

PREMIER CERTIFIED LENDERS PROGRAM IMPROVEMENT
ACT OF 2003

JUNE 12, 2003.—Committed to the Committee of the Whole House on the State of
the Union and ordered to be printed

Mr. MANZULLO, from the Committee on Small Business,
submitted the following

R E P O R T

together with

ADDITIONAL VIEWS

[To accompany H.R. 923]

[Including cost estimate of the Congressional Budget Office]

The Committee on Small Business, to whom was referred the bill (H.R. 923) to amend the Small Business Investment Act of 1958 to allow certain premier certified lenders to elect to maintain an alternative loss reserve, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the “Premier Certified Lenders Program Improvement Act of 2003”.

SEC. 2. LOSS RESERVES OF PREMIER CERTIFIED LENDERS TEMPORARILY DETERMINED ON THE BASIS OF OUTSTANDING BALANCE OF DEBENTURES.

Paragraph (6) of section 508(c) of the Small Business Investment Act of 1958 (15 U.S.C. 697e(c)) is amended—

(1) by striking “The Administration” and inserting the following:

“(A) IN GENERAL.—The Administration”; and

(2) by adding at the end the following new subparagraph:

“(B) TEMPORARY REDUCTION BASED ON OUTSTANDING BALANCE.—Notwithstanding subparagraph (A), during the 2-year period beginning on the date that is 90 days after the date of the enactment of this subparagraph, the Administration shall allow the certified development company to withdraw from the loss reserve such amounts as are in excess of 1 percent of the aggregate outstanding balances of debentures to which such loss reserve re-

lates. The preceding sentence shall not apply with respect to any debenture before 100 percent of the contribution described in paragraph (4) with respect to such debenture has been made.”.

SEC. 3. ALTERNATIVE LOSS RESERVE PILOT PROGRAM FOR CERTAIN PREMIER CERTIFIED LENDERS.

(a) IN GENERAL.—Subsection (c) of section 508 of the Small Business Investment Act of 1958 (15 U.S.C. 697e) is amended by adding at the end the following new paragraphs:

“(7) ALTERNATIVE LOSS RESERVE.—

“(A) ELECTION.—With respect to any eligible calendar quarter, any qualified high loss reserve PCL may elect to have the requirements of this paragraph apply in lieu of the requirements of paragraphs (2) and (4) for such quarter.

“(B) CONTRIBUTIONS.—

“(i) ORDINARY RULES INAPPLICABLE.—Except as provided under clause (ii) and paragraph (5), a qualified high loss reserve PCL that makes the election described in subparagraph (A) with respect to a calendar quarter shall not be required to make contributions to its loss reserve during such quarter.

“(ii) BASED ON LOSS.—A qualified high loss reserve PCL that makes the election described in subparagraph (A) with respect to any calendar quarter shall, before the last day of such quarter, make such contributions to its loss reserve as are necessary to ensure that the amount of the loss reserve of the PCL is—

“(I) not less than \$100,000; and

“(II) sufficient, as determined by a qualified independent auditor, for the PCL to meet its obligations to protect the Federal Government from risk of loss.

“(iii) CERTIFICATION.—Before the end of any calendar quarter for which an election is in effect under subparagraph (A), the head of the PCL shall submit to the Administrator a certification that the loss reserve of the PCL is sufficient to meet such PCL’s obligation to protect the Federal Government from risk of loss. Such certification shall be in such form and submitted in such manner as the Administrator may require and shall be signed by the head of such PCL and the auditor making the determination under clause (ii)(II).

“(C) DISBURSEMENTS.—

“(i) ORDINARY RULE INAPPLICABLE.—Paragraph (6) shall not apply with respect to any qualified high loss reserve PCL for any calendar quarter for which an election is in effect under subparagraph (A).

“(ii) EXCESS FUNDS.—At the end of each calendar quarter for which an election is in effect under subparagraph (A), the Administration shall allow the qualified high loss reserve PCL to withdraw from its loss reserve the excess of—

“(I) the amount of the loss reserve, over

“(II) the greater of \$100,000 or the amount which is determined under subparagraph (B)(ii) to be sufficient to meet the PCL’s obligation to protect the Federal Government from risk of loss.

“(D) RECONTRIBUTION.—If the requirements of this paragraph apply to a qualified high loss reserve PCL for any calendar quarter and cease to apply to such PCL for any subsequent calendar quarter, such PCL shall make a contribution to its loss reserve in such amount as the Administrator may determine provided that such amount does not exceed the amount which would result in the total amount in the loss reserve being equal to the amount which would have been in such loss reserve had this paragraph never applied to such PCL. The Administrator may require that such payment be made as a single payment or as a series of payments.

“(E) RISK MANAGEMENT.—If a qualified high loss reserve PCL fails to meet the requirement of subparagraph (F)(iii) during any period for which an election is in effect under subparagraph (A) and such failure continues for 180 days, the requirements of paragraphs (2), (4), and (6) shall apply to such PCL as of the end of such 180-day period and such PCL shall make the contribution to its loss reserve described in subparagraph (D). The Administrator may waive the requirements of this subparagraph.

