CONSUMER BANKERS ASSOCIATION

TESTIMONY OF TIMOTHY D. DIXON,

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HEAD OF SMALL BUSINESS ADMINISTRATION LENDING

CITIZENS BANK

ON BEHALF OF

THE CONSUMER BANKERS ASSOCIATION

BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON SMALL BUSINESS

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT & REGULATIONS

"Small Business Lending:

Perspectives from the Private Sector"

Chairman Coffman and members of the Subcommittee, my name is Tim Dixon. I am Senior Vice President and Head of Small Business Administration Lending for Citizens Bank. Thank you for the opportunity to appear before the Subcommittee to discuss small business lending, the SBA and ways to improve the effectiveness and efficiency of its programs.

Citizens Bank is part of a diversified financial services company providing a wide range of commercial, consumer, mortgage banking, trust and financial planning services to its client base. Citizens dates back to 1871 and is the 57th largest bank holding company in the U.S. ranked by assets. We serve communities located within Michigan, Ohio and Wisconsin, with 219 offices and 249 ATMs and 80% of our revenue is Michigan based.

We are a community oriented institution, with the majority of our revenue being derived from our core bank, which is heavily oriented towards small business. In order to effectively deliver credit solutions based on what our clients need and value, we are a Preferred SBA Lender with dedicated specialists to fast track the process and we also have expertise in other state and local loan programs. While we utilize a number of the SBA loan programs across the bank, the majority of our loan volume is originated under the Express program, with our average branch originated small business loan being about $60,000 in size.

We are proud to be consistently ranked among the top SBA lenders in Michigan and are the largest of the Michigan headquartered banks, which demonstrates our commitment to small business.

In addition to being Head of SBA lending for Citizens, I am also a member of the Consumer Bankers Association's (CBA) Small Business Banking Committee. For more than 90 years, CBA has been the recognized voice on retail banking issues in the nation’s capital. Member institutions are leaders in all areas of consumer financial services, including small business lending. The CBA Small Business Committee includes the top small business bankers in the country who share the common goal of helping small businesses meet their financial needs. This group is also focused on improving the state of small business, including promoting the Small Business Administration (SBA) programs.

Small businesses play an important role in the health of our economy. Unfortunately, today’s small business owners continue to face a number of challenges which has diminished the overall demand for loans. Despite several positive economic signs in the past year, recent economic indicators have signaled the economy remains fragile and a robust recovery does not appear imminent.

Small businesses rely on consumers and as recent headlines have shown, consumer confidence has faltered as economic uncertainty has increased in recent months. Add this to the high unemployment levels and consumers will likely remain cautious in spending their hard earned dollars. This ultimately hurts demand for the products and services of our small business owners.

We hear this from small business owners across the country and see these trends in our research. Many business owners who are doing well in this environment are also cautious to take on additional debt or to hire new employees without the certainty our economy is recovering enough to keep demand for their products at a level to sustain additional growth. And the continued reports of a possible double-dip recession and talk of a pending “economic cliff” will only further the concerns of business owners and the confidence of the American consumer.

During times of economic challenges, SBA lending has played an important role in helping small business owners meet their financial needs. Despite the decline in overall small business loan demand, we continue to see healthy SBA lending and the SBA 7(a) and 504 programs have been effective during these economic times. During the 2011 fiscal year, which ended September 30, 2001, SBA loan approvals supported $30.5 billion in lending to small businesses and start-ups through its two largest loan programs, compared to $22.6 billion in FY2010 and $17.9 billion in FY2009.

The FY2011 total is the highest volume fiscal year in the agency’s history, surpassing the $28.5 billion mark established in FY2007. The first quarter of FY2011 was the most active single quarter ever for SBA-backed loans ($12 billion supported), with more than four times the dollar volume of the same quarter in 2009 – the first three months of the recession – and more than double the volume of any quarter over the past four years. I was also pleased to see that Michigan was the leading SBA District in fiscal 2011 and our bank also experienced double digit growth in SBA loan originations during this period.

While SBA lending remains strong in the first half of 2012, numbers seem to be somewhat lower than those of 2011. Much of the difference can be attributed to the expiration of loan enhancements provided for under the Small Business Jobs Act that were in effect in early FY2011. Those loan enhancements allowed SBA to raise the guarantee on its 7(a) loans to 90 percent, waive fees on both its 7(a) and 504 loans, and increase the limit for Express to $1,000,000. These enhancements provided the necessary incentives for banks to make as many SBA loans.

Short of reinstating these temporary provisions, today's hearing is an opportunity to highlight positives and identify ways to improve the SBA programs. Earlier this year, CBA's Small Business Banking Committee compiled a list of recommendations focused on the SBA 7(a) and 504 programs. CBA sent these recommendations to Administrator Karen Mills and Congress in an April 17, 2012 letter highlighting our suggestions to improve the efficiency and effectiveness of these valuable programs.

The SBA listened to a couple of our suggestions and the most recent revision of the SBA's Standard Operating Procedures, or SOP version 50 10 (5) (E), is a positive step forward in improving the SBA lending process and incorporates a number of changes designed to address on-going lending issues.

