AN OVERVIEW OF SBA'S 7(A) LOAN PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT, AND REGULATIONS

OF THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

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THURSDAY, MARCH 9, 2017

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT, AND REGULATIONS,
Washington, DC.

The Subcommittee met, pursuant to call, at 11:00 a.m., in Room 2360, Rayburn House Office Building, Hon. Trent Kelly [chairman of the Subcommittee] presiding.

Present: Representatives Kelly, Chabot, Blum, Bacon, Marshall, Adams, and Velázquez.

Chairman KELLY. Good morning. Thank you all for being with us today. I call this hearing to order.

Our startups, our entrepreneurs, our small businesses, the true engines of our economy, continue to experience a rigid lending environment. While large companies are turning to debt and equity markets to raise capital, small businesses all over the country regularly turn to conventional bank lending to finance their projects. At times, small firms cannot access conventional lending, so they have nowhere to turn for the capital to grow their business or create jobs. Despite being creditworthy, they often do not have the proven track record for traditional lending. Instead of turning away the next great American company, lenders can work with small businesses and provide access to SBA's numerous lending programs.

We are here to talk about one of these lending programs today. The Advantage Loan Program, widely known as the 7(a) Loan Program, provides creditworthy small businesses the opportunity to receive capital if traditional lending is not available. The program, which is currently running at zero cost to the American taxpayer, does not provide direct loans; rather, the SBA offers guarantees of repayments made to lenders. With the recent growth of the program in terms of loan approvals, loan amounts, and the congressionally authorized lending limit, it is important for our Committee to comprehensively review the program. Does SBA have the correct tools in place to provide oversight? Where should there be improvement? Is the Credit Elsewhere Test, the test which determines whether or not a small business is able to obtain capital from traditional options, strong enough?

The hearing today will kick off a series of conversations focused on the 7(a) Loan Program.

Today, the Subcommittee will hear directly from the lender's window, those financial institutions participating in the program.

I appreciate each of the witnesses for being here today. I look forward to your testimony.

I now yield to Ranking Member Adams for opening remarks.

Ms. ADAMS. Thank you, Mr. Chair. And I want to thank Ranking Member Velázquez for being here as well. And to all of our witnesses.

With the economy showing continued growth, it is important to ensure that small businesses have the tools and the resources that they need to prosper. And in order for small firms to play their traditional job-creating role, a number of factors must be in place. Perhaps the most important ingredient is the availability of capital. Lending through the Small Business Administration is always critical for entrepreneurs seeking affordable capital to start new ventures and expand existing businesses.

SBA loan programs fill a critical gap in the market for small businesses that cannot access traditional lending sources. In particular, SBA's 7(a) Loan Program is a public-private partnership that helps private lenders provide capital to small businesses that would not normally qualify for credit on reasonable terms. In recent years, 7(a) loans have experienced unprecedented growth, making this hearing particularly timely today. While over 64,000 loans totaling $24 billion was supported in fiscal year 2016, only 26 percent of 7(a) loans went to minorities, and only 18 percent to women-owned firms. This is simply unacceptable.

In addition to these underwhelming numbers, the SBG OIG has identified lender oversight as a serious management challenge for SBA. The OIG first raised their concerns in fiscal year 2001, and the issue continues to this very day. As the 7(a) Loan Program grows, it is vital for the SBA to have the resources in place to conduct lender oversight and to guarantee that all entrepreneurs, no matter what gender or race, have equal opportunities to utilize the program.

I look forward to hearing from our witnesses and gaining their insights on making the SBA's flagship program work even better for small businesses. It is vital that loans in the 7(a) programs are targeted to businesses who need them most, particularly those who have been unable to secure capital through private channels. Putting capital in the hands of businesses that need it most will help further the economic development of America's small businesses.

So on that note, again, I would like to thank our witnesses for taking time to be here. Your views and experiences, of course, will be valuable to the Subcommittee as we consider how best to meet the entrepreneurs' capital needs.

Thank you, Mr. Chair. I yield back.

Chairman KELLY. Thanks to the ranking member. And this is such a bipartisan Committee, and I really thank the ranking member for her support and being here today and her timely comments.

If the Committee members have an opening statement prepared, I ask that they be submitted for the record.

I would like to take a moment to explain the timing lights to you. You will each have 5 minutes to deliver your testimony. The light starts out as green. It will turn yellow, and finally, after, when you have 1 minute remaining, that means start wrapping up, and finally, at the end of your 5 minutes, it will turn red. I ask that you try to adhere to the time limit and in my first Committee chairman not make me tap you out today.

Our first witness—I am going to introduce the three and then I will allow the ranking member.

Our first witness is Sonya McDonald. Ms. McDonald is an executive vice president and chief lending officer for Randolph Brooks Federal Credit Union in Universal City, Texas, which is located in southcentral Texas. She has been serving credit union members in various roles at Randolph Brooks Federal Credit Union for years, including numerous executive level and leadership positions. Along with being a recipient of the Presidential Volunteer Service Award, Ms. McDonald was named to the San Antonio's 40 Under 40 List and is a graduate of the University of Texas at Austin. She is testifying today on behalf of the National Association of Federally-Insured Credit Unions.

Our next witness is Ms. Cindy Blankenship. Ms. Blankenship is the vice chairman of Bank of the West in Grapevine, Texas. Having opened Bank of the West in 1986 with her husband, Ms. Blankenship has been a leader in community banking for many years. Ms. Blankenship is a former chair of the Independent Community Bankers of America and has testified before numerous congressional committees. She has been recognized in the past as one of the 50 most powerful women in banking. Ms. Blankenship is testifying today on behalf of the Independent Community Bankers of America.

Our next witness is Tony Wilkinson. Mr. Wilkinson is the president and chief executive officer of the National Association of Government Guaranteed Lenders. For over 25 years, Mr. Wilkinson has been at the helm of the Association which represents the 7(a) lending industry. Before coming to NAGGL, Mr. Wilkinson was an executive at Stillwater National Bank. He has served as a member of the SBA's National Advisory Council and as a member of SBA's Investment Advisory Council. He has also been a recipient of SBA's National Financial Services Advocate of the Year Award.

And I now yield to our ranking member.

Ms. ADAMS. Thank you, Mr. Chair.

I am so pleased to introduce Ted Ashby, a native of Mount Airy, North Carolina. I represent North Carolina, and we are happy to have a Tarheel in the place today. Mr. Ashby has a bachelor's degree in business administration and economics. He has held numerous positions in the banking industry, including branch administrator, chief lending officer, special assets manager, and senior vice president. In 1996, Mr. Ashby created Surrey Bank and Trust. As president and CEO, he has grown the bank to $278 million in assets, with six branches and a loan production office. He is testifying today on behalf of the American Bankers Association. Welcome, Mr. Ashby.

Chairman KELLY. And again, thank you to the distinguished panel.

And Ms. McDonald, you are recognized for 5 minutes, and you may begin.

STATEMENTS OF SONYA MCDONALD, EXECUTIVE VICE PRESIDENT AND CHIEF LENDING OFFICER, RANDOLPH BROOKS FEDERAL CREDIT UNION; CINDY BLANKENSHIP, VICE CHAIRMAN, BANK OF THE WEST; TONY WILKINSON, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS; EDWARD C. ASHBY, III, PRESIDENT AND CEO, SURREY BANK AND TRUST

STATEMENT OF SONYA MCDONALD

Ms. MCDONALD. Chairman Kelly, Ranking Member Adams, and members of the Subcommittee. Thank you for the invitation to appear before you this morning.

My name is Sonya McDonald, and I am testifying today on behalf of NAFCU. I am the executive vice president and chief lending officer at Randolph Brooks Federal Credit Union. In this role, I am responsible for a $6 billion portfolio that encompasses consumer, mortgage, and commercial lending. I appreciate the opportunity to share with you my experience with the Small Business Administration's 7(a) Loan Program.

RBFCU became a SBA preferred and express lender in September of 2005. We are delegated with SBA authority and are able to offer all of their products. In 2016, we were the number one SBA lending credit union in our 55 county district. SBA products allow us to leverage our lending dollars, mitigate the risk associated with the loans, and extend more credit to our community small businesses. Our current portfolio has 232 active SBA loans with a balance of approximately $22 million.

There are many stories of small business owners looking for that loan that will allow them to either start or grow their business. While other institutions may have scaled back their small-dollar business lending, credit unions have been willing to fill that void. At RBFCU, we are pleased that we have been able to step up to help meet the demand. SBA 7(a) loans make it easier for credit unions because the government-guaranteed portion of these loans does not count towards the arbitrary credit union member business lending cap.

In San Antonio, we have a great bagel shop, the Bagel Factory, owned by an Air Force veteran and his wife. They went to 20 different places and were denied before coming to Randolph Brooks for an SBA loan. That business is now in its seventh year and thriving.

Another example is a loan we did for a 100 percent disabled military veteran. With the help of a SBA express line of credit, he was able to secure 8(a) certification, and he can now fulfill software development contracts for the military.

Two years ago, NAFCU signed a memo of understanding with SBA to help address the challenge of getting more credit unions involved in the SBA. The MOU formalized a joint partnership that aims to increase the availability of small-dollar loans by providing more outlets for entrepreneurs to access SBA products in their neighborhoods, and it makes the small-dollar loans more accessible to underserved communities, including women and minorities.

We appreciate the work SBA has done and have some ideas on how to make the program stronger. One area where the SBA can help credit unions is to provide clarity. Sometimes when we email the SBA directly with a specific question about standard operating procedures, the response is nothing more than a screenshot of the website. We have also seen an example of a loan submitted through general processing where the SBA processor did not follow the SOP. It was a loan that required us to place a second lien on a borrower's rental property. Normally, we would use the tax assessed value on the home, but in this case, the processor insisted we use the value estimated by Zillow.com, which was not anywhere in the procedure manual.

If SBA would publish a best practices and clarify guidance, it would go a long way to helping credit unions when they are making SBA loans.

At RBFCU, we would also like to see the length of time it takes to approve a loan shortened. Right now it can take 8 weeks or longer.

For RBFCU and other credit unions, it would also be beneficial if the new SBA One software better integrated with the lending software used by the majority of lenders, something the old software used to do.

In conclusion, small businesses are the driving force of our economy and the key to its success. The ability for them to have access to capital is vital for job creation. While SBA's 7(a) program provides opportunities to established and struggling businesses, there are several relatively simple steps that could propel the program to its full potential, some of which the SBA can take without legislation. We urge Congress to do what is necessary to ensure these programs are successful.

We thank you for your time and the opportunity to testify before you today on this important issue. I welcome any comments or questions you might have.

Chairman KELLY. Ms. Blankenship, you are now recognized for 5 minutes.

STATEMENT OF CINDY BLANKENSHIP

Ms. BLANKENSHIP. Chairman Kelly, Ranking Member Adams, and members of the Subcommittee, I am Cynthia Blankenship, vice chairman, CFO, and corporate president of Bank of the West in Grapevine, Texas, an over $450 million community with 105 employees and serving the Dallas-Fort Worth suburban area. I am also a former chairman of the Independent Community Bankers of America, and I am pleased to testify today on behalf of more than 5,800 community banks represented by ICBA.

A robust 7(a) program with broad community bank participation will help small business thrive and create jobs. We are grateful for this Committee's strong support of the 7(a) program. Bank of the West is a 30-year partner with the Small Business Administration and a leading SBA lender in the Fort Worth District. We currently hold and service nearly $100 million in high-quality SBA loans with a minimum loss ratio. Historically, Bank of the West 7(a) loans have created thousands of jobs in the communities we serve and help sustain and strengthen our local economy.

Bank of the West uses the 7(a) Loan Program to supplement our lending and credit services by reaching a broader range of borrowers who would not qualify for a conventional loan. To safeguard the program from abuse, the SBA's Credit Elsewhere Test requires us to fully substantiate and document the reasons a given applicant cannot be served with conventional credit. The typical conventional small business loan has a maturity of 1 to 3 years because it is funded with short-term deposits. However, 7(a) program loans have average maturities of 16 years or more. The program even allows for loan terms up to 25 years. These longer terms lower the entrepreneur's loan payments and free up needed cash flow to hire, invest, and grow the business. When another recession occurs, the longer loan term may help many small businesses weather the crisis.

Bank of the West has been a preferred SBA lender for 30 years. This program is available to lenders with a proven track record, a successful SBA lending whose lending policies and procedures have been thoroughly vetted by the SBA. Once approved, a preferred lender can use streamlined procedures for processing SBA loans and make final credit decisions in-house. This is a critical advantage because it allows us to avoid a delay of up to 3 weeks at the SBA approval offices.

As an SBA preferred lender, we can be responsive to our credit applicants, and if they qualify, provide the funds in a timely fashion.

Stable funding is critical to the success of the 7(a) program and the thousands of borrowers who rely on it. While the program is fully funded by user fees, an authorization level must be approved by Congress each year, and once that level is reached, no more loans can be approved.

The program authority came to an abrupt halt in the summer of 2015 when it reached its authorization cap well before the end of the fiscal year. Congress was forced to pass an emergency increase to the authorization cap to restart the program. ICBA greatly appreciates the support and responsiveness of this Committee in passing that emergency increase. Thankfully, a hiatus was short lived. A longer program shutdown would have cut off the thousands of small businesses that rely on the program for payroll, investment, and expansion. We must work together to ensure that the program funding is never disrupted again. One way we might better achieve this funding stability is by creating a 2-year funding commitment and have it be renewed every year.

I have focused my remarks today on the 7(a) program. However, taking a broader perspective, I urge this Committee to support regulatory and tax relief that would strengthen community banks and enable more small business lending in SBA programs and in conventional markets.

ICBA's plan for prosperity is a robust set of legislative recommendations, many of which serve the same goal as the SBA, creating more small business credit that will in turn create economic growth and jobs. A copy of the plan is attached to my statement, and I would encourage you to read it and discuss it with the community bankers in your districts.

Thank you again for convening this hearing. I am happy to answer any questions you may have.

Chairman KELLY. Thank you, Ms. Blankenship. It is always nice to hear somebody who does not have an accent.

Mr. Wilkinson, you are now recognized for 5 minutes.

STATEMENT OF TONY WILKINSON

Mr. WILKINSON. Good morning, Mr. Chairman, Ranking Member Adams, and other members of the Committee. I am Tony Wilkinson. I am the president and CEO of the National Association of Government Guaranteed Lenders. I am happy to be here today to talk about the very successful SBA 7(a) program. It is a public-private partnership that works as there are almost 2,000 financial institutions who participate in the program, reaching about 65,000 small businesses annually. These lenders make private sector loans to small businesses who are credit worthy but fall into the well-known lending gap that small businesses face.

