OVERSIGHT OF THE SMALL BUSINESS ADMINISTRATION'S FINANCING PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

HEARING HELD
OCTOBER 26, 2011

Small Business Committee Document Number 112–041
Available via the GPO Website: www.fdsys.gov

U.S. GOVERNMENT PRINTING OFFICE

74–279 WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON SMALL BUSINESS

SAM GRAVES, Missouri, *Chairman*
ROSCOE BARTLETT, Maryland
STEVE CHABOT, Ohio
STEVE KING, Iowa
MIKE COFFMAN, Colorado
MICK MULVANEY, South Carolina
SCOTT TIPTON, Colorado
JEFF LANDRY, Louisiana
JAIME HERRERA BEUTLER, Washington
ALLEN WEST, Florida
RENEE ELLMERS, North Carolina
JOE WALSH, Illinois
LOU BARLETTA, Pennsylvania
RICHARD HANNA, New York
NYDIA VELÁZQUEZ, New York, *Ranking Member*
KURT SCHRADER, Oregon
MARK CRITZ, Pennsylvania
JASON ALTMIRE, Pennsylvania
YVETTE CLARKE, New York
JUDY CHU, California
DAVID CICILLINE, Rhode Island
CEDRIC RICHMOND, Louisiana
JANICE HAHN, California
GARY PETERS, Michigan
BILL OWENS, New York
BILL KEATING, Massachusetts

LORI SALLEY, *Staff Director*
PAUL SASS, *Staff Director*
BARRY PINELES, *General Counsel*
MICHAEL DAY, *Minority Staff Director*

C O N T E N T S

WITNESSES

APPENDIX

OVERSIGHT OF THE SMALL BUSINESS ADMINISTRATION'S FINANCING PROGRAMS

WEDNESDAY, OCTOBER 26, 2011

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 1:00 p.m., in Room 2360, Rayburn House Office Building. Hon. Sam Graves [chairman of the Committee] presiding.

Present: Representatives Graves, Chabot, Coffman, Mulvaney, Tipton, West, Walsh, Barletta, Velázquez, Schrader, Critz, Chu, Cicilline, Richmond, Peters, Owens, and Hahn.

Chairman GRAVES. Good afternoon. We will call the hearing to order today.

The most important thing this Committee can do is create an environment in which entrepreneurship is fostered, thereby producing jobs vital to the economic recovery. There are many aspects in creating this environment and in today's hearing we are going to focus on one of those, and that is access to capital.

The Committee has heard on multiple occasions from small businesses that they cannot get funds needed to operate and expand their businesses. At the same time, banks have testified before the Committee saying that they have the funds available to lend. The Small Business Administration oversees a number of programs working in conjunction with the private sector partners to bridge this apparent gap between the need and availability of capital. SBA statistics show that volume in its financing programs has increased. These efforts have been supplemented by promises from banks to raise lending to small businesses. It remains an open question whether these efforts are sufficient to provide the necessary funds for small businesses to expand and create jobs. The SBA programs operate with loan guaranties issued by the federal government.

Congress has determined that the risk to the taxpayers are outweighed by the benefits providing the needed capital to small businesses. Irrespective of that determination, this Committee has a responsibility to ensure that the desire to get money into the hands of small businesses does not come at the expense of exercising due diligence when making a loan, especially when taxpayers are on the hook for the government's bad decisions. Therefore, the Committee needs to know that the SBA and its partners are complying with the requirements of the Small Business Act and not issuing loans with document deficiencies as the inspector general has recently found. Ultimately, the Committee needs to understand whether the programs currently constituted are enabling small businesses to create jobs; if not, the Committee will need to examine legislative changes to promote access to capital without unduly placing the taxpayer at risk.

And with that I yield to Ranking Member Velázquez for her opening statement.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

In the last year, our nation's economy has experienced steady private sector job creation. However, it has not been enough to have a sizeable impact on the unemployment rate which remains stubbornly high at 9.1 percent. The reality is that we will still have a long road ahead of us with millions of Americans who are seeking work that cannot find it. Front and center to any solution to this dilemma are small businesses. In every previous downturn it has been small, innovative firms that have created the cutting-edge products and services to lead us forward. In fact, more than half of the companies on the 2009 Fortune 500 List were launched during a recession or bear market, along with nearly 50 percent of the firms on the 2008 Inc. List of America's Fastest Growing Companies.

Whether it is a Silicon Valley startup or a Main Street mom-and-pop, it is clear that small businesses are our nation's job creators. In order for entrepreneurs to continue to play this traditional job creating role, it is essential that they are able to access capital. Doing so provides the fuel for innovation and economic expansion across the spectrum of entrepreneurship. It enables unemployed individuals to start their own businesses, help domestically-oriented companies to sell their goods in foreign markets, and allows high tech firms to reinvest in R&D.

But small businesses face real challenges in the capital markets. While lending conditions and credit standards are easing, companies have still not recovered from the financial crisis and recent recession. This has left many without the assets to borrow against and with lower revenues than in years past. As a result, business owners now have fewer options to secure affordable financing. Lending through the SBA is always critical to fill in this void. Several provisions this Committee crafted in the Recovery Act temporarily boosted SBA-backed lending. Recent guaranties and cutting fees on SBA loans spurred demand and was key for the record-setting year the agency experienced with record 7(a) loan volume of nearly $20 billion, an increase of more than 50 percent. It is clear these policies work. Impressive growth in the SBA state program, as well as more moderate growth in the 504 program, confirmed important roles that these initiatives play in the capital markets.

With this growth came other challenges in the portfolio. The average 7(a) loan grew by nearly 40 percent, while there were percentage declines in smaller loans and those to startups. During economic downturns, smaller loans are especially important. As an average it costs nearly 75,000 to launch a new enterprise. With an average 7(a) loan size of now $365,000, five times the cost of a startup, we must make sure that the agency is not forsaking its roots solely to set records.

During today's hearing I am hopeful that we will not just tout past performances but instead focus on how we can expand access to capital for all businesses, especially those at the earliest stage of the business cycle. Startups, particularly those in the high-growth sectors, remain central to our economic recovery, and it is critical that we expand their ability to secure financing. Now is not the time to constrain free access to capital and problems like those at SBA are critical to creating jobs. Getting financing in the hands of would-be entrepreneurs has never been so important and doing so is not just critical to reducing unemployment but also to increasing tax revenue and decreasing our nation's debt. I know the next few months are critical in this regard, and I will be focusing on making sure small businesses are not dealt a bad hand when the Super Committee makes its final recommendation.

On that note, I would like to thank the witnesses for taking their time to be here. I am interested in hearing their thoughts on how best to meet the entrepreneurs' capital needs so they can create the jobs that we badly need.

Thank you, Mr. Chairman.

Chairman GRAVES. Thank you.

Our first witness today is The Honorable Karen Mills, who is the administrator of the Small Business Administration.

Ms. Mills has been the SBA administrator since 2009 and is obviously no stranger to this Committee. Prior to joining the Small Business Administration, Ms. Mills was an investor in small businesses, so the struggles that businesses have in obtaining capital are obviously very familiar to her. Thank you very much for being here. We appreciate you coming in.

STATEMENT OF THE HONORABLE KAREN MILLS, ADMINISTRATOR, UNITED STATES SMALL BUSINESS ADMINISTRATION

Ms. MILLS. Well, thank you very much, Chairman Graves and Ranking Member Velázquez and members of the Committee. Thank you for asking me to testify on Access to Capital for Small Business.

For the fiscal year that just closed, the SBA hit an all-time record in its 60-year history. We supported over $30 million in lending to 60,000 small businesses. We brought back 1,200 lenders, mostly community banks and credit unions who had not made an SBA loan since 2007. We also had a record year in our Small Business Investment Company program with nearly 2.6 billion in overall financings. This is a zero subsidy program that targets high-growth small businesses, the main driver of new jobs.

Today, SBA's lending volume is back at pre-recession levels. However, it is our agency's continued obligation to identify and fill gaps where the market is not working. This is particularly true for low dollar loans and loans to businesses in underserved communities. And as I describe this effort I want to be sure that the Committee understands that all of the SBA's programs and initiatives have been implemented in accordance with our authority as provided by this Congress.

So first, low dollar loans, under $150,000 have not come back. We found three root causes. They have a high cost of processing relative to their size so banks often do not want to make them. To answer that, we streamlined and simplified paperwork on these loans to incentivize lenders to step up.

Second, we need more points of access to get small loans to entrepreneurs in underserved markets. That is why we developed Community Advantage to let community-based lenders with proven track records and historically low default rates make 7(a) loans for the first time.

Third, when many of the large banks withdrew from lending during the recession and the credit crunch in October 2008, small businesses were very hard hit. That is why we have secured $20 billion in additional commitments over the next three years from 13 of our largest banks; many of them will focus on underserved markets.

I also want to be sure the Committee fully understands the facts about loan performance and our subsidy costs. Loan default rates now have begun to fall; they are not rising. And loans made in the past three years are actually performing significantly better than in the cohorts of 2005, 2006, and 2007. As I have testified before, we are also focused on lender oversight and the elimination of fraud, waste, and abuse through a three-pronged approach. We look at upfront eligibility to make sure the loans are flowing to the intended recipients. We continue monitoring and oversight of our lending partners. And finally, we focus on enforcement efforts to pursue fraud and bad actors.

My commitment is that we will continue to expand access to capital while protecting taxpayers' dollars as we embark on another critical year in SBA lending.

Thank you very much.

[The statement of Ms. Mills follows on page 41.]

Chairman GRAVES. Thank you, Administrator Mills.

We will turn to Mr. Coffman for opening questions.

Mr. COFFMAN. Thank you, Mr. Chairman.

Administrator Mills, since the SBA-backed loans are only a small percentage of overall small business lending, what steps are you taking to encourage private small business lending?

Ms. MILLS. As you heard me say earlier, we have, as you describe, on a good day, a small portion of the market, maybe 10 percent of the market. So the entire market, the conventional market for small business lending needs to also come back. We went out to our 13 largest lending partners, all the large banks which had not come back in force to SBA lending and other lending, and asked for increased commitments and promised to work with them to make sure they had access to the demand that we see out there. They have committed $20 billion of additional capital, incremental to what they have done.

Mr. COFFMAN. Who is "they" again?

Ms. MILLS. There are 13 banks.

Mr. COFFMAN. Thirteen banks.

Ms. MILLS. So we can give you the list. It was public. You know, our primary partners, J.P. Morgan Chase, Wells Fargo, U.S. Bancorp, PNC, Huntington Bank. And the aggregate amount is $20 billion incremental in small business lending over the next three years.

Mr. COFFMAN. Thank you. Administrator Mills, do you have any analysis to determine what SBA-backed lending would be without the reduced fees and higher guaranty—75 to 85 percent guaranty still provides banks a way to mitigate risk.

Ms. MILLS. Yes, we do have evidence. In a chart which was attached to my testimony you can see what happened. The actual 90 percent guaranties ended on December 31st last year. We had a big spike right before that happened so we had a recovery dip and then we came back to a level that was significantly above 2010 as well as 2008 levels. So it seems to be working.

Mr. COFFMAN. Thank you. Thank you, Mr. Chairman. I yield back.

Chairman GRAVES. Ranking Member Velázquez.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Madam Administrator, since startup rates typically rise during economic downturn, you might expect to see a rise in lending for such entrepreneurs. However, small dollar loans and loans to startups declined as a percentage of SBA lending last fiscal year. Does this mean that the agency is shifting away from making these type of loans and focusing on larger loans to more established, mature companies?

Ms. MILLS. No. The agency believes, as you do, that there is a gap in small dollar loans. And in fact, one of the real reasons for the high unemployment right now is that we are down about 100,000 new business starts. So we have been extremely concerned, as I know you have been, about the fact that the market did not come back. And that is why we came out with this three-pronged approach to promote small loans.

Ms. VELÁZQUEZ. Okay. So why is it that last year SBA spent nearly $70 million, 84 percent of your 7(a) loan subsidies on 7(a) loans of $1 million or more? By contrast, subsidy for loans of 250,000 or less, for which there is the greater need right now, were just 1.9 million? Does it seem fair that so much money goes to benefit fewer than 1 in 10 of all borrowers?

Ms. MILLS. As I said, we are in complete agreement with your analysis of this problem in that there is a gap in small business lending. We have continued to focus on that. But the job is not nearly done. We have made slight progress over the last year in the smaller loan sizes but there is still a very, very large gap. To that end——

Ms. VELÁZQUEZ. What do you think it will take so that we can see more loans going to smaller or startup businesses? Because that is where the need is.

Ms. MILLS. It will take the banks coming back to that area. What we have done is try to make it more cost-effective for them to use an SBA guarantee for a small loan. We have tried to bring together our large lending partners and get them to focus on it. We have tried to bring more points of access to all who make small loans, like Community Development Financial Institutions, and give them access to SBA lending. We will look at every possible program within our authority to do that.

Ms. VELÁZQUEZ. Okay. Okay. Thank you.

Last week your agency issued final rules to permit the wholesale of refinancing of commercial real estate in the 504 Loan program. With foreclosures expected to climb this year, how much will this new refinancing program contribute to the subsidy rate?

Ms. MILLS. Well, this new refinancing program has the authority to pay for itself, so it lives separate from the subsidy rate.

Ms. VELÁZQUEZ. So you do not expect the refinancing initiative to contribute to this subsidy rate?

Ms. MILLS. No.

Ms. VELÁZQUEZ. No? That is what we heard before regarding the regular financing 504 program and you came back and for next year you will require nearly $90 million in subsidies. So what would you or your agency do if defaults on refinanced 504 loans begin to exceed the fees charged to cover those losses?

Ms. MILLS. This program is authorized to charge additional fees, and we will charge the fees necessary to make a zero subsidy.

Ms. VELÁZQUEZ. I understand but it is the same situation that we have with the 504 regular program. And when you continue to charge those fees and increase those fees to cover for those losses, you could reach a point where you reach the maximum cap allowed by the law. So what will you do then? You will have to come back here and ask for subsidies to cover for those losses.

Ms. MILLS. The refinancing program ends a year from now.

Ms. VELÁZQUEZ. Okay. As you say that a year from now that will end, the same situation we find with the stimulus funding for the 7(a) and 504. It will expire in December. SBA's loan approvals have fallen back to levels not seen since the worst of the credit crunch. Why is it that two years after the credit crisis began, SBA cannot find a long-term solution to providing meaningful levels of credit to small firms?

Ms. MILLS. Well, the facts, as you have just stated them, I think, are not correct. If you look at the chart next to my testimony you will see that even in the last three quarters we have rebounded to levels that are at 2008 levels.

Ms. VELÁZQUEZ. Half of all your lending last year occurred in the first quarter when the incentives from the stimulus package were in place. And that is the only reason lending was up as high as it was. So every month since those provisions will expire we have seen the lowest number of loans that have been issued or backed by the federal government.

Ms. MILLS. With respect, I believe that those facts are not correct.

Ms. VELÁZQUEZ. It is not the amount. It is not the amount of money lent; it is the amount of loans that have been made.

Ms. MILLS. The number of loans that we have right now is impacted, as you mentioned before, by the fact that the decline—most of the loans are in the small level. In the previous years those have not come back.

Chairman GRAVES. Mr. Tipton.

Mr. TIPTON. Thank you, Mr. Chairman. Thank you, Ms. Mills, for being here. I appreciate your efforts and everything that you try and do to help small businesses in the country.

Just listening to some of your testimony, I would like to get a little bit of clarification. You had mentioned that in order to be able to get the banks to start making loans again you had streamlined some paperwork. Can you describe a little bit what were the actual cost savings to the bank as an incentive in the streamlining of that paperwork?

Ms. MILLS. I know we have that but I do not have it here. So I am happy to get back to you.

Mr. TIPTON. You know, I think we would like to hear that because we often hear government is simplifying things and that rarely is actually the case. And in terms of trying to be able to create some cost savings because that is a real issue. You had also mentioned that non-performing loans are dropping.

Ms. MILLS. Correct.

Mr. TIPTON. Right now. Is that the result of an improving economy or is that a result that people have simply gone bankrupt and they are no longer on the board?

Ms. MILLS. Our loan portfolio is made up of cohorts that were made in 2005, 2006, 2007.

Mr. TIPTON. Right.

Ms. MILLS. Many of those, when you look at our delinquency rate, failed in the recession and therefore, caused a peak in our default rate about 14 months ago, in August 2008. Now it is improving slowly as those loans have passed through the portfolio.

Mr. TIPTON. So the stabilization is the businesses basically went belly up?

Ms. MILLS. Well, actually, the new loans are defaulting. They are early. But they are defaulting at a much, much lower rate, measured from their month of inception, than the loans from those previous cohorts. So we anticipate that this improvement will continue. We also know that credit scores on our current portfolio of loans made in recent years are much stronger.

Mr. TIPTON. Okay. You had mentioned that there is a commitment of $20 billion in commitments from the larger banks. How much of that has been loaned out?

Ms. MILLS. We made the announcement on this three or four weeks ago, so probably not very much yet, but it is coming.

Mr. TIPTON. Okay. Great. You know, looking through your written testimony you seem to give a tip of the hat to the president in regards to the $467 billion stimulus and indicated that it was paid for. My concern and a lot of our constituents' concerns that are small businesses is it is being paid for on the backs of businesses that are currently struggling in terms of increased tax rates. Could you speak to that?

Ms. MILLS. We are talking about the American Jobs Act.

Mr. TIPTON. Right.

Ms. MILLS. The American Jobs Act has received very strong support from the small business community because it includes a payroll tax cut which they are very eager to get because it means cash in their pocket right away. As I understand it, no specific pay-for yet has been decided because the bill is still in the hands of Congress. But definitely small businesses are looking for that cash from the payroll tax cut in their pocket.

Mr. TIPTON. Do you think small businesses are going to be concerned about increased tax rates? I have a letter here from a gentleman named Jim Bartimus, a small construction company in Pueblo, Colorado. Been a successful business, small business, and because of a lack of access to capital he paid down his line of credit to zero. Went back to the banks trying to get that line of credit reupped. He had actually purchased a crusher—if you are familiar with construction to be able to grind up rocks to put on the roads—trying to grow his business and to be able to create jobs. But because of regulatory compliance the banks, they wanted to loan the money but could not loan the money. He had to line up his equipment, sell it off, call in 24 core employees, tell them that they no longer had a job.

But under the president's calculations right now, and there is some debate and we both need to probably pass on the message that the plan is not paid for, he would have been labeled rich a couple of years ago. Do you think it is counterintuitive and, in fact, counterproductive to be raising taxes on small businesses at this time?

Ms. MILLS. Well, first of all, if you have another small business like this or if he is still available, please tell your small business owner in that situation to get on SBA.gov and come into our district office because that is exactly the situation where we can help. And one of the tasks before me is to make sure that small businesses are aware that when the bank cannot lend because of regulatory issues, our guaranty can often, very often, make the difference.

Mr. TIPTON. So that is a lot of clean up that we could do in addition to streamlining paperwork, eliminating those regulatory requirements on banks so that they can loan. Would you not?

Ms. MILLS. We have sat with banks and I sit on a continuous basis with the regulators to make sure that the guidance they have given on small business lending at the top is making its way all the way down to their regional regulators so that we have a consistent set of regulations at the banks so that they can open their doors to small businesses and get some of this money out into their hands.

Mr. TIPTON. Well, I hope that will happen. I see my time is expired. Thank you, Mr. Chairman. Thank you.

Chairman GRAVES. Mrs. Chu.

Ms. CHU. Ms. Mills, I am the ranking chair of the Contracting Subcommittee and last week Congress Member Mulvaney and I were able to have a hearing in Los Angeles, my area, and it was about SBA and how it does or does not serve the businesses of our area. And at that hearing Jesse Torres, the CEO of Pan American Bank, testified about his small business lending program. He is doing the job we want. He is providing underserved communities with small business lending options. It is not easy but they are successful. But they do not operate a 7(a) loan program and he said that the reason they do not is because you need a team of experts to ensure that they meet all of the requirements to ensure that they get the SBA guaranty. The teams are expensive and not cost-effective for the bank and that if SBA finds out that some requirement is not met then they will withdraw the guaranty and the bank is liable for the entire loan.

Why would teams of experts be necessary to operate an SBA 7(a) loan? And what can we do to ease the process for smaller banks like Pan American Bank?

Ms. MILLS. Well, first, Mr. Torres and Pan American Bank are now on our list to come and do some training and some outreach so that we can get him into the program.

The problem that you describe, we have put forward what we call a 10-tab program. When a bank makes a loan we have a 10-tab system so that if they put the right paperwork in every single tab, when they come forward at some point to have us honor the guaranty if there is an issue, we will know that every piece of that paperwork is in place. So when we come out and we speak to Mr. Torres, we are going to teach him the 10-tab business and hopefully alleviate the need for the extra cost that he is concerned about and assure him that we will be able to make a proper payment on that guaranty because all of his paperwork will be in place. We do have paperwork. We do have rules. We cannot make payments on guaranties if those things are not in place.

Ms. CHU. So is this a program that you have in place, a technical assistance for the smaller banks that need this kind of training?

Ms. MILLS. Yes, it is. It is run through our district offices. That is one of their primary focuses.

Ms. CHU. How often do you withdraw the guaranty so that a bank might be held liable?

