NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

"Strengthening SBA's 7(a) Loan Program"

Testimony before the House Committee on Small Business

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Submitted by
Anthony R. Wilkinson, President and CEO
National Association of Government Guaranteed Lenders
101 Constitution Ave NW
Washington, DC 20001

Chairman Chabot, Ranking Minority Velázquez, and members of the Committee - my name is Tony Wilkinson and I am President and Chief Executive Officer of the National Association of Government Guaranteed Lenders (NAGGL). 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 — with NAGGL's lender members being responsible for approximately 80% of the total 7(a) loans made each year.

This Committee and its colleagues on the Senate Committee on Small Business and Entrepreneurship have been looking into the performance of the SBA 7(a) loan program and SBA's role in oversight of the program for the last three years. There has been great care taken by this Committee to approach this issue with diligence and as the CEO of the SBA 7(a) industry's trade association for the last thirty years, I can tell you honestly that your careful approach to this matter is a rarity in the history of this program and incredibly appreciated. Your staff, particularly Rob Yavor for the majority and Justin Pelletier for the minority, have been exceptional — they truly worked with all sides to understand the issues and unintended consequences at stake in a very technical program. We also very much appreciate the Committees' announced intention to continue to work with industry and the agency to perfect H.R. 4743 going into the markup process. The lending industry that NAGGL represents is grateful for this Committee and its staff's longstanding commitment and dedication to engaging the ***many*** stakeholders throughout the process, and we look forward to working with you and with SBA to assure that the final legislation provides appropriate direction for SBA's lender oversight efforts.

I am pleased to testify today to discuss NAGGL's support for H.R. 4743, a bill that will strengthen SBA's Office of Credit Risk Management (OCRM) and how it performs its role to oversee the 7(a) loan program. It is now when we are performing well and increasing our lending volume that we *should* be taking a step back and taking stock of what OCRM needs in terms of resources and authority to perform its responsibilities to the best of its ability.

So what benefits will H.R. 4743 provide to the program from NAGGL's perspective?

ADMINISTRATOR FLEXIBILITY

One of the most important provisions to the lending community included in H.R. 4743 includes granting flexibility authority to the SBA Administrator to increase the 7(a) program's authorization cap by 15% if the pace of lending is set to exceed that fiscal year's given cap. The authority to increase the authorization cap can only be utilized once a year and with approval from the Committees on Small Business in the Senate and House, as well as from the Financial Services and General Government Subcommittees on the Appropriations Committees in the Senate and House. NAGGL first presented this flexibility language to OMB and the Hill in the wake of the FY2015 7(a) lending shutdown, drawing on the same language and precedent set by the House and Senate Appropriations Committees in their treatment of various USDA loan programs. Since then, NAGGL has enjoyed the partnership of Senator Coons, Senator Shaheen, and Senator Risch, to name a few last Congress who introduced a bill in the Senate to establish cap flexibility, and this Congress, Ranking Member Velázquez championed a bill in the House to move this proposal forward. And as you know, OMB included this language in the last three Presidential budget proposals, so SBA has been a champion for this proposal as well.

In both FY2014 and FY2015, the SBA 7(a) program saw demand from small business borrowers reach the program's authorization cap before the end of the fiscal year, and in FY2015 the program shutdown for several days. In both of those fiscal years, Congress was able to pass emergency supplemental language that allowed the program to be reinstated. Some of you on this Committee helped see those unusual measures through to ensure the SBA 7(a) program remained available to the country's small businesses, and industry owes you a great deal of gratitude. But those were rare instances of Congressional intervention and these threats of shutdown destabilize the program. The issue largely stems from the great difficulty in anticipating the exact number of borrowers who will be applying for SBA 7(a) loans 18 months in advance during the budget process.

Unfortunately, these programmatic shutdown threats also alter lender behavior. Lenders continuously monitor the cap throughout any given Fiscal Year, as they must answer to both borrowers and their private-sector financial institution. There have been instances in the program's history in which lenders rush to process as many loans in their pipelines as possible, to avoid turning away a small business borrower if it is apparent that demand may come close to the cap. It is not Congressional intent to have lending pace set by lender panic, and the Administrator flexibility language solves for that potential risk in the future.

While this flexibility should never supplant the role of Congress in setting authorization caps, it will serve as a common-sense safeguard against last-minute panic. This Committee and its colleagues on the Appropriations Committee, and in the Senate, should not have to be backed against a wall every time there are more borrowers than anticipated walking through a lender's door on a given day, week, or month. Thank you to this Committee for embracing and now championing this concept — especially Chairman Chabot and Ranking Member Velázquez — and we look forward to discussing this more.

CREDIT ELSEWHERE CLARITY

H.R. 4743 also updates the credit elsewhere provision currently in statute — a clarification lenders have long asked for and which is critically important to the program. The cornerstone principal of the SBA 7(a) program is that it complements, but does not compete with conventional small business lending. The non-competitive status of the program is assured by the fact that before any SBA 7(a) loan guaranty can be approved, the participating lender must certify that the loan could not be made without the SBA guaranty. NAGGL believes the proposed legislation will strengthen compliance with the credit elsewhere requirement by clarifying the types of situations which cause the SBA guaranty to be required. If enacted, the statute will make clear the types of eligible, creditworthy small business applicants that cannot access credit without the SBA guaranty — including newer businesses, those with less collateral, those requiring longer maturities to better match the repayment terms to the cash flow from their operations, etc. NAGGL believes that this clarification is critically important to assuring that the loans made under the program continue to fill the existing small business credit gap.