Through the 7(a) program, lenders are able to meet the long-term financing needs of their small business customers. That means we can appropriately finance a long-term asset with a long-term loan. The significant majority of conventional loans, as Ms. Blankenship mentioned, have original maturities of 3 years or less, and the bulk of those loans actually have maturities of 1 year or less. So banks are really good at doing short-term financing, but with the SBA product we are able to do long-term financing. Again, financing those long-term assets with a long-term loan.

And as Ms. Blankenship said, our original maturities in an SBA 7(a) program are 16 years. And so those longer maturities mean lower payments for those small business borrowers. And when small business can get the financing that they need, they can expand and grow and create jobs. It has been estimated that well over 500,000 jobs are created or retained annually thanks to the 7(a) program.

Over the last several years, use of the program has grown dramatically. Loan volume in fiscal year 2016 was over 25 percent greater than it was just in fiscal year 2014, meaning more and more small businesses are being served. But it also means we have been operating at or near our congressionally authorized annual authorization cap. This fiscal year, under the current continuing resolution, the 7(a) program has a $26.5 billion authorization cap. Based on current loan volumes and projected growth, we anticipate lending about $26 billion net this year. So again, we are going to be getting very close to our annual cap.

I want to make sure that we understand that that is a net number. Our gross lending will probably exceed the cap somewhat. And as loans for whatever reason do not get closed, they get canceled, and so we get down to a net number, but it is very likely that our gross lending will exceed our cap, but it is the net lending number that is important.

As funding measures are considered with the April 28th expiration of the continuing resolution, a modest bump up in our authorization cap would be appreciated just to make sure that we have sufficient funds to get through this year as predicting future loan volumes, as you might imagine, is a very difficult task. Please keep in mind that the 7(a) program operates at a zero credit subsidy, meaning no appropriations are needed. The estimated costs of the program are paid for by the fees charged to lenders and borrowers. So let me repeat. No Federal appropriations are needed to fund credit subsidies for this program.

It is a long-held belief in our association for this program to pass the test of time to be here for small businesses for many years to come, it has to be a program of integrity. The program must be used the right way. That is what we teach in our training programs. It is what we expect from our members. It is why we understand that it is in the program's best interest to have SBA engaged in a sustained, efficient, and cost-effective oversight program to maintain that integrity. NAGGL has worked, and will continue to work, with the SBA and this Committee and SBA's Office of Credit Risk Management to ensure that integrity.

With that, I will close my remarks and be happy to answer any questions.

Chairman KELLY. Thank you. And Mr. Ashby, you are now recognized for 5 minutes.

STATEMENT OF EDWARD C. ASHBY III

Mr. ASHBY. Chairman Kelly, Ranking Member Adams, and members of the Subcommittee, I am Ted Ashby, president and CEO of Surrey Bank and Trust, headquartered in Mount Airy, North Carolina. I appreciate the opportunity to present the views of the ABA on the importance of the SBA Advantage Loan Program, widely known as the SBA 7(a) program for community banks like mine.

Our bank was chartered in 1996 with a focus on business lending. We are intentionally focused on building and maintaining long-term relationships with our customers. The success of Surrey Bank is linked to the success of our community. They are all our neighbors.

Community banks like mine actively pursue small business loans, which is critical to the economic growth and job creation in our area. The SBA program supports this with the help to fill a critical gap particularly for early stage businesses that need access to longer term loans. The guarantee helps reduce the risk and capital required for banks and facilitates loans that may never have been made without this important level of support from the SBA.

In 1999, Surrey Bank began using SBA to help local companies meet their credit needs. This is an integral part of our business model. We have 174 active loans with an average loan size of $200,000, which demonstrates that the 7(a) program is very important to us and to our community. In total, 19 percent of our business loans are insured by the SBA, and 13 percent of all our loans are insured by the SBA. Our active involvement in SBA has earned Surrey Bank the “Community Bank of the Year” award in North Carolina 12 of the past 14 years.

Let me give you a couple of examples to show the importance of SBA to our community. We extended credit to a precast concrete company that opened its doors in 2007, a terrible time to open. With the recession, economic activity was weak and the borrower had difficulty generating enough working capital to fund new orders. Our bank used the SBA's Cap Lines Contract Loan Program to fund these individual orders until they could be completed and the business paid. This company now generates sufficient cash flow to fund its operations without the SBA or bank assistance.

My second example, we extended credit to a woman-owned company that is engaged in traffic and safety control and highway and bridge construction. This company started in 2004 with four employees and just two trucks. Since inception, we granted 23 SBA loans to this company to help fund their expansion. Today, the company has over $12 million in revenue, 90 employees, and a fleet of over 100 vehicles and assorted other equipment. Quite a success story.

But our success is replicated over and over across communities in America in the banking system. This is why the ABA supports the Small Business Committee's efforts to build on the positive aspects of the program and consider improvements that would benefit the business climate in our communities.

I have noted in my written statement many positive features of the 7(a) program. The central focus of these features is that they reduce the cost of the transaction, lower general collateral requirements, provide faster response times, improve cash flow, and reduce the amount of working capital needed to operate the business. All of these facilitate loans that may have never been possible under conventional financing where under conventional financing you would require an abundance of collateral. You have a guarantor that has a strong secondary source of repayment, and you would most likely have shorter loan amortizations.

However, improvements can be made to any program. Primarily, this is involved in the servicing aspects. These include consolidating loans, allowing portfolio lenders to obtain a guarantee to avoid regulations on loans to one borrower limitations, facilitating and offering compromise in cases where they may be in liquidation through multiple programs, and making the SBA One platform fully operational to reduce our paperwork.

In conclusion, the SBA's 7(a) program is a success and should be supported in the future. It has encouraged economic growth and allowed Surrey Bank to meet the credit needs of many small and diverse businesses in our small portion of the state of North Carolina.

ABA strongly believes that our communities cannot reach their full potential without the presence of a local bank. Last year 251 banks disappeared. Since Dodd-Frank was enacted, nearly 2,000 banks have merged or closed their doors. If the pressures on our small banks are not relieved, the loss will be felt far beyond the bank and its loss of employees for that bank. It will mean something significant has been lost in that community that was once served by the bank. That is why it is imperative that Congress take steps to enhance the banking industry's capacity to serve their customers and facilitate job creation and economic growth.

Thank you. I will be happy to answer any questions.

Chairman KELLY. I want to once again just thank the distinguished members of the panel. Thank you so much for what you bring.

I think one of the main things that is important to me, and I recognize myself for 5 minutes, so I will hold myself to the same thing, but one of the most important things is this 7(a) Loan Program costs us, or costs the taxpayers nothing. So I think that is very important. So it is a great program because there is no cost associated with while creating small businesses or helping them to create small businesses it does not cost.

And this first question is for the entire panel, but I will start with—I will let Ms. Blankenship answer first and then we can go along the list. From the lender's perspective, can you describe the Credit Elsewhere Test and the steps you take to verify whether a small business can obtain capital from another source?

Ms. BLANKENSHIP. We look at the Credit Elsewhere Test and go through the parameters that SBA has lined out. And basically, that is how we qualify that small business as an alternative source of funding through the SBA. Many times those small businesses are not a good candidate for conventional financing because they do not have the collateral value or they are depending on future cash flows, projected cash flows. We personally do a lot of startups, as well as acquisitions for small businesses, as well as some franchise. And a lot of times there is not a historical record there. And personally, I was able to give my hair stylist Kim a loan to acquire a salon when the owner died. She was a young lady. She had good credit, but did not have a lot of collateral. So we were able to help her acquire that salon. She hired eight additional stylists, paid her SBA loan off early, and that is just one story where the Credit Elsewhere Test is a good tool, and we do use it so we can slot that customer in the right type of either conventional or SBA loans.

Chairman KELLY. Yeah, and I guess for the public, the few people who are watching this hearing, is the credit elsewhere means you are not competing with other sources. If they can get credit in another place, then they have to do that. They cannot use this program. They have to only use this if it is the only resource that they can use to get there. Is that correct?

Ms. BLANKENSHIP. That is correct.

Chairman KELLY. Okay. Do one of you other three, does anybody want to take a stab before I ask the next question?

Ms. MCDONALD. From my perspective, we are no different than our friends in the banking industry. We look at the loan and we see, first of all, can we do it in a conventional manner? And if we cannot—and it is usually because they do not have the down payment, they need a longer term, et cetera—but from a credit union's perspective, we follow the same rules as our friends in the banking industry.

Chairman KELLY. And Mr. Ashby, I think you had a comment?

Mr. ASHBY. We do not specifically look at the Credit Elsewhere Test. When we underwrite a loan, we are looking at the collateral coverage cash flow and secondary source of repayment. And a lot of the conventional financing is homogenized because regulators like to know what our loan policies are. And all our loan policies are generally the same as you go from bank to bank. So you can identify really very quickly which loans need this kind of support and help from the SBA on extended terms.

Chairman KELLY. Thank you very much.

Mr. Wilkinson, in your testimony, you described the PARRIS, P-A-R-R-I-S, review system as a tool in SBA's oversight tool box.

What other tools does SBA and the Office of Credit Risk Management utilize to conduct lender oversight?

Mr. WILKINSON. Sorry about that. A relatively new system that they put in place over the last 4 or 5 years, but it is an analytically driven program that they used to target what reviews are going to happen amongst their lenders. And that is where then they can choose what kind of reviews which lenders are going to get. And it appears to be working quite well. The one issue that we would be concerned about is making sure that the Office of Credit Risk Management has sufficient resources to do its job. With the growth we have had in the program, we need to make sure that their resources have increased commensurately so that they have the appropriate staff to continue to do the job that they need to do.

Chairman KELLY. And I yield back myself the time that I have not used. And I now recognize our ranking member from North Carolina, Ms. Adams, for 5 minutes.

Ms. ADAMS. Thank you, Mr. Chair. And thank you all for your testimony.

Mr. Ashby, in your written testimony you mention positive aspects of the 7(a) program and other SBA programs, including SCORE. Do you have any success stories or specific examples of how SCORE counseling has benefitted small business clients? And what improvements can be made there?

Mr. ASHBY. Comments were primarily related to feedback that we have gotten from customers that have gone through that process, and they think it is very valuable to have someone that has basically fought the fight and learned how to navigate through their business careers and how to help these people overcome some of the obstacles that happen in their business because we go through cycles, and some of these retired people have seen many business cycles. And so my experience is that we get great feedback. We are not present during those counseling sessions, but we do get feedback that it is most important to them to have a mentor.

Ms. ADAMS. Okay. Let me ask you. You know, I had a listening session last week, some people would refer to it as a townhall, up in the upper part of my district in Huntersville, and we had a lot of veterans to come in to talk to us. Do you deal much with veterans? Have they been interested in the program through your bank?

Mr. ASHBY. We have had—I think we probably made three or four loans to veterans last year. There is a special carve-out for veterans on fees for loans amount of a certain dollar amount. So we do have interest from veterans.

Ms. ADAMS. Okay. You also note that the SBA One program platform is not fully operational. What enhancements should be made to the system?

Mr. ASHBY. Well, right now, basically, we can only get the issuance of the guarantee, and I think it was originally designed that you can go soup to nuts. You can do the initial qualification and then you can print all the closing documents all on one platform. And so I guess the second half of that platform is not fully complete at this time.

Ms. ADAMS. Okay. To what extent, I mean, as a follow-up, has the SBA sought feedback from lenders to improve the system?

Mr. ASHBY. We get constant feedback from our district director, Lynn Douthett. And so we are being called on all the time to talk about what types of loans we are seeing. If we need any training, they oftentimes request Surrey Bank train some of the new people that are coming into the SBA lending arena because we have been at it a long time and we are a small bank. And we try to help them get the proper resources in-house in order not to run in trouble with the SOP and have problems going forward, so——

Ms. ADAMS. Okay. Thank you.

Mr. ASHBY.—we have a good relationship.

Ms. ADAMS. Great. Thank you.

Mr. Wilkinson, for a small business to participate in the 7(a) program it must not be able to obtain conventional lending. How does a lender determine if a borrower cannot get credit elsewhere?

Mr. WILKINSON. Okay. The Credit Elsewhere Test is that the borrower cannot find financing under reasonable terms and conditions. So a lender will take a look at each small business borrower and determine whether it fits into their own conventional credit policies. For instance, many of our credit policies say we do not lend to new business startups. In the SBA program, year-to-date, we are about 36 percent new business startups. So that is sort of one of the automatics that fit. As has been mentioned, sometimes it is collateral coverage. Sometimes it is cash flow coverage. There are some statistical numbers that lenders look at, and perhaps if those numbers do not reach a benchmark that is sufficient for conventional financing, then they would be candidates for the SBA program.

Ms. ADAMS. Okay. Given that it is the lender's best interest to make the determination that the borrower cannot obtain credit elsewhere so that they can make the loan, add to its assets or make money off of the loan, to what extent does a potential conflict of interest exist there?

Mr. WILKINSON. I guess the first thing is banks are in the business of lending money, and with every loan that they make they hope to generate a profit from those. I think what you are referring to is the ability to sell loans into a secondary market where the banks can recoup the funds that they have lent plus generate a profit on those. Those loans that are sold are typically sold by lenders who have liquidity issues. Lenders who do not have liquidity issues typically hold their loans. That is why only about 40 percent of the loans in the 7(a) market are sold into the secondary market. Most of the loans, a majority of the loans are actually held and not sold.

Ms. ADAMS. Okay. All right. I am out of time. Mr. Chair, I yield back. Thank you.

Chairman KELLY. I thank the ranking member.

I do want to recognize both our chairman, Chairman Chabot, from the great State of Ohio, and our Ranking Member Velázquez from New York. And I thank both of them for honoring me by being here today.

And now I recognize the gentleman from Kansas, Dr. Marshall.

Mr. MARSHALL. Mr. Chairman, I am so excited to be here. It is a breath of fresh air to talk about a government-private partnership that is working. I am just here to celebrate. I needed a breath of fresh air.

Thank you so much for the people that have made the effort. We need to keep accentuating the positive, and I appreciate some of you brought solutions. Ms. Blankenship talked about a 2-year funding commitment. What a novel idea to give you all certainty. I hope that the chairman and our staff take notes of these possible solutions. And Ms. McDonald, you talked about best practices. Give me the best practices and we will do it. What a novel idea. Timeliness. These people that need the money, they need to get in the game now because 6 months from now may be too late for this business opportunity.

You talked about software. Good luck with that. I have been fighting that one wherever I go.

I do not know about you all, but my community woke up November the 9th, and it was a breath of fresh air. My entrepreneurs have been drowning in regulation, and all of a sudden they started popping up, coming out of nowhere.

And Ms. Blankenship, have you seen an increased number of entrepreneurs out there since November the 9th? What is going on in the business world in Grapevine, Texas?