Ms. MILLS. We honor the guaranty in 95 percent of cases.

Ms. CHU. Hmm. Okay. On another topic, something else that we learned from our field hearing in Los Angeles is that microloans are incredibly important. In particular, the PRIME Program seems to really work, especially now that big banks are now likely to deal in millions of dollars. These micro entrepreneurs create jobs for themselves and contribute to our economy and they might start with one or two persons but before you know it they could be a major company. Many of these entrepreneurs only need 50,000 or a couple of hundred thousand to get started but I understand in SBA's 2012 budget you say that the PRIME Program is duplicative of the Small Business Microloan Program. But I believe the PRIME Program is different in that the PRIME Program gets entrepreneurs ready for a loan, whereas the Microloan Technical Assistance Program trains already existing programs for growth.

And just to give an example of a PRIME Program success story, two sisters, one a recent college graduate, invested in a business with fashion design and manufacturing. They had 135,000 but they needed to borrow 35,000 to help cover their working capital. But they came to PRIME because the regular banks would not help them. And where would businesses like this turn to if PRIME is eliminated?

Ms. MILLS. Well, first, you are correct. There are thousands of stories out there where PRIME has helped many, many small businesses with technical assistance. The issue we face is that everybody has to tighten their belt in these difficult budget times. So we looked for programs where we could execute those activities through other programs we had or through partners. And it turns out that our microloan intermediaries and our Community Development Financial Institutions provide terrific technical assistance. We felt that our value-added was to provide them with the ability to use our 7(a) program, get access to capital, and that we would use public-private partnerships to work together with them to make sure that the technical assistance through our entire network of Small Business Development Centers, microlenders, Women's Business Centers, was still robust and growing.

Ms. CHU. Well, thank you. I would like to get that list of these partners that you think would help get these micro entrepreneurs ready.

Ms. MILLS. Yes, we can do that.

Ms. CHU. And I yield back.

Chairman GRAVES. Mr. Barletta.

Mr. BARLETTA. Thank you, Mr. Chairman.

Ms. Mills, I represent Pennsylvania's 11th Congressional District and Northeastern Pennsylvania. My district has one of the highest unemployment rates in the state of Pennsylvania.

On September 8th, after Hurricane Irene and Tropical Storm Lee, we have experienced the worst flooding in the history of our area. Many people, many businesses, as you can see, have lost everything. Many people did not have flood insurance as they were told they were not in a flood plain. As I traveled around talking to the residents there, many businesses were saying they are not going to open again. They just do not know what they are going to do. Many of the folks there, a lot of them senior citizens, again, asking what will the federal government do to help us? And what I had to tell them was that they could qualify for a SBA loan. If you are an individual we will give a loan at 2.7 percent interest. If you are a business and you cannot get credit anywhere else, we will give you a loan at 4 percent. But if you could get credit somewhere else we will give you a loan at 6 percent interest.

I have got to tell you I was almost embarrassed to tell the people back home that, especially after, you know, whenever a disaster strikes somewhere else in the world, America, being the most generous country that we are, are always the first to help people. In fact, in the last two years we gave Pakistan $215 million for flood disaster relief. No interest. No payback. I do not know about you, but I think we should help America and Americans first. What do you say that I tell the people back home in Northeastern Pennsylvania why the interest rate would be 6 percent?

Ms. MILLS. Well, I am familiar with your district, and it was extraordinarily hard hit by both Irene and Tropical Storm Lee. For the benefit of those who are new on the Committee, we run a ready reserve of 2,000 disaster operators who actually within 24–36 hours are on the ground in these areas, assessing damage, speaking with people, co-locating with FEMA. We have a two-page application. We do homeowners. We do businesses that are damaged. And we do economic injury. So make sure that they know even if they did not have physical damage but because the area was cut off, businesses suffered some damage or because it is still distressed, they can get 30-year long, 4 percent economic injury loans.

Mr. BARLETTA. But——

Ms. MILLS. The issue about credit elsewhere——

Mr. BARLETTA [continuing]. But they could get credit elsewhere.

Ms. MILLS. The reason for the credit elsewhere test is that we are responsible for the good use of taxpayer money, and the reason for an uptick is that if there is a private sector mechanism, a bank, where they can get credit elsewhere, then the market should provide it. If they cannot, then that is our job. And that is where we step in and try to give the most benefit——

Mr. BARLETTA. Well, I guess the problem I am having is we gave Pakistan $215 million for flood disaster relief. So should I tell the people in Northeastern Pennsylvania they would have been better off if they were in Pakistan than if they were right here at home? I do not know. I think at some point we should take care of America and Americans first and American businesses. We cannot afford to lose any more jobs.

I introduced a bill. This has changed my life, this flood. I mean, I walked with these people. I cried with them and watched them as they put their life's possessions out on a curb to be taken away. I introduced a bill that would change the way America handles disasters by introducing a bill that would give a 1 percent loan for 30 years, enough to cover our administrative costs. If we could help other people I think we could help Americans at a time of disaster first.

Thank you. I yield back.

Ms. VELÁZQUEZ. Mr. Barletta, will you yield?

Mr. BARLETTA. Sure. I will.

Ms. VELÁZQUEZ. I really welcome your position. In fact, after Katrina I tried to reduce the interest rate and even provide a bridge loan, zero interest rate. And it did not happen. I did not have the support from your side so maybe this time around we could work together.

Mr. BARLETTA. Do you want to get on the bill with me?

Ms. VELÁZQUEZ. Okay.

Mr. BARLETTA. I think we could change the way we handle disasters. Thank you.

Chairman GRAVES. Mr. Schrader.

Mr. SCHRADER. Thank you, Mr. Chairman.

I am pleased to hear that some people in the majority party are beginning to rethink having to require to pay for our FEMA reimbursements upfront when there is a disaster and real people are hurting. And I assume Mr. Barletta was obviously one of those that was not willing to hold up the FEMA bill and have it paid for at the time. So I appreciate his help there.

Mr. BARLETTA. Will you yield just for a moment?

Mr. SCHRADER. No. I have got a limited amount of time.

I want to talk about I think the successes that this small business administrator has had over the last few years. I mean, I have—when I came here actually Administrator Mills came in at the same time and I was a little bit aghast at the status of the Small Business Administration. It had been hacked at and cut back dramatically by the previous administrations, not just the one before but over the years and it was in total disarray. We had a lot of testimony about waste, fraud, and abuse that we have had several subsequent sessions with the administrator and it looks like things have gotten, frankly, a lot better. I mean, there is a new sheriff in town, and I appreciate that, Madam Administrator.

And I think there is some misinformation here. I mean, people are talking about going, you know, they have not been here, I guess, but there is talk about what the role of the SBA is. And I assume that you are not trying to supplant private enterprise; you are trying to work with private enterprise. If for some reasons banks, credit unions, mortgage lenders cannot step in, that is where you step in. And so there is going to be some defaults. There are going to be some defaults.

But I think I need to hear clarity. You mentioned it but it seems to me that a lot of the subsidy rates that we have endured, you know, where we are paying back the Treasury for "bad loans," where under the previous administration's watch, and actually our rate of default since you have taken over, is down. Am I incorrect there?

Ms. MILLS. Well, thank you.

On your point about the current rates, have turned the corner on our default rates. They peaked in August 2010 and now have been reducing each month. Our current default rates overall are actually quite low. Our default rates tend to be under 5 percent. Our loss rates actually tend to be much lower. They are about two points higher than the normal Federal Reserve credit because we are giving credit where you cannot get credit elsewhere.

Mr. SCHRADER. I appreciate that, too. I mean, that is really the bottom line. You hit the nail on the head. We have got to get small businesses back in the business of hiring and growing the economy and growing America. And so you take a teeny bit of a risk and I am amazed that the default rates are where they are.

I also remember, and some members on the Committee are new, that one of our big angst when you took over was, well, the process is too bureaucratic. Trying to get a loan is impossible. The applications—we asked again and again and again, can you not streamline this application process? Can you make it simpler so that people can actually get in there and get the loans they need? We also were worried about the valley of death, you know, where a lot of small businesses, you get a little start up and then you try and get to the next level and all of a sudden you cannot get that credit. And you have developed some pilot programs. There is some controversy about that. I appreciate that. But I assume they are in response to our direct requests. Am I not correct on that?

Ms. MILLS. That is correct. So if we look at the Small Business Investment Company Program, I do want to thank our team and note that not only did they have a record year, they took the processing turnaround time for licensing new funds down from over 15 months to 5½ months.

Mr. SCHRADER. That was a big deal.

Ms. MILLS. And they are bringing in new funds. They are bringing some of the best funds, and they are putting more money into those funds and those funds are putting more money into small businesses. We do have some gaps, so we have orchestrated two other sets of funds under the SBIC authority. SBIC authority was not being fully utilized. It is a zero subsidy program. It pays for itself and therefore, we want to make sure we put as much money through it as the authorization has. So we have a new Impact Fund, which is designated to go to areas hard hit. The first one was in Michigan. Then we have a new Early Stage Equity Fund, which will be launched this year.

Mr. SCHRADER. Well, I appreciate your efforts there.

Just a last comment in the remaining seconds. It does not have a lot to do with you but I cannot tell everyone out there how disappointed I am in the Treasury Department and the way they are not run as efficiently as you and that Small Business Lending Fund having cratered horribly. When small businesses needed access to capital at the critical time and the regulators were beating up on the banks for, you know, having too much of this type of loan, this was a great opportunity to free up capital. In my state, you know, not a single bank got a loan. And a ton of them applied. And while I am sure some were probably in tougher shape than they let on, not all of them. So I am very, very disappointed in the Treasury. I would like to have a hearing with a Treasury official sitting right where Administrator Mills is, Mr. Chairman, at some point in time if that is not out of order.

And I yield back.

Chairman GRAVES. Mr. Walsh.

Mr. WALSH. Thank you, Mr. Chairman. Welcome. And Ms. Mills, thanks for coming in today.

My colleague, Mr. Schrader, mentioned that it is the purpose of SBA to help small businesses access capital when they cannot do that in the private marketplace. What is SBA's mission, in 20 seconds? Twenty-four seconds?

Ms. MILLS. There's the access to capital area. We also have disaster operations. We help small businesses—win $100 billion in federal contracts. That is a win-win situation. And we have a network of counselors, mentors, advisors, that are as equally as important as the capital.

Under access to capital, where the market is functioning, where a small business can get a loan from the market, why should taxpayers subsidize that activity because the market is handling it? But there are many, many small businesses out there that do not have access and opportunity. That is where we have been able to step into the market as you just saw in this credit crisis and provide that access and opportunity.

Mr. WALSH. I actually chair the Access to Capital Subcommittee, and we held a hearing a couple months ago and brought in heads of community and small banks and asked them pretty directly why they were not lending to small businesses, knowing full well this is where the bulk of small business gets their capital. And their answer was fairly clear and equally direct—our hands are tied. Government regulations have made it darn near impossible for us to lend to small business. I am curious, have you heard the same sort of thing?

Ms. MILLS. Well, as I said earlier, we work very closely with the regulators on guidance to small business. Out in the field we hear the same thing you have, which is that the guidance that has come down from Washington has been interpreted more tightly at the regional levels. When we have had these conversations we have gotten very strong assurance that the regulators will work with us to make sure that the guidance that they think is proper is the guidance that is being affected at the community bank level and in the regional level. We want to make sure the pendulum is in the right place and it has not swung back.

Mr. WALSH. And take that pendulum, do you feel that it has swung too far? I can tell you that I have probably spoken to the heads of 20 or 30 community banks in my district in the last six months and to a man and a woman they all say it has the last couple of years. They have seen a noticeable uptick. Are you sensing any of that?

Ms. MILLS. Well, that is a matter for the regulators, but our role was to bring to their attention that we were hearing concerns, and to make sure that they took their guidance all the way down. Our job is actually to make sure that we provide the product that can take some of that risk out of the system and allow banks the opportunity to make some loans they want to make but for various reasons cannot fulfill the total risk profile on their books right now.

Mr. WALSH. But you have heard that concern at that level?

Ms. MILLS. We have communicated. Every week I am somewhere different in this country and every week I have a roundtable with bankers and small businesses owners. So I have a pretty good sense that in the middle of the summer everybody—small business owners, bankers, everybody—had a moment of pause and we did go to the regulators and have conversations to make sure that everybody stays on the same page, and that access to capital is, within the proper constraints, available to small businesses as much as possible.

Mr. WALSH. Well, if you are out there as you say, and I believe that you are, I am convinced then that you have heard the same thing most of us have heard when you speak to small and community banks, that they are suffocating right now. Their hands are tied.

Ms. VELÁZQUEZ. Will the gentleman yield?

Mr. WALSH. Yes. Many of them allude specifically to Dodd-Frank. Yes, I would be happy to yield.

Ms. VELÁZQUEZ. Dodd-Frank will not apply to those community banks whose holdings, whose assets are less than $10 billion. And those are the community banks that are in our districts. I am a member of Financial Services and I work on Dodd-Frank.

Mr. WALSH. And I will close with this, and thank you, I guess they are not convinced of that. Thank you. Thank you, Mr. Chairman.

Chairman GRAVES. Mr. Critz.

Mr. CRITZ. Thank you, Mr. Chairman. Thank you, Administrator Mills for being here.

Going back to what Ranking Member Velázquez was talking about, the spike in lending that you had at the end of the first quarter of FY11 and then as December 31, 2010 hit, the precipitous drop in lending—I think the figure she used was half of your lending took place in that first three months for the entire fiscal year and some of the information I have been given is that SBA used to come to the Congress so that you get an appropriation to cover—to waive the upfront borrower fees on the 7(a) program. But you did not do it this time. And I have been told that you had $500 million of Jobs Act money that you might have been able to use to alleviate some of that. And I am just curious, as our economy was going the way it was, why you chose not to ask for that appropriation at that point or why you did not use the $500 million in Jobs Act money.

Ms. MILLS. I assure you we have used every penny of Jobs Act money for fee reduction that we possibly had.

Mr. CRITZ. Okay. Is there a reason you did not ask for a waiver or did not ask us for an appropriation to waive so you could waive the upfront borrower fee?

Ms. MILLS. We did waive all the upfront borrowing fees through the end of the Jobs Act period. We used every single penny and we are very grateful for it. Thank you.

Mr. CRITZ. Okay. One quick thing, and this builds on what Mr. Walsh was just saying, is I noticed in your statement that you say that you brought 1,200 lenders back to SBA lending. And obviously some of my community banks must be over that 10 billion in assets because they are asking and talking about how some of the regulations that they are having to meet are hindering them lending money, or some of the capital requirements that they have to keep are hurting in the way they lend money.

I was listening to you as you were saying you convene roundtables and you talk to banks all the time. I would be curious to hear what your suggestions are on the way we can be more effective or help you be more effective in getting money out and getting these small businesses energized.

Ms. MILLS. Well, thank you. I want to make sure that you are properly connected to all of our resources on the ground. So we have district offices, we have Small Business Development Centers, and we have a flow of small businesses that we match with banks. To the extent that you come in contact with banks and with small business owners who have concerns, who are struggling, who want to make more small business loans, we can help them with our programs. We are in high outreach mode and the best thing to do would be to send them to us.

Mr. CRITZ. I know your administrator in Pittsburgh is Carl Knoblock. He is a friend of mine and I can tell you where all the SBDCs are in my district as well. So we are pretty well plugged in. I was just, you know, my banks are talking about having troubles with lending money. And it is not just SBA money. Actually, I have a letter in front of me from one of my banks but it is the Treasury Program that Mr. Schrader was mentioning that one of the rules to get a Treasury loan is that the company has to certify that they are not child sex offenders. And there was a parliamentary trick played last year to defeat this bill and it actually got included, so now they are having trouble lending the money because of this provision because the small business owners are a little bit insulted that they have to certify—not that they are not rapists, not that they are not murders, but that they are not child sex offenders.

So, I appreciate your efforts. I am not going to belabor the point. My office is always available if we can be of any help, and I appreciate the work you are doing.

Chairman GRAVES. Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman. Administrator Mills, thank you very much for doing this.

At the risk of repeating what may have been said, I apologize for being a few minutes late. But I want to thank the chairman and the ranking member for giving me and Mrs.—Congresswoman Chu the opportunity to have a field hearing last week in the San Gabriel Valley where Mrs. Chu is the representative.

And instead of asking questions I would like to report back briefly to you on what we heard because it was very educational for me. This was an area that is literally driven by small business. It takes up an inordinate size of the economy in that part of Southern California. There are very few large, national Fortune 500 companies, but a very, very active small business community, entrepreneurs, in large part from the immigrant community.

And here is what we heard. We had small business lenders there, small banks, and one of the things they told us was that they were doing lots of lending to small business but no small business lending. They were not using any of the programs that were available to them. And when we asked them why they said it was too hard. And they said that the large banks were doing it. And really what the large banks had done is put together teams of professionals who did nothing but small business lending. So the Wells Fargo, the Bank of Americas of the world, they would have small business units because it was a specialty, and it had to be a specialty because it was so complex. And they did not have the human capital or the money available to develop that area of expertise. So they asked us to please do whatever we could to simplify the process.

We also heard that one of the things they focus on is micro lending. They do a lot of micro lending. We heard some great stories about loans under $100,000, how successfully they had been used. And when I asked them if they knew about the small business micro lending program, one of the things they said is they had looked at it but that the paperwork for a $50,000 loan was almost the same as the paperwork for a million dollar loan. And in terms of a return on the time and the investment that they had to make into setting up that loan it simply was not worthwhile. So they asked us to please take a look at anything, if anything, looking at making micro lending somehow streamlined so that they could do more of these things. And again, this was—a large majority of the loans they were issuing to the businesses in that area were under $100 to $150,000.

We also learned about the difficulties of opening a small business development center. That area had lost its SBDC in the recent past and there were a couple of organizations that were interested in reopening it only to find it was going to take at least three years to go through the paperwork necessary to open a new SBDC. And one of the things that we suggested or that Mrs. Chu and I talked about is maybe suggesting to you a grandfather process. So if there was an organization that was an SBDC that closed, that maybe they could be put on a fast track to reopen since they have already gone through the process at one point in the past.

I guess the last thing that we heard was that many of them had not heard of many of the programs that you offer. They were not aware of the Mentor Protégé Program. Only one of them even had ever been to the SBA website. So I do not know what you all are doing in terms of outreach to these small community banks. And maybe they dismiss it because of their impression that it is too difficult to work with the SBA because of past history. Again, I am not laying any blame here; that is not the point of the presentation. But that if the opportunity exists to reach out to educate these lenders, because again, the basic message I took away was that they are lending to small business and they want to do more but they are not using any of the tools that are made available to them through the Small Business Administration.

So again, not a question. A comment back from the field, and I appreciate your attention.

Thank you, Mr. Chairman. I yield back.

Chairman GRAVES. Absolutely. Mr. Peters.

Mr. PETERS. Thank you, Mr. Chairman. And Administrator Mills, it is great to have you here with us today, and I appreciate all the SBA has been doing, particularly in the state of Michigan. You mentioned some innovative programs that you have engaged in the state, and I thank you. We have been particularly hard hit as a result of what has been happening in the economy, and thankfully the auto industry is responding, been adding jobs in our area, but we all know that it is not just the auto industry or large industry in any particular region that is important, but the small businesses that are in the region that need to grow and prosper. And you have been a key player in helping us do that in Michigan. So I wanted to thank you for that first off.

And before asking some, a couple specific questions, I also just kind of want to get your sense on a statistic that you mentioned in your opening comments that "job creation is down starts by over 100,000," I believe was the quote that you had. And we, obviously on this Committee, are all big believers in small business and understand that small business is the engine of growth for an economy. But we also know that job creation is heavily skewed towards startups in order to get that kind of job creation.

And I just want to kind of get your assessment. You have been a very successful businessperson prior to your current position. As to what do you think accounts for that? Is it just as a result of lack of demand in the economy, a very weak economy we are in? Or are there some structural impediments, like financing that we are discussing here today? I mean, how would you weigh those and what sort of things should we be thinking of as members of the Small Business Committee to address the startup issue in particular?

Ms. MILLS. Thank you. I have enjoyed working in Michigan with all the great small businesses there. We focus on both Main Street small business and the kind of high-growth small businesses that could be part of the next large public company and employer. We are down 100,000 starts, and that is contributing to part of the employment problem. We do know that access to capital for startup businesses and for small growth amounts for those businesses is constrained. That, as they say, the valley of death has widened. We do have some programs, particularly the new one we are going to launch, but there is still a need for continued focus on getting more access to capital, particularly in underserved communities, particularly in distressed areas, particularly in places which have not traditionally had venture capital, because we know there are small, innovative businesses and entrepreneurs waiting to start up in all of those areas.

Mr. PETERS. Now, along those lines, and you mentioned the success that you had in the Recovery Act and as a result of that you were able to increase lending considerably which had higher guaranty rates as well as the waiver of fees. And I know your activity was up dramatically. Have you done any analysis as to what is more important—waiver of fees or the guaranties? And if given a choice as we go forward, how should we weigh that as perhaps a program going forward? Because we know the track record of success?

Ms. MILLS. Well, that is a very good question. We have done some analysis. I asked at every focus group for a long period of time and usually I would get half of them saying it is the fees and the other half saying it was the guaranty. So I think the jury is out.

