THIRD WAY

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Don’t Ignore Small Businesses’ Capital Requirements

Gabe Horwitz
Senior Vice President for the Economic Program
@HorwitzGabe

Financial regulation is never a quiet affair. On one side, voices say more rules are needed to rein in financial institutions. On the other side, voices argue back that increased rules will hurt the economy and overly burden our financial markets. In this discussion, it’s important to seek out the quieter voices that don’t often get heard. Recently, a bipartisan group of lawmakers came together to do just that. Their message: **any new rules need to make sure small businesses can thrive, especially those owned by women, people of color, veterans, and people in rural areas**.

The questions from Congress are in response to a recent proposal from US federal banking regulators. In July, the Federal Reserve, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency announced new rules that would increase the amount of capital large US banks would have to hold in reserve. Increasing capital requirements means that banks would have to hold more equity as a cushion against potential losses. Higher capital requirements were included in the landmark Dodd-Frank financial reform law that passed in 2010 and were one of many pieces designed to protect our banking system. As we have stated before, Dodd-Frank was one of the most important and underappreciated laws of this century. Regulators’ rationale for these new capital requirements is to further strengthen the financial system following the banking turmoil in March 2023, including the failure of Silicon Valley Bank.

There’s an important tradeoff to consider, though, especially since the Fed noted in June that “large banks are well positioned to weather a severe recession and continue to lend.” Further increasing the amount of equity held means there is less money that can be used to make loans. That's why a bipartisan group of Members of the House Small Business Subcommittee on Economic Growth, Tax, and Capital Access recently wrote to federal banking regulators and asked a series of questions. They wanted to know 1. What the new rules would mean for small businesses' access to capital, 2. What the effect would be on small business loans that are women-owned, minority-owned, veteran-owned, and in rural areas, and 3. Whether small businesses were considered as the proposal came together.

These are critical questions—especially in light of data from the Federal Reserve itself that demonstrates barriers facing women and people of color as they start and scale businesses. For example, in the Fed's 2022 Report on Firms Owned by People of Color:

- Black and Hispanic-owned businesses are more likely to be labeled a high credit risk.
- Minority-owned firms are half as likely as white-owned firms to receive all of the financing they sought.
- Minority-owned businesses are all more likely to be completely shut out of financing.
- Overall, firms owned by people of color were less likely to be approved for loans, lines of credit, and cash advances across banks and non-bank lenders.

Because of these barriers, and many more, only 2.5% of businesses with employees are Black-owned and only 6.9% are Hispanic-owned. Men own three times the number of businesses than women. Four-in-ten rural business owners have trouble accessing capital, and over half struggle with access to digital technology. Military spouses face unique burdens resulting from frequent moves and financial stress.

As Reps. Dan Meuser, Greg Landsman, Mark Alford, and Sharice Davids all note, we need policies that foster a thriving environment for small businesses—especially those facing outsized burdens. Entrepreneurship is key to the American Dream. It gives people the dignity of work and allows them to be their own boss. It creates jobs in communities, which is especially critical for regions in the center of the country that have seen economic growth flee to the coasts. And entrepreneurship leads to generational wealth.

We need a strong and stable banking system, which is why Third Way was enthusiastically in support of the Dodd-Frank financial reforms. But lawmakers and regulators need to make sure that future reforms adequately balance stability with economic growth. Small business owners face numerous barriers to accessing capital and need more opportunities to thrive. As it considers comments on the new proposed capital requirements to keep our banking system safe, we urge the Federal Reserve and banking regulators to pay particular attention to credit access and affordability for small and minority-owned businesses.