Ms. BLANKENSHIP. Well, I am proud to say we have seen an uptick and a demand for entrepreneurs. And really, I think, personally what I have seen coming through our loan committee, whether it be SBA or conventional lending, is there is just a renewed energy out there. During the crisis years, we saw a lot of our small businesses really pull back on expansion and investment and resources into their business because they did not know what the economy was going to do. And I think there is a new confidence. We are seeing people that would not have taken a gamble on starting a new business or just trying to acquire another business. We have seen quite an increase in that. And I think that accounts for the increase in the program. The program has been critical to us for 30 years. Some banks, you know, we see players come in and out of the market but we have been in it for 30 years. And I think the reason it works for us and some of the other people that stay in it is because you have to make a commitment and have your own resources in-house and just use the program as it was intended. And it is hugely successful.

Mr. MARSHALL. Well, thanks. And we do understand commitments to your community to do these types of projects.

Ms. McDonald, talk about agribusiness. I am just curious. Do you see much SBA loans like this for agribusiness, agriculture? Is that a big part of your market or not so much?

Ms. MCDONALD. It is not a big part of our market.

Mr. MARSHALL. That is too bad.

Mr. Ashby, I am not sure how rural you are. Do you see much agri-economics going on with yours?

Mr. ASHBY. We have seen a lot of activity in the poultry industry and we have participated, I think, probably maybe, I think, two or three loans last year. There is competition in that field with FSA.

Mr. MARSHALL. Okay.

Mr. ASHBY. USDA makes those loans, also. But that was a large growth industry in North Carolina last year.

Mr. MARSHALL. Ms. McDonald, let me come back to you. You talked about your bagel loan, and that is just a great, great story. Walk me through this business model just a little bit. And I am sure you are not supposed to give me too many specifics. Mr. Ashby talked about a $200,000 average loan, but a business like the bagel industry, that is not a $400,000—I mean, are these $40,000 and $60,000, $80,000, 90,000 loans? Give me just kind of a feel for what your more typical loan looks like.

Ms. MCDONALD. At Randolph Brooks, our average SBA loan is $90,000. So these are not high-dollar loans.

Mr. MARSHALL. Yeah. Let's kind of walk through the terms and differences between this and a more bank-traditional loan. I mean, I had some experience going through these. You know, first of all, the differences are does the SBA still guarantee 85 percent of the loan? Or about how much does it do now?

Ms. MCDONALD. It depends on the amount. So if it is less than $150,000, then it is 85 percent; if it is more than $150,000, it is 75.

Mr. MARSHALL. Okay. And, you know, typically, you would walk into a bank. These are kind of high-risk loans. If they are a well-qualified person, a bank might be asking 20, 30 percent down. How much down are these type of loans going to—how much capital?

Ms. MCDONALD. So at Randolph Brooks, our conventional loans are 20 percent down. With the SBA guarantee, it can be 10 percent down. And because we can extend the term, it makes the payment much more palatable.

Mr. MARSHALL. Exactly. So you addressed the term. What about interest rates? You know, as best as applies and apples, is it about the same as a conventional loan? Is it more? Is it less?

Ms. MCDONALD. I mean, it is a little bit more. You are taking on the risk.

Mr. MARSHALL. Meaning a little bit more, like half a point, 50 basis points, or what?

Ms. MCDONALD. I could not answer that.

Mr. WILKINSON. The interest rates are statutorily set. There is a maximum rate of prime plus 2-3/4. The average interest rate today is running at prime plus 2.

Mr. MARSHALL. Thanks. That solved it. Thank you.

Chairman KELLY. The gentleman's time is expired.

I now recognize the ranking member from New York, Ms. Velázquez.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Ms. Blankenship, thank you for being here today, and it is really nice to see you again.

I understand that SBA has been slow to fulfill their mandate to maximize the effectiveness of SBA LINC and SBA One. It is critical that SBA is using the best technological solutions to do so. How important is it to community banks and other SBA lenders that SBA continues to streamline their processes using technology to maximize the usefulness of SBA LINC and SBA One?

Ms. BLANKENSHIP. Well, I think especially of our community bank, timeliness is everything. So any advances and streamlining procedures that the SBA can finish up this SBA One and the LINC—it is not fully operational right now. We are using a third-party software and we are basically running those parallel. And we do get continued and regular communication from SBA encouraging us to use SBA One. And in talking to our lenders on the SBA side, they are very encouraged by the final product should it become fully functional. But right now it is not fully functional, but it looks like it will greatly increase our efficiencies. It will increase our turn times, and I think someone mentioned that funding is critical many times, especially in a small business startup or acquisition.

Ms. VELÁZQUEZ. Funding is critical, and in terms of funding for SBA?

Ms. BLANKENSHIP. Well, the funding for SBA is critical, but our ability to fund——

Ms. VELÁZQUEZ. Sure.

Ms. BLANKENSHIP.—in a timely manner is very critical as well.

Ms. VELÁZQUEZ. Yes, I agree.

Mr. Wilkinson, we have heard from many lenders about SBA's SOPs under lender guidelines. What is your view of those SOPs, and can they be improved?

Mr. WILKINSON. Well, just as a point of clarification, there are regulations that SBA has issued over the years, and they are fairly short. And then in addition to those regulations they have put out what they call Standard Operation Procedure Manuals, and those are not so short. They are pretty thick. And those are the ones that we have to pay very, very close attention to. Sometimes those SOPs get changed rather quickly, and sometimes without notice. We see it from emails coming in from some of our members. But for the most part, SBA does try to work with us and find ways to streamline the program.

If we go back to just fiscal year 2012, this was a $15 billion program. I tip my hat to the last couple or three folks that have been in charge of the Office of Capital Access at SBA. They were all former bankers. They understood our issues when we brought them to them, and really worked to try to streamline it.

So from a $15 billion program in 2012—and we have a request out for next year to make it a $30 billion program. So while the SOPs can be somewhat onerous and we pull our hair out sometimes in trying to figure out what some of the changes are, the fact is that things have gotten a lot better and we are looking at an industry that has doubled since 2012.

Ms. VELÁZQUEZ. Glad to hear that.

Mr. Wilkinson, I know that several members today have raised the Credit Elsewhere Test, but I want to ask you about whether or not you believe that there are instances where some lenders are not adhering to this test.

Mr. WILKINSON. Could there be some lenders who are originating loans that could be done conventionally? I could not say unequivocally the answer is no. I mean, there is most likely somebody who has made a loan today where a borrower could get a conventional product. But that is where the role of lender oversight at SBA comes into play.

As Ms. Blankenship described, every loan file has to explain why they cannot make that loan on a conventional basis, and they have to cover the things that cause that reason, be it lack of collateral or lack of cash flow that meets their conventional standards. Perhaps it is because the borrower needs the 25-year maturity rather than the much shorter maturity that banks like to do on conventional financing. That documentation needs to be in the file. And if it is not there and that lender goes to ask for the guarantee to be honored, chances are the answer is going to be no to the guarantee request.

Ms. VELÁZQUEZ. Okay. Thank you, Mr. Chairman. I yield back.

Chairman KELLY. I thank the gentlelady.

I now recognize the great gentleman from Nebraska, Mr. Bacon.

Mr. BACON. Thank you for being here. I appreciate your time and traveling here. I am grateful to you.

Most of my questions were already asked. I just want to express my concern with your comments, Mr. Ashby, about the banks that are closing, our community banks and the consolidations, a lot of it a result of Dodd-Frank. I think that is an underreported story, and we here should be concerned about it in Congress. I mean, for small communities, it is a bad trend and I think we have got to fix that. So I would have a commitment to help you out with that.

On that note with Dodd-Frank, when I talk to our folks in the Second District of Nebraska, I hear from the banks it is very hard to give small loans anymore separate from the SBA because of the Dodd-Frank regulations. I think that forces a lot of our small businesses to go to the SBA, which is a government program and policy causing a problem and then using another government solution to help fix it. Is this a correct observation? Do I have that right? For anybody who would like to answer.

Mr. WILKINSON. Our program has grown dramatically over the last few years and I do not know that we could singularly say that it was because of Dodd-Frank. I think there are a lot of things. The economy is improving. There are more entrepreneurs looking to borrow today. Our loan volume, our growth is up year-to-date about 7 to 8 percent over last year. Are there provisions of Dodd-Frank that are pushing lenders to shrink their conventional credit box and expand their SBA box? I would say the answer is probably yes. To what extent I could not quantify that.

Mr. BACON. Okay.

Mr. ASHBY. At Surrey Bank, we do not think there is as large a business opportunity in lending to individuals for personal needs as there are in small business lending because these regulations are very complex and the risk of running afoul of those regulations is significant.

Mr. BACON. One more question. I think each of you touch on it just a little bit, but I would love to have clarity together. If you could say or tell us one thing you would like us to help improve with the SBA and the 7(a) process what would it be?

Ms. BLANKENSHIP. I would like to see us be able to refinance an existing SBA loan on our books. We probably lose three to four loans a year because the rules will not allow us to take out another

SBA loan, and it becomes particularly cumbersome when it has been sold into the secondary market. But as a result, we end up losing not only the customer but the deposits, so the deposits go out of our community bank. That is deposit dollars that could have been leveraged into other loans and expansion into the community. And that is really a key obstacle for us right now. So we would like to see that refinance rule revisited.

Mr. BACON. Thank you. Great input.

Ms. McDonald?

Ms. MCDONALD. As I mentioned earlier, it would be great to have any unwritten rules or best practices published so that we do not find out after the fact. It would save us a lot of time. It would save the SBA a lot of time.

Mr. BACON. I think everybody would like that.

Ms. MCDONALD. Yes.

Mr. BACON. Any job they are in.

Mr. Wilkinson?

Mr. WILKINSON. Well, mine is more at a programmatic level. Over the last few years we have bumped into our authorization cap repeatedly, and we had proposed—last year it was included in—the budget request for the current year has been improved by OMB and actually was introduced in the Senate as potential language to give the administrator of the SBA the opportunity to increase our authorized cap with notice to the Appropriations Committees by a certain percentage, 10, 15 percent. So, for instance, this year, she could raise it another $3 billion, or up to $3 billion with notification to the Appropriations Committee so long as the program is operating at a zero credit subsidy.

So no appropriations are needed. It would give us that flexibility so we are not worrying about did we guess exactly right on the amount of loan volume we are going to see 18 months down the road, because that is a hard task to do. And with that kind of flexibility in the authorization cap, it would make my life a lot easier.

Mr. BACON. Thank you. And with about the 40 seconds remaining, Mr. Ashby?

Mr. ASHBY. We are a portfolio lender. We are a small bank and so I am kind of a small bank advocate. But I think one of the things that changed this past year was the inability for banks to write an SBA loan if it would get over their loans to one borrower limitation. And in a lot of these small communities that may have $100 million in assets and say $8 million in capital, that does not give you a very large loan limit that you can make to some of these customers in your market that may actually need that loan. So I think for portfolio lenders it would be great if there could be a carve-out for certain sized banks.

Mr. BACON. Okay. Thank you very much. I appreciate your recommendations, and I yield back.

Chairman KELLY. If it is okay with the panel, I think we are going to do another round of questions. Ms. Adams and I have both agreed. Is that okay with you guys? And so I will recognize myself for 5 minutes.

My first question is, and we kind of talked around this, but is the Credit Elsewhere Test, is it strong enough? And I would just like to hear your comments on that.

Mr. Wilkinson, I guess we will start with you.

Mr. WILKINSON. Well, I think it is. Clearly, it is raising a lot of questions here on the Hill as to whether it is or not. But I think from the lender's side we understand that we have to document in the file why that borrower cannot get conventional financing. And could we put some other language and statute to make that even more clear? That is a possibility and we would be happy to help draft some language with that, but it is pretty clear in our books. We treat what SBA means by credit elsewhere and the things that are detailed out in the SOP on how you document that.

Chairman KELLY. So you feel like it is strong enough and it is clear enough that you understand it and it is the right test right now, is that correct?

Mr. WILKINSON. I understand it, and I think our members understand it.

Chairman KELLY. Ms. Blankenship?

Ms. BLANKENSHIP. I think it works for us right now. If you look back at our historical volumes, they did not increase or decrease because of this test. And remember, when you are a small community bank, you have a fiduciary responsibility to your customer. I mean, we go to church and schools. Our kids go to school together. We cannot take advantage of our customer. So it is our job to put that customer in the right finance tool to get them their credit availability. Our reputation and integrity is riding on this as well.

Chairman KELLY. Mr. Ashby, do you agree?

Mr. ASHBY. I agree. When you look at our percentage of loans that we have with a SBA guarantee that are business-related purposes, it is 19 percent. And so when you just look at the broad category of business opportunities in our area that is not as vibrant as others, that is a very believable percentage.

Chairman KELLY. And Ms. McDonald?

Ms. MCDONALD. I think everybody has said it really well. We have a fiduciary duty to do the right thing. Everybody here agrees with that. We have to be able to note in the loan file or document the reasons why we went with an SBA loan, if we were ever audited, we can confidently give the information.

Chairman KELLY. Thank you. And I still start with you again, Ms. McDonald, since I left you the last, my second question is does the SBA have the correct tools in place to provide oversight?

Ms. MCDONALD. I think so. We have a very good relationship with the SBA. We are constantly talking to them about ways to improve the process. I would say yes.

Chairman KELLY. Mr. Ashby?

Mr. ASHBY. Well, SBA has had explosive growth over the last few years. You know, I think they are doing a good job. Mr. Wilkinson spoke to the PARRIS SCORE. And I do not know if those are confidential reports sent out quarterly to the banks that are participating in the programs, but they cover a lot of important things: your performance, your asset management and regulatory compliance risk management, and any special items and risk factors that the SBA sees out there. So I think it is well done.

Chairman KELLY. And either one of you two are welcome to comment.

Ms. BLANKENSHIP. Well, just as a preferred lender, you know, we have to have integrity in our portfolio and meet certain standards and not go over loss ratios. So I think that the oversight is working for us now. With the growth in the program you may need to enhance the resources at SBA, but for players like us, I think we are not feeling lack of oversight.

Mr. WILKINSON. I think it is a critical part of our business. We have a conference call every other week with the Office of Credit Risk Management to talk about issues that are out there. We stay very focused on oversight. Do they have enough tools and resources? We would like to see them. You know, they had approved prior to the hiring freeze six full-time equivalents to come on to be the lead auditors. Right now they hire contractors to do those. Hopefully, when the hiring freeze is lifted, SBA can hire their own staff that is dedicated specifically for doing those reviews.

We hear from our members that a lot of times they are training the consultants on what they ought to be examining that lender for, which does not seem to work well at all. So we are hopeful that they will be able to get that done.

