INDEPENDENT COMMUNITY BANKERS of AMERICA

Testimony of

Cynthia Blankenship
Vice Chairman/COO, Bank of the West

On behalf of the
Independent Community Bankers of America

Before the

United States Senate
Committee on Small Business and Entrepreneurship

Hearing on
"The Impact of the Credit Crunch on Small Business"

April 16, 2008
Washington, D.C.

Testimony of

Cynthia Blankenship
Vice Chairman/COO, Bank of the West

On behalf of the
Independent Community Bankers of America

Before the

United States Senate
Committee on Small Business and Entrepreneurship

Hearing on
"The Impact of the Credit Crunch on Small Business"
April 16, 2008
Washington, D.C.

Mr. Chairman, Ranking Member Snowe, and members of the committee, I am Cynthia Blankenship, Vice-chairman and Chief Operating Officer of Bank of the West in Irving Texas. I am also Chairman of the Independent Community Bankers of America.[1] I am pleased to have this opportunity to present the views of the nation's community bankers on the credit markets and small business lending. Community banks are independently owned and operated and are characterized by personal attention to customer service and lending to small business.

ICBA represents 5,000 community banks throughout the country. Bank of the West is part of a two-bank holding company with assets of $250 million. We have eight locations in the Dallas/Fort Worth metroplex. We serve the small business community with a strong focus on SBA lending and real estate. The other institution in the holding company is the Bank of Vernon with assets of $30 million located in Vernon, Texas which is an agricultural community.

Bank of the West has been a long-time partner with the Small Business Administration and has been strongly committed to helping small businesses in our communities using the SBA 7(a) and 504 loan

[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

programs. Bank of the West has more than $8 million in SBA loans in its portfolio, and it services these loans. This represents nearly 5% of our total loans.

Summary of Testimony

Credit fuels our economy and the broad credit markets are still sorting out many problems. The current turmoil in our economic and financial markets nationwide raises genuine concerns about the availability of needed capital and credit for small business. As the Administration and Congress continue to address the problems in the housing and housing finance sectors, policymakers must also focus on the needs of the small business sector during this economic slowdown. At a time when the economy is faltering, a sharp decline in the number and dollar amount of Small Business Administration loans is troubling. The SBA loan programs should act to bolster small businesses credit in economic slowdowns. Instead, the number of SBA loans being made is plummeting.

Against the long-term protests and advocacy of the community banking sector, sharp increases in SBA loan fees, reduced budget funding and staff, the elimination of the successful "Low-Doc" program, and increasing regulatory burdens all have hobbled the SBA's viability when it is needed most. Simply stated, costly and negative changes to the SBA loan programs in recent years have forced hundreds of community banks to drop out of the SBA programs while a handful of the nation's largest banks further dominated SBA lending. While there are more then 8,500 FDIC insured banks, just ten large banks made nearly 60 percent of all SBA loans. The top 25 banks originate nearly two-thirds (67%) of all SBA loans. This gross imbalance is a recipe for problems.

Unfortunately, many of the these largest financial players have tripped-up on toxic investments and sub-prime lending and have been forced to pull in their lending across the board -- including small business and SBA lending. Conversely, despite the dominant media coverage about a "credit crunch," common-sense community bank lenders are very much alive and well with capital to lend to small businesses.

However, the high fees and other program structure obstacles associated with SBA programs must be reversed to preserve the affordability and workability of SBA lending for banks and small business borrowers alike. Additionally, bank regulators will insist on tightening lending standards across the board during this economic slowdown. Given the declining employment numbers and troubled credit markets, small business access to capital is critical to keeping the economy's gears turning. To that end, SBA programs should serve a critical role. They supply nearly one-third of the long-term capital to small business. Now more than ever it is vital that SBA program be robust. However, a sharply declining number of SBA lenders and loans is the disturbing trend we see. The ICBA respectfully offers several recommendations to help boost SBA programs most widely used by lenders and small businesses in this challenging economic climate. These recommendations include:

- The Small Business Administration should offer a "Super SBA 7(a) loan program" for one year as an economic stimulus to help small business access needed capital. ICBA's nine-point economic stimulus plan advanced to Congress in January recommends a "Low-Doc," expedited 7(a) loan program with a 85% guarantee, and lender and borrower fees reduced to half of their current level for small business loans up to $250,000.

