Testimony of

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On behalf of

The National Association of Federally-Insured Credit Unions

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

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Introduction

Good Morning, Chairman Kim, Ranking Member Hern, and Members of the Subcommittee. My name is Gail Jansen, and I am testifying today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU). Thank you for holding this important hearing today. I appreciate the opportunity to share with you our perspective on the Small Business Administration's (SBA's) 7(a) Loan Program and the potential impacts of the proposed fee structure changes for fiscal year 2020.

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

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

As you may know, NAFCU is the only national organization that exclusively represents the interests of the nation's federally-insured credit unions at the federal level. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding the 7(a) loan programs and the budget proposal of the Small Business Administration.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial

services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for more than 116 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 § USC 1752(1)). While over 80 years have passed since the *Federal Credit Union Act* (FCU Act) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

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

The nation's approximately 5,400 federally-insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors, who are all members of the credit union, generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

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

Credit unions also play an important role in the on-going recovery from the financial crisis. As widely recognized by elected officials in Washington, credit unions did not cause the financial crisis. Because we did not engage in the same risky practices as big banks, credit unions fared well during the crisis and, as a result, had the capital available to lend. Surveys of NAFCU-member credit unions have shown that many credit unions saw increased demand for mortgage loans and auto loans as other lenders were leaving the market. A number of small businesses who lost important lines of credit from other lenders during that time turned to credit unions for the capital that they needed.

Our nation's small businesses represent 99.7 percent of all employer firms, employ nearly half of all private sector employees, pay more than 40 percent of total U.S. private-sector payroll, and have generated over 60 percent of net new jobs annually over the last decade. It is inarguable that the strength of the economy directly correlates to the health and well-being of America's small businesses. Many small business owners are members of credit unions around the country and rely on their services to help make their small businesses successful. Our nation's credit unions stand ready to help and, unlike some other institutions, have the assets to do so. Unfortunately, an antiquated and arbitrary member business lending cap prevents many credit unions from doing more for America's small business community.

Artificial Member Business Lending Cap at Credit Unions Hurts Small Business

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

CUMAA also established, by definition, that business loans above $50,000 count toward the cap. This number was not indexed and has not been adjusted for inflation in the more than 20 years since enactment, eroding the *de minimis* level. Where many vehicle loans or small lines of credit

may have been initially exempt from the cap in 1998, many of those that meet the needs of small business today are now included in the cap due to this erosion. To put this in perspective relative to inflation, what cost $50,000 in 1998 costs $77,500 today, using the most recent consumer price index data. That is more than a 55% rate of inflation change that is completely ignored by current law and greatly hamstrings a credit union's ability to meet its members' needs.

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

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

Memorandum of Understanding between the SBA and NAFCU

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

SBA Lending at Kinecta Federal Credit Union

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

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

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

full-time employees and has begun to create a reserve account with the future intention of purchasing a commercial real estate property.

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

As previously mentioned, small businesses are the backbone of our economy and an essential source of jobs for Americans. The Small Business Administration's loan programs serve as an important resource that help credit unions provide small businesses with the vital capital necessary for growth and job creation – in many cases to businesses that would otherwise not be able to obtain financing. While there are positives to SBA's overall FY 2020 budget request, such as the increase in the SBA Express loan limit from $350,000 to $1 million, it was troubling to see the request to modify its statutory fee structures and potentially increase its fees because of a refinement to its economic modeling. The bottom line is that the fee increases, as proposed by the SBA in its budget submission, will impact both our small business members and the credit union.

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

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

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

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

Conclusion

Small businesses are the driving force of our economy and the key to its success. The ability for them to borrow and have improved access to capital is vital for job creation. Although the Small Business Administration's 7(a) program provides much needed opportunities to established and fledgling businesses, increasing fees for the program will have an impact on both borrowers and small lenders. We recognize that maintaining a zero subsidy for the program is important, but we urge you to examine potential alternative solutions to avoid a fee increase scenario.

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