Mr. PETERS. So we still have to find that out. But certainly, the——

Ms. MILLS. We think the combination clearly worked.

Mr. PETERS. Certainly, the combination worked. And I guess in thinking of how the jury is out, I do not know who were your focus groups. Probably smaller companies in particular get impacted by fees perhaps more than anything else. And I am very concerned about access for underserved communities. I represent a community that has an unemployment rate well in excess of 20 percent and we have a large urban area in the Detroit area, as you know, which also suffers. You talked about the program we are bringing large banks, and I believe it says it is going to target underserved markets in particular. And I would like you just to tell us more what does it mean by "in particular" and how do you define "underserved"? And how are we going to really monitor what is going on with these banks and have some sort of report as to the success they are having and hopefully focusing completely in underserved areas. But I want to know what it means by "in particular." What is your hope for that program and how will you assess it?

Ms. MILLS. Well, once again, this is a voluntary program that private sector banks came in because we asked them to step up. Each bank has a different set of activities and commitments that they are interested in pursuing. Many of those banks demonstrated that part of that commitment will be around underserved markets. We are going to partner with them, connecting them to Community Development Financial Institutions, and making sure their CRA contributions go as much as possible to help proven programs that will get money in the hands of small business. So it will be a wide array of programs.

Mr. PETERS. Great. Well, thank you very much. Thank you for your time. I think my time is up.

Mr. COFFMAN. Mr. Chabot from Ohio.

Mr. CHABOT. I am going to pass, Mr. Chairman.

Mr. COFFMAN. Mr. West. Mr. Cicilline, Rhode Island.

Mr. CICILLINE. Thank you, Mr. Chairman and Ranking Member Velázquez. Welcome, Administrator Mills. It is good to have you here.

I always want to begin my comments about the SBA with recognizing the great director in Rhode Island, Mark Hayward and his staff who are doing really excellent work and I want you to be aware of that.

As you know, the SBA has $3 billion in authorized leverage annually through the SBIC program. And each year anywhere between $1 and $2 billion in leverage authority remains untapped. And I understand that the Early Stage Innovation Fund and the Impact Investment Fund are intended to leverage a portion of that existing and yet untapped authority with the hope of really propelling into the hands of startups and entrepreneurs the capital that they need to be successful. And I know there are some studies that indicate that the unmet need for early stage capital equity financing for small businesses is somewhere in the neighborhood of $60 billion annually. This is a really important issue in my state, and I think all of us are trying to encourage new startups. And those typically are small businesses.

And so there is a particular, you know, just to use as an example, a constituent of mine, along with his partners, is forming a company called Axena Technologies, which has developed an anti-microbial material that can be used on medical devices to combat healthcare associated infections with huge potential for savings in healthcare and improved outcomes in health. And they have been working with SBA programs, including SBIC. And I am just wondering if you could explain how the Early Stage Innovation Fund and the Impact Investment Fund would help a company like that access startups to really get through, as was just described, this valley of death, which is really the most challenging time and get to that place where they can actually create jobs and grow our economy.

Ms. MILLS. Well, thank you. As you know, I am a person who spends quite a bit of time in Rhode Island. My husband's family is all there, so I know that you have fabulous entrepreneurs.

The SBIC fund had a record year, and it had a record year in a number of ways. Number one, it had a record year in the financings that went out the door to small businesses. Number two, it had a record year, as you see in the charts in the back of my testimony, in SBA commitments to the funds. We would like to fully utilize that authorization because, as I said earlier, this is a zero subsidy program and it directly impacts jobs.

We have built a great pipeline of credible funds who are applying, and they can come into the regular program or they can apply to an Impact Fund, which is really very much similar to the regular program but it is our way of directing potential investors to areas that are distressed and are trying to turn around and have had a difficult time in this recession. The Early Stage Fund will be run slightly differently. It will be a one deadline fiscal 2012 activity. For each of those two programs we have committed a billion dollars, $200 million per program, per year, for five years.

So those will ramp up. We are doing it as expeditiously as possible. Our licensing time has gone down from 15 months to 5½ months, so we are taking our pipeline through faster. But that said, we need to get capital into the hands of these terrific private partners. They need to then deploy it out to their small companies. They have been doing it remarkably quickly. I think you are going to hear that in the next testimony, but we are also doing it thoughtfully because we want to maintain this program at its positive levels.

Mr. CICILLINE. Will that be acting as early stage equity funding for those two funds?

Ms. MILLS. Correct. Our current funds are actually mezzanine funds. But within the early stage there will be a deferral mechanism where they can essentially be an earlier stage equity contribution.

Mr. CICILLINE. Well, I thank you. And I hope that the SBA will really focus on both innovative and creative ways to do this kind of financing because I think we have a lot of financing tools that were designed during a different age of industrial and manufacturing, and we really need to have this nimbleness in government to be able to respond to this new economy and have financing mechanisms that provide the kind of support that our small businesses, our entrepreneurs. And our early stage capital is one of those examples. So I applaud you for that and look forward to its results.

Thank you. I yield back the second that I had.

Chairman GRAVES. Ms. Hahn.

Ms. HAHN. Thank you, Mr. Chairman, Ranking Member Velázquez.

Ms. Mills, it is wonderful to listen to you today and I know while we are bringing forward problems and issues that we have heard in our districts, it is clear that you and the entire Small Business Administration is working, I think, you know, daily to try to do what you are intended to do, which is really to support our small businesses and try to get the capital into the hands of startups, current businesses, and I think you are doing a great job.

Since I have been on the Small Business Committee, I have done what many of the members have been doing longer than me, and that is actually going and meeting with small businesses in my district. I think I am up to 80 just in the last month that I have met with personally. And I have held roundtables, I have walked into their businesses unannounced, and I am beginning to hear sort of a common theme, which I think you have heard today, which is the paperwork that is needed to apply for these small business loans is many times daunting, and as we have heard some of them feel like it is not really even worth their time.

You know, as of February of this year, the SBA preferred lenders can approve loans using the new Small Loan Advantage Process. And the goal of this program is to expand the availability of small dollar loans by allowing existing SBA lenders to make loans under 250,000 using a two-page application. SBA has shortened the approval time to minutes if the application is submitted online, and from 5 to 10 days for non-delegated lenders. It seems to me that this Small Loan Advantage Program is exactly the type of solution that I think small businesses are looking for.

What do you think we could do to expand this program and make it accessible to everyone? How can we ensure that preferred lenders are using the small loan advantage process for all of their small loans?

Ms. MILLS. Well, thank you, Congresswoman, and thank you for your letter. I know that you have met with over 50 small businesses.

Ms. HAHN. It is up to 80 now.

Ms. MILLS. And clearly you just said it better than I could. We have a product that we have designed. We are reducing our paperwork, increasing our turnaround times, keeping a level of underwriting to make sure we have risk oversight. We are taking those principles of that product and now broadening them exactly as you had asked.

Ms. HAHN. You know, one of the other things I heard from my small businesses was under the Loan Guaranty Program. The criteria that SBA has to qualify for the loans is sometimes broadened when they actually go to the banks to, you know, access the loan. The banks put on more criteria than SBA requires. One of the issues they brought forward to me was while SBA, the Loan Guaranty Program does not require collateral—real estate as collateral. When they go to the bank, the banks say, by the way, we are going to require that you put up real estate as collateral. What can we do in working with the banks that are lenders, you know, to not add criteria or add restrictions to these loans when SBA is clearly not setting these criteria forward to small businesses as a means to qualify?

Ms. MILLS. We work with about 5,000 of the 8,000 banks. They are our partners. The first line in the credit process is generally the bank. The bank will make a credit decision because they are on the hook for somewhere between 50 and 25 percent of the loan as well. They have to have an independent credit decision. We have tried to coordinate, to work on paperwork reduction, but we have to make sure that both of us are satisfied in risk oversight.

Ms. HAHN. Well, again, I would urge you to maybe work with some of our partners out there because, again, that clearly stops many of these small businesses, these startup companies from accessing this capital. So if you could work with them on maybe trying to keep their criteria at least the same as yours.

And the last thing I will just say, and I wrote you in my letter, I would love to invite you to sunny Southern California and come to my district. I know that would be a great honor to have you there and I think there would be a lot of folks out there that would really enjoy listening to you and really hearing more about the programs that are available to small businesses. Come during the winter.

Chairman GRAVES. Mr. Richmond.

Mr. RICHMOND. Thank you, Mr. Chairman. Thank you, Administrator Mills.

One thing, and I will ask out of order, but we are talking about making sure that small businesses have the capital and access to capital so that they can flourish and they can fulfill their mission and they can continue to employ people, which is an important aspect of it, but the other aspect of it which drives all business is demand. How do we increase demand so that those businesses can continue to sell their products or widgets or gadgets or whatever it is that they are doing?

Ms. MILLS. With the American Jobs Act, we want to put more cash in the hands of small business right now because we have seen that when they have more cash available, such as in the payroll tax cut, they can take that money and they can put it into advertising. They can put it into inventory. That creates more demand for their products. That creates more jobs. Then they can come for financing expansion.

That is one of the first things, to prime the pump.

Mr. RICHMOND. Also, let me thank you for your administration coming down and participating in my small business fair that we had. We had over 347 small businesses sign up. I had a chance to talk to almost 120 of them on the opening night. And many of them sang the praises of our local SBA office in terms of the outreach and assistance that it gives. And now the new push, which I think is very important, is helping them understand that 95 percent of the consumers in the world are outside the United States and China, we must help them get to a point where we can sell our goods over there. And a few of them are taking us up on the offer of attempting to do that. And many of them left the small business fair with contracts with new vendors. So that was a very good thing.

There are two issues and two suggestions they gave to me, and I think we submitted them to you. And I will give them to you.

When the president announced expedited pay for contractors working with the government, they wanted to make sure that that trickled down to the subcontractors, to make sure that when the PRIME contractor was paid, that they do not unnecessarily hold up the subcontractors' money. And I think there was a program, maybe 10 years ago, where the PRIME contractor had to indicate that the subs were paid or would be paid in a short period of time. So they expressed that that would help. Because if they do not have access to capital, they do not have the time. Well, they do not have the resources to float payroll and all of those things, waiting on that payment.

The other suggestion that was made was—and I am sure it would ease a lot of members of Congress' workload—was if we could put the status of 8–A and other programs, the application process, on line, almost like colleges can do now where they can log into a secure account and see if all of their documents are turned in. See if they need anything else. See if they are on a background check phase or whatever, because a lot of times if they know, then they can make better decisions. And I think that now with technology we can offer that so that they can keep up with that.

Other than that, I do not have much else to offer. I would just again thank you for what you are doing and give you an opportunity to offer anything that you think you can need or what we need to do to help.

And I will say that we are looking forward, at least in Louisiana, to working more and maybe another round of teaming grant opportunities which we were not successful in the first round, so maybe we can look at second and additional rounds to see if we cannot participate.

Thank you, Mr. Chairman.

Chairman GRAVES. Mr. Coffman has one more.

Mr. COFFMAN. Thank you, Mr. Chairman.

Ms. Mills, I think you had mentioned the issue about banking regulations and its impact on small business and your view was, as it filters down, that at the top that there is certainly clarity and there is balance but that as it filters down perhaps there is not balance. And I just want to say that there is not balance, and I think it has hurt small business lending, particularly the community bank level, where you do have a wide latitude for which the regulators can go, but yet they obviously take the most conservative approach just in case anything ever happens, that their fingerprints are not on it. And you have performing loans out there that are being downgraded, causing these institutions to increase their capital requirement and pull in their ability to lend. And I just think that is a huge issue impacting small business at the community bank level.

One thing, I was visiting businesses last week in the district and, you know, you always wonder did you get the right cross section. But it seems like there were some signs of life. It seemed like although we felt like we were still skipping along the bottom, that the firms that survived this seem to have adapted. And, you know, they adjusted their business model, they made changes, and adding some employees.

I visited a manufacturer and probably three services companies last week. Very different picture from 2009 when the economy was in freefall and these poor—these small businesses were getting their credit lines just cut off. I mean, and everybody was just going down. And so that was tough.

I will get the other—get to probably a better picture next week when I am doing a job fair back in the district because I know there are a lot of unemployed folks that have been out of work for a very long time. And just last point, and if you could just respond to these, and that is I have had small businesses that are service-related companies come to me and they are very concerned about the impact—and these are kind of relatively low wage employees, one was a dry-cleaners who had a chain of dry cleaning stores but incorporated under the same entity had about—you know, had well over 50 employees. The other new as a janitorial firm with well over 50 employees. What is the impact on the health care bill going to be on their firm and their ability to keep these employees. And I will turn it over to you then.

Ms. MILLS. Well, number one, I think you characterized it exactly right. We are seeing some signs of life among small business. We have some demand now and we have to make sure that they get access and opportunity.

In October 2008, I was hearing "I need a loan to save my business." Now I hear "I need a loan to buy that next piece of equipment, hire that next worker, make that next expansion." That is good news, but that also means we have to be there with access and opportunity.

Mr. COFFMAN. And let me just say real quick, I was able to visit—one of them, in fact, that I did mention was a restaurant that is being built and, in fact, that is with an SBA loan. So, thank your department for that.

Go ahead, please.

Ms. MILLS. Thank you.

I would also ask small businesses to come to our website, where we can walk them through everything. With the Affordable Care Act, we know that small businesses now pay 18 percent more than large businesses, and when the exchange is open that premium will go down or disappear. So there are many good prospects. There is also the health care tax credit. We have a tool on the website to see if they qualify. Those would be opportunities I would suggest.

Mr. COFFMAN. Thank you, Mr. Chairman. I yield back.

Ms. VELÁZQUEZ. Ms. Mills, you recognized the need to increase lenders in your loan programs. Last year you had 2,727 total lenders; 1,349 made three loans of less. And my guess is that some of the lenders who came into the program were attracted by the provisions of the Recovery Act. So once those provisions expire I just wondered how many of those lenders are still active and making those loans. In the second panel we are going to have a credit union testifying.

And my question to you is what will you do to retain the lenders that are participating as SBA's loan programs, but also, what are you doing to increase direct union participation in your loan programs.

Ms. MILLS. Thank you. Credit unions are about 10 percent of the current activity. We love credit unions and we think they can do a very good job with SBA. We are bringing them in through training, through education, through participation. Active participation with their association. On the ground, you are exactly right. We have to work very, very hard now to make sure that we continue to meet one of our base goals, which is active lenders. About 5,000 of the 8,000 banks actually hold an SBA loan. But we track how many have made a loan within that year, and that number is around 3,000, in the high 2,000.

So we need to keep that number up. And we are going to be working. We hold lender roundtables. We simplify our program. We walk them through applying. We do everything we can. So if you have lenders in your communities, particularly those who are on the ground and know these good small businesses, we will bring them in. That is why we are opening our doors to community development financial institution, who have good lending track records and we want to be there with as many doors, points of access, as possible.

Ms. VELÁZQUEZ. The challenge that I see when it comes to either community banks or credit unions is that you need the personnel. And they do not have that type of capital and expertise. So what will you do to help them? It is just not walking through. Just because of the pressure coming from regulators to make sure that they are complying with credit standards. How do you balance that?

Ms. MILLS. Well, as you know we have a product for a lender that is only going to make one or two or three or four loans that allows them to use much more of their own documentation. We continue to streamline that so they are able to come into our program without undue burden.

Ms. VELÁZQUEZ. Okay. Thank you, Mr. Chair.

Chairman GRAVES. Thank you, Administrator Mills for being here today. We appreciate it. I think that is the end of the questions. We will go ahead and seat the second panel, if we could.

STATEMENTS OF LYNETTA TIPTON STEED, EXECUTIVE VICE PRESIDENT, REGIONS FINANCIAL CORPORATION, TESTIFYING ON BEHALF OF THE CONSUMER BANKERS ASSOCIATION; SALLY ROBERTSON, PRESIDENT, BUSINESS FINANCE GROUP, TESTIFYING ON BEHALF OF THE NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES; K. RODGER DAVIS, MANAGING PARTNER, NORTH CREEK MEZZANINE, TESTIFYING ON BEHALF OF THE SMALL BUSINESS INVESTOR ALLIANCE; GARY GRINNELL, PRESIDENT AND CEO, CORNING FEDERAL CREDIT UNION, TESTIFYING ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Chairman GRAVES. Let me take a moment to explain the lights to you. Each of you have five minutes to testify and the lights will be green during that time. When you get down to one minute they will change to yellow and then when your five minutes is up it will go to red.

And with that I will introduce our first witness today, which is Lynetta Tipton Steed, the executive vice president of Business and Community Banking at Regions Bank. Regions Bank is headquartered in Birmingham, Alabama. It is one of the largest full-service providers of financial services with 1,800 bank offices in 16 states across the Midwest and the South. Ms. Steed joined Regions in 1992 and is now responsible for managing Regions' Credit Underwriting, Documentation, and Administration for Small Businesses. She is testifying today on behalf of the Community Bankers Association. Thank you for coming all this way. I look forward to hearing your testimony. You might turn on your mike, too. There we go.

Ms. STEED. Thank you.

Chairman GRAVES. Go ahead and give your testimony, and then we will go through each one and then open it up for questions.

STATEMENT OF LYNETTA TIPTON STEED

Ms. STEED. Yes, sir. Chairman Graves, Ranking Member Velázquez, and members of the Committee. My name is Lynetta Tipton Steed and I am an executive vice president and division head for Business and Community Banking for Regions Financial.

Regions is a full service financial company headquartered in Birmingham, Alabama, with over 1,800 branches and 2,200 ATMs in our 16 state footprint. I am also a member of the Consumer Banking Association Small Business Committee, which includes top small business bankers who share the goal of improving the state of small business banking, including SBA programs.

Small businesses are facing a number of challenges—weak economic conditions, high levels of unemployment, and low consumer confidence have led to low sales volumes, which have resulted in a lack of demand for small business loans. Despite the decline in overall loan demand, we continue to see healthy SBA lending. The SBA 7(a) and 504 programs have been effective during these economic times. Earlier this month, the SBA announced it supported $30 billion in fiscal year 2011, bringing the three-year total to over $70 billion in support of small businesses lending.

Regions recognizes the value of SBA partnership and has a proven track record with its programs, having been a preferred lender since 1996. In 2010, Regions identified increased SBA lending as a strategic initiative. Significant resources have been devoted to this initiative to improve the delivery and our special lending efforts. As a result, we have more than doubled our SBA lending staff.

Regions has ranked in the nation's top five for overall 504 loan approvals for the past two years. We have also dramatically increased our 7(a) lending over the past year by 82 percent. In addition to the SBA 504 and 7(a) programs, Regions participated in the Americas Recovery Capital Loan Program when it was in place, and recently added the export working capital and export programs as well.

We intend to implement the newly named working capital CAPline program in the first quarter of 2012, and we were strongly considering the contract CAPline program as well.

So what can be done to make things better? The loan enhancements provided under last year's Small Business Jobs Act, allowed the SBA to raise the guarantee on its 7(a) and waive certain fees on both (7a) and 504 loans. While in effect, these provisions had a tremendous effect on the ability of banks and small businesses to utilize these important programs.

As an example of this effectiveness, in the fourth quarter of 2010, Regions' application trends and approval trends increased by more than 25 percent over the prior quarter. Also, the Small Business Jobs Act's permanent increase in 7(a) and 504 limits from $2 million to $5 million and its permanent increase in microloan limits from $35 to $50,000 have been helpful. However, the act only temporarily increased the cap on SBA express loans, a subprogram of 7(a) from $350,000 to $1 million. In order to expand access to much needed working capital.

A further streamline 7(a) loan process would help borrowers attain loans more easily. The SBA has done a good job at enhancing but there are relatively easy to implement adjustments that could be made to the 7(a) loan process that would expedite originations of small business loans.

For example, allowing financial institutions to use their own application and notes for all SBA loans would be helpful.

The SBA currently allows lenders and credit policies on express loans, which has greatly improved that process. Effective aside from the SBA Lender Oversight is another crucial area of concern. While there needs to be strong and consistent lender scrutiny, fluctuating economic conditions often call for flexibility. Overall, CBA's members have all reported increased efforts to help small business access capital. Many CBA members have hired new small business bankers, initiated second look programs to ensure that every possible loan is being made, and incorporated other initiatives to improve delivery of SBA programs.

I could cite many good outcomes for SBA programs, but as we look forward, CBA encourages Congress to monitor the SBA guaranty levels. It is also important that they have the funding and authorization necessary to continue to work with the private sector in financing American small businesses.

In conclusion, we support improvements in the SBA loan structure, but there is also a need for greater certainty in SBA programs, especially during these difficult economic times.

CBA looks forward to working with this committee and the SBA to improve lending disputes and the SBA to improve lending to small businesses. Thank you for the opportunity to appear before the Committee to discuss the SBA and the current status of small business loans lending. I would be happy to address any questions you may have.

[The statement of Ms. Steed follows on page 71.]

Chairman GRAVES. Thank you, Ms. Steed.

Our next witness here today is Sally Robertson, president and chief executive officer of Business Finance Group, a community development company located in Fairfax, Virginia. Ms. Robertson is testifying today on behalf of the National Association of Development Companies. She has served Business Finance Group as president and CEO for 15 years and she has also been involved in several CDC industry organizations. Serves as vice chair of the board of directors of the National Association of Development Companies. Thank you for being here.