- Restore a reasonable budget appropriation of $250 million to help offset and lower the recent sharp fee increases on both 7(a) lenders and borrowers.

- Quickly enact the pending SBA reauthorization legislation and improvements in the "Small Business Lending Reauthorization and Improvements Act," (H.R. 1332 & S. 1256).

- Quickly enact the "Small Business Lending Stimulus Act of 2008," (S. 2612) that would lower SBA loan fees similar to the successful policy implemented to help the economy and small businesses post "9-11."

- Boost the SBA budget which has been cut nearly in half in the past six years.

- Permanently reinstate the successful SBA "Low-Doc" program to better meet the needs of small business borrowers.

- Reinstate the availability of combination ("piggyback") financing to help serve small businesses with larger borrowing needs.

- Apply additional SBA budget resources to better staff and support regional SBA offices to serve the thousands of non-PLP, non-CLP community lenders available to deliver SBA loans to deserving small businesses nationwide.

Small Business is Vital to Economic Strength

Small businesses are vital to the strength of our economy and employment. Small businesses represent a whopping 99% of all employer firms and employ half of the private sector workers. There are more than 26 million small businesses in the U.S. Small businesses have created 70 percent of the net new jobs over the past decade. Community banks are essential to the strength and success of small businesses nationwide. Community banks like Bank of the West specialize in small business relationship lending. Community banks stick with their local communities and small business customers in good times and in bad. Notably, for their size, community banks are disproportionately large small business lenders. While community banks represent about 12% of all bank assets, they make 20% of all small business loans.

Because small businesses are integral to our economic strength, ICBA believes it is urgent to properly meet the credit needs of small businesses as the economy has softened and employment levels have declined for three straight months. The Federal Reserve has taken unprecedented actions to slash interest rates, provide liquidity, and recently put $29 billion of private sector assets on its (taxpayers') balance sheet to assist large financial firms JPMorgan Chase and Bear Stearns and to keep the credit markets functioning. GDP growth slowed to a minuscule 0.6 percent in the fourth quarter of 2007. Unemployment has jumped to 5.1 percent in March as a result of three consecutive months of declining payroll jobs. Small business optimism is plummeting and credit availability is a genuine concern. In March, the National Federation of Independent Business index of small-business optimism dropped to its lowest level since it began this survey in 1986. Soaring energy costs are challenging many small business budgets and profit margins. The January Federal Reserve senior loan officer opinion survey shows that large banks continue to tighten lending standards for households and businesses. The report is discouraging as tighter lending standards will reduce the availability of credit for small businesses and work to further weaken a struggling economy. Therefore, the federally guaranteed SBA loan programs should work to counter tightening credit markets and help provide funding to small businesses in this more difficult economic climate when they need the program the most. Declining SBA loan volume tells us it is not.

SBA Lending Invaluable

The SBA loan programs are a success story where thousands of small businesses that otherwise would not have had access to capital are funded. However, recent budget cuts, sharp fee increases on both lenders and borrowers, and the elimination of the successful Low-Doc program have undermined the full potential of the SBA loan programs. These and other negative changes have caused a disturbing decline in the number of community lenders actively participating in the SBA loan programs. Today, just the top 10 SBA lending banks make nearly 60 percent of all SBA loans. This in turn jeopardizes the ability of interested community lenders to reach a wide variety of deserving small business borrowers and geographic areas with affordable and flexible SBA loan programs.

Banks could be extending more SBA loans to meet the needs of small businesses during this economic slowdown. However, the number of SBA loans is actually falling sharply. As of the end of March 2008, the year-over-year number of SBA 7(a) loans was down more than 17% and the dollar amount down nearly 9 %. The SBA 504 loan program is also in decline. This is unacceptable if the SBA program is to properly support small business lending needs and bolster economic strength. We need more small business lending not less.