“(F) QUALIFIED HIGH LOSS RESERVE PCL.—The term ‘qualified high loss reserve PCL’ means, with respect to any calendar year, any premier certified lender designated by the Administrator as a qualified high loss reserve PCL for such year. The Administrator shall not designate a company under the preceding sentence unless the Administrator determines that—

“(i) the amount of the loss reserve of the company is not less than \$100,000;

“(ii) the company has established and is utilizing an appropriate and effective process for analyzing the risk of loss associated with its portfolio of PCLP loans and for grading each PCLP loan made by the company on the basis of the risk of loss associated with such loan; and

“(iii) the company meets or exceeds 4 or more of the specified risk management benchmarks as of the most recent assessment by the Administration or the Administration has issued a waiver with respect to the requirement of this clause.

“(G) SPECIFIED RISK MANAGEMENT BENCHMARKS.—For purposes of this paragraph, the term ‘specified risk management benchmarks’ means the following rates, as determined by the Administrator:

“(i) Currency rate.

“(ii) Delinquency rate.

“(iii) Default rate.

“(iv) Liquidation rate.

“(v) Loss rate.

“(H) QUALIFIED INDEPENDENT AUDITOR.—For purpose of this paragraph, the term ‘qualified independent auditor’ means any auditor who—

“(i) is compensated by the qualified high loss reserve PCL;

“(ii) is independent of such PCL; and

“(iii) has been approved by the Administrator during the preceding year.

“(I) PCLP LOAN.—For purposes of this paragraph, the term ‘PCLP loan’ means any loan guaranteed under this section.

“(J) ELIGIBLE CALENDAR QUARTER.—For purposes of this paragraph, the term ‘eligible calendar quarter’ means—

“(i) the first calendar quarter that begins after the end of the 90-day period beginning with the date of the enactment of this paragraph; and

“(ii) the 7 succeeding calendar quarters.

“(K) CALENDAR QUARTER.—For purposes of this paragraph, the term ‘calendar quarter’ means—

“(i) the period which begins on January 1 and ends on March 31 of each year;

“(ii) the period which begins on April 1 and ends on June 30 of each year;

“(iii) the period which begins on July 1 and ends on September 30 of each year; and

“(iv) the period which begins on October 1 and ends on December 31 of each year.

“(L) REGULATIONS.—Not later than 45 days after the date of the enactment of this paragraph, the Administrator shall publish in the Federal Register and transmit to the Congress regulations to carry out this paragraph. Such regulations shall include provisions relating to—

“(i) the approval of auditors under subparagraph (H); and

“(ii) the designation of qualified high loss reserve PCLs under subparagraph (F), including the determination of whether a process for analyzing risk of loss is appropriate and effective for purposes of subparagraph (F)(ii).

“(8) BUREAU OF PCLP OVERSIGHT.—

“(A) ESTABLISHMENT.—There is hereby established in the Small Business Administration a bureau to be known as the Bureau of PCLP Oversight.

“(B) PURPOSE.—The Bureau of PCLP Oversight shall carry out such functions of the Administration under this subsection as the Administrator may designate.

“(C) DEADLINE.—Not later than 90 days after the date of the enactment of this Act—

“(i) the Administrator shall ensure that the Bureau of PCLP Oversight is prepared to carry out any functions designated under subparagraph (B), and

“(ii) the Office of the Inspector General of the Administration shall report to the Congress on the preparedness of the Bureau of PCLP Oversight to carry out such functions.”.

(b) INCREASED REIMBURSEMENT FOR LOSSES RELATED TO DEBENTURES ISSUED DURING ELECTION PERIOD.—Subparagraph (C) of section 508(b)(2) of the Small Business Investment Act of 1958 (15 U.S.C. 697e(b)(2)) is amended by inserting “(15 percent in the case of any such loss attributable to a debenture issued by the com-

pany during any period for which an election is in effect under subsection (c)(7) for such company)” before “; and”.

(c) CONFORMING AMENDMENTS.—

(1) Subparagraph (D) of section 508(b)(2) of the Small Business Investment Act of 1958 (15 U.S.C. 697e(b)(2)) is amended by striking “subsection (c)(2)” and inserting “subsection (c)”.

(2) Paragraph (5) of section 508(c) of the Small Business Investment Act of 1958 (15 U.S.C. 697e(c)) is amended by striking “10 percent”.

(d) STUDY AND REPORT.—

(1) IN GENERAL.—The Administrator shall enter into a contract with a Federal agency experienced in community development lending and financial regulation or with a member of the Federal Financial Institutions Examinations Council to study and prepare a report regarding—

(A) the extent to which statutory requirements have caused overcapitalization in the loss reserves maintained by certified development companies participating in the Premier Certified Lenders Program established under section 508 of the Small Business Investment Act of 1958 (15 U.S.C. 697e); and

(B) alternatives for establishing and maintaining loss reserves that are sufficient to protect the Federal Government from the risk of loss associated with loans guaranteed under such Program.

(2) TRANSMISSION OF REPORT.—The report described in paragraph (1) shall be transmitted to the Committee on Small Business of the House of Representatives and the Committee on Small Business and Entrepreneurship of the Senate not later than 90 days after the date of the enactment of this Act.

