



Testimony of

Sonya McDonald

Executive Vice President and Chief Lending Officer
Randolph-Brooks Federal Credit Union

On behalf of

The National Association of Federally-Insured Credit Unions

“Strengthening SBA's 7(a) Loan Program”

Before the

House Small Business Committee

January 17, 2018

Introduction

Good Morning, Chairman Chabot, Ranking Member Velázquez, and Members of the Committee. My name is Sonya McDonald, 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 my experience with the Small Business Administration's 7(a) Loan Program and our views regarding potential improvements to it.

As the Executive Vice President and Chief Lending Officer at Randolph-Brooks Federal Credit Union, I am responsible for a \$6.6 billion portfolio that encompasses consumer, mortgage and commercial lending, including \$23.6 million in SBA loans. The majority of my nearly 25 years of experience in marketing, strategic planning, management, and lending has been spent in the credit union industry. Prior to joining Randolph-Brooks in 2003, I was employed by Centris FCU (Nebraska) and Day Air CU (Ohio).

Randolph-Brooks Federal Credit Union (RBFCU), based in Live Oak, Texas, was originally chartered in 1952 with \$45 in deposits to serve personnel at Randolph Air Force Base. RBFCU is a full-service financial cooperative whose mission is to improve members' economic well-being and quality of life. With assets exceeding \$8.6 billion, RBFCU serves more than 710,000 members from 55 branch locations throughout Texas. Ranked among the top 20 of nearly 6,500 financial cooperatives, RBFCU is recognized for financial stability, and consistently receives the highest ratings of "Five Star" and "Superior" from respected organizations that rate financial institutions in the United States. At RBFCU, we do more than conduct business in the

communities where our branches are located. We become a member of the community and share our philosophy of “people helping people.” We provide assistance to hundreds of local charitable organizations including the Children’s Miracle Network, United Way, USO, American Red Cross, and the Fisher House Foundation.

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 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 more than 110 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* (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 nearly 5,000 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.

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 they 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 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 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 a 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 18 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 \$76,000 today, using the most recent consumer price index data. That is more than a 50% rate of inflation change that is completely ignored by current law and greatly hampers 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 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 8% of all small business loans from insured depository institutions), and are not a threat to banks (who control nearly 92% 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' lending 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.

We would urge the Committee to support legislation to remove the arbitrary cap on credit union member business lending.

Memorandum of Understanding between SBA and NAFCU

In September of last year, 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. The MOU was entered into with the desire of both parties 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 of capital for small businesses, especially for underserved borrowers. Involving more credit unions in SBA's programs will expand accessibility of SBA products and ultimately strengthen small businesses and their communities. 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 Randolph-Brooks Federal Credit Union

RBFCU started its business program fourteen years ago, and today we have over 28,000 business checking accounts and 4,747 member business loans. We have a well-diversified member business loan portfolio of approximately \$523 million with minimal delinquencies (a delinquency ratio of 0.72%). Our commercial losses have been minimal as we have an

experienced lending staff and a sincere and devoted membership. RBFCU has been an important source of capital for existing, new and growing businesses throughout the areas we serve.

At the request of our membership, and to provide more loan options for our field of membership, RBFCU became an SBA Preferred and Express Lender in September of 2005. We are delegated with SBA authority and are able to offer all SBA products including 7(a) loans, Small Loan loans, Express loans, and SBA 504 loans. In 2016 and 2017, RBFCU was the #1 SBA lending credit union in our 55 county SBA district. Given our diverse membership of over 710,000 members, we see a wide variety of SBA loan requests. From start-up franchises, to business acquisitions, to purchasing owner-occupied real estate, RBFCU has provided SBA loans for as little as \$15,000 and as much as \$3,000,000. SBA products allow us to leverage our lending dollars, mitigate the risk associated with the loans, and extend more credit to our communities' small businesses.

RBFCU currently has 210 active SBA loans in its portfolio with a balance of approximately \$23 million. Our current SBA delinquency ratio is 2.32% and our net charge off ratio is 0.54%. At RBFCU 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. The SBA loan option provides eligible member borrowers with more favorable loan terms, such as lower down payment options and longer maturities.

For example, The Bagel Factory, in San Antonio is owned by an Air Force veteran and his wife. They were denied more than 20 times by various banks before finding a loan approval at

RBFCU. That business is now in its 7th year and thriving. Another SBA loan was provided to a 100% disabled military veteran, for his company, AppDiction. With the help of an SBA Express Line of Credit, the business secured 8a certification and is now able to fulfill software development contracts for the military. These success stories are a small sample of the many that have occurred since our partnership with the SBA.

