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

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

March 9, 2017

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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