SBA 7(A) BUDGET PROPOSAL AND THE IMPACT OF FEE STRUCTURE CHANGES

HEARING

BEFORE THE

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OF THE

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SBA 7(A) BUDGET PROPOSAL AND THE IMPACT OF FEE STRUCTURE CHANGES

WEDNESDAY, APRIL 10, 2019

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX, AND CAPITAL ACCESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:04 a.m., in Room 2360, Rayburn House Office Building, Hon. Andy Kim [chairman of the Subcommittee] presiding.

Present: Representatives Velázquez, Kim, Davids, Delgado, Crow, Hern, and Stauber.

Chairman KIM. Good morning. The Subcommittee will come to order.

I want to thank everyone for joining us this morning, and I want to especially thank the witness—witnesses who have traveled from across the country to be here today.

Just before we jump into things, I do want to just remark that we will have votes coming up shortly. We are going to try to see if we can get through some of our opening remarks before we are able to—before we are called over to go and vote. So I am just going to just jump straight in here.

On this Subcommittee, we are focused on making sure that small businesses, whether in my district or in Ranking Member Hern's district in Oklahoma, and every district across this country, can access the capital that they need to start, grow, and create new jobs. And we know that when capital is affordable and accessible, small businesses can do what they do best, which is strengthen our communities and fuel our economy.

This is certainly something that I have witnessed firsthand in my own home State in New Jersey, where we have more than 850,000 small businesses, making up 99 percent of our State's businesses, employ over half of our workers.

Recognizing that access to capital is a challenge for many entrepreneurs, SBA offers a variety of loan programs designed to help borrowers who may have a difficult time securing financing through other conventional lending markets, which brings me to the reason that we are here today, and that is to ensure that SBA's flagship 7(a) loan guaranty program is functioning to best serve our small businesses and taxpayers.

This critical program has been a vital source of capital access for thousands of small businesses in my home district since 2008. In 2018 alone, the 7(a) program has supported 204 businesses in my district, totaling over $58 million in loans. Additionally, the program has served businesses in an incredibly wide range of industries ranging from catering companies to nurseries.

Under the 7(a) program, SBA partners with banks and nonbank lending institutions who make up loans to small businesses, with SBA reimbursing a portion of the loan in the event the borrower defaults, also known as the guarantee. This guarantee minimizes the lender's risk in making the loan to the small businesses. And generally, SBA guarantees from 50 to 90 percent of each 7(a) loan made, depending on the loan characteristics.

Now, to offset that cost of issuing these guarantees, SBA charges an upfront, one-time guarantee fee and an annual ongoing service fee for each 7(a) loan approved and dispersed. Now, traditionally, one of SBA's goal is to achieve a zero subsidy rate for its loan guaranty programs, including for the 7(a) loan. This occurs when the programs are projected to generate enough revenue through fees and recoveries of collateral to issue that year's guarantee without requiring congressional appropriation.

Now, to calculate that subsidy rate, SBA and the Office of Management and Budget use an econometric model that takes into account numerous macroeconomic and SBA-specific assumptions, and if they predict a shortfall, SBA requests an appropriation from Congress to address it.

Now, excluding the period from 2010 to 2013, when our Nation was recovering from the Great Recession, SBA has operated at zero subsidy since 2005. However, in its congressional budget justification for fiscal year 2020, SBA predicts that without modifications to the current law, it cannot achieve a zero subsidy rate for the 7(a) program.

I look forward to hearing from Mr. Gribben about what goes into the calculation and understanding of why cash outflows exceed inflows resulting in a positive subsidy in the 7(a) program for fiscal year 2020.

In response to the positive subsidy, SBA proposed numerous and considerable fee increases on both borrowers and lenders, and this caused a great deal of anxiety among small businesses, small business borrowers, and the lending institutions that participate in the 7(a) program. Any increases in fees like those SBA has suggested to cover this shortfall could result in fewer small businesses applying for and getting access to capital, and that is why today's hearing is so timely and important.

And I look forward to hearing from our witnesses on potential solutions to this issue. And we can all at least agree that these programs are incredibly important, and I look forward to working with my colleagues on both sides of the aisle to address the challenges facing our small business owners when it comes to securing capital.

Again, I want to thank all the witnesses for being here. I now yield to the Ranking Member, Mr. Hern, for his opening remarks.

Mr. HERN. Thank you, Mr. Chairman.

Mr. Gribben, thank you for being here.

Despite ongoing positive economic news, the Nation's smallest firms continue to face challenges when it comes to regulations, saving for retirement, access to capital. I know these challenges personally and professionally. I have been a small business owner for over 34 years. Additionally, I have served 17 years on bank executive boards; 13 years on McDonald's leadership team, which represents over 3,500 franchises; 8 of those years as ombudsman; 5 years as Chairman of the Systems Economic Team; 5 years on the McDonald's Tax Policy Team; and 8 years on the McDonald's Insurance Corporation Board. I know these issues facing our Nation's smallest firms firsthand.

In order to help fill the gap that exists for small businesses when it comes to access to capital, the Small Business Administration offers numerous financing and lending options. The flagship and largest program is the 7(a) loan program that does not provide direct loans to small businesses but provides guarantees on the loans made by partnering financial institutions to eligible small firms.

The program has grown rapidly in recent years with the program's authorization cap going from $18.75 billion fiscal year 2015 to fiscal year 2020 budget request of $30 billion.

Additionally, the 7(a) loan program has built-in fees to help offset the cost of any losses in the program per the Federal Credit Reform Act of 1990. Because fees have been sufficient over the last half dozen years, the program has been running on zero cost to the American taxpayer.

Within the fiscal year 2020 budget submission, the model that calculates the cost of the program indicates that the 7(a) loan program will no longer be at a zero subsidy. Rather, the program may require $99 million appropriation for and by American taxpayers or an adjustment to the fee structure that hits program participants.

According to CRS, the average loan size in the SA loan—7(a) loan program is approximately $420,000. That is a total of $25.4 billion in loans last year, over 60,000 total loans. A bill is important to run this average to the SBA's legislative proposal that would bring the program to zero subsidy.

While I acknowledge there are nuances to the fee structure, the average loan size of $420,000 does not seem to be impacted by the fee proposal if the maturity of the loan is more than 12 months.

The upfront fee that goes to borrowers on the small business owner for loans of $500,000 or less seems to remain at 3 percent. Additionally, that fee that lenders have to pay, the ongoing fee, also does not appear to change for loans under $500,000.

However, before we entertain the legislative options of either appropriation or fee change to close this potential $99 million gap, we must explore the reasons behind the shortfall and gain a better understanding of the model used to calculate the cost.

What variables or assumptions are used in a model and has the model changed over the years? I look forward to both panels that will explore these questions and more.

And, Mr. Chairman, I ask unanimous consent to enter this letter from the Credit Union National Association, that is addressed to you and I, and it is challenging us to find an amiable solution to keep this program viable.

Chairman KIM. So ordered.

Mr. HERN. And, Mr. Chairman, I yield back.

Chairman KIM. Thank you.

We certainly are very blessed to have the extraordinary experience that the Ranking Member brings to the Small Business Committee, and he and I are committed to be able to work on this in a bipartisan way. Hopefully before votes, we will be able to finish on up, so I just wanted to have a chance to be able to introduce our first witness here.

Our first witness is Mr. Tim Gribben. Mr. Gribben is the chief financial officer and associate administrator for performance management at the U.S. Small Business Administration. And in this role, he has the responsibility of all aspects of SBA's financial management, internal controls, and acquisition. He has been with the SBA since 2009, when he started as a director of performance management and deputy performance improvement officer.

Mr. Gribben, why don't we just jump right in. You are recognized for 5 minutes.

STATEMENT OF TIM GRIBBEN, CHIEF FINANCIAL OFFICER AND ASSOCIATION ADMINISTRATOR FOR PERFORMANCE MANAGEMENT, U.S. SMALL BUSINESS ADMINISTRATION

Mr. GRIBBEN. Thank you, Chairman Kim, Ranking Member Hern, and members of the Committee. Thank you for inviting me to discuss SBA 7(a) loan program and our fiscal 2020 budget proposal.

I have served as the chief financial officer or the deputy CFO for nearly 7 years, and every year, with respect to our 7(a) loan program, my office engages in a process to evaluate and project loan performance. This process occurs annually, notwithstanding administration, and is a routine executive branch function.

My written testimony provides greater overall detail on that process, so let me provide some general context and walk you through the basic steps we take every year. First, we model for future loan performance. Next, we determine what fee structure to achieve zero subsidy, and then we review what the agency might be able to offer for fee relief if that fee—if it shows that the fees could be set to achieve fee relief.

Every year, my office looks closely at the elements that go into our model, and we make refinements to more accurately capture and reflect the future loan performance. The goal is to determine the true cost of the program and then to set our fees accordingly. The model is thoroughly reviewed by the agency, by a third-party contractor, by the Office of Management and Budget, and also by our external auditor every year.

Looking back at trends over the last couple of years, we have been near or at the ceiling for our statutory fee structure, and as a result, we have not been able to offer the same fee relief each year. These recent trends bring us to this year's budget discussion and the projection of a positive subsidy rate for the fiscal year 2020 program under current law.

In order to operate our 7(a) program in fiscal year 2020, SBA will either need an appropriation of Federal dollars or an adjustment to the fee rates. In our annual budget submission and in our briefings that we did to the different Committee staffers over the last few weeks, the agency presented options for Congress so as to support an annual level of $30 billion in 7(a) loans.

The fee—the first option would involve a subsidy appropriation of $99 million; the second option involves statutory changes to the fee structure in order to maintain zero subsidy; and the third option involves a combination of statutory changes to the fee structure and an offset to the agency's business loan administration cost also to maintain zero subsidy.

Our annual budget and my written testimony also prevents—presents details on the proposed fee structure. We attempt within that fee structure to maintain the ability to incentivize small dollar loans and lending in underserved communities.

In closing, Mr. Chairman, the agency's annual modeling and performance projects a positive subsidy rate for fiscal year 2020. And it is important to note that even absent refinements that my office makes to performance assessments, the program still projected a positive subsidy for the next fiscal year, and the Committee and Congress will need to consider options for the agency's 7(a) loan program.

Thank you again, Mr. Chairman, for inviting me to testify today, and I look forward to answering any questions that you may have.

Chairman KIM. Okay. Great. Thank you for your testimony here. I am going to start off with a couple questions of my own, and it looks like we have a little bit more time to go, so we will get through as much as we can.

Well, the reason we are here today is to examine the proposed changes to the 7(a) program and to ensure that any of these proposed changes would not further strain capital access for small businesses.

Now, to that effect, the goal of the 7(a) program is to operate at zero subsidy, meaning that fees and collections cover the cost of running the program. And as we heard from your testimony, we are aware you are now predicting the program to generate sufficient revenue in fiscal year 2020, meaning that the program will be operating positive subsidy.

I wanted to ask, will the 7(a) program have to shut down if the program remains in positive subsidy?

Mr. GRIBBEN. Absent an appropriation for dollars, it would have to shut down, yes.

Chairman KIM. So if Congress does not appropriate the money or the raised fees as you proposed, it would have to shut down?

Mr. GRIBBEN. That is correct.

Chairman KIM. So the program is not historically funded by appropriations, so I would like to take a deeper dive into the calculations that projected the need for additional funds to keep the program going.

SBA's economic modeling and OMB's economic assumptions are leading to a bleak outlook for fiscal year 2020 performance—program performance. And right now, it is still unclear to me what factors went into that model and the weight each of them carried when the model was calculated.

You know, for example, the Small Business Act's requirements do not factor in good and bad economic times, so why would it make sense to propose a scenario where assumptions are tied to adverse economic trends if the Small Business Act itself doesn't contain such assumptions?

Mr. GRIBBEN. Prior to 2014, the—our subsidy model was not as—did not take into account the macroeconomic assumptions, and as a result, it was leading to large upward subsidy reestimates. That is—that is the reestimate process that we do every year to see the assumptions that we made in prior years, is that meeting the actual performance projections, and the answer is that it was not.

So we made a modification to the model in twenty—that we introduced in 2014 to take the long-term macroeconomic assumptions into account. When a loan is made in times when the economy is good and if the projections are a change in the assumptions over the long term, those loans have a tendency to default at a higher rate than when loans that are made when the economy is bad and the projections are assuming that the economy will improve over time.

That is why, as part of the Federal Credit Reform Act, we are supposed to take things like that into account to bring the cost of the program into today, rather than having it borne by future reassessments being paid by the taxpayers that way.

Chairman KIM. Well, I just want to dive into, you know, one of these particular issues that I am having trouble understanding through. Now, the programs—when we look at the 5-year average recovery rate on the defaulted loans as reported to Congress last December was about 50 percent. But that seems to stand in contrast to the fiscal year 2020 budget, which assumes a projected recovery rate of only 37.29. So I just wanted to get a sense from you how that is being generated and why there is a discrepancy there.

Mr. GRIBBEN. There is—it is two different ways at looking at the performance measures. So the 50 percent number that you are mentioning is looking at all the purchases that were made in a 5-year period of time, all the recoveries on those purchases made over a 5-year period of time, regardless of the year that those loans were approved. And in June of 2018, that was 50 percent, according to a 5-year rolling average. That number has also changed. It has decreased since that time.

But in the model, we have to look at it from the aspects of that—what will happen with the cohort that—the loans that are made and approved in that year over the lifetime of those loans. That is a different way of looking at it. It is not looking at it from a portfolio perspective, which is what the Office of Credit Risk Management uses, it looks at it as what is this loan cohort going to look like over the future of the loans. And in that case, the—when you look at it from that perspective, that is where we calculate the 37 percent. That is what history is showing us.

Chairman KIM. So I think the main thing that you are likely to hear from all of us today is just that, obviously, this is an incredibly important program, and a lot of small businesses depend on this type of access to capital. And when we are experiencing right now is something that really stands at a fundamental moment of what are we going to do with this going forward.

So what we need from you is just an assurance that you are going to be able to provide us with the details that we need, the documentation that we need to understand what went into your calculations and why it is that we face this decision before us here in Congress right now.

So I just want to have your assurances there that we are going to be able to get those documents and be able to work with you on an expedited timeline so that we can understand what went into this and we can understand the decisions that are placed before us that didn't have to come before us in any other previous year.

Mr. GRIBBEN. We can provide more information. As an example, the briefings that I have been providing more details into the model. The models are very complex. They do use some information that are agency projections and projections from the Office of Management and Budget.

And the models are thoroughly reviewed. The documentation on the assumptions of what changed from the prior year, the inputs into that model, those are all reviewed by external parties to determine that the agency is doing the best job it can to forecast future performance to make sure that we are accurately reflecting the cost of those programs today over the lifetime of the loans that are being—that the loans will be serviced.

Chairman KIM. No, that is—I appreciate that insight. And I look forward to working with you on this more, because, you know, as we are being asked to consider, you know, $99 million in taxpayer money, we just need to make sure that we are doing our due diligence and thoroughly analyzing whether or not that is a good use of the taxpayer dollars and if every other effort has been made to try to avoid that from happening. And I think right now, we just want to think of this as a factfinding operation, be able to get everything that we need for us to be able to make those considerations.