STATEMENT OF SALLY ROBERTSON

Ms. ROBERTSON. Thank you very much. Again, my name is Sally Robertson, president of Business Finance Group in Fairfax, Virginia. We are a non-profit certified development company and I also serve as vice chair of the National Association of Development Companies. I am very pleased to provide comments regarding the niche filled by the 504 Program for small businesses seeking long-term capital to grow and create jobs.

Successful small businesses are innovators who often buck the trend in order to realize a market advantage. Many small businesses are now ready to take that next growth step, but banks are constrained by the impact of losses on their capital and they face regulatory criticism for their real estate and small business lending. As the need for new long-term capital increases, conventional sources and financing are less available. What is the real impact? Without capital even successful businesses cannot grow. Capital is the grease that enables businesses to grow and add new jobs. Without new jobs, America cannot pull itself out of this jobless recovery.

As you all know, 504 is a leverage program that incentivizes banks to lend to small businesses by sharing the risk of a long-term loan. Small business owners benefit from a 20-year loan, and an attractive 20-year fixed rate, along with terms that allow them to preserve cash flow for growth. With short-term deposits as their source of funds, banks cannot offer the same terms to small businesses, but as a participant in the 504 project, banks are able to offer a low-risk, conventional loan that provides a return to their stockholders. The 504 program is an excellent match of the private sector and public sector working together to provide capital for growing small businesses.

Best of all, 504 projects create new jobs and save jobs in communities across the country. The 504 program is the most successful economic development financing program provided by the federal government. A study completed by California State University three years ago demonstrated that in just a two-year period, 504 loans directly created 54,000 new jobs and indirectly led to another 66,000 jobs. Further, for every dollar SBA spent to operate the 504 program, federal, state, and local governments realize $94 in new tax revenues.

We would like to note that NADCO supports effective SBA oversight and we applaud SBA's steps to improve those functions. SBA is currently staffing senior managers for the Office of Credit Risk Management, and we encourage SBA to rethink its oversight systems. Today, SBA has two different 504 portfolio oversight systems operated by two different departments. Not surprisingly, they sometimes come up with different reviews of CDC loan performance. We encourage SBA to move towards a single portfolio monitoring system, establishing firm boundaries, making the rules clear, and providing consistent oversight will lead to a stronger lending process that reaches program needs yet curbs abuses.

During the recent recession, the 504 program saw dramatic increases in defaults over historical levels. What the statistics, however, do not show are the small businesses that were saved. With troubled debt restructuring rules, banks are very inflexible in workout situations. However, the CDCs and SBA have some flexibility with the second trust. These successful workout situations have resulted in a business surviving that might otherwise have failed, resulting in more lost jobs in a fragile economy.

The 504 program has become one of the most successful and largest economic development programs in the federal government. By leveraging its guaranty authority and private sector capital, SBA has directly assisted in the creation of millions of jobs through more than 150 billion in 504 first mortgages by banks and 504 second mortgages by CDCs.

The public-private partnership is a unique program feature that encourages the investment of private capital in growing small businesses. The value of the 504 program can also be seen in successful small businesses who have used the 504 program to finance their next level of growth. Every CDC in every state can provide stories of small businesses who would not have achieved their current success without the ability to use the 504 program. And as we begin to climb out of this terrible recession, there are many small businesses whose continued existence is a result of successful workouts hammered out by CDCs and SBA on their behalf.

We are excited to be working closely with the skilled and innovative SBA management team to look carefully at how the 504 program can continue to be relevant and beneficial to future small businesses. We hope that this effort will lead to improved oversight, improved processing, and more flexibility to encourage more banks and borrowers to participate in the 504 loan program. Small businesses that are nimble and forward thinking will lead us out of this recession by creating the new jobs we need. Let us help them do it sooner. Working together we can get America working.

Our thanks to Chairman Graves, Ranking Member Nydia Velázquez, and the Committee for your leadership and support for America's Small Businesses. Thank you.

[The statement of Ms. Robertson follows on page 45.]

Chairman GRAVES. Mr. Chabot.

Mr. CHABOT. Thank you very much, Mr. Chairman.

I am pleased to welcome to the Committee this afternoon a constituent of mine from Cincinnati, Ohio, Rodger Davis. Mr. Davis is co-founder and managing director of North Creek Mezzanine, a small business investment company located in our community. Mr. Davis is testifying on behalf of the Small Business Investor Alliance, the industry association for small business investment companies. Mr. Davis has 25 years of experience in the banking sector, including commercial banking, real estate, leveraged finance, direct equity, and fund investing to name but a few areas of his expertise. We welcome you here this afternoon, Mr. Davis, and look forward to your testimony.

STATEMENT OF K. RODGER DAVIS

Mr. DAVIS. Thank you, Congressman Chabot, and thank you to the rest of you for giving me the chance to talk today.

I am proud to represent the Small Business Investor Alliance. As Congressman Chabot pointed out, that is the old NASBC for those of you who do not recognize the name.

My name is Rodger Davis, and I am co-founder and managing partner of North Creek. We are a $70 million SBIC fund located in Cincinnati. And to put that in perspective, that puts us at the smaller end of the range for SBIC funds. And frankly, we think that is a good thing. We can focus on smaller companies.

My partner, Barry Peterson, and I are lifelong bankers to small businesses. And when Provident was sold in 2004, we set off to create a fund dedicated to lending and investing in small businesses, really continuing what we love to do at the bank.

The credit crunch in '08 and '09 really served as the catalyst for the creation of our fund. Our research quickly led us to the SBIC program for several reasons. We were comfortable with the regulatory oversight and licensing process, the program is targeted exclusively towards small business where we felt there was really the greatest need, and it could amplify our private capital through the use of low cost leverage from the SBA debenture program.

To me, the SBIC program is a perfect example of a public-private partnership that works. So in the spring of 2010, we opened our doors for business. The biggest surprise I think that Barry and I have experienced so far has been the overwhelming response to the nation's small business need for capital. We reviewed over 350 business plans from company owners nationwide seeking capital. We originally thought that we would see a lot of companies losing money that frankly did not deserve the capital, but it has been quite the opposite. There are many companies that we have been unable to help that we would have liked to.

Unfortunately, for most small businesses the traditional markets remain constrained or closed altogether. I have a few thoughts on why that is still the case. Many companies reside in the workout area of the banks because their revenues and profits declined in the recession. And until that backlog clears these companies will have a very difficult time growing as all cash flow will be dedicated to paying down the bank debt. I kind of call this the hangover from the credit crunch.

Bank consolidation, although there has not been as much in recent years, continues to have a negative impact on lending to small business. As a former banker, I understand the need for process ratios, systems, credit scoring, but for us it is about meeting management teams, listening to the story, and determining if they deserve the capital. Regional and small community banks are helping but it is not enough.

So herein lies the value of the SBIC program in a firm like North Creek. In a year and a half we made seven loans to five companies. These companies are located in Cincinnati, Ohio; Austin, Texas; Elkhart, Indiana; Boulder, Colorado; and Sanford, Florida. I find this statistic remarkable myself when we put this data together, but these five companies have added over 200 new jobs in really less than a year. That is a 20 percent increase over their base employment.

You can see the impact on a management team that now has the capital to grow. If Todd Cleveland and Any Nemeth of Patrick Industries and Elkhart were here they would tell you that bank lending is still very tight. But they would thank you for the SBIC program because of the capital they received from us they are now in position to grow and prosper.

Randy and Rick Girard of Girard Environmental Services in Florida will tell you that the capital that they received from North Creek now puts them back on offense and they can now take advantage of growth opportunities in the market.

Troy Augustine of iNET Interactive and Cincinnati would tell you that the acquisitions he has made to more than double the size of his company would not have been possible without the SBIC program and North Creek.

Just a few thoughts on the future of the program. We need to make sure we keep successful fund managers in the program and Congressman Chabot's bill 3219 will help by raising single and family fund limits. What happens is as funds grow they bump up against single and fund limits and those need to be kept modernized to keep up with funds as they grow so we keep them in the program.

Secondly, we need to make sure banks continue to be active investors in the program. Banks have been long-term supporters of SBICs. It is a great partnership where we can work with their lending staff and they can work with us. Let us make sure they stay in the program in a big way.

And lastly, I just want to make sure you understand that by raising taxes on carried interest, for small fund managers like me, the only impact will be that I have less capital to put into small businesses. The management fee that we earn pays for the overhead of the business and we only make money on the carried interest if our companies prosper and grow. So thank you.

[The statement of Mr. Davis follows on page 52.]

Ms. VELÁZQUEZ. Mr. Chairman, it is my pleasure to introduce to the Committee Mr. Gary Grinnell. He is the president and CEO of Corning Federal Credit Union located in Corning, New York. He is testifying today on behalf of the National Association of Federal Credit Unions, a leading advocate for America's Credit Unions and all of their members. Welcome.

STATEMENT OF GARY GRINNELL

Mr. GRINNELL. Good afternoon, Chairman Graves, Ranking Member Velázquez, and members of the Committee. My name is Gary Grinnell and I am testifying today on behalf of NAFCU. We appreciate the opportunity to participate in this discussion regarding financing programs under the Small Business Administration.

At Corning Credit Union we have a well diversified business lending portfolio with minimal delinquencies. For the last two years we have been recognized as the top small community lender by the Small Business Administration in the 34 countries that make up the SBA district in which we are located. We started our business services program in 2006 and have been an important source of funding for small businesses in our areas ever since.

During the recent economic downturn, many banks in our market stopped lending to their clients. Corning Credit Union has been able to fill the void and provide these businesses with the funding they need to continue to grow and create jobs.

Since our SBA programs' inception, we have made several SBA loans totaling over $8.2 million. Our average SBA loan is about $116,000. We participate in the SBA 7(a), SBA Express, and Patriot express loan programs.

Many of our SBA loans are for entrepreneurs wanting to start a new business and create new jobs. A 2011 study commissioned by the SBA indicated that credit union small business lending has increased in terms of the percentage, both before and during the recent financial crisis. Well, bank small business lending has decreased. This demonstrates that credit unions continue to meet our capital needs of our business members, even during the most difficult times.

Unfortunately, when Congress passed the Credit Union Member Access Act in 1998, it put in place an artificial cap on the ability of credit unions to offer member business loans. It should be noted that the non-guaranteed portions of SBA loans count toward this arbitrary cap. At Corning Credit Union we are approaching the cap and expect to reach it next year. This would ultimately impact our ability to make member-business loans, including SBA loans to the small businesses we serve. Fortunately, there is bipartisan legislation in the form of H.R. 1418, the Small Business Lending Enhancement Act pending before the Financial Services Committee that would address this issue. We urge the Committee members to support this important bill.

Some NAFCU members tell us that they have scaled back on the number of small SBA loans, as a response to comments arising from SBA examinations. These credit unions feel that the SBA's lender evaluation and scoring process disadvantages those that make a number of small, lesser collateralized loans as it compares them with those institutions making large, fully collateralized loans in their evaluations and scoring. If this evaluation process is not changed, it may eventually drive a number of small loans from lenders' portfolios. NAFCU members have requested that the SBA address this deficiency, and we hope that the small businesses committee will be able to help as well.

At Corning Credit we are an approved SBA lender. We are fortunate that we have hired an experienced SBA lending officer with knowledge of the system to help run our program. Still one of the hurdles that we see is that our local SBA 7(a) applications are sent off to national offices for review by underwriters who do not understand our local economy. This impersonal step adds time to the approval process for the small business owner.

Furthermore, the lack of having local SBA underwriters to interact with, they discouraged those lenders who do not have the expertise that we do on their staff. This makes it harder for those institutions that may want to do SBA loans but would only have limited volume that does not justify hiring an in-house SBA expert. As a result, some credit unions in this situation may opt not to get involved in SBA lending at all.

There is a way that this concern can be addressed. NAFCU supports the reintroduction of the Credit Union's Small Business Lending Act. This bill would make it easier for credit unions to become more involved in SBA lending and open the door to more access to credit for those small businesses and communities served by credit unions.

In 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. While the SBA's financing programs are providing much needed opportunities to businesses, there are still obstacles withholding the programs from their full potential. We are confident this committee will do what is necessary to ensure that these programs are successful.

Thank you for the opportunity to testify before you here today. I would welcome any questions that you may have.

[The statement of Mr. Grinnell follows on page 57.]

Chairman GRAVES. Thank you to all our witnesses. And I have one question for each of you actually. Out of curiosity, how responsive is the SBA when—you come to them with problems within the programs. How responsible are they to trying to rectify those? And are they very open for, for suggestion, for criticism?

Ms. Steed.

Ms. STEED. Yeah, I will start.

I would say that the SBA is more receptive today more than ever. And undressing issues the community faces for lending. An example would be the rewriting of the 504 refinance provision we talked about earlier. That will have a dramatic effect on a lot of these small businesses who have conventional loans that are ballooning and it allows them to access their capital—access their equity to use for capital. So anytime we have given feedback to them they have been very responsive and very helpful.

Chairman GRAVES. Ms. Robertson.

Ms. ROBERTSON. I would certainly have to concur. The SBA has been extraordinarily responsive anytime we have gone to them with issues and concerns. It is a large agency. It may not happen as quickly as we would like but I think they have tried their best to listen and to actually come up with workable solutions.

Mr. DAVIS. I found them to be very responsive. I think if you talk to some people in our industry that find them to not be responsive it is because of probably something on their end.

Mr. GRINNELL. We have found them to be responsive, as well. The main change that we have seen from a negative perspective is the consolidation to the national offices, as I mentioned in my report, as opposed to the local focus of where it used to be.

Chairman GRAVES. How about when it comes to loans getting approved. I have had people come to me and talk to me about the fact that particularly if it is a new startup and they have got construction issues in there and it is delayed in getting that loan approved. As that delay spreads out then their costs go up, contractor costs go up. Where is that breakdown? Is it SBA approval? Is it just requirements that you have in the process? In some cases it seems to just drag on and drag on and drag on and then you have to, apply for more money on that loan, which creates more problems because the costs are going up?

Mr. GRINNELL. I can speak to that. We would certainly like to see the process quicker. Again, I think it goes back to trying to work with somebody out of one of the national offices who does not understand the local economy. We've seen them be less experienced people over the last couple of years and we think that slows down the process. Sometimes it can take up to three to four weeks to get a loan approved, and if we were doing that loan in-house it would take a couple of days. So we definitely see that as an area for improvement.

Chairman GRAVES. Ms. Robertson.

Ms. ROBERTSON. From a 504 standpoint, we are now required to provide construction bids at the time a 504 application is submitted on a construction project for approval. A commercial reasonable standard would be that construction documents are provided at the time of a construction loan closing with the bank rather than at the time of SBA approval. So that is certainly delaying the approval process and likely causing borrowers funds not only delaying their settlement on a property but also if contractors are charging them fees for those kinds of things they are having to pay those in advance of having a loan approval.

Chairman GRAVES. Ms. Velázquez.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Ms. Steed, you heard a lot of the members here asking questions to the administrator regarding the need to have more smaller loans, those defined at $150,000 or less. And since the Jobs Act increased the maximum SBA loan size to 5 million, the percentage of smaller loans has declined from 17 percent of total lending dollars in 2009 to just 8 percent in 2011. And the administrator, when I asked why this is happening, she said that banks are not making those smaller loans. My question to you is why.

Ms. STEED. Well, I cannot speak for all banks. I can only speak for my bank and the members that I sit on with the Small Business Committee with the CBA. And we are not finding it difficult to fund those customers. It is an opportunity that we have through our 7(a) and our express programs. It is a core program we already have in play today. We also have a small loan advantage. We do not participate in that one separately at Regions because we have the core programs that accomplish the same thing. And so we are not finding that to be a challenge. It is just a matter of incenting them to kind of get in the game, make sure they have the business plan to support the credit.

Ms. VELÁZQUEZ. The SBA loans that your bank makes, what is the percentage of smaller loans, under 50,000 or less?

Ms. STEED. I do not have it off the top of my head.

Ms. VELÁZQUEZ. Would you be able to find it?

Ms. STEED. I could. I absolutely could do that for you. Yes, ma'am.

Ms. VELÁZQUEZ. Thank you.

Ms. Robertson, last week the SBA released final rules for the 504 Refinancing program. We do not allow CDC lenders to make loans in excess of $12.5 million with no requirement that they create a single job. And as we all know, with this job loss economy, the challenge that we have is job creation. So given that fact, was it a good idea for the agency to abandon this critical element of the 504 program?

Ms. ROBERTSON. I think the intention here is to save businesses that might not be able to find financing or alternatively provide a financing structure that is more appropriate to the business, improving their cash flow so that hopefully they can then add jobs.

Ms. VELÁZQUEZ. The intent of the program, 504, has always been economic development and job creation. And to me this flies in the face of the original purpose of 504. The fact that it requires to create jobs does not take away the debt refinancing, even if you tell me, well, it did not create new jobs but at least we are preserving.

Mr. Davis, the SBIC program has had proven success at helping later stage businesses but has struggled to raise early stage and startup firms since the participating securities program was eliminated. Are there ways that the debenture program could be adapted to help meet the needs of earlier stage businesses?

Mr. DAVIS. Well, I think the first comment, the debenture program, because it has a current pay interest feature we need to be sure that we have portfolio companies that are paying our investments current.

Now, some SBIC firms could take lower leverage and so they could sprinkle in some additional equity investments that could go towards more early stage. But the classic 2:1 leverage, which we are, it is really incumbent upon us to stay away from those. We need to be financing companies that are just going to the next level. So I think lower leverage could be an avenue. And maybe, you know, just relook at what was wrong with the participating securities program and, you know, look at it retrospectively and say what could we have done differently? So.

Ms. VELÁZQUEZ. Mr. Grinnell, in your testimony you emphasized the continued need for credit, especially among businesses who are seeking smaller loans. Do you believe that the SBA large bank lenders overemphasize more profitable loans, like loans to established businesses with larger credit—greater credit needs to the detriment of smaller firms?

Mr. GRINNELL. Well, in terms of our credit union, we like to make small loans to help your members. And I think credit unions in general like to make small loans. We have seen very strong demand throughout the entire financial crisis. As I mentioned before, we are almost at our member business loan cap and we are going to have to stop lending. From what we heard from our members the banks have turned them away. We have helped entrepreneurs star started with very small loans that the banks were not interested in. And those members are now hiring additional individuals, additional employees in our communities and making a real positive impact in our communities.

Ms. VELÁZQUEZ. Ms. Steed, I do have some numbers here about how your bank increased by 58 percent in terms of the average of your loan by 146. It seems to me that you are making much larger loans at the expense of smaller loans. And I will encourage the bank at least when you are doing 7(a) loans that you tackle the gap that exists because you have a responsibility. You are participating in a program that is a guaranty by the federal government. And the same is true with a lot of the other banks.

Ms. Robertson, beginning this year, taxpayers will be paying $90 million to subsidize 504 loans. In the past, some CDCs have provided their executive staff with salaries and benefits that defy their supposed status as a non-profit company. And I just would like to hear—we know that IG did an investigation. What is it that your members are doing—your company is doing to ensure that this type of practice does not take place any more. You have executives making or at least they were making $800,000 in salaries.

So I would like to hear what you are saying because we have to protect the taxpayers' dollars.

Ms. STEED. Absolutely. I think our trade association is extraordinarily concerned about those practices. We have provided guidance to our members on IRS requirements for non-profits, on board governance. We have talked to SBA about oversight and enforcement. Unfortunately, the trade association is not really an enforcement or police vehicle but is doing its best to provide training to members on those topics.

Ms. VELÁZQUEZ. Well, training them to have the discussion because I know that you cannot enforce how much salary you are going to provide any of the executives but it is a good PR that it might benefit the entire association.

Ms. STEED. Absolutely.

Chairman GRAVES. Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman.

A few quick questions just to clarify and make sure I heard correctly the first time through. Ms. Steed, did you say that your organization had doubled SBA lending staff over the course of the last period of time?

Ms. STEED. Yes, sir.

Mr. MULVANEY. Are they—do they specialize in SBA lending or are they doing SBA lending part of the time and then regular commercial lending the rest of the time?

Ms. STEED. No, they specialize in SBA lending. It is a build out for underwriting, paralending, packaging, everything, so that the process is streamlined. We are reeducating our relationship managers out in the field with this new—we have this streamline process because that is a negative connotation. We heard it earlier today when Administrator Mills was speaking. It is cumbersome. So what we are trying to do as an industry and as a bank is streamline it so when you have opportunities you do not have to reinvent the wheel every time. So that is dedicated SBA.

Mr. MULVANEY. And I guess one of the things, Regions is a large bank. They have a presence in my district.

Ms. STEED. They are a regional bank.

Mr. MULVANEY. They are good folks, right? I mean, I am from South Carolina. You all have a presence there.

Ms. STEED. Yes.

Mr. MULVANEY. And I guess what I am struggling with is—here is my question. In your opinion, has SBA lending gotten to the point where it is so complex that you have to do that in order to do it in a cost-effective manner?

Ms. STEED. I think the impression is that is the impression for your borrowers out there and the bankers. So reeducating them is important. You can streamline it. You just have to get back out and reeducate because that perception is out there.

Mr. MULVANEY. Gotcha. Thank you very much.

You also mentioned I think that the SBA now allows you to use your own notes. Is that right?

Ms. STEED. For the 7(a) express program. We are suggesting that could be something we could look at for all of the core programs, to streamline it.