We know that the Office of Credit Risk Management is supposed to get a certain allocation of resources every year. We would like to make sure that the Office of Credit Risk Management is actually getting those resources to make sure that they do have the tools necessary to stay on top of our growth.

Chairman KELLY. And I yield back. And now I recognize Ms. Adams.

Ms. ADAMS. Thank you, Mr. Chairman.

Ms. McDonald, credit unions are a vital part of our Nation's lending to small businesses and share the same mission, people helping people. How can Congress make it easier for credit unions to participate in SBA loans, SBA programs?

Ms. MCDONALD. Well, I think we have to look at raising the member business cap. At Randolph Brooks, we are 6-1/2 percent loaned out, so we are not near the cap, but there are a lot of small credit unions out there who cannot get into SBA lending because as soon as they put in the resources and spend the money and spend the time, they get a couple of loans and then they would have to shut down their program.

Ms. ADAMS. Okay. Encouraging more credit unions to participate in SBA programs is critical to serving many businesses in underserved markets. So what impact will increased credit union participation mean to small firms?

Ms. MCDONALD. Well, it gives people the opportunity—it gives credit unions the opportunity to serve their members. I mean, that is why Randolph Brooks got into member business lending. Our members were asking for this type of loan. And so the more players that are out there able to offer these loans, the more you are going to have them in the communities that we serve.

Ms. ADAMS. Let me ask. Do you all recruit members? You say your members are asking. I am just curious.

Ms. MCDONALD. So we have membership, and we serve them for their personal loans, their auto loans, their mortgage loans, and some of those same members, because they trust us, have come to us and say, you know, we would like to have our business needs served by you.

Ms. ADAMS. Okay. Do you do any special outreach or it is kind of word of mouth?

Ms. MCDONALD. Not particularly for business loans. We do outreach for members in general and then they come to us for their business needs.

Ms. ADAMS. Okay. Thank you.

Ms. Blankenship, in your written testimony, you note the increase in authorization for the 7(a) program that was required in July 2015. Could you please elaborate on the importance of stable funding and the proposal for a 2-year funding commitment?

Ms. BLANKENSHIP. Our loans go a loan committee and we approve those loans in, let's just say it is 30 or 60 days in advance of closing the SBA loan. So at any given time we have approved loans that have not closed. And as Mr. Wilkinson said, sometimes those loans fall out. For whatever reason, they end up not closing. But we have this listing of loans that our loan committee has approved and we have told the customer was approved, but then in order to get it fully funded, we have to get the authorization from SBA. And so you are always fighting. We are trying to project, too, into the future, how much funding will be available based on the total market demand. And it is continually and annually a challenge that is I think particularly a challenge for smaller community banks and other SBA participant lenders. And if we could go to a 2-year funding, that would give us—the regulators like to see us plan and do our risk assessments annually, and it would just help us with our funds management, our liquidity, and our funding needs.

Ms. ADAMS. Okay. Thank you very much.

Mr. Wilkinson, what efforts have the National Association of Government Guaranteed Lenders made to expand the universe of small business lending to traditionally underserved markets?

Mr. WILKINSON. Thank you for that question. We have been working diligently with the SBA on what we call our smart business toolkit. It is a program that we put together to help small businesses understand how to get credit ready, and we have paid for the underwriting of that course and have given it to SBA. We have had it translated into Spanish. We have been working with the Urban League to get that program out into their membership as well. We have had veteran outreach programs. We take lending to underserved markets very seriously and I think it is showing in that the numbers across the board are up in many of the underserved areas.

Ms. ADAMS. Okay, great. Thank you very much, Mr. Chair. I yield back. My time is up.

Chairman KELLY. I thank the ranking member and gentlelady lady from North Carolina again. Thank you for today.

Thank you, witnesses, for being here today and sharing your thoughts and views. I believe it is important to hear directly from lenders participating in the program. Your role is extremely important to our hardworking small businesses that are striving every day to create themselves and to grow, to expand and create jobs for others in my district and the ranking member's district and in districts all across this great Nation. It is vital that the 7(a) Loan Program operate in an efficient manner and on behalf of all our small businesses and the American taxpayer. We will use this conversation from today as we continue to review and examine SBA's loan programs.

I ask unanimous consent that the members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered.

This hearing is adjourned.

[Whereupon, at 12:04 a.m., the Subcommittee was adjourned.]

APPENDIX

NAFCU

Testimony of

Sonya McDonald

Executive Vice President and Chief Lending Officer

Randolph-Brooks Federal Credit Union

On behalf of

The National Association of Federally-Insured Credit Unions

"An Overview of SBA's 7(a) Loan Program"

Before the

House Small Business Subcommittee on Investigations, Oversight, and Regulations

March 9, 2017

Introduction

Good afternoon, Chairman Kelly, Ranking Member Adams and Members of the Subcommittee. My name is Sonya McDonald, and I am testifying today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU). Thank you for holding this important hearing today. I appreciate the opportunity to share with you my experience with the Small Business Administration's 7(a) Loan Program.

As the Executive Vice President and Chief Lending Officer at Randolph-Brooks Federal Credit Union, I am responsible for a $6 billion portfolio that encompasses consumer, mortgage and commercial lending, including $22 million in SBA loans. The majority of my nearly 25 years of experience in marketing, strategic planning, management, and lending has been spent in the credit union industry. Prior to joining Randolph-Brooks in 2003, I was employed by Centris FCU (Nebraska) and Day Air CU (Ohio).

Randolph-Brooks Federal Credit Union (RBFCU), based in Live Oak, Texas, was originally chartered in 1952 with $45 in deposits to serve personnel at Randolph Air Force Base. RBFCU is a full-service financial cooperative whose mission is to improve members' economic well-being and quality of life. With assets exceeding $7.7 billion, RBFCU serves more than 675,000 members from 55 branch locations throughout Texas. Ranked among the top 20 of nearly 6,500 financial cooperatives, RBFCU is recognized for financial stability, and consistently receives the highest ratings of "Five Star" and "Superior" from respected organizations that rate financial institutions in the United States. At RBFCU, we do more than conduct business in the communities where our branches are located. We become a member of the community and share our philosophy of "people helping people." We provide assistance to hundreds of local charitable organizations including the Children's Miracle Network, United Way, USO, American Red Cross, and the Fisher House Foundation.

As you may know, NAFCU is the only national organization that exclusively represents the interests of the nation's federally-insured credit unions at the federal level. NAFCU is celebrating its 50th anniversary this year. The association is comprised of roughly 800 member-owned and operated federally-insured credit unions. NAFCU member credit unions collectively account for approximately 70 percent of the assets of federally-insured credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding the 7(a) loan programs under the Small Business Administration.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for more than 106 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 § USC 1752(1)). While over 80 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism. Credit unions are not banks.

The nation's nearly 6,000 federally-insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed, with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided, but also—more importantly—to quality and cost of those services. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

Credit unions also play an important role in the on-going recovery from the financial crisis. As widely recognized by elected officials in Washington, credit unions did not cause the financial crisis. Because they did not engage in the same risky practices as big banks, credit unions fared well during the crisis and, as a result, had the capital available to lend. Surveys of NAFCU-member credit unions have shown that many credit unions saw increased demand for mortgage loans and auto loans as other lenders were leaving the market. A number of small businesses who lost important lines of credit from other lenders turned to credit unions for the capital that they needed.

Our nation's small businesses represent 99.7 percent of all employer firms, employ nearly half of all private sector employees, pay more than 40 percent of total U.S. private-sector payroll, and have generated over 60 percent of net new jobs annually over the last decade. It is inarguable that the strength of the economy directly correlates to the health and well-being of America's small businesses. Many small business owners are members of credit unions around the country and rely on their services to help make their small businesses successful. Our nation's credit unions stand ready to help and, unlike some other institutions, have the assets to do so. Unfortunately, an antiquated and arbitrary member business lending cap prevents credit unions from doing more for America's small business community.

Artificial Member Business Lending Cap at Credit Unions Hurts Small Business

When Congress passed the *Credit Union Membership Access Act* (CUMAA) (P.L.105-219) in 1998, it put in place restrictions on the ability of credit unions to offer member business loans. Credit unions had existed for nearly 90 years without these restrictions. Congress codified the definition of a member business loan and limited a credit union's member business lending to the lesser of either 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets.

CUMAA also established, by definition, that business loans above $50,000 count toward the cap. This number was not indexed and has not been adjusted for inflation in the more than 18 years since enactment, eroding the *de minimis* level. Where many vehicle loans or small lines of credit may have been initially exempt from the cap in 1998, many of those that meet the needs of small business today, are now included in the cap due to this erosion. To put this in perspective relative to inflation, what cost $50,000 in 1998 costs $74,500 today, using the most recent consumer price index data. That is close to a 50% rate of inflation change that is completely ignored by current law and greatly hamstrings a credit union's ability to meet its members' needs.

It should be noted that the government guaranteed portions of SBA loans do not count toward the member business lending cap, but the non-guaranteed portions do. This could ultimately lead to a situation where a credit union may be an excellent, or even preferred, SBA lender and ultimately have to scale back participation in SBA programs as they approach the arbitrary cap. This would likely hit SBA Express loans first, as those have lower guarantees and thus may have a bigger impact on money available below the cap.

Also, pursuant to section 203 of CUMAA, Congress mandated that the Treasury Department study the issue of credit unions and member business lending. In January 2001, the Treasury Department released the study, "Credit Union Member Business Lending" and found the following: "...credit union's business lending currently has no effect on the viability and profitability of other insured depository institutions." (p. 41). Additionally, when examining the issue of whether modifying the arbitrary cap would help increase loans to businesses, the study found that "...relaxation of membership restrictions in the Act should serve to further increase member business lending..." (p. 41).

The 2001 Treasury study found that credit unions do not pose a threat to the viability and profitability of banks, but that in certain cases, they could be an important source of competition for banks. It is important to note that credit unions have a nominal market share of the total commercial lending universe (approximately 8% of all small business loans from insured depository institutions), and are not a threat to banks (who control nearly 92% of all small business loans from insured depository institutions) in this environment.

A 2011 study commissioned by the SBA's Office of Advocacy affirms these findings. (James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, Small Business Research Summary, SBA Office of Advocacy, No. 387 (Sept. 2011)). The SBA study also indicates, importantly, that credit union business lending has increased in terms of the percentage of their assets both before and during the 2007-2010 financial crisis while banks' lending decreased. This demonstrates not only the need for lifting the MBL cap in order to meet credit union members' demand, but also that credit unions continued to meet the capital needs of their business members even during the most difficult of times. One of the findings of the study was that bank business lending was largely unaffected by changes in credit unions' business lending. Additional analysis in the study also found that credit unions' business lending can actually help offset declines in bank business lending during a recession.

We would urge the Subcommittee to support legislation to remove the arbitrary cap on credit union member business lending.

SBA Lending at Randolph-Brooks Federal Credit Union

RBFCU started its business program thirteen years ago, and today we have over 27,000 business checking accounts and 4,500 member business loans. We have a well-diversified member business loan portfolio of approximately $432 million with minimal delinquencies (a delinquency ratio of 0.35%). Our commercial losses have been minimal as we have an experienced lending staff and a sincere and devoted membership. RBFCU has been an important source of capital for existing, new and growing businesses throughout the areas we serve.

At the request of our membership, and to provide more loan options for our field of membership, RBFCU became an SBA Preferred and Express Lender in September of 2005. We are delegated with SBA authority and are able to offer all SBA products including 7(a) Advantage loans, Small Loan Advantage loans, Express loans, and SBA 504 Grow loans. In 2016, RBFCU was the #1 SBA lending credit union in our 55 county SBA district. Given our diverse membership of over 675,000 members, we see a wide variety of SBA loan requests. From start-up franchises, to business acquisitions, to purchasing owner-occupied real estate, RBFCU has provided SBA loans for as little as $15,000 and as much as $3,000,000. SBA products allow us to leverage our lending dollars, mitigate the risk associated with the loans, and extend more credit to our communities' small businesses.

RBFCU currently has 232 active SBA loans in its portfolio with a balance of approximately $22 million. Our current SBA delinquency ratio is 2.32% and our net charge off ratio is 0.54%.At RBFCU we strive to strengthen our communities by offering our members new entrepreneurial opportunities. Many of our SBA loans are for entrepreneurs wanting to start a new business and create new jobs. The SBA loan option provides eligible member borrowers with more favorable loan terms, such as lower down payment options and longer maturities.

For example, The Bagel Factory, in San Antonio is owned by an Air Force veteran and his wife. They were denied more than 20 times by various banks before finding a loan approval at RBFCU. Today, that business is now in its 7th year and thriving. Another SBA loan was provided to a 100% disabled military veteran, for his company, AppDiction. With the help of an SBA Express Line of Credit, the business secured 8a certification and is now able to fulfill software development contracts for the military. These success stories are a small sample of the many that have occurred since our partnership with the SBA.

There are many more stories, like these, of small business owners looking for that loan to enable them to start or grow their business. The demand is out there. Unfortunately, in this current environment, many banks have scaled back their smaller dollar business lending that credit unions are readily able and willing to fill. At RBFCU, we are pleased that we have been able to help step up to meet the pent-up demand.

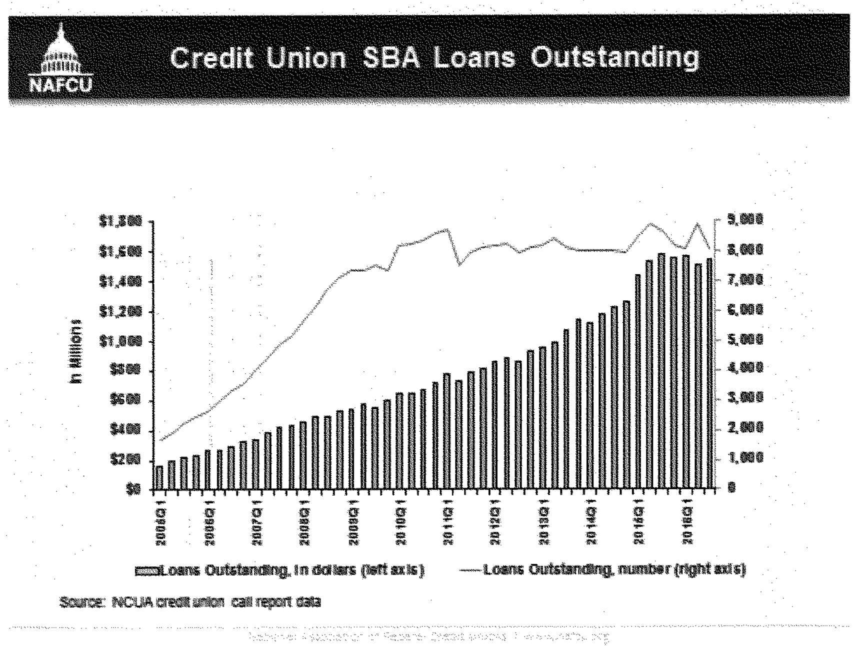
I am also pleased that NAFCU signed a memorandum of understanding (MOU) with SBA in February 2015 to help address the challenge. The MOU formalized a joint-partnership that aims to increase the availability of small dollar loans by providing more outlets for entrepreneurs to access SBA products in their neighborhoods. The partnership also helps small business owners get capital for investments into their new or existing business they may have otherwise put on a high-interest credit card or a personal credit line. And finally, it makes the small dollar loans more accessible to underserved communities, including women and minorities.