One last question for you. As we are going through this, based on what you know and the processes that you were running there, do you think that we need to be able to speak with OMB to be able to have a full picture of what is going on here?

Mr. GRIBBEN. I personally don't believe that is necessary.

Chairman KIM. Okay. Well, I am going to turn it over to the Ranking Member here for a couple questions.

Mr. HERN. Thank you, Mr. Chairman.

Mr. Gibben—Gribben, I am sorry—as mentioned in the opening statement, the 7(a) loan program has been growing rapidly over the last couple years, $18.75 billion, 2015, to $30 billion in 2020. And the congressional budget indicates the number will be $99 million that you need for the $30 billion program.

In your testimony, you state there are three main inputs into the model: performance assumption, cohort composite assumptions, and macroeconomic assumption. Are these variables weighed the same?

Mr. GRIBBEN. They are treated differently. The—but they all go into factoring what the cost of the program might be. The model looks at the actual performance of the portfolio over 26 years. That has the bigger impact on the model than anything else, that and the projections for—when we—I said we—in 2014, when we introduced the changes to the model to put greater weight on some of the macroeconomic assumptions, it was on long-term unemployment. So the history of unemployment and the projections of unemployment in the future have the biggest impact on the model than most of the other factors.

Mr. HERN. Yeah. So I have a lot of questions around it. But in fiscal 2020, the congressional budget justification, you stated that you altered how your estimate—estimate purchase amounts. Can you describe in detail the old method versus the new method?

Mr. GRIBBEN. The old method was taking a simpler approach to—what we have to try to figure out is, in the future, what percentage of the loans that are approved in that fiscal year are going to default and at what amount we would have to purchase them. The old model was assuming there was a period of time from the time that a loan went into default until it was actually purchased.

When we look at the actual history, the time length between when a loan defaults and when it is actually purchased was longer than the model had been assuming. So taking that into account, what that means is the purchase amounts on average over this span of 20 years was about 8 percent higher than the model had been forecasting.

So we changed the—we changed the way that we looked at the—that time to calculate what is an average default to purchase event and to be able to calculate what a purchase amount would have been. That was the refinement that we made for this 2020 model.

Mr. HERN. You also state that you annually test the predictive ability of the existing assumptions and adjust the methodology as necessary. I think that is what you were just referencing.

So I have got a couple questions. Since you also have a program, SBDC, where you are out helping folks understand their business models before they ever get a loan or go to a lending institution as a service to small businessmen and women in America, based on what you have seen with failure rates, have you adjusted that coaching model that you have out there to maybe look a little more stringent at business plans to make sure they are more long-term viable as opposed to what is causing the failures now? Or would you say it is a naturally not predictable failure rates that are going on?

Mr. GRIBBEN. I am struggling to answer that question just because I am not sure exactly what the Small Business Development Centers, when they talk to the small businesses about potential lending, what they might be discussing with them.

Mr. HERN. Well, it just seems that if you have got businesses that are failing and you are responsible, you are going to come back and ask the American taxpayers for $100 million or ask small businessmen and women to pay—I am just running some numbers—anywhere from 23 cents a day to 46 cents a day over a life of a loan because there is a higher failure rate than you originally had predicted, that we would somehow, in that same guise of helping people actually get to these loans, that you would help them maybe not make the same mistakes as their predecessor.

I mean, you just referenced that you have taken 26 years of history and using that to formulate and sort of benchmark your model going forward, it seems like we would also take some of those failures maybe where you are advising some potential businessmen and women to not make those same mistakes again.

Mr. GRIBBEN. Which is exactly what happens in the micro loan program. That micro loan program where the technical assistance is directly tied to the loans that are made, those—that is the counseling and training that they get that are really focused on their business plans and their ability to repay the loans over time.

And in terms of what I was referring to when we look at the assumptions that we make in the model to project future purchase events, the cash flows that are going to occur over the next 20 to 30 years of the lifetime of the loan, there are a number of different factors why a business might not be able to repay back a loan.

And we are trying to determine from—and there is a lot of factors that go into it, from geography to industry to loan sizes, the different sub programs that comprise the 7(a) category. There are a number of different factors why a small business might fail.

Mr. HERN. Sure. Well, I think that would help us understand, as the Chairman said, because as we are looking at failure rates that are beyond—or earlier than you originally projected that is causing the problem you are saying.

One last thing and then I will yield back. Since the 7(a) loans are sort of lender of last resort because banks say they can't take them, then you are obviously looking at something that may be a little riskier than a traditional commercial bank, that there has been a little bit less take rate in 2018, which would probably indicate that commercial banks are a little more willing to take more risk now, marginally more risk.

The failure rate, the predictability of the failure rate, also realizing that a traditional bank is not going to give you a 20-year fixed rate, so that is a unique thing, are you looking to see if banks have changed their model of evaluating the loans? I mean, it is a big portfolio. But I am just curious as the relationship of the bank and how they are looking at these business models.

Chairman KIM. If you can just be brief in your remarks here.

Mr. GRIBBEN. Okay. We do not look at it from that aspect. We look at it as the 7(a) portfolio. We look at the early indicators of default rates and use that to make projections for the 7(a) program itself.

Mr. HERN. Mr. Chairman, thank you.

Chairman KIM. I just wanted to recognize Representative Davids to be able to ask questions. You are recognized for 5 minutes.

Ms. DAVIDS. Thank you, Mr. Chairman.

Well, I appreciate the testimony that you have provided today. And I would actually love to follow up on the Ranking Member's line of questioning, because I think there has been maybe a view that we don't have a holistic approach to how the lending is happening and how the fee structure is working and the modeling that is being put out.

And I am not positive if that is where he was going, but it does seem as though with the—that there are maybe some missing links here for some of us. When we look at an unemployment rate that in the modeling is like optimistic maybe, and then we look at the projection of a—like a deteriorating or higher failure rate, I think the question is how—why do you think that is happening based on the modeling that you have got?

And then I suppose a follow-up question is, do you think it would be helpful for your program to start working with other programs within the SBA that is providing service—I see the votes just got called—but providing services to folks who are seeking to use the SBA 7(a) program?

Mr. GRIBBEN. So in answer to your first question, if you look at the history of the fee structure, where the fees have been set, and our ability to offer fee relief, the pattern is clear that over the last few years, we are not able—we were not able to offer the fee relief that we were able to offer in the prior year, because we were coming closer and closer to that point where the fees were not going to cover the expected future defaults.

So that is where—when you look at that trend over time and you look at 2020, that is where the tipping point happened. And so there—and it is, I admit, it is an extremely complicated model. There are a number of things that go in to try to predict and project what might happen in the future, and there are a lot of assumptions that we have to make, which is why we have 26 years of data now to help us.

In the very beginning of credit modeling, it was more difficult when we switched to the Federal Credit Reform Act way of calculating these future costs. This is also something—when you mentioned the banks, this is something that they are going to be faced with the new accounting rules of how they are going to have to calculate their loan loss reserves.

But in terms of the subsequent question about the feeding—the—and correct me if I am misstating, but it is how we partner with other loan program—the other programs within the SBA in regards to the 7(a) loan program. And under my office is also the Office of Performance Management, so we closely tie all the strategies, the priorities of the agency, and as that relates across the different program offices, whether it is capital access or the Office of Entrepreneurial Development, in order to make all of the programs successful, whether it is 7(a), whether it is the 8(a) contracting loan program, in order to be able to achieve the mission of the agency to be able to support small businesses to be able to help them grow and achieve their goals.

Ms. DAVIDS. Thank you. I yield back.

Chairman KIM. Okay. We are going to try to do two more before we have to run for votes. So I just want to recognize Representative Stauber for questions here for 5 minutes.

Mr. STAUBER. Thank you, Mr. Chair. I just have one question.

Mr. Gribben, in your testimony, you state that performance assumptions you use over 25 years of historical 7(a) program and the macroeconomic data. But for the cohort composition assumptions you use characteristics, quote, from recent years. Please describe to the Committee why you use two different data sets.

Mr. GRIBBEN. We use the historical data in order to be able to understand the performance of the loan based on conditions of, let's say, what unemployment GDP might have been at that time. And we use assumptions for the future to be able to better predict performance of the loans over the future period. So we use past assumptions to help better inform our predictions for the future.

Mr. STAUBER. Thank you. That is my only question. I yield back.

Chairman KIM. I just wanted to recognize Congressman Crow quickly here before votes.

Mr. CROW. Thanks, Mr. Chairman. I will yield to my colleague from New York.

Ms. VELÁZQUEZ. Let me thank the gentleman for yielding.

Mr. Gribben, based on looking at the reestimate data, it appears that SBA's model has been somewhat inaccurate. There have been downward reestimates every year since 2010. Isn't that correct? Yes or no.

Mr. GRIBBEN. Yes.

Ms. VELÁZQUEZ. Okay. So given this, how can you defend raising fees again? Everyone in this room knows that you are going to end with a surplus, just like every year since 2010. Why do we have to play this game, sir? Whose idea is this?

Mr. GRIBBEN. This was——

Ms. VELÁZQUEZ. Is this your idea or is this OMB?

Mr. GRIBBEN. Oh, no, this is completely under the agency.

Ms. VELÁZQUEZ. Okay.

Mr. GRIBBEN. So prior—but if you looked at—prior to when I mentioned that the model changed in 2014, prior to that time, there were large upward reestimates. It was when we changed to take the macroeconomic factors into account that you see the downward reestimates in 2010, 2011, 2012, 2013. They didn't exist before.

Then if you look at it from the history since 2014, 2014, 2015 had higher reestimates than you see now, because once we made that change to the model, we also fine tuned it. We look at—and we have to look at each——

Ms. VELÁZQUEZ. Let me just say, I want every piece of document, every piece of document submitted to the Committee that will justify raising the fees. I will not do anything, no legislation until we are convinced that that is the way to move forward.

Let me say this to you, the mission of SBA is to provide resources and lending access to capital, affordable capital to those who cannot get it through traditional means. So the mission of the SBA is not going to be to make profit on the back of small businesses, and that must be clear.

I yield back to the gentleman here. Thank you.

Mr. CROW. One quick question, and it is regarding the Veteran Entrepreneurs Act program. And I know in the fiscal year 2020 budget request, the SBA says that it intends to offer the fee waivers for the veterans program, but in light of the clear direction that the SBA can implement these or the—the President's budget submission to Congress outlines the positive subsidy, obviously, which is what we are talking about here today for the 7(a) program. How do you think SBA can still offer those waivers under the veterans program?

Mr. GRIBBEN. Because we provided the option to achieve zero subsidy. Under the zero-subsidy scenario we can offer the veterans fee waiver.

Mr. CROW. So—but the entire budget—obviously, the entire request or the entire hearing today is about the fact that there is a positive subsidy, correct?

Mr. GRIBBEN. It is about the options that Congress has in order to achieve zero subsidy or to appropriate money. I view the hearing about the options.

Mr. CROW. All right. Mr. Chairman, I yield back.

Chairman KIM. Okay. Thank you.

Well, one thing is we are looking at these options because of, you know—because of, you know, what we are hearing from your particular administration. So, you know, this is something that we are going to have to look into very carefully.

I do want to recess right now for votes. We will come back afterwards, if you don't mind sticking around a little bit longer, as we do have a few other members that look like they might want to ask questions. I just want to make sure they have that. So we will come back in just a little bit.

[Recess.]

[11:44 a.m.]

Chairman KIM. Hi. Good morning. Thank you for your patience and sticking around with us as we wrangled our votes together down there on the House floor. Why don't we just jump right back in and just be able to get started here. I am just going to just briefly introduce the witnesses and then we can start with your remarks there.

So our first witness today is Mr. Tony Wilkinson. Mr. Wilkinson is president and CEO of NAGGL, the only national trade association representing the SBA 7(a) lending industry. He has served in this role for more than 25 years and is responsible for working closely with agency executives and the Small Business Committee and ensuring the continued stability and availability of the 7(a) program.

Our second witness is Ms. Lynn Ozer. She is the president of the SBA Lending Department at Fulton Bank headquartered in Lancaster, Pennsylvania. She also manages all the SBA lending, which covers my home State of New Jersey, Pennsylvania, Maryland, Delaware, Virginia, Washington, D.C., and 249 office locations.

Also, our next witness is Ms. Gail Jansen. She is the vice president of business services and operations at Kinecta Federal Credit Union, where she is currently responsible for all areas of loan origination within business services, has over 25 years in commercial lending experience.

And I would like to now yield to our Ranking Member, Mr. Hern, to introduce our final witness.

Mr. HERN. Thank you, Mr. Chairman.

Our next witness is Gordon Gray. Mr. Gray is the director of fiscal policy at the American Action Forum, which is the leader in pro-growth fiscal policies in Washington, D.C., and across the country. Mr. Gray is an expert on budget matters and has previously testified before the House Budget Committee. Prior to this current role, Mr. Gray held senior staff positions in the U.S. Senate, has spent time with the AEI, the American Enterprise Institute.

Mr. Gray, we are pleased to have you testify, and we welcome your participation.

Chairman KIM. Great. Thank you.

Mr. Wilkinson, why don't we start off with you. You are recognized for 5 minutes.

STATEMENTS OF TONY WILKINSON, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS; LYNN G. OZER, PRESIDENT, SBA LENDING, FULTON BANK; GAIL JANSEN, VICE PRESIDENT OF BUSINESS SERVICES AND OPERATIONS, KINECTA FEDERAL CREDIT UNION; AND GORDON GRAY, DIRECTOR OF FISCAL POLICY, AMERICAN ACTION FORUM

STATEMENT OF TONY WILKINSON

Mr. WILKINSON. Thank you, Chairman Kim, Ranking Member Hern. My name is Tony Wilkinson, and since 1987, I have served as the president and CEO of NAGGL, a national trade association representing lenders and other entities that participate in the SBA 7(a) loan program. Prior to this job, I was an SBA lender for a community bank based in Stillwater, Oklahoma.

The President's fiscal year 2020 budget request included what we believe is an unnecessary positive subsidy of $99 million for the 7(a) program. This is a major shift from the program's track record of operating at zero credit subsidy since fiscal year 2005, except during the years covered by the Recovery Act.

This subsidy calculation is not a proposal like the rest of the budget request. Congress must react to this calculation. Congress will have to appropriate $99 million or amend the Small Business Act to raise the current fee caps on borrowers and lenders to cover the cost of the program.

The President will need to sign into law one of these paths forward by September 30 or the popular 7(a) program will shut down on October 1. But first, we must collectively question the positive subsidy calculation. My plea is that you challenge both OMB and SBA to explain this subsidy estimate in detail.

The fiscal year 2020 budget documents provide insufficient justification for an increase in estimated program costs. The proposed subsidy increase does not track with performance data, and the subsidy calculation lacks transparency as neither SBA nor OMB has disclosed the details of their calculation.

We say this for three reasons. First, SBA has overestimated the cost of the portfolio year after year for nearly a decade. In the fiscal year 2020 budget, SBA reported for last year a $757 million excess subsidy reserve, meaning the program took money out of borrower and lender pockets and sent that money to the Treasury. Doesn't that sound like a tax, an unauthorized tax?

For all programs at the SBA, the overestimation of cost recognized last year totaled almost $1.5 billion, that is with a B, billion dollars. This is not an isolated incident. Since fiscal year 2010, the SBA 7(a) model has overestimated the cost of the program by almost $3.2 billion. This is a staggering amount of money that means nearly a decade of unnecessary fees on small business borrowers and lenders.