There are many more stories, like these, of small business owners looking for that loan to enable them to start or grow their business. The demand is out there. Unfortunately, in this current environment, many banks have scaled back their smaller dollar business lending that credit unions are readily able and willing to fill. At RBFCU, we are pleased that we have been able to help step up to meet the pent-up demand.

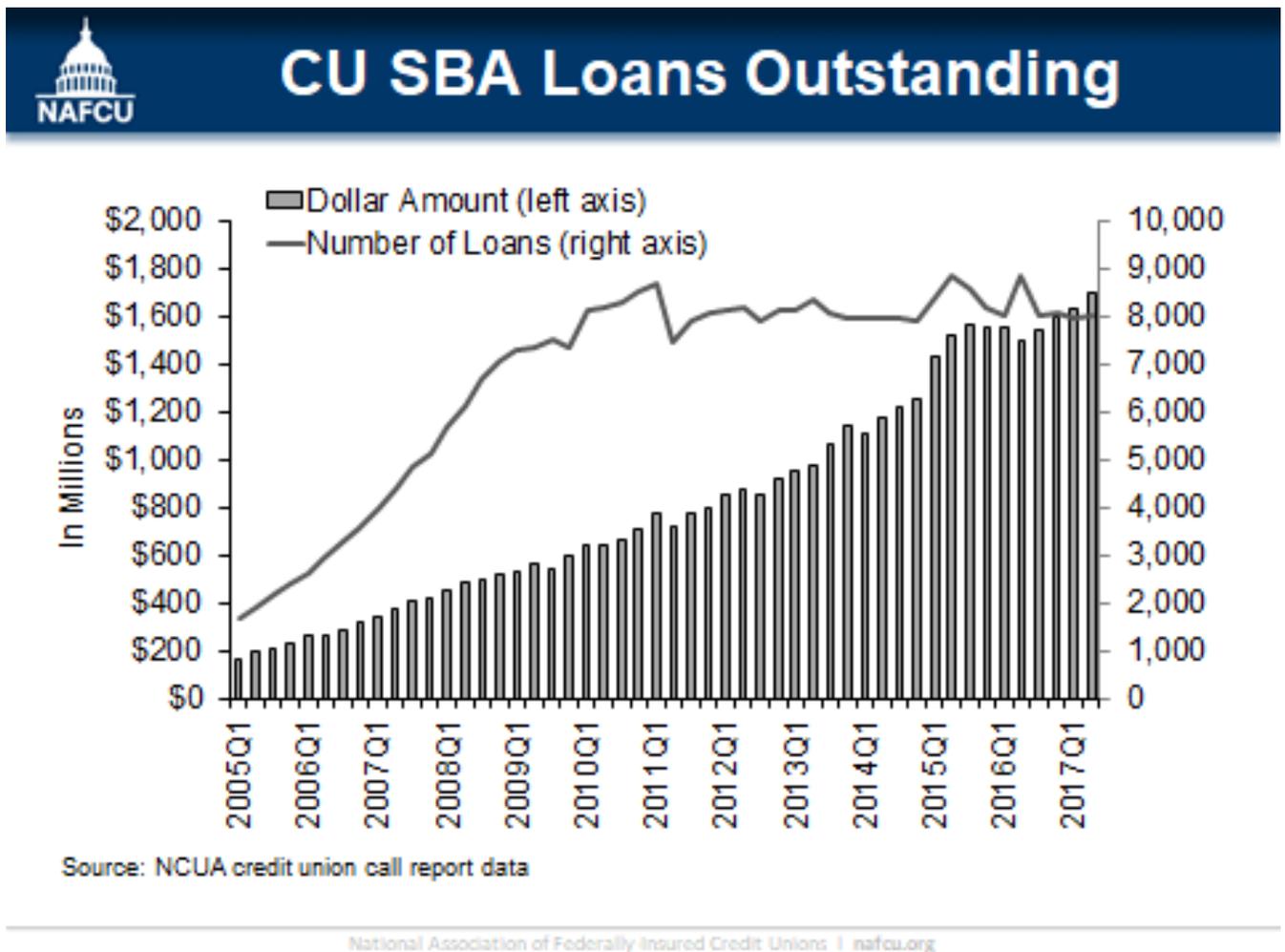
SBA and Access to Capital for Credit Union Members

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 helps 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. 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