Community Banks are Strong Supporters of SBA Lending

Bank of the West strongly supports the work of the Small Business Administration and actively participates in the SBA's lending programs, specifically the flagship 7(a) and the 504 loan programs.

Community lenders like Bank of the West are proud to work with the SBA in helping supply needed capital to small businesses across our nation, especially now when the economy is weak and many large, money-center banks are cutting back sharply on small business lending. Whether located in small towns, suburbia or big city neighborhoods, community banks grow our towns and cities by funding small business using local dollars. Community banks are one of the key sources of credit and other financial services to small business, the most prolific job creating sector of our economy.

Community-based banks form the building blocks of our nation's communities by providing small business capital and credit to all geographic regions of the country. They have played a vital role in the stability and growth of each of the fifty states by providing a decentralized source of capital and lending. This wide dispersion of our nation's assets and investments helps preserve the safety, soundness, fairness, and stability of our entire financial system.

I want to make it very clear that the SBA guarantee loan programs are unique and extremely valuable in providing needed long-term capital to small business. The SBA loan programs truly represent a success story of how the federal government, working with private sector lenders, can fund small businesses that otherwise would not have had access to capital. The SBA 7(a) loan program provides 30 percent of all the long-term small business lending.

SBA Loans Serve Unique Role

Lenders need to match short-term deposits with short-term small business loans. While the typical commercial small business loan has a maturity of one to three years, SBA 7(a) loan maturities average 12 or more years. Importantly, SBA lending allows longer loan terms up to 25 years. This lowers the entrepreneur's loan payments and frees up needed cash flow to start or grow the small business. As small businesses do their best to weather the current difficult economic climate, the longer loan term offered by an SBA loan is a huge help.

The SBA 7(a) and 504 guaranteed loan programs serve a unique role in providing an alternative means for entrepreneurs to access capital where funding is not available through conventional lending methods. Therefore ICBA believes the economic slowdown and greater credit-risk aversion in the credit markets should be fostering a stronger demand for guaranteed SBA loans. Unfortunately, small business SBA loan volume is declining sharply. This is aggravating the economic problems and only validates the importance of ensuring a more robust Small Business Administration with affordable and workable loan programs for a wide range of lenders and borrowers. Thriving small businesses are exactly what is needed to turn this economy around and to boost payroll and business income tax revenue back to federal, state and local government. Small businesses are critical to supporting a tax base.

Like thousands of community banks across our nation, Bank of the West is doing its part to support our local economy with small business lending and is dedicated to the success of small business and the community. Bank of the West has facilitated more than $8 million in SBA loans in our local communities. These SBA loans create hundreds of jobs by financing the local preschool, health center, hardware store, or auto dealer. Bank of the West has dedicated half of our bank facility lobby to a small business center where our customers can come in and get online to place orders or use our conference room to meet with their clients. We work intimately with our small business customers. For example, Bank of the West counseled a local entrepreneur, assisted with a business plan, and facilitated a SBA loan for a small salon. Today, the SBA loan has been paid off and the successful salon employs 20 people.

With small business development one of the fastest growing segments of our changing economy, the demand for small business capital will only increase. The demand for SBA 7(a) and 504 loans will increase as well and it is critical to ensure these programs are best suited for meeting the needs of small business. However, ICBA believes recent changes to the budget and loan programs are causing the SBA to fall far short of its ability to facilitate affordable small business capital.

Disturbing Decline in the Number of Active SBA Lenders

Despite the growing need for small business capital, the SBA loan programs have been harmed by recent policy changes. In recent years, many community banks have found it much harder, not easier, to provide needed capital to small businesses through the SBA loan programs. Notably, the number of lenders that have made at least one SBA 7(a) loan has dropped almost in half from 5,288 in 2001 to less than 2,700 today. This is a disturbing trend.