In fact, Congress has also been overcharged. In the few years when there were congressional appropriations, the fiscal year 2020 budget documents also show significant downward reestimates for those years, meaning that the—many of the appropriation dollars were not necessary.

In a series of GAO—in a series of reports, GAO describes a pattern of discrepancies between actual performance and SBA's projected performance, resulting in repeatedly overestimating the cost of the program. One GAO report documents that SBA hired Pricewaterhouse to conduct a study which found the subsidy rate calculation is perceived by SBA to be a tool for gaming the congressional appropriations process.

Another GAO report stated they could not determine whether a bias existed in the model by systematically excluding variables to influence the subsidy rate in a particular direction, and SBA could not provide adequate documentation to demonstrate the rationale for the model. These are alarming conclusions.

Actual portfolio—actual performance of the portfolio is starkly different than the projected portfolio. For instance, the program's 5-year average recovery rate on defaulted loans, as reported to Congress last December, was 50 percent. In sharp contrast, the fiscal year 2020 budget assumes a projected recovery rate of only 37.29 percent.

Why has the subsidy modeling ignored this established trend of steadily increasing recovery rates? Also, in fiscal year 2018, SBA reported a chargeoff rate of 0.51 percent, a historic low. We simply cannot see that there has been a negative shift in the performance of the portfolio.

Lastly, we are concerned that the model fails to take into account appropriate assumptions such as recent significant programmatic changes that have improved the performance of the portfolio. There is a troubling pattern in how SBA and OMB model the subsidy cost which GAO has highlighted over multiple administrations for the last 22 years.

SBA's preferred method to cover the unnecessary positive subsidy is to raise fees on borrowers and lenders. But without justification, how can we simply accept this projection? Based on the data we can see, there surely must be an error in the fiscal 2020 calculation.

Yes, Congress gave the executive branch authority to calculate subsidy cost, but Congress did not give unfettered authority for cost to be calculated without transparency or outside of congressional oversight. I urge you to challenge both SBA and OMB to explain the fiscal year 2020 subsidy model or this program and small business borrowers will suffer the consequences.

Congress created the SBA in 1953 to aid, counsel, assist, and protect the interest of small business concerns. Levying an unauthorized tax does not comply with this mission.

Thanks for inviting me here today, and I look forward to answering any questions.

Chairman KIM. Thank you, Mr. Wilkinson.

Ms. Ozer, over to you. You are recognized for 5 minutes.

STATEMENT OF LYNN G. OZER

Ms. OZER. Thank you, Chairman Kim, Ranking Member Hern, and members of the Subcommittee. I appreciate this opportunity. My name is Lynn Ozer, and I am currently the president of Fulton Bank's SBA Lending Department, where I oversee all aspects of

SBA lending in the mid-Atlantic region in the five States that our bank is located.

I have believed and trusted in SBA's mission to aid and protect these borrowers for the entirety of my career. However, it is disheartening to see a fiscal year 2020 budget request from the SBA that takes advantage of these small business borrowers. The budget states positive subsidy calculation for the 7(a) program for fiscal year 2020 of $99 million, a marked shift from the program's track record operating at zero subsidy and no cost to the taxpayer.

SBA has essentially told Congress that it has a choice, to either appropriate $99 million or hike up fees on borrowers and lenders or the program shuts down on October 1. My first thought as a seasoned lender is to question whether or not there have been any performance issues in the portfolio. Purchase rates are at a near all-time low. Recovery rates are at an all-time high. SBA reports a record low chargeoff rate in 2018. When we see a positive subsidy, you would think that the portfolio would show some signs of worsening, but it does not.

SBA has also overestimated the cost of every cohort of loans made for the past 9 fiscal years, which means SBA could have asked for much less from the borrowers and the lenders and still have covered the cost of the program at a zero subsidy. This tells me the current subsidy model used is not working as it should.

I urge this Subcommittee to work with OMB and SBA to obtain the details of this subsidy calculation. The subsidy model has always been shrouded in mystery. Lenders are the stewards of this program, and Congress gives the program its authority to exist. Does it make sense that none of us know how the cost of this program is calculated?

SBA has made it clear their preferred solution to cover the unnecessary positive subsidy is to hike fees on the borrowers and lenders. This is a tax on small business. Under SBA's proposal, some of my borrowers would have seen a 7 percent increase in fees, others a 16 percent increase, and some borrowers' fees would have doubled. This would mean shrinking access to capital.

And the impact to lenders, under the SBA's proposal, the cost of my SBA department would increase by roughly 25 percent just on new loan originations in fiscal year 2020, with that number multiplying itself year over year into the future since these fees are charged on an ongoing basis annually for the rest of the life of the loan.

When the costs increase on the lenders, that creates a domino effect, the results of which hurt the small business borrower in the end. The goal is to increase opportunities for small business. The budget request would do just the opposite. It would shrink access to capital, closing the door on many small borrowers and lenders.

I also want to take a moment to respond to Mr. Gribben's comment about the portfolio doing worse in good times and his admission that his model does not take lender behavior into account. I am a lender. Lenders administer this loan program.

When times are good and when times are bad, my credit policy does not change. This inverse relationship we have with the conventional market speaks to loan volume. When times are good, borrowers have options and our volume may plateau. When times are bad, borrowers have less options and our volume increases. But we are not talking about volume. We are talking about cost. When times are good, my credit committee is not going to allow us to approve riskier loans just to make up volume. Why?

We still need to have a portfolio that meets safety and soundness standards for our regulators. SBA lending has certain rules that govern prudence regardless of economic swings, like always requiring a personal guarantee from the borrower, requiring borrowers to have skin in the game, prescribing debt service coverage ratios and collateral requirements.

And there is just only so much risk a lender can take. Actual performance does not support their assumption that we make riskier loans in good times. The emphasis on macroeconomic trends seems inappropriate for this highly regulated loan program.

Do not simply take these projections at face value, and I ask that you seriously challenge the subsidy rate. Small business borrowers, lenders, and the ability of the 7(a) loan program to serve access to capital needs are dependent on how you respond to this surprising calculation.

Thank you.

Chairman KIM. Thank you.

Let's see, Ms. Jansen, over to you for 5 minutes.

STATEMENT OF GAIL JANSEN

Ms. JANSEN. Good afternoon, Chairman Kim, Ranking Member Hern, and members of the Subcommittee. My name is Gail Jansen. I am testifying today on behalf of NAFCU.

Thank you for the opportunity to share with you our perspective on SBA 7(a) loan program and the potential impacts of the proposed fee structure changes for fiscal year 2020.

As the vice president of business services and operations at Kinecta Federal Credit Union, I am responsible for a portfolio of nearly $1 billion in member business loans, which includes nearly $35 million in SBA loans. Business lending is an important aspect of our service to members at Kinecta. A key part of that is our ability to offer SBA 7(a) loans.

Kinecta started our business program in 2013. We are a preferred lender with the SBA. We are the number one credit union SBA lender in all of California. Our SBA loans range from a low of $50,000 to a high of $5 million, but the average size of our loans is $250,000. On average, we make about 20 loans a year, and currently, we have 100 SBA loans in our portfolio.

The kind of companies that turn to us for SBA loans include small manufacturers, brick-and-mortar retail shops, independent restaurants, and professional service companies. A business owner will apply for an SBA loan with the credit union because they are looking for something different than what the bank can offer. They are often pleasantly surprised that a credit union offers small business loans, and as a result, they are willing to consider us as a viable alternative.

Our ability to offer SBA loans allows us to meet the needs of our members, like the one who turned to us in July 2018 with a small, growing residential home remodeling company to refinance existing business debt and provide working capital to support new jobs and projects.

At the time of the loan request, the company had only one full-time employee and one part-time employee. The subject debt to be refinanced was originated from an online lender that was charging the business owner an exorbitant interest rate of 44 percent.

After underwriting the loan request, Kinecta approved and funded the SBA loan in the amount of $110,000 at an interest rate of 7.75 percent. The refinancing of the business debt resulted in a significant savings for the business owner. As a result, the business has since hired two full-time employees and has begun saving money to purchase commercial real estate.

Small businesses like this one are the backbone of our economy and an essential source of jobs. The SBA's loan program serve as an important resource that help 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.

There are positives to SBA's overall fiscal year 2020 budget request, such as the increase in the SBA express loan limit from $350,000 to $1 million. However, it was troubling to see the SBA's request to modify its statutory fee structures and potentially increase its fees because of a refinement to its economic modeling.

The bottom line is that the fee increases as proposed by the SBA in this budget submission will impact both our small business members and the credit union. SBA's proposed fee structure will make it more expensive for members to get loans greater than $500,000 by increasing the guarantee fee on those loans. For loans greater than $1.5 million, the proposal introduces an even higher new fee rate.

It is important to note that the small business member pays the guarantee fee one time, usually at funding. The moneys are often dispersed directly from the loan proceeds so the member does not have a direct out-of-pocket cost at origination. However, the lender, Kinecta in this case, pays an ongoing annual fee for each loan that is originated. This fee is currently 55 basis points.

Under the SBA's proposal, the fee will be unchanged for loans up to $1.5 million, but it will increase to 83 basis points for loans over $1.5 million. The SBA proposal will make loans more expensive for lenders like Kinecta.

In a high-cost real estate market, such as California and New Jersey, among others, $1.5 million is not a lot when you are talking about commercial real estate. Increasing the costs of these loans to both the small business and the lending institution will likely make it more difficult to get an SBA loan for commercial real estate in higher markets.

We urge the SBA and Congress to work together to protect and strengthen the SBA 7(a) program. This includes examining all efforts to avoid the proposed fee increases on SBA's small business loans and the lenders that serve them.

In conclusion, the ability for small businesses to borrow and have improved access to capital is vital for job creation. We recognize that maintaining a zero subsidy for the program is important, but we urge you to examine all potential alternative solutions to avoid a fee increase.

I thank you for your time and the opportunity to testify before you here today, and I welcome any questions you may have.

Chairman KIM. Thank you for your testimony.

Mr. Gray, over to you for 5 minutes.

STATEMENT OF GORDON GRAY

Mr. GRAY. Chairman Kim, Ranking Member Hern, and members of the Committee, I am honored to be before you today to discuss the budgetary considerations of the Small Business Administration's 7(a) loan program.

This is an important program that provides access to small business entrepreneurs who otherwise have no recourse to adequate financing in the market, supporting hundreds of thousands of jobs throughout American communities. As a taxpayer-funded program, it should be subject to continuous and rigorous oversight, and I appreciate the Committee's attention to this program in today's hearing.

In my testimony, I wish to make three basic observations. Federal Government is a prolific lender, providing guarantees on and direct loans of $4 trillion as of fiscal year 2018. The budgetary treatment of credit programs is somewhat unique in budgeting, adhering to the principles of accrual accounting as set forth in the Federal Credit Reform Act, FCRA, of 1990.

FCRA accounting addresses the deficiencies of cash accounting in measuring the cost of credit programs, but necessarily introduces additional complications, some of which animate today's discussion. I will briefly discuss these observations in turn.

The Federal Government currently has a combined $4 trillion in credit assistance outstanding as of 2018. In general, the goal of this assistance is to provide credit to borrowers who otherwise would not receive credit at market terms from lenders.

The credit assistance takes two forms: direct loans where the Federal Government is the lender or loan guarantees where the government commits taxpayer funds to guarantee private lending. As of fiscal year 2018, the Federal Government has $1.4 trillion in direct loans outstanding and guarantees on $2.6 trillion as of last year.

It is loan guarantees that concerns today's hearing, specifically the 7(a) loan program. The 7(a) program provides eligible small businesses with private sector financing with a public guarantee. The program includes several specialized features, but in general, provides up to 75 percent guarantee on loans up to $5 million. The program requires lenders to ensure borrowers demonstrate adequate ability to repay, management ability in equity, among other considerations. Credit is also contingent on borrowers demonstrating that credit is otherwise unavailable at reasonable terms.

According to the SBA, the 7(a) loan program supported over 60,000 loans totaling $25.4 billion in fiscal year 2018. The budgetary treatment of this program is prescribed in the Federal Credit Reform Act of 1990 and its amendments.

In general, this reform requires recording credit assistance programs in the Federal budget on an accrual basis. Accrual accounting more accurately captures the taxpayer exposure for a given credit program by recognizing the value of the upfront outlay by the taxpayer but also the associated repayment stream, even if it is outside the budget window.

This treatment also captures the value of preferential credit terms, such as longer loan maturities or interest deferral. It is important to recognize that this calculation more accurately reflects the totality of the Federal commitment for a given credit program. It also necessarily introduces additional complications.

By nature, FCRA requires projecting all associated cash flows for a given loan over its duration. This also requires projecting likely delinquencies, defaults, prepayments, interest rates, and other factors to determine credit subsidy rates.

Underpinning a number of these elements are OMB's economic assumptions, which the agency is required to use as part of the calculation. The strength of the economy substantially effects default rates, for example, and a worsening economic outlook, would all else equal, increase the subsidy cost to the Federal Government through higher defaults, among other considerations.

The subsidy cost is thus exposed to fluctuations for any of these factors. Those will always persist, however, and measurement uncertainty in is not limited to this program or credit programs generally.

Any time a measurement requires projecting into the future, some uncertainty, however, is introduced. Annual reestimates of these programs enhance the estimating process. Since FCRA was enacted, subsidy costs of the 7(a) program have been on net underestimated with a net positive lifetime reestimated subsidy cost. Yet these costs are quite small over the nearly three decades and relative to the overall size of the loan disbursements.

It does appear, however, that this net underestimate is driven largely by the effects of economic downturns. Accordingly, it is important to understand the factors that animate these subsidy costs as policymakers consider how to adequately resource this important policy objective while safeguarding taxpayer funds.

I believe the Committee's desire to hold this hearing reflects that intention, and I look forward to answering your questions.

Chairman KIM. Thank you so much for your testimony.

Thank you again to the four of you for coming out here. I just have a few questions and then I will turn it over to the Ranking Member, and we may have some more after that.

But, Mr. Wilkinson, I would like to start with you. You know, you have now heard—we have all heard from the SBA's CFO and regarding the data that was used for the subsidy calculation, and I wanted to ask you about your response to that. Was there anything that he said that was new to you, anything that helped shed a little bit more light on their process there? And what are the questions that you have lingering from his testimony?

Mr. WILKINSON. Thank you for that question. I have actually got a lot of comments on his testimony. First of all, he talked about tweaking the model in 2014 to accurately reflect program performance. That was his quote. But the reestimates tell a very different story.

In fiscal year 2014, we started out at a zero subsidy rate. Now, remember, he said this was the year that they changed their model to more accurately reflect what was going on. The 2014 subsidy rate has now been estimated to be a negative 2.08. So they missed by their own calculation so far of about $359 million.

In 2014, if you look at repurchase rates in 2018 versus 2014, our repurchase rate has gone down 35 percent. So the——

Chairman KIM. Between 2014 and——

Mr. WILKINSON. And 2018. So our performance today is much better today than it was in just 2014. And even with the rates in 2014, they had a negative subsidy reestimate of $359 million.