Mr. MULVANEY. And I used to do some corporate work. Tell folks why that is important.

Ms. STEED. You do not have to duplicate your efforts. It is one application one time. It goes through the process easier. When you have extra documentation from the SBA side you seem to be duplicating your efforts. And this just makes it very, very convenient, very fast, and you will get onto getting that loan funded.

Mr. MULVANEY. And the standardization, them allowing you to use your own documentation, which is absolutely critical, is it just in 7(a) or are you seeing it in other programs as well?

Ms. STEED. Right now I believe it is just 7(a) Express and we are trying to get that broadened. We are making that suggestion.

Mr. MULVANEY. Gotcha. Thank you very much.

Mr. Grinnell, you said some of your members, and again, I come from an area, textile communities, very strong credit union presence where I am from. And you said that some of your members have scaled back on some of their smaller loans. Is that correct? Did I hear that right? The number of loans and so forth?

Mr. GRINNELL. I said that—well, we have very strong demand. We are continuing to make a very large number of small loans as a credit union. What I have heard from other credit unions is based on the way that the SBA does their risk ratings and it does not really compare apples to apples; it compares institutions that do a lot of small loans with institutions that do a very few large loans. And based on that, so if you have a lot—if you have more small loans that go past due, that can basically hurt your rating. So it could potentially discourage institutions from making the smaller loans.

Mr. MULVANEY. Is there a fix to that?

Mr. GRINNELL. I believe they should change the risk rating system.

Mr. MULVANEY. Give me an example. I am not familiar with the risk rating system that they use.

Mr. GRINNELL. Well, first of all, I should say that that is also what we have heard in talking with other credit unions, other NAFCU members, as a credit union, Corning Credit Union, we have not had a particular challenge with this issue, so I am not an expert on exactly, you know, what needs to change but, you know, we have definitely heard that—and it just does not make—I mean, just common sense approach. You know, you are comparing apples—you are not comparing apples to apples.

Mr. MULVANEY. I gotcha. Mr. Davis, I think I heard you say that there was some level of consolidation going on within your industry and that I think you said that that led to less small business lending. Is that accurate?

Mr. DAVIS. You know, the statistics probably may or may not support that. What it does though is it significantly changes it.

Mr. MULVANEY. In what fashion?

Mr. DAVIS. Well, for example, if you have fewer assets, a service company, for example, a lot of the larger banks now, they will be happy to give you an asset-based loan. Very simple, very easy to standardize. So it is different. I am sure the large bank would say we are making small business loans, but they are not making small business loans to companies that have a wrinkle in their past and, boy, a lot did. I call Asset Light companies service companies. Specialty manufacturing companies. Those are very difficult for the large banks to make.

So, you know, again, we are in the market day in and day out. We are finding—I will give you an example. We had a portfolio company of ours that went out to the market. Great company. Very light in terms of assets. They went out to 10 banks, got 1 proposal. Great company but it just did not have—it did not fit the box. So if you do not fix the box, you are in trouble. And so you are going to need a firm like us to step in and work with a bank that can do a small piece that is simple straightforward and does not have a wrinkle to it.

Mr. MULVANEY. Thanks very much. Thank you, Mr. Chairman.

Mr. CHABOT. Thank you very much, Mr. Chairman.

Mr. Davis, I just have a couple questions. First, how will an increase in the SBA leverage limits for SBICs as proposed in the legislation that we have introduced, the H.R. 3219 as you had mentioned, how will that affect the ability to provide capital to more small businesses?

Mr. DAVIS. Well, what happens, so you get fund managers like ourselves. This is our first fund. It is a $70 million fund. If we are successful, and I hope we are and I am confident we will be, we will go out for a second fund. We will probably be able to raise more capital in the second fund. So our family of funds can start bumping up into an aggregate limit that the SBIC program currently has. In addition, there are single aggregate limits and so there are a lot of successful fund managers that start in the SBIC program and then they graduate out of it and move on to a non-SBIC program. And as they move out they may or may not stick with small business. They may move on. So by expanding that family of funds' limit you will keep more managers dedicated to small business.

Mr. CHABOT. Thank you. And you had mentioned, I think you have 70 million available funds and I think you had seven loans out to five companies. How much of the 70, for example, would you have used up in those loans, approximately?

Mr. DAVIS. 12.3 million. So we are making—again, we are on the small end of the range for SBICs, and I think that is a really good thing, especially for our market. There is a lot of small business owners that do not need $10 million or $20 million. We are making—our average loan size is about $1.8 million. And we have got a half million dollar loan. It was our first loan. It turned out to be a great loan. The company now has made two subsequent acquisitions and they have doubled the number of employees they have.

Mr. CHABOT. That is great. Now, as far as the—I think you said you had about 350 companies that you had looked at.

Mr. DAVIS. Correct.

Mr. CHABOT. Those are actually applications that they had gone through the process or is that what it was basically?

Mr. DAVIS. Yeah. We manage a pipeline database so every transaction that we evaluate is logged and entered. So we will have received information on the company. If we just get a phone call and it is not a fit, we do not enter it into the pipeline. So I think we put in our business plan to the SBA that we would review 200–250 business plans in a year and it is almost doubled that.

Mr. CHABOT. Okay.

Mr. DAVIS. And the other interesting part is we thought we would get a lot of just no right out of the gate but we are not seeing that. We are seeing a lot of companies that are making money, that have a business, that deserve capital. Now, you know, we pick and choose the ones we think are best for our fund but we are seeing a high percentage of very viable candidates.

Mr. CHABOT. What were the other ones missing or wanting? You know, if there were only seven loans and you had, you know, 350 applications and they were good, you know, what——

Mr. DAVIS. It just may be the structure. It may be the business. Again, you know, we have got private investors so our job is to take the best of what we see and we do that. It could be we lost it to a competitor. Somebody else saw it differently than we did and were willing to price it differently. There is a whole host of—we have some bias. You know, we have been in this industry a long time so I have seen certain industries be good candidates for loans and some be not quite so good candidates for loans. And so we make that distinction as well.

Mr. CHABOT. Okay. Thank you.

This is a little broader question and I would be happy—anybody who might want to take this one on. You know, there has been a lot of talk lately, whether it is the president's Jobs Bill or talk that was related to the debt ceiling debate that occurred last summer and various things about increasing taxes in one capacity or another on investors. Or, you know, the top 1 percent are not paying their fair share but I do not think it is really the top 1 percent they are talking about. They are talking about a lot bigger percent of the people than that that allegedly is not paying their fair share. What affect would actually increasing taxes, especially in these economic times? What sort of affect would that do you believe have on the economy overall and small business investing in particular?

Ms. STEED. That is actually a topic that, you know, we watch in the banking industry quite closely. You know, we were starting to see an increase in our application volume this summer and then when the media started paying a lot of attention to the debt ceiling discussions that were happening you could literally just watch the application volume just drop. And so what is happening is small business owners are tuning in to anything that creates a level of uncertainty and they are responding to it by holding back, maybe sitting on the sidelines, not expanding, not hiring new people. They have learned to do, you know, more with less because they are just not sure what is happening. So anything we could do to keep certainty around it. That is taxes, that is any regulation. That is anything that is coming out that creates a level of unknown, they are doing a wait and see and that is not helping us to get them motivated to get back in the game.

Mr. CHABOT. Okay. Thank you. Anybody else, Mr. Chairman, if they have time to answer it if anyone wants to or are we——

Mr. DAVIS. I would just chime in we heard the same thing from our business members. It is just the uncertainty, whether it is taxation or regulation, and it just, you know, it puts them more on the sidelines from a borrowing expanding perspective. So, you know, we definitely hear evidence of that.

Mr. CHABOT. Thank you very much. I yield back, Mr. Chairman.

Ms. VELÁZQUEZ. Yes. I have a question for Mr. Grinnell.

You told us that your credit union hired an expert, right, on 7(a)?

Mr. GRINNELL. Correct.

Ms. VELÁZQUEZ. So how could we encourage other credit unions who might not have maybe the resources to hire someone to be able to participate in the SBA loan programs?

Mr. GRINNELL. Well, I think there are a couple different ways. One of them I mentioned is the increasing of the MBL cap because credit unions can only lend up to 12.25 percent of their assets in business loans. So that in itself does not incent credit unions to get into the business lending game. Only about 2,200 credit unions out of 7,300 offer business loans. So that in itself would help credit unions do more SBA lending. The other would be the reintroduction and passage of the Credit Union Small Business Lending Act. There are provisions in there that are designed to encourage more SBA lending.

Back to your comment about our expertise. If we did not have the expertise on staff we would not be doing the number of SBA loans that we are doing today. We would not be willing SBA awards if we did not have that expertise on staff. It is critical because of the paperwork-intensive process.

Ms. VELÁZQUEZ. Let me ask you a question or for you to clarify to me. The guaranty portion of SBA loans do not count against the membership cap, right?

Mr. GRINNELL. That is correct.

Ms. VELÁZQUEZ. Okay. Thank you.

Chairman GRAVES. With that I want to thank all of you for participating today. This has obviously been a very enlightening and timely hearing as a matter of fact.

But with that I would ask unanimous consent that all members have five legislative days to submit statements and supporting materials for the record. And without any objection it is so ordered. And with that the hearing is adjourned. Thank you.

[Whereupon, at 2:26 p.m., the Committee hearing was adjourned.]

U.S SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

TESTIMONY OF

KAREN G. MILLS
ADMINISTRATOR
U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

"Oversight of the Small Business Administration's Financing Programs"

OCTOBER 26, 2011

Chairman Graves, Ranking Member Velázquez and members of the Committee – thank you for inviting me to testify on access to capital for small businesses.

I'm pleased to say that the SBA hit an all-time record in our 60-year history. We supported over $30 billion in lending to 60,000 small businesses for the fiscal year that just closed. So, how did we get here?

In October 2008, lending markets froze. Banks simply weren't giving loans to small businesses. Then, Congress passed the Recovery Act. We were able to temporarily raise the guarantee on SBA loans to 90% and reduce or eliminate many fees.

It worked. SBA lending roared back. We brought 1,200 lenders back to SBA lending who had not made an SBA-guaranteed loan since 2007. Congress extended these provisions six times, including this quarter last year which was our highest ever. Overall, since 2009, we have supported $70 billion in lending to about 150,000 small businesses and provided secondary market liquidity.

I've visited dozens of businesses that got these loans. They've said: "SBA saved my business." "SBA helped me buy a bigger building." "SBA helped me hire more workers." Today, SBA lending is back up to pre-recession levels.

We also had an all-time record year in our Small Business Investment Company program, with nearly $2.6 billion in financings. This is a program that targets high-growth small businesses – the main drivers of net new jobs. We also streamlined SBIC, which cut licensing times for new fund managers from 15 months to less than 6.

Throughout all of these programs, we foster strong public-private partnerships that help us foster small business financing beyond just SBA. In fact, we recently secured $20 billion in additional small business lending commitments from 13 of the largest U.S. banks over the next three years. They plan to target underserved markets, in particular.

At the same time that we expand access, we have made it a priority to go after fraud, waste, and abuse in all of our programs. As I've testified before, we use a comprehensive three-pronged approach. Up-front eligibility to make sure loans flow to the intended recipients. Continued monitoring and oversight, including of our lending partners. And enforcement efforts to pursue fraud and bad actors.

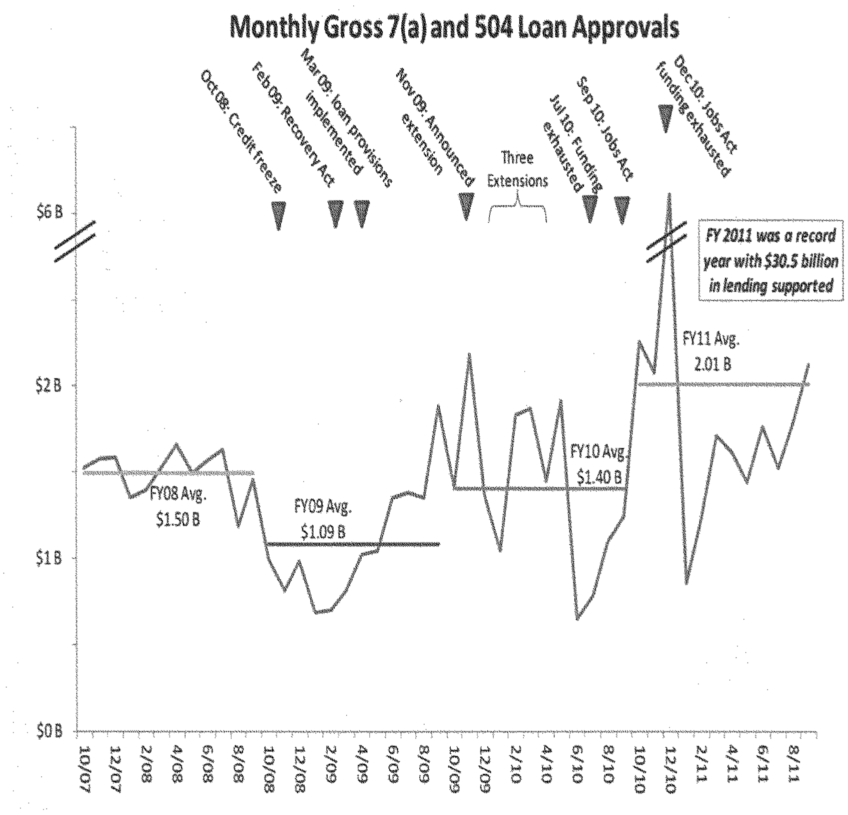
Overall, we have made credit risk management a greater priority throughout our lending enterprise. For example, when a loan comes in from a lender whose risk level has risen, we flag the loan and scrutinize it more closely. In addition, we have worked with our Inspector General to share best practices in identifying loan-agent fraud.

Finally, the core of the American Jobs Act is helping small businesses create jobs. We're asking Congress to pass this bipartisan, paid-for plan that will put more money in the hands of America's biggest job creators. Three quick examples: It cuts in half the payroll taxes for all small business owners, with even more cuts for those who give raises and hire more workers. It gives big tax credits for hiring veterans and the long-term unemployed. And it makes much-needed investments in schools and transportation – and small businesses can compete for those contracts.

Right now, we're embarking on another critical year in SBA lending.

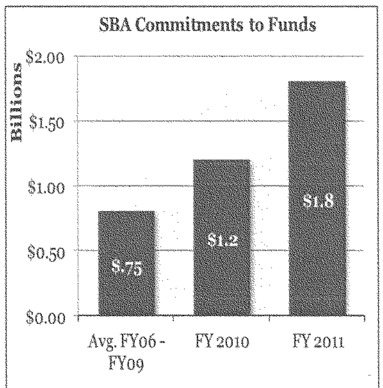
We will continue to leverage our existing authority and fill market gaps so that entrepreneurs and small business owners can continue doing what they do best – create jobs.

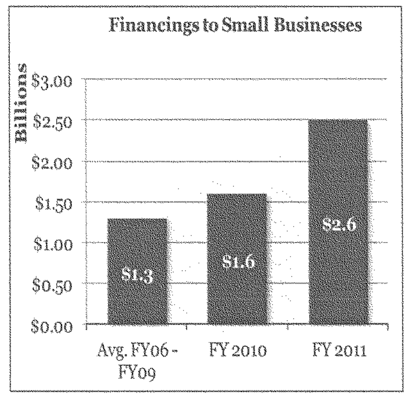
The Recovery and Jobs Acts drove significantly improved monthly loan volumes that led to a record year.

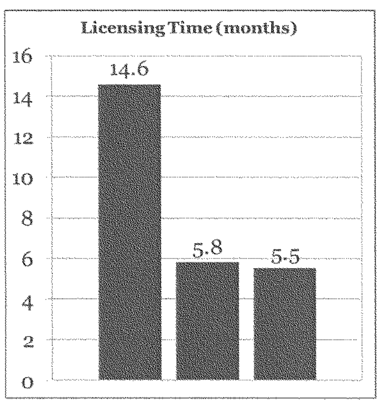


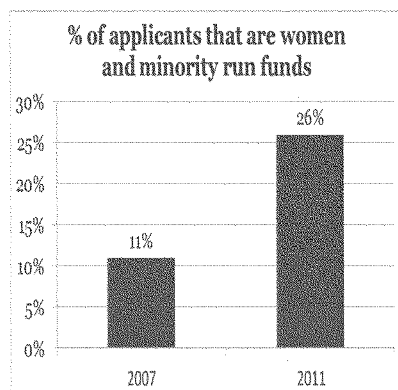
NOTE: All loan volumes are gross loan value approved. Typically, due to cancellations and loan size reductions, approximately 9-12% of gross approval value does not get disbursed.

FY2011 was an all-time record year for the SBIC program









STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

SBA 504 Loan Guarantee Program

Submitted to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

by

Ms. Sally Robertson
President & CEO
Business Finance Group, Inc.
Fairfax, VA.

October 26, 2011

The National Association of Development Companies (NADCO) is pleased to testify before the House of Representatives Committee on Small Business regarding the use of the SBA 504 loan guarantee program by small businesses for expansion and job creation.

NADCO is a membership organization representing the Certified Development Companies (CDCs) responsible for the delivery of the SBA 504 program. We represent more than 250 CDCs with over 800 offices, and 250 affiliate members. Our CDC members provided more than 95% of all SBA 504 financing to small businesses during 2011, as well as many other small business programs and services in their communities. CDCs are for the most part not-for-profit intermediaries with a statutory mission to provide community and economic development through the delivery of the 504 loan program and other economic development programs and services customized to the needs of their respective communities.

NADCO would like to thank Chairman Sam Graves, Ranking Member Nydia Velazquez, and the Committee, for continued support of small business and small business lending in America, and for your focus on the critical need for access to capital in order to restore growth to our economy. We would like to especially thank you for passage of the Jobs Act in 2009, which has provided access to long term capital for many more thousands of small businesses. This bill contains many program enhancements our industry has long advocated, and its impact has been substantial.

NADCO's member CDCs work closely with SBA and our lending partners (generally banks and federal credit unions) to deliver what is certainly the largest and most successful federal economic development finance program in history (since 1986, over two million jobs have been created via the authorization of $60 billion in 504 loans that leveraged over $100 billion in private investment).

Why 504? Capital Equals New Jobs:

The "grease" that gets the small business jobs engine going is capital: both short term and long term funding to pay for business plant and store expansions and for inventory, raw materials, and labor costs. Without funding, businesses cannot grow. With funding, businesses can finance their growth and hire new workers. The fact that the unemployment and under-employment rates are so high is an indicator that many small businesses are not yet growing at historical rates.

Rather than emulating the expensive and sometimes exotic financial programs used so far to bring the economy back, simple programs like SBA 504 have been efficient job-creation tools used by many Adminstrations over the past twenty-five years, with little or no cost to the American taxpayer. In fact, 504 has operated at "zero subsidy" since 1996, meaning there was no appropriation required to deliver the program and pay for any loan losses through defaults.

Banks are slowly returning to lending long term to cover fixed assets, land and building purchases, and plant and store expansions. But as this Committee has heard many times recently, private lending is not back where it was when small businesses were adding millions of new jobs in the early to mid-2000s. The argument today is: which comes first --- long term lending or new borrower growth? Truly, a chicken or egg situation!

But there ARE still growing small businesses in every city, county, and state, and MANY of them cannot get the funds they desperately need to buy machinery, build new stores and plants, or simply acquire that foreclosed, inexpensive building down the street that would mean twenty new jobs and a new assembly line.

The banks are still reeling from losses, delinquencies, and even regulator "over-aggressiveness". They are moving slowly and conservatively back into the lending markets. Small businesses must move faster than the banks will go.

This leads us to the true value of 504: Banks take in short term deposits and are very reluctant to lend long term. 504 mitigates much of the risk, and convinces banks to lend to small businesses. Our lending track record in three minor and one major recession proves it. The very structure of the 504 program, as a second mortgage lender, induces both community and large regional banks to make the loans to small businesses that they might not make while still recovering from loan losses in this recession.

504 is a "leverage" program, and the only one operated by the federal government. With a 504 second mortgage, a bank gets a first mortgage with only a 50% loan to value ratio. This loan structure convinces a bank to make a loan due to its secure nature; i.e., it's a much lower risk than a regular loan that could go bad and cause a substantial loss. With the 504 second mortgage behind the bank, it's likely the bank will obtain its funds in the event of a default. First mortgage lenders even pay for this benefit in the form of a 0.5% fee to SBA for their loans. They know the value of the 504, and the protection it provides to them.

Thus, 504 is the only program that the federal government can use to convince banks to return to more risky long term, fixed rate small business lending, other than simply providing a full loan guarantee for a bank. Instead, operating at zero subsidy, 504 costs both the borrower and the government far less than other guarantee programs, as the fees support any losses due to defaults. The icing on the cake for a small business is that, with a lower interest rate and lower program fees, the borrower pays less for debt, and uses his savings to expand even more. A 504 loan is simply a less risky and lower cost loan for a borrower.

504 is a program designed by Congress and the SBA to leverage small business back into job-creating growth, and the economy out of a recession. No other federal program comes close to 504's job creation track record at no cost to the taxpayer!