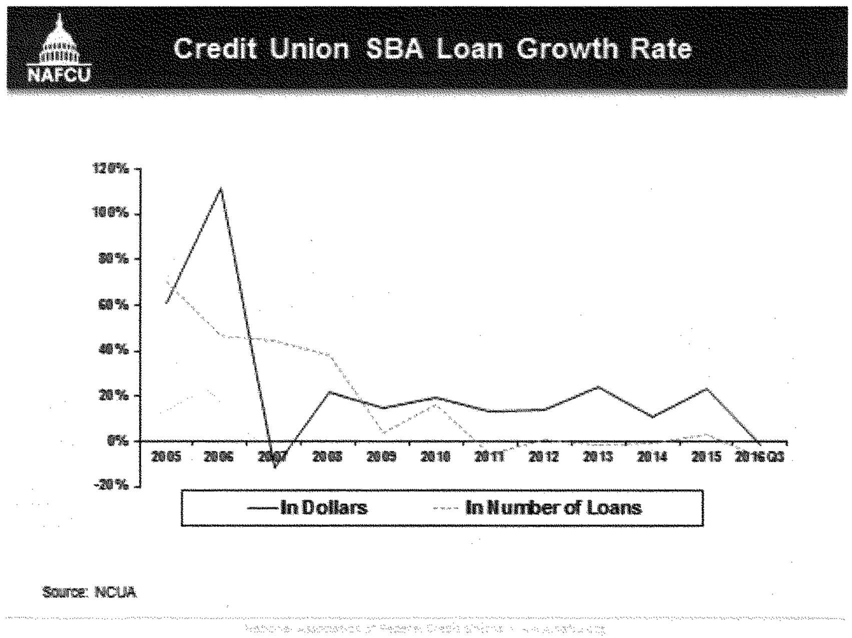
SBA and Access to Capital for Credit Union Members

As previously mentioned, small businesses are the backbone of our economy and an essential source of jobs for Americans. The Small Business Administration's loan programs serve as an important resource that helps credit unions provide small businesses with the vital capital necessary for growth and job creation – in many cases to businesses that would otherwise not be able to obtain financing. However, utilizing any SBA loan guaranty program requires meeting stringent government regulations.

Determining overall applicant eligibility to participate in an SBA program is nearly as important as determining the applicant's creditworthiness. Failing to meet certain eligibility criteria may preclude the applicant from participating in an SBA guaranteed loan program. Eligibility criteria includes among other things: size restrictions, type of business, use of proceeds, credit standards, and meeting a 'credit-elsewhere' test.

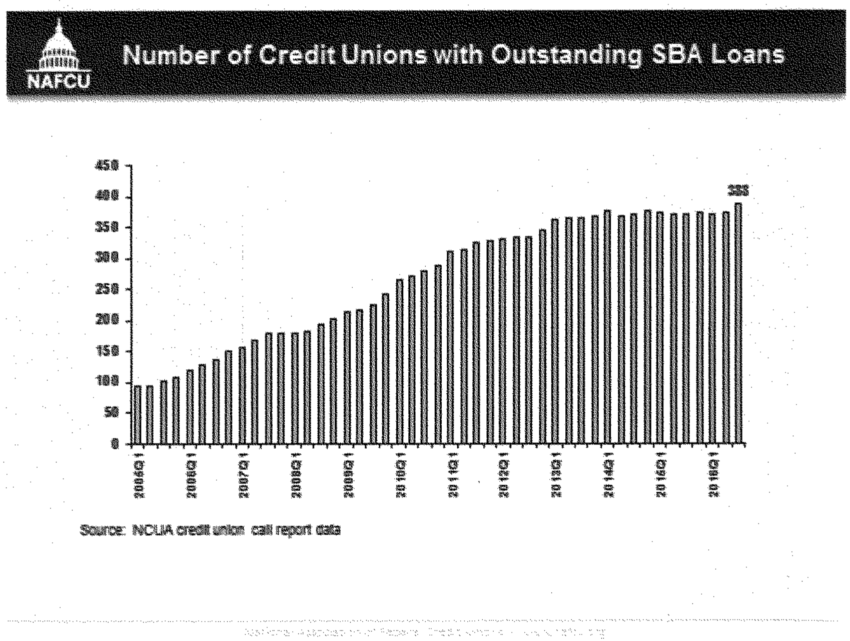
While credit union SBA loans have generally increased in both total number and dollars, the growth rate of credit union SBA lending has fallen since the recession (see charts below).





Much of the decrease in SBA lending can be associated with the overall economic downturn the nation as a whole experienced. However, some credit unions tell NAFCU that they have scaled back on the number of small loans as a response to comments from the SBA and its examinations.

Another way that Congress could help improve the 7(a) lending program would be to reintroduce the *Credit Union Small Business Lending Act*, which was first introduced by Ranking Member of the full committee, Nydia Velazquez in the 110th Congress. The bill would amend the *Federal Credit Union Act* to exclude any SBA loan (guaranteed and non-guaranteed portions) from the meaning of "member business loan" of a credit union. These loans would thereby be exempted from the arbitrary credit union member business lending cap. As you can see from the chart below, the number of federally-insured credit unions participating in SBA programs has been steadily increasing since the SBA opened up its programs to more credit unions in 2003. Enacting legislation such as the *Credit Union Small Business Lending Act* will help this trend continue.



Compliance with any regulation requires work, but clear guidance is necessary for a credit union to know they are doing what is required of them. If RBFCU has a question regarding SBA's Standard Operating Procedures (SOP), we are able to email them directly, but the response does not always result in a definitive answer. Many times, SBA's response to a request for clarification is merely a screenshot of the page of the SOP in question. Additionally, when loans are submitted through General Processing, some of SBA's processors deviate from standard SOP requirements. For example, one recent loan request required us to place a second lien on a borrower's rental property. In order to establish value, RBFCU would normally use the tax assessed value on the home. In this case, the SBA processor insisted on using the value estimated by the real estate website Zillow.com, which of course is nowhere in the SOP manual. Issuing, improving, and adhering to guidance or published "best practices" would go a long way to helping credit unions get more involved in SBA lending programs. Additionally, shortening the length of time it takes to have a loan approved, which can take 8 weeks or longer, as well as something as simple as improving the user friendliness of the SBA One software are other ways to encourage credit unions to offer SBA products.

If Congress and the SBA were to make it easier for credit unions to participate in these programs, small businesses throughout the nation will have greater access to capital at a time when it is greatly needed. While we support SBA loans being permanently exempted from counting against a credit union's MBL cap, we also would support efforts to temporarily increase the guarantee on SBA loans. Our experience indicates that the recent SBA fee reductions and temporary guarantee increase helped the small businesses in our market and encourage other credit unions to get involved.

These suggested changes, which would allow credit unions to do more to help our nation's small businesses, are an important step to help our nation's continued recovery from the recent economic downturn.

Conclusion

Small businesses are the driving force of our economy and the key to its success. The ability for them to borrow and have improved access to capital is vital for the job creation that will lift our nation out of the economic malaise in which we find ourselves today. And while the Small Business Administration's 7(a) program provides much needed opportunities to established and fledgling businesses, there are several relatively simple steps that could propel the program to its full potential. We are confident this Subcommittee will do what is necessary to ensure that these programs are successful, while ensuring eligibility requirements and other qualifying criteria aren't overly burdensome on the financial institutions that participate in them.

We thank you for your time and the opportunity to testify before you here today on this important issue to credit unions and our nation's economy. I would welcome any questions that you may have.

INDEPENDENT COMMUNITY BANKERS of AMERICA

Testimony of

Cynthia Blankenship

Vice Chairman, Chief Financial Officer, and Corporate President

Bank of the West

Grapevine, Texas

On behalf of the

Independent Community Bankers of America

Before the

United States House of Representatives

Committee on Small Business

Subcommittee on Investigations, Oversight and Regulation

Hearing on

"An Overview of the SBA's 7(a) Loan Program"

March 9, 2017

Washington, D.C.

Chairman Kelly, Ranking Member Adams, and members of the subcommittee, I am Cynthia Blankenship, Vice Chairman, Chief Financial Officer, and Corporate President of Bank of the West in Grapevine, Texas. Bank of the West is a $450 million asset community bank serving the Dallas-Fort Worth suburban area with rural branches in Ponder and Vernon, Texas. We have 105 employees, eight full service branches, and two mortgage company locations.

I am also a former Chairman of the Independent Community Bankers of America, and I am pleased to testify today on behalf of the more than 5,800 community banks represented by ICBA at today's hearing titled "An Overview of the SBA's 7(a) Loan Program." A robust and sustainable 7(a) program with broad community bank participation will help small businesses thrive and create jobs, strengthening and extending a sluggish economic recovery. We are grateful for this committee's strong support for the 7(a) program, and I am pleased to offer the community bank perspective on it.

America's community banks are prolific small business lenders. We play an outsized role in funding small businesses and the jobs they create. While community banking organizations represent 17 percent of all U.S. bank assets, we make more than half of all small business loans. Small businesses account for over half of all U.S. employment and nearly two thirds of all employment growth.

What sets community banks apart is their first-hand knowledge of the borrower, the community, and the local economy. Community bank small business lending simply cannot be duplicated by a bank based outside the community. As noted in a recent study by scholars at Harvard's Kennedy School of Government: "In certain lending markets, the technologies larger institutions can deploy have not yet proven effective substitutes for the skills, knowledge, and interpersonal competencies of many traditional banks."[1] The Small Business Administration's 7(a) loan program allows community banks to leverage their unique underwriting skills to more effectively serve the small businesses in their communities.

Bank of the West's Longstanding Partnership with the SBA

Bank of the West is a 30-year partner with the Small Business Administration and has been strongly committed to helping small businesses in our communities using the flagship 7(a) program as well as the 504-loan program. We are a leading SBA lender in the Dallas-Fort Worth SBA District. We underwrite approximately $20 million in 7(a) loans annually and currently hold and service nearly $100 million in SBA loans in our portfolio, which represent about 20 percent of our total loans. These are high quality loans with minimal loss ratio. We use the program to provide credit to a broader range of borrowers and ensure sound underwriting.

Bank of the West uses the SBA 7(a) program to supplement our lending and credit services. We actively encourage our loan officers to consider whether we can use the program to serve small business credit applicants with flexible terms available under the program who would not otherwise qualify for a conventional loan. To safeguard the program from abuse, the SBA's

[1] "The State and Fate of Community Banking." Marshall Lux and Robert Greene. Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School. February 2015.

"Credit Elsewhere Test" requires us to fully substantiate and document the reasons a given applicant cannot be served with conventional credit.

The 7(a) program allows us to leverage our lending dollars and provide more small business credit. We also highly value the option of selling the guaranteed portion of 7(a) loans into the secondary market, which provides an alternative source of liquidity should we need it. Historically, Bank of the West's 7(a) loans have created thousands of jobs in the communities we serve and helped to sustain and strengthen our local economy.

While community banks are not the only lenders that provide small business credit, we are the most steadfast. Community banks provide small business credit in good times as well as challenging times. During the financial crisis of 2008 and 2009, while overall small business lending contracted, lending by a majority of small community banks (those of less than $250 million in assets) actually increased, and small business lending by banks with asset sizes between $250 million and $1 billion declined only slightly. By contrast, small business lending by the largest banks dropped off sharply.[2] The viability of community banks is linked to the success of our small business customers in the communities we serve, and we don't walk away from them when the economy tightens.

This is probably one of the reasons that community banks received the highest lender satisfaction scores in the most recent Small Business Credit Survey, a collaboration among seven Federal Reserve Banks, which surveyed almost 3,500 small businesses in 26 states.[3] The community bank satisfaction score of 75 percent exceeded the scores of other categories of lenders by a wide margin.

The 7(a) Program Helps Community Banks Reach Additional, Credit-Worthy Borrowers

I would like to provide a couple of examples of7(a) loans made by Bank of the West that illustrate the value of the program. Some years ago, my hair stylist, Kim, wanted to purchase the salon she worked at in Las Colinas, Texas following the death of the owner. Without the help of a loan to purchase the salon, it likely would have closed and she would have been forced into the job market. Kim was not a good candidate for conventional credit because of the low value of the collateral. However, Bank of the West was able to offer her a 7(a) loan based on historical and projected cash flow, underwriting factors which the SBA program allows. The salon thrived and Kim hired eight additional stylists. Her cash flow was so strong that she made early and additional payments, paying off the loan early.

In another SBA success story, Bank of the West helped a gentleman who ran a pet boarding business near Love Field in Dallas. He had an SBA loan from another bank but his business was in leased space. We made a loan to refinance his original SBA loan and finance the purchase of the building he occupied. Our loan saved him money on rent, improved his cash flow, and allowed him to build more equity in the business. A couple of years later we financed the

[2] "Community Banking in a Period of Recovery and Change." Speech by Federal Reserve Chairman Ben S. Bernanke before the ICBA Annual Convention. March 23, 2011.

[3] 2015 Small Business Credit Survey: Report of Employer Firms. December 2016.

expansion of his building to add more kennels, which dramatically increased his cash flow and profits.

Success stories like these and numerous others are why I'm passionate about community banking. These loans would not have been possible without the SBA.

Longer Loan Maturities Reduce Borrower Payments and Increase Flexibility

A typical, conventional small business loan has a maturity of one to three years. This maturity is determined by the lenders' need to fund the loan with short-term deposits. However, 7(a) program loans have average maturities of 12 years or more. Importantly, SBA lending allows longer loan terms of up to 25 years. These longer terms lower the entrepreneur's loan payments and free up needed cash flow to hire, invest, and grow the small business. When another recession occurs, the longer loan term offered by an SBA loan will help numerous small businesses weather the crisis.