In Mr. Gribben's verbal testimony, he did not give one single detailed reason why the subsidy rate increased. Mr. Gribben's comments on future repurchases may not be supported by the SBA's own data risk warehouse. Metrics in projected purchase rates, they have a very sophisticated model that the Office of Capital Access manages that will show a very different number for purchase rates than what is included in the model.

So there are a lot of questions in here. It appears that they are ignoring the President's own economic assumptions, and they continue to factor in another Great Recession or another 9/11 end of the model when the President's economic assumptions don't forecast that. They forecast strong GDP and a low unemployment rate.

So we are confused as to how we can have an upward subsidy cost need when our performance tells us a very different story.

Chairman KIM. Thank you for that.

I wanted to turn to Ms. Jansen. I wanted to ask you, in your opinion, would a steady unemployment rate have any effect on the quality of your portfolio, the quality of your borrowers?

Ms. JANSEN. Unemployment rate won't really factor in, other than access to capital. That is what we are really looking for as far as SBA goes.

Speaking from my perspective with the members who walk into our member service centers and request SBA loans, they want to grow their own business, and in order to do that, they are going to have to have access to capital.

Chairman KIM. I appreciate that.

Ms. Ozer, I wanted to ask you a similar question to Mr. Wilkinson. I wanted to just hear from you just straightforward, you know, why do you think this subsidy calculation deserves to be challenged? How do you respond to what the CFO said today?

Ms. OZER. Listening to what he said means that we have to either go on to appropriations or they have to raise fees. I have been doing this for longer than I want to admit, and I have seen this go—this whole program go through being on appropriations, not being on appropriations, raising fees, lowering fees. And all the instability in the Small Business Administration creates problems for borrowers and lenders and definitely, as Ms. Jansen said, shrinking the access to capital.

The biggest problem that I see is the effect that it has on the borrowers, specifically the increase in the cost of fees. The fees for loans under $500,000, they will be the same. But for borrowers between $500,000 and $700,000, the fees increase dramatically. We have a lot of borrowers, in your area actually, that have felt that.

The effect on the lenders is that the ongoing fees that we are charged on our loans is going to go up. And whatever happens to cost more money to the lenders, eventually gets put back onto the borrowers, and their fees rise.

I have to run a budget and explain to my shareholders, my board of directors, and all my stakeholders why are the costs of this program increasing. And if we look at what Mr. Gribben said, it flies in the face of what our own statistics, given to us from the SBA about how our portfolio and our peers' portfolio performed, that I have been reporting to the Credit Oversight Committee, what they are saying flies in the face of all the actual facts. So it is going to be very difficult for me to explain that.

Chairman KIM. Thank you for explaining that to me.

So I am going to turn it over to the Ranking Member here for some questions.

Mr. HERN. Thank you, Mr. Chairman.

Mr. Wilkinson, welcome from Oklahoma. It is good to see you.

Ms. Ozer and Ms. Jansen, I will tell you that this whole Congress needs more people like you testifying from people who actually experience what is going on with the legislation that has passed and what actually happens. It is so refreshing to hear—even though you are with the majority party here as their witnesses, it is so great to hear you actually talk about what happens out of Congress, and I just so appreciate it. It is so refreshing to hear you all. I wish every committee had folks like you testifying on the realities of what comes out of Congress.

Mr. Gray, question for you. And by the way, I chaired a loan committee for 10 years on a bank, so I so appreciate it. It is music.

Mr. Gray, do you know any of the requirements surrounding what an agency can and can't use as assumptions for modeling purposes?

Mr. GRAY. So as I understand it, the 1997 Balanced Budget Act tried to apply more uniformity to the methodologies that the agencies have. I am aware of the fact that OMB's economic projections are one of those factors that they are required to consider.

Mr. HERN. Are agencies provided guidance on how to select their assumptions?

Mr. GRAY. Like I said, I believe those—they are given parameters set in statute by, for example, by FCRA and its subsequent amendments, like the 1997 Act, and, the previous witness spoke to some of this, there is some discretion at the agency level as well.

Mr. HERN. So we will talk about the discretion. Economic assumptions, are they a major driver for their models?

Mr. GRAY. I think the state of the economy performance of—or the outlook on credit markets, credit conditions certainly underpin their assumptions.

Mr. HERN. Because I will tell you, as a member of Budget, where we get to see all the assumptions from both side——

Mr. GRAY. Right.

Mr. HERN.—both parties, there isn't a doom and gloom from either party, yet the financial guru from SBA says—appears to think there is. So I would like to get his thinking. Maybe he has a crystal ball the rest of us don't have, because I would be interested.

In your testimony, you touched on the reestimate process. Can you share with us how that reestimate process impacts a credit subsidy calculation?

Mr. GRAY. Sure. So every year, on an ongoing basis, the agencies do revisit their past calculations, what elements of that may have changed. And so we basically get a performance exam of all of these programs since they were put on an accrual basis under FCRA.

In the credit supplement we get, tables 9 and 10, I think, of past performance, and we can see how these were estimated at their inception and then over the lifetime of their performance. And those have been pretty instructive in thinking about how to think about these programs over time and under various economic conditions.

Mr. HERN. Thank you, Mr. Gray.

Mr. Wilkinson, in your testimony, you state that the subsidy calculation was amended in the past. Can you describe the events in the environment surrounding this amendment?

Mr. WILKINSON. Yes, sir. Back in 1997, a similar discussion was ongoing. At some point in time, the agency decided that they had made an error in their calculation and they filed a formal budget amendment adjusting the subsidy rate.

Mr. HERN. Who was involved in that, do you remember?

Mr. WILKINSON. The Office of Management and Budget and SBA. I would say that the Senate Small Business Committee under Senator Kit Bond at that time was a driving force in getting that done.

Mr. HERN. So what was the outcome of that?

Mr. WILKINSON. At that particular time, we were on an appropriations so we were able to leverage those appropriation dollars much farther.

Mr. HERN. Okay. So was it similar to today's conversation or dissimilar or——

Mr. WILKINSON. It is very similar. GAO has documented this in a series of reports. We have had multiple former SBA employees tell us that the way the system works is OMB dictates to SBA a subsidy rate, and it is SBA's jobs to adjust the assumptions to get to the rate that they have been told to get to. And that is why you saw the Pricewaterhouse report come to the conclusion that the SBA and OMB is gaming the process.

Last week, in a Senate Small Business Committee, Mr. Manger from the SBA testified that the macroeconomic assumptions come directly from the Office of Management and Budget and that he has no knowledge what those are, basically, you know, leaving that all to the Office of Management and Budget.

So what we have got is a subsidy calculation that is shrouded in mystery. We can't see the details. We don't know how in the world they can say all of a sudden we are going to have a 10 percent spike in our net losses when our performance trends are going exactly the opposite direction.

Mr. HERN. Before I close, I would just like to say thanks to each of you again for being here and your honesty. And certainly, I can see in your—when you are reading your testimony that you really have a lot of passion. So thank you so much.

Mr. Chairman, I yield back.

Chairman KIM. Thank you.

I have a few more questions I just want to get into here. Ms. Ozer, back to you. As you were mentioning, you know, you have a sizable footprint in New Jersey. And I am trying to think about this a lot in terms of how it is going to affect the borrowers, how it is going to have a real impact where the rubber hits the road.

So I wanted to ask you, how do you think this proposal will impact the extent to which you were able to reinvest in local communities like ours, specifically how exactly would increased fees affect their desire to apply for 7(a) loans and your ability to provide more loans?

Ms. OZER. Thank you for your question. Specifically, I can give you an example. We just did a loan to a trucking company in Robbinsville, New Jersey, right outside of Bordentown. This business has been growing tremendously. With online businesses, trucking and delivery is just an exploding industry.

They were renting space to keep all their trucks. They needed to buy the building they were in because their lease was up, and they wanted to buy it as well as the adjacent property, and the cost was over $3 million. They put a substantial amount of money down, and we made them a loan. Their fees for that loan of $2.9 million were—let me see. I have that here actually—$81,000.

The company, under the new fee structure, would be paying an additional $5,500, $5,578.11 to be exact. That money could be used for them to buy another truck, hire another driver, expand their business in many other ways, instead of having to pay for the subsidy rate or whatever in additional fees.

How that affects us, when we get a loan this big, our cost to this program would increase by 25 percent on an ongoing basis. Having that loan on our books, that larger loan, that is real estate secured, as opposed to some of the very small loans that aren't real estate secured and may not perform as well help balance risk. If we can't make these larger loans because of the cost to the bank and the cost to the borrower, we will have less capital to invest in other areas in New Jersey.

We have to make a certain amount of money to keep my department going. And if our infrastructure and our efficiency ratio goes up, my bank directors and so forth are going to say to me, what is going on here. You are not making enough money. And they are going to cut the amount of staff that I have and my ability to provide ongoing community investment to projects like this.

The smaller loans in your area that are $300,000, they don't pay nearly as much fees and their fees won't be affected. But if we can't balance out our investments with larger loans and smaller loans, we are going to have to have—there is going to have to be give somewhere. And who is going to pay for it but the small business borrowers. They are going to have less access to capital.

Chairman KIM. A lot of my concerns here. That is very helpful, because I always want to make sure that we understand, you know, the tangible impacts, really understand what that is going to translate to in terms of the borrowers and small businesses.

And as I have talked to a lot of small business owners, they talk to me about the importance of having that predictability for them to be able to do planning, you know, that they are dealing with razor-thin margins here, and, you know, of their ability to plan not just 1 year out but 10 years out in the growth, it really depends on that predictability.

And my concerns here are certainly about what is going to happen given this, you know, fiscal year 2020 structure. But the lack of transparency and the lack of understanding of what is going into this concerns me about if we are going to be right back at here a year from now or 2 years from now and just, you know, what is going to be happening going forward.

As we understand that, you know, we are—in many ways, it looks like, from what you are saying, that we are, you know, forcing or we will potentially be forcing small businesses and the borrowers into riskier loan products, and that is something that is going to be, you know, very damaging going forward.

I wanted to ask, on that front, what are you hearing from borrowers in terms of their reactions to, you know, what has been happening here with the 7(a) and these developments? Are they understanding sort of the magnitude in which this is going to affect them and, you know, affect their abilities to be able to have access to capital? Please, anyone.

Ms. JANSEN. Honestly, most of the borrowers that we deal with at the credit union don't really understand an SBA loan. When they come in and they ask for a business loan, we have referred them out to the SBDC to get their financials together to answer those questions, but there is an education process for a lot of the smaller people that we deal with, our members.

You know, as a nonprofit, we want to help them build their business. They come to us and they trust that we are going to guide them in the right direction. So honestly, most of the borrowers that we deal with, they don't understand how this would affect them.

Ms. OZER. As soon as they get here, as soon as they get to us, though, they quickly understand. When they hear the amount of the fees that they are paying and the fact that, you know, let's hurry up and get this in because if this passes on October 1, this is going to cost you twice as much money as it would if we do it now.

I mean, then they will understand the urgency. And what they can do with an additional $5,500, it doesn't sound like a lot to a lot of people, but for small businesses, that could be a large part of their cash cycle. They could pay payroll for another month and it makes a huge difference and it has a huge impact.

But I agree with Ms. Jansen, you know, they don't necessarily understand the workings, but they do trust that the bank is looking out for them and putting them into the proper product. I mean, we as a commercial lending institution offer them conventional financing. They only come to my department when my bank is not going to be able to do it.

So they are already sort of in a difficult spot, and then you tell them how much it is, and they feel like they are getting hammered over the head. But the problem for us is exactly what you said, and it is not just the borrowers who have to plan; it is banks and their lending institutions that have to plan.

And we have to budget and we have to know how much this program is going to cost so we can allocate human resources to making more of these loans and doing outreach into the communities that need these loans the most. And we can't afford to add personnel if we are going to keep paying fees to the government.

Chairman KIM. That is right. And the same way that the borrowers turn to you and trust you about this analysis and understanding what they are going to need to do, they should also be trusting the SBA. They should be trusting us here in Congress to do our due diligence, that we recognize that the mission of the SBA is to help small businesses across this country, make sure that they can get a leg up, that they have a fair shot at being able to run a successful business and be able to grow.

You know, the mission was not to create a revenue stream for the government on the backs of small businesses. Instead, everything should be geared towards what it is that we can to do to be able to help them. And what I assure you and assure you—this Committee on both sides of the aisle, we are committed to that. We are committed to ensuring that SBA stays true to the mission of helping small businesses across this country, giving them a fair shot, giving them a chance to really be able to succeed on this front.

I wanted to ask a question, I wanted to ask this panel a question, a question that I asked the CFO, which is, do you think it will be the benefit to this Committee and for us here in Congress to hear from OMB on this?

Mr. WILKINSON. I do. I think that is where the answers are, based on what we hear from former SBA employees, that is OMB and their macroeconomic assumptions that are driving the subsidy calculation. So I think it would be critical that you hear from OMB. Hopefully, we can get some straight answers.

Chairman KIM. Is that the idea for every—does everyone else share that conclusion?

Ms. OZER. I agree wholeheartedly.

Chairman KIM. Does anyone disagree?

Mr. GRAY. No.

Chairman KIM. Well, no, thank you for that and your expert thoughts on this.

I did want to just open up one last time, if there is anything else that anyone wanted to add for the record before this Committee before we start to move to conclusions.

Mr. WILKINSON. The performance of the portfolio remains strong. We have actually had a very good working relationship with the Office of Capital Access at SBA. Over the last several years, we have worked hand-in-hand to improve the performance of portfolio, tightening up program parameters where they needed to be. I think that is reflected in the performance of the program.

Unfortunately, we now have a subsidy calculation that does not reflect reality. There are some ulterior motives that we don't see, and it is not borne out by the statistics in front of us. So I beg this Committee to dig deep into the subsidy calculation and find out what is going on. We need the details. There has got to be a paper trail somewhere of how these assumptions are come to and put into the model.

I heard Mr. Gribben talk about all the auditors. From our understandings, they are checking the spreadsheets. They are not determining what the inputs are into the model. That is vastly different. We need to figure out what the inputs are and how those were derived. So there is a lot of detailed information that needs to be looked at.

Thank you.

Chairman KIM. Anyone else?

Ms. JANSEN. Yeah. I would definitely like to dovetail on that and say, you know, we support examining every available option to avoid the fee increases, not passing them on to the small businesses, crippling their abilities, and passing them on to the small lenders, you know, large or small lenders. We have got to make this capital available to increase small businesses' opportunities.

Chairman KIM. Great. Thank you.

Well, I appreciate, again, your time to be able to come and traveling here and be able to inform us and be able to help us do our jobs and make sure we are looking out for small businesses here.

We know that the 7(a) program is the economy's main vehicle for entrepreneurs to be able to access affordable capital on reasonable and fair terms. It is also an engine of job creation responsible for supporting over 540,000 jobs in 2018 alone; therefore, preserving the integrity of 7(a) is a top priority of this Committee. And any proposals that threaten that integrity, especially by raising fees on small business borrowers, will be reviewed with the highest degree of scrutiny.

And I certainly look forward to working with my colleagues on both sides of the aisle. And I think you, you know, certainly heard that the Ranking Member and myself are very much on the same page in making sure that we are going to get all the information that we need to be able to make an assessment about this and understand whether it is fair.