Also troubling is the fact that many of the large financial institutions that consumed the lion's share of the SBA loan programs are the same banks that are struggling under the sub-prime mess and unable to continue the same level of SBA lending at this critical economic time. The majority of our nation's commercial banks are community banks. The geographic dispersion of community banks around the country fosters a financial system where money and resources are made available not only in large urban areas, but in suburban and rural areas as well. That is why it is perplexing to note that the top 25 SBA lenders eat up two-thirds of the SBA's 7(a) loans with just 10 big lenders making more than 55 percent of the loans. ICBA does not believe Congress intended the SBA loan programs to be functional for only a handful of the nation's biggest financial entities. ICBA urges that SBA programs be allowed to work for as many interested lenders as possible in many geographic areas to best meet the needs of small business borrowers.

During his Congressional confirmation hearings, the new SBA Administrator Steven Preston stated:

> *Ultimately, the SBA must serve its constituents in a way that is responsive to their needs and responsible to taxpayers. If nonparticipation from smaller and community banks in SBA programs results in small businesses not being able to benefit from its programs, it will be critical for me to get to the heart of the issue and address it.*

Community bankers run small businesses themselves, live and work in the communities with their small business customers, and will do everything possible to ensure they can support the credit needs in these more difficult economic times. SBA lending is an important part of this equation. ICBA wants to help identify ways to have more interested lenders be able to successfully leverage the SBA loan programs to serve a wide range of small businesses in as many geographic locations as possible.

SBA Programs have been Hurt in Recent Years

The sharp drop-off in active SBA lenders has been the result of a combination of discouraging factors that has undermined the community banking industry's ability to participate. These damaging changes include sharp SBA budget cuts, the elimination of any appropriations for SBA 7(a) loan programs, increased lender and borrower fees, the elimination of combination or "piggyback" financing, reduced staffing and service from local SBA offices, lower loan guarantee levels, as well as the elimination of popular loan programs such as "Low-Doc."

Chairman Kerry, and Ranking Member Snowe, the ICBA appreciates your strong support for the popular and successful "Low-Doc program. In fact, you wrote to, petitioned, and directly requested the Small Business Administration at your committee hearings not to end the Low-Doc program. You specifically urged the SBA to work with Congress to strengthen the Low-Doc program rather than terminate it. Unfortunately, the SBA unilaterally ended the Low-Doc program and as a result, hundreds of SBA lenders dropped out of making any SBA loans altogether because of lower loan guarantees, higher fees, and greater paperwork burdens.

ICBA sincerely appreciates your leadership and efforts, Chairman Kerry, in holding this important hearing to help get the SBA loan programs back on track at this difficult time for small business borrowers and lenders. We fully support your "Small Business Lending Stimulus Act" legislation (S. 2612) that will lower SBA loan fees similar to the successful policy implemented to help the economy and small businesses post "9-11." We believe this will allow more lenders to facilitate SBA loans so that more small businesses can get the funding they need to be successful and jumpstart economic activity.

Small Business Access to Capital is Key to Economic Growth

As small businesses represent a large and growing share of our economic well-being, the sharp budget cuts the SBA has suffered in recent years have come home to roost in this challenging credit market. We cannot shortchange SBA lending and small business needs without consequences, especially when the economy softens. Small businesses employ more than half of the private sector workforce and produce more than 50 percent of the nonfarm private sector Gross Domestic Product. Small businesses are responsible for two-thirds of all the net new jobs being created. Given the significance of small business growth to our economy, this is no time for the SBA loan programs to be in a sharp decline. The need for affordable small business capital is greater today than ever.

However, we have witnessed sharp SBA budget cuts in recent years. The SBA budget proposed for fiscal year 2009 is a tiny 0.02 percent of the proposed federal budget. In fact, the SBA's non-disaster program budget is about half of what it was in 2001. While there are efficiencies with new technology that can be achieved, when an agency's budget is nearly cut in half, the service and functionality of its programs will suffer. This was most evident in the troubled SBA disaster lending response after the Gulf Coast hurricanes. We don't want to witness a similar fate now in the SBA 7(a) and 504 loan program as loan volumes decline just when credit is needed most. If stimulating our troubled economy and supporting our nation's small businesses is a priority, we urge that more, not less, budget resources be allocated for the SBA and its proven lending programs.

