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United States Senate Small Business and Entrepreneurship Committee

Reauthorization of the SBA's International Trade Programs

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April 10, 2019

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Good afternoon Chairman Rubio, Ranking Member Cardin, and members of the Committee. My name is Daniel Pische and I am here on behalf of First American Bank, where I manage the Bank's Trade Finance division, as well as my colleagues at other institutions who are active under the SBA's export programs. In addition to my work as a Trade Finance lender, I have recently been appointed to the Department of Commerce's Trade Finance Advisory Council. While the suggestions outlined in my testimony are not related to the work of the Council, the goals of supporting small business exporters and improving access to Trade Finance loans are shared objectives.

First American Bank is a privately held commercial bank based outside of Chicago with operations in South Florida and Wisconsin. As a commercial bank based in the Midwest with an active Trade Finance department in South Florida, our institution has a unique perspective on the various ways businesses engage in international trade. First American maintains delegated authority under all of the SBA guaranteed lending programs, including the Export Working Capital Program (EWCP) and the Export Express loan programs. Through our use of the export programs, the SBA recognized First American Bank as Export Lender of the Year in 2017, and the Department of Commerce awarded the Bank the President's "E" Award for Export Service in 2018.

With the support of the SBA export programs, we have been a part of a number of success stories that highlight the potential of the program. With the support of the Export Working Capital Program, a South Florida medical device manufacturer grew from $3MM in revenue in 2009 to $12MM in 2018 with a workforce that now totals over 75 employees. The EWCP program also supported a paper exporter based in Coral Gables, FL, which grew its business over ten years before establishing a manufacturing plant in Houston with the help of the SBA 504 program. In Chicago, a food exporter got its start by utilizing a small amount of working capital under the Export Express program, which allowed it to grow and transition to an Asset Based loan under the EWCP program. Under all three of these examples, growing exporters obtained the working capital financing they vitally needed in order to capitalize on new opportunities and expand their businesses.

The flexibility and support provided by the SBA's export programs is unmatched; however, the programs do not see the adoption amongst financial institutions that they deserve. This lack of adoption can result in difficulty for some small business exporters to obtain the working capital they need to support their international customer base. Furthering the availability of the SBA export loan programs is one way to help alleviate this constraint for growing exporters.

As companies begin to export, they often do so by securing a few orders with cash payment made in advance. As a company begins to expand internationally, payment terms are often required at which point the need for working capital and the ability to borrow against foreign receivables becomes a central component of their export plan. Depending on the financial institution the business is working with, their international offerings may be limited which can force the company to find a new bank. While finding a financial institution with the required services is often a necessary step as exporters grow, the lending services may not be as accessible at earlier stages due to minimum borrowing requirements that might be in place.

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The nature of exports is such that it takes a specialized infrastructure at the bank level to administer and monitor the loans effectively. This infrastructure is predominantly based on Asset Based Lending, a product not available at all banks. As a result, the challenge of furthering the adoption of the SBA's export programs will not be solved through a groundswell of community banks alone. Engaging the nation's existing Asset Based lenders will be essential to the long-term success of the program.

Due issues ranging from compliance costs to the allocation of experienced personnel, many lenders involved in Trade Finance and Asset Based Lending set minimum loan requirements of $1MM or $2MM as an entry point for those services. Given that the SBA program has a maximum loan limit of $5MM, that constraint results in a rather narrow band of loans that would be eligible at such institutions. Combined with the requirement for the lender to understand a standalone set of rules, many established and capable lenders simply avoid the programs or have withdrawn after minimal use.

In order to expand the adoption of the SBA's export programs and improve exporters' access to working capital, the following is a series of changes for consideration that have been reached amongst the active lenders under the programs:

<u>Increase the Limit on the Export Working Capital Program to $10MM:</u>
Under the existing $5MM SBA program limit, a domestic distributor could obtain an Asset Based line of credit under the CAPLine program. If you imagine this same distributor as an exporter, the same $5MM line of credit would not be equally sufficient to support the exact same amount of sales. The reason is that export sales have a much longer cycle than their domestic counterparts due to the increased transit times and extended payment terms required to compete internationally. For example, an exporter must often build in 30 days for ocean freight, in addition to normal payment terms of 30 and 60 days from receipt of the goods. When combined with payment delays, international trade cycles can easily extend beyond 90 days.

Increasing the maximum loan amount on the Export Working Capital Program to $10MM will afford exporters greater warehousing capacity under the line of credit; while providing the flexibility to offer the payment terms necessary to secure new international business. On average, an export transaction can take up to two or three times as long as a domestic transaction to complete. Understanding the elongated cycle of international trade is central to crafting a working capital program that is built to support exporters. It is for this reason that I recommend the $10MM limit exclusively for the Export Working Capital Program.

The $10MM limit also helps to address the issue raised earlier regarding lenders with minimum loan size requirements for Trade Finance and Asset Based Lending facilities. By expanding the range of loans that are supported under the EWCP, established Trade Finance and ABL lenders will have more reason to invest in the program as it would then be able to serve a greater range of relationships.

