

Testimony of

Edward G. Francis

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Small Business Committee

United States House of Representatives

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Chairwoman Velázquez and Members of the Committee, my name is Edward G. Francis. I am Chief Commercial Officer of Hancock Holding Company headquartered in Gulfport, Mississippi. I am pleased to be here today to represent the American Bankers Association (ABA). ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

Thank you for the opportunity to present the ABA's views regarding the effectiveness of disaster lending by the Small Business Administration (SBA) in the aftermath of the hurricanes that struck the Gulf Coast in the late summer of 2005.

Hancock Holding Company, a certified SBA lender, is a \$6 billion, four-bank holding company that has been in existence since 1899. During this tenure, our six CEO's have guided the bank through the Great Depression, Hurricane Camille in 1969, and now Hurricane Katrina. By the afternoon of Monday, August 29, 2005 our management team realized that we had lost our 14-story headquarters building in downtown Gulfport, and that numerous branches along the coast had been

wiped off the map. Many of our branches in the New Orleans area were flooded and would not be occupied again for several months. In addition, we lost our entire computer operations center and our loan and deposit operations shop. Despite all of this devastation, we were able to open some of our branches the very next day to service the needs of our customers.

Even though communications were not available the week after the storm, our associates were nevertheless motivated to show up for work. This is due to the fact that our company's culture is embedded with the notion that we will be the first to open and the last to close after any hurricane. We view banking as a vital service in our communities, much like grocery stores and gas stations. It took weeks before we were able to account for all of our associates, but one by one, and by the grace of God, they were all accounted for and all were willing to do whatever it took to ensure that our customers' needs were taken care of. Many of these associates showed up for work with nothing but the clothes on their backs, having lost everything they owned.

On a personal note, the disaster struck my family particularly hard. From my grandparents, who lived on the Mississippi Gulf Coast, to my parents, brothers and sisters, aunts and uncles, and cousins – all of whom lived in the New Orleans area – we lost a total of 7 homes. Today, we continue to experience first-hand what life is like after Hurricane Katrina. And, like so many other families, we have worked hard to support one another and put the pieces back together again.

In the days after the storm it became very obvious that small business owners had been hit very hard by this disaster. Therefore, we immediately created an outreach program designed to make contact with all of our commercial clients. Our goal was to be sure that they were safe, to better understand their needs, and to get a better grasp of the magnitude of the risk in our portfolios.

Through this outreach program we witnessed a huge demand for loans that were needed for a wide range of purposes such as new equipment, cash for payrolls, and real estate purchases. We also witnessed the entrepreneurial spirit of many small business owners who wanted to take advantage of the cleanup and rebuilding opportunities. Many others wondered whether they would be able to retain their employees and when they could return to their place of business and begin the rebuilding process.

During this time, we immediately recognized the need to partner with the SBA and the economic development organizations of Mississippi and Louisiana. It was evident that we needed to move quickly to help small businesses recover from this disaster. Insurance claims could take months or years to settle – these businesses needed cash immediately. During a series of successive meetings with Hector Barreto (the former head of the SBA) and his staff, we urged Mr. Barreto to develop a plan that would allow banks to make disaster loans with the support and backing of the SBA. Unfortunately, our ideas were never fully incorporated into the SBA's disaster lending program. As my testimony will make clear, the failure of the SBA to allow banks to get more directly involved in disaster lending caused massive delays and backlogs in processing the loan applicants of more than 2 million disaster victims.

The SBA did create the GO Loan program in the aftermath of the Gulf Coast hurricanes, and it proved to be a real help for small businesses. Banks that were already approved Express Loan lenders were authorized to make GO Loans for up to \$150,000. These loans carried an 85 percent government guarantee, as opposed to the normal 50 percent guarantee of the Express Loan program. To date, Hancock Bank has made 68 GO Loans for a total of \$6,193,483, or an average of \$91,080 per loan. However, the cap of \$150,000 has proven to be inadequate for the rebuilding needs of many of our clients.

Frustrated by the slowness of the SBA, both Louisiana and Mississippi developed Emergency Small Business Bridge Loan programs. These loans were 100 percent guaranteed, were interest free, were limited to six-month terms, and had a maximum loan amount of \$100,000. The total pool of available funds was \$30 million for each state. Hancock Bank participated in both of these programs. Needless to say, demand for these loans was incredible and the funding disappeared quickly – demonstrating the need for long-term disaster relief.

