

Senator Olympia J. Snowe
Chair, Committee on Small Business
Statement Introducing the Small Business Credit Liquidity Act of 2003
October 3, 2003



Mr. President, I rise today to introduce the Small Business Credit Liquidity Act of 2003, and I am pleased to be joined by my colleagues, Senator Pryor and Senator Bond, as sponsors of this bill.

The genesis of this legislation was a proposal made by the Small Business Administration. When the President's Fiscal Year 2004 budget request was transmitted to the Congress this past February, it stated that the SBA was exploring a possible new approach to expand the opportunities of small businesses to access capital markets by facilitating the securitization of non-SBA small business loans (*i.e.*, loans that were not already guaranteed by the SBA). Increasing access to capital is a high priority of small businesses, and has been one of the Committee's priorities throughout its history. We are always seeking innovative ways to increase access to capital for small businesses, while at the same time measuring the cost and risk of loss that the Federal government must incur to facilitate such financing. Accordingly, we recognized the potential benefits of this proposal for small businesses across the nation.

At our roundtable on April 30, 2003, the Committee discussed the idea of the securitization of non-SBA small business loans. The SBA reported that it had been exploring this type of program for some time and thought the idea had considerable merit. The agency was uncertain, however, whether it had the statutory authority to develop and implement such a program, absent legislative authorization. After the roundtable, we consulted with the SBA and with participants in the small business financing industry to determine the program's appropriate elements.

In addition to the support the SBA expressed for the proposal in its budget request, at the Committee's roundtable, and in subsequent discussions with Committee staff, the SBA took other steps to help make the proposal a success. For example, the agency entered into a contract with Dun & Bradstreet and with Fair, Isaacs, Co., to create a credit scoring model for small businesses, similar to individual consumer credit scores, to help small businesses gauge their credit quality. The scoring model will be an important asset to the pooling proposal by providing uniformity of pricing, thus reducing one obstacle to the securitization of non-SBA small business loans. The Office of Advocacy of the SBA has also helped build support for the proposal by publicizing the need to take the foundational steps to build a secondary market for small business loans, rather than later trying to create such a market in one step when economic pressures called for an immediate response.

Support for a program to securitize small business loans has also been advocated by the Board of Governors of the Federal Reserve System. In its September 2002 Report to the Congress on the Availability of Credit to Small Businesses, the Federal Reserve stated that the securitization of small business loans could "substantially influence the availability of credit" to small businesses. The Federal Reserve noted that one primary benefit of a secondary market would be that small business borrowers could enjoy lower financing costs.

In addition to the Federal Reserve report, other studies have shown that small businesses could benefit from an efficient secondary market for small business loans. Several, including the Federal Reserve report, have noted that a primary obstacle to a wide-spread secondary market for small business loans has been the lack of standardized information to evaluate and price small business loans efficiently for resale. As noted, the SBA has exercised foresight by securing the contract with Dun & Bradstreet and Fair, Isaacs to address this problem. With the information provided by this new credit-scoring model, the securitization of non-SBA small business loans will be far more feasible.

With input from the SBA, small businesses, and financial firms in hand, and having considered many studies regarding small business credit and the effectiveness of secondary markets, we included a provision similar to this Act in S.1375, the Small Business Administration 50th Anniversary Reauthorization Act of 2003, which was approved unanimously by the Committee on July 10, 2003.

Working with Senator Pryor and with other colleagues, we endeavored to provide sufficient specificity in the instructions the legislation gives the SBA regarding the pilot program, so as to ensure that the pooling proposal provides the greatest benefit to small businesses in need of capital while limiting risk to the Federal government.

Unfortunately, despite all the hard work and input from the SBA and from other participants in the small business financing industry, some apparently either failed to recognize or understand the benefits for small businesses that exist in this idea that originated with the SBA. In the interest of expediting the passage of S.1375 before the SBA's authorizing legislation expired, I reluctantly removed that provision from S.1375 to focus on those elements of the bill that had to be enacted before the legislation expired. I continue to appreciate the benefits of this proposal, and I am now introducing this provision as a separate bill. With the support this proposal already has, I am confident we can implement this innovative program, and I look forward to the benefits it can provide as we try to assist small businesses to prosper, create more jobs, and pull the economy out of its current doldrums.