Value to the Government:

Not only does the 504 program create tens of thousands of new jobs for borrowers; it provides enormous benefits for many other small businesses and for governments at all levels. An economic impact study was commissioned by NADCO in 2007-08 and completed by California State University and Applied Development Economics, Inc. to quantify these benefits.

This study sampled a portion of the entire 504 portfolio by obtaining financial and actual job creation/ retention data from almost 1,000 small businesses and CDCs. Some of its results include:

- 77% of borrowers reported increased revenues, on average going from $3.2 million to $4.8 million per year for their business.
- During the 2-year study period (2003 – 2005), these loans generated 54,000 new jobs and additional payroll of $4.6 billion.
- This borrower business growth provided an economic multiplier impact of an additional 66,000 new private sector jobs and a further $4.5 billion in new salaries.
- This business growth increased federal taxes revenues by $1.75 billion and state and local taxes by $2.2 billion PER YEAR.
- SBA spent $46 million operating the 504 program. With increased federal revenue of over $37 per $1.00 spent on program costs, and $57 in state and local revenues for each $1.00, the 504 program returns about $94 to government for each $1.00 of program cost.

The Need to Cover Short Term Program Losses:

Unfortunately, the user fees charged to borrowers, banks, and CDCs have been insufficient to offset extraordinary loan losses during this recession. For the first time since 1996, the Administration requested a relatively small appropriation of about $80 million to help supplement program fee collections for FY 2012. At the authorization ceiling of $7.5 billion that will enable about $16 billion in 504 capital projects, the cost of this funding request is extraordinarily low.

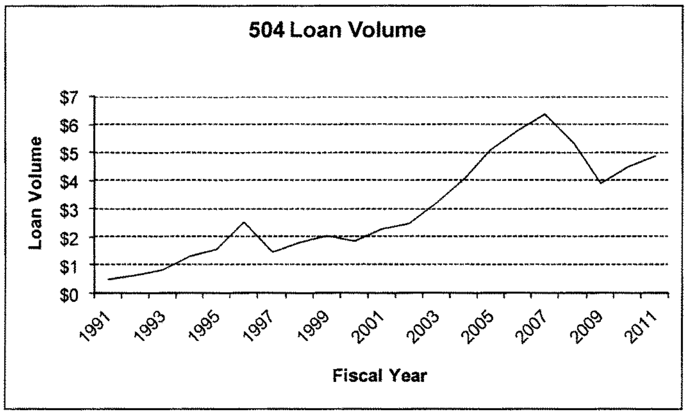
Each dollar of this appropriation will fund a twenty year loan amount to a small business of $200. The cost is 0.5% to the government for a loan of 20 years. Put another way, with the 504 program creating one job for each $65,000 lent, that well-paying new job will cost taxpayers about $325, or $16 per year over the loan's 20-year span. We know of no other economic development program that is nearly as effective in creation of new jobs for our country.

The Effects of the Recession on SBA 504 Lending:

LOAN DEMAND: 504 financing provides long term fixed rate financing to companies that are established and ready to implement a program of substantial growth. Our borrowers are those small firms that are successfully growing their companies, expanding their businesses, locations and plants, and hiring new workers. These firms have historically created an average of one new job for every $65,000 in 504 loan amount (historical job creation average exceeds this requirement).

For business financing in general, a combination of the recession (resulting in lower sales) and the credit crisis (resulting in a near-collapse of credit availability) have severely restricted access to capital for small businesses for all types of uses, including commercial real estate acquisition and plant expansion. The downturn in sales and business revenues has resulted in declining net income and weaker financial statements making it harder for companies in every business sector to qualify for the financing they need to again fulfill their role as America's traditional job creation engine.

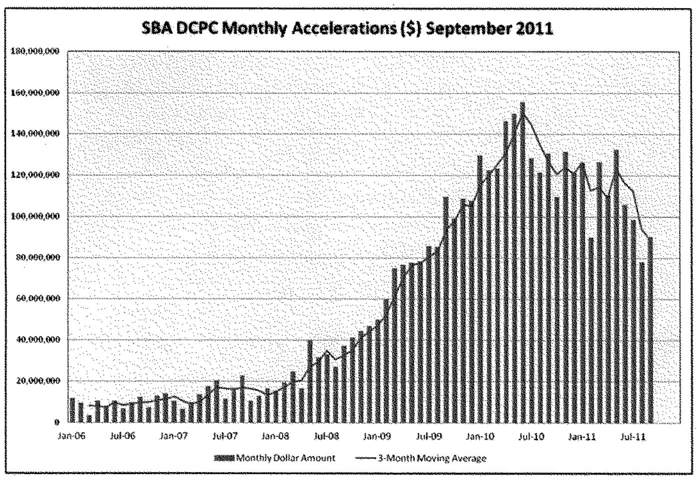
The chart below reveals how devastating this recession was for small business borrowing using the 504 program. In 2007, we provided almost $6.4 billion in long term financing. By 2009, demand had dropped by 40% to under $4.0 billion, as consumer spending dried up, businesses saw their revenue drop, and they stopped expanding and creating new jobs.



However, since 2009 as the economy has stabilized and began to grow, 504 demand has increased by over 25% from its low point. Small businesses have seen their customers returning and are frequently taking advantage of lower cost real estate and construction costs to again consider expanding their stores, offices, and plants. The result is not only existing jobs being saved and layoffs declining, but new jobs are being added by our borrowers.

LOAN DEFAULTS: At the same time that loan demand was falling beginning in 2008, many of our small business borrowers were unable to weather the loss of revenues as customers slowed their spending. The result was an extraordinary and unprecedented increase in 504 loan defaults. This is shown in the chart below, which illustrates the rapid uptick in defaults from about 2% (our historical average) to more than 9% at the peak in early 2010. Actual loan defaults have lagged the recession's impact, as SBA and CDCs attempted to work with delinquent borrowers by deferring loan payments and even restructuring loans to decrease the payment impact. Only when all efforts fail is the final result for many borrowers to default and accept lender foreclosure on their business assets securing their loan.

Here also is there some good news, with 504 defaults rapidly declining from 9% to about 5% over the past two years. Additionally, 504 loan delinquencies, a precursor to potential defaults, are falling rapidly to less than 3% of the portfolio. These statistics reveal that the 30,000 504 borrowers are coming out of this recession, able to keep their loans current, and beginning to restore the stability of their businesses. This bodes well for both these firms, and the millions of jobs they've created. The results will be increasing employment, improving sales, and stabilization of sales, property, income, and employment taxes for governments at all levels.



 12

504 Program Oversight:

Unlike the multiple federal regulators that oversee the commercial banking industry, the 504 Certified Development Companies licensed by the SBA are regulated solely by this agency. SBA is responsible for auditing the loan portfolios of loans originated and serviced by CDCs, their financial statements, overall portfolio performance, internal operations, and staffing resources.

In the 1990s, SBA established a "performance benchmark" system which measures only the quantitative performance of a CDC's 504 portfolio of loans. This system creates a series of about five statistics that are compared to an arbitrary series of industry performance standards. It calculates whether the CDC is meeting or failing each benchmark test. This system is operated by the Office of Financial Assistance (OFA) within the Office of Capital Access.

In the early 2000s, the Office of Credit Risk Management (OCRM) was established within the Office of Capital Access, with the purpose of reviewing the overall risk of the 504 portfolio for SBA, and developing a loan forecasting system to project the performance of loans and CDC portfolios. To accomplish this, OCRM contracted with outside firms, including Dunn & Bradstreet, to build a sophisticated loan performance forecasting model using D & B databases.

Additionally, OCRM contracted with a small accounting firm to create multiple field review teams that would go to CDC offices each year (for those with larger portfolios) and report on their compliance with SBA loan documentation and operational standards. This contract has been moved to a new vendor due to performance issues.

The result is that two different departments within the Office of Capital Access are assessing the performance of CDCs using two very different data collection and analysis processes. Not surprisingly, these two systems frequently provide very different assessments of CDC performance. This results in a deep mistrust by the CDC industry of each of these systems, with a view that they are insufficient for the auditing of an industry managing a taxpayer-guaranteed loan portfolio exceeding $30 billion, and growing at a rate of $4-5 billion per year.

Our industry recognizes that new SBA managers are being hired to reorganize and operate the OCRM. We are strongly supportive of a single, quantitative, accurate auditing and performance measurement system being operated by SBA. NADCO hopes that SBA will collapse these two systems into one unified audit system that will provide consistent results and restore confidence in SBA's ability to regulate and oversee this industry. We encourage the Committee to continue to review the OCRM restructuring efforts, given its importance in the 504 program.

CONCLUSIONS:

For many years, 504 has been an extremely cost effective capital access program for thousands of growing small businesses that are the core job creators of the American economy. The program was in such demand that for several years its growth rate exceeded 20% each year. As the country slid into this deep recession, many small business owners decided they could not take a risk of continued growth of their firms, so they stopped borrowing all but the necessary working capital to maintain their existing operations.

It is the sense of both SBA and NADCO that many small businesses are beginning to experience an economic turnaround. We can see it in the calls that CDCs are getting about 504. Our "pipeline" of loan projects is coming back. Certainly the stimulus and Jobs Act enacted by Congress is working, beginning a slow but steady upturn of the American business cycle and the economy is beginning to move forward.

It is imperative that the SBA 504 program be available to provide long term, low cost capital for small businesses seeking to expand or acquire fixed assets and new buildings. Through 504, thousands of borrowers will be able to expand their business operations and hire more employees.

We believe that more than 130,000 loan authorizations for over $60 billion in 504 loans and the resulting $150 billion in new small business expansion projects have resulted in more than two million new and retained jobs for America. We look forward to working with Congress to continue improvements to the program to build upon this track record of job creation.

Thank you for your support of the 504 program, and of small businesses across America.

SBIA
SMALL BUSINESS
INVESTOR ALLIANCE

Testimony of Rodger Davis with Northcreek Mezzanine

On behalf of the Small Business Investor Alliance

Before the House Small Business Committee

October 26, 2011

Good afternoon and thank you for the opportunity to testify before you today on behalf of the Small Business Investor Alliance, formerly known as the National Association of Small Business Investment Companies.

My name is Rodger Davis and I am a co-founder and managing partner of Northcreek Mezzanine located in Cincinnati, Ohio. Northcreek is a licensed Small Business Investment Company (SBIC) with total capital of approximately $70 million that makes debt and equity investments in domestic small businesses.

Thank you for your support of small businesses and the SBIC program.

Today I want to tell you a little bit about who we are, what we do, and how the Small Business Investment Company program has helped Northcreek grow small businesses and increase jobs by 20% – at no net cost to the taxpayer. I would also like to share my thoughts on what you can do to facilitate more small business investment and increase the number of jobs that go with it.

My partner, Barry Peterson and I were lifelong bankers to small and medium sized businesses. I spent 18 years at Provident Bank in Cincinnati, and Barry worked eight years with me at Provident after working for Continental Bank in Chicago. Our careers have centered around providing credit to privately held small business owners. Of all of things we did in banking, helping privately owned family companies achieve their goals was the most rewarding.

The credit crunch of 2008-2009 became the catalyst for the creation of our SBIC, Northcreek. Small businesses always have greater challenges accessing capital, but the financial crisis drove many large financial institutions away from most small businesses because "small" equates to "risky." This flight from risk, some of which was partly driven by banking regulators, left small businesses with almost nowhere to turn for capital.

Thank goodness for the SBIC program. The SBIC program was designed in 1958 to create a market-based system to facilitate investments in domestic small business. What was true in 1958 is still true today: the larger the financial institution, the harder it is for them to provide capital to small businesses. SBICs are highly regulated private equity funds that invest exclusively in domestic small businesses. Debenture SBICs raise private capital, pass a rigorous licensing process, and then are able to increase the amount of capital available for investment by accessing leverage through an SBA-backed credit facility. The SBIC program is successful because 1) it is market driven (there is no political picking of winners or losers) and 2) it aligns investor interests with the public interest (SBICs create jobs and SBICs have very strong incentives to protect the taxpayer's money). In fact, debenture SBICs are actually making the taxpayer money, while providing the capital critical for job creation.

The conditions in the credit markets and our interest in creating a vehicle to provide loans to small business, led us to the SBIC program. The access to low cost leverage, the regulatory oversight of the SBA, and focus on small businesses were all factors in our ability to attract private capital. Without this program we might not be investing in small businesses today.

We applied for our license in 2009 and a little less than a year later were in business as a licensed SBIC. The SBA deserves credit for reducing licensing times from over two years to about six months while maintaining very high standards and taxpayer protections. Fixing administrative problems such as these have made the SBIC program much more attractive not only to us, but to scores of other funds who are currently raising SBIC funds.

When we launched Northcreek we thought there was a need for our capital, but we never envisioned the response we would receive. In the year and half since we received our SBIC license we have reviewed over 350 opportunities from business owners throughout the United States. Small businesses have a myriad of reasons for needing capital, but the demand far outstrips what is available. The SBIC program has been a critical resource in filling this need. Since 2009 over 50 SBICs were licensed representing billions in new small business investment. In FY 2011 alone there was over $2.6 billion invested in domestic small businesses – an increase of over 60% from FY 2010 – and FY 2010 had been a record year. I think you can expect SBICs to continue to increase investments and to continue to create jobs in FY 2012.

For larger companies, the credit markets have improved over the last several years. The most recent Federal Reserve Study of Senior Loan Officers reported an easing of credit for companies with revenues in excess of $50 million. Pepperdine University's Capital Access studies have repeatedly shown that large businesses can access capital, but for many smaller businesses it remains nearly impossible. They found that well over 90 percent of small business owners were ready to execute growth strategies, but over 80 percent could not access capital to execute those growth strategies. The Pepperdine studies find that credit is more accessible for businesses with over $15-20 million in earnings and much more accessible, almost frothy, for business above that mark. However, access to investment grows significantly harder the smaller the businesses. If not for SBICs, many small businesses would have few options.

These capital starved small businesses represent an enormous segment of the US economy and the employer base. For example, there are approximately 650,000 companies in the US with revenues between $5 and $20 million. By contrast, there are 200,000 companies in the US with revenues between $20 and $100 million. Herein, lies the value of the SBIC program and a firm like Northcreek. By targeting the small business segment of the market we are addressing a basic and fundamental need for capital that is not being served by traditional sources of capital. We invest 100 percent of our capital in domestic small businesses and at least 25 percent in the smaller subset of small businesses – and we do it at no net cost to the taxpayer.

Job Creation

We are proud to report that of the five (5) companies that have received capital from Northcreek, four (4) are "smaller enterprises" as defined by the SBA. We started Northcreek to assist privately held company owners achieve their dreams and aspirations and that is exactly what we are doing. Since our inception in 2010, we have provided seven (7) loans to five companies located in Cincinnati, Ohio; Elkhart, Indiana; Austin, Texas; Boulder, Colorado; and Orlando (Sanford), Florida. The impact of our capital is quite impressive**. In aggregate, these five companies have added over 200 jobs in less than a year**. **On the original employment base, that's over a 20% growth in employees.** The management teams can now run their business without fear of the bank calling their loan, or dedicating all available cash flow to paying down their bank debt. The impact on the management teams, the company owners, and the employees is profound.

Why do companies come to Northcreek? Here is a common theme. A company may have experienced a downturn of revenues and profits in 2009 at the height of the recession. As you know, many did. In many cases that company was transferred to the workout area of the bank, otherwise known as the Special Assets Division. Although the company survived the recession and experienced improving results in 2010, they remained in the workout area of the bank. Now the company is ready to capitalize on improving market conditions and they have little to no capacity to expand their credit at the bank. These businesses survived the collapse, are ready to grow, and are not able to access growth capital from banks. I guess you could call this the hangover from the credit crunch.

To pursue their growth strategy, these companies turn to private equity. In some cases, a new bank may be brought in together with a mezzanine provider like Northcreek to refinance their existing debt and to provide the capital they need to begin to grow again. Since our founding, this has been a common theme of companies we have helped and opportunities we have evaluated. We are not stripping out businesses or layering them with debt. We are empowering them to adjust to the new economy and to grow.

Patrick Industries in Elkhart, Indiana- Patrick is a manufacturer and distributor of materials and products for the recreational vehicle and manufactured housing industries. Northcreek initially assisted in an entire refinancing of Patrick's debt and has recently participated in the funding for an acquisition. If you were to talk to Todd Cleveland and Andy Nemeth they could share with you the impact of having the capital to grow and, more importantly, the time to think about how to grow their business. Located in one of the hardest hit economies during the recession, the company is now poised for growth.

Girard Environmental Services in Sanford, Florida- Girard is one of the largest privately held and independent providers of commercial landscape maintenance and installation services in the State of Florida. Northcreek and a local bank recently joined to refinance their existing bank debt and provide capital for growth. Randy and Rick Girard could tell you how they can now take advantage of growth opportunities in the market: to acquire equipment, hire new employees and to open new offices to meet the increased demand for their products and services. Most importantly, they can now sleep at night knowing that they have capital providers that want to do business with them and are incentivized to see their business grow and prosper.

iNET Interactive in Cincinnati, Ohio- The Company owns a portfolio of properties that generate revenue through advertising, events, and premium content subscriptions. The vast majority of the Company's properties are websites pertaining to community forums involving information technology development, Internet services, and tech hardware discussion. Northcreek has provided capital to support two acquisitions and has committed to a third. Troy Augustine of iNET Interactive in Cincinnati could tell you how difficult it has been to get bank financing and how the SBIC program and Northcreek, in particular, have been essential to their growth strategy.

All of these companies need capital, but more importantly, they earned the capital by running their businesses well, making it through the recession, and positioning their companies for growth. Thanks to good management of the program, constructive oversight of the program, and a solid private sector partnership, the SBIC program is growing rapidly to fill critical market needs of small businesses. Our investments are examples of how SBICs are creating jobs in the U.S.

Opportunities and Threats to Small Business Investing

I am pleased to report that many successful SBIC funds are staying in the program, many new SBICs are forming, and many new investors are looking to provide capital to SBICs. This is great news because it means that the people that are the best at investing in the small business space are sticking with small businesses. To continue this trend we strongly support Representative Chabot's bill, H.R. 3219, "the Small Business Investment Company Modernization Act of 2011" which would raise the SBIC leverage limit for multiple SBIC license holders and raise the individual SBIC leverage limit for proven, repeat SBICs. Neither of these provisions cost the taxpayer money nor would they increase the risk of the program. It makes sense that we should keep successful managers in the program and not curtail their ability to grow. These provisions would benefit only high performing, repeat licensees. With your continued support and improvements to the program, like those in Representative Chabot's bill, even more capital can be released to domestic small businesses.

One of the biggest constraining forces for growing the program is the amount of institutional capital that is being invested in SBICs. SBICs are relatively small in the private equity universe and most large institutions will not provide capital to funds below $100 million dollars in private capital. Given the 2:1 leverage ratio of the program, the Chabot bill would make investment in SBICs much more attractive for large institutional investors. If more institutional investors start providing capital to SBICs, you will see a significant increase in capital to small businesses.

Banks are significant investors in SBICs. Scores of community banks as well as regional and national banks have been investors in SBICs. Banks are supposed to get Community Reinvestment Act Credit for investments in SBICs. However, some bank regulators are not giving full dollar-for-dollar credit to banks investing in SBICs. Banks want to invest in small businesses via SBICs, but regulatory uncertainty does not increase capital to small businesses. We would welcome any support from the Small Business Committee with the banking regulators to provide clarity that SBIC investments will receive full credit and to determine if any additional incentives might be available to keep and perhaps stimulate investment in SBIC's by banks.

Finally, it is important to mention tax reform. While there has been a lot of talk about Warren Buffet and "carried interest" taxation. It is critical to set the record straight. SBICs are not Warren Buffett and none of us live anything like him. Increasing the tax on carried interest would be significantly more damaging to small business investing than it is any hedge fund or billionaire. SBIC fund managers are making long term investments in small businesses and are only rewarded if these companies grow and prosper. Management Fees earned by small fund managers are used to fund the overhead of the business, and our profit incentive lies in the carried interest. If Congress acts to increase the taxes on the carried interest you can be sure that investment in small businesses will decline. My partner and I are all in on Northcreek and by raising the tax on carried interest it will simply reduce the funds we will have available to invest in small businesses going forward. Please speak to your colleagues on the tax writing committees and super committee to make sure they consider the impacts on small business investing before they do anything rash with treatment of carried interest.

Thank you for the opportunity to testify. I would welcome any questions you might have for me.

NAFCU

Testimony of

Gary Grinnell

President/CEO of Corning Federal Credit Union

On behalf of

The National Association of Federal Credit Unions

"Oversight of the Small Business Administration's Financing Programs"

Before the

House Small Business Committee

October 26, 2011

Introduction

Good afternoon, Chairman Graves, Ranking Member Velazquez and Members of the Committee. My name is Gary Grinnell, and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). Thank you for holding this important hearing today. I appreciate the opportunity to share my views on the Small Business Administration's financing programs.

I have been with Corning Credit Union since 1997 and have served as President/CEO since 2007. Corning Credit Union was founded in 1936 in Corning, NY in an effort to keep Corning Glass Works employees from being victimized by street-corner lenders. Today, we have over 79,000 members and $896 million in assets. We have 250 employees and 17 branches in New York, Pennsylvania and in the Wilmington, North Carolina area.