Bank of the West is an SBA Preferred Lender

Bank of the West has been a preferred SBA lender for 30 years. This program is available to lenders with a proven track record of successful SBA lending whose lending policies and procedures have been thoroughly vetted by the agency. Once approved, a preferred lender can use streamlined procedures for processing SBA loans and make final credit decisions in-house. This is a critical advantage because it allows us to avoid a delay of up to three weeks at the SBA Office of Credit Risk Management. As an SBA preferred lender we can be responsive to our credit applicants and, if they meet or underwriting criteria, get them the funds they need to grow their businesses in a timely fashion. Our preferred lender status is subject to recertification every two years, which gives us a strong incentive to make sound loans and minimize our loss ratio.

Stable Funding is Critical

Stable funding is critical to the success of the 7(a) program and the thousands of borrowers that rely on it. As is well known to this committee, program funding came to abrupt halt in the summer of 2015 when it reached its authorization cap well before the end of the fiscal year.

The 7(a) program is fully funded by user fees. No taxpayer dollars are appropriated. Nevertheless, a program authorization level must be approved by Congress each year, and once that level is reached, no more loans can be approved. In July 2015, Congress was forced to pass an emergency increase to the authorization cap to restart the program so that the program hiatus was short-lived. ICBA greatly appreciates the support and responsiveness of this committee in passing that emergency increase. A longer program shutdown would have cut off the thousands of small businesses that rely on this program for payrolls, investment, and expansion. Small business owners often put their entire net worth at risk to make their businesses succeed. If, at the time they are ready to take on a loan, the SBA reaches their funding cap, it could be devastating for the borrower. Instable program funding also discourages lenders from getting into the SBA market. Lenders need to know they can rely on stable funding.

We must work together to ensure that program funding is never disrupted again. One way we might achieve better funding stability is by creating a two-year funding commitment for the program that would be renewed every year.

Community Banks Need Regulatory and Tax Relief to Sustain and Grown Small Business Credit

I have focused my remarks up to this point on the 7(a) program. Taking a broader perspective, I urge this committee to support regulatory and tax relief that would strengthen community banks and enable more small business lending in SBA programs and in the conventional markets.

ICBA's Plan for Prosperity, which we released in January, is a robust set of legislative recommendations, many of which serve the same goal as the SBA – creating more small business credit that will in turn create economic growth and jobs. A copy of the Plan is attached to this statement. While I won't describe the Plan in detail, I would like to note a couple of recommendations that are directly relevant to community bank small business lending.

Small Business Lending Data Collection

Dodd-Frank Section 1071 requires the CFPB to implement rules for the collection and reporting of data on financial institutions' small business lending under the Equal Credit Opportunity Act. Section 1071 requires the collection and reporting of 12 pieces of data in connection with credit applications made by women- or minority-owned businesses of any size as well as all small businesses regardless of ownership, including the race, sex, and ethnicity of the principal owners of the business. Section 1071 also gives the CFPB discretion to require the reporting of any additional information that would assist the Bureau in fulfilling the purposes of the statute.

If the CFPB proceeds with implementation of this onerous data collection requirement, it will impose significant new burdens on community banks at a time when they are absorbing numerous other regulatory requirements. It will likely require the reporting of information regarding every small business loan application and will fall disproportionately upon smaller banks that lack scale and compliance resources.

Tax Incentives for Targeted Community Bank Lending

Carefully designed tax incentives for community bank lending would lower credit costs for targeted borrowers and help community banks diversify their loan portfolios and comply with the Community Reinvestment Act. ICBA believes tax incentives should support community bank lending to low-to-middle income individuals, small businesses, and small farms.

Preserve Interest Deduction for Business Borrowers

Debt financing plays a critical role in economic growth and job creation. ICBA opposes the removal or limitation of current law interest deduction for business borrowers. Such proposals have the potential to stunt the formation and expansion of small businesses that are vital to the American economy.

Community bank credit is a critical – and frequently the only viable – source of capital for small businesses, which typically have very limited or no access to equity capital, especially in the early stages of their development. Moreover, community bank credit allows small business owners to invest and grow their businesses without diluting their control. Many small businesses are closely held to retain control over strategic decision making and direction. Outside equity capital would change the essential character of these businesses.

Conclusion

Thank you again for convening this hearing and for your ongoing support for an SBA program that will play a critical role in strengthening our economic recovery and creating jobs. Bank of the West and many other community banks are fully committed to the future of the 7(a) program and will continue to dedicate the resources needed to make it work.

I'm happy to answer any questions you may have.

Attachment: ICBA's Plan for Prosperity

Plan for Prosperity: The Community Bank Agenda for Economic Growth

America's community banks stand ready to join with the 115th Congress and the incoming administration in creating a new era of economic growth and prosperity.

Providing nearly half of all small business loans as well as customized mortgage, consumer, and agricultural loans suited to the unique characteristics of their local communities, America's nearly 6,000 community banks serve a vital role in creating and sustaining economic growth in communities of all sizes and in every region of the country.

To reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks need relief from suffocating regulatory mandates. The exponential growth of these mandates affects nearly every aspect of community banking. The very nature of the industry is shifting away from community investment and community building to paperwork, compliance, and examination. The new Congress has a unique opportunity to simplify, streamline and restructure every aspect of the regulatory and tax environment.

ICBA's Plan for Prosperity ("the Plan") is an agenda for regulatory relief that will allow community banks to thrive by doing what they do best — serving and growing their communities one loan at a time. By reducing unsustainable regulatory burden, the Plan will ensure that scarce capital and labor resources are used productively, not sunk into unnecessary compliance costs, allowing community banks to better focus on lending and investing that will directly improve the quality of life in our communities.

Each provision of the Plan was developed with input from community bankers nationwide and crafted to preserve consumer protections and bank safety and soundness. ICBA and community bankers are committed to working with Congress and the administration to enact the provisions of the Plan with the use of every resource at our disposal. If we act boldly and make fundamental reforms, the American economy will grow and prosper for the benefit of generations to come.

Capital: Simplified Rules and New Options for the Creation and Preservation of Community Bank Capital

The Plan for Prosperity would strengthen community bank viability and independence by enhancing access to capital and simplifying capital regulation. New capital options for community banks would fuel economic growth and prosperity for all Americans.

Basel III Amendments: Restoring the Original Intent of the Rule. Basel III was originally intended to apply only to large, internationally active banks. Non-systemically important financial institutions (non-SIFIs) should be fully exempt from the rule.

In lieu of a full Basel III exemption for all community banks (which is ICBA's strong preference) ICBA proposes the following amendments:

- *Exemption from the capital conservation buffer.* The new buffer provisions impose dividend restrictions that have a chilling effect on potential investors. This is particularly true for Subchapter S banks, whose investors rely on dividends to pay their pro-rata share of the bank's tax. Exempting non-SIFIs from the capital conservation buffer would make it easier for them to raise capital.
- *Full capital recognition of allowance for credit losses.* Provide that the allowance for credit losses is included in tier 1 capital up to 1.25 percent of risk-weighted assets with the remaining amount reported in tier 2 capital. This change would reverse the punitive treatment of the allowance under Basel III. The allowance should be captured in the regulatory capital framework since it is the first line of defense in protecting against future credit losses.
- *Amend risk weighting to promote economic development.* Provide 100 percent risk weighting for acquisition, development, and construction loans. Under Basel III, these loans are classified as high-volatility commercial real estate (HVCRE) loans and risk weighted at 150 percent. ICBA's proposed change would treat these loans the same as other commercial real estate loans and would be consistent with Basel I.
- *Reverse punitive capital treatment of mortgage servicing.* For banks with assets of $50 billion or less, reverse the punitive Basel III capital treatment of mortgage-servicing rights (MSRs) and allow 100 percent of MSRs to be included as common equity tier 1 capital

More Accurate Identification of "Systemic Risk." The current threshold of $50 billion for the identification of "systemically important financial institutions" (SIFIs) under Title I of the Dodd-Frank Act is too low and sweeps in too many banks that pose no systemic risk and should not be subject to higher prudential standards. A higher threshold and a more flexible SIFI definition under Title I would more accurately identify those institutions that pose systemic risk.

Additional Capital for Small Bank Holding Companies: Modernizing the Federal Reserve's Policy Statement. The Federal Reserve Board should be required to revise the Small Bank Holding Company Policy Statement — a set of capital guidelines that have the force of law. The Policy Statement, which makes it easier for small bank and thrift holding companies to raise additional capital by issuing debt, should be revised to increase the qualifying asset threshold from $1 billion to $10 billion. Qualifying bank and thrift holding companies must not have significant outstanding debt or be engaged in nonbanking activities that involve significant leverage.

Relief from Securities and Exchange Commission Rules. The following SEC rule changes would allow community banks to commit more resources to their communities without putting investors at risk:

- Provide an exemption from internal control audit requirements for banks with a market capitalization of $350 million or less. The current exemption applies to any company with market capitalization of $75 million or less. Because community bank internal control systems are monitored continually by bank examiners, they should not have to sustain the unnecessary annual expense of paying an outside audit firm. This provision would substantially lower the regulatory burden and expense for small, publicly traded banks without creating more risk for investors.
- Regulation D should be reformed so that anyone with a net worth of more than $1 million, including the value of their primary residence, would qualify as an "accredited investor." The number of non-accredited investors that could purchase stock under a private offering should be increased from 35 to 70.

Repeal Collins Amendment for Non-SIFIs. The Collins Amendment to the Dodd-Frank Act (Section 171) was originally intended to equalize large bank and community bank capital treatment. In practice, however, the amendment limits regulators' discretion in implementing Basel III and has proved to be a stumbling block to simpler capital rules for community banks. ICBA supports full repeal of the Collins Amendment for non-systemically important financial institutions (non-SIFIs).

Address Minority Bank Capital Challenges. ICBA will work with Congress to explore options for addressing capital challenges faced by minority banks. These banks serve a critical role in providing credit, capital and financial services to low-to-moderate income and minority communities in urban, rural and suburban areas that are economically distressed.

Regulatory Relief

Community bank regulation, which has steadily increased for decades, is a cumulative, oppressive burden that limits access to credit in our communities and drives industry consolidation that will directly harm consumers and small businesses. Regulatory relief for community banks will promote greater economic growth in our local communities.

Balanced Consumer Regulation: More Inclusive and Accountable CFPB Governance. The following changes would strengthen Consumer Financial Protection Bureau accountability, improve the quality of the agency's rulemaking, and make more effective use of its examination resources:

- The CFPB should be granted additional statutory authority to exempt or tier regulatory requirements for community banks and/or community bank products and services.
- The governance structure of the CFPB should be changed to a five-member commission rather than a single director. This change would strengthen accountability and bring a diversity of views and professional backgrounds to decision-making at the CFPB.
- The Financial Stability Oversight Council's review of CFPB rules should be strengthened by changing the vote required to veto a rule from an unreasonably high two-thirds vote to a simple majority, excluding the CFPB director.

Eliminate Arbitrary "Disparate Impact" Fair Lending Lawsuits. Amend the Equal Credit Opportunity Act and the Fair Housing Act to bar "disparate impact" causes of action and to require discriminatory intent for fair lending violations. Disparate impact describes differential results that arise despite the use of practices that are facially neutral in their treatment of different groups. Lenders must consider factors such as race and national origin in individual credit decisions to protect themselves from fair lending regulatory enforcement actions and lawsuits. Legislation is needed to require discriminatory intent for a finding of fair lending violations. This would ensure lenders that uniformly apply neutral lending standards are not subject to unnecessary regulatory enforcement actions or frivolous and abusive lawsuits under the Equal Credit Opportunity Act or the Fair Housing Act.

Ensuring the Viability of Mutual Banks: New Charter and Capital Options. A new national charter for mutual banks would allow institutions to choose the charter that best suits their needs and the needs of the communities they serve. Mutual institutions should be authorized to issue mutual capital certificates, an additional option for raising capital. Existing federal savings associations chartered under the Home Owners' Loan Act should be able to elect to have the rights and privileges of a national bank without changing charters.

Rigorous and Quantitative Justification of New Rules: Cost-Benefit Analysis. The financial regulatory agencies should not be allowed to issue notices of proposed rulemaking unless they first determine that quantified costs are less than benefits. The analysis should take into account the impact on the smallest banks, which are disproportionately burdened by regulation because they lack the scale and the resources to absorb the associated compliance costs. In addition, the agencies should be required to identify and assess available alternatives including modifications to existing regulations. They should also be required to ensure that proposed regulations are consistent with existing regulations, written in plain English, and easy to interpret.

Modernizing the Bank Secrecy Act. ICBA recommends raising the currency transaction report (CTR) threshold from $10,000 to $30,000 and indexing future increases on an annual basis for inflation. The current threshold, set in 1970, is significantly dated and captures far more transactions than originally intended. A higher threshold would produce more targeted, useful information for law enforcement. ICBA also supports the creation of a tax credit to offset the cost of BSA compliance. (See "Tax Relief" below.) In addition, beneficial ownership information should be collected and verified at the time a legal entity is formed by either the Internal Revenue Service or other appropriate federal or state agency, rather than by financial institutions. This would provide uniformity and consistency across the United States.

Cutting the Red Tape in Small Business Lending: Eliminate Burdensome Data Collection. ICBA supports full repeal of the statutory authority (Dodd-Frank Section 1071) for new small business loan data collection requirements. This provision, which will likely require the reporting of information regarding every small business loan application, will fall disproportionately upon smaller banks that lack scale and compliance resources.

Risk Targeting the Volcker Rule. Non-systemically important financial institutions (non-SIFIs) should be exempt from the Volcker Rule, which should apply only to the largest, most systemically risky banks. Proposals to apply the rule to non-SIFIs carry unintended consequences that threaten to destabilize segments of the banking industry.

Preserve Access to Investment Advice for Middle Class Savers. ICBA supports full repeal of the Department of Labor's misguided fiduciary rule, which, if allowed to go into effect, would raise costs, limit choices, and reduce access to sound retirement investment advice for thousands of low and middle income Americans.

Mortgage Reform for Community Banks

Every aspect of mortgage lending is subject to new, complex, and costly regulations that are driving community banks out of this line of business. The Plan for Prosperity would support a robust housing market by providing relief from new mortgage regulations, especially for loans held in portfolio. When a community bank holds a loan in portfolio, it has a direct stake in the loan's performance and every incentive to ensure it is properly underwritten, affordable, and responsibly serviced.

Safe Harbor from Onerous Underwriting. Loans originated and held in portfolio by banks with less than $50 billion in assets, including balloon mortgages, should be granted "qualified mortgage" (QM) safe harbor status from the underwriting requirements of the ability-to-repay rule. In addition, any loan transferred to Fannie Mae, Freddie Mac, or a Federal Home Loan Bank should be automatically granted QM safe harbor status.