The SBA disaster loan program was developed for a very important reason – to provide financial assistance to help homeowners, renters, and businesses of all sizes recover from disasters such as earthquakes, hurricanes, and terrorist attacks. In this capacity, the SBA plays a critical role in bringing the resources of the federal government to bear on individuals and businesses as they seek to reinvigorate their local economies. In fact, the SBA disaster loan program is the primary federal program for long-term private sector recovery, and is the only form of SBA assistance not limited to small businesses.

As important as the SBA's disaster loan program is, the Gulf Coast hurricanes demonstrated that it is not without its flaws. It can, in fact, be significantly enhanced so that the goal of providing financial assistance to disaster victims can be achieved more quickly and efficiently.

In my statement today I would like to make the following points regarding the SBA's lending effectiveness in the aftermath of the devastating hurricanes of 2005.

- ▶ Significant delays and backlogs in processing SBA disaster loan applications resulted from systemic problems in the SBA's disaster lending program, preventing the SBA from efficiently handling the challenges posed by the Gulf Coast hurricanes quickly and efficiently.

- ▶ Banks are uniquely positioned to serve the immediate needs of small businesses and individuals affected by disasters and should be more directly involved in disaster assistance lending.

- ▶ A public-private partnership between the SBA and preferred and certified lenders will result in quick and efficient delivery of disaster loans to the greatest possible number of victims, facilitating a speedy economic recovery for areas affected by disasters.

I will address each of these points in greater detail.

Inherent Problems Prevented Efficient Distribution of SBA Disaster Loans

The hurricanes that ravaged the Gulf Coast in the late summer of 2005 dealt an obvious blow to the people and the economy of the region. According to a recent report by the Government Accountability Office (GAO), Hurricanes Katrina, Rita, and Wilma caused nearly \$120 billion in property damage. Small businesses were hit especially hard – particularly in Louisiana where small firms with fewer than 500 employees comprised more than 50 percent of the state’s non-farm private sector prior to the hurricanes.

Small businesses are the engine of our economy, and capital is the oil that keeps the engine running smoothly. When disaster strikes, the most pressing immediate need is money – money for building materials, for professional waste removal, for wages, and more. Thus, in the aftermath of

the Gulf Coast hurricanes, timely and efficient delivery of disaster recovery loans was, and continues to be, vital for the region's economic recovery. However, several factors combined to prevent the SBA from responding to this need in a timely and efficient manner.

The SBA's disaster loan program is a direct lending program. Loans go directly from the SBA to individuals and businesses at very low interest rates, usually around 4 percent, over a 30-year period. Several steps are involved in the lending process. Applications are pre-screened for acceptability, victims must be evaluated based on their income level and repayment ability, and in some cases losses must be verified. The final stages involve legal review, followed by closing and funds disbursement. A necessary element to the loan processing system is a staff that is experienced in this type of lending.

Under a presidential declaration of disaster, the SBA secures space within Federal Emergency Management Agency (FEMA) disaster recovery centers in order to facilitate distribution of disaster loans. Staff members meet with victims to explain the loan process, distribute applications, and, if requested, assist victims in completing applications.

The GAO report indicates that as of late May 2006, the SBA had distributed more than 2.1 million applications to victims affected by the hurricanes – almost four times the amount distributed after the Northridge, California earthquake in 1994, the single largest disaster the SBA had previously faced. The large volume of loan applications created a pressing need for the SBA to hire additional personnel. In the months following the hurricanes, nearly 2,000 temporary staff members were added to the SBA's rolls.

Hiring temporary staff is not unusual for the SBA. Because of the unpredictable nature of disasters, and the costs associated with keeping people on staff it may not need, the SBA routinely hires and trains temporary staff to help deal with large scale disasters. However, according to the

GAO report, it took roughly 30 days for loan officers without prior SBA experience to become fully productive. Furthermore, the SBA had to secure additional space and equipment to house its increased staff and support loan processing – a process that took somewhere between 30 and 60 days.

