders in our State. So that might be the most practical thing.

In terms of HMFA as a source of credit: The Federal government has allowed the low-income tax credit and the tax free status of mortgage revenue bonds to expire. Those two tax subsidies are the basis of the whole HMFA program. So if we could get those renewed, that would help the housing credit that is made available by the HMFA.

SENATOR SINAGRA: Thank you.

COMMISSIONER CONNOR: Thank you, Senator.

SENATOR SINAGRA: Thomas Desch?

THOMAS K. DESCH: Good morning.

SENATOR SINAGRA: Good morning.

MR. DESCH: Thank you very much for inviting me to be here. I really appreciate the opportunity, Mr. Chairperson, to participate in the important effort to improve credit availability that the Joint Legislative Committee on Economic Recovery in New Jersey has established.

With your permission, I'll read my prepared remarks, if that's all right?

SENATOR SINAGRA: Certainly.

MR. DESCH: Because credit availability is the fuel for economic recovery, banks are especially important in helping finance our nation's needs. In the way of background, the past year was in many respects a transitional period of the U.S. banking system. After having experienced weak profitability and a rise in problem assets for several years, the commercial banking industry in 1992 reported its highest profitability in more than a decade, and problem assets decreased. These achievements were possible in large part because of declining market interest rates. The industry's capital ratios also improved significantly from 1991, with the equity capital ratio reaching its highest point since 1966. Banking organizations drove up their capital ratios mainly by retaining a greater share of their profits and by issuing record amounts of new stock. These actions were taken in anticipation of the full phase-in of the international capital standards, and in preparation for domestic banking legislation that went into effect at the end of 1992.

One consequence of this overall improvement was that the number of bank failures during 1992 was lower than had been anticipated. Nonetheless, the number of troubled and failed institutions remained high, and problem commercial real estate loans continued to stress much of the industry. Earlier efforts by banking organizations and the regulatory agencies to address the industry's problems, and to strengthen lending standards have led to concerns about the availability of bank loans to creditworthy borrowers. Problems with the availability of credit have been especially significant for small- and medium-sized businesses and farms.

Surveys of senior lending officers indicate that banks have generally taken measures to adopt more conservative lending policies and practices, in part, in response to the losses associated with some laxities in the 1980s. Anecdotal evidence indicated that the move to tighten standards was caused, in part, by concerns that examiners were being overly critical in evaluating loans. Building on earlier policy statements, the Federal Reserve during the year further addressed possible disincentives to prudent bank lending. These efforts included continuing clarification of Federal Reserve policies to examiners and other supervisory staff members to promote realistic loan evaluation procedures.

The industry's recent problems gave rise in late 1991 to major legislation designed to improve banking and bank supervisory practices, generally with the purpose of reducing potential costs to the public. The Federal Deposit Insurance Corporation Improvement Act of 1991, FDICIA, contained numerous provisions covering broad aspects of bank lending and operating standards. Developing regulations to implement this statute was a major activity during 1992, and will remain one throughout much of 1993. FDICIA specifies supervisory policies and actions for all banks, especially for those that are undercapitalized. The statute also directs the banking and thrift regulatory agencies to more formally address on credit risks in bank capital standards. Many provision of FDICIA require the issuance of uniform rules by the banking and thrift regulatory agencies. As a consequence, the amount of interagency coordination on supervisory matters is extensive.

The challenge in creating the 100-plus new regulations has been to be neither so specific that they result in industry micromanagement and excessive regulatory burden, nor so general that they miss the intended wishes of Congress.

Nevertheless, the banking industry is overwhelmed with regulatory burden. As a consequence, the banking industry has taken a somewhat longer lasting, cautious attitude toward taking on new risk.

I say this because slower credit flows are normal events in an economic downturn, but this credit crunch is lasting longer than usual. In the 1990s, bankers seem to be concentrating on improving the quality of their loan portfolios by reducing significantly the risk levels, thereby slowing overall credit availability.

As part of a general effort by the Federal banking agencies to address issues affecting the availability of credit to creditworthy borrowers, Federal Reserve officials have taken a number of steps designed to assure effective communication of Federal Reserve policies and practices to bankers, borrowers, and Federal Reserve examiners. These actions have included: 1) participating in regional town meetings with bankers and borrowers; 2) holding special meetings with the senior management of banks; and 3) discussing, during examinations, concerns bank officials may have regarding supervisory and examination policies and practices, particularly those related to credit availability issues. Federal Reserve Bank officials have also held, on an ongoing basis, meetings with bank examiners to assure that examiners are informed and fully understand the credit availability issues.

On March 10 of this year, the four Federal regulators of banks and thrifts announced a new major program of changes to deal with problems of credit availability, especially for small- and medium-sized businesses, to alleviate the apparent reluctance by some banks and thrifts to lend. The agencies have since completed most of the proposed changes, and published the details as each change was finalized. In establishing the plan, the agencies reaffirmed their belief that it is in the interest of lenders, borrowers, and the general public that creditworthy borrowers have access to credit.

In the last several years, the buildup of certain regulations and practices has become overly burdensome, and in some cases may have stifled lending.

Accordingly, one focus of the program is to help ensure that regulatory policies and practices do not needlessly impede lending that is consistent with safe and sound banking practices.

This program is one aspect of an overall effort to evaluate carefully and react appropriately to risk in the financial services industry. That overall effort envisions substantial oversight, in some cases more than we have now, in areas that pose greater risk. Similarly, regulatory burden will be reduced where risk is low, especially for strong, well-managed banks and thrifts. This program is also part of a broader effort to ensure equal credit opportunity for all Americans, and to make credit and other financial services available to low- and moderate-income neighborhoods and disadvantaged rural areas.

The program involves a variety of regulatory and administrative changes agreed to in principle by the agencies, and embodied in five categories.

1) Eliminating impediments: Strong, well-managed banks and thrifts; that is, those rated 1 or 2 and with adequate capital are permitted to make and carry a basket of loans with minimal documentation requirements consistent with applicable law. To ensure that these loans are made to small- and medium-sized businesses, a maximum loan size of the lesser of $900,000 or 3 percent of total capital has been established. In addition, the total of such loans is limited to 20 percent of the institution's capital. These loans are evaluated solely on the basis of performance and are exempt from examiner criticism of documentation.

2) Improving the real estate climate: The experience of the last decade has underscored the importance of sound underwriting standards and effective supervision for commercial real estate loans. Nonetheless, in certain instances regulatory burden may be adversely affecting loans to sound borrowers, particularly in the case of loans secured by real estate that are primarily used for nonreal estate business purposes. Real estate collateral is often pledged for loans to small- and medium-sized companies that have few other tangible assets.

In some cases, currently required real estate appraisals may not add to the safety and soundness of the credit decision. Accordingly, the agencies are making changes to rules relating to expensive real estate appraisals.

3) Enhancing appeals and complaint processes: It is important for bankers to have an avenue by which they can obtain a review of an examiner's decision. For that reason, each of the agencies already has an appeals process, and will take steps to ensure that its appeals process is fair and effective.

Each agency also has a process to handle more general complaints from the institutions they regulate and from the public. These agencies recognize that responding to complaints is an important element of proper supervision and are particularly concerned that complaints of discriminatory lending practices be handled expeditiously and with the utmost seriousness. Accordingly, complaint processes will be reviewed to improve both the care with which complaints are scrutinized and the timeliness of responses.

4) Improving examination process: The examination process, by its nature, involves some disruption to the examined institution. Accordingly, the agencies have agreed to intensify efforts to minimize such disruptions, and in particularly to take the following steps: First, eliminate

duplication by multiple agencies, unless clearly required by law. Secondly, increased coordination of examinations among the agencies when duplication is required. And thirdly, establish procedures to centralize and streamline examinations of multibank organizations.

Since uncertainty regarding regulations may contribute to a reluctance to make some credit available, the agencies will review their regulations and interpretations to minimize ambiguity wherever possible. Furthermore, the agencies will reemphasize that examiners follow agency policies and guidelines carefully and accurately in carrying out examinations and in reviewing applications. Every effort is being made to ensure that examinations and applications processing are performed uniformly across the country.

5) Further efforts: Other items are being reviewed for possible changes. Just last week, on June 10, the bank regulators announced six additional initiatives to implement the March 10 program to improve the availability of credit to businesses and individuals.

Efforts are also underway to reduce the paperwork burden, to eliminate duplication and other excesses that impedes the flow of funds to creditworthy borrowers. I believe that improvement in credit availability is happening now, but the upswing is only gradual. I have a chart here which shows the turnaround in New Jersey for the first time, in the first quarter of this year. It shows that loans are now at about $12.5 billion, and made a swing from the end of the year. It's a gradual turnaround, I do admit.

I also believe bankers will lend more as the health of their particular institutions improves. The banking industry is still returning itself to good health.

It is also my opinion that we can help the processes by relieving the regulatory burden where possible and appropriate at both the State and Federal levels. Every little bit helps. I believe the recent change in lender liability law in New Jersey is a sizable positive step towards improving credit availability in New Jersey.

Last year, the American Bankers Association tried to quantify the costs of complying with various banking regulations by surveying 1000 banks. The study concluded by saying that banks spent $10.7 billion in 1991 for regulatory compliance, equal to 59 percent of net income. Bankers say every minute that is spent on compliance and every dollar that is spent on compliance is time and money taken away from the real business of banking, which is being out in the community making loans. This argument hit a high point last December when the ABA President stated that a reduction in bank regulations would generate $86 billion in new lending.

Unnecessary costs cause losses to society. Minimizing unnecessary regulatory burden, within the overriding constraints of other regulatory goals, should be an objective of both the states and the Federal government. The reduction of unnecessary burden increases economic efficiency by wasting fewer resources in obtaining the desired regulatory goals. Simply stated, some burden may be necessary to achieve public policy goals, but unnecessary regulatory burden represents a deadweight loss to society. I think that's what we're experiencing when we refer to the credit crunch, a deadweight loss to society.

Some suggestions of things that might be done at the community level to reduce the credit crunch are:

1) Provide guidance to potential borrowers on how best to proceed to apply for credit. I think some potential borrowers do not get to the credit window because they do not know how to package their request.

2) Provide a review mechanism for turndowns. The intent is the same as in my previous suggestion -- guidance.

Both of these proposals could be handled by volunteers, preferably retired bankers from their communities.

Possibly at the State level we could make a special effort that important information concerning the many State programs for helping business are made known throughout the State.

Let me close by saying that I am anxious to hear what others here today have to say regarding credit availability, because we need to stay focused on that need. I say this because banks are where capital for business expansion and new jobs are traditionally found.

Thank you for inviting me here today.

SENATOR SINAGRA: Thank you.

Are there any questions?

SENATOR INVERSO: Yes. It's good to see you again, Tom. It's nice to have you here.

MR. DESCH: It's nice to see you.

SENATOR INVERSO: Excuse me for calling him Tom. We've met previously, and we were talking a little bit before the session began about that vital ingredient that's back in the lending process -- "C" for character. I think that that unfortunately has been something that has been out of the lending parameters until very recently because of the conditions of, certainly, the economy in New Jersey, and the impact that has had on banks.

Tom, I do appreciate you coming out today. I was wondering if in some instances you could provide us with a little more specifics about some of the things you touched on in your comments. For instance, regarding the real estate climate and initiatives to change the rules regarding expensive real estate appraisals, could you touch on that more specifically, what's being done?

MR. DESCH: We have a proposal now out to increase the appraisals from $100,000 to $250,000. We're urging that to be adopted by the four agencies. That applies mainly to residential real estate, but the biggest issue, I think, that helps small business is that where collateral is taken in real estate for an abundance of caution-- In other words, you would have made the loan based on cash flow, projections, or other issues going to the character aspect. If the individual is of strong character and knowledge of the business, we're not even going to require any kind of appraisal on pledging the company's real estate. Again, that doesn't even have to be in that basket of loans.

But too often borrowers are reluctant -- small business people -- to borrow, because most of the costs of borrowing would be eaten up by the cost of appraisals, accountants, projections, and all the like that go into it. So that's where the character loan--

SENATOR INVERSO: No, no, stay away from the accountants, Tom. We can pick on the appraisers, but not the accountants. (laughter)

MR. DESCH: Okay.

SENATOR INVERSO: I was going to say that the recent banking laws have really been a retirement program for appraisers. I know that money that the banks are spending for appraisals: one, when they give the loan; two, when they take it back; and three is, they have to monitor it and other real estate for purposes of valuation. So it's been really a windfall for a lot of appraisers. Well, thank God, some segment of the economy is flourishing.

With regard to -- I think you touch on, yes-- You mentioned that other items being reviewed for possible changes: On June 10, the bank regulators allowed six additional initiatives to implement the March 10 program. I was wondering if you could just touch on those briefly, Tom?

MR. DESCH: Some of those deal with technical issues such as insubstance foreclosure. In the past, if a loan -- a real estate loan -- was close to going to foreclosure or into a problem area, the examiners were required to classify it as an insubstance foreclosure. That is being eliminated as a practice. There are other practices with regard to returning--

SENATOR INVERSO: Excuse me. Is the insubstance foreclosure category-- That's not being done away with, is it?