(3) LIMITATION.—The amount of the contract described in paragraph (1) shall not exceed \$75,000.

PURPOSE OF LEGISLATION

The purpose of this legislation is to amend the Small Business Investment Act of 1958 to allow certain Premier Certified Lenders (PCL) under the Small Business Administration’s (SBA) 504 Certified Development Company (CDC) Program, to elect to maintain an alternative loss reserve.

BACKGROUND AND NEED FOR LEGISLATION

In the 1990’s Congress made a variety of changes to SBA’s 504 CDC Program to lower the default rate and eliminate its annual appropriation so that it operates solely on user-fees. The 504 CDC Program provides small businesses with long-term, fixed-rate financing for the purchase of fixed assets such as land, buildings, and equipment generally for business expansion purposes. The loans are made by CDCs, usually non-profit corporations organized to contribute to the economic development of a particular community or region.

Unlike the SBA’s other main flagship access to credit program, the 7(a) general business loan guarantee program, there is a job-creation component to every CDC project before it is approved (usually, for every \$35,000 guaranteed, one job has to be created or retained). The SBA guarantees debentures issued by a CDC for 40 percent of a project cost, up to \$1 million (or up to \$1.3 million in certain cases if the project serves one of nine public policy goals). The debentures are sold on the market to private investors.

To model a similar effort in the 7(a) program, Congress also established a Premier Certified Lender Program (PCLP) that gives discretion to certain qualified CDCs to approve 504 loans subject to the borrower being eligible and available loan authority. In return for this lower regulatory oversight, these PCLP CDCs must maintain a higher loss reserve (the amount of money set aside to cover bad loans) than regular CDCs.

Some PCLP CDCs believe that this amount of reserves is well beyond what is prudently required because their vast experience in making 504 loans has caused them to become sophisticated in weeding out bad risks. Requiring PCLP CDCs to maintain unnecessarily large loss reserve accounts reduces their ability to serve additional small businesses and to attract new lenders to join the program.

SUMMARY OF LEGISLATION

The amendment in the nature of a substitute creates a two-year Alternative Loss Reserve Pilot Program starting 90 days after enactment. The new program permits qualified CDCs that are a part of the PCLP to elect to use a risk-based approach to calculate their loan loss reserve requirements. It allows certain qualified PCLP CDCs to make withdrawals on a quarterly basis from their loan loss reserves in excess of the greater of \$100,000 or the amount that is determined under the new program to be the proper loss reserve amount. PCLP CDCs not in the new pilot program may for a 2-year period withdraw from their loss reserves such amounts that are in excess of 1 percent of the total outstanding balances of debentures to which the loss reserve relates.

In order to ensure that PCLP CDCs' loan loss reserves are sufficient to protect the Federal Government's interest, the substitute establishes a Bureau of PCLP Oversight within the Office of Lender Oversight. The substitute requires the SBA to draft rules for administration and oversight of the Alternative Loss Reserve Pilot Program. In addition, this substitute provides for a study to evaluate alternative loan loss reserve approaches.

COMMITTEE ACTION

Representative John Doolittle (CA) introduced H.R. 923 in February with the purpose of allowing PCLP CDCs, like private sector banks, to use a risk-based management approach to calculate their loan loss reserve requirements. The bill was referred to the Committee. On March 22, 2003, the Committee held a hearing with respect to SBA's financial programs that provided a forum for discussion of the 504 Loan Program and the provisions of H.R. 923. On Thursday, May 22, 2003, the Committee held a mark-up with respect to H.R. 923 at 9:30 a.m. in room 2360 of the Rayburn House Office Building. Mr. Manzullo, the Chairman of the Committee and Ms. Velázquez, the Ranking Democratic Member, offered an amendment in the nature of a substitute to H.R. 923. The amendment in the nature of a substitute was not further amended and H.R. 923, as so amended by the substitute, a quorum being present, was ordered favorably reported by voice vote.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the recorded votes on the motion to report legislation. There was no recorded vote taken in connection with ordering H.R. 923 reported.

COMMITTEE OVERSIGHT FINDINGS

With respect to the requirements of clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee's oversight findings are reflected in this report.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

With respect to the requirements of clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, and section 308(a) of the Congressional Budget Act of 1974, the Committee references the report of the Congressional Budget Office included below.

STATEMENT OF CONGRESSIONAL BUDGET OFFICE ESTIMATE

With respect to the requirements of clause 3(c)(3) of rule XIII of the Rules of the House of Representatives and section 402 of the Congressional Budget Act of 1974, the Committee has received the cost estimate for H.R. 923 from the Director of the Congressional Budget Office as follows:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, June 5, 2003.

Hon. DONALD MANZULLO,
*Chairman, Committee on Small Business,
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 923, the Premier Certified Lenders Program Improvement Act of 2003.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Melissa E. Zimmerman.
Sincerely,

DOUGLAS HOLTZ-EAKIN,
Director.

Enclosure.