Further complicating matters was the inability of the SBA's new Disaster Credit Management System (DCMS), to handle such a high volume of users. According to the GAO report, the SBA began using the new system in January 2005, but established its maximum user capacity based solely on historical data, primarily from the Northridge earthquake. Since none of the available information from catastrophe risk modeling firms or disaster simulations was used, the number of staffers that could access the DCMS system at any one time was limited to a maximum of 1,500 people. This proved insufficient given the large number of loan applications.

The sheer volume of loan applications, the time required to bring thousands of temporary staff up to speed, and the capacity limitations of the DCMS proved too much for the SBA's disaster loan program to handle. Loans that once took 30 minutes to process were taking several hours to complete. Backlogs resulted – peaking at 204,000 applications in late December 2005, according to the GAO report. The report further states that victims waited an average of 74 days for the SBA to process their loan applications. This is a far cry from the SBA's stated goal of processing applications within 21 days.

Some mitigating circumstances help explain the backlog. For example, disaster loans for reparation of physical injury require documentation of property damage prior to disbursement. However, the current level of response is still grossly inadequate. As of July 2006 – nearly a full year after the hurricanes – some 120,000 approved disaster loans had either not been disbursed, or had

only been partially disbursed. The failure to quickly provide disaster assistance has stalled recovery and frustrated reconstruction efforts.

Banks Should Be More Directly Involved in Disaster Assistance Lending

As noted, problems with the SBA's disaster loan program prevent the power and resources of the government from being efficiently used to provide direct lending assistance to disaster victims. A practical solution for preventing this from happening again is to integrate banks more fully into disaster lending.

Banks are well-suited for this purpose. Many are already certified SBA lenders and SBA loans comprise an important part of their lending practice. As such, they are already familiar with the rules and procedures of the SBA and are well-positioned to work with the agency toward disaster recovery. Furthermore, small businesses rely on banks as their primary source of credit throughout the country. In fact, half of the banks in the tri-state region affected by Hurricane Katrina have a quarter of their loan portfolios dedicated to small business lending.

Moreover, banks that lend to small businesses know their clients well. They know the character of the management. Their employees are often neighbors with the employees of the small businesses they lend to. Furthermore, many banks are small businesses themselves. In fact, over one-third of the banks in the tri-state region have fewer than 30 employees. In many instances, the relationships that bankers forge with their small business customers becomes a personal one built on mutual trust and understanding.

Thus, small businesses look to banks operating in their communities for leadership as they seek to grow and thrive, and banks have a vested interest in the continual welfare of their communities. The assistance of federal agencies, including the SBA, is an essential part of disaster recovery. However, once these agencies leave, banks remain. As mentioned previously, it is ingrained in the culture of Hancock Bank that we will be the first to open and the last to close after any hurricane, and we created an outreach program immediately after the disasters so that we could thoroughly assess the needs of our business clients. These efforts are undertaken to ensure that the relationships we have built over the years will not be simply swept away with the tides of disaster. Moreover, while we are proud of our accomplishments, we are certain that Hancock Bank is not the only bank in the region that is dedicated to ensuring the continued vitality of its business customers in the aftermath of the Gulf Coast hurricanes.

In fact, bankers have long been in the forefront of efforts to prepare for, cope with, and recover from disasters. This was never more apparent than in the aftermath of the Gulf Coast hurricanes. Bankers not only made financial services available, they provided humanitarian aid and ongoing support for individuals, families, and businesses that were struggling to recover. Bankers personally rose to the occasion, rolled up their sleeves, and lent a hand.

Integrating banks more directly into disaster lending will allow the SBA to take full advantage of the established relationships that banks already have in their communities, and the familiarity many banks already have with SBA lending practices. It will also allow the SBA to rely on the existing expertise and efficiency of bank loan processors, and avoid problems associated with hiring temporary staff that are unfamiliar with SBA loan processing. Capitalizing on these existing assets is the most effective way to get the largest amount of disaster lending into the greatest number of victims' hands in the shortest time possible.

A Public-Private Partnership Promises Greater Disaster Lending Efficiency

The SBA's disaster lending program should be transformed to more closely resemble its 7(a) lending program. The 7(a) program is significantly different from the disaster loan program. Rather than the SBA making loans directly to applicants, under the 7(a) program, banks fulfill the loans and the SBA provides a government guarantee if the loan defaults.