MR. DESCH: Yes.

SENATOR INVERSO: It is?

MR. DESCH: Yes, I believe.

SENATOR INVERSO: When is that effective?

MR. DESCH: Under existing accounting guidelines for determining when the collateral loan has been an insubstance foreclosure, the loan is transferred to other real estate loans and appropriate losses are recognized if certain criteria are met. Such RE designations may impede efforts to improve credit availability, and may discourage lenders from working with borrowers experiencing temporary financial difficulties. The Financial Accounting Standards Board recently issued statement No. 114, "Accounting by Creditors for Impairment of Loan," addressing accounting for an impaired loan. This standard also clarifies the existing accounting for insubstance foreclosures.

Under the new impairment standards are related amendments to statement No. 15, "Accounting by Debtors and Creditors for Troubled Real Estate Restructuring." A collateral real estate loan would be reported as ORE only if the lender had taken possession of the collateral. For other collateral dependent real estate loans, loss recognition would be based on the fair value of the collateral if foreclosure is probable. Such loans would no longer be reported as ORE. Rather, they would remain in the loan category.

SENATOR INVERSO: Loan category. Well, that's a substantive change.

MR. DESCH: Yes.

SENATOR INVERSO: I know there is a lot of effort spent on determining whether the insubstance foreclosure and the evaluation, and everyone was going crazy about that.

MR. DESCH: Right.

SENATOR INVERSO: That's significant.

MR. DESCH: There are a number of other, I think, important changes like that, particularly in restructuring--

SENATOR INVERSO: Could you provide, through the Chair, Tom, the details of those initiatives?

MR. DESCH: Yes, I have all of those with me.

SENATOR INVERSO: I think they are pretty significant initiatives. I'm not a banker, but I know that one area from a banking and accounting implication, and that's a rather substantive change. I think it's a good direction to go in.

I'm happy to hear you say that more attention is being given to coordinate the examinations. Banks today are absorbed by the regulators and their reviews. I understand the necessity for regulatory review and regulatory oversight, and the need to adhere to the standards and the parameters to make a financial institution healthy and to safeguard the depositors, as well as the customers in general. But it seems to me that, of late, because of the condition we're in, there are more bank examiners, more auditors pouring over the books of the bank; therefore, consuming invaluable resources in terms of time, not only of the financial people within the bank, but of the lending people within the bank. I'm glad to hear that's being better coordinated. It would be wonderful if some day we were to have one examination. You know, we have in the governmental, nonprofit area, we have one audit concept -- single audit concept. We have that single audit concept as relates to our financial institutions. Maybe that's something we need to address going forward.

According to your closing comments you said, "Some burden may be necessary to achieve public policy goals, but unnecessary regulatory burden represents a deadweight loss to society." I'd say that's what we're experiencing. I would agree 100 percent with you. So what initiatives are underway to maybe lighten the load of the regulatory burden that's being presented? I know the initiatives you addressed are probably part of that. Is there anything else that you can--

MR. DESCH: I think with regard to FDICIA, where all these new regulations are coming from, that the Federal agencies over the last year have looked more towards guidelines rather than hard and fast rules, and approached the regulations that way. But that is really still not enough. I think the fact that they just keep coming diverts the bankers from having an opportunity to serve their communities, when they're constantly saying, "Well, we've got to do this -- implement this new law," particularly for a community bank. It's very difficult for a community bank to absorb this burden. I mean, every day additional regulations are coming to their desks.

SENATOR INVERSO: I'm glad to see that we have people in high places now in the Fed that are cognizant of that and are taking initiatives to remedy that situation.

Tom, in final, why do you think New Jersey is lagging so far behind the rest of the country with regard to its -- not to say the general economic climate -- but with regard to the banking sector? I know a lot of New Jersey banks are recovering, but there are still others like smaller banks that have still struggled. Why do you think it is? Is it the regulatory climate in New Jersey, per se? Is it the impact of real estate that hit us harder than our neighboring states, which I can't imagine because the whole corridor, it seems to me, was impacted by the real estate depression? What is it in your opinion?

MR. DESCH: In my opinion, it's associated with the degree of success you had in the early '80s. You had, I think, a very, very robust economy in New Jersey. It seems where we've looked at the downturn, it's been hardest where the upturn was the strongest. So it's kind of, I think, related to that.

A good example is real estate values. If you've had them go up over 400 or 500 percent over a number of years, the adjustment process that we're going through now seems to take a heavier toll in those areas. We've seen it in Pennsylvania, where it stops at a certain -- almost like a county line, where the markets change. It's associated, I think, to that market.

SENATOR INVERSO: Do you attribute it to that primarily?

MR. DESCH: Yes.

SENATOR INVERSO: Comparable to our neighboring states and the whole mid-Atlantic area, I thought that we all experienced that buoyancy in the '80s. You think New Jersey had a better experience, vis-a-vis our neighboring states in that period of time, and therefore, that's why our depression is greater at this point.

MR. DESCH: That's my humble opinion, yes. And I think New England had the same kind of experience. In the Boston area, real estate values were the highest in the nation, and they've taken a stronger hit, so to speak, in the downturn.

SENATOR INVERSO: What do we do to prevent that?

MR. DESCH: I have my own theory that bank examiners are needed in good times to go into board rooms and do a better job of communicating those kind of issues. I was told that the ABA early in the-- The first downturn occurred in the agriculture area in the U.S. When they tried to analyze why some banks right across from each other and others failed, they found that it was associated with the willingness of the banker to lend on these new inflated values on farms out there that other bankers would say, "I'm not going to lend that amount of money on run-up values on acreage." I think that mind-set kind of happens everywhere. It's a euphoric thing. The values, the success, we had six years of a strong economy. People start to lose perspective with regard to how much run-up in values has occurred. I think that's where examiners don't micromanage the bank, but point out the differences in different markets that they are working in, the dynamics of what's happening there, and leave it at that. It's the directors of the bank who are going to be responsible. But I'm sure if they heard that kind of a message in good times when the stocks were at an all time high that, "You're reaching out a little bit on your lending here, it might be good to tighten down a little bit," that would help.

SENATOR INVERSO: Do you think we should ever have a condition where 100 percent is being lent to a project? That occurred to me.

MR. DESCH: I think that's the kind of thing we got into. We lost our perspective with standards. So, no, I don't think so.

SENATOR INVERSO: Going forward, at least in our lifetime, we won't see that occur.

MR. DESCH: I have a pet saying, that we built 20 years worth of real estate in 10 years, and now we have to take the next 10 years to absorb it.

ASSEMBLYMAN KRAMER: I like that.

SENATOR INVERSO: Can a bank today lend 100 percent on a project, for a project cost?

MR. DESCH: Not under the new guidelines, no. They're limited to 80 percent.

SENATOR INVERSO: Eighty percent. And then they have their in-house limitation on--

MR. DESCH: Yes, right. They're part of the guidelines of FDICIA, which I hope-- That's why we're trying to use guidelines, because, again, we become the management of the institutions if we make everything according to that. That's not what we want to do.

SENATOR INVERSO: Thank you.

SENATOR SINAGRA: Harriet?

ASSEMBLYWOMAN DERMAN: I just had a client this week who purchased a dental practice -- a young dentist. He borrowed $100,000 and the cost of the practice was $80,000.

MR. DESCH: That would be a character loan.

ASSEMBLYWOMAN DERMAN: Based on his character?

MR. DESCH: That would go in this basket and be acceptable. I would say that the bank sees an individual here who is going to be successful, and they are willing to take some risk to help have that person in their community. I guess that's what banking is all about.

ASSEMBLYWOMAN DERMAN: I practice in a commercial firm, and mostly what I see in my office is just a lot of quiet. Unfortunately, nobody seems to be buying or selling businesses.

Do you feel that the banking industry was adequately prepared for the phaseout of deductions associated with real estate from the Tax Reform Act of 1986?

MR. DESCH: No. No, I don't think so. I think they were caught up in it as much as-- You know, when I say that, I don't mean all banks; I mean some banks were caught up in it.

ASSEMBLYWOMAN DERMAN: I have always attributed a lot of our problems to that particular piece of legislation.

MR. DESCH: Yes, there is quite a bit of feeling along that line.

ASSEMBLYWOMAN DERMAN: We hear a lot of dire predictions in Trenton when we're involved with different pieces of legislation, but it seems to me that that probably was one that absolutely came true.

MR. DESCH: But I guess my response to that would be: If we kept going, how far would up have been? You know, I guess at some point-- Now, maybe we went back too far, as far as cutting the standards for tax--

ASSEMBLYWOMAN DERMAN: There's no doubt of it, because I can remember transactions -- it didn't matter what the price was. It was irrelevant.

MR. DESCH: Right, exactly.

ASSEMBLYWOMAN DERMAN: Okay. Thank you.

SENATOR SINAGRA: Paul?

ASSEMBLYMAN KRAMER: Just a thought, and maybe it doesn't fit: I heard, from the first day that I got on the Financial Institutions Committee, the problems with regulation. Something that happened on the Insurance Committee that I was a part of, and that's where all the insurance commissioners in the country got together with the industry -- that would be the insurance industry and, I guess, the Federal government -- and came up with standards for accreditation on a national basis, so that an examination in New Jersey of an insurance company would be recognized in Michigan, or anywhere else in the country, as long as everybody is standardized in respect to how they run their insurance companies, and those requirements -- capital surplus requirements, etc., etc.

As both you and the CommissioneB spoke, I thought: Can anything come out of a coalition like that, of the commissioners of insurance, if in fact the states of the country had insurance commissioners, and the industry on a national basis tried to get together and look at certain standards so that there wasn't the kind of burdensome regulations and whatever that seem to come out of your problems? Is anything like that possible? And I guess that's probably a question for the Commissioner?

MR. DESCH: I think, yes-- I'm not-- I don't want to address the insurance industry, per se, but I think that if you touch on the importance for everyone to recognize that when they pass a law, that isn't the only law or regulation that this business has to deal with. I mean, people have stacked books on tables and said, "Well, you know, you're thinking of your rules and regulations, but over here are four other agencies that just loaded a burden on us." So there are complete tables like this, piles of it. Someone said there are

2700 laws that they have to abide by if you run a small bank. I don't know how you count those, but I know today the word violation is very seriously regarded. There are all kinds of fines and penalties, so people don't want to violate the laws and regulations. They say if they spend all of their time doing that, they just can't run a business and make money besides.

So we need to work together. The answer is--

ASSEMBLYMAN KRAMER: Are they working together? Has that ever been tried, Commissioner?

COMMISSIONER CONNOR: (speaking from audience) We have a conference of state bank supervisory, which is a (indiscernible) has accreditation. We have an agreement with the FDIC whereby they accept our examinations so that we can alternate. We examine not only for State law but also for Federal law, in terms of our examinations should be the same as the FDIC examination.

We are negotiating with the OTS to do the same thing with savings and loans, but it's unlikely that we will have the same kind of agreement because they have, they feel, a mandate themselves to go in every year and not to alternate, but to maybe allow us to do a concurrent examination where we go in with them.

We also have agreements with the Federal Reserve in New York and Philadelphia in terms of sharing information and cooperating.

So, yes, we are moving in that direction.

SENATOR INVERSO: Could I piggyback on that, getting back to my single-audit concept? Can't we reach an agreement at some point with the Fed to have one or the other perform the audit, as opposed to sharing the information? I mean, there are situations where both audit teams are in a bank at the same time.

COMMISSIONER CONNOR: (speaking from audience) Well, I know it sounds odd, but we look at the banks and the Fed looks at the holding companies, which are two distinct entities.

SENATOR INVERSO: But with the Fed's examination of the holding companies, obviously, embraces and involves looking at the banks. They are auditing the banks in much the same way as you are -- we are, the State. It seems to me to be duplicative.

I don't know. There ought to be some way to meld the two together and streamline the process. It's costly and duplicative.

MR. DESCH: We are doing that quite a bit, and we share -- even when we are there together, we share our work. In other words, we split, "You go and handle this," and we take their work papers and vice versa.

SENATOR INVERSO: Could you see down the road, then, a one-audit report?

MR. DESCH: Yes. And in fact, I think part of the legislation in FDICIA, which calls for a full-scope examination annually, does say that we can accept the state reports to fulfill that requirement. So there is great effort going into this right now as part of the June 10 items.

I might mention that in New Jersey, we're doing an exam right now where we have coordinated all of our own exams to the point where we expect to be out of the bank two months sooner than normal. We would have normally been, with the different types of examinations required to do during the year -- I think there were seven different examinations. We're doing them all at one time, and we're going to be out two months sooner from being in the bank.

So we're doing a lot, I'd say, internally, even in our own examinations to consider the burden the bank has.

SENATOR INVERSO: I think banks must be the most overaudited segment of our economy, when you talk about Federal, State, and independent auditors. I mean, it's just incredible. I'm glad, Tom, that you included in your comments the regulatory burden, as to the impact it has. We talk about a credit crunch, I mean, just some savings in this area alone would go a long way to putting dollars back out on the street for lending purposes.