You certainly heard the words from the Chairman of—Chairwoman of the Committee of the whole that this is something that certainly has our attention and that we will be very focused on going forward.

This is just going to be the initial steps. As I mentioned in the panel one, very much factfinding at this point. We certainly will be, if you don't mind, calling upon you again, I am sure, to be able to get your thoughts as we move forward and get more information about what is best.

So I certainly feel passionate about this. I certainly want to make sure we are looking out for small businesses and also understanding on the lenders side, you know, how this is affecting your work and your ability to plan, your ability to be successful, which we certainly want to see done. So we are going to work on both sides of the aisle, find a solution that will protect small business borrowers and the 7(a) program.

I am going to ask unanimous consent that members have 5 legislative days to submit statements and supporting material for the record. And without objection, it is so ordered.

And if there is no further business to come before the Committee, we are adjourned. Thank you.

[Whereupon, at 12:29 p.m., the Subcommittee was adjourned.]

APPENDIX

U.S. Small Business Administration

Statement of Timothy Gribben
Chief Financial Officer and Associate Administrator
for Performance Management
U.S. Small Business Administration

before the
House Committee on Small Business
Subcommittee on Economic Growth, Tax and Capital Access

Hearing on "SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes"

April 10, 2019

Statement of Timothy Gribben
Chief Financial Officer
U.S. Small Business Administration

Thank you, Chairman Kim, Ranking Member Hern, and members of the subcommittee for inviting me to discuss with you the Fiscal Year (FY) 2020 budget proposal for SBA's 7(a) loan program.

In my testimony, I want to outline our credit subsidy model, our annual process to update and execute the model, as well as the options we have for operating the program in FY 2020. This will help provide context to the projection of a positive subsidy rate for the 7(a) program in FY2020 under current law, and the options for Congress to consider in order for the agency to operate at a $30 billion program level.

Credit Subsidy Model

The credit subsidy model is a series of processes and calculations that use historical program data and macroeconomic projections to generate the expected cash flows for the entire life of a cohort. For the sake of clarity, a cohort is the group of loans approved in a given fiscal year.

Annual Process to Update and Execute the Model

Annually, we update our model with the most recent year of 7(a) loan data and macroeconomic indicators. This data results in updates to the three main inputs into the model: performance assumptions, cohort composition assumptions, and macroeconomic assumptions. The model is thoroughly reviewed by the agency, then by an outside auditor, and eventually by the Office of Management and Budget.

Performance Assumptions

We use the performance assumptions to project prepayments, purchases, and recoveries on purchases. We develop the performance assumptions using over 25 years of historical 7(a) program and macroeconomic data. Annually, we test the predictive ability of the existing assumptions and adjust the methodology as necessary to appropriately capture program performance. Our performance assumption methodologies evolve as the 7(a) program and the macroeconomy changes, and as more data is available to us for analysis.

Cohort Composition Assumptions

The cohort composition assumptions are what we assume the characteristics of the loans approved in the budget year will be. We develop the cohort composition assumptions by reviewing the cohort characteristics from recent years and using that information to inform our assumptions for the current cohort. These characteristics include the distribution of loans by region, industry, loan size, maturity term, 7(a) subprogram, and several other factors that impact the cost of the program.

Our model projects a range of costs for a loan depending on the loan's characteristics. As the portfolio changes each year, we are mindful to consider these changes when developing our subsidy rate. We use the most recent data and work with staff from the program office to develop reasonable assumptions for the cohort we are formulating.

Macroeconomic Assumptions

We use macroeconomic assumptions provided by the Office of Management and Budget (OMB). Our portfolio is very sensitive to changes in macroeconomic conditions and the model uses assumptions for interest rates, unemployment rates, and GDP growth rates to develop the subsidy rate estimate.

We update the cash flow model with each of these sets of inputs to develop our subsidy estimate. For the past several years, after updating the inputs, we estimated that the fees we would earn from the loans would be adequate to cover the expected losses, and in fact, in excess of what we would need to cover losses. This allowed us to offer various forms of fee relief. For the loans we expect to approve in FY 2020, we no longer estimate that their fees will be sufficient to cover the expected losses.

Steps Forward

In order to operate our 7(a) program in FY 2020, SBA will need either a subsidy appropriation, or an adjustment to the fee rates. The agency presented three options for Congress to consider to support $30 billion in 7(a) loans. The first option would involve a subsidy appropriation of $99 million. The second option involves statutory changes to the fee structure in order to maintain zero subsidy, and the third option involves a combination of statutory changes to the fee structure and an offset to the agency's administration costs, also to maintain zero subsidy.

The fee rates we propose in the budget, including an attempt to minimize any impact on smaller loans, are as follows:

- Increase the ongoing fee for loans over $1.5 million to 0.69%, from 0.55%;
- Increase the upfront fee for loans over $1.5 million to 3.75%, from 3.5%;
- Increase the upfront fee for loans $500,001 to $700,000 to 3.5%, from 3.0%;
- Increase the upfront fee for loans with a maturity of one year or less to 0.5% from 0.25%.

In conclusion, the agency annually reviews the model's predictive ability and revises performance assumptions when appropriate. We develop assumptions for portfolio composition and update the model with the most recent economic assumptions. This year, this process resulted in a positive subsidy rate after setting fee rates to their statutory maximum and removing all fee waivers.

Thank you again, Mr. Chairman, for inviting me to testify today. I look forward to answering any questions you may have.

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

"The SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes"

Testimony before the Subcommittee on Economic Growth, Tax, and Capital Access of the House Committee on Small Business

April 10, 2019

Submitted by
Tony Wilkinson, CEO and President
NAGGL
Dallas, Texas

Chairman Kim, Ranking Member Hern, and Members of the Subcommittee—my name is Tony Wilkinson and I have served as the CEO and President of the National Association of Government Guaranteed Lenders (NAGGL) since December 1987. NAGGL is a national trade association of approximately 800 banks, credit unions, non-depository lenders and other entities that participate in the Small Business Administration's 7(a) loan guarantee program. NAGGL's lender members are responsible for approximately 80% of the total 7(a) loans made each year. I began as a Director in this trade association almost 35 years ago while serving as a lender in Oklahoma, and I am proud to say that since then, NAGGL has been working hand in hand with the House Committee on Small Business on the most pressing issues for small business borrowers and lenders in the 7(a) industry. Thank you for continuing our practice of tackling the tough challenges together by having this hearing today to discuss the grave danger in which the President's FY20 budget submission has placed the 7(a) program.

At the heart of the SBA's success is its flagship 7(a) lending program, the agency's largest source of access to capital for small business borrowers across the country. The numbers tell a story of great success in the 7(a) program. In Fiscal Year (FY) 2018, financial institutions large and small provided about $25.4 billion in approvals to about 60,350 small businesses nationwide through the SBA 7(a) program. Roughly 543,100 jobs were created or retained just last year thanks to the SBA 7(a) program-- if we assumed just $30,000 in average annual wages for those employees affected by the program, that means the 7(a) program is responsible for supporting at least $16.3 billion in income across the country. The impact does not stop with just those topline numbers—there are other benefits that are often hard to measure, like employment opportunities, increased tax revenue for federal and local governments, and community growth driven by small business expansion in cities, small towns and rural areas across the country. There is a never-ending domino effect of benefits gained from the 7(a) loan program.

The performance metrics also tell a success story. I am pleased to report that the performance of the SBA 7(a) loan portfolio has remained sound. Repurchase rates on defaulted loans remains near an all-time low, while recovery rates on collateral is at an all-time high. Putting the two together, SBA reports a record-low charge off rate for the portfolio in FY 2018.

Over the past two Congresses, this Committee and its colleagues on the Senate Committee on Small Business and Entrepreneurship have been incredibly active in taking a closer look at the 7(a) loan program, and as a result, a number of historic legislative accomplishments were realized last year by updating the *Small Business Act*. By far, the most significant achievement in the access to capital programs for the Committee and its Senate colleagues was drafting and passing into law the *Small Business 7(a) Lending Oversight Reform Act of 2018*, a bipartisan, bicameral effort that spanned three and a half years of work on the part of this Committee and staff. The 7(a) lending industry partnered with the Committee every step of the way to refine and create stronger oversight standards—it is not lost on the 7(a) lending industry that we have the *privilege* of being stewards of a government program with a public mission that must operate with integrity.

However, this year, we are presented with a different kind of challenge—one which threatens the ability of the 7(a) program to create and grow access to capital for the tens of thousands of borrowers that we serve. The President's FY20 budget request, presented a little over three weeks ago to Congress, sent a shock wave through the 7(a) industry when it included a subsidy calculation requiring additional funding of 33 basis points (0.33%), or $99 million, for the 7(a) program. This is a major shift from the program's track record of operating at zero subsidy since FY05 (except during the years covered by the Recovery Act), which means that the fees collected from borrowers and lenders cover were projected to cover the cost of making the loans. By projecting a positive subsidy rate for FY20, the budget request is triggering the necessity for Congressional action. Now, Congress needs to either appropriate $99 million to the 7(a) program or amend the *Small Business Act* to raise the current fee caps in order to collect $99 million in additional fees from borrowers and lenders on top of what participants already pay to cover the cost of the program. Both of these paths forward will need to pass the Senate, House, and be signed into law by the President by September 30—or the 7(a) program will shut down on October 1.

The positive subsidy rate from SBA and OMB has placed Congress in a tough predicament. This industry has been proud of the fact that we operate at zero cost to the taxpayer, and we acutely recognize the challenges appropriators face to stay within spending caps each fiscal year. On the other hand, raising fees on small business borrowers and lenders will shrink and impede access to capital, creating more barriers for the program's participants—the exact opposite direction we all would hope to see this program move toward. SBA's FY20 budget has created a lose-lose scenario for Congress, industry, and the country's small businesses.

But before we can even consider how Congress might best move forward to prevent a very successful, popular small business program from simply shutting down on October 1, we *must* first collectively question the positive subsidy calculation. **My plea to this Committee is that before you simply take the FY20 subsidy calculation at face value, you first challenge both OMB and SBA to explain this subsidy estimate in detail, and specifically, the assumptions that went into the calculation and how those assumptions are weighted in the subsidy model.** Not only do the FY20 budget documents provide insufficient justification for a $99 million increase in estimated subsidy costs, but there is ample evidence to suggest that a troubling pattern exists in the way SBA and OMB model the subsidy cost. This testimony will walk this Subcommittee through a number of overwhelming factors that should leave us all with more questions than answers.

I am not the only one asking questions. The Government Accountability Office (GAO) has been raising the same concerns about SBA's ability to appropriately estimate the cost of the 7(a) portfolio before this Committee and Congress since 1997, spanning multiple Administrations. In a series of reports, GAO has looked into the accuracy of SBA's subsidy rate- or lack thereof- no less than on four occasions over the past twenty-two years—this is a pattern, and one we cannot ignore. I will be referencing a number of GAO's findings throughout my testimony to highlight concerns with SBA's cost estimates that are shared by both GAO and industry.

Allow me to also take the time to briefly explain what a subsidy calculation is and how this is reported every fiscal year. The 7(a) subsidy calculation is an estimate of the cost of the loan program to the government for loans originated in a given fiscal year and is governed by the *Federal Credit Reform Act of 1990* (FCRA). This statute dictates that the cost of credit portfolios shall be the net present value of the portfolio, excluding administrative costs to the government. By enacting FCRA, Congress delegated to the Executive branch the responsibility for estimating the future credit performance of loans into a subsidy rate, which Congress then uses to determine any necessary appropriations for each fiscal year.

The majority of the Administration's budget requests are just that—proposals that make up a sort of budget wish list from the Executive branch to Congress. Some of these proposals in this year's budget request will always stay proposals—for instance, I expect Congress will once again not act on charging all borrowers and lenders to pay for SBA's employees' salaries and expenses in what the budget calls "counter-cyclical measures," namely because it is an egregious violation of FCRA. However, the portion of the FY20 budget request that is not a proposal is the statement of a positive subsidy. SBA's proposed fee increases to borrowers and lenders in order to cover the positive subsidy *is just a proposal*, giving Congress one option to cover the cost this fiscal year, and we all know that there are more options than the increased fee structure SBA presented. But Congress does not have a choice but to react and address the fact that the 7(a) program has a positive subsidy calculation starting the first day of the new fiscal year—and Congress has been given a limited timeframe in which to do so. Otherwise, absent a way to cover the stated costs for FY20, the program will not be permitted to operate past September 30.

Why is the 7(a) industry questioning the FY20 subsidy calculation?

Performance—Discrepancy Between Actual v. Projected
First, the portfolio's actual performance data projects a starkly different picture than this positive subsidy estimate would suggest. Since the subsidy calculation is the projected performance of the portfolio, it stands to reason that SBA may have detected a significant decline in the current performance of the portfolio to lead them to this conclusion. However, by SBA's own reporting to Congress and the industry, the health of the 7(a) portfolio is strong. The portfolio has seen a steady decline in charge-off rates over the past ten fiscal years on an annualized basis and risk has generally declined since September 2012.

In fact, there is a significant discrepancy over actual portfolio performance and projected performance in FY20. The program's five year average recovery rate on defaulted loans, as reported to Congress last December, was 50%. In sharp contrast, the FY20 budget assumes a projected recovery rate of only 37.29%. Why has the subsidy modeling ignored this established trend of steadily increasing recovery rates?

GAO reports on SBA's subsidy calculations have highlighted this very issue of repeated discrepancies between actual loan performance and projected performance. In an August 2001 GAO letter and briefing to the Senate and House Committees on Small Business titled "Section 7(a) General Business Loans Credit Subsidy Estimates," **GAO describes a consistent pattern of SBA's estimations showing a marked disconnect with actual performance, resulting in repeatedly overestimating the cost of the program.** GAO states "review of actual and originally estimated defaults and recoveries showed that, on a cumulative basis since 1992, defaults were overestimated by approximately $2 billion… During this same period, SBA overestimated the cost of the 7(a) program by $958 million as evidenced from a trend of downward reestimates. The majority of these downward reestimates can be attributed to the overestimate of defaults." GAO goes on to explain that at the time, SBA was in the midst of proposing a new methodology to OMB that uses the 5 most recent years of actual loan performance, rather than all actual loan performance which can often include anomalies from various economic cycles that have no bearing on the current economic climate. Since this 2001 report, SBA's model has been adjusted and there has been a shift to a more sophisticated econometric modeling that attempts to create relationships between performance and economic trends and other indicators—but it seems more pertinent than ever for Congress and industry to understand how SBA and OMB currently utilize historic loan performance and for what period of time given what seems to be history repeating itself.

Pattern of Overcharging Borrowers, Lenders, and Congress
Another concerning element of the FY20 budget request that should lead to many questions about the accuracy of the 7(a) model is the documentation of repeated and significant downward re-estimates in every cohort of loans since FY10, as reported in the FY20 budget. Downward re-estimates mean that the portfolio is consistently performing *better* than originally projected in each fiscal year's original subsidy

calculation, and that the model used by SBA and OMB has been significantly overestimating program costs. In other words, data that shows in dollars the net lifetime amount of a particular fiscal year's downward re-estimate is how much borrowers and lenders have been *overcharged* in fees to cover the cost of the program. These excess charges are simply returned to the Treasury as miscellaneous receipts.

