Calendar No. 351

115TH CONGRESS
2d Session

SENATE

REPORT
115–265

SMALL BUSINESS 7(a) LENDING OVERSIGHT REFORM ACT OF 2018

JUNE 5, 2018.—Ordered to be printed

Mr. RISCH, from the Committee on Small Business and Entrepreneurship, submitted the following

R E P O R T

[To accompany S. 2283]

[Includiing lost estimate of the Congressional Budget Office]

The Committee on Small Business and Entrepreneurship, having considered the bill (S. 2283) to amend the Small Business Act to strengthen the Office of Credit Risk Management within the Small Business Administration, and for other purposes, reports favorably thereon with amendment in the nature of a substitute and recommends that the bill, as amended, do pass.

I. INTRODUCTION

The Act (S. 2283), was introduced by the Committee's Chairman Senator James Risch and the Committee's Ranking Member Jeanne Shaheen on January 9, 2018. Cosponsors include Senators Michael B. Enzi and Tammy Duckworth.

The Small Business 7(a) Lending Oversight Reform Act of 2018 amends the Small Business Act to codify the Small Business Administration (SBA)'s Office of Credit Risk Management (OCRM) and provide the office with the authority to impose specified monetary penalties on any 7(a) lender that violates the law, regulations or other requirements of the SBA's 7(a) loan guaranty program. The legislation also codifies the Lender Oversight Committee (LOC), which acts as an advisory body to OCRM and has a role in approving formal enforcement actions made by the director of OCRM. The bill also updates and defines the "credit elsewhere" test, and provides flexibility to the Administrator to increase the authorization cap of the program in circumstances where the con-

79–010

gressionally authorized cap is going to be reached before the end of a fiscal year.

II. HISTORY (PURPOSE & NEED FOR LEGISLATION)

The lack of access to affordable capital limits the creation, growth, and expansion of small businesses and is the main contributing factor to their failure. Nearly a quarter of small businesses fail in their first year, and nearly half do not make it past their fifth year. During the 2008 recession, small and medium-sized businesses disproportionately experienced more layoffs and failure rates. This was primarily driven by contraction in credit markets and increased collateral requirements. Bank loans are the main source of capital for small businesses; however, banks have continued to reduce their small business lending. From 2008 to 2016, bank lending to small business decreased by 13.7 percent, while lending to larger firms increased by 48.9 percent.

As part of their mission to promote and support small businesses, SBA manages multiple loan programs designed to provide small businesses with capital. The SBA's flagship loan program is the 7(a) Loan Guaranty Program, which was originally authorized by Section 7(a) of the Small Business Act of 1953. Loans originate from private-sector lenders and a portion of the loan—usually 75 to 85 percent, based on loan size—is guaranteed by the SBA. This program provides small business owners who are unable to obtain credit through conventional lending methods with the capital they need for a broad range of purposes, from working capital for payroll and inventory to financing for changes of ownership, and the purchase of buildings and equipment. The lengthier terms generally available under the 7(a) program reduce monthly payments for small businesses with a maximum loan size of $5 million, and a maximum loan term of 25 years. The program currently operates at zero cost to taxpayers, with costs covered by borrower and lender fees.

Since 2007, the 7(a) loan program has seen growth of 78 percent and the total value of approved 7(a) loans has risen from $17.86 billion in 2013 to $25.44 billion in 2017. This growth has required five authorization cap increases in the past four years. The exponential growth of the program and the need for several emergency increases in the authorization cap have raised congressional concerns about oversight of the program by OCRM, especially the credit elsewhere determination and whether it is being properly documented and verified by SBA, as well as the ability of the program to operate appropriately if the authorization cap proves insufficient before the end of a fiscal year.

To address these concerns, the Committee favorably reported S. 2992 in the 114th Congress. This bill would have codified OCRM and provided the office with more authority for enforcement actions. During the markup of the bill, the Coons-Risch amendment, was approved. The amendment allowed the Administrator to increase the 7(a) loan authorization cap by 10 percent if the intent to increase the cap was submitted in writing to Senate and House appropriators 45 days in advance of taking action. The amendment was substantially similar to S. 2496, the "Help Small Business Access Affordable Credit Act," which was introduced on February 3, 2016 by Senators Christopher A. Coons, James Risch, and Jeanne

Shaheen. Though the bill passed out of Committee, it did not receive consideration by the full Senate. The concerns this bill was meant to address remain, which led to the introduction of S. 2283, the Small Business 7(a) Lending Oversight Reform Act of 2018.

III. HEARINGS & ROUNDTABLES

114th Congress

On May 26, 2016, the Senate Committee on Small Business & Entrepreneurship held a hearing entitled "Oversight of the SBA's 7(a) Loan Guaranty Program." The Honorable Maria Contreras-Sweet, then Administrator of the SBA, served as the hearing's sole witness. The Committee examined whether taxpayers and small businesses would receive more adequate protection by reforming the 7(a) program to strengthen OCRM and authorizing graduated enforcement options that provide OCRM with greater flexibility. The Committee also recognized support for these types of reforms from the National Association of Government Guaranteed Lenders (NAGGL), the Independent Community Bankers of America (ICBA), and the American Bankers Association (ABA).