Mr. President, the Small Business Credit Liquidity Act of 2003 authorizes the Small Business Administration (SBA) to develop and implement an innovative three-year pilot program to facilitate the securitization of small business loans in order to increase the liquidity of capital available to small businesses. Under the pilot program, the SBA could provide partial guarantees on pools of securitized small business loans that are not otherwise guaranteed by the SBA. The legislation seeks to increase capital available to small businesses, without creating additional risk for the government since the SBA's guarantees would be paid for by fees charged to the financial firms administering the pooling of loans, and thus no appropriations will be necessary.

I believe this pilot program has a great potential to provide increased access to capital on terms that are beneficial to small businesses. The pilot program will also allow lenders, including small lenders such as community banks, to utilize their capital better, and make more loans available to small businesses on better terms, by increasing the liquidity of existing loans.

The pooling structure is based on similar arrangements for home mortgages, credit card loans, and car loans, which have active secondary markets based upon their pooling and securitization. The increased liquidity of loans provided by a secondary market allows lenders to be confident that the loans they make can be sold to investors, so that the lenders can utilize again capital that is otherwise locked into existing loans. In addition, because lenders receive a quick “turnaround” on the loans that they make and then sell to investors, the profit that the lenders receive from the interest rates charged to borrowers becomes less important for the lenders, who can receive a smaller per-loan profit, but increase the number of loans they make, and thereby receive a greater profit. Lenders are thus able to make more loans and to provide better terms to borrowers on those loans.

As Chair of the Committee on Small Business, I realize that access to credit for small businesses is often a challenge. The Committee has consistently found that encouraging more lending to small businesses that have a likelihood to succeed, grow, and create new jobs is a sound national policy. The pilot program takes advantage of the successful example of the prior securitizations of SBA small business loans, and of changes in the investment community, to facilitate lending in the small business community for years to come.

This pilot program is not a departure from the SBA’s current practice of guaranteeing loans and regulating the securitization of those loans. The SBA already regulates the securitization of both guaranteed portions of 7(a) and 504 loans to small businesses and non-guaranteed portions of the same loans. These loans are made both by Federally-regulated lenders and by lenders that are not Federally regulated. In Fiscal Year 2002, the SBA regulated the securitization of \$3.4 billion in government-guaranteed 7(a) loans to small businesses. When the guaranteed portions of the 7(a) loans are securitized separately from the non-guaranteed portions, the SBA is guaranteeing 100 percent of the loan pools.

This bill authorizes a pilot program with a much more modest SBA involvement than is represented by the SBA’s current financing programs. Under the pilot program, financial firms approved by the SBA would pool loans not individually guaranteed by the SBA. These pooling entities would then issue securities offering returns based upon the returns from the loans in the pool. The securities would be rated by a rating agency and sold to investors.

The pooling entities, also known as “loan poolers,” would also offer a partial “first-loss” guarantee to investors on the securities’ returns. If the loans had insufficient returns to pay the expected returns on the securities, the pooling entities’ guarantees would be the first guarantees called into performance to pay investors. The SBA would issue partial, not complete, “second-loss” guarantees on the return from the securities, but not on individual loans within the pool. The agency’s guarantees would thus be available only after the first-loss guarantees offered by the loan poolers are exhausted.

Significantly, the cost of the SBA guarantees will be fully funded by fees paid by the loan poolers, so no Federal appropriations will be necessary. The bill provides that the SBA will adjust the fees required from the poolers under the pilot program annually, as necessary.

The legislation also includes other provisions to ensure that the pilot program will not lead to increased risk or liability for the government. In particular, it caps the SBA's guarantees on any loan pool at a maximum of 25 percent of the value of the securities issued for that loan pool. In contrast, the SBA's guarantees for the 7(a) and 504 loan programs are as high as 90 percent and 40 percent, respectively, of each loan in those programs. Moreover, in the 504 loan program the SBA is in a first-loss position, sustaining the loss of its full guaranteed amount on a defaulted loan before the private lender incurs any loss, whereas in the pilot program the SBA will be in a second-loss position.

