



CUNA & Affiliates

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WRITTEN TESTIMONY

OF

**ROGER HEACOCK
PRESIDENT AND CEO
BLACK HILLS FEDERAL CREDIT UNION
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION**

**BEFORE THE COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES**

**“Laying the Groundwork for Economic Recovery: Expanding Small Business
Access to Capital”**

JUNE 10, 2009

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Chairwoman Velazquez, Ranking Member Graves, and Members of the Small Business Committee, thank you very much for the opportunity to testify at today’s hearing on “Laying the Groundwork for Economic Recovery: Expanding Small Business Access to Capital” on behalf of the Credit Union National Association (CUNA). CUNA is the nation’s largest credit union advocacy organization, representing over 90% of our nation’s approximately 8,000 state and federal credit unions, their State credit union leagues, and their 92 million members.

My name is Roger Heacock, and I am President and CEO of Black Hills Federal Credit Union in Rapid City, South Dakota. Our field of membership includes businesses located in and individuals, who live, work, worship, or attend school in Pennington, Custer, Fall River, Lawrence, or Meade Counties in South Dakota.

I am honored to be here to speak to you about the impact that SBA lending has on our local economy, to our credit union and most importantly to our members, and to suggest ways to improve SBA programs.

I would also like to note that CUNA President Dan Mica appreciated being among those at the White House March 16 when President Obama announced his Small Business Lending Initiatives, and we are looking forward to working with new SBA Administrator Karen Mills, who has already undertaken steps to revitalize the agency.

Black Hills FCU’s Experience with the Small Business Administration

Black Hills FCU was first authorized to do SBA lending in January 2003, and we truly value our partnership with the SBA. In May 2009, Black Hills FCU received the District Director's Leadership Award from the South Dakota SBA. Black Hills FCU wrote more SBA loans in the state of South Dakota than any other financial institution during 2008—29 SBA loans for a total of \$1,644,400, which is an average of \$56,703 per loan.

We find working with the SBA beneficial to the credit union and our members for several reasons.

SBA Programs Are Particularly Helpful for Start-up Businesses

First, our relationship with the SBA gives us the opportunity to serve our members who are interested in starting their own businesses. We have a number of members that started small businesses, using SBA loan funds, while continuing to work at their primary job as their main source of income. Many of these businesses started out in their home or garage, and as their small business slowly began to grow, they were able to move their business to a bigger location and were able to quit their job. The business matured and we were able to help them out. The SBA helped us be there for our members.

There is additional risk to these types of borrowers and, quite frankly, other lenders shy away from helping them because there is not a proven cash flow with these borrowers. We are able to lend to this type of borrower because of the guarantee that SBA provides. The programs allow us to help the borrower who comes in and may not have the equity investment we would generally like to see, but has a good business plan. We looked to the SBA to help us create an acceptable level of risk and it was a win-win situation for all of us – the Credit Union and the SBA and the borrower.

As a result of our ability to make these small loans to start-up businesses, we have seen these businesses grow, and that has resulted in additional employment opportunities, even during these difficult economic times.

Excellent Support from Small Business Development Centers and Our District Office

We find we receive excellent support from the Small Business Development Center, an affiliate of the SBA. When someone comes into the credit union inquiring about an SBA loan, we often refer them to the SBDC because they have people with expertise that can work with the borrower to develop the business plan, complete cash flow projections, as well as pro forma income statements and balance sheets. We accept documents from the SBDC as part of our review plan, and it facilitates the application process and increases the member's probability of being approved for a loan.

In addition, we also have an excellent relationship with the South Dakota District Office in Sioux Falls. We can generally call or e-mail them with a question or a concern and they get right back to us. And, if there is a question that they cannot answer, they will refer it to the national level. They give us direction and guide us on certain programs processing and servicing issues. This level of service is ultimately advantageous for the borrower. They are just very supportive. I cannot say enough about the SBA District Office here in South Dakota on the SBA and how supportive they have been for us.

SBA Supports the Borrower

The SBA seems to approach its mission from a similar perspective as we approach our lending—with the borrower as the primary focus. When there is a problem, the SBA, in our experience, has been open to work-out solutions. They do not pressure us to liquidate the borrower. They want to work with us and the borrower on a solution to bring the business back to a state of financial health. In many respects, the approach we have found the SBA takes with problem loans is consistent with the credit union spirit. Instead of asking, "What's the best way to cut our loss," they ask, "What's the best solution?"