Restore 7(a) Appropriation and Lower Steep Fees

An ongoing major concern of the community banking industry has been the elimination of the long-running appropriation for the SBA 7(a) loan program that was as much as $115 million in FY2001. As a result of the elimination of any appropriation for 7(a), the lender and borrower fees have been increased sharply and continue to increase under the "zero-subsidy" model. With no appropriated money, more and more Small Business Administration costs are being passed on to the lenders and borrowers. When the appropriation was being eliminated with the blessing of the SBA, the SBA officials assured concerned lawmakers, lenders, and small business groups the program would be better off. Today, with declining loan volumes and far fewer SBA lenders, the evidence is clear that this is not the case. Community lenders have been forced to drop out of the program, and a greater concentration of SBA loans have gone to a handful of the nation's biggest banks where many are embroiled in their own capital difficulties and unable to meet the SBA borrowing needs of small business.

With higher fees, many deserving entrepreneurs that were on the margin of obtaining a 7(a) loan are no longer able to afford such financing. This has the effect of shifting the delivery of SBA 7(a) loans further away from the fundamental mission of reaching deserving small businesses in greatest need of inexpensive, guaranteed financing. ICBA believe the decline in the number of SBA lenders and the shrinking of average loan size has left many small businesses with less capital to grow their businesses and create jobs.

For smaller SBA loans, today's higher fees can translate into nearly $1,500 to $3,000 more in upfront closing costs for entrepreneurs. The added costs from today's higher fees can be up to $50,000 for larger small business loans. Higher fees only discourage the very type of small business borrowers the SBA guaranteed loan programs were intended to reach from accessing needed capital during difficult economic times.

The House of Representatives has repeatedly acted to address the higher SBA loan fees by restoring an appropriation for the 7(a) program. On a *bipartisan* basis, the House has successfully passed an appropriation several times to help offset higher fees, only to be thwarted in the final budget for SBA loan programs. The appropriation for 7(a) had the support of some 20 small business groups nationwide and was not opposed by any small business group.

In order to help improve the SBA 7(a) loan program, ICBA again urges Congress to restore an appropriation for the 7(a) loan program. Any appropriation should be applied proportionally to reduce the lender and borrow fees. This will help bring back a greater number of community bank lenders into the SBA loan programs and deliver more SBA loans to deserving small businesses in local communities across America. SBA has claimed the appropriation exposes the SBA program to a shut-down scenario should the appropriation be delayed or not approved. This is not correct. There should be absolutely no reason to shut down the 7(a) loan program as SBA has done in the past due to the timing of any Congressional appropriation. The existing program fees can be set to continue to fund the program and any subsequently appropriation can be applied to adjust these existing fees.

Restore "Low-Doc" Program

With the fallout from slashed SBA budgets, the elimination of any 7(a) appropriation, and higher loan fees to compensate, something had to give. Unfortunately, the popular and successful low documentation or "Low-Doc" program was eliminated in an attempt to contain sharply rising fees under a system without any 7(a) appropriation. Frankly, the name "Low-Doc" may be a misnomer. While the SBA Low-Doc application may be streamlined, bank regulators would strongly criticize the bank if its loans were not adequately and thoroughly documented. Lenders still have to perform due diligence and approve all Low-Doc loan requests prior to the SBA's additional review and approval. So despite the streamlined application, lenders will still require enough data to fulfill their need to thoroughly evaluate a loan request based on their own credit policy.

The Low-Doc program worked extremely well for many small business borrowers and served an important niche for lenders making a small number of SBA 7(a) loans. The Low-Doc program especially enabled small and rural-based lenders to participate in the 7(a) program. Low-Doc worked well for community banks that were not in the Preferred Lender Program (PLP) or Certified Lender Program (CLP) yet had considerable small business lending experience. In many towns served by community banks, where the population may be under 3,000, a small number of SBA Low-Doc loans makes a big difference in the local economy.

