NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

"An Examination of SBA Programs: Eliminating Inefficiencies, Duplications, Fraud and Abuse"

Testimony before the U.S. Senate Committee
On Small Business and Entrepreneurship

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Submitted by
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Chairwoman Landrieu, Ranking Member Snowe, and members of the Committee, my name is Greg Clarkson.

I am the Executive Vice President and SBA Division Manager for BBVA Compass. As manager, I am responsible for the various aspects of originating, closing, funding, servicing and liquidating a multi-state Preferred Lending Program. Our SBA loan portfolio is approximately $970 million, consisting of 7(a) guaranteed loans and 504 first lien mortgages. BBVA Compass is an active SBA lender centrally administered in Dallas, Texas. We participate in the regular 7(a) program, as well as SBA Express and 504 first mortgage loans. BBVA Compass was awarded SBA's Large Bank 7(a) Lender of the Year in 2009 and 504 First Mortgage Lender of the Year in 2010.

BBVA Compass is the brand name for Compass Bank, a Sunbelt-based $65 billion financial services company headquartered in Birmingham, Alabama. We operate over 700 branches in Alabama, Arizona, California, Colorado, Florida, New Mexico and Texas. Through three major business units – Corporate Banking, Retail Banking and Wealth Management – we offer clients innovative and industry leading products and services to meet their financial goals. Additionally, as a subsidiary of the BBVA Group, our clients have access to a full range of international products and services in more than 30 countries. BBVA Group is headquartered in Madrid, Spain with approximately $750 billion in total assets, 48 million clients, 7,400 branches and over 100,000 employees.

I am also the volunteer Chairman of the Board of Directors of the National Association of Government Guaranteed Lenders (NAGGL), a trade association of approximately 700 banks, credit unions, and non-depository lenders that participate in the Small Business Administration's 7(a) loan guarantee program. Our members are dedicated to providing critical capital to our nation's small businesses so that these businesses can grow, create more jobs, and contribute to our nation's economic vitality. NAGGL's lender members are responsible for approximately 80% of the annual SBA 7(a) loan volume as well as most of the first mortgage portion of SBA 504 loans.

Thank you for inviting me to testify today on inefficiencies in the SBA process, specifically related to the SBA's current lender oversight program.

A vibrant SBA lending program is essential to economic growth and job creation. The 7(a) program keeps credit flowing to small businesses and fills a critical gap for those businesses, particularly startup and early stage companies—those that need access to longer-term loans. SBA, through its private sector lending partners, accounts for well over 70% of all long-term small business loans made in America, making the agency the single largest provider of long-term capital to U.S. small businesses.

The importance of SBA lending to small businesses is clearly evidenced by the demand for the programs. According to SBA statistics, in the last two years the agency has helped deliver $42 billion to small business owners through its 7(a) and 504 guarantee loan programs. When the dollar value of the private sector first mortgage portion of the 504 loans is included, the total volume goes even higher. It is also important to note that more lenders are participating in the 7(a) program. SBA Administrator Karen Mills recently stated that SBA had brought more than 1,200 lenders back to SBA lending over the last two years. This increased participation, combined with the existing lender base, provides more access and more opportunity for more small businesses in more communities.

In order to continue the positive impact of SBA lending programs, the agency needs to create an environment that fosters responsible participation by its lending partners. A key component in that effort is an effective lender oversight program. Lender oversight should be a means for the agency to identify variances from established lender benchmarks and to provide a reasonable process for lenders to remedy deficiencies. The oversight program should be timely, consistent, and constructive, while it provides value to the agency, lenders, and taxpayers. Risk and losses cannot be eliminated from any lending program; however, they can be managed to reasonable tolerances. For a lending program that has at its core a public policy goal, such as the SBA 7(a) and 504 programs, these risk tolerances should be higher than conventional lending tolerances.

To create a truly meaningful lender oversight program, SBA should establish and publish performance benchmarks and periodically update them as economic conditions warrant. These performance benchmarks need to provide an appropriate measurement of risk with *definable* correlation between public policy initiatives and commercial bank standards.