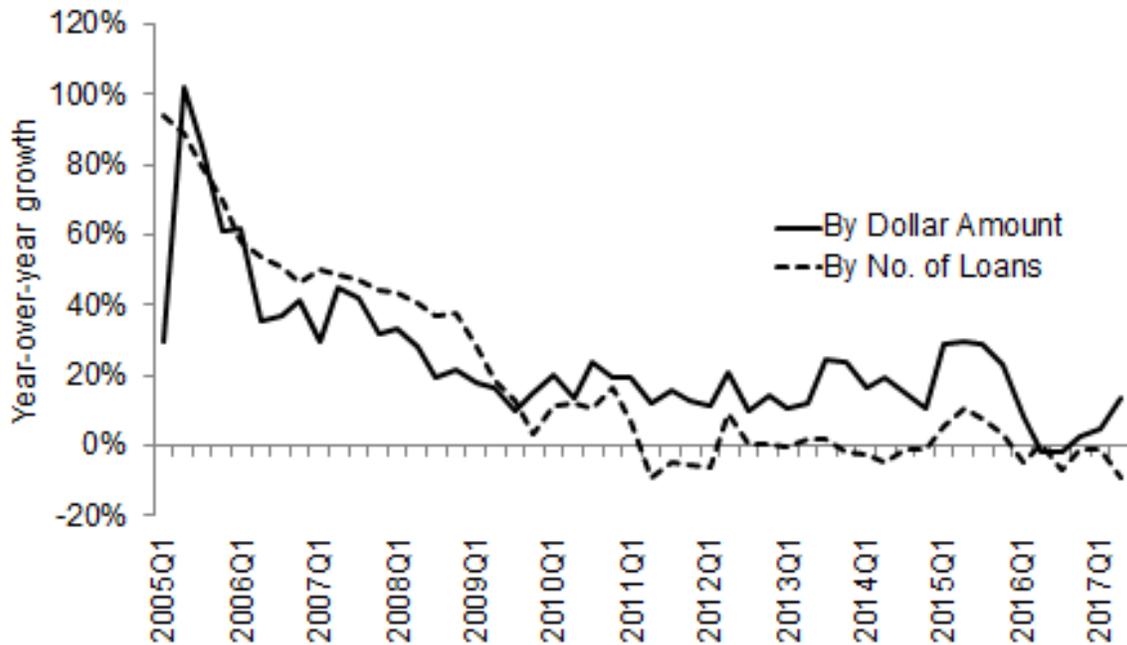
preclude the applicant from participating in an SBA guaranteed loan program. Eligibility criteria includes among other things: size restrictions, type of business, use of proceeds, credit standards, and meeting a ‘credit-elsewhere’ test.

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





CU SBA Loan Growth



Source: NCUA credit union call report data

National Association of Federally Insured Credit Unions | nafcu.org

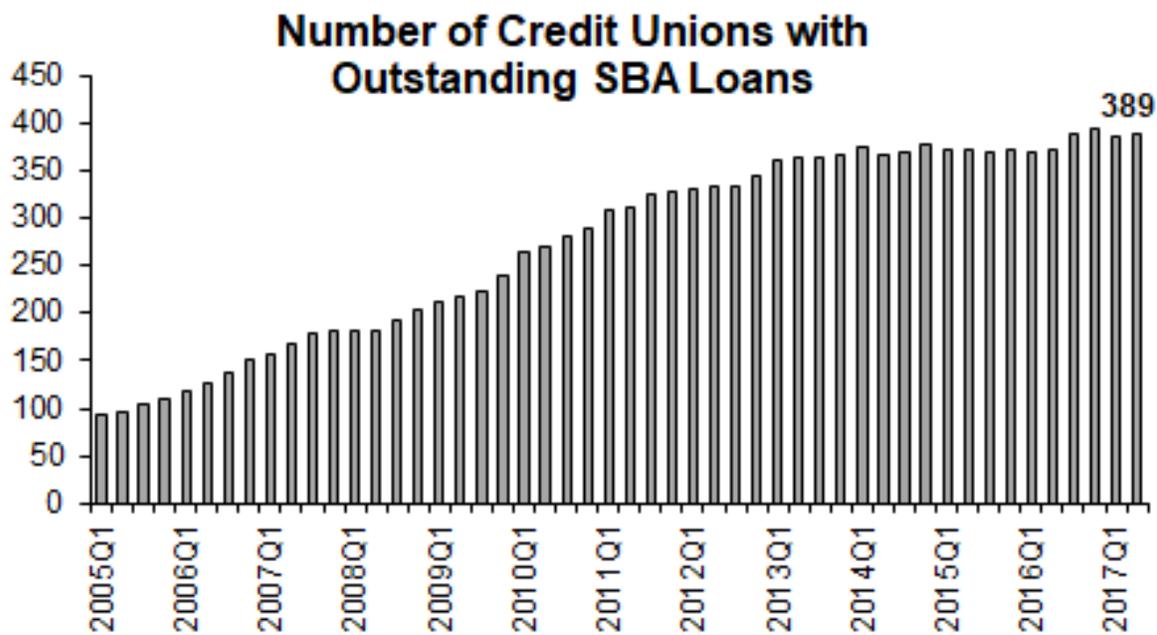
Much of the decrease in SBA lending can be associated with the overall economic downturn the nation as a whole experienced. However, some credit unions tell NAFCU that they have scaled back on the number of small loans as a response to comments from the SBA and its examinations.