H.R. 923—Premier Certified Lenders Program Improvements Act of 2003

H.R. 923 would make several changes to the loan program that the Small Business Administration (SBA) operates in cooperation with certified development companies (CDCs). Based on information from the SBA, CBO estimates that implementing H.R. 923 would not have a significant impact on the federal budget. Enacting the bill would not affect revenues and would have no significant impact on direct spending. H.R. 923 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would impose no costs on state, local, or tribal governments.

CDC loans, also known as section 503 and 504 loans, provide small businesses with long-term, fixed-rate financing for the purchase of land, buildings, and equipment. The Premier Certified Lenders Program allows a participating CDC the authority to review and approve loan requests and to foreclose, litigate, and liquidate loans made under the program. Under current law, CDC's

can qualify as Premier Certified Lenders (PCLs) if, among other requirements, they agree to pay 10 percent of SBA's potential loss on a defaulted 504 loan. A PCL must hold 10 percent of this potential loss (i.e., 1 percent of the total loan) in a reserve for the life of the loan.

During a two-year pilot period, H.R. 923 would have two effects on the requirements for loss reserves under the PCLs Program. First, the bill would change the loss reserve requirement from 1 percent of the total value of the loan to 1 percent of the total loan outstanding. PCLs would be allowed to withdraw any funds from their loss reserve in excess of this amount. Second, certain PCLs would have the option to maintain an alternate loss reserve level based on risk rather than a fixed percentage. The amount of the reserve would be determined by an independent, SBA-approved auditor. Under the bill, if a PCL chooses this option, it must pay 15 percent of SBA's total loss on defaulted CDC loans.

Under current law, the Administrator of SBA must adjust an annual fee on CDC loans to produce an estimated subsidy rate of zero at the time the loans are guaranteed. Enacting H.R. 923 could affect the subsidy rates for previous cohorts of CDC loans. Decreasing the loss reserve requirement for PCLs would cause SBA to collect a smaller amount of recoveries if a small business defaults on a loan and a PCL is unable to pay its portion of SBA's total loss. However, increasing the required loss coverage to 15 percent for PCLs who opt to maintain a loss reserve level based on risk would increase SBA's recoveries on default CDC loans. It is unclear if, taken together, those two effects would increase or decrease the average subsidy cost for previous CDC loans. However, CBO estimates that the net result of those two effects would not have a significant impact on the federal budget.

H.R. 923 also would create a Bureau of PCL Program Oversight and require SBA to study and report to the Congress on the loss reserve requirements for PCLs. Based on information provided by SBA, CBO estimates that those provisions would cost less than \$500,000, assuming appropriation of the necessary amounts.

The CBO staff contact for this estimate is Melissa E. Zimmerman. This estimate was approved by Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee finds that the Constitutional authority for this legislation is provided in Article I, section 8 of the Constitution of the United States, which grants to Congress the power to enact this bill

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or

accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

The short title is the “Premier Certified Lenders Program Improvement Act of 2003.”

Section 2. Loss reserves of Premier Certified Lenders temporarily determined on the basis of outstanding balance of debentures

Paragraph (6) of section 508(c) of the Small Business Investment Act of 1958 is amended by adding a new subparagraph (B) that permits the Administrator of the SBA to all PCLP CDCs to withdraw from loss reserves amounts that are in excess of 1 percent of the total outstanding balance of the debentures to which the loss reserve is applicable. However, such withdrawal may not be made with respect to a debenture before 100 percent of the contributions (in cash or letters of credit) are made to the loss reserve attributable to that debenture. The reduction based on outstanding balance is temporary and is effective for a 2-year period beginning 90 days after enactment of the bill.

Section 3. Alternative Loss Reserve Pilot Program for certain Premier Certified Lenders

Subsection (c) of Section 508 of the Small Business Investment Act of 1958 is amended by adding a new paragraph (7) that creates a new alternative loss reserve which a qualified high loss reserve PCL may elect to implement with respect to any eligible calendar quarter. A qualified high loss reserve PCL that makes an election with respect to any calendar quarter, shall before the last day of such quarter, ensure that its loss reserve is no less than the greater of \$100,000 or the loss reserve amount determined by an independent auditor to be sufficient to protect the Federal Government from risk of loss.

Before the end of a calendar quarter for which an election is in effect, the head of the PCL and the auditor must certify to SBA that the loss reserve is sufficient to protect the Federal Government from risk of loss. The form and content of the certificate is to be established by the Administrator of the SBA. At the end of each calendar quarter for which an election is in effect, the Administrator may permit the qualified high loss reserve PCL to withdraw from the loss reserve any amounts in excess of the greater of \$100,000 or the auditor certified loss reserve.

In any subsequent quarter that the alternative loss reserve does not apply, the qualified high loss reserve PCL must make a contribution to its loss reserve as the Administrator shall determine, but not in excess of the loss reserve that would have been applicable had no election been made. The contributions may be in one lump sum or a series of payments, as the Administrator shall determine.