Any SBA oversight program should be designed to address systemic risk versus SBA's payment risk on an individual defaulted loan. SBA's guarantee is a conditional guarantee, which means that if a lender fails to fully meet its responsibilities, the SBA can—and does—reduce the amount of the guarantee payment to lenders. In the most egregious cases of imprudent lending, the SBA denies its liability under the guarantee. Therefore, the very nature of the guarantee relationship serves to assure that lenders comply with SBA's various program requirements while engaging in quality lending. In considering appropriate oversight for the 7(a) program, it is important to remember that loss risk on individual loans is shared between SBA and the lender: it is not a complete transfer of risk away from the 7(a) lending community. Lenders have an ongoing responsibility to their bank's regulatory oversight entity, as well as to shareholders, to ensure that safe and sound lending practices are maintained.

NAGGL recognizes the benefit of a quality lender oversight program and continues to be a strong proponent of such efforts. Since the introduction of federal credit reform which fixed program pricing based on anticipated losses, our member institutions have witnessed the impact that portfolio performance has on subsidy rates and program fees. We are acutely aware that when individual lenders do not engage in appropriate loan underwriting, servicing and internal control practices, the impact on the program can be detrimental in terms of the future access to capital for small businesses and the overall cost to borrowers and lenders.

A quality lender oversight program should provide a cost effective, statistically valid means of detecting increased risk in the overall SBA portfolio as well as in individual lenders' portfolios. Initially, this is typically accomplished with a properly functioning offsite monitoring program. Upon detection of adverse trends, the offsite oversight program should direct additional investigation, including contact with the lender and possibly an onsite review of the institution's asset quality and lending practices to validate concerns, provide corrective actions, or issue enforcement directives. And, in the case of the 7(a) program, which has a public policy purpose, devising an appropriate oversight strategy must also include consideration of how well those public policy goals are being met.

Current practice of the SBA is to update a lender's program performance data quarterly through the Lender Portal. The SBA also conducts periodic onsite reviews of a lender's loan files, policies, and practices. This review is conducted approximately every two years on each lender that has an SBA loan portfolio in excess of $10 million. The SBA may conduct an onsite review of lenders with other problems or issues that may come to SBA's attention. The SBA also conducts safety and soundness examinations for the SBA-supervised lenders that participate in the 7(a) program. The SBA lender oversight program should be used to detect systemic risk in the overall SBA portfolio or risk in individual lender's portfolio. Loss risk associated with individual defaulted loans is monitored and controlled through the SBA guarantee purchase process.

The SBA has established an infrastructure that can support an effective lender oversight program; however, management of the program has not created the needed value for the lenders and the agency. Lenders have raised serious concerns to NAGGL about timeliness and transparency of the agency's existing lender oversight program. Among these concerns include the following: the timeliness with which lenders received their written onsite review reports; inconsistencies with findings in the report versus onsite exit summaries; timeliness of Preferred Lender status renewals; ability for certain lenders classified by SBA as "higher risk" to timely complete secondary market sales; transparency of the application of the rules under which lenders are expected to perform;

and accuracy of Lender Portal information and ratings. In addition, lenders have expressed ongoing concerns about the fees that are charged for various aspects of SBA's oversight program and question whether appropriate value to the SBA and lenders is received for these costs. These issues have been noted by the agency and corrective managerial and administrative action has begun. NAGGL would be remiss if it did not acknowledge the commitment and leadership shown by Administrator Mills and Associate Administrator Smits in their efforts to improve the SBA's oversight program.

NAGGL does not believe the current <u>offsite</u> monitoring program being employed by the SBA provides a cost effective, statistically valid method for detecting increased risk in the portfolio. The SBA has access to significant amounts of data relating to historical loan performance, delinquencies, geographic diversity, concentrations, and overall lender activity. However, it does not appear that this information is routinely utilized as part of an early warning risk assessment system. Instead, SBA relies upon a contractor-provided computer program that uses loan performance data provided by SBA, together with credit scoring for the individual loans in a lender's portfolio, to forecast a percentage of loans in a lender’s portfolio at high, moderate, and low risk of default. Due to the proprietary nature of the contractor's program, a lender is unable to determine whether it agrees with the analysis, and if it does agree to take appropriate action. While lenders are required to pay an annual fee equal to their share of the total contractor charges based on their outstanding loan portfolios, there is little evidence that appropriate value is provided for this expense. Moreover, portfolio performance forecasts by the contractor model are highly questionable. It appears that SBA's internal analysis of ongoing information obtained by the SBA through the lenders' monthly reporting would provide a more meaningful and timely assessment of any systemic risk in the portfolio without creating duplication and inefficiency in the process.