HMDA Relief. A recent Home Mortgage Disclosure Act (HMDA) rule more than doubled the number of data fields lenders must report in connection with every loan application, forcing community banks to overhaul their systems and retrain staff at significant cost. ICBA supports repeal of the Dodd-Frank authority for expanded HMDA reporting. In addition, the loan-volume threshold for HMDA reporting should be increased to 1,000 closed-end mortgages and 2,000 open-end lines of credit. The current reporting threshold exempts a maximum of 34,000 loans, according to a CFPB estimate, a minimal fraction of the nearly 10 million annual mortgage applications reported through HMDA last year. ICBA's recommended threshold would provide relief for many more small lenders without significantly impacting the mortgage data available to the CFPB or impairing the purpose of the HMDA statute.

Escrow Relief. Banks with assets of less than $50 billion should be exempt from escrow requirements for loans held in portfolio. Such banks have direct stake in protecting their collateral by ensuring taxes and insurance are paid on a timely basis.

Appraisals. In recent years, appraisal requirements have become more costly, and rural America is experiencing a critical shortage of appraisers. When a mortgage is held in portfolio, a bank should be able to substitute an in-house "property evaluation" for a full residential property appraisal completed by a licensed appraiser.

Preserve Community Bank Mortgage Servicing. Simplified servicing regulation would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation, which is harmful to borrowers. The "small servicer" threshold should be raised from 5,000 loans serviced to the greater of 30,000 loans serviced or $5 billion in unpaid principal balance on loans serviced. To put this proposed threshold in perspective, the average number of loans serviced by each of the five largest servicers subject to the national mortgage settlement is 6.8 million, and each has an unpaid principal balance of more than $300 billion.

Reform of Closing Process and Paperwork. The TILA-RESPA Integrated Disclosure (TRID) rule, which governs the residential mortgage closing process and paperwork, is a uniquely complex rule with unclear liabilities. The rule has caused some community banks to cease offering mortgages and has greatly increased compliance expenditures for others. TRID reform should: (i) make waiting periods waivable at the request of the consumer; (ii) limit liability to violations that cause consumers actual, material harm; (iii) permit creditors to cure errors and make consumers whole before allowing the consumer the right to file a lawsuit; and (iv) exempt loans secured by large, mixed-use properties.

Bank Oversight and Examination

A trend toward oppressive, micromanaged regulatory exams is suffocating community banks' ability to serve their customers and communities. The following reforms would allow community banks to lead an economic revival on Main Streets across America.

Strengthening Accountability in Bank Exams: A Workable Appeals Process. An independent body should be created to receive, investigate, and resolve material complaints from banks in a timely and confidential manner. The goal is to hold examiners accountable and to prevent retribution against banks that file complaints.

Reforming Bank Oversight and Examination to Better Target Risk. ICBA makes the following recommendations to allow bank examiners to better target their resources at true sources of systemic risk:

- A two-year exam cycle for well-rated banks with up to $5 billion in assets would allow examiners to better target their limited resources toward banks that pose systemic risk. It would also provide needed relief to bank management for whom exams are a significant distraction from serving their customers and communities.
- Non-systemically important financial institutions (non-SIFIs) should be exempt from stress test requirements.
- Community banks should be allowed to file a short-form call report in the first and third quarters of each year and file the current, long-form call report only in the second and fourth quarters. The quarterly call report represents a growing burden on community banks without being an effective supervisory tool.
- The Community Reinvestment Act (CRA) asset thresholds should be modernized. The "small bank" and "intermediate small bank" thresholds determine how a bank is assessed. A separate threshold determines how often a bank is assessed. These thresholds do not reflect consolidation in the community banking industry and should be increased. Community banks prosper by reinvesting local deposits and serving all customers in their communities. Too frequent or intrusive CRA exams are unnecessary and force banks to expend resources that could otherwise be dedicated to serving customers.
- All banks with assets of $50 billion or less should be exempt from examination and enforcement by the CFPB and instead be examined and supervised by their prudential regulators for compliance with consumer protection regulation. CFPB backup (or "ride along") authority for compliance exams performed by a bank's primary regulator should be eliminated.

Community Bank Tax Relief

The 115th Congress presents a unique opportunity to restructure, modernize and simplify our complex and inefficient tax code. Tax reform and community bank tax relief, done properly, have the potential to strengthen our economy and spur job creation for a generation or more.

Lower Marginal Rates Needed for Individuals, Corporations, and Businesses. ICBA strongly supports tax rate relief for American individuals, corporations, and businesses. Significant tax relief will provide a much-needed boost to a sluggish economic recovery and possibly help stave off another recession by spurring consumer purchasing, business investment, and hiring. Rate relief must be a part of any tax reform package.

Incentivizing Credit for Low- and Middle-Income Customers and American Agriculture. ICBA supports the creation of new tax credits or deductions for community bank lending to low- and middle-income individuals, businesses, farmers, and ranchers. Such tax credits or deductions would help to sustain and strengthen lending to low- and moderate-income customers and America's farmers and ranchers, and would help offset the competitive advantage enjoyed by tax-exempt credit unions and Farm Credit System lenders.

Modernize Subchapter S Constraints. Subchapter S of the tax code should be updated to facilitate capital formation for community banks, particularly in light of higher capital requirements under the proposed Basel III capital standards. Congress should: increase the limit on Subchapter S shareholders from 100 to 200; allow Subchapter S corporations to issue preferred shares; and permit the holding of Subchapter S shares, both common and preferred, in individual retirement accounts (IRAs). These changes would improve the ability of the nation's 2,200 Subchapter S banks to raise capital and increase the flow of credit within their communities.

Limited Liability Corporation Option for Community Banks. In addition to modernization of Subchapter S for banks (as described above), ICBA supports the creation of a limited liability company (LLC) option for community banks. The LLC election would allow pass-through tax treatment for community banks without the limitations of Subchapter S organization.

Estate Tax Repeal. ICBA supports full, permanent repeal of the estate tax, which jeopardizes the succession of many family-owned community banks from generation to generation. A family estate should never be forced to sell its interest in a community bank to pay a transfer tax. Forced sales of once-family-owned community banks to other community banks or, frequently, to larger regional or national banks, coupled with a recent surge in regulatory burden, accelerate the current trend toward consolidation in the banking sector.

Update Bank Qualified Bond Issuer Limitation. Since 1986, the tax code has provided a special incentive for banks to purchase bonds issued by municipalities, school districts, sanitation districts, and other public entities, provided the issuer expects to issue no more than $10 million of bonds annually. These are known as "bank qualified bonds." Because the $10 million limitation has been severely eroded by inflation, today only a small number of issuers are eligible to take advantage of lower interest rates by issuing bank qualified bonds. The limitation was temporarily increased to $30 million by the American Recovery and Reinvestment Act of 2009. ICBA supports a permanent increase in the limitation to $50 million to be indexed prospectively. A higher limitation would allow local bank deposits to support needed, local public infrastructure investments at a lower interest rate, as originally intended by the 1986 Tax Reform Act.

Five-Year Loss Carryback Supports Lending During Economic Downturns. Banks with $15 billion or less in assets should be allowed to use a five-year net operating loss (NOL) carryback. The five-year NOL carryback is countercyclical and will support community bank capital and lending during economic downturns.

Tax Credit for Bank Secrecy Act Compliance Costs. For community banks, BSA compliance represents a significant expense in terms of both direct and indirect costs. BSA compliance, whatever the benefit to society at large, is a purely governmental, law enforcement function with no direct benefit to the bank or its customers. As such, the costs should be borne by the government. ICBA supports the creation of a tax credit to offset the cost of BSA compliance.

Agriculture & Rural America

A vibrant rural economy is vital to America's prosperity. Community banks, which fund nearly 80 percent of all agricultural loans, serve a critical role in creating and sustaining rural economic prosperity. The following provisions will help rural America thrive by strengthening the community banks that serve agricultural enterprises.

Agricultural Loan Concentration Limits. Regulatory agencies and bank examiners should not treat agency guidance as official agency rule making, particularly with regard to concentration limits that could unnecessarily restrict community bank lending. Many banks in rural areas do not have economic choices beyond agriculture and such guidance, if interpreted as rule making, could dramatically increase their risks as they venture into new lending markets.

Tax Relief for Rural Lending. ICBA supports the creation of tax incentives to support agricultural lending and residential mortgage lending in rural areas. See Community Bank Tax Relief for more information.

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

"An Overview of SBA's 7(a) Loan Program"

Testimony before the House Committee on Small Business Subcommittee on Investigations, Oversight, and Regulations

March 9, 2017

Submitted by
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101 Constitution Ave NW
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Mr. Chairman, Ranking Member Alma Adams, and members of the Committee—my name is Tony Wilkinson and I am President and Chief Executive Officer of the National Association of Government Guaranteed Lenders (NAGGL), a national trade association of approximately 800 banks, credit unions, and non-depository lenders who participate in the Small Business Administration's 7(a) loan guarantee program.

The American entrepreneurial spirit is stronger than ever. Unfortunately, there is a very real gap in conventional bank lending in this country and even the most qualified business owners often struggle to secure financing that meets their business needs. A small business seeking capital is often offered loans with terms of 90-days to 3 years when they really need much longer term financing to thrive. The needs of this country's small businesses have always been a depository mismatch for banks that simply cannot, or may be reluctant to, tie up their capital in long-term loans for borrowers, especially in the wake of the Recession.

At the heart of the SBA's success is the 7(a) loan program, the agency's largest public-private partnership with close to 2,000 active participating private-sector financial institutions. These lenders make private-sector loans to small business borrowers who are creditworthy and healthy, but that fall through the very wide and well-known lending gap that American small businesses face. Instead of 90-day to 3-year term loans, the 7(a) loan program loan has an average term of 16 years—in other words, the kind of long-term financing that small businesses need to grow and thrive, but that generally cannot be found in the conventional market.

In Fiscal Year 2016, financial institutions large and small provided a little over $22.9 billion in loans to about 64,000 small businesses nationwide through the 7(a) loan program. Unlike other federal programs that pass the cost on to the taxpayer, the 7(a) loan program is completely self-funded by the fees collected from lenders and borrowers. In fact, the 7(a) loan program has returned more than $1.55 billion—that's with a "b"—to the Treasury since Fiscal Year 2010. In other words, the 7(a) loan program is currently a revenue stream for the federal government.

Numbers don't lie. About 500,000 jobs are estimated to be created or retained annually thanks to the 7(a) loan program. In addition, there are other benefits that are often hard to measure, like increased tax revenue governments, and community growth driven by small business expansion in small towns across the country.

SBA 7(a) lending is a rare program where the federal agency has figured out how to get out of its own way and leverage private-sector expertise: lenders know how to make loans. SBA does not pick "winners and losers" because SBA does not make the loans and its 7(a) loan program is open to any eligible, creditworthy small business borrower. The 7(a) program does not supplant the lending market; it supplements it. SBA conditionally guarantees a percentage of the loan, leaving a healthy level of risk on the lenders as incentive to serve as prudent stewards of the program.

I must stress this point because it is critical to understanding the lender's 'skin in the game': SBA's guarantee is a *contingent* guarantee, which means that if a lender fails to fully follow 7(a) program requirements and meet its responsibilities, the SBA can—and does—reduce the amount of the guarantee payment to lenders. In the most egregious cases of imprudent lending, the SBA completely denies its liability under the guarantee. Therefore, the very nature of the guarantee relationship serves to assure that lenders comply with the various SBA regulations while engaging in quality lending. The guarantee program is a sharing of risk and not a complete transfer of risk. Beyond responsibilities to the SBA and the taxpayer, as responsible stewards of the program, lenders have an ongoing responsibility to their federal and state regulators, their internal regulatory oversight groups, and even their shareholders to ensure that safe and sound lending practices are maintained. In part, this 'skin in the game' is what makes the private sector such ideal partners in the 7(a) loan program.

NAGGL is pleased to testify in front of the Subcommittee on Investigations, Oversight, and Regulations because we recognize the benefit of quality lender oversight and strongly support the continuing implementation of SBA's oversight program. Since the introduction of federal credit reform, our member institutions have witnessed the impact that portfolio performance has on subsidy rates and program fees. And, just as important as maintaining healthy portfolio performance, proper lender oversight is needed to protect the main purpose of the 7(a) loan program—its public policy mission to serve those small business borrowers in the community who cannot otherwise receive credit elsewhere on reasonable terms and conditions. An appropriate oversight approach must also include consideration of how well the public policy goals of the program are being met. In other words, effective oversight ensures that Congressional intent is met.

As Members of the House Small Business Committee, and of the Congress as a whole, the maintenance of the SBA programs and the responsibility to oversee the agency starts and stops with you. As the 7(a) lending industry, we strongly join you in calling on both SBA lending partners and the SBA itself to continue their efforts to maintain the integrity of the program. Our joint goal is for the 7(a) loan program to stand the test of time in order to serve many more thousands of small businesses across the country. And, NAGGL members fully understand that it is in their individual and collective best interests that SBA continue to engage in a sustained, effective lender oversight program to meet that goal.

History shows that the lending community is aware of the need to work with the SBA to police itself. For example, it was the 7(a) industry that raised concerns about the SBA's implementation and management of the now discontinued LowDoc Program soon after it was introduced. Why? There were no written policies for quite some time after the LowDoc pilot program was implemented. Similarly, in the 1990s, it was NAGGL that raised concerns to SBA and Congress about the practices of the industry's then largest lender. Also, in 2007, I testified before the Senate Small Business Committee to advocate for continued onsite reviews of 7(a) lenders, insisting that offsite reviews alone would not be enough to capture potentially risky behavior. I could go on, but the evidence is clear:

lenders and the industry do care about the integrity of the 7(a) loan program.

At the same time, it is also important that the lender oversight pendulum does not swing too far in the opposite direction resulting in lenders and borrowers finding the program unattractive, or resulting in duplication of existing oversight activities from other regulatory agencies (as well as a duplication of the costs already associated with those activities). It is an established fact that the bank and credit union industries already have substantial lender oversight from the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Federal Reserve Board (FRB), and various state banking regulators. NAGGL has always believed that SBA should be required to demonstrate that it is adding value to current federal and state oversight efforts, not merely duplicating existing efforts.

So, what is a current snapshot of SBA oversight? The SBA Office of Credit Risk Management (OCRM) is working overtime at smart, effective oversight of a fast-growing program.

One notable improvement is OCRM's coordination with other federal bank regulators. In 2007, when testifying in the Senate, I advocated for SBA to partner with the federal and state banking regulators on procedures and lenders of interest to ensure that the safety and soundness testing of SBA portfolios was being conducted in a way that was consistent with the requirements imposed on participating lending partners by their regulators. I said then:

> "We recognize that an inter-regulatory agency partnership will require the commitment and cooperation of several agencies; however, we believe that this type of arrangement is necessary to provide the most cost effective and meaningful determination of risk. We would hope that the SBA is willing to pursue this avenue prior to arbitrarily requiring that participating lenders bear the cost of additional regulatory examination."