To be designated by the Administrator as a “qualified high loss reserve PCL,” as defined in the Act, the PCL CDC must: (1) have a loss reserve that is not less than \$100,000; (2) employ an established risk management system that analyses the risk of loss asso-

ciated with its portfolio of loans and grades the risk of loss of each loan; and (3) meet or exceed 4 out of the 5 “specified risk management benchmarks,” as defined in the Act, i.e., currency rate, delinquency rate, default rate, liquidation rate, and loss rate. If the qualified high loss reserve PLC does not meet or exceed 4 out of 5 of the management benchmarks, and noncompliance lasts for 180 days, the PLC must make such payment(s) into the loss reserve to meet the usual loss reserve requirements. The Administrator may waive the requirement with respect to meeting the benchmarks.

Also defined for purposes of the Alternative Loss Reserve Pilot Program are the terms “qualified independent auditor,” “PCLP loan,” “eligible calendar quarter,” and “calendar quarter.” A “qualified independent auditor” means an auditor that is paid by the qualified high loss reserve PCL; is independent of such PCL; and has been approved by the Administrator during the preceding year. “PCLP loan” means any guaranteed 504 loan. “Eligible calendar quarter” means the first calendar quarter that begins after the end of the 90-day period beginning with the date of enactment of the Act and ending 7 succeeding calendar quarters thereafter. The terms “calendar quarter” means: (1) the period which begins on January 1 and ends on March 31 of each year; (2) the period that begins on April 1 and ends on June 30 of each year; (3) the period which begins on July 1 and ends on September 30 of each year; and (4) the period which begins on October 1 and ends on December 31 of each year.

The Administrator has 45 days to issue and implement final regulations required to administer and perform oversight of the Alternative Loss Reserve Pilot Program. The regulations shall be published in the Federal Register and transmitted to Congress. The regulations shall provide for, but not be limited to, the requirements that auditors must meet to be approved and the terms upon which a PCL may qualify for admittance to the Program, including the effectiveness of the PCL’s risk management system.

The Act would create a bureau within SBA dedicated to oversight of the Alternative Loss Reserve Pilot Program. The “Bureau of PCLP Oversight” is to be staffed by persons presently employed by SBA. The Committee intends that the persons assigned to the Bureau would have expertise in oversight of 504 lending and be properly trained to perform the functions required. No additional amounts are authorized to be appropriated for this purpose. The Bureau is to be fully operative 90 days after enactment. The SBA Office of Inspector General is required to report to Congress on the preparedness of the Bureau.

A qualified high loss reserve PCL must reimburse the Federal Government for 15 percent (an increase from 10 percent) of any loss attributable to a debenture issued by the company during any period for which an election is in effect. A study of the Alternative Loss Reserve Pilot Program is to be performed by a Federal agency experienced in community development lending and financial regulation or with a member of the Federal Financial Institutions Examinations Council. Members of the Council include: the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. The study is to examine the extent to which

statutory requirements have caused overcapitalization in the loss reserves maintained by CDCs participating in the PCLP. Also to be studied are the alternatives for establishing and maintaining loss reserves sufficient to protect the Federal Government from losses associated with guaranteeing securities issued under the PCLP. The study and report are to be completed and transmitted to the Committee on Small Business of the House of Representatives and the Committee on Small Business and Entrepreneurship of the Senate within 90 days of enactment of this Act. An amount not to exceed \$75,000 is authorized for the study and report.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SECTION 508 OF THE SMALL BUSINESS INVESTMENT ACT OF 1958

SEC. 508. PREMIER CERTIFIED LENDERS PROGRAM.

(a) * * *

(b) REQUIREMENTS.—

(1) * * *

(2) DESIGNATION.—The Administration may designate a certified development company as a premier certified lender—

(A) * * *

* * * * *

(C) if the company agrees to assume and to reimburse the Administration for 10 percent of any loss sustained by the Administration as a result of default by the company in the payment of principal or interest on a debenture issued by such company and guaranteed by the Administration under this section (*15 percent in the case of any such loss attributable to a debenture issued by the company during any period for which an election is in effect under subsection (c)(7) for such company*); and

(D) the Administrator determines, with respect to the company, that the loss reserve established in accordance with **subsection (c)(2)** *subsection (c)* is sufficient for the company to meet its obligations to protect the Federal Government from risk of loss.

* * * * *

(c) LOSS RESERVE.—

(1) * * *

* * * * *

(5) REPLENISHMENT.—If a loss has been sustained by the Administration, any portion of the loss reserve, and other funds provided by the premier company as necessary, may be used to reimburse the Administration for the premier company's **10 percent** share of the loss as provided in subsection (b)(2)(C). If the company utilizes the reserve, within 30 days it shall replace an equivalent amount of funds.