The results of the ongoing offsite analysis should be supplemented with higher lender interaction and onsite reviews for any participating lenders deemed to be 'high risk'. It is imperative that the onsite activity provides timely feedback and meaningful analysis to the participating banks and to the SBA. It is also important that this oversight does not result in duplication of existing oversight activities from other regulatory agencies (and a duplication of the cost already associated with those activities).

It is an established fact that the bank and credit union industries already have substantial lender oversight from the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration, the Federal Reserve Board, and various state banking regulators. NAGGL believes that before initiating its own onsite lender oversight activities, the SBA should be required to demonstrate that it is adding value to current federal and state oversight efforts and not just duplicating existing efforts. It would appear reasonable for the SBA to work with the existing regulatory agencies to accomplish its onsite examination objectives, something that NAGGL has long-recommended. A partnership of this nature would ensure consistent application of examination procedures as well as regulatory experts to provide safety and soundness testing of SBA portfolios.

We recognize that an inter-regulatory agency partnership will require the commitment and cooperation of several agencies; however, we believe that this type of arrangement is necessary to provide the most cost effective and meaningful determination of risk.

This type of cooperation would certainly support the ongoing efforts to reduce regulatory burdens and eliminate duplicative federal processes. We would hope that the SBA is willing to pursue this avenue prior to arbitrarily requiring that participating lenders bear the cost of additional regulatory examination.

As this Committee is aware, over the past decade the SBA has delegated to lenders significant authority to process, close, service, and liquidate 7(a) loans. Appropriate oversight of these delegated efforts should not amount to second-guessing the specific actions that a lender takes on an individual loan. Rather, NAGGL and its members believe that any onsite review of a participating lender's SBA portfolio should focus on whether the lender's overall 7(a) credit practices are prudent, commercially reasonable, and consistent with actions taken on its unguaranteed loans. In addition, the oversight should focus on whether the lender has appropriate internal controls to manage risk and whether the lender is in compliance with SBA specific program requirements. The oversight program should provide an objective process to proactively identify lender risk and provide a methodology to work with the lender to manage the risk.

Most importantly, SBA’s lender oversight function should provide the necessary results without unduly increasing the regulatory burden on lenders. The SBA should use information that is already available to identify on a real-time basis those lenders whose portfolios are exhibiting a form of stress, to determine whether an onsite review is warranted due to such stress, and to work with the lender to address any portfolio problems. This is similar to other regulatory oversight programs conducted by the banking agencies.

In closing, on behalf of my bank and other 7(a) and 504 lenders, I want to thank Chairman Landrieu, Ranking Member Snowe, this Committee and the SBA for the leadership to support the SBA's loan programs and make credit more accessible and cost-effective to small business borrowers and lenders during these economically trying times. Over the past several years, working together on a non-partisan basis, SBA and Congress have crafted a number of excellent short- and long-term solutions aimed at jump-starting lending to small businesses. The success of those solutions is readily illustrated by the dramatic increase in SBA lending that occurred subsequent to enactment of the Recovery and Small Business Jobs Acts. The results are clear — unprecedented lending levels in the SBA 7(a) and 504 programs realized last fiscal year, and that are on track to be realized again this fiscal year.

The public-private partnership that exists in SBA's lending programs has been, and continues to be, a shining example of what can be achieved when the federal government and the private sector work together. We know that small businesses lead the way in creating new jobs and we know that having a vibrant small business segment in our economy is vital to continuing the fragile economic recovery that we are seeing today. We also know that keeping SBA's 7(a) and 504 loan programs available to meet the capital needs of the tens of thousands of creditworthy small businesses that have nowhere else to turn is equally important. These loan programs merit continued bipartisan support in the Congress.

Chairwoman Landrieu, this concludes my prepared statement. Thank you for all you have done to support America's small businesses, and for giving me the opportunity to testify before you today. I would be pleased to answer any questions.