In the FY20 budget, SBA reported for FY18 a $757 million excess subsidy reserve that captured re-estimates from all prior years over what had been reported for FY17, and another $143 million is already expected for FY19. These are not isolated incidents – overfunded subsidy reserves have occurred for every cohort of 7(a) loans since FY10. In fact, since FY10, borrowers and lenders have been overcharged by approximately $3.2 billion, all transferred to the Treasury as miscellaneous receipts during that period. This is a staggering amount of money that has unnecessarily burdened the delivery of these important small business loans, and is a clear indication of the degree to which the process for developing 7(a) subsidy estimates appears to be badly broken. A subsidy model certainly cannot be perfect and it is wrong to expect that it will ever be a perfect estimation—but a pattern this egregious is concerning, especially considering that now SBA is asking for $99 million more from borrowers and lenders.

In fact, Congress has *also* been overcharged since FY2010. In FY2010- FY2013, following the Great Recession, the 7(a) program received appropriations from Congress in order to cover the cost of the program, on top of fees charged to borrowers and lenders. Since those same years of congressional appropriations have shown significant downward re-estimates into the negative, just a few years of distance has shown that appropriations were not even necessary to cover the cost of the program.

A GAO report from March 1998 to the Senate Committee on Budget, titled "Greater Effort Needed to Overcome Persistent Cost Estimation Problems," highlighted a concern with consistently inaccurate subsidy calculations at SBA. This report discussed when SBA hired Price Waterhouse to conduct a diagnostic review of SBA's internal subsidy estimation process and states that, "This September 1997 study said that 'the credit subsidy process is not viewed as a way of assessing the future risk and costs of the program for management purposes. **Rather, the rate calculation is perceived [by SBA] to be a tool for gaming the congressional appropriations process.**'" SBA went on to insist this report was inaccurate, while Price Waterhouse continued to assert its accuracy. I'm sure that this Subcommittee and Congress join the industry in hoping that this is not currently an accurate representation of SBA's subsidy calculation process, but given the repeated downward reestimates that have overcharged small business borrowers, lenders, and also Congress, the subsidy model, methodology, and assumptions deserve a closer look.

Programmatic Improvements Should Factor Into the Subsidy Calculation

Further, I am concerned that the model fails to take into account significant programmatic changes. The successful passage of the *Small Business 7(a) Lending Oversight Reform Act of 2018* lead by this Committee and its Senate counterparts improved SBA's oversight capabilities and provided changes to the program to ensure lenders stay between the lines. These changes do not seem to factor into the Administration's view of the program in the FY20 7(a) subsidy calculation. SBA's Office of Capital Access has made significant improvements to ensure the program operates with integrity, including updating the agency's Standard Operating Procedure (SOP) to require that borrowers have more skin in the game—this change does not seem to matter when the Administration is assessing the future performance of this program in its FY20 budget request. When Congress increased the maximum loan size to $5 million from $2.5 million in the *Small Business Jobs Act of 2010*, lenders were able to make loans involving real estate and which contributed significantly more fees to the 7(a) subsidy account –two factors that provided more stability to the portfolio. These are just some examples of the countless programmatic changes to the

7(a) program over the past decade that SBA and OMB should factor in to the current subsidy calculation, and which do not seem to weigh heavily in current subsidy calculations.

As far back as July 1997, GAO provided testimony before this Committee titled "Credit Subsidy Estimates for the Sections 7(a) and 504 Business Loan Programs" that stated, "In the President's budget for fiscal year 1997, SBA estimated that the costs of 7(a) and 504 program loans to be made in fiscal year 1997 would be significantly higher than the costs of loans made in fiscal year 1996, **despite legislated program changes designed to keep costs down**." There is a long-established track record of repeated over-estimations of cost, followed by an attempt on GAO's part to determine whether significant programmatic changes appropriately affected assumptions—these inquiries are just as relevant today.

Assumptions and Models Should Not Be Precluded from Congressional Oversight
I urge you to keep in mind throughout this conversation that SBA and OMB are simply making projections, basically educated guesses, about how loans that are made during FY20 might perform over the lifetime of those loans. Of course, this is no simple task and the model behind this subsidy calculation is complex, but it bears stressing that this subsidy calculation is really not a mathematical absolute based on a formula that cannot be challenged. Rather, modeling assumptions that were included, assumptions that were determined should not be included, and how these assumptions are weighted in the model must be reviewed and challenged—and it's appropriate to do so as members of this Committee and as the industry. Absent holding SBA and OMB accountable for correcting or amending the subsidy calculation, this Committee is going to have to carry out the results of a calculation that it seems no one, except SBA and OMB, understands. It hardly seems appropriate that the subsidy calculation's econometric assumptions and modeling should be shrouded in mystery. Yes, Congress gave the Executive branch authority to calculate subsidy costs, but Congress did not give *unfettered* authority to be carried out in a manner lacking in transparency or otherwise not responsive to Congressional oversight.

To this end, the findings in a March 2004 GAO report to the Senate and House Committees on Small Business, titled "Model for 7(a) Program Subsidy Had Reasonable Equations, but Inadequate Documentation Hampered External Reviews," point to a consistent inability to really discern whether the 7(a) subsidy model is most accurately estimating cost. Among the report's findings is that GAO and two other independent reviewers **could not determine whether a bias existed in the model by systematically excluding variables to influence the subsidy rate in a particular direction**. This is an alarming conclusion and one that should be looked into as it applies to the FY20 calculation. **The report goes on to state that SBA could not provide adequate documentation, a key internal control, to demonstrate the rationale and basis for key aspects of the model.** Even after SBA provided 800 pages of documentation to GAO, the report "concluded that this information would be of questionable or no usefulness in assessing SBA's development of the assumptions and selection of variables used in the modeling process." In addition, one of GAO's recommendations to OMB was not implemented, which was to update and improve OMB's Circular A-11 guidance which is either silent or unclear about the level of documentation necessary for credit subsidy model development. I urge this Subcommittee to look into these seemingly open-ended conclusions.

Impact of SBA's Proposed Fee Structure: Shrink Access to Capital
In the FY20 budget request, SBA indicates that its preferred method to cover the 7(a) program's cost is to restructure fees in the *Small Business Act,* raising costs for borrowers and lenders. The industry could understand this proposal *if* the portfolio was displaying a troubling pattern of poor performance in the portfolio. However, in this instance, there are no apparent performance issue that can be identified in the

portfolio, the budget's own data shows significant and repeated overcharging of borrowers for nearly the last decade, and SBA and OMB have yet to reveal the model's methodology and assumptions. Given these factors, SBA's proposed fee increases are nothing more than a tax on small business borrowers.

The consequence of SBA's proposals will be shrinking access to capital. Small business borrowers may be dissuaded from considering a SBA loan in the future, resulting in a reduction in access to capital. The benefits of having a program that is built on private-sector participants are numerous, but it also means there is a stark reality that the program needs to make sense financially for private-sector banks as well. If the program does not make financial sense for lenders, then they will participate less in the 7(a) program and access to capital will be further restricted.

In the aforementioned 1998 GAO report to the Senate Committee on Budget, we are reminded that we have been here before—OMB and SBA made a correction to their stated subsidy calculation mid-year for FY97 after noticing a "technical error" which GAO describes as a "large error" resulting in a significantly higher cost estimation than necessary. GAO goes on to state that by **"correcting this error...SBA was able to guarantee approximately $2.5 billion more in section 7(a) small business loans**. OMB and SBA officials acknowledged that better oversight and improved internal controls at both OMB and SBA are needed to prevent similar errors in the future." Over-estimations of cost are not just philosophical arguments—they have real consequences that translate to real dollars that otherwise could be available to this country's small business borrowers.

Without appropriately holding OMB and SBA accountable for their assumptions, something as arcane and bureaucratic as a flawed financial model for the 7(a) portfolio is essentially dictating the parameters of access to capital, rather than allowing Congress and the *Small Business Act* to exercise that authority.

Thank you for holding this hearing and I appreciate the opportunity to testify before this Subcommittee. I hope that my experience in the industry and my perspective on this incredibly detailed, technical issue sheds some light on the very real way that subsidy calculations and portfolio accounting can impact the level to which the 7(a) industry will be able to provide access to capital in the years ahead. I look forward to your questions.

"The SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes"

Testimony before the Subcommittee on Economic Growth, Tax, and Capital Access of the House Committee on Small Business

April 10, 2019

Submitted by

Lynn Ozer

Fulton Bank

Lancaster, PA

Chairman Kim, Ranking Member Hern, and Members of the Subcommittee—my name is Lynn Ozer and I am currently the President of Fulton Bank's SBA lending division. After graduating from Temple University with a BBA majoring in accounting, I got my first job at the U.S. Small Business Administration (SBA). After five years there I began my career in commercial lending with an emphasis on SBA lending. I have been leading SBA lending departments in both large banks, regional banks and community banks ever since.

In my current role at Fulton Bank, I oversee all aspects of SBA lending in our bank's five-state footprint including Pennsylvania, New Jersey, Delaware, Maryland, Virginia, and Washington DC. I am also the past Chairwoman of the National Association of Government Guaranteed Lenders (NAGGL), and in that role, I represented over 800 financial institutions and partners that participate in the 7(a) lending industry. I thank this Committee for giving me the opportunity to testify both in my capacity as a veteran lender, but also as a voice for the thousands of lenders who devote their careers to helping small businesses.

The 7(a) lending program is the agency's oldest and largest public-private partnership with approximately 2,000 participating private-sector financial institutions. Participating lenders make private-sector loans with their own capital based on their own financial decisions to small business borrowers who meet program standards for creditworthiness and financial health, but who fall into the very common lending gap for American small businesses. I have believed and trusted in SBA's mission to aid and protect these borrowers for the entirety of my career; however, it is disheartening to see an FY20 budget request from SBA that takes advantage of small business borrowers.

As a lender, when the President's FY20 budget was released, I was surprised. The budget states a positive subsidy calculation for the 7(a) loan program for FY20 of $99 million—a marked shift from the program's track record of operating at zero subsidy, or no cost to the taxpayer. Even more surprising is that SBA makes clear that its preferred solution for this $99 million cost is to increase fees on both small business borrowers and lenders in a proposal that would have serious ramifications that I will speak to later in my testimony. In reality, SBA has essentially told Congress that it has a choice of either appropriating $99 million or hiking up fees on borrowers and lenders—or the program shuts down on October 1.

My first thought as a seasoned lender is to question whether or not there have been any performance issues in the portfolio: there have been none that SBA has made the industry aware of, none that I can see in the data presented by SBA, and none that I have observed as a lender with boots on the ground. The subsidy calculation projects the net present value of the portfolio so that the government may appropriately account for the best estimate of what the cost of that portfolio will be –in other words, it is an estimated measure of how 7(a) loans originated in FY20 will perform over the lifetime of those loans. It stands to reason that for the portfolio to go from a zero subsidy cost to a positive cost of $99 million, there would be some indication in a worsening of the portfolio's performance, but there is not. In fact, as a lender who has seen many economic swings in my career, while volume has plateaued in the portfolio, the quality of our portfolio has remained high.

It is also disconcerting that the FY20 budget reveals that every cohort of loans made for the past nine fiscal years show significant downward reestimates—meaning that in those years when SBA asked for a certain level of fees from borrowers and lenders, SBA could have asked for much less and still covered the cost of the program at zero subsidy. SBA has been repeatedly overcharging borrowers and lenders, which tells me that the current subsidy model used is not working as it should. As a lender, I deal with the consequences of explaining to my borrowers and my institution what SBA fees are owed—borrowers make sacrifices to pay for those fees and my bank has to carefully account for every dollar spent. It is discouraging to learn that small businesses and participating SBA lenders did not need to pay that much in fees for nearly the past decade, yet we have no way to recoup those unnecessary losses for the borrowers.

I am fully aware that the subsidy model for the program is complex and involves a number of different assumptions. But as a lender and a steward of access to capital for thousands of small business borrowers, I think it is appropriate for both the industry and Congress to be made aware of what goes into this subsidy calculation. Much of the subsidy calculation involves projections and assumptions—projections and assumptions can be wrong and are not necessarily hard and fast truths. The model to develop the subsidy calculation for the 7(a) program, and all lending programs, has always been shrouded behind a black curtain—never discussed with industry, and I strongly doubt ever discussed with the Hill. This is not right, namely because the results of these subsidy calculations have real life consequences that, in this instance, will absolutely serve to shrink access to capital. I urge this Subcommittee and the House Committee on Small Business to work with OMB and SBA to obtain the details of this subsidy estimate, and specifically, the assumptions that went into the calculation and how those assumptions are weighted in the subsidy model. Lenders are the stewards of this program without whom there would be no SBA lending, and Congress gives the program its authority to exist each fiscal year—does it make sense that neither of us know how the cost of the program is calculated, but are expected to simply take SBA and OMB at their word without any discussion?

There seems to be an expectation that we should simply trust a calculation that does not follow logic, despite the fact that portfolio performance is better than ever with a repeated overcharging of participants for nearly the last decade. This expectation is even more incredulous given the consequences the 7(a) program will experience as a result of SBA's calculation.

If we refer to SBA's proposed increased fee structure to cover the cost of the $99 million subsidy calculation, the small business borrower's fees will increase measurably—this is a tax on small business. Anyone who claims that SBA's proposed fee increases are not impactful to the borrower must not be a lender. Not only is SBA proposing increasing caps on the upfront fees to borrowers, but they are also adjusting several tiers that currently separate the various fee caps by loan size (see Table 1 below). The result is that for loans made in the range of $500,001 to $700,000, borrowers would pay an increased fee that was formerly reserved for only loans greater than $700,000, and for loans greater than $1.5 million, there is a new tier created at a higher rate than borrowers have seen before. There is also an increase in the fee charged to borrowers for a loan term less than a year.

Table 1: Proposed Changes in Upfront Fees

Current Fee Structure on Upfront Fee on Borrower	SBA Proposed Fee Structure on Upfront Fee on Borrower to Cover the $99 Million Subsidy
Loans <= $150,000: 2.0%	Loans < = $150,000: 2.0%
$150,000 < Loans <= $700,000: 3.0%	$150,000 < Loans <= $500,000: 3.0%
Loans > $700,000: 3.50%	$500,000 < Loans <= $1.5 million: 3.50%
	Loans > $1.5 million: 3.75%
Additional 0.25% fee for any guaranteed amount over $1 million	Additional 0.25% fee for any guaranteed amount over $1 million
Loan term less than 1 year: 0.25%	Loan term less than 1 year: 0.50%

At Fulton Bank, many of our loans are made between $500,000 and $700,000 and would be impacted, as well as our larger loans and working capital with a one year term or less. By way of example, in Mercer County in New Jersey, we made a $520,000 loan to Emcom Systems, a small manufacturing company employing 20 individuals that makes security devices for public and transport use—think security phones on subways and blue light phones on college campuses. Upfront fees to the borrower were $11,700 and under the new scenario, those fees would have been $13,650. The additional $1,950 may not sound like that much, but in Emcom's world, these funds could be utilized to hire additional staff or increase profitability through bulk material purchasing and process improvements.