As you may know, NAFCU is the only national organization that exclusively represents the interests of the nation's federally chartered credit unions. NAFCU is comprised of nearly 800 member-owned and operated federal credit unions. NAFCU member credit unions collectively account for approximately 62 percent of the assets of federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding financing programs under the Small Business Administration.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for nearly 93 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 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

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

The nation's approximately 7,200 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

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

Artificial Member Business Lending Cap at Credit Unions Hurts Small Business

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

CUMAA also established, by definition, that business loans above $50,000 count toward the cap. This number was not indexed and has not been adjusted for inflation in the more than 13 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 into the cap due to this erosion. To put this in perspective relative to inflation, what cost $50,000 in 1998 costs $69,500 today, using the August consumer price index data. That is a 39% rate of inflation change that is completely ignored by current law and which greatly hamstrings a credit union's ability to meet its members' needs.

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

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

The 2001 Treasury study found that credit unions do not pose a threat to the viability and profitability of banks, but that in certain cases, they could be an important source of competition for banks. It is important to note that credit unions have a nominal market share of the total commercial lending universe (approximately 5% of all small business loans from insured depository institutions), and are not a threat to banks (who control nearly 95% of all small business loans from insured depository institutions) in this environment.

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

Bipartisan legislation to address this issue, in the form of H.R. 1418, the *Small Business Lending Enhancement Act*, is pending before the Financial Services Committee. We would urge Committee members to support this important bill.

SBA Lending at Corning Credit Union

At Corning Federal Credit Union (CCU) we have a well-diversified business lending portfolio with minimal delinquencies (a delinquency ratio of 0.36%). Our commercial losses have also been minimal as we have an experienced lending staff and a sincere and devoted membership. For the last two years, we have been recognized as the top small community lender by the Small Business Administration in the 34 counties that make up the SBA district (Syracuse) in which we are located.

We started our business services program in 2006 in response to demand from our existing membership, and CCU has been an important source of funding for existing, new and growing businesses in the Southern Tier and Finger Lakes region of New York, and the greater Wilmington area of North Carolina. We took a planned and deliberative approach toward starting our program, hiring an outside consultant to help us explore the opportunity and put a detailed, strategic plan together. We have deliberately hired experienced commercial lenders and business services professionals from outside the organization. We have added jobs over the past several years to support our growth and member demand, and now have commercial loan officers, credit analysts, business development officers, supervisors, administrative and business account specialists on staff. During the recent economic downturn, banks in our markets, particularly in the Wilmington area, stopped lending to their clients. CCU has been able to fill the void and provide these businesses with the funding they need to continue to grow and create jobs as the demand has not subsided.

To increase the products available and provide more options for our field of membership, Corning became an SBA lender when we started our member business lending program. SBA products allow us to leverage our lending dollars and extend more credit to our communities' small businesses.

Since our SBA program's inception, we have made 71 loans totaling over $8.2 million in SBA lending. Our average SBA loan is about $116,000. Corning participates in the SBA 7(a), SBA Express and Patriot Express loan programs. 7(a) eligible use of funds include purchasing commercial real estate, equipment, inventory, working capital, etc., while the Patriot loan program is designed to create opportunities specifically for veterans and members of the military community wanting to establish or expand small businesses.

At Corning Credit Union we strive to strengthen our communities by offering our members new entrepreneurial opportunities. Many of our SBA loans are for entrepreneurs wanting to start a new business and create new jobs.

For example, in 2007, one of our members in upstate NY had a dream of starting up her own pet care business. She worked with the local small business development center to create a comprehensive business plan. She approached a large bank for startup capital, but they had no interest in the loan. Based on a recommendation from another business owner, she approached CCU. Thinking creatively and with the help of the US Small Business Administration, we were able to put together a package of financing to help this member get her dream off the ground. CCU has since assisted her as her business has grown at a rate of 18-20% per year. She has expanded the business with additional services and added half a dozen jobs to the local community.

There are many more stories, like this one, of small business owners looking for that loan to enable them to start their business. The demand is out there. Unfortunately, in this current environment, many banks have scaled back their lending. At Corning Credit Union, we are pleased that we have been able to help step up to meet this pent-up demand.

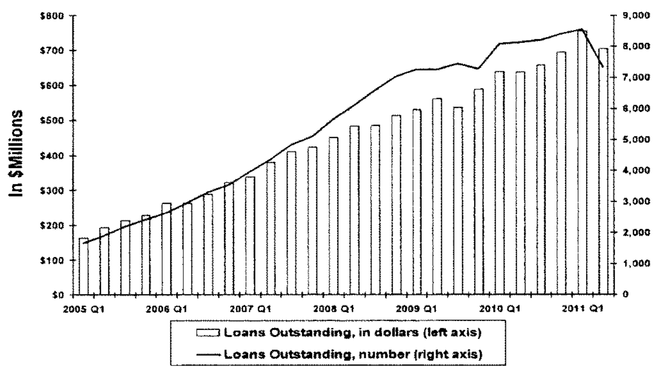
SBA and Access to Capital for Credit Union Members

Small businesses are the backbone of our economy and an important source of jobs for Americans. The Small Business Administration's loan programs serve as an important resource that helps credit unions provide small businesses with the vital capital necessary for growth and job creation. However, utilizing any SBA loan guaranty program requires meeting stringent government regulations.

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

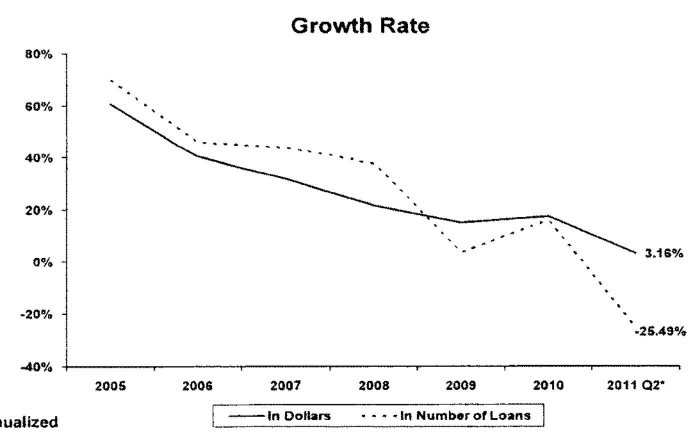
While credit union SBA loans have generally increased in both total number and dollars, the growth rate of credit union SBA lending has fallen during the recession (see charts below).

FICU SBA Loans



Source: NCUA

FICU SBA Loans



* Annualized

Source: NCUA

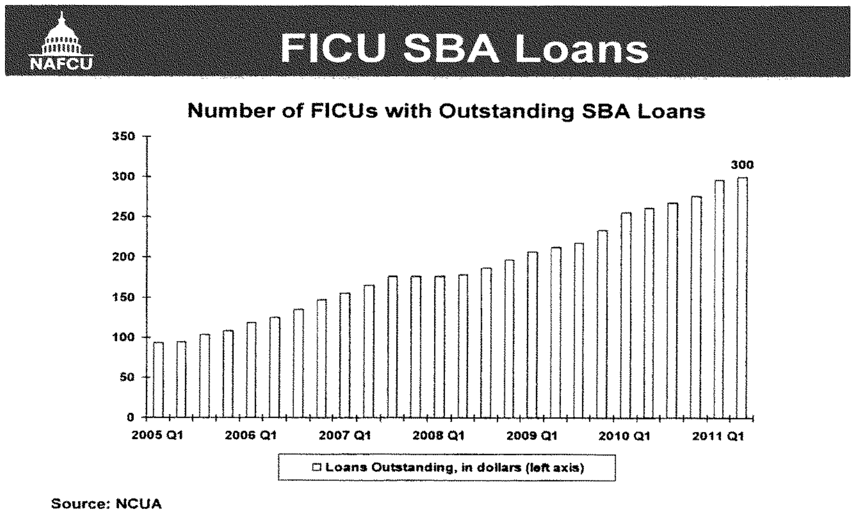
Much of the decrease in SBA lending can be associated with the overall economic downturn the nation as a whole has experienced. However, some credit unions tell NAFCU that they have scaled back on the number of small loans as a response to comments from the SBA and its examinations.

On one hand, the SBA vigorously encourages granting small loans to qualifying businesses, yet, on the other, the agency matter-of-factly states that a lender's status with SBA can be rescinded or imperiled if these higher risk loans default. The SBA provides a Lender Portal and a lender 'score' derived from SBA's Credit Risk Assessment Model. While this information is useful, it would be more beneficial for a lender to see how they compare to other lenders with similar loan portfolios. A lender's 'score' is derived by averaging other lenders', mostly large 7a loans, with small SBA Express loans. The blending of all lenders with varying portfolios to arrive at a 'score' dilutes the true picture as one cannot compare a small SBA unsecured working capital line of credit with a large SBA loan secured with commercial real estate. Clearly the two loans are different and should have different evaluation processes. If this evaluation process is not changed, it may eventually eliminate all small loans from lenders portfolios. NAFCU members have requested that the SBA via the Office of Credit Risk Management address this deficiency. A level playing field, along with more accurate information being dispensed, is critical to participating lenders in order to determine the soundness of their respective SBA loan portfolios. We hope that the Small Business Committee will be able to help in this regard as well.

As mentioned above, at Corning Credit Union our portfolio includes SBA 7(a) loans, Patriot Express and SBA Express Loans. We are fortunate that we have hired an experienced SBA lending officer with knowledge of the system to help run our program. Still, one of the hurdles that we see is that, as a general and not "preferred" lender, our local SBA 7(a) loan applications are sent off to national offices for review by underwriters who may not have a handle on a local economy. This impersonal step also adds time to the process. Additionally, this approach could discourage those lenders who do not have the expertise we do on their staff, as they are not likely dealing with a local person to help them through the process of preparing all of the paperwork. This makes it harder for those institutions that may want to do SBA loans, but would only have limited volume. As a result, some credit unions in this situation may opt not to get involved in SBA lending at all.

There is a way that this concern can be addressed. NAFCU supports the reintroduction of the *Credit Union Small Business Lending Act*, which was first introduced by Representative Velazquez in the 110th Congress. The bill would amend the *Federal Credit Union Act* to exclude any SBA loan (guaranteed and non-guaranteed portions) from the meaning of "member business loan" of a credit union. These loans would thereby be exempted from the arbitrary credit union member business lending cap. It would also amend the Small Business Act to direct the SBA Administrator to implement a program to: (1) provide outreach and assistance to credit unions to increase their participation in the SBA small business loan program; (2) simplify the application process for such participation; (3) provide a guarantee of up to 85% for loans made by credit unions to their members in underserved areas; and, (4) clarify the participation of credit unions to in the SBA's 504 loan program. These steps would make it easier for credit unions to become more involved in SBA lending and open the door to more access to credit for those small businesses and communities served by credit unions.

As you can see from the chart below, the number of federally-insured credit unions participating in SBA programs has been steadily increasing since the SBA opened up its programs to more credit unions in 2003. Enacting legislation such as the *Credit Union Small Business Lending Act* will help this trend continue.



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

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

Conclusion

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

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

CBA | CONSUMER BANKERS ASSOCIATION

TESTIMONY OF LYNETTA TIPTON STEED,

EXECUTIVE VICE PRESIDENT, DIVISION HEAD

BUSINESS & COMMUNITY BANKING

REGIONS FINANCIAL

ON BEHALF OF

THE CONSUMER BANKERS ASSOCIATION

BEFORE THE COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

"Oversight of the Small Business Administration's

Financing Programs"

CBA | CONSUMER BANKERS ASSOCIATION

Chairman Graves, Ranking Member Velasquez and members of the Committee, my name is Lynetta Tipton Steed. I am Executive Vice President and Division Head for Business & Community Banking for Regions Financial Corporation. Regions is a full-service financial services company headquartered in Birmingham, Alabama. Our subsidiary, Regions Bank, has over 1,800 branches and 2,200 ATM locations in 16-states which include Alabama, Arkansas, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Mississippi, Missouri, North Carolina, South Carolina, Tennessee, Texas and Virginia.

Regions' Community Banking division is dedicated to supporting the needs of small businesses with annual revenues up to $20 million. Our customer base includes approximately 500,000 households which are supported through one of two channels based on client size. Clients with revenues up to $2 million are supported by our branch network while larger clients are assigned dedicated relationship managers. As of the close of September 2011, Regions had approximately $12.8 billion of small business loans in our portfolio, and $14.3 billion in deposits.

CBA | CONSUMER BANKERS ASSOCIATION

We have generated approximately $5.6 billion in new and renewed business loans so far this year.

Our focus on customer service for this segment is extremely important since our Business and Community Banking line provides 40% of the total Business Services revenue for Regions. In fact, Regions ranks number 7 among national banks in the JD Power & Associates' 2011 U.S. Small Business Banking Satisfaction Study. Regions has also been named recipient of the 2010 Greenwich Excellence Award in Small Business Relationship Management.

In addition to leading Business & Community Banking for Regions, I am also a member of the Consumer Bankers Association's (CBA) Small Business 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

CBA | CONSUMER BANKERS ASSOCIATION

share the common goal of improving the state of small business banking including promoting Small Business Administration (SBA) programs.

Thank you for the opportunity to appear before the Committee to discuss the SBA, its programs and the current state of small business lending.

Small businesses are facing a number of challenges that have greatly diminished overall demand for loans. The weak economic conditions and high levels of unemployment have resulted in lower sales volumes and the poor general economic outlook has made small business owners less inclined to take on additional debt. Economic uncertainty and continued reports of a possible double-dip recession combined with weak consumer confidence are driving this lack of demand for small business loans.

Despite the decline in overall small business loan demand, we continue to see healthy SBA lending. The SBA 7(a) and 504 programs have been effective during these economic times. In FY2009 and FY2010, SBA reported these programs helped support $42 billion in lending.

CBA | CONSUMER BANKERS ASSOCIATION

Earlier this month, the SBA announced it supported $30 billion in FY2011 bringing the three-year total to over $70 billion in support for small business lending. The FY2011 total is the highest volume fiscal year in the agency's history, surpassing the $28.5 billion mark established in FY2007.

Regions recognizes the value of the SBA partnership and has a proven track record with its programs, having been a Preferred Lender since 1996. In 2010, Regions identified increased SBA lending as a strategic initiative for the bank. Significant resources have been devoted to this initiative starting with the creation of a new government-guaranty lending manager position overseeing the delivery and efficacy of our SBA lending efforts. As a result, we have more than doubled our staffing in SBA underwriting, packaging and processing growing from 8 full time employees to 18, with plans to add more.

In FY2010, Regions ranked in the nation's top five for overall SBA 504 loan approvals, with 118 loans approved for $64 million. In FY2011, we remained in the top five nationally; approving 131 loans for $54 million.

CBA | CONSUMER BANKERS ASSOCIATION

Our 7(a) lending has increased dramatically during FY 2011; Regions now ranks in the top 25 in the nation having approved $93 million – an increase of 82% year over year.

In addition to the SBA 504 and 7(a) programs, Regions participated in the America's Recovery Capital Loan Program (ARC) when it was in place and has recently added the Export Working Capital and Export Express Programs. We intend to implement the newly named Working Capital CAPLine Program in the first quarter of 2012 and we are strongly considering the Contract CAPLine Program as well.

What can be done to make things better? The loan enhancements provided under last year's Small Business Jobs Act allowed SBA to raise the guarantee on its 7(a) loans to 90 percent and waive certain fees on both 7(a) and 504 loans. The government's guarantee increased to 90 percent from 75 or 85 percent for all 7(a) loans regardless of loan amount. Previously original loan amounts of more than $150,000 or more were guaranteed at 75 percent. Original loan amounts of less than or equal to $150,000 were guaranteed at 85 percent. These increased government guarantees and fee waivers were effective until January 1, 2011, at which time the percentage guarantees and fee waivers reverted back to the original levels.

While in effect, these provisions had a tremendous impact on the ability of banks and small businesses to utilize these important programs, especially during difficult economic times, and both CBA and Regions express continued support for further enhancements of this kind. As an example of the effectiveness of this legislation, in Q4 2010 - Regions application trends and approval trends increased by more than 25% over the prior quarter.

Also, the Small Business Jobs Act's permanent increase in 7(a) and 504 limits from $2 million to $5 million and its permanent increase in micro-loan limits from $35,000 to $50,000 continues to help more entrepreneurs with start-up costs and small business owners in underserved communities. However, the Act only temporarily increased the cap on SBA Express loans, a subprogram of 7(a), from $350,000 to $1 million in order to expand access to much-needed working capital. A

CBA | CONSUMER BANKERS ASSOCIATION

reinstatement of these higher limits for the Express program would be in the interest of increased small business lending.

A furthered streamlined 7(a) loan process would help borrowers obtain loans more easily. The SBA has done a good job in enhancing the processes in many ways, but there are relatively easy-to-implement adjustments that could be made to the 7(a) loan process that would expedite origination of small business loans. For example, allowing financial institutions to use their own application and notes for all SBA loans would be helpful. The SBA currently allows lenders to use their own notes and credit policies on Express loans, greatly improving that process.

Furthermore, allowing banks to accelerate loans, with no guarantee impairment, for clients who refuse to provide basic financial information in a timely fashion would help support greater SBA utilization. Lenders are required to obtain current borrower information, but the SBA does not allow for banks to call a technical default in this instance.

CBA would also like to see the SBA 504 refinance program extended for an additional two years. The need for this program is even greater now as many owner-occupied commercial real estate loans are set to mature over the next two years from purchases made five years ago. We also need the SBA First Mortgage Pooling Program to be extended as it is providing an additional source of liquidity. Furthermore, a permanent increase in the Express Program limits to $1 million coupled with greater guarantees would keep this program viable and expedite funds to businesses that need them quickly.

While every institution has a different relationship with the SBA, CBA members have an ongoing interest in further improvement of the SBA programs. The before-mentioned enhancements and the easing of SBA loan application requirements would help many banks make loans to small businesses that would otherwise be difficult to underwrite.

Effective SBA lender oversight is another crucial area of concern. While there needs to be strong and consistent lender scrutiny, fluctuating economic conditions often call for flexibility in the agency's rating

CBA | CONSUMER BANKERS ASSOCIATION

policies. SBA performance benchmarks for risk tolerances should be higher than conventional loan tolerances and should provide lenders with a reasonable process to remedy deficiencies. Benchmarks should be established and reviewed periodically to ensure the SBA programs are properly aligned with current economic conditions and the public policy determinations that support SBA programs such as 7(a) and 504 lending.

Overall, CBA's members have all reported increased efforts to help small businesses access capital. Despite a decline in loan demand due to a decline in sales and high unemployment, many of our member institutions have hired new small business bankers, initiated second-look programs to ensure that every possible loan is made and incorporated other initiatives to improve delivery of SBA programs.

These activities by CBA members banks and by CBA as a trade organization are accomplishments that can make a difference, but what we really need is continued support of effective SBA programs, which, again, are absolutely critical for continuing the flow of credit to small businesses.

For example, deferred capital expenditures and M&A activity are areas that seem to be generating the most demand for loans. For businesses with revenues under $30 million, SBA loan programs have become their lifeline – and this benefits the public by allowing businesses to grow and create jobs. When a business acquisition can be provided with relatively low-cost SBA financing, jobs are retained.

I could cite many good outcomes for SBA programs, but as we look forward, CBA encourages Congress to monitor the SBA guarantee levels. As we have seen an increase in use of these programs, it is important they have the funding and authorization necessary to continue to work with the private sector in financing American small businesses.

In conclusion, we support improvements in the SBA loan structure, but there is also a need for greater certainty in the SBA programs, especially during these difficult economic times. One means to accomplish this is

CBA | CONSUMER BANKERS ASSOCIATION

to make permanent a number of the temporary enhancements that have been made to these programs in recent years. The SBA has done a good job implementing new initiatives that are just gaining traction and momentum - Dealer Floor Plan Pilot, Patriot Express, larger loan amounts, and the re-invention of CAPLine. Small businesses and SBA-approved lenders are all facing economic and regulatory uncertainty and would benefit from greater certainty in the loan programs provided by the SBA.

Thank you and I would be happy to address any questions you may have.

Questions for Administrator Mills

1. Even though SBA rules require notice and comment, why does the agency establish pilot programs, like dealer floor plan financing, community advantage and small loan advantage without going through notice and comment before establishing the programs?

2. SBA regulations the proceeds of 7(a) loans for floor plan financing. Pursuant to the Supreme Court's decision in *Motor Vehicle Manufacturers Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983), an agency must use notice and comment to repeal an existing legislative regulation. Under what authority did the SBA start its floor plan financing pilot program without going through notice and comment as required by its own rules and the Administrative Procedure Act?

3. You have recently been discussing the record lending year for SBA. What has this lending meant in terms of economic growth?

4. Do you believe the agency has proper performance measures in place to determine the outcomes of increased SBA lending?

5. The Small Business Jobs Act established two small business lending programs at the Department of Treasury. As the federal agency responsible for small business lending, what role did you play in establishing and administering these program? Did Treasury seek advice from SBA in reviewing small business lending plans submitted by lenders?

6. Along with increasing lending, what additional steps are you taking to make sure that risk is properly managed? Are you increasing staff in your processing centers and for lender oversight?

7. Do you believe that the current authorization level for the lending programs is adequate?

8. When the SBA designed the Community Advantage program, what design features were incorporated to prevent default similar to those of the now discontinued Community Express Pilot Program?