Anyway, I think it's something that we have to look at, another task force or committee of some sort. We ought to take a look at it.

SENATOR SINAGRA: Thank you very much.

MR. DESCH: Thank you.

SENATOR SINAGRA: Marsha Dubrow? Good morning.

MARSHA DUBROW: To those of you responsible for inviting me here today, let me say thank you for giving me this opportunity to participate in a process of democracy. When I received a fax a couple of weeks ago to attend the last session at the State House in Trenton, I thought to myself, "I didn't even know such a Committee existed. This is great. I wonder who they have already heard from?" Chris Berry was kind enough to forward me some of the previous testimony so I would have a frame of reference for the last session and this one. I have found the previous testimony enormously absorbing, with the exception of some of the niggling details regarding taxation issues, and have been most touched by the entrepreneurs who have come before me.

Chairperson Sinagra, Vice Chairperson Derman, and distinguished members of the Committee, my name is Marsha Dubrow. I am a native New Jerseyan and have lived in this State most of my life, with the exception of college and some graduate study. I returned here, though, to come to Princeton as a graduate student, and have not left the State since.

Although I began my career in public television, my path has been eclectic and nonlinear. My degrees are in music, specifically music history and theory, and my chosen career path after leaving television, where I had wished to create cultural programming but there was no money, was university teaching and scholarly writing. I am a nonpracticing Schubert scholar.

Without descending into the abyss of the myriad of details surrounding my leaving academe, my circuitous career path to corporate America, and subsequently to the world of entrepreneurship, I will tell you that today, some 15 years since I left graduate school, I am President and Founder of the Technolog Corporation, a company providing technical and management consulting services to technology-based and technology-intensive businesses principally in New Jersey. I am also the Managing Director of Marsha Dubrow Associates, a consulting firm serving both for-profit and not-for-profit organizations in the areas of strategic planning, business and organizational development, and human resources empowerment or training.

Basically, today I make my living as a management consultant, and am a successful entrepreneur -- owner of two businesses. I am also a composer, lyricist, producer and director, and am a recipient of a Composer's Fellowship in Musical Theatre from the New Jersey State Council on the Arts. I share these glimpses of my past and present with you because I now know that my vicissitudes of yesterday and portfolio of the present will indeed be the way of the future for many of our citizens -- the new reality, if you will.

I am a Fellow of Leadership New Jersey, sponsored by the Partnership for New Jersey, a public sector/private sector coalition dedicated to addressing strategic issues facing the State. I am also a member of the New Jersey Business Higher Education Forum established by executive order last year, and the National Business Alliance's Leadership Institute on Workforce Development here in New Jersey. As you can see, I have been immersed for some time in thinking about the problems.

I know Bob Hughey was named as the recovery czar, and I am not up on the outputs of his efforts to date. But the fact is: We've got incredible resources to facilitate the economic shift we all want in this State. They are simply not being adequately funded and appropriately harnessed to achieve the kind of results I know we all here today are so committed to achieving.

There are many areas that I would like to address today, but I have chosen to restrict my remarks to the subject of new business creation and empowerment because I believe it is the single most forceful direction toward change to our State's economic fiber into the future that we can promote, facilitate, harness and manage. Moreover, much has already been said on the subject of legislative reform for existing businesses in areas such as environmental regulation and taxation among others. Besides, new business creation and empowerment is directly in sync with the new reality I alluded to a few minutes ago.

In the highly acclaimed book, "The Age of Unreason," about the transformation of the workplace as we know it, published by the Harvard Business School Press; and in the article, "The Coming Workplace," which was published in "Lear's Magazine" last year and in which I was featured, Charles Handy discusses the reality of the corporate downsizing we've all witnessed over the last few years and which is still continuing today. Now, of course, it's not called downsizing anymore; it's called rightsizing.

On the one hand, this change of terminology can be viewed as a simple euphemism intended to soften the blow of layoffs and the resultant low employee morale. On the other hand though, it does reflect an intention on the part of business to operate far more lean and mean, thereby improving profitability. Handy's main point is that regardless of the whys, the shrinkage of employee ranks at America's largest corporations has transformational implications for the fiber of our workplace and our society.

He maintains that workers need to revision their relationship to the workplace, remoding themselves as workers having a portfolio of skills, flexible and adaptable to the changing demands of the workplace.

This Committee uses the term, "recovery," which to me implies a return to what was. Handy maintains, and I concur with him, that we will never again know an economic landscape in this country that mirrors the landscape of the past. Therefore, although I'm not suggesting that you legislate a change to the name of the Committee, I am proposing that you think about the problems of what we are calling economic recovery from the vantage point of transformation. Is it not economic transformation that we are seeking? Are we not looking for new ways to generate economic growth and development? Have we not already concluded that the ways of the past no longer are working and cannot work in a changed economy?

It is from this perspective that I offer my ideas here today. We will be much better off in providing answers to the questions if we are sure first we are asking the right questions. We must be clear about how we are defining the problem before we can propose solutions. If we simply react to the sores on the surface, we will only be providing Band Aids that ultimately will not be ensuring a bill of good health. We have to embrace a paradigm shift and change our habits, as it were, to completely heal our workforce and by implication, the economy, and guarantee societal well-being into the future.

To this end I would like to provide some background to the nature of the transformation we are witnessing. By having an improved understanding of the collective profile of the transformed workplace and workforce, we will be able to create innovative solutions.

Three years ago I was selected to be a mentor in the United States Small Business Administration, Office of Women Business Ownership, in a program called The Women's Network for Entrepreneurial Training, and have worked agressively on behalf of women entrepreneurs to ensure the viability of their businesses as a means to their economic independence. Needless to say, the influx of women into the world of entrepreneurship has already had a significant impact in terms of job creation and contribution to GNP. According to the United States Small Business Administration, women are starting businesses at three times the rate of men, and that by the year 2000, over half of the businesses in this country will be woman-owned.

What are we doing today here in New Jersey to ensure that those newly created businesses -- the hope, quite frankly, for future employment of many, many New Jersey citizens and most of the currently unemployed -- make it to that five-year point and beyond? Remember, the downsizing mega-corporations of today will not by upsizing into the future.

Another sector of the workforce eager to be empowered as entrepreneurs cuts across gender lines. It is the regiments of outplaced middle managers and senior executives from across the State who have been cut off in their prime, who want desperately to work, not only to feed their families, pay their mortgages, and finance their children's higher education, but to recover their sense of self-worth and self-esteem lost in the wake of the tidal wave of job destruction.

Then there are those less skilled, perhaps even unskilled, and less educated, perhaps even illiterate unemployed workers filling the unemployment and welfare payrolls at great cost to all of us. Numerous articles have appeared recently attesting to the immeasurable success of training programs geared to providing skill training for welfare recipients. But once again, what good is skill training if there are no jobs? And where must the job seekers go if the big corporations have rightsized and are not hiring?

It seems to me that we have a remarkable opportunity facing us at this critical juncture in our nation's and State's history. With one of the highest unemployment figures in the nation, New Jersey has phenomenal human capital available for investment, and I believe the key to job creation will be new business creation. Let's not lose this precious human resource, rich in energy, creativity, know-how and experience, by not creating a context for work. Let's not have them leave the State altogether to find employment in another part of the country. This would be a great tragedy for us.

In an attempt to classify the various ways in which State government can work toward facilitating the creation, growth, and well-being of new businesses, I offer the following suggestions:

1) Funding for improved communications and training for entrepreneurs: What good are all the excellent programs that the Department of Commerce and Economic Development has in its Export and Small Business Divisions if there is inadequate staff and materials available to let would-be entrepreneurs know they exist, and to provide the necessary hand-holding required to ensure they thrive? What good is providing legislative reform to ease the credit crunch and facilitate financing for new businesses if would-be entrepreneurs cannot receive managed hand-holding from the public and private sector regarding how to manage a business?

Being an entrepreneur is a far cry from being a corporate executive. Something like one out of every two businesses fail in the first year of operation. Only about 10 percent of the survivors make it to five years. Having the financial capital is no assurance of success. I cite the example of the $250,000 a year insurance company executive described in the "Harvard Business Review" last year who, using money received in a golden parachute early retirement, purchased a cell animation franchise -- you know, Mickey Mouse, Donald Duck, etc. -- and relocated to Phoenix, Arizona on the promise that the burgeoning shopping mall near the airport where his retail store was located would be booming with tenants and customers. It never happened.

What did happen was that a competitor moved in about two miles down the road into an already thriving shopping center and basically put the guy out of business. Moreover, the guy had a huge staff in his former life and could delegate just about every task that needed to be done. Now he was wearing 27 different hats and was doing everything himself, including buying the supplies for the coffee that he was making for himself. He simply wasn't ready for what he encountered.

Entrepreneurial training is absolutely key. No matter how seasoned in business someone thinks he or she is, there is a need for hand-holding, both formally and informally, from those who've been there.

Unfortunately, the way the banking business is currently structured, banks do not provide this service. Typically, in my experience, banks may be in the business of lending money to small business, but not really managing their customer relationships in a meaningful way. I believe we are in a crisis in this regard, most especially because we probably have the largest pool of new entrepreneurs in the State than we've ever had, right now. We need to create a new definition to the role of the lending officer. He or she ought to have direct entrepreneurial experience. Looking at the numbers is simply not enough. The numbers do not tell all.

I am currently working with a major New Jersey bank on developing a program of entrepreneurial training that will oversee new commercial borrowers to ensure their success with seminars and planning sessions on all functional areas of business operations. It might be a good idea for the current lending officers to go through this training too. I would like to see improved linkages with the State and the banking community in this regard. I know some banks are already participating in general seminars for entrepreneurs sponsored by the Department of Commerce, but I think we need a much more overarching plan in this regard.

Again, right now what's being done seems to be a Band-Aid solution to a systemic problem. We need a plan, and we need the funding to allow for regiments of emissaries carrying the flag of the Department of Commerce and Economic Development, and other appropriate agencies as well, to go out and be proactive in spreading the word about what the State has to offer. If this can be facilitated through the banking community, so much the better.

2) Improved communications regarding other agency resources; for example, the Department of Labor: Only as a result of my participation in the Leadership Institute for Workforce Development this spring, sponsored by the National Alliance of Business, chaired by John Heldrich, also Chairman of the State Employment and Training Commission, did I come to understand the phenomenal resources and opportunities available to the entrepreneurial community at the Department of Labor. The dollars funded by the Workforce Development Training Act are there, but small business doesn't know about them. Why not?

Again, inadequate communication links. Remember, entrepreneurs are always wearing 27 different hats. We don't have the time and resources to be proactive all the time about what's available for us in the public sector. The State should be going this extra mile to ensure that programs of this nature intended to create jobs of the future are accessed by the single most promising job creating community of the future, small business. We need an overarching strategy and plan for reaching out to the newly evolving entrepreneurial sector of our economy to enable them to take advantage of what exists. We have heard numerous times about how underfunded Commerce is with respect to facilitating this process. Legislators can exercise influence and control that could be directed toward further empowering this entrepreneurial community.

3) Improved communications for the Commission on Science and Technology and its programs; for example CAIP: Last November at the fifth annual New Jersey High Tech Conference, Mike McKay, a representative of the Center for Computer Aids for Industrial Productivity at Rutgers -- one of the centers created and funded by the Commission -- spoke about the Center and the opportunities available to New Jersey businesses for computer-related R&D. He mentioned that at present only about 31 companies were taking advantage of their services and partnership programs. It seemed to me, and we spoke about it at that time, that this was an example of an ideal way small- and mediume-sized businesses, and most especially start-ups, could take advantage of an incredible resource that was very much underutilized. Once again, the fundamental void is in the area of communications.

If I was unaware -- and I make it my business to be actively aware -- of the details of this Center, how many hundreds, maybe thousands of entrepreneurs, who are New Jersey citizens are not incorporating into their thinking, planning, and development strategies the resources we have already established in the State.

The main point that I am trying to make today is that we must recognize that the nature of the work place and workforce is changing. The State Employment and Training Commission has developed an impressive statement of philosophy for change, but in my opinion, implementation is all. We need to get busy with that, forging improved linkages between the public and private sector to empower the entrepreneurial community, especially new entrepreneurs, to ensure that they not only survive, but thrive, creating more and more 21st Century jobs for New Jersey's workers. Thank you for listening.

SENATOR SINAGRA: Thank you. Does anyone have any questions?

SENATOR INVERSO: I'd like to just thank you. I think there are a couple of aspects of your comments that we need to move forward with; and that is, the linkage of communication as to what exists. There's no question that the Workforce Development Partnership Act is a very good program, and small businesses, whether it be a sole proprietor on up to a small corporation, aren't aware of that. We've got to ensure that the Department of Labor, in particular, is doing a better job of getting that out there.