(6) DISBURSEMENTS.—[The Administration]

(A) *IN GENERAL.*—*The Administration shall allow the certified development company to withdraw from the loss reserve amounts attributable to any debenture that has been repaid.*

(B) *TEMPORARY REDUCTION BASED ON OUTSTANDING BALANCE.*—*Notwithstanding subparagraph (A), during the 2-year period beginning on the date that is 90 days after the date of the enactment of this subparagraph, the Administration shall allow the certified development company to withdraw from the loss reserve such amounts as are in excess of 1 percent of the aggregate outstanding balances of debentures to which such loss reserve relates. The preceding sentence shall not apply with respect to any debenture before 100 percent of the contribution described in paragraph (4) with respect to such debenture has been made.*

(7) ALTERNATIVE LOSS RESERVE.—

(A) *ELECTION.*—*With respect to any eligible calendar quarter, any qualified high loss reserve PCL may elect to have the requirements of this paragraph apply in lieu of the requirements of paragraphs (2) and (4) for such quarter.*

(B) CONTRIBUTIONS.—

(i) *ORDINARY RULES INAPPLICABLE.*—*Except as provided under clause (ii) and paragraph (5), a qualified high loss reserve PCL that makes the election described in subparagraph (A) with respect to a calendar quarter shall not be required to make contributions to its loss reserve during such quarter.*

(ii) *BASED ON LOSS.*—*A qualified high loss reserve PCL that makes the election described in subparagraph (A) with respect to any calendar quarter shall, before the last day of such quarter, make such contributions to its loss reserve as are necessary to ensure that the amount of the loss reserve of the PCL is—*

(I) *not less than \$100,000; and*

(II) *sufficient, as determined by a qualified independent auditor, for the PCL to meet its obligations to protect the Federal Government from risk of loss.*

(iii) *CERTIFICATION.*—*Before the end of any calendar quarter for which an election is in effect under subparagraph (A), the head of the PCL shall submit to the Administrator a certification that the loss reserve of the PCL is sufficient to meet such PCL's obligation to protect the Federal Government from risk of loss. Such certification shall be in such form and submitted in such manner as the Administrator may require and shall be signed by the head of such PCL and the auditor making the determination under clause (ii)(II).*

(C) DISBURSEMENTS.—

(i) *ORDINARY RULE INAPPLICABLE.*—*Paragraph (6) shall not apply with respect to any qualified high loss reserve PCL for any calendar quarter for which an election is in effect under subparagraph (A).*

(ii) *EXCESS FUNDS.*—At the end of each calendar quarter for which an election is in effect under subparagraph (A), the Administration shall allow the qualified high loss reserve PCL to withdraw from its loss reserve the excess of—

(I) the amount of the loss reserve, over

(II) the greater of \$100,000 or the amount which is determined under subparagraph (B)(ii) to be sufficient to meet the PCL's obligation to protect the Federal Government from risk of loss.

(D) *RECONTRIBUTION.*—If the requirements of this paragraph apply to a qualified high loss reserve PCL for any calendar quarter and cease to apply to such PCL for any subsequent calendar quarter, such PCL shall make a contribution to its loss reserve in such amount as the Administrator may determine provided that such amount does not exceed the amount which would result in the total amount in the loss reserve being equal to the amount which would have been in such loss reserve had this paragraph never applied to such PCL. The Administrator may require that such payment be made as a single payment or as a series of payments.

(E) *RISK MANAGEMENT.*—If a qualified high loss reserve PCL fails to meet the requirement of subparagraph (F)(iii) during any period for which an election is in effect under subparagraph (A) and such failure continues for 180 days, the requirements of paragraphs (2), (4), and (6) shall apply to such PCL as of the end of such 180-day period and such PCL shall make the contribution to its loss reserve described in subparagraph (D). The Administrator may waive the requirements of this subparagraph.

(F) *QUALIFIED HIGH LOSS RESERVE PCL.*—The term “qualified high loss reserve PCL” means, with respect to any calendar year, any premier certified lender designated by the Administrator as a qualified high loss reserve PCL for such year. The Administrator shall not designate a company under the preceding sentence unless the Administrator determines that—

(i) the amount of the loss reserve of the company is not less than \$100,000;

(ii) the company has established and is utilizing an appropriate and effective process for analyzing the risk of loss associated with its portfolio of PCLP loans and for grading each PCLP loan made by the company on the basis of the risk of loss associated with such loan; and

(iii) the company meets or exceeds 4 or more of the specified risk management benchmarks as of the most recent assessment by the Administration or the Administration has issued a waiver with respect to the requirement of this clause.

(G) *SPECIFIED RISK MANAGEMENT BENCHMARKS.*—For purposes of this paragraph, the term “specified risk management benchmarks” means the following rates, as determined by the Administrator:

- (i) *Currency rate.*
- (ii) *Delinquency rate.*
- (iii) *Default rate.*
- (iv) *Liquidation rate.*
- (v) *Loss rate.*

(H) *QUALIFIED INDEPENDENT AUDITOR.*—For purpose of this paragraph, the term “qualified independent auditor” means any auditor who—

- (i) *is compensated by the qualified high loss reserve PCL;*
- (ii) *is independent of such PCL; and*
- (iii) *has been approved by the Administrator during the preceding year.*

(I) *PCLP LOAN.*—For purposes of this paragraph, the term “PCLP loan” means any loan guaranteed under this section.