IMPROVED OVERSIGHT REVIEWS AND TIMELINESS OF PROVIDING REVIEWS

Finally, I would like to applaud the Chairman and Ranking Member for the provision of the bill which improves the oversight review process for lenders. NAGGL has long called for full-time employees (FTEs) of SBA to lead each team of reviewers that conducts the oversight reviews of the program's participating lenders. When there is a FTE present and supervising each review, it ensures that there is a deep foundation and understanding of the incredibly complicated policies that are specific to SBA lending. This is critical to ensure the highest level of oversight for the program and provides lenders assurance that the payments they make to cover the costs of their reviews go toward financing a review process that is thorough and meaningful.

Another important provision of H.R. 4743 is the new requirement that SBA send a lender's oversight review report within a reasonable amount of time. The language still gives SBA the ability to take longer if needed, but the agency must notify the lender of this extension and the reason for the delay. Lenders are expected to be responsive and prudent participants, and this new language will put an onus on the agency to be responsive in a timely manner. Why is this so critical to improving oversight? Robust oversight requires timely communication between the lender and the agency to ensure errors on the part of lenders — that can range from simple mistakes to significant issues — are caught and behavior is modified as necessary. So, if an oversight review finds that the lender has engaged in behavior that does not fully meet SBA's requirements, it is important that the lender be informed as soon as possible so that it can take the steps necessary to improve and bring its performance into compliance.

These are some of the more important provisions to lenders in the proposed legislation, but certainly not an exhaustive account. H.R. 4743 also reinstates a critical appeal process to give lenders, especially small community banks, a method by which to elevate an appeal of a decision made by the Office of Credit Risk Management (OCRM) within the agency without having to resort to suing the agency, which is almost never a realistic option for a participating lender. The bill also codifies offices and procedures that have long been established within SBA — namely OCRM, its enforcement procedures, and the Lender Oversight Committee (LOC) — but which have either been buried in the agency's Standard Operating Procedure or simply not clear to participating lenders. And finally, NAGGL is enthusiastic to see H.R. 4743 include report requirements which will identify portfolio risks on an annual basis without naming lenders, a common-sense practice to aid participating lenders in better understanding their own portfolios and encourage prudence, as well as increase transparency. In fact, this is a long-standing historical request from NAGGL that SBA make this information public. There is also a report requirement included in the legislation that will require a budget submission from SBA to give transparency to the way in which lenders' oversight fees are utilized by SBA, an important step toward greater transparency between the lending community and the agency while giving Congress a greater sense of confidence with the agency's program management. I am happy to discuss any of the other provisions in further detail.

Given these concepts which can only go to further strengthening the program's integrity, NAGGL is supportive of H.R. 4743 and its companion bill in the Senate, S. 2283, and we look forward to continuing to be a part of discussions going into the markup process as the agency and industry work with the Committee to perfect this language.

I'd like to also take this time to comment that the importance of this bill goes far beyond the words on the pages. All too often, and I'm sure much to your frustration, Congress and regulators find themselves having to *react* to a problem when it comes to the financial services industry. Wouldn't it be ideal if in each of those instances, Congress and industry had come together *before* a problem arose as those portfolios were performing well and as participation was growing to consider how the portfolio's soundness could be improved?

Well, here we are with the SBA 7(a) program, attempting to break that cycle. This Committee is ***not*** reacting to a malady that needs to be quickly repaired to prevent disaster. Instead, this Committee is coming together in a bipartisan, bicameral approach to discuss how to further improve a program that is performing well.

I know there are probably some that are asking — 'why fix something that isn't broken'? But those who are asking are not sitting in your seats and most certainly are not the individuals having to battle the appropriations cycle every year to increase the authorization cap of this program.

First, as Members of the House Small Business Committee and of Congress, the maintenance of the SBA programs and the responsibility to oversee the agency starts and stops with you. It is in my members' individual and collective interests that SBA engages in a sustained, effective lender oversight program so that 7(a) lending stands the test of time for many more years to come in order to serve many more thousands of small businesses across the country

Second, the challenge to push for a growing authorization cap year in and year out during the appropriations process all but requires a serious piece of legislation to ensure all involved — appropriators and authorizers — have peace of mind that as they increase the program cap, Congress took the appropriate steps to ensure that risk would be mitigated.

As a point of reference, the FY2014 the program's authorization cap was set at $17.5 billion. For FY2018, should we see an omnibus appropriations bill pass, the program's authorization cap will most likely be set at the level both the House and Senate agreed upon, which is $29 billion. That is almost a 66% increase in the authorization cap of the SBA 7(a) program in the last four years. It is entirely appropriate for this Committee and its colleagues in the Senate to make sure OCRM has the appropriate resources and processes in place to monitor this growth. We at NAGGL are fully supportive of your efforts.