9. Please provide the total number of lenders in either the 7(a) loan program or the program established through Title V of the Small Business Investment Act of 1958 (colloquially and incorrectly referred to as the "504 Loan Program") for which the SBA has: a) lowered their preferential status; or b) eliminated their authority to operate in the program since 1995?

10. In your opinion, does the SBA have sufficient statutory authority to take appropriate action to suspend the ability of lenders to operate in the 7(a) and "504 Loan Programs"?

11. If the answer to the previous question is that the SBA does not have sufficient legal authority, what changes are needed in the Small Business Act and Small Business Investment Act of 1958 to provide the SBA with appropriate powers?

12. The credit supplement to the President's Budget shows that recoveries in the "504 Loan Program" are significantly lower than in the 7(a) loan program. What statutory or regulatory changes or some combination thereof do you have to improve recoveries in this program?

13. What is the difference in default rates and loan losses between Premier Certified Lenders and all other certified development companies (CDCs) that must obtain pre-approval by the the SBA?

14. Have you compared the recovery rates on loans liquated by SBA staff or contractors to those liquidated by CDCs ?

15. Have you performed any analysis as to who is better at modifying loans in a way to get distressed borrowers back on track, CDCs or SBA?

Rep. Tipton

1. At the hearing you committed to responding to the Committee on steps you are taking to streamline the process for SBA lending partners and resulting cost savings. Please provide information on your efforts to streamline the loan application and SBA loan approval process and detail any cost savings resulting from these efforts?

Rep. Keating Questions for the Record

1) Administrator Mills, the House and Senate have different versions of the Small Business Innovation Research (SBIR) reauthorizations, with the Senate version preserving the Phase I grant program and the House version eliminating it. The Phase I grants are intended to spur innovation by funding new technology that has yet to be fully tested. In my state alone, 575 awards totaling $71.5 million were given to small companies. I don't think it's a coincidence that Massachusetts also falls 2 points behind the national average in the unemployment rate. What do you think the impact will be of eliminating the Phase I grant program to small research and development firms and the states which have benefited from their good work? Will elimination of the program lead to a decrease in the participation of small, high technology firms in federal research and development (R&D) endeavors?

2) I am the Ranking Member on The Homeland Security's Subcommittee on Oversight, Investigations and Management. Many of the firms utilizing SBIR Phase I grants, like Massachusetts-based Radiation Monitoring Devices, Inc., that testified before this committee in March, are small, high technology firms engaged federal research and development (R&D) endeavors to help make our country more secure. Radiation Monitoring Devices, for example, is working to expand nuclear detections technologies at our ports of entry. Has the Small Business Administration looked into the correlation of eliminating Phase I grant funding and the impact of that on our national security? What do you think the impact will be?

3) Administrator Mills, The SBIR program has been a great success since its inception, and I can think of few better or more effective ways to allocate federal resources.

   My question concerns a particular aspect of HR 1425, and I would appreciate your insight. When this Committee marked up HR 1425 in the spring of 2011, we adopted a provision that became Section 505 of the bill. The language in question would place limits on the number of SBIR awards and the amount of SBIR funding that entities can receive in a given year. The proposed limits would derive from a formula that incorporates aggregate award volume and dollar amounts across the states. The purpose of the language was to, theoretically, redistribute opportunity under the SBIR program to entities in states that, in general, don't typically receive as may SBIR awards, or participate in the program.

   Since we marked up the bill, I have been made aware of very serious concerns within the small business community, and within certain federal agencies, regarding Section 505. The people I've heard from believe that the provision will limit opportunity for SBIR participants that have been highly successful in the past and would place arbitrary quotas on their ability to win SBIR awards. While I still appreciate the goal of making SBIR a broadly accessible program, I am increasingly concerned that placing limits on entities, simply on account of geography, would undermine the competitive spirit of the program. Beyond that, I have come to think that such award caps would unintentionally penalize federal agencies, by requiring them to choose less competitive ideas.

A number of my colleagues and I have expressed this concern to Chairman Graves and Ranking Member Velasquez. I would appreciate your opinion on the subject of award caps and whether Section 505 comports with the SBA's view of how the SBIR program has and should continue to function. Can the SBA provide any data that would support the supposed intent of Section 505, and demonstrate how geographic award caps would create opportunity for states and entities that are currently less active SBIR participants?

Questions for Administrator Mills

1. Even though SBA rules require notice and comment, why does the agency establish pilot programs, like dealer floor plan financing, community advantage and small loan advantage without going through notice and comment before establishing the programs?

SBA pilot programs are conducted under the authority of 13 C.F.R. § 120.3, which was issued under Administrative Procedure Act notice and comment procedures. The rule reads as follows:

> *120.3 Pilot Programs.*
> *The Administrator of SBA may from time to time suspend, modify, or waive rules for a limited period of time to test new programs or ideas. The Administrator shall publish a document in the Federal Register explaining the reasons for these actions.*

The rule does not require use of notice and comment procedures to commence pilot programs; what is required is the publication of a Federal Register notice "explaining the reasons" for the pilot. Although notice and comment procedures are not required, SBA nevertheless often includes a request for comments in the Federal Register notice announcing a pilot program (e.g., Dealer Floor Plan (DFP) Pilot Program and Community Advantage Pilot Program).

SBA's authority to conduct pilot programs is recognized by the Small Business Act, which defines a pilot as "any lending program initiative, project, innovation, or other activity not specifically authorized by law." 15 U.S.C. 636(a)(25). The purpose of the pilot authority is to allow SBA to test different ideas in order to address, for example, a specific event (like Gulf Opportunity Pilot Program loans for hurricane relief), a specific type of loan (like Export Express Pilot Program loans for international trade), or a specific type of borrower (like Patriot Express Pilot Program loans for veterans).

It should also be clarified that there were two DFP pilots, one administrative and one statutory (as further discussed under #2 below). Finally, we note that Small Loan Advantage is not a pilot program, but a streamlined delivery method for small 7(a) loans.

2. SBA regulations the proceeds of 7(a) loans for floor plan financing. Pursuant to the Supreme Court's decision in *Motor Vehicle Manufacturers Ass'n v. State Farm Mut. Auto. Ins. Co.,* U.S. 29 (1983), an agency must use notice and comment to repeal an existing legislative regulation. Under what authority did the SBA start its floor plan financing pilot program without going through notice and comment as required by its own rules and the Administrative Procedure Act?

There have been two Dealer Floor Plan (DFP) pilots permitting floor plan financing: one administrative (2009 - 2010) and one statutory (2010 - 2013). The administrative pilot was established under the authority of 13 C.F.R. § 120.103, as discussed above, and the statutory pilot was created by Section 1133 of the Small Business Jobs Act of 2010. As the administrative DFP pilot temporarily suspended SBA's regulation prohibiting dealer floor plan financing (13 C.F.R. section 120.130(c)) under the authority of the pilot regulation, and did not repeal that regulatory prohibition, there was no need for SBA to issue a rule removing section 120.130(c) from the regulations. One purpose of the administrative DFP pilot was to assess whether SBA should permit floor plan financing in the 7(a) program on a permanent basis and if so on what terms, which would be accomplished through a removal of or revision to section 120.130(c). The statutory DFP pilot also did not require notice and comment rulemaking because the legislative text creating the pilot overrode the regulatory prohibition against floor plan financing in 13 C.F.R. §

120.130(c). SBA did publish a notice in the Federal Register that announced the statutory DFP pilot and provided an overview of its terms and conditions. As noted above, that notice included a request for comments on all aspects of the pilot. (76 FR 7101, February 9, 2011).

3. You have recently been discussing the record lending year for SBA. What has this lending meant in terms of economic growth?

Small businesses have a multiplier factor. When a company receives a loan, it enables them to succeed; they pay salaries, buy goods and services locally and often employ other small businesses in the provision of their products and services. The $70.4 billion in lending, which SBA made possible through government guarantees, has enabled our Agency to support approximately 1.6 million jobs.

4. Do you believe the agency has proper performance measures in place to determine the outcomes of increased SBA lending?

While SBA has performance measures in place to determine the outcomes of increased SBA lending, we are always searching for ways to improve those measures. In the 7(a) program, the application forms include information on the number of employees at the time of application and the number of jobs to be created and/or saved as a result of the loan.

Last year 7(a) lenders reported 582,707 jobs created and/or saved. The 504 Certified Development Company (CDC) Loan Program specifically focuses on job creation and economic development. CDCs report that financing projects in the program have created approximately 482,794 jobs in the last five years.

Perhaps the most important measure of our success is that the vast majority of SBA borrowers pay off their loans in full. These are small businesses that did not have credit available elsewhere. That translates to thousands of businesses employing millions of workers that have been able to remain in business, expand and add employees thanks to SBA lending.

5. The Small Business Jobs Act established two small business lending program at the Department of Treasury. As the federal agency responsible for small business lending, what role did you play in establishing and administering these program? Did Treasury seek advice from SBA in reviewing small business lending plans submitted by lenders?

As required by the statute SBA met with the Department of Treasury several times to give an SBA perspective on the implementation of the Act. SBA also detailed a staffer to Treasury to help with the implementation of the SBLF. Having a strong dialogue between federal agencies remains important to the success of any federal program.

6. Along with increasing lending, what additional steps are you taking to make sure that risk is properly managed? Are you increasing staff in your processing centers and for lender oversight?

As of January 1, 2011 OCRM (Office of Credit Risk Management) staffing was at 21 (excluding the Director). Through a concerted effort to re-staff critical functions, OCRM ended calendar year 2011 at a staff level 34, with two additional staff on-board January 3, 2012 (excluding the Director). In addition, we are also pleased to report the addition of Brent Ciurlino, as the Director of the Office of Credit Risk Management on January 3, 2012. Mr. Ciurlino comes to SBA from the FDIC, where he previously served in two terms with FDIC, first as a Deputy Director for FDIC to Manage the Resolution Trust Corporation and

FSLIC Southwest Plan , and recently to serve as Corporate Manager for Assets and Asset Marketing for the 13 State - US Western Region Satellite Office. Mr. Ciurlino joins us with over 25 years of lending and banking experience including tenure as the Director of Large Loans for the Farm Credit Banks of Spokane and St Louis, CEO of Union Bank Holding Company, and Managing Partner with RSMi McGladrey/H&R Block for the Banking and International Regulatory Practice leading projects for the World Bank-IFC, IMF, IDB and HUD.

There is no plan to increase the staff level in our processing centers. Instead SBA is focused on increasing efficiency by leveraging technology and mitigating the risk by strengthening our center quality control. This initiative is being delivered across all of our centers through enhanced and continual work product testing, employee training and leveraging technology and process improvement projects.

SBA strongly believes that risk management at our Centers must be not only reactionary, but more importantly, a fluid process. We have orchestrated and continue to enhance a streamlined process that injects deficiency findings from both internal Quality Control process as well as external input such as OIG and SBA's Internal Control, immediately back into our Centers, while working horizontally with other stakeholders within the Agency, to ensure that program policies that are causing systematic issues are promptly identified and corrected.

Such a robust process is maintained through SBA's continued focus on training and oversight of our Centers.

7. Do you believe that the current authorization level for the lending programs is adequate?

SBA believes that current authorization levels should be continuously evaluated in light of current loan demand. SBA exhausted its authorization in FY 2011 because of the impact of the fee relief and higher loan guarantees of the Small Business Jobs Act. Now loan volume is back on track to where it was in FY 2010 on a dollar basis, which is below the FY 2012 statutory loan program levels. The recovery to the FY 2010 levels is now happening without the help of Recovery Act or Jobs Act incentives. Furthermore, we have seen six consecutive quarters of credit easing, as reported by the Federal Reserve, which may result in lower demand for SBA guaranteed loans, which can only be made to businesses that cannot obtain credit elsewhere.

8. When the SBA designed the Community Advantage program, what design features were incorporated to prevent default similar to those of the now discontinued Community Express Pilot Program?

A number of risk mitigation features were incorporated into Community Advantage that were not present in the Community Express Pilot program, including the following:

- *First, we made the distribution channel for Community Advantage (CA) mission-based lenders rather than commercial lenders. Mainly non-profit institutions, these lenders have a long history of lending to underserved markets with solid loan performance. They do this by careful underwriting and, in many cases, the use of extensive management and technical assistance.*
- *Second, CA lenders are required to follow the credit underwriting procedures utilized in the Small/Rural Lender Advantage Initiative.*
- *Third, we require that loans by each CA lender, including the initial loans by the strongest lenders who have been granted delegated authority, be reviewed and approved by our Loan Processing Center so that there is an additional check on the underwriting quality of CA loans.*

9. Please provide the total number of lenders in either 7(a) or 504 loan program for which the SBA has: a) lowered their preferential status; or b: eliminated their authority to operate in the program since 1995?

For the last three fiscal years, SBA did not renew delegated lender status for the following numbers of 7(a) lenders, resulting in a lowered preferential status:

FY 2009 -- 85 lenders
FY 2010 -- 115 lenders
FY 2011 -- 111 lenders

In addition, recent enforcement actions for 7(a) lenders include two suspensions of delegated authority (between fiscal years 2007 and 2008) and seven instances where lenders choose not to request renewal of their delegated authority (between fiscal years 2009 and 2010).

With the downturn in the economy, CDCs participating in the Premier Certified Lenders Program have elected to make 504 loans without the use of their delegated authority. As a result, SBA reviews the underwriting on each 504 loan.

SBA has not in recent years suspended or revoked the authority of any 7(a) lender or CDC to operate in the program. However, with increased oversight and supervisory efforts, some risky lenders have opted to leave the SBA loan programs. Finally, many of SBA's problem lenders have been merged into other financial institutions and/or taken over by the FDIC.

10. In your opinion, does the SBA have sufficient statutory authority to take appropriate action to suspend the ability of lenders to operate in the 7(a) and 504 loan programs?

SBA is following the statutory authority provided by Congress in the oversight of lenders to operate in lending programs.

11. If not, what changes are needed in the Small Business Act and Small Business Investment Act of 1958 to provide the SBA with appropriate powers?

See response to Question 10.

12. The credit supplement to the President's Budget shows that recoveries in the "504 Loan Program" are significantly lower than in the 7(a) loan program. What statutory or regulatory changes or some combination thereof do you have to improve recoveries in this program?

Under new leadership, OCRM is conducting a full review of its recovery functions and powers to determine whether additional mechanisms are needed to increase the CDC debenture recovery rate. The findings of that review will inform the agency's legislative and regulatory proposals for improved recoveries.

13. What is the difference in default rates and loan losses between Premier Certified Lenders and all other certified development companies (CDC) that must obtain pre-approval by the SBA?

Below is a comparison of the 12 Month Purchase Rate (default rate) and the Charge-Off Rate (loss rate) for those lenders with current Premier Certified Lenders (PCLs) status, vs. all other 504 lenders as of 12/31/11. (Note that Premier Certified Lenders (PCLs) can make either Premier Certified loans or regular 504 loans (submitted to SBA for approval). Please note that OCRM (Office of Credit Risk Management) calculates purchase/charge-off rates as a percentage of the current outstanding portfolio. OCFO (Office of the Chief Financial Officer) calculates these rates using cumulative percentages. Therefore, OCRM's figures will differ from OCFO's figures. (Note that OCFO figures are the 'official' reported agency figures.)

CDC Type	12 Month Purchase Rate	12 Month Charge-Off Rate
PCLP CDCs	2.38%	2.72%
All Other CDCs	2.81%	3.79%

14. Have you compared the recovery rates on loans liquidated by SBA staff or contractors to those liquidated by CDCs?
No, but the Agency will review if that makes sense going forward.

15. Have you performed any analysis as to who is better at modifying loans in a way to get distressed borrowers back on track, CDCs or SBA?

No, we have not performed any analysis as to who is better at modifying loans in a way to get distressed borrowers back on track. However, it's imperative to note that SBA and CDCs work cooperatively on all loan modifications

There are two phases where a modification can be made to a 504 loan – before and after the debenture purchase. In the first case, where the 504 debenture has not been purchased back from the investor, CDCs and SBA work together very closely with SBA's Central Servicing Agent, to establish an appropriate deferment and the catch-up plan.

Once the debenture has been purchased, there are many more modification options. Again, SBA works hand in hand with CDCs during this phase to assist the borrowers to get back on track. SBA considers all modification options and relies on the CDC's familiarity with the local economy as well as the borrower's financial condition to find the best solution.

Given the intricate relationship between SBA and CDCs' efforts in finding the best servicing solution, it is not feasible to analyze their respective contributions separately.

Rep. Keating Questions for the Record

1) Administrator Mills, the House and Senate have different versions of the Small Business Innovation Research (SBIR) reauthorizations, with the Senate version preserving the Phase I grant program and the House version eliminating it. The Phase I grants are intended to spur innovation by funding new technology that has yet to be fully tested. In my state alone, 575 awards totaling $71.5 million were given to small companies. I don't think it's a coincidence that Massachusetts also falls 2 points behind the national average in the unemployment rate. What do you think the impact will be of eliminating the Phase I grant program to small research and development firms and the states which have benefited from their good work? Will elimination of the program lead to a decrease in the participation of small, high technology firms in federal research and development (R&D) endeavors?

If the Phase I portion of SBIR program is eliminated, fewer nascent businesses would be able to participate in the federal R&D system. The impact of funding fewer companies would likely translate into a lower number of high-risk, high-reward research and innovations entering the program. Phase I of the SBIR program is designed to capture and fund a broad number of potentially promising R&D ideas that can be evaluated after a short period of time (six months) before larger amounts of Phase II funds are invested over a longer, two year period.

In 2010 there were 4,146 Phase I grants awarded, totaling $539,000,000 and 1,845 Phase II grants awarded, totaling $1,431,512,000, for a combined total of 5,991 grants awarded totaling $1,970,512,000. The money saved from eliminating Phase I awards would allow for an increased number of Phase II awards. Taking this reallocation into account would translate to approximately 3,451 fewer awards offered to small businesses if Phase I was eliminated in 2010. Reallocating Phase I dollars toward Phase II may result in more conservative evaluation criteria by participating agencies.

2) I am the Ranking Member on The Homeland Security's Subcommittee on Oversight, Investigations and Management. Many of the firms utilizing SBIR Phase I grants, like Massachusetts-based Radiation Monitoring Devices, Inc., that testified before this committee in March, are small, high technology firms engaged federal research and development (R&D) endeavors to help make our country more secure. Radiation Monitoring Devices, for example, is working to expand nuclear detections technologies at our ports of entry. Has the Small Business Administration looked into the correlation of eliminating Phase I grant funding and the impact of that on our national security? What do you think the impact will be?

The Small Business Administration does not currently have the statistics required to analyze the correlation between the elimination of Phase I grants and contract funding and national security.

The SBA is the process of collecting baseline commercialization measures, which will help determine some outcomes of the SBIR program. These measures focus on sales, investment, IPOs, patent, and product launches resulting from SBIR funding, but they will not, on their own, be sufficient to determine the impact of SBIR Phase I funding on national security. For that, SBA would also need access to measures of national security, which SBA does not have the expertise or access to determine. The SBIR program at DOD may be better able to address this question. The SBIR DOD program has collected extensive commercialization statistics for past SBIR awardees and DOD will be in a better position to determine measures of national security.

3) Administrator Mills, The SBIR program has been a great success since its inception, and I can think of few better or more effective ways to allocate federal resources.

My question concerns a particular aspect of HR 1425, and I would appreciate your insight. When this Committee marked up HR 1425 in the spring of 2011, we adopted a provision that became Section 505 of the bill. The language in question would place limits on the number of SBIR awards and the amount of SBIR funding that entities can receive in a given year. The proposed limits would derive from a formula that incorporates aggregate award volume and dollar amounts across the states. The purpose of the language was to, theoretically, redistribute opportunity under the SBIR program to entities in states that, in general, don't typically receive as may SBIR awards, or participate in the program.

Since we marked up the bill, I have been made aware of very serious concerns within the small business community, and within certain federal agencies, regarding Section 505. The people I've heard from believe that the provision will limit opportunity for SBIR participants that have been highly successful in the past and would place arbitrary quotas on their ability to win SBIR awards. While I still appreciate the goal of making SBIR a broadly accessible program, I am increasingly concerned that placing limits on entities, simply on account of geography, would undermine the competitive spirit of the program. Beyond that, I have come to think that such award caps would unintentionally penalize federal agencies, by requiring them to choose less competitive ideas.

A number of my colleagues and I have expressed this concern to Chairman Graves and Ranking Member Velasquez. I would appreciate your opinion on the subject of award caps and whether Section 505 comports with the SBA's view of how the SBIR program has and should continue to function. Can the SBA provide any data that would support the supposed intent of Section 505, and demonstrate how geographic award caps would create opportunity for states and entities that are currently less active SBIR participants?

SBA acknowledges that some states and regions are much more successful in securing SBIR awards than others. However, SBA recommends utilizing existing SBIR programs that are designed to help applicants based in states that are less successful in SBIR program, rather than penalizing successful applicants with a geographic quota system. The FAST program, which was funded in FY 2004, 2010, and 2011, is designed to help increase the performance of states and regions with lower levels of SBIR program participation. SBA is in the process of collecting and compiling reports from 2010 awardees and will begin a performance analysis of the data in the coming months.

Implementing award caps by geography would also have the disadvantage of placing an additional administrative burden on participating agencies in the program.