First, the new SOP clarifies polices governing the eligible uses of proceeds by an Operating Company (OC) in connection with an SBA-guaranteed loan to an Eligible Passive Company (EPC). This allows the OC/EPC structure to be used for business acquisitions with both entities executing the note and other loan documents as co-borrowers and removes a largely antiquated hurdle for many small business ventures.

Second, the new SOP incorporates a policy recommendation regarding personal debt refinancing. The previous SOP stated that SBA-guaranteed loan proceeds may NOT be used to refinance debt in the personal name of the borrower, with limited exceptions for personal, but business related, credit card debt. The new SOP incorporates a broader range of personal debts allowed such as home equity lines of credit which are often used by small business owners. This reinstates previously allowed practices under the SOP and will go a long way to help small business borrowers in today's economic environment.

We applaud the SBA for incorporating these and other important changes to the SOP, such as enhancements to the Small Loan Advantage program. However, CBA believes there are still a number of changes the SBA can make to help increase SBA lending. In our letter, we outlined a number of critical changes to the SBA lending process.

Additional Program Changes

First, the SBA 7(a) loan program is one of the most used and helpful SBA tools for small businesses. The 7(a) loan is a valuable credit enhancement tool that allows the lender to receive additional security in making the loan in the form of a SBA guaranty. The following are suggestions for possible improvement of this important program:

- We believe it is crucial to allow Express Loan forms and processes to be used for all 7(a) loans. Leveraging loans through the SBA can be a timely process, especially considering the amount of demand for 7(a) loans. Allowing for Express Loan forms and process for all 7(a) loans would greatly improve efficiency in the process.
- We encourage the SBA to revert back to pre-2008 policy on life insurance so that requiring such would not be part of a delegated lender's overall credit analysis. The current SOP explicitly states the lender may waive life insurance but if a loss is sustained then the lender is responsible for the loss. This requires the borrower to establish a life insurance policy and assign proceeds to the lender, all of which extends the time to close an increases the cost to the borrower. Delegated lenders should be able to make the decision for life insurance as part of a prudent underwriting process and not be penalized by the SBA.
- We believe the SBA should eliminate the requirement under the SBA Express for the refinancing of Same Institution Debt (SID) to maintain at least the current level of bank exposure.

Second, the SBA 504 loan is an attractive financing solution for many business owners. There are several key benefits to the 504 loan including lower down payments and longer repayment terms. We believe the following changes in the 504 program will strengthen this valuable program:

- Most importantly, the SBA 504 refinance program is scheduled to sunset in September 2012 unless Congress provides an extension. This program is critical to small businesses that need to refinance their property but can only do so with the higher leverage offered by the program – up to 90% loan to value. Up to 25% of all SBA 504 loans being approved currently are 504 refinances, so clearly if this program disappears, we will be taking a step backwards. The need for this program is even greater now as many owner-occupied commercial real estate loans are set to mature over the next year from purchases made over five years ago.
- We ask that the SBA do away with the "substantial adverse change" clause that prevents a Community Development Company (CDC) from appropriately funding a loan, which can leave a bank at 90% or more LTV and inhibit lending.
- We encourage consideration of the impact that the "right of redemption" is having in the 504 program. This allows federal agencies (including the SBA) the right to come back to a lender after the agency has decided to not foreclose on property and allow the lender to take possession. Specifically, if the lender were to sell

the property within 12 months of this decision, the SBA has the right to any of the proceeds in excess of the lender's lien plus some costs. We urge a more nuanced approach be allowed for a release of the right of redemption under the proper circumstances.

- Change the owner occupancy requirements for ground up construction to match that of straight purchase which is 51% of the space needs to be owner occupied. Today, ground up construction must be 60% owner occupied, with intent to occupy 80% of the space within 3 years.

The SOP Process

The SBA SOP is a complicated document that likely deserves a more formalized amendment process for more substantive policy issues.

While having the ability to make slight tweaks can be beneficial at times, quick and frequent changes to the SBA lending process through the SOP process can create real-world challenges. As the terms of the SOP are ever-changing, it creates practical challenges to interpret revisions, train staff, update systems and be in compliance if these changes are coming too frequently. The ability of an institution to keep up with changes to the SOP can have large compliance costs implications, which can adversely affect lending.

Furthermore, the clarification of SOP terms can be time consuming and difficult. For example, the improvements to the CAPLine program issued in late 2011 did not provide clear terms for loan qualification. In response to industry inquiries, the SBA took nine months to provide clarification. The lack of timely calcification and consistency within the SBA can lead to lender uncertainty, which has adverse effects on the utilization of these programs. As such, we recommend a more methodical and consistent approach to SBA SOP policy changes.

Lender Oversight

Finally, effective SBA lender oversight is another crucial area of concern. Some members of the CBA have found that the SBA audit process can be a very time consuming exercise and is not always useful to assess and mitigate risk, relative to the other risk assessment processes within banks. A more transparent and streamlined audit process would go a long way in improving lender efficiency. Lender oversight should be a means for the agency to identify variances from established lender benchmarks and provide a reasonable process for lenders to remedy deficiencies. The oversight program should be timely, consistent, and constructive.

CBA applauds the continued efforts of this Committee and members of Congress as they focus their attention on the Small Business Administration. The SBA plays an important role in helping small businesses gain access to capital and your work to improve the efficiency and the effectiveness of the SBA is critical as we look to strengthen our economy.