Another way that Congress could help improve the 7(a) lending program would be to reintroduce the *Credit Union Small Business Lending Act*, which was first introduced by Ranking Member of the full committee, Nydia 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. 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. We hope NAFCU's MOU with the SBA will help in this regard. Additionally, enacting legislation such as the *Credit Union Small Business Lending Act* will help this trend continue.



CU SBA Lenders



Source: NCUA credit union call report data

Compliance with any regulation requires work, but clear guidance is necessary for a credit union to know they are doing what is required of them. If RBFCU has a question regarding SBA's Standard Operating Procedures (SOP), we are able to email them directly, but the response does not always result in a definitive answer. Many times, SBA's response to a request for clarification is merely a screenshot of the page of the SOP in question. Additionally, when loans are submitted through General Processing, some of SBA's processors deviate from standard SOP requirements, although we have seen improvements since I testified on this subject last March. One recent improvement has been SBA's listing on their website of franchises eligible for SBA financing, which helps expedite the process of lending to a franchise and removed unnecessary burden from the institution to determine eligibility of a franchise.

An example of previous deviation from SOP requirements occurred when a loan request required us to place a second lien on a borrower's rental property. In order to establish value, RBFCU would normally use the tax assessed value on the home. In this case, the SBA processor insisted on using the value estimated by the real estate website Zillow.com, which of course is nowhere in the SOP manual. Issuing, improving, and adhering to guidance or published "best practices" would go a long way to helping credit unions get more involved in SBA lending programs. While the user friendliness of the SBA One software has improved since last March, there are additional ways to encourage credit unions to offer SBA loans such as shortening the length of time it takes to have a loan approved, which can take 8 weeks or longer.

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

greatly needed. 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 and encourage other credit unions to get involved.

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

H.R. 4743, the "Small Business 7(a) Lending Oversight Reform Act of 2018"

NAFCU is pleased to see the bipartisan and bicameral work on the *Small Business 7(a) Lending Oversight Reform Act of 2018*, H.R. 4743, and we thank Chairman Chabot and Ranking Member Velázquez for their leadership on this bill. This legislation provides a number of improvements that will help bring more clarity to SBA's 7(a) program including:

- Strengthening SBA's Office of Credit Risk Management by outlining in statute the responsibilities of the office and the requirements of its director;
- Enhancing SBA's lender oversight review process, including increasing the office's enforcement options;
- Requiring SBA to detail its oversight budget and perform a full risk analysis of the program on an annual basis;
- Strengthening SBA's Credit Elsewhere Test by clarifying the factors that must be considered.

We are particularly pleased to see the Credit Elsewhere Test better defined compared to what is included in the Standard Operation Procedures (SOP). This will help clear up ambiguity for lenders.

One of the most important parts of the bill is the Administrator's authority to increase the budget amount to 115% of the limit. This would be beneficial to both borrowers and lenders versus the hard cap that currently exists and help ensure that lenders and small businesses will not face a situation where the ability to use the 7(a) program comes into doubt due to the popularity of the program.

One area where we think the legislation could be improved would be to have better definitions for penalties. For example, what constitutes a small penalty versus a \$250,000 penalty? Adding clarity that requires the Director to distinguish between minor compliance errors and willful or negligent violations would be helpful. Also, will the budget to be submitted each fiscal year include estimated penalties? If so, how will the office ensure correct fees are being charged?

Overall, we believe this is a solid legislative package and would urge the Committee to support and advance this legislation in a timely fashion.

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 7(a) program provides much needed opportunities to established and fledgling businesses, there are several relatively simple steps that could propel the program to its full potential. We are hopeful that the Committee's work on H.R. 4743 will provide these improvements, and NAFCU stands ready to work with you to achieve these objectives. The small businesses and communities around the country will benefit greatly from improvements to these programs. Finally, it is our sincere hope that the SBA 7(a) lending program is successful in luring new credit unions to participate in them while also ensuring eligibility requirements and other qualifying criteria are not overly burdensome on the financial institutions that want to 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.