In addition, the bill requires that firms licensed as loan poolers adhere to certain standards, such as being well-capitalized and maintaining sufficient reserves. The bill also provides that the SBA will set standards for the licensed poolers and will review these entities annually to verify that they are conforming with SBA requirements. Among the requirements the SBA would establish for such loan poolers would be standards relating to loan delinquency, default, liquidation, and loss rates. If any licensed loan pooler fails to meet the SBA's standards, the SBA may terminate the pooler's participation in the pilot program.

To ensure that the pilot program is initially implemented on a manageable scale, the legislation specifies that no individual loan pool created by a licensed pooler will exceed \$350 million in loans in Fiscal Year 2004, \$400 million in loans in Fiscal Year 2005, or \$450 million in loans in Fiscal Year 2006. The bill also specifies that the SBA's total guarantees under the pilot program will not exceed \$2.1 billion for Fiscal Year 2004, \$3.25 billion for Fiscal Year 2005, or \$4.5 billion for Fiscal Year 2006.

Finally, this legislation requires three separate types of reports to ensure that the pilot program is properly monitored and evaluated. First, the SBA must provide to the Senate and House Committees on Small Business a report detailing the pooling program before it is implemented, and wait 50 days after submitting the report before implementing the program. In addition, the SBA must file with the Congress, in the SBA's Budget Request and Performance Plan, an annual report about the program's performance. To strengthen the on-going oversight of the pilot program, the bill also specifies that the SBA's annual report to Congress will include information about the pooled loans, including delinquency, default, loss, and recovery rates. Third, the GAO is required to study the program once implemented, and report on the program's performance, including any effects the program may have on the 504 or 7(a) programs, before calendar year 2006.

Mr. President, my Small Business Committee has received expressions of support for the pilot program from representatives of thousands of small businesses that believe the program could improve access to capital, and could improve the terms of loans received, for many small businesses, particularly those without significant real estate property to use as collateral. In particular, support for the program has been expressed by minority-owned small businesses and by women-owned small businesses. For these small businesses, which often have less real estate collateral than other small businesses, this pilot program holds great potential for creating capital resources to meet their financing needs.

For instance, a recent study by the SBA's Office of Advocacy, issued in September 2003, reveals that small businesses owned by women are more likely than other small businesses to rely on expensive personal credit cards to finance the business, rather than more traditional types of loans. For these small businesses, an increase in the availability of traditional business loans, with lower financing costs and on terms beneficial to the borrowers, would be a welcome development.

In addition, the same study showed that minority-owned small businesses, in addition to being less likely than other small businesses to obtain credit, were far less likely to obtain their credit from traditional Federally regulated depository institutions, and were more likely to resort to financing their businesses through sources such as family, friends, and acquaintances of the business owners. While this bill does not address subjective lender behavior, it does address the objective cost/profit opportunity presented to a lender by a loan to a small business, including a minority-owned or women-owned small business. If a lender is able to sell a conventional small business loan in an efficient secondary market, the potential downside cost of the loan to the lender (*e.g.*, its default risk) is decreased, and the lender is assured that its capital will still be available for other loans.

Financial firms currently involved in the pooling and securitization of loans issued in the SBA's two primary loan guaranty programs, under Section 7(a) of the Small Business Act ("7(a) loans") and under Section 504 of the Small Business Investment Act of 1958 ("504 loans"), have also expressed their support for the program, and have stated their belief that it will increase small businesses' access to effective capital.

In closing, Mr. President, the Small Business Credit Liquidity Act of 2003 is an innovative approach to a persistent problem for small businesses in this country – access to capital. I believe it has the potential to address this problem for small businesses with effectively no risk to the Federal government. At a time when our small enterprises are helping to lead the country back onto the road to economic recovery, we should be doing all we can to eliminate obstacles facing small businesses, which hold the greatest potential for job creation in America today. This bill is an important step in that direction, and I urge my colleagues to join me in supporting its enactment.

I ask unanimous consent that a copy of the bill and a summary of its provisions be printed in the record following my statement.

Thank you, Mr. President.