I made a couple of notes on a couple of things. I know Mike McKay personally, so there we can follow-up on-- That's an interesting point because there are so many resources available. It's just a matter of communication and maybe enhancing some of the programs here and there to make them more responsive to the smaller businessperson.

MS. DUBROW: Of course, the reason why there is this gap in terms of the communication problem is that there's just inadequate funding. So they simply can't establish-- In some of the previous testimony, I think from maybe two sessions ago, someone spoke about the fact that there are only three representatives covering the entire State, serving as so-called account executives to forge the economic development activities of that part of the Department.

SENATOR INVERSO: When we heard the Department of Commerce at our budget hearings, we recognized that the budget constrictions over the last several years have impeded them in their mission, and we have to address that, and hopefully we will. It's kind of a "Catch-22." It's like advertising: You spend the dollars, you don't get the business, and you say, "Should I stop spending the dollars or do I continue, because that's how the business starts?"

We really are attempting to address that, and I made a note of that. I appreciate it, thank you.

MS. DUBROW: I think some others have mentioned, and I echo this, that it's really in many ways a marketing problem. You know, the citizens of the State are your customers, and as such -- most especially because in essence, we're paying for you -- we would like to see much more of that kind of--

SENATOR INVERSO: I'm on overtime now, actually.

MS. DUBROW: Pardon me.

SENATOR INVERSO: I'm on overtime now.

MS. DUBROW: I understand. I didn't mean you, individually.

SENATOR INVERSO: No. I was kidding.

SENATOR SINAGRA: Thank you very much.

I think we're going to do something that probably is unexpected. I'd like to have all the bankers -- can we manage that -- up at the podium at one time. I guess that would be Mr. Reeves, Mr. Izzo, Van Grofsky, Depaul, Swoyer, Johnson, and Griffith. If you would all like to come up there.

SENATOR INVERSO: You have now all been formally merged.

SENATOR SINAGRA: Right. I'm sure we're not breaking any laws either.

GERALD REEVES: Talk about consolidation.

SENATOR SINAGRA: Exactly.

I'm under the impression you would like to make an opening statement. Is that the case or not the case? If you would like to comment on something you've already heard or not heard?

ALFRED H. GRIFFITH, C.A.E.: Mr. Chairman, I'm Al Griffith. I'm President of the New Jersey Bankers Association. We represent 104 commercial banks in the State of New Jersey. I might say, with all due candor, that none of us have gotten together to coordinate our presentations or anything. I don't think any of us knows what we're going to say. They received my comments a few minutes before the session, so whichever way you want to go will be fine.

ASSEMBLYMAN KRAMER: I thought you could just be the spokesman for all of them.

MR. GRIFFITH: Well, I don't know about that. We may have some disagreements. You never know.

RICHARD DEPAUL: I thought I might make just a few comments and observations. My name is Richard Depaul, with Chemical Bank, New Jersey. I've been in this business now for just about 18 years, and as a banker-- Usually, a banker is one of two sides of the equation. You're a marketing individual or an individual on the credit side of the equation. I think my golf game is sufficiently horrendous that I would categorize myself, more or less, on the credit side of the equation.

I have been working in New Jersey now -- the banking environment community -- since 1988. I originally came out to New Jersey as part of the Manufacturers Hanover organization and set up a loan production office in Livingston, New Jersey. By 1989, I made a suggestion to my superiors that we might give serious thought to leaving the State of New Jersey. The reason that I had made that suggestion was: I was very concerned on how we were going to compete in the marketplace in New Jersey, given the underwriting standards that we were experiencing and the competition that we were experiencing. I think one of the reasons why there is, perhaps, a feeling that there is a credit crunch is that what has happened, at least in my opinion, in the State of New Jersey in the banking environment, is that in the mid '80s you had some very aggressive underwriting standards that were taking place in the State of New Jersey. What you find yourself now is an environment where a lot of the banks have looked at historical lending practices, some of the things that have unfortunately gotten the banks in trouble, and have been a little bit more selective in their underwriting procedures.

I think a great example of that is, in the mid '80s -- and I don't know if my colleagues would agree, but my own personal opinion -- the most aggressive asset-based lender in the State of New Jersey was the Bank of New England. I think we all know what happened to the Bank of New England.

I think, in general, one of the things that the banking community has to do is be relatively constant in its underwriting standards, from the standpoint that we can't turn it on and turn it off when times are good and times are bad. I think we're finding that there is tremendous liquidity in the banks right now. I think the banks are very aggressively looking to put on new business. I can attest that I have the budget in terms of new business that I'm trying to meet. And it's interesting to note that we have one situation right now, which we were working on yesterday, a small business located in Central New Jersey that owes us about $2 million. The company has had some very historical tough times. It was actually a classified loan, has more recently done a little bit better, and now we find ourselves competing against three banks in terms of trying to retain that business.

So I think the point that I'd like to make there is that, although there may be a perception of a credit crunch, I think the banks are basically out there very aggressively looking for new business. In our own organization, the way we're set up is we have two commercial operations. I'm responsible for North, West, Central, and Southern New Jersey, and have basically a portfolio of roughly $1 billion that I'm responsible for. But for the five months ending May of 1993, we have made 11,000 -- just shy of 11,000 -- officer calls on businesses in the State of New Jersey. That basically shakes out between 50 percent with existing customers, and 50 percent in terms of trying to develop new business.

I think one of the other comments that I just would like to make is, I have experience in lending to large corporate, mid-sized business, and small businesses. I think one of the challenges in this small-business arena, and I think this is where the banking community can also help on small business, is help the small businessman package himself. We've heard a little bit about that in terms of how does he go about sitting down and talking to a bank. Quite frankly, we often get involved in assisting the small businessman in terms of putting together a business plan, putting together projections, because unfortunately, a lot of people may be very good sales people; they may be very good in terms of their technical area of expertise, but a lot of small business individuals don't have the background, quite frankly, in terms of approaching a bank and how to go about it.

I think the other thing that I would just like to make a general comment about the Chemical Bank organization, and one thing that we're focusing on is, we haven't done the best job in the world in the past few years in terms of taking advantage of some of the government assisted financing programs. We have been working very closely in this past year with the New Jersey EDA, and also with the Small Business Administration. How we're viewing ourselves is that we are the sales force for the New Jersey EDA, and we are the sales force for the SBA, because if you leave it up to those two organizations, they have limited time and limited resources. I think what we're trying to do is be their extension in the marketplace.

Having said that, it's interesting to look at who are the most aggressive SBA -- particularly SBA -- lenders within the State of New Jersey. I would tend to say that it might not be names that you would necessarily be familiar with, so I think we as a community have to do a little bit better job in that area.

One of the things that you talked about earlier which I would just like to mention because it's always an issue, is the difference between a line of credit and a committed facility in terms of lending. I think a lot of difficulty can come into play in terms of a line of credit, which is, in essence, an informal mechanism where a bank is lending money to a company. I think what we try to do as an organization is, if we are having difficulty with a company, and if we are expecting and unhappy with the situation, we don't necessarily wait until that line of credit expires and then tell them we're going to have difficulty renewing it. Quite frankly, we like to do it at least six months in advance, and also tell them ways in which we think it might be appropriate for them to tackle the problem, things that they might consider in terms of looking at changing their business.

I was in a meeting last night until about 6:00 where we had a customer who has been a customer of the bank for a number of years. We have a committed facility -- this is a three-year revolving credit for $5 million -- which is coming due in March of 1994. The company has been having some difficulty over the past three years. We are at a point in time where we do not feel there is a risk of loss in the loan, but we feel it's necessary that they obtain outside help to help them work with their business to find ways in which they can improve their profitability and cash flow with the business. There is a fundamental disagreement; They don't necessarily feel that that's necessary. So what we're doing now, today, is suggesting to them, don't wait until March of 1994. If we have this fundamental disagreement, now is the time to see if you can find a new financing institution.

Unfortunately, we'd like to retain the business; we'd like to work along with these people. But there is a fundamental difference of opinion, and that happens from time to time.

In essence, I would just like to say that I think the banking community in general is very aggressively looking for new business. I mean, I'm competing head-to-head with these gentlemen on a daily basis, and I can tell you that the competition out there is fierce -- very aggressive pricing. I think we're also seeing somewhat of a return to fairly aggressive underwriting standards.

But I think the one thing that the Committee might want to keep in mind is that in the banking business it's difficult in a new business situation to book a classified loan. I think a lot of the businesses that are experiencing problems, if you were to risk rate those individual companies, they might fall into a classified category. That's when it becomes very difficult to work with those businesses.

Thank you.

DOUGLAS JOHNSON: Should I go?

SENATOR SINAGRA: Sure.

MR. JOHNSON: I'm Doug Johnson from First Fidelity. I've been in this business for over 30 years. I started out in New York. I'm a Jersey Shore native. I was at Irving Trust Company in the early '60s, and then in the late '60s I came down to the Ocean County National Bank in Point Pleasant, New Jersey. In 1970 I became Chairman and President of that bank and ran it for a while, and sold it to the Summit Bank Corporation in '81. We had eight banks in Summit. I then became a Vice Chairman of Summit, and I was responsible for seven of the eight banks of the Summit Bank Corporation. So I've had quite a bit of experience with larger banks and small banks. Now I'm back with a very large bank, of course, for New Jersey comparisons.

But I also had an interesting experience. About three years ago, I left Summit to go over and try to rescue the First National Bank of Toms River. I became the CEO of that bank. It was interesting to me to see the loans that I had turned down in my prior life that I now was working with in this life at First National. Tom Desch, behind us here, is very familiar with my experiences over the years, both good and bad.

It was interesting, in talking with directors and accountants and so forth in the Toms River area, the economy had caused serious problems down there. I said, "That's interesting. Why didn't the economy do that to the Ocean County National Bank -- which was then called Ocean National Bank -- which had a number one CAMEL rating in the same marketplace?" To me, the answer was management.

We are not back, in my opinion, to more conservative standards than we've ever had before. We're back to more conservative, and what I consider to be sound standards that we had before -- before we got into trouble in the '80s -- and did, to me, silly things. My old directors used to think I was too conservative. Sometimes they'd say, "How come bank 'X' can do this loan?," or, "How come bank 'Y.'" And some of them were pretty popular banks. I said, "I don't know, but we're not going to do it, and when we have less than an 80 percent loan to deposit ratio, you can come back and talk to me about being too conservative." Now, those people don't think that I was too conservative it turns out.

So experiencing this from both sides of the coin is very interesting to me. I make no apologies for First Fidelity's or any other banking company's credit policy manuals, which I think for the most part now are very well done.

One thing I would like to stress: We are in the business of managing risk, and we should not be in the business of avoiding risk. I think that we have acquired that kind of a mentality. And I also think that it's improper to blame it on the regulators. I think we are, a lot, ourselves to blame for going into the foxholes. Of course, these things don't happen overnight, and they're not going to be cured overnight. But I think, having been in this business for so long, I've seen various swings-- Our Chairman said to me, "Doug, we've got to get these lenders out of the foxholes." And I said, "Tony, if you have a dog, and you come home every night and the dog greets you at the door wagging his tail, and you kick him, you know, after a few days he's going to be doing one of several things. He's either going to be hiding in the bedroom somewhere, he's going to bite you, or he's going to run away from home after he's made a mess all over your rug." We have been hitting our relationship bankers, as we call them, both internally and externally with examiners. Let's not make a mistake. Our own internal credit auditors and so forth are just as tough, sometimes tougher, than our external auditors.

So I think what we have to do is live within our present policies, which I think are fine. But we have to have the guts and the common sense to know when you make exceptions. We're trying to weed out -- improve, not weed out -- but improve the breed of our relationship bankers. We need more and more people to stand up and do the right thing, not blame it on somebody else. We do have to get back to more of the character -- that "C" in credit, there's no question. We've gotten away from that I believe.

Just to comment: Earlier, we talked about directors. I have a hard time understanding why anyone would want to be a director of a small community bank. I think that we should have small community banks going forward. I really think that there should be some kind of a State sponsored legislation to address the Federal regulators, and ask them to make some kind of provisions so that there is not unreasonable action taken when the different agencies might go after bank directors. That is not to make excuses for directors where we have had some abuses. Those people should be dealt with with the full force of the law. But as I said earlier, I just can't see being a local bank director in this kind of an environment.

That's about all I have to say.

SENATOR INVERSO: You mention CAMEL--

MR. JOHNSON: Pardon me.

SENATOR INVERSO: CAMEL. I know CAMEL. It's capital, assets, management, earnings, and--

MR. JOHNSON: Liquidity.

SENATOR INVERSO: Liquidity. The ratings.

MR. JOHNSON: One is very good, and five, you're--

SENATOR INVERSO: To show how smart I am. I didn't know if my colleagues would--

SENATOR SINAGRA: That's why you run this Committee.

SENATOR INVERSO: That's right, yes.