(J) *ELIGIBLE CALENDAR QUARTER.*—For purposes of this paragraph, the term “eligible calendar quarter” means—

- (i) *the first calendar quarter that begins after the end of the 90-day period beginning with the date of the enactment of this paragraph; and*
- (ii) *the 7 succeeding calendar quarters.*

(K) *CALENDAR QUARTER.*—For purposes of this paragraph, the term “calendar quarter” means—

- (i) *the period which begins on January 1 and ends on March 31 of each year;*
- (ii) *the period which begins on April 1 and ends on June 30 of each year;*
- (iii) *the period which begins on July 1 and ends on September 30 of each year; and*
- (iv) *the period which begins on October 1 and ends on December 31 of each year.*

(L) *REGULATIONS.*—Not later than 45 days after the date of the enactment of this paragraph, the Administrator shall publish in the Federal Register and transmit to the Congress regulations to carry out this paragraph. Such regulations shall include provisions relating to—

- (i) *the approval of auditors under subparagraph (H); and*
- (ii) *the designation of qualified high loss reserve PCLs under subparagraph (F), including the determination of whether a process for analyzing risk of loss is appropriate and effective for purposes of subparagraph (F)(ii).*

(8) *BUREAU OF PCLP OVERSIGHT.*—

(A) *ESTABLISHMENT.*—There is hereby established in the Small Business Administration a bureau to be known as the Bureau of PCLP Oversight.

(B) *PURPOSE.*—The Bureau of PCLP Oversight shall carry out such functions of the Administration under this subsection as the Administrator may designate.

(C) *DEADLINE.*—Not later than 90 days after the date of the enactment of this Act—

(i) the Administrator shall ensure that the Bureau of PCLP Oversight is prepared to carry out any functions designated under subparagraph (B), and

(ii) the Office of the Inspector General of the Administration shall report to the Congress on the preparedness of the Bureau of PCLP Oversight to carry out such functions.

* * * * *

ADDITIONAL VIEWS

The amendment in the nature of a substitute adopted by the Committee will increase the availability of capital to Certified Development Companies (CDCs), permitting CDCs to make more loans to small businesses, while safeguarding taxpayers' interests. This is not only sound public policy, but also a means to enhance the flow of capital to small businesses.

While access to capital is vital to the success of small businesses, many find it difficult to get funding, especially given the current lending environment. SBA's lending programs address these difficulties by providing a critical stream of funding to small businesses. Last year, these programs supplied \$21 billion in capital, accounting for 40 percent of all long-term small business lending to this country's entrepreneurs.

One of the SBA's most important loan programs is the 504 CDC Loan Program. The 504 program is a low-cost, high-return economic stimulus initiative that contributes to overall economic growth in our communities. A typical 504 project is financed through a combination of a commercial loan and a financing component backed by government-guaranteed debentures. Given the weak state of our economy, the 504 program is especially important now because it promotes investment where we need it most—in the small business sector.

While the 504 program does provide capital to hundreds of small businesses each year, problems with the program's administration prevent the program from realizing its full potential. One of the program's most significant problems is SBA's inability to consistently process 504 loan applications within a short time period. Since the SBA processing time for 504 applications can frequently approach 30 days, borrowers and lenders are often deterred from participating.

In response to these long processing delays, Congress created the Premier Certified Lender Program (PCLP). Through this public-private partnership, CDCs are permitted to process their 504 loans without SBA approval. In exchange for this autonomy, SBA requires CDCs to assume responsibility for some of the losses associated with the loans they make. In order to protect the government's interests, these CDCs (called Premier CDCs) are required to maintain loan loss reserves.

Although some 25 to 30 CDCs have elected to join the PCLP, there are over 200 CDCs that have decided not to take advantage of the program. CDCs are deterred from participating in the PCLP because the current PCLP prevents CDCs from making withdrawals from their loan loss reserves until their debentures are fully repaid. As a result, CDCs often maintain loan loss reserves in excess of what is sufficient to protect the government's interests.

In addition to deterring CDCs from joining the PCLP, the excessive loan loss reserve requirements prevent Premier CDCs from making more loans to small businesses. Funds maintained in excess of what is necessary to protect the government's interests could serve a much better purpose—such as financing for small businesses—the number one job creator in the U.S. Instead, these funds are not being used, helping no one at all.

To address these issues, the amendment creates two pilot programs that give 504 program lenders the ability to reduce their loan loss reserves, while adequately protecting the government's interests. By creating a system that frees lenders from excessive loan loss reserve requirements, 504 program lenders will then be able to make more loans to small businesses, which is exactly what this nation needs in a time of such economic uncertainty. Economic recovery is only within reach if small businesses are able to start-up and grow. And this is impossible without capital.

The first pilot program allows Premier CDCs to draw down their loan loss reserves based on the repayment of their outstanding 504 program debentures. This pilot program was created to ensure that a CDC's loan loss reserve does not maintain amounts that are in excess of those necessary to protect the government's interests. When the PCLP program was established, the statute did not recognize that the amount of SBA's risk of loss decreases as the debenture ages. debentures are issued for either a ten or twenty year term and are amortized over the duration of the term. As the borrower makes payments, the outstanding balance of the debenture is reduced. The amount of the CDC's loss reserve, however, does not decrease until the debenture is fully paid off, at which point the CDC is permitted to withdraw the amount in full. Thus, as the principal on the debenture decreases each year and the amount of the loss reserve remains constant, the loan loss reserve percentage actually increases.