It should be noted here that this growth is not a result of uncontrollable or unchecked trends in lending — in fact, the growth we've experienced over the last several years is not only a success for small businesses in every one of your districts and across the country, but also proof positive that this program is operating as a gap financing program as intended. There is a gap for small businesses in conventional bank lending in this country and the most qualified, creditworthy small business owners continue to struggle to secure financing that meets their needs. A small business seeking capital is often offered loans with terms of 30 days to three years when they really need much longer-term financing. The needs of this country's small businesses are frequently a depository mismatch for banks that are often unable to tie up capital in long-term loans. Despite the overall improvement in lending since the Great Recession, there is still a need for more financing options that provide greater stability for small businesses. The SBA 7(a) program has stepped up to the plate to fill this gap and has an average term of 16 years—in other words, the kind of long-term financing that small businesses need to survive but generally cannot find in the conventional market. It should be no surprise that given today's conventional credit box for small businesses, a credit elsewhere program would grow and thrive. This also reaffirms the intent of Congress that this program not compete with the private sector's conventional markets or make loans to borrowers who could receive a conventional loan. As Chairman Chabot has stated in front of this Committee in the past, this program should supplement the markets, not supplant them.

The benefit of quality lender oversight is not lost on the lending industry. Since the introduction of federal credit reform, our member institutions have witnessed the impact that portfolio performance has on subsidy rates and program fees. I am pleased to report that the performance of the SBA 7(a) loan portfolio has remained sound, we continue to operate at a ZERO credit subsidy rate, and loss rates continue to be low.

But equally important as maintaining the portfolio's performance is that proper lender oversight is necessary to protect the main purpose of the SBA 7(a) program — its public policy mission to serve those small business borrowers in the community that cannot otherwise receive credit elsewhere on reasonable terms and conditions. An appropriate oversight approach must also include consideration of how well the public policy goals of the program are being met. In other words, effective oversight ensures congressional intent.

It is also important that this oversight does not swing the pendulum too far in the opposite direction to restrict lenders and borrowers from finding the program attractive — and in NAGGL's view, H.R. 4743 does **NOT** swing too far. This is an important perspective to bear in mind whenever there is a call for increased oversight to avoid duplication of existing oversight activities from other regulatory agencies, as well as a duplication of the cost already associated with those activities. It is an established fact that the bank and credit union industries already have substantial lender oversight from the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration, the Federal Reserve Board, and various state banking regulators. NAGGL has always believed that SBA should be required to demonstrate that it is adding value to current federal and state oversight efforts, not just duplicating existing efforts and we believe that H.R. 4743 helps accomplish just that.

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

By most regulatory practice standards, the PARRiS system is in its infantile stage after about three years off the ground. As an industry, we are still looking to see how this system performs and encourage you as authorizers to allow this system to develop in greater sophistication with SBA's ongoing improvements every year. We believe H.R. 4743 will help move SBA's processes even closer to these goals.

I must also stress that to understand the full picture of oversight, it is critical to know that lenders have skin in the game. SBA's guarantee is a *contingent* guarantee, which means that if a lender fails to fully meet its responsibilities, the SBA can — and does — reduce the amount of the guarantee payment to lenders *if* the loan should default and a deficiency balance remain after the lender has exhausted the remedies available to it to collect on the unpaid balance. In the most egregious cases, the SBA will deny its liability under the guarantee. Therefore, the very nature of the guarantee relationship serves to assure that lenders comply with the various SBA program requirements while engaging in quality lending. The guarantee program is a sharing of risk and not a complete transfer of risk away from the SBA 7(a) lending community. Beyond responsibilities to SBA and the taxpayer as responsible stewards of the program, the lenders have an ongoing responsibility to their federal and state regulators, their internal regulatory oversight group, and even their shareholders to ensure that safe and sound lending practices are maintained. In part, this skin in the game is what makes the private sector such ideal partners in the SBA 7(a) program, serving as an incentive to all lenders to be prudent stewards.

As lenders, we are incredibly proud of who we serve and the role we play in your individual districts. Over the past several years, lending to nearly every underserved market — from veterans, rural communities, urban areas, women, Hispanics, and African Americans to name a few — has increased. While we can always do more to improve access to capital to these markets, we are confident that the SBA 7(a) lending industry is fulfilling the intent of Congress to serve the country's small businesses.

The numbers tell the story. In Fiscal Year 2017, financial institutions large and small provided about $25.4 billion in approvals to about 62,430 small businesses nationwide through the SBA 7(a) program. At an estimated one job per $35,000 lent, over 650,000 jobs were created or retained just last year thanks to the SBA 7(a) program. In addition, there are other benefits that are often hard to measure, like employment opportunities and 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.

The issues that SBA 7(a) loans solve for are the issues that every Main Street across the country is struggling with and which every Republican and Democrat wants to desperately find an answer to over the next four years — jobs, community rejuvenation, and opportunity, which is why it is so important to come together to ensure we protect this portfolio.

Chairman Chabot and Ranking Member Velázquez—I would be pleased to answer any questions.