I always had trouble with the "L". I thought it was liquidity or lending. Assets and lending are the same thing, so--

MR. REEVES: Hi. I'm Gerry Reeves. I'm kind of wearing two hats today. I am a commercial lender. I am employed by Sturdy Savings Bank in Cape May County. I am a lifelong resident of Cape May County. When I say I'm wearing two hats, I've been involved for the past nine months as the co-chairman of a committee with the County Chamber of Commerce in Cape May County for the assistance and development of small businesses. It's been a very interesting experience. Basically, what I wanted to tell you on behalf of my involvement at that level is that there really is a credit crunch in Cape May County. There is a problem in terms of businesses getting theiB working capital type lines of credit. It is still a very real problem today.

This past spring we ran a seminar through the County Chamber of Commerce group that was apparently very appropriately entitled. We called it, "Where the money is, and how to get it." As speakers we had: Assemblyman LoBiondo and Freeholder Garry Jessel. We had a local accounting firm send a representative. A local brokerage firm sent a representative. We had a representative from the Small Business Administration, and also from the EDA.

What we notice is: Number one, the Executive Director of the Chamber of Commerce said that was the most well-attended seminar they had ever run, period. So apparently this is a very hot topic -- where the money is, and how to get it.

That's been almost two months ago that we ran the seminar. We're still getting a considerable amount of calls and feedback through the County office.

Before we put together that seminar, our committee invited a representative from all the banks which had local offices in and around Cape May County. We had excellent attendance, and we had a very good round-table type discussion. Some of the comments that I've already heard from the other bankers here today were brought to the surface. Basically, we reported those findings at that seminar which we held.

A couple of the key things that I would just like to emphasize that we passed on to the attendees of that seminar were: The quality of financial statements that are presented to the bank do need to be upgraded. That's one of the things that basically bankers are looking at, because regulators have suggested that we need to have them upgraded, in addition to the fact that as lenders we need to look at better quality financial information before we can make our credit decisions.

So I just wanted to reemphasize that, once again, my findings through that committee are that the credit crunch is very real. The question that has been raised by several of the people who have contacted me through that committee involvement is about the lines of credit and the committed versus uncommitted status of the line of credit. Traditionally, in that area and, I guess, around the State, there was more or less what we would call a committed line of credit, where a customer would get a letter at the beginning of the year and it would say, "Your line of credit has been renewed in "X" amount of dollars for the following year, and here are the terms and conditions." Basically, that has changed so that anybody who does get a line of credit, now gets what's known more as an uncommitted line of credit. The language on the letter goes something to the extent that, "The bank would like to advise you that we have favorably reviewed your request to have a line of credit available," and, "The bank will be willing to meet your borrowing needs as they arise, upon the review of those needs."

So basically, what it has really done is kind of thrown those people for a loop who were used to the other kind of line of credit letter. I'm not saying-- Of course, I'm a banker. I would feel more comfortable with the one that is uncommitted. But it definitely has caused a lot of concern for the business owners who have had to deal with that kind of situation.

I would probably hold my banking comments until everybody else would have a chance to make their remarks. Thank you.

SENATOR SINAGRA: Would you like to make an opening statement?

DAVID SWOYER: Sure. My name is Dave Swoyer, and I manage wholesale lending for CoreStates New Jersey National Bank. I've been with CoreStates 13 years, the last three on the New Jersey side, and the first 10 managing commercial lending functions in Philadelphia.

In terms of the current environment, I would agree with some of the other comments that, with the bank earnings being strong, the very strong liquidity positions that the bank enjoys, banks are interested in making loans. The presence of a credit crunch is one of perspective, hotly debated, and obviously if you were a borrower and not been able to find money in this environment, you would believe there is a credit crunch.

We at New Jersey National believe we have maintained an external focus for the last several years through the recession, interested in making new loans. While our loan portfolio grew, it was relatively modest.

One of the statistics that I think is commonly used to debate this issue is, loans now versus loans several years ago. I don't particularly think that that is a very good barometer of banks' intent, because businesses have managed themselves better during this period of time. Term loans that amortized that were used to buy equipment or to replace new equipment, because new equipment isn't being purchased-- Businesses have created cash through turning their receivables and inventory more rapidly, have created internal efficiencies that have made them less reliant on the banks. So we have seen in typically strong borrowing customers less reliance on us, and that means loans go down from existing customers.

In terms of the recent environment, we have seen more activity in the last five months, and more loan growth in the last five months than any time in the last three years. Some of that is coming from new business customers that come from other banks. While that is good for us at CoreStates, it has nothing to do with the system as a whole. It's take away business that leaves one bank and moves to another. Still, we are seeing existing customers look more toward expansion in modest expectation of some more growth.

We have not changed our policies. Our manual was the same three years ago as it is today with regard to things we're interested in doing and thing we're not interested in doing. I'd like to believe that a loan that we would have made three years ago, we'll make today. If we're not interested in it today, probably we weren't interested in it three years ago.

That statement may not be true for the system as a whole. I agree with Richard that some of the criteria several years ago was not necessarily wise, and the practices of the banking industry as a whole have returned to more normal. Again, it's one of perspective. If you were able to borrow in that kind of an environment, it seems different. It is different than it was a few years ago.

But we have seen -- and I'm more familiar with our own criteria and policy -- but we have seen in the last five months more of the banks that may have spent some time recently: putting mergers together, dealing with earnings problems and reorganizations, being externally focused, interested in customers, interested in new loans, being creative, and finding ways to get deals done. Pricing is starting to become more aggressive, which is a good sign for the economy as a whole.

So my basic message is that while there are irritants to the banks in terms of process -- the appraisal process has been mentioned -- environmental concerns--

I'll stop and make one point: While the secured lender exemption will help banks avoid catastrophic loss, we won't be looking at $2 million loans with potential liabilities of $10 million on a cleanup. A $2 million loan is still a $2 million loan, and you can have impairment of collateral and still lose $2 million. So there is still an awful lot of time and money being spent in assessment of environmental risk. That's an impediment to getting deals done on a timely basis and being responsive.

I am also not someone who will blame the regulatory scrutiny for the credit crunch, to the extent that one exists. I believe that we need to look at the marketplace, follow the policies we have, and be secure in the lending environment we're in.

Those would be my opening comments.

SENATOR SINAGRA: Good. Just a comment before anyone else wants to make an opening statement. Maybe there is a misunderstanding about what we're trying to accomplish here today. This is not an inquisition. From the opening statements it seems to be, if there isn't -- from our numerous meetings from all over the State-- I am one of those rare positions that I am not an attorney; I am a businessman. We have a CPA on the board, and have gone around from the Commissioner to the Federal Reserve. There truly is a credit crunch.

Now, regardless of what the blame is-- And we're not here saying, you know, you have all this liquidity and you're not lending it. We're not trying to say you're making money elsewhere and not making it in loans. That's not the purpose of this Committee and this meeting today. The purpose is what we can do to try to alleviate some of the things that we have control over -- we have no control over Federal -- some of the things we can do within our own State that would help small- and medium-sized firms access to capital.

These opening statements tend to be that there really is no credit crunch. You're saying there is no money in Cape May. Well, go to Chemical. They have tons obviously, because they can't find people to lend it to. But I mean that's really not what we're here for today. We're trying to just get some feeling of what we can do as a Committee to help you, actually, in order to help small- and medium-sized businesses.

These opening statements are getting a little far afield.

SENATOR INVERSO: Mr. Chairman, it may be that we may be poised in time where we're coming out of the constraints in lending that we experienced in the past. Bank earnings are better; interest rates are low. It's really attractive now for businesses to borrow. The money is there. I think the capital ratios are in place for many of the banks now. I think some of the community banks are still suffering -- at least in my experience, still suffering -- so they are at the other end of the spectrum where they're just starting to get a sense that they can emerge from their problems and go out and make the marketing calls that a company the size of Chemical can do. Cape May may be in that same category with regard to community banks, as opposed to the Chemicals and the First Fidelities and the MidLantics of the world.

So you've got a dichotomy here of banking concentration and experience. I know that the bank that I'm associated with, we've told our commercial lenders they've got to go out there and start knocking on doors because the spread is too thin between investing in T-Bills or Federal funds and what we're paying to depositors. So now, and I think one of you mentioned this, the banks are not in a position to minimize risk -- I mean, not to eliminate risk -- but to control and manage it. That's so true.

I think what we're hearing here is it varies by bank. It varies by experiences they've incurred in the last several years and how they've emerged from that experience. So we may have both situations. We may have localized credit crunches--

SENATOR SINAGRA: I'm more interested in knowing as far as what this Committee can do to help. I don't really believe that it's as much as a perceived problem -- a real problem -- for those people who can't in that small- and medium-sized firm find-- Chemical doesn't happen to be calling on them and soliciting their business when they are trying to get funds.

SENATOR INVERSO: I think the other thing is, in term of-

SENATOR SINAGRA: We've heard much of this at all our meetings.

SENATOR INVERSO: Right. We're here to get a sense from you, who are the experts in the field and the people who are controlling to a great extent the economic health of our State, what can we do to help you? If it's regulatory involvement, we can do that. If it's new legislative initiatives, we can do that. And we know that you are businesspeople, and businesspeople know that they are there to serve their customers and to provide services to their customers. That's what you have to do in banking.

SENATOR SINAGRA: But we're not here to beat you up today. You don't have to get defensive at all.

SENATOR INVERSO: Not that you are defensive. I don't think anyone was defensive.

SENATOR SINAGRA: No? I keep hearing, "There's no credit crunch. There's no credit crunch."

MR. SWOYER: I think-- I don't mean to appear defensive. I think what's important is kind of what the jumping off point is for where we sit today, versus where we may have been three years ago. I personally am more optimistic, given what I've seen, that this is a much better environment than three years ago.

SENATOR INVERSO: But do find-- I was going to ask you-- I'm sorry to interrupt the process here, and I'm really running an hour behind. I'm supposed to be down in Trenton for a budget hearing.

SENATOR SINAGRA: I'm an hour-and-a-half -- I'm over an hour behind too. We're all--

SENATOR INVERSO: At least.

But do you find that a lot of customer activity that you're seeing are customers being shed by other banks saying, "Go elsewhere and do your financing." Obviously, there is a pent up demand, it seems to me. But also I think banks are saying to some customers that they have to stay and abide with that, "We couldn't do anything about your situation. You know, the value of the collateral is so bad, we had to stay with you. We don't like you as a customer." Now, when the economy to some extent is coming back, they're saying to the customer, "Go elsewhere. Get your financing elsewhere."

Are you guys getting a sense of any of that happening?

FRANK VAN GROFSKY: Senator, Frank Van Grofsky. Our best prospect, I think my colleagues will agree, is our existing customer. In a competitive-- It's such that we're basically trying to steal market share from each other. If there is a client that's creditworthy, that's teetering, that's needs assistance, these colleagues will do whatever they can to be creative and innovative to protect that customer, or find a way to enter an exit strategy with a reasonable amount of time to allow that client to find financing elsewhere.

In many cases it's an equity situation.

SENATOR SINAGRA: I kind of find that interesting. Having a rather large line in my company that, you know, over the last few years we've all learned how important our bank is and our relationship with our bank. If you have a relationship with a bank, it's certainly long term. I couldn't imagine that anyone in a medium-sized -- or maybe a small -- medium-sized firm, all of a sudden, because Chemical comes in and says, "Gee, you can have another half off of the prime, and we're going to do this and that for you," that anybody would really change that relationship knowing what we've all gone through over the last three or four years. I would imagine it must be difficult to steal an account away, certainly one of creditworthiness, from one bank to another knowing what we've all gone through.

MR. VAN GROFSKY: It is extremely difficult, but if there is that one slippage or lack of responsiveness by our relationship manager, which gives the entrepreneur, the businessman, the capitalist to say, "Well, my other banker from Chemical was here last week. Maybe I will give him a call." Then that window is wide open for that business to go away.

In recognizing your comment to the group, I want to reinforce one point that my colleagues made, and try and relate what I think are some issues of importance to the Committee that could be helpful to our business going forward. Clearly, we've accepted the new regulations. We've reacted in a positive way to create product and reengineer our internal process to try and respond to the needs of the small businessman. Demand is very soft. We have product that goes from a loan of $5000 to $10 million. A product that is so easy to apply for-- We have a product in Cape May that responds to the needs of the hotels and the seasonal community in Cape May and Wildwood. I would welcome to discuss that in more detail off-line.

Interestingly, when you look at the businessmen, their concerns are not the availability of credit. Their concerns are taxes, overregulation, demand for their products, labor costs, labor supply, and quality of labor. Working with the National Federation of Independent Businesses during 1992 -- a group of 600 small businesses -- on a list of 70 items, lack of credit responsiveness by their bankers is number 54. Less than 3 percent of their concerns fall into that side of it. Earlier this morning, Commissioner Connor made some comments about the need for these production offices for foreign banks. I can assure you that the banks here today are seasoned with quality veterans that can provide trade import/export finance; that have been doing it for the last 20 years here in New Jersey; and have been responsive to the small businessman and the large corporation that exports or imports in New Jersey.

Equally important, the efforts put out by our CRA groups, I think, creates a window to build on that base, rather than to create community banks that are only going to take away talent from other banks, when we have a mechanism in place that will allow us to get into various communities and build that side of the business.