<u>Allow for Limited Availability on Domestic Accounts Receivable under EWCP:</u>
Many of our exporters in South Florida derive over 80% of their income from international sales. While this allows the majority of their business to be financed under one of the existing export loan programs, it also leaves a significant portion of their business in need of alternative financing.

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Currently, the EWCP excludes all domestic receivables as ineligible for borrowing purposes. Allowing for 30% of the overall asset based availability to come from domestic receivables will allow for cohesive monitoring of the loan facility, while forgoing the need to structure a separate working capital loan to address domestic orders.

Realign the Fee Structure for Working Capital Loans Over 12 Months:
At present, the guaranty fee structure for loans of 12 months or under is 0.25%. For any loan over 12 months, that cost increases to as much as 3.75%. This pricing model suggests that the SBA believes loans of 12 months to be less risky than those with a term exceeding one year, which is reflected in the increased guaranty fee charged for the loan.

Working capital loans are traditionally underwritten and reviewed on an annual basis. This practice is done so that the lender and borrower can adjust to the working capital needs of the coming year, not because extending a line of credit for more than 12 months makes it any more risky.

This existing SBA fee structure fundamentally misattributes the correlation between risk and guaranty fee pricing. The monitored nature of EWCP and CAPLine programs, combined with the widely adopted use of trade credit insurance are the primary reasons that those facilities have some of the lowest occurrences of loss amongst all SBA programs. Rather than assess a bimodal fee based on single point in time, currently 12 months and one day, the guaranty fee should be assessed on a per-year basis in a step fee manner.

Graduating the fee structure in order to allow for a step fee approach provides a small business the ability to pay a proportional expense on an annual basis. This reform better recognizes the true relationship between risk and guaranty pricing. Additionally, this would provide the ability to support export projects with a term exceeding 12 months. For example, companies involved in custom machine manufacturing can often have projects that well exceed 12 months as the delivery of their products are often based on the schedule that involves other suppliers and contractors. At present, these projects are hindered by the massive increase in the guaranty that would be assessed.

At First American Bank, we are cautious about having borrower pay for a full guaranty fee on a larger line of credit in order to obtain a multi-year authorization. Our primary concern is that the working capital needs of the business can change over time and that the small business may end up paying for a loan guaranty that they no longer need.

I believe reforming the fee structure for working capital loans to a step fee method would eliminate this risk and better position the program amongst borrowers and lenders alike.

Allow For the Refinance of Working Capital Loans with Newly Issued Working Capital Loans:
The Export Express and the domestically focused CAPLine program can be used to support growing exporters and those just beginning to expand internationally. Given the fee structure outlined above, many lenders attempt to issue these loans on a 12-month basis in order to manage the cost of the program. In addition to the cost, the inability for the lender to issue a new Export Express or CAPLine to pay off an existing Export Express or CAPLine severely restricts the instances in which the program can be used in an effective manner. As such, these factors contribute to the underutilization of the programs.

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Permitting SBA working capital lines of credit to be refinanced by newly issued credit lines, as already allowed for Export Working Capital Program lines, would greatly simplify the programs and expand their usefulness. The existing restriction on one SBA loan paying off another SBA loan appears to be born out of a desire to curb borrowers and lenders from refinancing government guaranteed term loans with newly issued government guaranteed term loans. That restriction makes sense in the context of term loans but is out of place when dealing with working capital facilities as those loans are designed to be adjusted and renewed on a regular basis.

While the Export Working Capital Program is best positioned to support businesses that are predominantly involved in export sales, the Export Express and CAPLine programs are valuable tools in support of companies beginning to transact internationally.

Working Capital Authorization Reform:
The adoption of the proposals regarding the fee structure and the refinance provision would allow for reforms to the authorization process for working capital loans as well. Rather than have a borrower obtain a new authorization annually, it would be possible to allow authorizations to be issued for three years at a time, which is the current limit on the Export Working Capital Program.

By utilizing the step proposal, the small business would pay their annual guaranty fee and then be allowed to renew their loan under the authorization. At the end of the three year period, a new authorization could be obtained and that loan would then be able to pay off the existing working capital loan.

Combined, this reform has the potential to greatly reduce the administrative burden of all working capital loan programs and encourage further adoption amongst lenders.

The financing needs of exporters within the United States varies from region to region, and the working capital programs supporting those companies should reflect that. While there is certainly some overlap, the profile of an exporter in the Midwest will vary from those in South Florida. Therefor I believe the focus should be on developing a flexible suite of working capital programs that allows the SBA to support all exporters with equal support.

With so much of the SBA world driven by commissions derived from secondary market sales, SBA working capital programs should both be thought of and structured independently from the term loan guaranty programs. With no way of deriving a commission from the sale of the guaranty, the lenders involved with the working capital programs often have different motivations from those active under other SBA term loan programs.

I greatly appreciate the opportunity to outline my thoughts before this Committee. The SBA's export loan programs are exactly what the nation's exporters need in order to succeed internationally. My hope is that a series of modest revisions to the working capital programs would increase the number of active lenders and ultimately the number of exporters served by them.