CUNA is aware that some lenders, including some credit unions, have not had such a good relationship or positive experience with the SBA. In addition to the barriers presented by the statutory credit union member business lending cap, credit unions also identify the application process, fees, timeliness of decision-making and difficulties with SBA district and central offices as reasons that they either do not participate in SBA programs, or do not do more SBA lending. In that connection, we think there are ways to improve the work that is done by the SBA.

Maintain or Lower Fees

CUNA strongly supports legislative initiatives to reduce the SBA fees and has advocated for the highest possible appropriation in order to keep SBA programs even more beneficial to small business and accessible to credit unions. CUNA believes that the greater the number of available sources of credit to small business, the more likely a small business can secure funding and contribute to the nation's economic livelihood.

We encourage Congress and the SBA to maintain or lower fees because cost has become a major obstacle for the small entrepreneur. We greatly appreciate Congress setting aside \$375 million for the temporary elimination of fees on SBA-backed loans and raising SBA's guarantee percentage on some loans to 90 percent, as part of the American Recovery and Reinvestment Act of 2009. This additional assistance is available until the end of the year or whenever the funds are exhausted, whichever comes first.

As the Committee reviews SBA programs, we encourage Congress to make additional funds available to the agency so that fees can remain low and the guarantees can remain generous. SBA fees have a direct impact on small businesses' ability to borrow under SBA programs. A 3% fee on a \$200,000 SBA loan is \$4,500 that the business must pay either at origination or over the course of the loan. The fees can become an obstacle for us as a lender when we are working with a borrower.

Improvements to the SBA's Electronic Communication and Application Systems

We encourage the SBA to develop an email notification system for lenders in order to improve communications regarding procedural changes. Currently, we are not notified when the SBA makes procedural changes to its programs. Lack of notification opens us up to exposure because we are operating under a certain set of rules that has changed without our knowledge—if we do not follow the proper procedure, we may not get the guarantee if the loan goes bad. This could be avoided if lenders were made aware of changes in procedure at the SBA.

While this certainly is not a suggestion that requires a legislative fix, we would also encourage the SBA to continue to make improvements to the agency's website aimed at making it more user-friendly to both lenders and borrowers. Many of the forms that we are required to use are not up-to-date on the website.

Additionally, we encourage the agency to find ways to improve its E-Tran system. While we appreciate the goal to make the application process more efficient, as it has currently been implemented, we find it to be more time consuming. The application pages are difficult to complete, and errors on the application are easier to make and harder to correct using the system.

The Size of Eligible Business

The SBA has adopted an interim final rule that will revise the size criteria for a small business eligible for a 7(a) loan; the rule took effect on May 5, 2009. In addition to the current size limit, the new rule will allow a small business to be eligible if it has a tangible net worth of up to \$8.5 million and average net income after federal taxes of up to \$3 million. SBA estimates about 70,000 businesses would meet the new criteria. While the new size standards will end September 30, 2010, we support this initiative as a very positive step to help boost the small business community and the broader economy.

Credit Union Involvement in SBA's 7(a) Loan Program

CUNA is a strong supporter of the 7(a) loan program, which provides America's 26 million small business owners with the capital and technical assistance needed to start and expand their businesses. We view the 7(a) program as an essential tool for achieving the credit unions' mission of serving all the credit needs of members, particularly low-to middle-income individuals and groups living in communities that are not adequately served by other traditional financial institutions.

CUNA strongly encourages our members to make use of the 7(a) program. Yet, while the number of credit unions participating has increased, currently, less than 3% of all U.S. credit unions offer SBA loans to their members. Larger credit unions are more likely to be involved with SBA loans, and with business lending generally. About 28% of credit unions with more than \$500 million in assets offer 7(a) business loans. And, while the number of credit union 7(a) loans has grown steadily since 2003, such loans represent only a small portion (1.6%) of all business lending to credit union members.

Several important factors discourage larger numbers of credit unions from participating as 7(a) lenders. First the statutory cap on credit union member business lending (MBL), which is

discussed in detail below, restricts the ability of credit unions offering MBLs from helping their members even more, and discourages other credit unions from engaging in business lending. Even though the cap does not apply to SBA loans, it is a real barrier to some credit unions establishing an MBL program at all. That is because not all loans fit SBA parameters and credit unions are reluctant to initiate an MBL program when they may reach the cap in fairly short order.

A second factor limiting credit union participation has been SBA policies that, until 2003, limited credit union eligibility to participate in the 7(a) program only to credit unions with geographic or community charters. Since the number of credit unions with community charters still represents a small percent of all credit unions, this severely limited credit union access to the program. Fortunately, SBA issued a revised legal opinion on February 14, 2003, removing restrictions on the types of credit unions eligible to participate as 7(a) lenders.