The last point I wanted to make, earlier on one of our guests today quoted about the -- I guess it was Marsha Dubrow -- very articulate ideas. A lot of that capital that's needed to stimulate the entrepreneurial spirit here in New Jersey, because of the new regulations and because of the way we underwrite loans, would create a classified credit. The focus there, from your point of view, is really to force venture capital -- or funding of capital to these businesses, which as they become mature would then become creditworthy clients for the banks.

But it's clearly a way-- The backbone of this State is entrepreneurial, small business lending. If there is a way to link that together, I think it would be very helpful.

SENATOR INVERSO: I'm glad you mentioned that, because I think I mentioned it earlier when the Commissioner was up here, that I'm troubled with that situation. Because there are certain lending opportunities that, should you take the step and make the loan, immediately it's a classified loan; immediately you have to make a loan-loss provision against that. I'm wondering if there ought to be some relief in certain categories. I know the character aspect is 20 percent and so is a step in that direction, but it doesn't negate the loan-loss provision requirement. Maybe it's another stratum of loan classification, I don't know, another echelon in there somewhere. But if you make a loan and it's classified to begin with, you've got to provide a reserve against it almost arbitrarily -- not arbitrarily, but almost by fiat you've got to provide a reserve against that.

MR. VAN GROFSKY: It's not so much the reserve, it's the administrative burden of dealing with that credit report, process -- people get involved, reviews, audits. It's just--

SENATOR INVERSO: All right. So you're addressing more of that aspect than the provision?

MR. VAN GROFSKY: It's a cumbersome aspect to undertake that kind of credit risk. Being with MidLantic for the last 20 years in a variety of small business lending, private banking, and commercial lending, we're all risk takers. We all respect and understand that as business grows, it creates opportunities.

SENATOR INVERSO: Are you putting on substandard loans -- new substandard loans?

MR. VAN GROFSKY: We're not putting on new substandard loans. On occasion we will take a classified loan, whether it be OLOM or substandard, and respond to the needs of that client and provide additional availability.

SENATOR INVERSO: But would you make a loan -- I should probably ask all of you -- would you make a loan that would be substandard initially?

MR. VAN GROFSKY: Not a new loan today, no. But we would have to deal with existing credits that are classified.

SENATOR INVERSO: That you have to deal with. There's nothing you can do about that. I understand that, but--

MR. VAN GROFSKY: In a limited way you might take on one. Asset-based lending for example, where you're lending against receivables, inventory, fixed assets. In a marginal business, it's break-even at best. By definition, from an examiners point of view, you have an OLOM credit -- other loans of special mention. So from that point of view, you might be undertaking a classified loan if you see the proper return and are satisfied with the management and the long-term capabilities.

SENATOR INVERSO: Well, I know your bank is active in asset-based lending, or it has been active. I don't know about the others, Chemical and so on, and CoreStates, I suppose, too.

Some of the community banks, I don't think--

MR. VAN GROFSKY: Have that ability or depth to deal with that.

SENATOR INVERSO: Exactly. So that's where we get back to the community banks. Interesting, thank you.

SENATOR SINAGRA: Paul, do you have any questions? (no response)

SENATOR INVERSO: Oh, Jack said to give you the opportunity to respond. Does anyone make a substandard loan -- an initial substandard loan, or is that verboten?

MR. JOHNSON: We might.

MR. DEPAUL: We might.

MR. JOHNSON: Under special circumstances.

MR. DEPAUL: In a company-- You know, I've heard that a company that loses money can't get a loan. That's not true. We will lend money sometimes to a company that's lost money, and I think all the other banks will.

SENATOR INVERSO: What I get disturbed by, and maybe I'm off base when I say that-- You have a performing loan, payments are being made, somehow or other the loan from an underwriting evaluation approach fails somewhere, and it's classified. And then the regulators say you have to provide a reserve against it.

MR. VAN GROFSKY: The word classified is misleading

SENATOR INVERSO: Yes, I know.

MR. VAN GROFSKY: I think when you get the distinction between substandard and criticized-- A big category, a big spread.

SENATOR INVERSO: Well, a criticized loan is not necessarily a classified loan. A substandard loan or a DOFO (phonetic spelling) is obviously a classified loan, right.

MR. SWOYER: I had recently--

SENATOR INVERSO: Excuse me. If a loan is criticized, you don't have to provide a reserve against it.

MR. VAN GROFSKY: Well, you're providing a reserve, but it's part of your general reserve.

SENATOR INVERSO: Unless internally you want to. It's part of your general reserve. That's whatever your bank uses, right? But once the reserve is evaluated and deemed to be substandard, you do have to provide a reserve against that.

MR. VAN GROFSKY: Potentially, you could evaluate your risk for loss and specifically put aside a set amount or use your general pool, depending upon how you evaluate the collateral. Each bank has a similar process--

SENATOR INVERSO: Right, right. So banks will put on criticized loans. But the question is: If a loan were to be classified as substandard, would you put it on? Some do and some don't, apparently.

MR. GRIFFITH: Mr. Chairman, looking for suggestions, I've prepared a few thoughts for you which I am not going to read obviously. Please read them at your leisure. But we have some thoughts which are generated by our entire membership, which is a cross section of banks by all sizes and locations in the State.

Before I mention that though, I just might follow up on Senator Inverso's comments about the community banks. There are a number of community banks in the State right now that are working very hard to get themselves to par. There is some comment that perhaps the regulators visited the larger banks in New Jersey first, before they visited the smaller banks. I don't know whether that's true or not, but there is some feeling on the street that that may be the case. So some of our community banks right now are working hard to get themselves back to speed.

Looking at the issue, I first want to commend all of you for this process -- this process of seeking information on how the medium- and small-business community can advance itself is very important to us, because most all of our banks in New Jersey are small businesses as well as those who provide financing to medium and small businesses. So it's particularly timely.

We only wish that the chairmen of the banking committees in Washington -- Henry Gonzalez, the Chairman of the House Banking Committee, and Donald Riegle, the Chairman of the Senate Banking Committee -- we only wish that they would have the fortitude to do what you're doing. Because we really believe our membership, to a large degree, believes that a major part of the problems that we're experiencing in being in a position to serve our marketplace is greatly the result of the enactment of legislation in Washington, specifically FDICIA, which was a law designed to take the risk out of banking. It's as simple as that. The Congress did it not only out of a distrust of banks, but they also did it out of distrust of regulators. Their sense was the Federal regulators can't be trusted either.

They used the savings and loan industry and its regulatory process, which was very much different from the commercial banking regulatory process, as their example in enacting that legislation. But they drew a bill that's so tight, and provides so little flexibility even for regulators that it's very difficult to find sufficient elbowroom at times to accommodate people who have been long standing customers of banks. Those banks who decide to look the other way, or look at a different interpretation of the law or the regulations, obviously do it in peril that there could be some reaction to them.

We really sincerely believe that it is absolutely essential that in Washington this legislation be either-- Well, clearly it will never be repealed, but at least amended to such an extent that while it will not eliminate safety and soundness provisions in it, a number of provisions would be modified such as, provisions dealing with directors, which was mentioned previously by Senator Inverso and by Mr. Johnson. It's almost impossible for a person right now, in his right mind to want to be a director of a bank when you consider the tremendous extent of liability that's being heaped against he or she in that capacity. And to a large degree that is the result of very specific language within FDICIA. While we may think of trying to enact some State law in that regard, it really wouldn't work. We really need an amendment to FDICIA to do that.

Section No. 132 of FDICIA is a comprehensive section that provides for the micromanagement of banks. They've got all kinds of formulas and details that handle and cover just about every aspect of a bank. At this point, if those provisions are literally followed, the bank president might just as well be a robot, because there is no discretionary judgment that's left in that language.

FDICIA has provisions in it with respect to risk-based capital requirements. As an example, within those provisions, if you were to make a loan to a small business or a business per se, and it goes bad, your capital hit is 8 percent. If it goes sour or sad on a home mortgage loan, it's 4 percent. If you invest in a security, there's no capital hit. So here the capital provisions -- the capital risk provisions of this law have the ultimate and the most severe penalty to financial institutions who decide they want to lend to business.

All this is being done right in the middle of a recession, and so it is extremely important that we in the banking community, and I guess we could ask you as well, to join us in some way. Call upon our congressional delegation in Washington -- our New Jersey congressional delegation -- perhaps through even a legislative resolution memorializing Congress to make action on H.R. 962 and Senate 265, or some other legislation if you prefer not to identify one, as to be the order of the day before the banking committees in Washington. Unless and until Mr. Gonzalez and Mr. Riegle get surrounded and pressured, we're going to continue to have sad stories from borrowers and banks that we're not able to do all the things we should do.

I've included in your material a brief summary of some of the highlights of that legislation. Thus far it has been cosponsored by Congressman Andrews, Congressman Gallo, Congressman Zimmer, Congressman Franks, and I understand yesterday Congressman Menendez from Hudson County signed on to the bill. So we have five of our delegation thus far on it. Unfortunately, Congressman Klein and Congresswoman Roukema, who are our two New Jersey members on the House Banking Committee, neither one of them at this point have seen fit to go on it.

I'm sorry to say, and I may be wrong, that there is a tremendous extent of intimidation being carried on by the two chairmen of those committees. The word on the street is: If you're on the House Banking Committee, and you want to move a bill and that particular committee is a member of the Committee, you better not go on H.R. 962. We all kind of know that story. Sometimes that even happens--

SENATOR SINAGRA: Do those things happen in government?

MR. GRIFFITH: It doesn't happen in Trenton. It just happens in Washington.

But these chairmen have such an ego at stake on this thing that the word is on the street for their own committee members. And so our strategy with all of our national banking groups has been to surround them by gaining as many cosponsors as we can. Thus far, we have 240 members of the House who are cosponsors. And we're getting near to 40 members of the United States Senate who are cosponsors.

So I really believe that it's important that we put a fire under these two chairman, because you can work as hard as you can at the State level -- and you are, and are doing some effective things. I have a couple of other ideas here at the State level you might be able to do. But that's really where the heart of the action is right now, as far as the banking community and what we can do further.

Loan demand is soft, as has been mentioned, and we're all probably struggling to go after what is a limited market because of the rules limiting to who is available. The manufacturing community at this point in the State is downsizing itself and restructuring itself, to a large degree as a result of Washington. Not knowing, for example, what

Congress is going to do with respect to taxes; what they're going to do with respect to health care reform. As was mentioned earlier by Assemblywoman Derman, the 1986 law certainly did not help in any way in the real estate community or anywhere within the State of New Jersey. So there again we look to Washington, and while that's a separate subject from H.R. 962 and Senate 265, they are impacting us at the State level in New Jersey.

With respect to the State, our banking community commends all of you for your willingness to support the legislation that provides a certain level of environmental lender liability for banks. We hope that it will be able to be the difference between whether or not we make a loan, particularly in some of our urban areas where there is a great degree of environmental sensitivity. We commend you for the action on Senate Bill No. 1070, which makes some significant amendments to ECRA. There is a section in there that we were very concerned about, and raised an issue about at the 11th hour in the Assembly, which may undermine, to some degree, the ability to which we're able to exercise our environmental lender liability bill. But we can hopefully work that out over time because we know it's an important move, S-1070.

The comments made by the Commissioner with respect to actions on commercial foreclosures is extremely important. And the Commissioner has been working along with the Attorney General's Office on this. It is an issue, as Jeff mentioned previously, where you've got constitutional sheriffs who are subject to their own authority, and the courts. It may be, however, if we are unable to work something out and there is a legislative remedy in some way, though you might not want to take on the sheriffs and the courts, it might be something that this particular Committee of the Legislature might want to address. But there appears to be some positive movement on that.

We might say, in conclusion: We commend the chairmen of the two banking committees in Trenton, Senator Cardinale, Assemblyman Penn, and the members of the Committee, including Assemblyman Kramer, for a very evenhanded way of handling a number of very pressing issues in their Committee over the last four years, which there were certain bills that may be sexy publicly that could have had a very negative impact on banks to do the job they are able to do now. We credit the chairmen for treating those kinds of bills with the moderation that they did, as well as moving things that were positive.

So if I were to just make one last conclusion, and it goes back to something I asked previously, we respectfully suggest that you consider memorializing Congress to move on this legislation.

SENATOR SINAGRA: We've decided to do that already--

SENATOR INVERSO: We decided to do that while you were talking.

SENATOR SINAGRA: --while you were talking.

MR. GRIFFITH: I think that would be a very, very valuable message to our delegation in Washington, if you were in a position to do that.

That's all I have to say, Mr. Chairman. Thank you.

SENATOR SINAGRA: Anything else from the Committee?

SENATOR INVERSO: I'd just like to thank the gentlemen. I know we've got a wealth of experience and expertise here. We do appreciate you coming out. I know there are a million other things you could be addressing, like putting money out there in the economy. Thank you for coming in from great distances. We appreciate it.

SENATOR SINAGRA: Thank you very much.