As a result of the enactment of the first pilot program, all Premier CDCs will be able to limit their loan loss reserve requirement to one percent of their outstanding debentures, which is equal to the initial requirement under existing statute. This will make more funds available to all Premier CDCs and, ultimately, to small businesses. At the same time, it will preserve sufficient loan loss reserves to adequately protect our taxpayers' investment.

The second pilot program allows qualifying Premier CDCs to estimate their loan loss reserves using a risk-based approach. Due to the lack of portfolio diversification of CDC's loan portfolios, both in terms of region, industry, and asset size, the Committee had initial reservations about the applicability of a risk-based approach to the 504 program.

In order to address these reservations, the amendment imposes requirements on those Premier CDCs electing to maintain risk-based loan loss reserves under the second pilot program. The amendment requires these Premier CDCs to meet or exceed specified SBA risk management standards, which include benchmarks for currency, delinquency, defaults, liquidations, and losses. By requiring that Premier CDCs meet or exceed these benchmarks, the SBA can reduce the likelihood that poorly performing CDCs will be able to qualify for the risk-based loan loss reserve pilot program.

The amendment requires that Premier CDCs electing to use the risk-based approach hold a minimum of \$100,000 in their loan loss reserves. By requiring these Premier CDCs to hold a minimum loan loss reserve of \$100,000, the Committee seeks to provide the government with a minimum level of protection as well as to impose a not insignificant opportunity cost on the CDCs. It is the Committee's objective to align the incentives of the qualifying Premier CDCs with those of the government. By ensuring that CDCs are liable for significant costs under the 504 program, the Committee believes that such CDCs will be more likely to behave in a manner that will limit the government's losses.

The amendment also preserves the original legislation's requirement for the quarterly certification of Premier CDCs' risk-based loan loss reserves. Each quarter, qualifying Premier CDCs must submit a certification to SBA that their loan loss reserves are sufficient, as determined by an independent auditor, to protect the government's interests. Because the Committee wanted to ensure that CDCs practice corporate responsibility, the CEO, president, or equivalent senior executive of the qualifying Premier CDC must attest to this quarterly certification.

Because the legislation provides certain CDCs with the authority to use a risk-based approach to determine their loan loss reserves, the amendment increases such CDCs' loss exposure under the 504 program. By increasing the loss exposure from 10 percent to 15 percent for Premier CDCs using the risk-based approach, such Premier CDCs will be more likely to employ rigorous underwriting standards in approving 504 program loans and will be less likely to underestimate their loan loss reserves. This exchange of enhanced authority for increased loss exposure is consistent with the intent of the original PCLP, which provided CDCs with delegated loan approval authority in exchange for increased loss exposure.

In order to ensure that the adoption of this new risk-based approach will not increase the government's risk, the amendment establishes the Bureau of PCLP Oversight. The Bureau will approve and monitor CDCs' risk-based loan loss reserve approaches to make certain that the government's interests are adequately safeguarded. This Bureau will draw on existing resources and will not require new funding. It is simply to ensure that SBA will properly oversee this pilot program.

In the past, the SBA has been negligent in its responsibilities for developing and issuing regulations. Delays in issuing regulations, such as the lengthy periods of inaction following the enactment of the original PCLP program, only serve to hurt small businesses. The Committee believes that it is critical for the agency to take this responsibility seriously because the pilot programs are self-executing; Premier CDCs will be able to start using the pilot program 90 days from the date of enactment, regardless of whether or not the SBA has issued regulations to implement the Bureau's operations. SBA must develop the capabilities to monitor the loan loss reserves of Premier CDCs to ensure that these CDCs are acting appropriately. The Committee expects the SBA to issue regulations in the Federal Register promulgating this legislation within 30 days of its enactment. The Committee expects the regulations to specify SBA's plans for overseeing the Premier CDCs risk-based

approaches and quarterly certifications, certifying auditors under the pilot program, and monitoring the Premier CDCs increased loss exposure requirements.

Finally, the amendment provides for a study of the level of over-capitalization of Premier CDCs' loan loss reserves and an analysis of alternative loan loss reserve approaches. This study will be the basis for further consideration of the loan loss reserve issue and is to be submitted to Congress within 90 days. The Committee intend to use this study to determine whether a risk-based loan reserve approach is appropriate for the 504 program and whether a \$100,000 minimum requirement is sufficient for those CDCs participating in a risk-based program. In addition, the Committee expects the study to discuss the benefits and drawbacks of alternative loan loss reserve approaches.

The excessive PCLP loan loss reserve requirements restrict the ability of Premier CDCs to make capital available to the foundation of the American economy—small business. This legislation proves immediate relief to Premier CDCs that are excessively burdened by the PCLP's loan loss reserve requirements. The legislation, however, does not address the fundamental issue at hand—the extensive and unnecessary processing times of 504 loan applications. By reducing the PCLP's loan loss reserve requirements and introducing safeguards to protect taxpayers, the Committee is taking the first of several near-term steps to centralize, streamline, and modernize the 504 program so that it is better able to meet the needs of small business.

NYDIA M. VELÁZQUEZ.