The public-private partnership elements that are inherent in the SBA's 7(a) program should be applied to the disaster lending program. A partnership of this nature will allow the power and resources of the government to combine most effectively with existing bank expertise and relationships. More importantly, it will promote efficient distribution of disaster assistance.

As noted, many banks are already certified SBA lenders and are familiar with SBA rules and procedures. Through the 7(a) program, banks have been very successful in helping many small businesses get started, and the program is responsible for the close relationships that many banks have with their small business clients. Thus, transforming the disaster lending program to more closely resemble the 7(a) program is a natural way to take full advantage of both of these elements.

However, due to the unpredictable nature of disasters and the issues associated with disaster recovery, the program will necessarily be different. Currently, the risk of default is shared by the government and the bank under a 7(a) loan. In most cases, 7(a) loans provide a 50 percent to 75 percent government guarantee if the loan defaults, which places the lender at risk for 25 to 50 percent of the loan principal. For disaster loans, the SBA should guarantee a higher percentage. A 25 to 50 percent risk of default may be acceptable for a bank to bear under a traditional 7(a) loan because the loan can be partially or wholly securitized by the assets of the business. Obviously, disasters often wipe out most, if not all, of the assets of a business. Hence, a higher guarantee by the

government will provide greater incentive for banks to make disaster loans. Even if the guarantee were as high as 85 percent, the 15 percent stake that banks assume would be considerable and would ensure an appropriate level of due diligence in making loans while significantly increasing the flow of funds.

Furthermore, 7(a) loans operate much like a traditional mortgage with monthly payments, and the terms range from 7 to 10 years. Because it can take several months, and sometimes years, for a business to fully recover from a disaster, longer repayment terms are more appropriate for disaster lending. Payments under longer terms would be more affordable for borrowers and would significantly reduce the likelihood of default. Instituting a deferred payment option would also be beneficial. This would allow time for businesses to rebuild and help prevent the cash-flow burden that businesses face in the immediate aftermath of disasters.

Existing SBA loan programs also require some form of collateral. Transforming the disaster loan program to resemble the 7(a) program should be accompanied by a policy that waives collateral requirements for any loan under \$250,000. When disasters on the magnitude of the Gulf Coast hurricanes strike, the value of collateral that many small businesses have to offer is greatly diminished. Waiving the collateral requirement would help small businesses that need limited capital and would contribute to the rebuilding process.

Since banks, rather than the SBA, will be making disaster loans directly to victims, fees associated with making loans should also be structured differently. Currently, the SBA exacts a loan guaranty fee from lenders for 7(a) loans. The fee ranges between 2 percent and 3.75 percent, depending on the size of the loan, and may be passed on to the borrower after the lender has made up-front payment to the SBA. Obviously, lowering this fee for disaster lending would result in cost savings for victims. SBA-certified lenders should also be allowed to charge the agency a reasonable

fee for processing disaster loans. A fee of 1 percent to 2 percent would cover banks' costs and banks could capitalize on their existing loan processing efficiency. Relative to the cost to the SBA of hiring and training loan officers and processing loans directly, paying a small processing fee is *likely to result in an overall savings to the government.*

Employing the principles of public-private partnership that are inherent in the 7(a) program will allow the SBA to optimize its current disaster lending program. But because of the unpredictable nature of disasters, certain elements of the 7(a) program will need to be different. By including the changes described above, the SBA's disaster lending program can be transformed to ensure the most timely and efficient distribution of capital to the greatest number of disaster victims.

Conclusion

The hurricanes that struck the Gulf Coast in the late summer of 2005 not only had a devastating effect on the local economy, they brought to light some serious problems with the SBA's disaster lending program. In order to prevent these problems from resurfacing, the disaster lending program should be modeled on the SBA's 7(a) program and should integrate banks more fully into the disaster lending process. A public private partnership that relies on the experience of bank lenders and the existing efficiency of bank loan processing, offers a cost-effective way to quickly deliver disaster loans and thereby jump start any economy damaged by disasters.

Thank you for your time. I would be happy to answer any questions you might have.