Terminating the successful Low-Doc program eliminated an important choice for small businesses seeking affordable capital. The end of Low-Doc further pushed SBA lending into a one-size-fits all program. The SBA Express program, often touted as a substitute for Low-Doc, provides only a 50 percent guarantee versus the Low-Doc's 80 percent guarantee. SBA Express program was pitched as a better fit for borrower needs but is not a viable substitute for Low-Doc. The 50 percent guarantee under an Express loan is often not enough to rely on for a new start-up business to qualify for financing, so in the end, entrepreneurs suffer the fallout. The SBA Express program is down

27.9 % in number of loans and 22.6% in dollars year-over-year as of March 2008. The lesson here is that SBA 7(a) lending should not be allowed to morph into a one-size-fits-all, cookie cutter program that works only for a limited number of big bank lenders and limited small business needs.

The end of the popular Low-Doc program in turn led to the greater concentration of SBA loans in the largest lenders. The top ten lenders account for nearly 60 percent of all SBA loans. ICBA believes the small business borrowers are best served if the loan programs are workable for a broad array of lenders and in many geographic areas across America, both urban and rural. The SBA 7(a) loan program should be allowed to work well for lenders making 10 loans or 10,000 loans.

Reinstate "Piggyback" Financing

The ICBA requests that the successful use of combination ("piggyback") financing be restored as an option for SBA lenders. SBA suspended this valuable lending option in 2004. Piggyback financing provided lenders with greater flexibility in meeting the financing needs of small businesses, especially small businesses in need of greater financing levels.

Once again, adding more flexibility to SBA lending will avoid the one-size-fits-all problem that prevents deserving small businesses from accessing affordable capital. Ironically, this combination loan structure is quite similar to the loan structure provided in the successful SBA 504 program on mortgage lending. Reinstating piggybacking financing will prevent the unfortunate result where many small businesses with larger loan needs are being completely shut out from accessing financing through the 7(a) program.

SBA Needs Staff

The proposed FY 2009 SBA budget falls far short of reversing the dramatic budget cuts the SBA has suffered in recent years. ICBA request that SBA increase agency staffing and increase the number of satellite SBA offices. SBA budget cuts and the elimination of regional offices and staffing are why many lenders have found the SBA program less responsive and more difficult to navigate. Having huge SBA processing offices in Fresno or Sacramento, California may serve the needs of some lenders. However, if SBA programs are to work best, minimize risk and facilitate proper oversight, it is also important that SBA officers be located closer to where lending is taking place to be familiar with local business conditions.

ICBA recommends that additional budget staffing resources be allocated in part to assisting the thousands of non-PLP lenders serving small business needs. This can help reverse the decline in SBA participating lenders and help meet the needs of many more businesses seeking SBA funding nationwide.

Conclusion

America's small businesses are facing difficult economic times and accessing needed credit is getting more problematic. As policymakers work on ways to stimulate the economy and strengthen credit markets, small business credit needs and SBA lending should be front and center in the debate. Given the importance of small businesses for job creation and economic strength, the plummeting levels of SBA lending is cause for alarm. Community banks like Bank of the West are well-positioned and prepared to help. However, lenders and borrowers need the SBA programs fees to be reasonable. The ICBA pledges to work with the Small Business Committee to ensure our Nation's small businesses have the access to capital and credit they need to invest, grow, and to provide jobs and continued economic growth. ICBA will continue to urge Congress and the Administration to adequately fund the Small Business Administration and the successful 7(a) and 504 loan programs.

Today's changing economic environment is a time to strengthen small business resources and build upon the successful SBA loan programs. Providing needed capital resources to small businesses through broad community bank participation in SBA lending will help strengthen economic growth and foster greater job creation. ICBA sincerely appreciates the opportunity to testify today on the important issue of available small business capital and lending. Thank you.