Or take the example of a $515,000 loan to Kaylah Designs, Inc., a jewelry manufacturer with locations in Pikesville, Maryland and Lakewood, New Jersey. The upfront fee on this loan was $11,587.50 and under the proposed budget, this small business would pay an additional $1,931.25—to this small business, that savings represents additional raw materials to boost sales and represents more than a 16% increase in fees.

Fulton Bank's borrower, Three Eye Research, in Cherry Hill, New Jersey received an Export Working Capital line of credit for $1,000,000—they paid $2,500 in an upfront fee for a 12-month credit facility. Under SBA's new proposal, the fee would have doubled to $5,000, potentially hampering the company from being able to utilize these excess funds to create jobs or increase productivity.

T Group, LLC is a trucking company just outside of Bordentown, New Jersey that has seen its business expand due to the enormous boom in delivery services from online purchasing. The company borrowed $2,975,000 to purchase their location and adjacent property to house their fleet. Their upfront fees totaled $81,171.87. Under SBA's proposed fee structure, the company would pay an additional $5,578.11.

These fee increases are especially taxing on small business borrowers in light of the repeated overcharging of borrowers to operate this program for the past eight fiscal years. In the end, if SBA's current proposal is adopted by Congress, many small business borrowers may be dissuaded from considering a SBA loan and there will be a reduction in access to capital. This negative consequence of SBA's own proposal seems antithetical to SBA's stated mission and the mission of the 7(a) program.

What would be the impact to participating SBA lenders? Again, if we refer to SBA's own proposed fee structure to cover the cost of the $99 million subsidy calculation, lenders' costs increase significantly (see Table 2 below). For Fulton Bank, the costs for my SBA department would increase by roughly 25% just on new loan originations in FY20, with that number multiplying by itself year over year into the future since these lender fees are charged on an annual basis for the life of the loan.

Table 2: Proposed Changes in Ongoing Fee

Current Fee Structure on Ongoing Fee on Lender	SBA Proposed Fee Structure on Ongoing Fee on Lender to Cover the $99 Million Subsidy
55 bps on all loans	55 bps for loans up to $1.5 million 69 bps for loans over $1.5 million

It is important to emphasize for this Subcommittee that when costs increase on lenders, there is a domino effect on how lenders will utilize this program—the results of which will only hurt the small business borrower in the end. For instance, in an effort to recover lost revenue, lenders who are not at current interest rate maximums (which are capped by statute and regulation), will be forced to increase interest rates on borrowers wherever they can in an effort to recoup losses. For the lenders who are at the current interest rate maximums, they will have no choice but to simply shrink their 7(a) loan portfolios to still afford to make 7(a) loans with measurably higher costs. At Fulton Bank, many of the larger loans we make are not at the interest rate maximums and we will have to seriously consider increasing those rates, as well as rates on any other loans in our portfolio that we do not currently charge at the interest rate maximum.

Lenders could turn to selling significantly more of their loans on the secondary market in order to create necessary liquidity, putting potential stress on the Secondary Market Guarantee Program. Since lenders with a high percentage of secondary market sales in their portfolio are flagged higher risk in OCRM's risk reviews, OCRM will likely report to Congress in the coming years that lenders are exhibiting higher risk profiles than they were in prior years, which will be a consequence of SBA's own making.

To make matters worse, SBA's proposed fees on lenders are concentrated on large dollar loans, which makes sense if the goal is to find the easiest source of revenue to achieve $99 million in additional fees since larger loans generate higher fees. However, this Subcommittee needs to understand that when you disincentivize lenders from making larger loans, which is what this proposal will do, the subsidy in future years will be negatively impacted since the fee income from larger loans contribute more to the subsidy account and provides overall subsidy stability—again, another potential consequence of SBA's own making.

Finally, when banks take such a drastic hit to internal costs, efficiency ratios in the bank increase. This efficiency ratio is simply the bank's operating costs, referred to on the bank's income statement as 'non-interest expenses' divided by its net revenue (total income minus interest expense). Banks strive to have their efficiency ratio as close to 50% as possible. As a result of increased costs and efficiency ratios, many SBA lenders could be faced with a tough conversation with their management, board of directors, or stockholders about whether or not the bank can invest any more in their SBA department or whether SBA lending is a good option for the bank at all. From a big picture perspective, banks will likely shrink their current volume or, at the very least, halt current volume—and they will certainly find it difficult to *increase* their volume of SBA loans. Is this really the outcome that SBA hopes for when it comes to their flagship loan program?

There are several other concerning provisions in the President's FY20 budget request that warrant discussion, such as the continued request for borrowers and lenders to pay for SBA's employees' salaries and expenses by collecting excess fees beyond what SBA needs to cover the credit costs of the program. This is an outrageous request given the questionable positive subsidy calculation this year. The consequences of an additional $99 million estimated cost to the program I have outlined above will only be exacerbated since this proposal, combined with the necessary cost of covering the positive subsidy, will cost 7(a) borrowers and lenders $197 million in fees on top of what they already pay. To even request this additional fee structure shows an alarming disconnect between SBA and the reality of the costs of this program on small business borrowers and lenders. I am only comforted by the fact that Congress made clear in FY19 that it would not tax borrowers and lenders for SBA's administrative costs when SBA proposed this same request last year.

But make no mistake, the part of this budget request that is not just a request is the subsidy calculation. SBA reports the subsidy rate every fiscal year and Congress reacts accordingly through the appropriations process. <u>I urge you not to simply take this subsidy calculation at face value and seriously</u>

challenge the subsidy rate—borrowers, lenders, and the ability of the 7(a) program to serve access to capital needs across the country are dependent on how you react to this surprising calculation.

Thank you for holding this hearing and I appreciate the opportunity to testify before this Committee. As lenders, we are incredibly proud of who we serve and the role we play in each of the districts you represent. We want to continue increasing opportunities for small businesses and open the doors to access to capital. The SBA's FY20 budget request would do just the opposite—it would shrink access to capital, closing the door on many borrowers and lenders. I hope that I have helped to make sure that this Subcommittee and Congress are aware of the real consequences that will result from SBA's questionable subsidy calculation and its flawed proposal to address it. I look forward to your questions.

NAFCU

Testimony of

Gail Jansen

Vice President of Business Services and Operations

Kinecta Federal Credit Union

On behalf of

The National Association of Federally-Insured Credit Unions

"SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes"

Before the

Subcommittee on Economic Growth, Tax and Capital Access

House Small Business Committee

April 10, 2019

Introduction

Good Morning, Chairman Kim, Ranking Member Hern, and Members of the Subcommittee. My name is Gail Jansen, 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 our perspective on the Small Business Administration's (SBA's) 7(a) Loan Program and the potential impacts of the proposed fee structure changes for fiscal year 2020.

As the Vice President of Business Services and Operations at Kinecta Federal Credit Union, I am responsible for a portfolio of nearly $1 billion in member business loans that includes nearly $35 million in SBA loans. I hold a bachelor's degree from California State University, Fullerton and a master's degree from Azusa Pacific University and have over 20 years of experience in the financial services industry.

Kinecta Federal Credit Union, based in Manhattan Beach, California, was originally chartered in 1940 with $60 in deposits from 12 members as Hughes Aircraft Employees Federal Credit Union. Today, we have over 300,000 members nationwide with over $4.4 billion in assets and 22 branches. We changed our name to Kinecta in 2001, but our mission to serve our members has not changed as we have been consistently named as the South Bay's best credit union.

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 and the entire credit union community appreciate the opportunity to participate in this discussion regarding the 7(a) loan programs and the budget proposal of 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 116 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* (FCU Act) 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 services; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism. Credit unions are not banks.

The nation's approximately 5,400 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, who are all members of the credit union, 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 we 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 during that time 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 many 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 each credit union's member business lending to the lesser of either 1.75 times the actual net worth or 1.75 times the minimum net worth of a well-capitalized credit union (12.25 percent).

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 20 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 $77,500 today, using the most recent consumer price index data. That is more than a 55% 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 but 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.

We would urge Congress to support legislation to provide relief from the arbitrary cap on credit union member business lending.

Memorandum of Understanding between the SBA and NAFCU

In September 2017, the SBA and NAFCU renewed a 2015 Memorandum of Understanding (MOU) in a joint effort to improve access to small dollar loans to small businesses across the nation. Both parties entered into the MOU with the desire to increase the number of credit unions offering SBA loan products. Credit unions, with their not-for-profit, mission-based focus, are positioned to fill the gaps in capital for small businesses, especially for underserved borrowers. Involving more credit unions in SBA programs will expand the accessibility of SBA products and ultimately strengthen small businesses and the communities in which they operate. With greater participation in SBA's lending programs, credit unions stand to benefit from the reduction of their risk on small business loans and from increasing financing resources available to their small business members.

SBA Lending at Kinecta Federal Credit Union

Business lending is an important aspect of our service to members at Kinecta. A key part of that is our ability to offer SBA 7(a) loans. Kinecta is a Preferred Lender with the Small Business Administration, and was ranked as the #1 credit union SBA lender in all of California. We currently have an SBA portfolio of $35 million with an average size of $250,000 per loan. Our SBA loans range from a low of $50,000 to a high of $5 million. Our members turn to us for SBA loans for working capital, inventory and equipment purchases, tenant improvements, business acquisitions, debt refinancing, start-up financing and to purchase commercial real estate. On average, we make about 20 SBA loans a year.

The kinds of companies that turn to us for SBA loans include small manufacturers (10-40 employees), logistic companies (5-30 employees), brick-and-mortar retail shops, independent restaurants, franchises, ecommerce and tech companies, and professional services. A business owner will apply for an SBA loan with a credit union because they want or are looking for something different than what a bank can offer. The business owner is often pleasantly surprised that a credit union offers small business loans and as a result is willing to consider us as a viable alternative. Credit unions are already well known for offering home loans, auto loans, personal loans, and credit cards to their members, so there is additional value added when the member is a business owner and is in need of financing to support their small business.

Our ability to offer SBA loans allows us to meet the needs of our members, like the one who turned to us in July 2018 with a small, growing residential home remodeling company. The use of funds was to refinance existing business debt and provide working capital to support new projects. At the time of the loan request, the company had only one full-time employee and one part-time employee. The subject debt to be refinanced was originated from an online lender that was charging the business owner an exorbitant interest rate of 44.28 percent. After underwriting the loan request, Kinecta approved and funded the SBA loan in the amount of $110,000 at an interest rate of 7.75 percent. The refinancing of the business debt resulted in a cash flow savings of 91.10 percent for the small business owner. As a result of these savings, the business has since hired two full-time employees and has begun to create a reserve account with the future intention of purchasing a commercial real estate property.

SBA's 7(a) Budget Proposal and the Impact of Fee Structure Changes on Credit Unions

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 help 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. While there are positives to SBA's overall FY 2020 budget request, such as the increase in the SBA Express loan limit from $350,000 to $1 million, it was troubling to see the request to modify its statutory fee structures and potentially increase its fees because of a refinement to its economic modeling. The bottom line is that the fee increases, as proposed by the SBA in its budget submission, will impact both our small business members and the credit union.

Currently, the SBA guaranty fee for loans $150,000 and less is 2.0 percent. That will not change under the current proposal, and that is a positive. The 3.0 percent guaranty fee for loans in the range of $150,000 to $700,000 is proposed to remain at 3.0 percent for loans in the range of $150,000 to $500,000, but increase to 3.50 percent for loans in the range of $500,001 to $1,500,000. That proposed structure will make it more expensive for members for loans greater than $500,000, and we do have a number of members who seek loans in this range. For loans greater than $1.5 million, the proposal introduces a new fee rate of 4.0 percent.

It is important to note that the small business member pays the guaranty fee one time, and that is usually at funding. The monies are usually disbursed directly from the loan proceeds so the member does not have a direct out-of-pocket cost at origination. However, the lender, Kinecta in this case, pays an ongoing annual fee for each loan that is originated. This fee is currently 55 basis points (bps). Under the proposal, the fee will be 55 bps for loans up to $1.5 million and 83 bps for loans over $1.5 million. This will make loans over $1.5 million more expensive for the credit union.

In high-cost real estate markets, such as California, New York, and Washington, D.C., among others, $1.5 million is not a lot when talking about commercial real estate. Increasing the cost of these loans to both the small business and the lending institution will likely make it more difficult to get an SBA loan for commercial real estate in higher-cost markets.

We urge the SBA and Congress to work together to protect and strengthen the SBA 7(a) program, which includes examining all efforts to avoid potential fee increases on small businesses and the small lenders who serve them.

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 job creation. Although the Small Business Administration's 7(a) program provides much needed opportunities to established and fledgling businesses, increasing fees for the program will have an impact on both borrowers and small lenders. We recognize that maintaining a zero subsidy for the program is important, but we urge you to examine potential alternative solutions to avoid a fee increase scenario.

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.

SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes

Testimony to the U.S. House
Committee on Small Business, Subcommittee on Economic Growth, Tax, and Capital Access

Gordon Gray
American Action Forum*

April 10, 2019

*The opinions expressed herein are mine alone and do not represent the position of the American Action Forum.

Introduction

Chairman Kim, Ranking Member Hern and members of the Committee, I am honored to be before you today to discuss the budgetary considerations of the Small Business Administration's (SBA) 7(a) loan program. This is an important program that provides access to small business entrepreneurs who otherwise have no access to adequate financing and supports hundreds of thousands of jobs. As a taxpayer-funded program, it should be subject to continuous and rigorous oversight, and I appreciate the Committee's attention to this program in today's hearing.

In my testimony, I wish to make three basic observations:

- The federal government is a prolific lender, providing guarantees on and direct loans of $4 trillion as of fiscal year (FY) 2018.
- The budgetary treatment of credit programs is somewhat unique in budgeting, adhering to the principles of accrual accounting as set forth in the Federal Credit Reform Act (FCRA) of 1990.
- FCRA accounting addresses the deficiencies of cash accounting in measuring the cost of credit programs, but necessarily introduces additional complications.

Let me discuss these in turn.

Federal Credit Assistance

The federal government is a prolific lender, providing a combined $4 trillion in credit assistance as of FY2018 to American households and businesses.[1] In general, the goal of this assistance is to provide credit to borrowers, who otherwise would not receive credit at market terms from lenders.

The nature of this credit assistance is varied across federal agencies and activities, but generally takes two forms: direct loans and guaranteed loans. The Office of Management and Budget (OMB) defines direct loans in circular A-11, the executive branch's primary set of guidelines for budget preparation and execution as: "a disbursement of funds by the Government to a non-Federal borrower under a contract that requires the repayment of such funds with or without interest. The term also includes certain equivalent transactions that extend credit."[2] Essentially, for direct loan programs, the federal government assumes the role of the lender – underwriting and issuing loans to recipients on terms that are generally more favorable than those provided by the market. These preferential terms can take the form of below-market interest rates, repayment grace periods, interest-only

[1] https://www.whitehouse.gov/wp-content/uploads/2019/03/ap_22_credit-fy2020.pdf
[2] https://www.whitehouse.gov/wp-content/uploads/2018/06/a11.pdf

periods, and other features that are designed to provide eligible borrowers with greater access to credit than would otherwise be available. As of FY2018, the federal government has $1.4 trillion in direct loans outstanding.