In the final months of 2016, nearly ten years after that testimony, SBA entered a Memorandum of Understanding (MOU) with the FDIC to coordinate information sharing on mutual 'lenders of interest'. NAGGL continues to encourage SBA to negotiate similar MOUs with the OCC and the Federal Reserve Board. This kind of coordination reduces duplication of federal efforts and is critical to an SBA oversight process capable of keeping up with lending program growth.

It is important to note that just a decade ago, the SBA's oversight efforts only applied to the largest lenders, even though its own statistics showed lenders with portfolios under $1 million still pose a significant risk to the 7(a) loan program. And it was only recently, in December 2014, that the SBA created and implemented the PARRiS review system, a risk-basked review protocol that oversees all 7(a) lenders and takes into account qualitative and quantitative performance data. PARRiS stands for "Portfolio Performance," "Asset Management," "Regulatory Compliance," "Risk Management," and "Special Items." The PARRiS methodology is meant to better identify a lender's specific risk areas, assess the level of risk a lender poses to SBA, and to make recommendations for corrective action. Lenders are scored "1" through "5" as part of a data-driven lender-profile assessment. Lenders are also subject to multiple levels of scrutiny and reviews, from analytical and virtual to full onsite reviews.

By most regulatory practice standards, having been implemented just two years ago, the PARRiS system is in its infancy. We encourage you, as authorizers, to allow the PARRiS system to continuing to develop ever greater sophistication and to support SBA's ongoing improvement efforts. For instance, this past January and after nearly two years of advocacy on the issue, NAGGL successfully shepherded through a policy change in PARRiS that establishes a lender mission rating in the methodology used to risk rate lenders. Prior to this change, PARRiS' lender risk rating did not account for traditionally lower performance of loans to underserved markets, yet lenders were simultaneously strongly encouraged to focus on underserved markets. Now, with this policy change to PARRiS a reality, lenders are given "credit" if they meet certain benchmarks in lending to an underserved market (small loans, loans to rural communities, minority-, women-, and veteran-owned businesses, startups and export businesses)—in other words, the oversight review process will no longer be at odds with the public policy mission of SBA lending.

But these are only pieces of an effective lender oversight puzzle. Authorizers, appropriators, and the SBA must commit to an open flow of communication regarding what is needed to get the job done. For example, does OCRM have adequate resources to conduct the full range of their oversight activities? Is there enough OCRM staff? These questions are especially relevant as we see continued increased demand for the SBA programs from small business borrowers.

Since Fiscal Year (FY) 2014, the authorization cap has increased by 51% (Note: while the program operates at zero subsidy, it relies on an authorization cap set by the Committees on Appropriations in close conjunction when the authorizers every FY). The net dollars in loans that were disbursed from participating banks to small business borrowers, the amount of lending increased by about 28%. This growth is a result of a confluence of factors, but most pertinent to this conversation is that as a gap financing program lending where borrowers cannot find capital conventionally, we *should* be growing at a time when conventional lending to small businesses plummeted post-Recession and has yet to reach pre-Recession levels. The very fact that volume increased at a time when conventional lending receded from the market clearly demonstrates that the 7(a) loan program is indeed doing its job as a gap financing program.

No one could predict how many small business borrowers would turn to the 7(a) loan program in the wake of the Recession, nor how many lenders would see the SBA as an avenue for being able to help small business borrowers that they were otherwise turning away. While the gap in access to capital has *always* existed for small business borrowers, the climate post-Recession exacerbated this gap.

With the leadership and action of the House Small Business Committee, the Senate Small Business Committee, the House and Senate Committee on Appropriations, and House and Senate Leadership, the 7(a) program has continued to serve small business borrowers despite the fact that borrower demand reached the program's authorization cap prior to the end of the fiscal year in both FY 2014 and FY 2015. In both of those fiscal years, the House and Senate were able to pass language that allowed for the program to be reinstated and avoid a mid-fiscal year shutdown. Allow me to take a moment to thank you all for your continued support of the program.

7(a) volume is a sign of great success for the program. This period of growth is also the perfect time to ensure oversight is run appropriately as our potential balance sheet has more than doubled in size over approximately two-and-a-half years. As a trade association, NAGGL believes it is perfectly reasonable to ask questions about whether the oversight capabilities of SBA have grown commensurate with the increased volume of the lending program.

NAGGL and SBA lenders are incredibly proud of who we serve and the role we play in each of your individual districts. Over the past several years, lending to nearly every underserved market—from veterans, rural communities, urban areas, women, Hispanics, and African Americans, to name a few—has increased. While we can always do more to improve access to capital to these markets, we are confident that the 7(a) lending industry is fulfilling the intent of Congress to serve the country's small businesses. Put simply, the issues that 7(a) loans solve are the issues that every Main Street across the country struggle with, and which every legislator, whether Republican or Democrat, wants to desperately find an answer to over the next four years—jobs, community rejuvenation, and opportunity.

Chairman Kelly and Ranking Member Adams—I would be pleased to answer any questions.

March 9, 2017

Testimony of

Edward C. Ashby, III

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Chairman Kelly, Ranking Member Adams, and members of the Subcommittee, I am Ted Ashby, President and CEO of Surrey Bank & Trust, Surrey Bank is a community bank headquartered in Mt. Airy, North Carolina with $278 million in total assets. I appreciate the opportunity to present the views of the American Bankers Association (ABA) on the state of the Small Business Administration's (SBA) 7(a) Loan Program and the importance of this program to my community and banks like mine, The ABA is the voice of the nation's $16 trillion banking industry, which is composed of small, mid-size, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $9 trillion in loans.

Our bank was chartered in 1996 with a focus on business lending. At my bank, as is true of my banker colleagues around the country, we are intensely focused on building and maintaining long-term relationships with our customers. We view our customers not as numbers but as individuals and business owners. The success of Surrey Bank is inextricably linked to the success of the communities we serve. They are, after all, our friends and neighbors.

Small businesses are an engine of growth and job creation for the U.S. economy. In order for small businesses to grow, they require safe and reliable funding. Community banks in particularly focus intensely on small business lending. According to the FDIC, community banks increased small loans to businesses (defined as less than $1 million) at more than twice the rate of non-community banks in 2016 and account for 43 percent of all small loans to businesses.

The SBA programs are an important part of business lending for many banks. It helps fill a critical gap, particularly for early stage businesses that need access to longer-term loans. The guarantee helps reduce the risk and capital required for banks and facilitates loans that might never have been made without this important level of support.

In 1999, Surrey Bank began using SBA and other government sponsored credit enhancement programs as a tool in its strategy of helping local companies meet their credit needs. As a portfolio lender, this allowed our bank to attract a wider range of customers and improve the financial condition of the bank. SBA granted Surrey Bank its Preferred Lender Status in 2003 after determining the bank had sufficient experience and resources to properly administer the program. Since that time, the bank has actively participated in the SBA 7(a) Loan Program and has earned "Community Bank of the Year" award in North Carolina twelve of the past fourteen years.

Participation in the SBA 7(a) Loan Program is an integral part of our business model as a commercial bank. The bank has $212 million in outstanding loans, of which about 67% (or $142 million) is for business related purposes. Currently, the bank has $34.7 million in SBA loans of which $26.5 million is guaranteed by SBA. Thus, a total of 18.7% of our business related loans and 12.5% of all loans have SBA guaranties.

The success of the SBA 7(a) Loan Program for my community and Surrey Bank is evident by the 174 active loans with an average loan size is $199,366. As an example, the bank extended credit to a pre-cast concrete company that opened in 2007. Economic activity was far below expectations and the borrower experienced difficulty generating working capital to invest in new work orders. The bank used SBA's Cap Lines Contracts Loan Program to fund the individual orders. This company now generates sufficient cash flow to funds its operations without SBA or bank assistance. Also, the bank extended credit to a start-up operation engaged in traffic and safety control for highway and bridge construction. The company started in 2004 with four employees and two trucks. Since inception, the bank has extended them 23 SBA loans over 12 years to fund expansion. The company now has annual revenue over $12,000,000, a fleet of over one-hundred vehicles and 90 employees. Our success is replicated over and over across communities in this country. This is why ABA supports the Small Business Committee's effort to build on the positive aspects of the Program and consider improvements that would benefit the business community.

In my comments below, I will outline some of the positive aspects of the program and provide some suggestions for improvements to make the program even more effective.

Positive Aspects of SBA 7(a) Loan Program

Let me begin by complimenting the staff in the SBA's North Carolina District Office. Our bank has received a high level of support and encouragement from District Director Lynn Douthette and her staff. The professionalism and dedication to help small businesses and banks is part of the equation of success of the SBA programs. In addition, the complementary local programs, particularly the free counseling through SCORE (Service Organization of Retired Executives) has proven very helpful in mentoring business clients.

Here are some key features of the SBA Program that are very positive:

> The Express Loan Program is very effective. It reduces the level of paperwork, utilizes the internal loan policies of the originating bank and reduces the cost of the transaction to the small business customer.

> Loans to start-up businesses require a business plan as part of the approval process. This requirement has proven very useful in helping the owner to consider various facets of the business that are essential to achieve profitability and grow the company.

> The program allows the use of projections in start-up businesses to underwrite cash flow to support the credit request. Under conventional financing, banks would normally require an abundance of collateral or a guarantor with a high level of liquidity to grant credit.

> The credit score generated by the SBA software to determine eligibility is very helpful in providing fast response times to prospective borrowers.

> The program provides for extended loan amortizations on secured loans at a higher percentage of the useful life of the collateral. This improves the borrower's cash flow.

> The advance rates on secured loans are higher than general loan policy. This reduces the amount of working capital a small business needs to invest into the fixed assets of the business.

> The program provides for a long-term commitment without the time, expense and uncertainty associated with of balloon payments typically used in conventional financing.

> Loans can be underwritten based on cash flow without relying on collateral coverage or book equity in the business as a condition for credit.

> The use of "Delegated Authority" for Preferred Lenders allows the bank to modify loans. This provides the borrower an opportunity to work through short term cash flow issues and or reschedule debt payments without being forced into liquidation.

> Veterans enjoy reduced fees on loans between $150,000 and $700,000.

Opportunities for Improving the SBA 7(a) Loan Program

Below are some examples of how the program can be improved, primarily relating to the servicing of SBA loans:

> SBA loans cannot be consolidated or refinanced by the same lender. In instances where the borrower is experiencing rapid growth, the bank is required to make multiple loans on the same collateral. Frequently, loans are cross collateralized, which make extending additional loans more complex. Serv-

icing and administration of the loans is difficult for the borrower and the bank.

> SBA guidelines no longer allow a bank to obtain a guaranty to avoid regulatory loans-to-one-borrower limitations. This is a disadvantage to small banks that are portfolio lenders attempting to meet the credit needs of customers in their market. A carve-out for banks that are under $1 billion in assets engaged in portfolio lending should be considered.

> The use of subcontractors in the liquidation process at times resulted in confusion over the correct version of the Standard Operating Procedures (SOP) used to determine eligibility for repurchase. This caused delays in the liquidation process. We suggest sub-contractors receive additional training on identifying the appropriate SOP in affect when the loan was originated.

> A loan is liquidated based on the type of loan program. When a borrower has multiple loans, liquidation can involve multiple service centers in different states. This creates a duplication of work for the bank. More importantly, borrowers have a difficult time making an "Offer in Compromise" until all claims are processed.

> The SBA One platform is not fully operational, which results in duplication of work to produce the forms required to properly close the loan.

Conclusion

The health of the banking industry and the economic strength of the nation's communities are closely interwoven. We strongly believe that our communities cannot reach their full potential without the local presence of a bank—a bank that understands the financial and credit needs of its citizens, businesses, and government. The SBA 7(a) Loan Program is a success and should be vigorously supported in the future. It has encouraged economic growth in our community and allowed Surrey Bank to meet the credit needs of many small businesses. The positives of the program are many and the areas of improvement are primarily related to servicing aspects of the program.

Before closing, I want to express the concern shared by many of my banking colleagues that the community banking model we know today will collapse under the massive weight of rules and regulations. Lack of earning potential, regulatory fatigue, lack of access to capital, limited resources to compete, inability to enhance shareholder value and return on investment, all push community banks to sell. The Dodd-Frank Act has driven all of these in the wrong direction and is leading to consolidations with very real consequences for local communities.

Last year 251 banks disappeared; since Dodd-Frank was enacted, nearly 2,000 banks have merged or closed their doors. For community banks, it goes beyond just our parochial interests. We are very much a part of our community. It is why every bank in this country volunteers time and resources to make their communities better. If the relentless pressures on our small banks are not relieved, the loss will be felt far beyond the impact on any bank and its employees. It will mean something significant has been lost in the community once served by that bank. This is why it is imperative that the Administration and Congress take steps to ensure and enhance the banking industry's capacity to serve their customers, thereby facilitating job creation and economic growth.

Credit Union National Association
CUNA

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March 9, 2017

The Honorable Trent Kelly
Chairman
House Small Business Subcommittee on
Investigations, Oversight and Regulations
Washington, DC 20515

The Honorable Alma Adams
Ranking Member
House Small Business Subcommittee on
Investigations, Oversight and Regulations
Washington, DC 20515

Dear Chairman Kelly and Ranking Member Adams:

On behalf of America's credit unions, thank you for holding the hearing "An Overview of SBA's 7(a) Loan Program." The Credit Union National Association (CUNA) represents America's state and federally chartered credit unions and their more than 100 million members.

Credit unions are active participants in the Small Business Administration (SBA) loan programs. At the end of 2016, there were 400 credit union SBA lenders – collectively they reported $1.6 billion in SBA loans outstanding in 8,134 individual loans (the average SBA loan size is roughly $197,000).

We encourage Congress to improve credit unions' ability to offer SBA 7(a) and government guaranteed loans. Specifically, Congress should exempt government guaranteed loans in their entirety from the credit union member business lending cap; currently, only the guaranteed portion of the loan is exempt.

SBA guaranteed loans are important for borrowers who otherwise would not be able to receive a conventional business loan. Unfortunately, the loans are complicated to make and the costs of these loans are more expensive than conventional loans for both the lender and borrower. Specialized staffing is also necessary for credit unions to participate in SBA lending.

We encourage the SBA to simplify and clarify the language of its regulations, eliminate inconsistencies and conflicts that make rules more complex and confusing, allow electronic submission of standardized forms, and incorporate industry consensus standards into regulations as appropriate. These changes will allow credit unions to tap their considerable potential for increased SBA lending.

On behalf of America's credit unions, thank you for holding today's hearing. We look forward to continuing to work with you to find ways to improve the SBA 7(a) program and other SBA loan products.

Sincerely,

Jim Nussle
President & CEO