While SBA's 2003 policy change was good news for credit unions, it may prove to be even more important for small businesses. In 2005, an SBA research publication noted that large bank consolidation is making it more difficult for small businesses to obtain loans.¹ Given the fact that the average size of a credit union member business loan is approximately \$216,000, and the average credit union SBA 7(a) loan is approximately \$73,000, this is a market that credit unions are well suited to serve. And this is a market that credit unions are eager to serve.

¹ Small Business Administration. The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks. March 2005.

Credit Union Member Business Lending

Madame Chairwoman, you undoubtedly hear a lot of rhetoric surrounding credit union member business lending. However, please allow me to paint a picture of the member business loan (MBL) activity of credit unions.

As noted above, member business loans that credit unions provide their members are relatively small loans. Nationally, credit union business lending represents just over one percent (1.06%) of the depository institution business lending market; credit unions have about \$33 billion in outstanding business loans, compared to \$3.1 trillion for banking institutions.² In general, credit unions are not financing skyscrapers or sports arenas; credit unions are making loans to credit union members who own and operate small businesses.

Despite the financial crisis, the chief obstacle for credit union business lending is not the availability of capital—credit unions are, in general, well capitalized. Rather, the chief obstacle for credit unions is the arbitrary statutory limits imposed by Congress in 1998. Under current law, credit unions are restricted from member business lending in excess of 12.25% of their total assets. This arbitrary cap has no basis in either actual credit union business lending or safety and soundness considerations. Indeed, a subsequent report by the U.S. Treasury Department found that business lending credit unions were more regulated than other financial institutions, and that delinquencies and charge-offs for credit union business loans were “much lower” than that for either banks or thrift institutions.³

The cap is overly restrictive and undermines public policy to support America’s small businesses. It severely restricts the ability of credit unions to provide loans to small businesses at a time when small businesses are finding it increasingly difficult to obtain credit from other types of financial institutions, especially larger banks.

The cap not only restricts the credit unions that are engaging in business lending and approaching their limit, but also discourages credit unions who would like to enter the business lending market. The cap effectively limits entry into the business lending arena on the part of small- and

² All financial data is March 2009. Credit union data is from NCUA; Bank data is from FDIC.

³ United States Department of Treasury, “Credit Union Member Business Lending.” January 2001.

medium-sized credit unions—the vast majority of all credit unions—because the startup costs and requirements, including the need to hire and retain staff with business lending experience, exceed the ability of many credit unions with small portfolios to cover these costs.

Today, only one in four credit unions have MBL programs and aggregate credit union member business loans represent only a fraction of the commercial loan market. Eliminating or expanding the limit on credit union member business lending would allow more credit unions to generate the level of income needed to support compliance with NCUA's regulatory requirements and would expand business lending access to many credit union members, thus helping local communities and the economy.

While we support strong regulatory oversight of member business lending, there is no safety and soundness rationale for restricting credit union member business loans as the law currently does. There is, however, a significant economic reason to permit credit unions to lend without statutory restriction, as they were able to do prior to 1998: America's small businesses need the access to credit. As the financial crisis has worsened, it has become more difficult for small businesses to get loans from banks, or maintain the lines of credit they have had with their bank for many years.

A growing list of small business and public policy groups agree that now is the time to eliminate the statutory credit union business lending cap, including the Americans for Tax Reform, the Competitive Enterprise Institute, the Ford Motor Minority Dealer Association, the League of United Latin American Citizens, the Manufactured Housing Institute, the National Association of Mortgage Brokers, the National Cooperative Business Association, the National Cooperative Grocers Association, the National Farmers Union, the National Small Business Association, the NCB Capital Impact, and the National Association of Professional Insurance Agents.

We hope that Congress will eliminate the statutory business lending cap entirely, and provide NCUA with authority to permit a CU to engage in business lending above 20% of assets if safety and soundness considerations are met. We estimate that if the cap on credit union business lending were removed, credit unions could—safely and soundly—provide as much as \$10 billion in new loans for small businesses within the first year. This is economic stimulus that would not cost the taxpayers a dime, and would not increase the size of government. We also support

revising the statutory floor on what constitutes an MBL from the current \$50,000 to a more realistic level of \$250,000.

Madame Chairwoman, thank you very much for convening this hearing and inviting me to testify. I look forward to answering the Committee's questions.