The federal government also provides substantial credit assistance in the form of loan guarantees. OMB defines loan guarantees as: "any guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender. The term does not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions." In these instances, a financial institution is responsible for underwriting (subject to program guidelines) and issuing loans to eligible individuals and institutions. Repayment of those loans is made directly to the lender, but the government typically receives compensating fee payments as a condition of the guarantee. If the borrower defaults on the loan, however, the federal government is liable for the amount of the loan that it guaranteed, which is typically a percentage of the overall loan amount. As of FY2018, the federal government had extended guarantees to $2.6 trillion in loans outstanding.

It is this form of credit assistance that concerns today's hearing: the 7(a) loan program. The 7(a) program provides eligible small businesses with private-sector financing with a public guarantee. The program includes several specialized features, but in general provides up to a 75 percent guarantee on loans up to $5 million. The program requires lenders to ensure borrowers demonstrate adequate ability to repay, management ability and equity, among other considerations. Credit is also contingent on borrowers demonstrating that credit is otherwise unavailable at reasonable terms. According to the SBA, the 7(a) loan program supported over 60,000 loans totaling $25.4 billion in FY2018.[3]

The Budgetary Treatment of Credit Programs

Prior to 1992, federal credit assistance programs were recorded for budgetary purposes on a cash basis like any other federal spending program. For any credit program, this presents a distorted view of the program's effects. In the most simplistic terms, a loan is a lump payment to a borrower in exchange for future payments. On a cash basis, this would look like a large outlay in the year of the loan's origination, and assuming the life of the loan is longer than the budget window, an insufficient funding stream. Loan guarantees present more difficulties still. The defining feature of a loan guarantee is that it is a contingency only recognized upon realization. Which is to say, at origination, a federal loan guarantee commitment would not record any budgetary flows on a cash basis (except perhaps any fees collected). Cash accounting simply does not capture the commitment of taxpayer funds that is the basis for the value of the federal guarantee. This budgetary treatment also confounded oversight of program performance.

[3] https://www.sba.gov/sites/default/files/aboutsbaarticle/2018_SBA_PAR_FINAL_1218_508.pdf

The Federal Credit Reform Act changed the budgetary treatment of these credit programs beginning in 1992.[4] The Act required that new federal credit commitments (among other budgetary flows) be recorded on an accrual basis going forward. Under the new methodology, the net present value of the taxpayer subsidy would be recorded in the year of the new commitment. Accrual accounting has the advantage of capturing all cash flows associated with a given credit program and accounts for the effect of the timing of those payments through discounting. FCRA requires the use of Treasury yields for discounting future cash flows under FCRA.[5]

Accrual accounting more accurately captures the taxpayer exposure for a given credit program by recognizing the value of the upfront outlay by the taxpayer, but also the associated repayment stream even if it is outside the budget window. This treatment also captures the value of preferential credit terms, such as longer loan maturities or interest deferral.

The Anatomy of a Subsidy Rate

The net present value of cash flows associated with a given loan cohort represents the cost of the credit subsidy. It is this subsidy cost for which Congress provides funding. For example, according to the SBA, new 7(a) loans in FY2020 are projected to incur a positive subsidy cost, which must either be offset through an appropriation, fee changes, or other terms that would reduce taxpayer exposure. According to the SBA, the program is projected to have a 33 basis point subsidy cost on $30 billion in loans, requiring a $99 million congressional appropriation to support the additional lending in FY2020. SBA reports this is due to, "refinement of the model to increase precision for estimating purchase amounts and sensitivities of the model related to long term macroeconomic assumption."[6]

As noted above, prior to the enactment of FCRA, the basic unit of measurement of the budgetary effects of a credit program was the annual cash flow. Under FCRA, the basic unit of measurement is the subsidy cost, which is the net present value of all future cash inflows and outflows, discounted at term-matched Treasury rates, for a cohort of loans. These flows include the net effects of defaults, fees, and recoveries. It does *not* include administrative or incidental effects to other federal budgetary flows.

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[4] P.L. 101-508; The 1997 Balanced Budget Act made several technical changes to FCRA generally designed to improve the uniformity and consistency of estimates of the costs of credit programs: https://www.govinfo.gov/content/pkg/BUDGET-1999-PER/pdf/BUDGET-1999-PER.pdf

[5] There is a robust debate among policy observers as to whether a discount rate that incorporate market risk would be a more accurate measure of the cost to tax payers, known as fair-value accounting. This discussion, however, is outside the scope of my testimony.

[6] https://www.sba.gov/sites/default/files/2019-03/SBA%20FY%202020%20Congressional%20Justification_V2_15Mar19_508Statement_0.pdf

To illustrate how these values are calculated, consider the following examples developed by the Congressional Budget Office.[7] Assume the federal government provides $100 in credit assistance to the public. Also assume that the Treasury rate over the term of the loan is 5 percent. At 5 percent, the cost of repayment would be $105. Discounted at the same rate, the $105 in future payments equals the face value of the loan. This example assumes no fees or other associated flows. Now consider a cohort of loans with a 25 percent default rate. For simplicity, assume that borrowers have no assets to recover. Under this scenario, the federal government would collect $78.75 in cash repayments, which are worth $75 in present value. The program thus has a $25 subsidy cost. If Congress were to enact this program, it would need to provide $25 in budget authority to fund this credit assistance. Note that if the federal government merely guaranteed these loans rather than originated them, it would face the same subsidy cost, assuming the government guaranteed 100 percent of the loan. The subsidy *rate* for this program is expressed as the subsidy cost over the disbursement of the loan, which in this case is 25 percent. Additional flows would further affect this rate, such as recoveries and fees.

It is important to recognize that this calculation more accurately reflects the totality of the federal commitment for a given credit program. It also necessarily introduces additional complications, however. By nature, FCRA requires projecting all associated cash flows for a given loan over its duration. This also requires projecting likely delinquencies, defaults, prepayments, interest rates, and other factors to determine credit subsidy rates. The subsidy cost is thus exposed to fluctuations for any of these factors.

Underpinning a number of these elements is OMB's economic assumptions, which the agencies are required to use as part of this calculation. The strength of the economy substantially effects default rates for example, and a worsening economic outlook, would all else equal, increase the subsidy cost to the federal government through higher defaults among other considerations.

The federal government annually reestimates subsidy rates for credit programs. These reestimates are presented in a supplement to the president's budget and provide a crosswalk from the original estimate to the current estimate, detailing which of the major elements of the subsidy rate changed. These elements include changes to interest rates as well as technical assumptions, which includes delinquencies, defaults, and other performance factors. Note that under FCRA, increased reestimated costs are funded in the following year by permanent indefinite budget authority, while decreased costs are returned by the agencies to the general fund. Thus, there is no legislative consequence for underestimating the cost of a loan cohort. For example, the subsidy cost for loan guarantees issued under the SBA 7(a) program have on net been reestimated upwards by about $1.7 billion (excluding interest) since 1992, but Congress did not have to enact additional

[7] https://www.cbo.gov/sites/default/files/108th-congress-2003-2004/reports/08-19-creditsubsidies.pdf

funding into law.[8] Not surprisingly, the largest upward reestimates occurred for loans issued immediately before during and after the Great Recession. Note, however, that this reestimate covers guarantees on over $292.9 billion in loans disbursed under the program.

Conclusion

The Small Business Administration's 7(a) loan program is critical to providing entrepreneurs with access to credit, supporting over 60,000 borrowers with over $25 billion in guaranteed loans last year. As a credit program, however, accurately measuring the taxpayer exposure to risk is somewhat more complicated than is estimating the cost of typical federal spending programs. The current standard, FCRA, represents an important reform that improved the measurement of these risks over the cash-accounting method that prevailed until 1992. The new method records subsidy costs that reflect the performance of the loan over its full term. This approach necessarily requires projecting the associated cash flows of that loan over time. Any time a measurement requires projecting into the future, some uncertainty however is introduced. Since FCRA was enacted, the subsidy costs of the 7(a) programs have been underestimated, with net positive lifetime reestimated subsidy costs. Yet these costs are quite small over nearly three decades and relative to the overall size of loan disbursements. It does appear, however, that this net underestimate is driven largely by the effects of the economic downturns.

[8] https://www.govinfo.gov/content/pkg/BUDGET-2020-FCS/pdf/BUDGET-2020-FCS.pdf

CBA | CONSUMER BANKERS ASSOCIATION

April 10, 2019

The Honorable Nydia M. Velázquez
Chairwoman
Committee on Small Business
U.S. House of Representatives
2302 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Steve Chabot
Ranking Member
Committee on Small Business
U.S. House of Representatives
2371 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Andy Kim
Chairman
Subcommittee on Economic Growth, Tax, and Capital Access
U.S. House of Representatives
1516 Longworth House Office Building
Washington, D.C. 20515

The Honorable Kevin Hern
Ranking Member
Subcommittee on Economic Growth, Tax, and Capital Access
U.S. House of Representatives
1019 Longworth House Office Building
Washington, D.C. 20515

Dear Chairwoman Velázquez, Ranking Member Chabot, Subcommittee Chairman Kim, and Subcommittee Ranking Member Hern:

On behalf of the Consumer Bankers Association (CBA), I would like to thank you for convening the Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access hearing on "SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes." CBA is the voice of the retail banking industry, whose products and services provide access to credit for consumers and small businesses. Of the 100 most active Small Business Administration (SBA) 7(a) lenders, CBA members make the majority of the total number of 7(a) loans.[1] Our members operate in all 50 states, serve more than 150 million Americans, and collectively hold two-thirds of the country's total depository assets.

The 7(a) Loan Program is a vital source of capital for thousands of small businesses unable to secure financing through traditional lending. The demand for these loans has grown substantially and the dollar amount of gross loans approved has nearly doubled since 2012. Throughout this growth, the performance of the program has remained healthy, closing last year with record-low charge-off rates. Furthermore, in recent years, the current fee structure has generated in excess of what SBA actually needed to cover the 7(a) credit costs. Overall, the program continues to be strong and provides an option that meets the needs of many of America's small businesses.

Considering how well the 7(a) portfolio has performed historically, CBA encourages Congress to closely examine SBA's FY2020 budget request, specifically in regards to the agency's prediction that the 7(a) program will not be able to maintain a zero-subsidy rate. In the budget, SBA requested flexibility to modify its statutory fee structures, stating under current law the 7(a)

[1] Office of Capital Access, "100 most active SBA 7(a) lenders," *Small Business Administration*, December 31, 2017, https://www.sba.gov/article/2017/oct/01/100-most-active-sba-7a-lenders

program would not be able to operate at zero subsidy based upon the administration's modeling and subsidy rate estimates.

The budget request projects an additional $99 million will be required to cover the cost of the program and proposes an increase in the fee structure to offset the shortfall. If the agency's subsidy rate is not modified, and in lieu of amending the *Small Business Act* to allow for an increase in fees to be assessed on lenders – which the banking industry would strongly oppose – Congress would need to appropriate the dollars to cover the proposal's estimated budget deficiency in order to prevent the program from being shut down on October 1.

Given the nature of the 7(a) program and the small businesses that utilize it, CBA is concerned any increase in fees will lower participation by small business borrowers in the program and further restrict them from accessing needed capital to start and grow their small businesses. The fee structure outlined in the budget request proposes a 33 basis point (bps) increase on the fees already assessed to lenders. This increase, as well as the budget's proposed counter-cyclical measures that would also increase fees by an additional 31 bps to pay for the program's administrative costs, would be a significant increase for current lenders and force them to adjust their 7(a) loan rates to reflect the change. Considering the program's credit elsewhere requirement, borrowers that rely on this program cannot obtain credit though conventional lending, and the proposed fee structure would only further reduce the already limited options available to these small businesses and increase the cost of capital for borrowers.

CBA commends the committee for holding this hearing to examine the SBA budget request for FY2020 and the impact the fee structure changes will have on small business lending. We greatly appreciate this thoughtful approach to ensuring the continued success of the SBA 7(a) Loan Program and look forward to working with members of the Committee and Congress.

Sincerely,

Richard Hunt
President and CEO
Consumer Bankers Association

Credit Union National Association
CUNA

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April 9, 2019

The Honorable Andy Kim
Chairman
The Committee on Small Business
Subcommittee on Economic Growth, Tax, and Capital Access
United States House of Representatives
Washington, DC 20515

The Honorable Kevin Hern
Ranking Republican Member
The Committee on Small Business
Subcommittee on Economic Growth, Tax, and Capital Access
United States House of Representatives
Washington, DC 20515

Dear Chairman Kim and Ranking Member Hern:

On behalf of the Credit Union National Association (CUNA), I am writing to commend you for holding the hearing on the "SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes." I respectfully request that this letter be made part of the record for this hearing. The Credit Union National Association represents America's credit unions and their more than 115 million members.

Since 2003, when the Small Business Administration (SBA) first expanded its loan guarantee programs to include originations by credit unions, credit unions have become an increasingly important provider of loans to America's small businesses, including through participation in the SBA's 7(a) Loan Program. CUNA and credit unions are strong supporters of this Program, as we believe its objectives are laudable.

In the aftermath of the financial crisis, it was credit unions that significantly increased their small business lending to provide businesses with the necessary capital to sustain and grow their operations. Between 2008 and 2016, credit unions' small business lending activity doubled to more than $60 billion. The more than 5,000 credit unions currently operating in the United States and their over 100 million members have a vested interest in the continued availability of the SBA's loan programs.

While the 7(a) Loan Program traditionally operates without appropriations from Congress, the SBA indicated in its budget request for FY 2020 an expected shortfall in funding. In response, the SBA has proposed to increase associated fees in order to cover the shortfall. As discussed below, CUNA has concern over the unintended consequences of such an increase in fees.

One of the many services credit unions provide their members is lending through the SBA's 7(a) Loan Program. Currently, there are 6,532 outstanding SBA loans by credit unions in the aggregate amount of $2,768,245,096. Any increase to the current cost to participate in the Program could unintentionally lead to a decrease in these numbers. The primary concern with a fee increase is that it could dissuade potential borrowers from pursuing loans through the 7(a) Loan Program, which is often one of, if not the, last possible source of credit for an aspiring entrepreneur or existing small business owner striving to increase his or her operations.

CUNA supports the SBA charging appropriate fees that are necessary to sustain the 7(a) Loan Program without cost to taxpayers. We believe this is the original intent of the Program and has allowed it to operate effectively. In addition, we understand it is necessary for fees associated with the SBA's loan programs to increase on occasion to compensate for related increases in administrative costs. However, we are concerned that the 7(a) Loan Program fees continue to increase without an obvious increase in costs, such as those related to administering the Program or those resulting from a significant deterioration in the SBA's loan portfolio.

The SBA's loan programs remain a critical tool for credit unions as they seek to meet members' needs for business capital and credit. Accordingly, CUNA understands reasonable fees are necessary to ensure continued availability of programs such as 7(a). However, since any increase will be passed on to the borrower by the lending credit union or other 7(a) Loan Program participant, we have concerns that the amount of the fee increase proposed for FY 2020 could cause some potential borrowers to forego or delay a small business loan backed by the SBA. Therefore, we ask this Subcommittee to request the SBA reevaluate its proposed fee increase to ensure the amount of any increase is absolutely necessary to maintain the Program.

On behalf of America's credit unions and their 115 million members, thank you for recognizing the importance of this issue and holding this important hearing.

Sincerely,

Jim Nussle
President & CEO