ASSEMBLYMAN KRAMER: Is there anybody else? (no response)

SENATOR SINAGRA: I think that's it. Thank you.

(MEETING CONCLUDED)

APPENDIX

TESTIMONY OF NEW JERSEY BANKING COMMISSIONER JEFF CONNOR
BEFORE THE JOINT COMMITTEE ON ECONOMIC RECOVERY
ON THE ACCESS TO CAPITAL IN NEW JERSEY
JUNE 16, 1993
SOUTH BRUNSWICK, NEW JERSEY

Thank you Senator Sinagra and Assemblywoman Derman and members of the Committee. My name is Jeff Connor, and I am Commissioner of the New Jersey Department of Banking. I am here to offer the Department's testimony as to the difficulties small and mid-sized businesses are experiencing gaining access to capital in New Jersey. First off, I would like to point out that the Credit Crunch Task Force held an open public meeting last Thursday, June 10th in Trenton. The Task Force was created by Governor Jim Florio in order to call banks "... to get back to the business of lending" particularly to small businesses. The Task Force consists of eight members, including myself as Chairman and representatives of both the public and private sectors. They include: Ron Berman, Chairman of DKM Properties Corp., Lawrenceville, Charles Bertsch, President of Marketing Communications, Westfield, Joseph Burke, a partner of Peat Marwick, Short Hills, Beatrice D'Agostino, President of New Jersey Savings Bank, Somerville, Gelorma Persson, President, Business Dynamics Associates, Farmingdale, John Thurber, Executive Director of Trenton's Office of Policy Studies, Joseph Yewaisis, President of First Savings Bank, Perth Amboy, and former Commerce Commissioner George Zoffinger, President of The National State Bank, Elizabeth.

During the hearing, we heard testimony from members of the public who are in business, industry and banking throughout the State. Many of the speakers told a story of their inability to obtain a loan or establish credit in order to maintain a business venture. It was a shared belief that over-regulation at the federal level, resulting in particular from the Federal Deposit Insurance Corporation Improvement Act of 1991, has been a large factor in the cause of what has been termed the credit crunch.

The Task Force will recommend solutions to the Governor and State and federal legislators through a report to be issued at the Department's Annual Day with the Commissioner on September 17, 1993 at the Princeton Marriott.

While it is fashionable to blame over-regulation for the credit crunch, certainly the main cause in our free market economy has been adverse economic trends. The past several years have provided the biggest shock to the banking system since the Great Depression. In New Jersey in the last four years, we have seen the failure of 35 savings and loans with assets of $23.8 billion and 11 banks, including one savings bank, with assets of $6.5 billion. Not only are these lenders no longer in the market, but their failure and the accompanying stricter regulatory standards, as well as self-imposed standards, have made the remaining institutions more hesitant to lend.

Whether or not "credit crunch" is the appropriate term for the problem, statistics bear out that a constriction of credit in fact exists in New Jersey. As of September 30, 1989, loans outstanding in New Jersey from banks and thrifts, both federal and state chartered, totalled $105 billion. Three years later that figure was down to $80 billion, a decline of $25 billion. By the end of the year, 1992, that figure had improved somewhat to

$81 billion. Focusing solely on commercial and industrial loans from commercial banks, for which we have more recent figures and which are directly relevant to your inquiry today, the number has gone from $17.6 billion in June of 1990 to $12.5 billion as of March 30, 1993.

Now, I believe we are beginning to see a return to more stability in the banking industry with higher profits and greater net worth of our depository institutions. We are also seeing low interest rates on deposits, which mean large spreads for banks and which signal lower inflationary expectations for the future. For the calendar year 1992, banks and thrifts in New Jersey reported profits of $859 million. Even the much maligned savings and loans, the scapegoat of the banking fiasco of the eighties, have announced a return to profitability. Those New Jersey thrifts not under the jurisdiction of the RTC earned $259 million in 1992, compared with losses of $62.5 million in 1991. The first quarter of 1993 is even better with bank profits nationwide reported to be up ~~47%~~ 44% over the previous year.

While much of this is great economic news for the banks, it means little to the rest of the economy unless doors can be opened to allow those who need loans, like small businesses, to get them and thus stimulate the economy and create jobs.

Not that the problem has gone unaddressed. Earlier this year, President Clinton announced a major initiative which the four federal bank regulators are reducing to regulation which will make it possible for well run banks to lend up to 20% of equity in a "character loan" basket, meaning less documentation will be required.

The Clinton Administration has proposed other solutions to these problems with a particular emphasis on encouraging lending to small business. Governor Florio and the State Banking Department agree with these suggestions because small businesses, not the downsizing Fortune 500, are what will create jobs to lead us out of this recession.

The concept of a percentage of small business loans being made on a hand-shake or based upon character is an idea that has long been dormant and needed to be revived. Institutions which are healthy and well managed should be allowed to continue to do business with customers whom they have come to know and trust as being good credit risks. This type of loan, to small businesses with a stable track record by a well managed bank, is key to our State and country's economic recovery.

President Clinton and Senator Bill Bradley have also announced a Community Development Bank program which may well provide a source for credit flow in economically depressed neighborhoods. If enacted, this initiative would provide nearly $400 million over a four year period to community development loan programs throughout the country. It is up to us to develop a program for New Jersey and to apply for funding. With this in mind, I have scheduled a meeting of the Community Financial Services Advisory Board for July 20, 1993 to hear testimony on what programs would make the most sense for New Jersey to seek to fund.

The Banking Department is in the final stages of establishing a community development credit union in Camden and we hope that success in that city will allow us to duplicate the process in other locations in the State where the need exists. In some areas, like Camden and Paterson, check cashers have virtually replaced bankers for many individuals. While check cashers provide a valued service, they should not take the place of banks. Community Development Banks or Credit Unions may be just what is needed for these communities.

I have also proposed that the RTC participate in community development initiatives to help low and moderate income people. When United Savings Bank of Paterson was closed by the RTC, $240 million was paid out in deposits to people who waited in line for hours. Now its headquarters across the street from Paterson's City Hall stands vacant and the depositors are gone. It is obvious that had United of Paterson been converted into a mutual community development bank, rather than closed outright, the community would be far better off, using that building and the resources of those depositors to allow low and moderate income people access to traditional financial services.

We must create a system whereby individuals are empowered to take control of their own destinies. What is more symbolic of empowerment than having those individuals who do business with an institution also having a stake in that institution's ownership and success, which is the case with the mutual form.

Currently, eight institutions have been referred to the RTC for resolution. They include: Carteret Savings Bank of Newark, Hansen Savings of Hammonton, Marine View Savings of Middletown, Prospect Park Savings of West Paterson, Polifly Savings of New Milford, Security Savings of Vineland, Volunteer Savings of Little Ferry and Trenton's White Horse Savings. I see no

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reason why a mechanism could not be developed to convert those remaining RTC institutions or branches, for which no buyer can be found, into community development institutions.

Alternative sources of credit provide another temporary solution to the credit crunch. These can be found through the New Jersey Housing and Mortgage Finance Agency, and its "Welcome Home" programs, as well as the State EDA and federal SBA programs which provide needed support in the fight to make credit available to create affordable housing and opportunity for low and moderate income individuals and small businesses.

Not all causes of the credit crunch emanate from Washington. One major cause of the credit crunch which we can address on the State level is commercial foreclosure delay. Why should bankers take a chance on lending to a business when they know, should the business go belly-up, they face the prospect of having a non-performing asset for at least two years and in some cases longer before they can take title and sell the asset? New Jersey has the worst record in the nation in terms of the time it takes to foreclose.

Representatives of the New Jersey Bankers Association and I have met with the Governor and the Attorney General on the issue of commercial foreclosure delay. Following those meetings, at the Governor's direction, a Task Force was created on commercial foreclosures. After two meetings, the Task Force recommended the appointment of "special referees" to facilitate commercial real estate foreclosure matters. These referees would handle the foreclosure after judgment is entered. Post judgment delays are at the crux of the problem. This recommendation would allow for a standing order to provide for the routine appointment of special referees whether on a State-wide basis or in specific counties where severe delays exist. The Attorney General's Office has met with the Sheriffs and the Civil Practice Committee of the Chancery Judges to discuss our recommendations. Our Task Force will continue its efforts until this problem is resolved.

Eliminating lender liability may also provide relief to the "credit crunch." The Governor recently signed into law Senate Bill 577 which will hold the lender harmless in the event it foreclosed on an industrial property polluted by toxic waste. The bankers had expressed their concern over making loans in urban areas which have been the prime location of industrial sites if they would be at risk for environmental clean-up costs upon foreclosure, particularly if that risk exceeds the amount of the loan and is unquantifiable. In such a case, the collateral would have a negative value and becomes a substantial burden to the bank. The bankers had also indicated that the federal regulators have been setting particularly onerous standards for their credit reviews of New Jersey bank portfolios because of environmental risk. This legislation should go a long way in providing lenders with incentive to invest in companies who wish to do business in these areas. ECRA reform and enactment of S-1070 ~~would~~ will help as well.

Governor Florio is committed to breaking down the barriers which have reduced the number of loans being made to small and medium-sized businesses. Banks have shown a return to profitability over the past year and our hope is that this will be reflected in increased business lending. He and I both feel that S-577 will begin to alleviate the credit crunch and provide a

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boost for the state's economy. More important, we believe that these types of initiatives will create jobs!

I recently contacted several bankers to determine whether banks are now willing to make industrial loans and earlier this week addressed a bankers seminar on this legislation wherein I challenged institutions to make loans in industrial areas. I am pleased to announce that there are several loans ready to be made based on this lender limited liability initiative.

Also before your Committee is Senate Bill 1599, a measure sponsored by Senator Leanna Brown, which would permit foreign banks to conduct loan production activities through the operation of agencies and representative offices in New Jersey.

Basically, an agency can lend money, maintain credit balances, incidental or arising out of the exercise of its banking powers, and can take deposits from non-U.S. residents. A representative office can solicit business, conduct customer relations and acts as a liaison between the foreign and corresponding banks. A loan production office can solicit loans, and investors to purchase loans, assemble credit information, conduct property inspections and appraisals, secure title information and prepare loan applications.

The Department has provided substantial comments on the bill to the Senator and is presently formulating its position on the legislation which it views as an alternative solution to some of the problems brought on by the credit crunch and particularly as a source for import-export financing. The bill would potentially provide additional sources of loans, facilitate international trade and has the ability to create jobs in New Jersey, as well as to provide tenants for vacant commercial real estate. The Governor previously sought my input on adopting Delaware banking initiatives in New Jersey and this measure, modeled on Delaware law, does just that. Foreign banks employ over 100,000 people in the U.S., approximately half of them in New York City. They occupy 35 million square feet of real estate. We are almost certain to attract some of these jobs and tenants to N.J. with this bill.

I hope the Committee understands the Florio Administration's concerns over the credit crunch and will recognize that we have made significant strides in our efforts to deal with the economic problems faced by the public and private sector. I look forward to continuing to work with you on a bi-partisan basis to find solutions to our common problems. Feel free to ask me any questions you may have. Thank you Senator and Assemblywoman and members of the Committee.

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PRESIDENT
ALFRED H. GRIFFITH, C.A.E.

June 16, 1993

Good morning, I'm Al Griffith, President of the 104 member New Jersey Bankers Association, which proudly represents and is an advocate for the banking industry. Speaking on behalf of Chairman John Collins, who is Vice Chairman of UJB Financial, and our Association membership, I welcome this opportunity to share our ideas on issues of mutual concern to your Joint Committee, our customers and our banks.

We congratulate you for taking testimony on the present problems our businesses are having in our state. Please bear in mind that most of our New Jersey banks fit into the medium and small business community as well. We know that you are working on a number of solutions at the state level regarding environmental reform for business, tax assistance, etc.

Our businesses, including our banks, are experiencing the most unusual post recovery period since 1960. This recovery period is unique in that, while real property values continued to grow during previous recovery periods, real property value has consistently declined over a three year period. The reduction of property value has significant ramifications for borrowers and bankers. This recovery is unique in that it is the first recovery where bank lending, which usually leads business out of recession, has actually declined. This is the first recovery period where loans made based on a borrower's character, obviously along with other factors, are prohibited by federal law and regulation. It is also the first recovery where loan demand, despite low interest rates, has been consistently soft.

While declining real property value may be the result of cyclical conditions and there is unusually soft loan demand, there is a clear answer to the questions about the change in banking's role in lending, including the prohibition of character loans. The answer does not belong in Trenton, but most certainly belongs in Washington. **In their desire to treat banks like savings and loans, the Congress enacted the most restrictive piece of bank regulation ever right in the middle of the recession. The enactment of FDICIA , which is designed to take the risk out of bank lending, has driven a wedge between banks and their borrowers, many of whom have been good customers for many years.**

While there are some things New Jersey can do to improve the situation, the heart of the necessary reform belongs in Washington. Two bills (H.R. 962 and S. 265) are an excellent starting point toward making changes that will allow New Jersey banks to help the Legislature and Governor move our economy. The Chairmen of the House and Senate Banking Committees, who have pride of authorship in their overkill legislation, continue to resist any consideration of the bills, even though a majority of the House are cosponsors and a majority is nearing the Senate.

Sadly to date, only four New Jersey members, Congressmen Andrews, Franks, Gallo and Zimmer, have signed on the bills as cosponsors. The rest have not to date, despite our three explanatory letters, as well as outreach from constituent banks. Most of our delegation expresses sympathy with our situation but give us the typical response that "they will consider the legislation once it's marked up by their respective Banking Committees." They might not have that luxury as long as the Committee Chair sit on the bills. and our state continues to suffer.

The bills are supported by an impressive group of 17 national business groups, including the U.S. Chamber of Commerce, National Association of Manufacturers, etc. As members of a "Coalition For Ending The Credit Crunch", they have written the Administration and Congress asserting "The Coalition believes that S. 265 and H.R. 962 provide a sound starting point by proposing to streamline the regulatory process, eliminate duplicative reporting requirements and unnecessary paperwork." With members comprised primarily of small and medium-sized businesses, they believe "the regulatory environment has, over the past several years, severely restricted the flow of credit to small and medium-sized businesses."

We believe your Joint Legislative Committee on Economic Recovery could play an important role in bringing the message to our public and New Jersey Congressional delegation by proposing a Joint Resolution memorializing the House and Senate Banking Committee Chair to make S. 265 and H.R. 962 the order of the day and calling on our delegation to cosponsor the bills as an important starting point.

Our discussion and research leads us to indicate that there are number of factors that shed light on our present economic situation. The following factors should be considered in your review of possible recommendations.

1. First and foremost, loan demand is extremely soft. Significant layoff activity has led consumers to fear for their jobs and reduced their interest in consumption and borrowing. Creditworthy borrowers are not abundant. That view is shared by the Clinton Administration and Fed Chairman Alan Greenspan who said **"Weak demand for loans has been the biggest factor for the decline bank lending."** A number of polls point to soft demand as a major problem for the so-called credit crunch. In fact, Bruce Coe, who leads the New Jersey Business and Industry Association, which largely consists of thousands of medium and small-sized businesses, indicated last week that bank credit availability is down the list of problems for the businesses community. My recent conversation with William Faherty, the President of the New Jersey State Chamber of Commerce, concurred with Mr. Coe's remarks.

While having one hand tied behind their backs, banks are advertising the availability of business credit and are offering low rates. Obviously, until there is some modification in the federal statute and the way federal regulators look at bank loans, such credit will be available only to those who are extremely creditworthy, have good cash flow and show clear promise of success.

2. Manufacturing expansion and employment is at an all time low. Businesses are contracting in the wake of low demand, environmental disincentives and the significant uncertainty over federal decisions on taxes and health care. Many New Jersey manufacturers, regardless of which party is in power, feel they are in an unfriendly state for business where their costs of garbage disposal, labor costs, and taxes are significantly higher than other states and approvals for expansion are lengthy and costly. They frequently find the DEPE bureaucracy hostile and unsupportive. Their major concern appears to be, similar to banks, over-regulation.

3. Real estate property value has declined significantly during the past four years and is a major deterrent to borrowing and lending. Unlike previous recovery periods where property value rose, this recovery period has just the opposite situation. Chairman Greenspan said in March "Commercial real estate values have not stabilized enough to allow most banks to feel confident that they know what their collateral is really worth." While real property once was an important stable form of collateral, its declining value minimizes its importance in a lending transaction. In fact, it could be seen to be detrimental under certain circumstances.

4. Congress and the federal regulators share much of the blame for the present slow recovery. Reacting to a previous savings and loan crisis, the Congress enacted the most devastating regulatory control package in the history of banking to limit bank lending and establish capital and anti-due process requirements to bankers and directors who fail in their loan judgments. They have criticized federal regulators to such an extent that the examiners under President Bush and to some extent to date under President Clinton remain fearful of retribution by a hostile Congress.

5. The negative growth of bank lending in this recovery, compared to others, is rather dramatic evidence that something unusual is constraining the growth of bank credit. **There are many reasons for negative growth in bank lending, but there is no question that a primary reason is the oppressive federal regulatory environment.** In fact, over the past five years alone, more than 40 major provisions affecting bank operations have been passed in Washington, resulting in thousands of pages of new regulations at the cost of funds that could be used for lending. The clear message to bankers and their boards from both Congress and the regulators has been "make no mistakes in lending." But there is no such thing as risk-free lending.

In attempting to take risk out of lending, Congress has enacted in FIRREA and FDICIA statutory requirements that virtually eliminate discretion for banks in lending. Section 132 of FDICIA, the micromanagement section, causes bank management and lenders to be robots making loans based on various formulas. The risk based capital provisions in the law establish major capital punishments for banks who lend for a business purpose, while creating no penalty for investing in securities. The penalties and limitations on directors discourage business persons from serving on boards that make business lending determinations. These are just a few of the statutory impediments that can only be changed by Congressional action.

Returning to our introductory remarks, we would be less than candid if we told you that regulatory reform is the only magic wand. There are a few things relative to banks we can do or have had done at the state level that will assist our banks in playing their role.

Our Association credits the Legislature and Governor for enacting legislation that will at least provide legal guidance and protection, under certain circumstances, for banks wanting to loan to business, particularly in our more environmentally sensitive urban areas. Senate No. 577, regarding environmental lender liability protection for lenders, will provide important assistance for lending, particularly in environmentally sensitive areas. However, section 44 to Senate No. 1070, that would subject a subsequent purchaser, as an example an urban business, to liability under the state Spill Act unless he proves his innocence, undercuts much of the potential job producing value of the new law. The section is based on the often litigated "innocent purchaser" provisions of the federal CERCLA law, which, like most cleanup laws, have been a boondoggle for lawyers.

We believe that bankruptcy laws are being exploited and are causing unreasonable delays in our ability to move property and make loans. Significant bankruptcy changes are being proposed in Washington and we will aggressively support those changes. Our state has an unusually serious problem in foreclosure delays that are structural and may be intentional as well. It is not uncommon for foreclosure delays to exceed two years or more. Foreclosure delays, particularly on commercial properties, have had a negative impact on bank lending and have created potential safety and soundness problems for some institutions. We have been working on ways to at least expedite commercial foreclosures because commercial customers are more sophisticated than a consumer and expedited foreclosures free up funds and provide more protection for banks who want to lend to business.

We must also commend Banking Commissioner Connor for not taking some of the same counterproductive steps the federal regulators took in examining banks during the recession period. We also very much appreciate the fact that the State Legislature did not display the same hostility toward banks, as the federal Congress. Senator Cardinale and Assemblyman Penn, with the support of legislative leadership, have done an outstanding job in dealing with bills that both help and might hurt the ability of New Jersey banks to serve our borrowers in their committees.

New Comptroller Eugene A. Ludwig testified recently that there are a number of forces at work that affect bank lending. He indicated that "a significant portion of the decrease in short-term bank lending stems from cyclically weak loan demand." He asserted that "those businesses that do seek credit have less financial capacity to service their loans (since sales volumes are down) than they would during full employment." He added "When economic activity slows, individual depositors are more likely to withdraw funds, increasing banks' need for liquidity. In addition, payments of bank loans are often interrupted or delayed, and secondary markets for bank loans tend to become less liquid." Thus, despite potential punishments for lending securities purchases bring more liquidity and less chance for error.

It is clear that, while larger corporations are restructuring, that small business lending, along with housing, provides important private sector employment opportunities. It must be remembered from the beginning, however, that small business lending has always one of the most risky lending ventures. Traditional economic textbooks will throw a scare into a potential small businessperson when the rate of failure during the first year is displayed.

Comptroller Ludwig made some reflective comments on the plight of small businesses when he indicated before a House Committee on Small Business why small businesses have experienced greater problems with credit availability than have larger borrowers. He made the following observations.

1. **Unlike large publicly traded firms, small business typically does not have audited financial statements.** Now that documentation is king, banks could easily have themselves written up for not having detailed financials. The President of the New Jersey CPA Society wrote every New Jersey paper suggesting that borrowers would be better served if they weren't required to have all the documentation required of banks from their regulatory bodies. Here's a perfect example of where federal law and regulation harms small business.
2. **Small business income streams can be less predictable than larger publicly traded firms**. Comptroller Ludwig asserted that the lack of financials and less predictable income streams makes it more costly for them to supply the financial data required by bank managers and their supervisors.
3. **Small businesses are less likely than large vertically and horizontally integrated firms to have any assets that can be pledged as collateral.** As a result, small business borrowers often have offered their residences as collateral. And, of course, Congress demanded an expensive and time consuming appraisal be done on the collateral. The declining value of real estate has thus had a chilling impact on the value of residential property as collateral.
4. **Small loans generate smaller profits, in dollar terms, with which to support the increased cost of loan administration.**
5. **Unlike large, publicly traded corporations, which have other sources of financing, such as the market for commercial paper, small businesses rely heavily on bank loans to obtain capital and financing for expansion, as well as for start-ups.**

Even profitable small businesses with excellent credit histories may find it difficult to succeed when they cannot get credit because of the economic and regulatory climate.

6. **Small businesses have been the beneficiary of so-called character lending. Bankers, especially community bankers, who have had long term positive relationships with their borrowers, lent, among other things, with the knowledge and understanding that the loan would be repaid, even though the borrower might not have excess collateral. Chairman Greenspan told the Tax Foundation that "the recent thrust of legislation and the associated supervision has virtually eliminated the so-called character loan that has so dominated the lending practices of a large number of banks to the detriment of the economy."**

The Clinton Administration has begun to take some positive steps administratively. It is a start but we will have to await the full details. Some Congressmembers continue to blame the Administration and duck away from their responsibility by saying it is in the Administration's lap. We believe such a position shows that the member is unaware of the specifics of the legislation he either voted for or saw for the first time as a new member.

In conclusion, our Association believes that action is required by Congress to eliminate the uncertainty that hangs over the heads of business, banks and their federal regulators. Consumer confidence must be restored so borrowing can expand at a level that will help the business community re-emerge from the present doldrums. Chairman Gonzalez and Riegle must make bank legislative reform the order of the day, even if H.R. 962 and S. 265 are not the vehicle. The longer they are allowed to wait, the longer banks will be unable to do their share. Congress must give regulators the signals that they are willing to allow banks to have more flexibility to do what their personnel are primarily trained to do. That means let banks get back to business- both large and small.

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EXECUTIVE SUMMARY OF S. 265 and H.R. 962

Both S. 265 (The Economic Growth and Regulatory Paperwork Reduction Act of 1993) and H.R. 962 (The Economic Growth and Financial Institutions Regulatory Paperwork Reduction Act of 1993), the Senate and House regulatory relief proposals, represent a comprehensive approach to promoting economic growth, creating jobs, and eliminating the regulatory red tape that currently impedes credit availability, while preserving the integrity and the safety and soundness of our nation's financial institutions. While the bill contains over 40 important provisions, some primary areas of focus are:

- reducing substantial auditing costs and burdens by modifying auditor attestation, management report and internal audit committee requirements and restrictions;
- minimizing government micromanagement of financial institutions by repealing (Senate bill) or modifying (House bill) the requirement that Federal regulators in Washington, D.C. set nationwide standards on bank internal operations;
- reducing the impact that potential liabilities and regulatory sanctions have on bank risk-taking by reducing the risk of liability of bank officers and directors;
- minimizing the regulatory burdens and costs associated with Community Reinvestment Act compliance by, among other things, directing regulators to reduce the burden and providing a "safe harbor" to financial institutions with outstanding CRA ratings;
- amending risk-based capital rules to eliminate the required consideration of concentration of credit and non-traditional activities risk in capital calculations; the inclusion of interest rate risk in determining risk-based capital levels is delayed until similar standards are developed on an international level; also requires a study on the impact that risk-based capital rules have on credit availability and safety and soundness;
- directing the Federal Reserve Board to develop legislative recommendations which streamline the lending process and reduce consumer inconvenience, cost and time delays, while minimizing the cost and other burdens on financial institutions;
- eliminating a host of unnecessary costs and burdens imposed upon financial institutions which drive up costs to consumers, reduce credit availability or otherwise unnecessarily complicate the credit-granting process; the bill modifies rules on real estate lending, bank secrecy, holding company applications, examinations and other areas to eliminate overregulation and unnecessary paperwork;
- modifying a variety of laws not related to safety and soundness to reduce their burdensome effects. Would make changes to the Expedited Funds Availability Act, the Electronic Fund Transfer Act, the Truth-in-Lending Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, housing law, the recently-enacted Truth-in-Savings Act, and other laws in ways which reduce regulatory compliance costs, while in no way affecting the underlying purpose of the affected act;
- directing regulators to review the compliance burdens that current risk-based capital rules have placed on community banks, and to reduce such burdens where possible;
- requiring regulatory review of current call report reporting burdens, repealing publication requirements, and minimizing the frequency of changes to call reports; and
- directing review of regulatory burdens associated with written policy requirements.

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