IV. DESCRIPTION OF BILL

The primary goals of this bill are to strengthen the SBA's ability to conduct effective lending oversight, ensure the credit elsewhere test is being applied correctly by SBA and lenders and appropriately verified by SBA, provide flexibility to the Administrator to ensure the stability of the program, and to provide Congress with information regarding the SBA's oversight actions to ensure the longevity of the program as a critical source of capital for America's entrepreneurs and small business owners. S. 2283 achieves these objectives by codifying OCRM and bolstering its enforcement authority while requiring a budget justification to ensure transparency and effective funding of OCRM, codifying the LOC as an advisory body to OCRM, updating the definition of credit elsewhere, giving the Administrator flexibility to adjust the program authorization, and requiring an annual report to Congress on risk in the program.

V. COMMITTEE VOTE

In compliance with rule XXVI (7)(b) of the Standing Rules of the Senate, the following vote was recorded on March 14, 2018.

A motion to adopt, S. 2283, the Small Business 7(a) Lending Oversight Reform Act of 2018, a bill to amend the Small Business Act to strengthen the Office of Credit Risk Management within the Small Business Administration, and for other purposes, was approved unanimously by a roll call vote as part of a manager's package. Senators Risch, Cardin, Rubio, Paul, Scott, Ernst, Inhofe, Young, Enzi, Rounds, Kennedy, Shaheen, Cantwell, Heitkamp, Markey, Booker, Coons, Hirono, and Duckworth voted for the bill.

Chairman Risch filed a substitute amendment that included a number of technical changes and minor modifications. Senator Booker filed an amendment requiring the SBA to include information on their compliance with an SBA Inspector General (IG) report, *Evaluation of SBA 7(a) Loans Made to Poultry Farmers* (Report Number 18–13, published March 6, 2018), in their first annual portfolio risk analysis report to Congress. The Risch and Booker amendments were included in the manager's package.

VI. COST ESTIMATE

In compliance with rule XXVI (11)(a)(1) of the Standing Rules of the Senate, the Committee estimates the cost of the legislation will be equal to the amounts discussed in the following letter from the Congressional Budget Office:

MAY 22, 2018.

Hon. JAMES E. RISCH,
Chairman, Committee on Small Business and Entrepreneurship, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 2283, the Small Business 7(a) Lending Oversight Reform Act of 2018.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

KEITH HALL.

Enclosure.

S. 2283 Small Business 7(a) Lending Oversight Reform Act of 2018

S. 2283 would direct the Small Business Administration (SBA) to establish the Office of Credit Risk Management (OCRM), which would supervise certain entities that issue loans guaranteed under the SBA's 7(a) loan program, develop risk analysis reports, and perform on-site reviews of those entities' operations. The bill also would direct the SBA to establish the Lender Oversight Committee, which would review the OCRM's recommendations for enforcement action and fulfill other responsibilities, The SBA's existing OCRM and Lender Oversight Committee perform functions similar to those required under S. 2283.

S. 2283 would require the OCRM to conduct additional risk analyses for the SBA 7(a) loan program portfolio, allow that office to impose new sanctions and civil penalties on lenders for certain prohibited actions, and require the SBA to report on enforcement actions taken by the Lender Oversight Committee. Using information from the SBA, CBO estimates that implementing those provisions would require about 10 new employees (at an average annual cost of about $120,000) and cost $6 million over the 2019–2023 period for the agency to meet additional reporting and enforcement requirements and to revise and write new regulations. That spending would be subject to the availability of appropriated funds.

S. 2283 also would require the SBA to supervise on-site reviews of 7(a) loan program lenders, using information from the SBA, CBO estimates that implementing that provision would require about 10 new employees and would have a gross cost of $5 million over the 2019–2023 period. However, the SBA has the authority to recover the examination and review costs of the 7(a) loan program through fees imposed on lenders; therefore, CBO estimates that the net cost of those provisions would be negligible, assuming agency actions consistent with that authority. Enacting S. 2283 could increase revenues from new civil penalties; therefore, pay-as-you-go procedures apply. However, CBO estimates that those revenue increases would not be significant. Enacting the legislation would not affect direct spending.

CBO estimates that enacting S. 2283 would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2029.

S. 2283 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

On May 22, 2018, CBO transmitted a cost estimate for H.R. 4743, the Small Business 7(a) Lending Oversight Reform Act of 2018, as passed by the House of Representatives on May 8, 2018. The pieces of legislation are similar, and CBO's estimates of their budgetary effects are the same.

The CBO staff contact for this estimate is Stephen Rabent. The estimate was reviewed by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

VII. EVALUATION OF REGULATORY IMPACT

In compliance with rule XXVI (11)(b) of the Standing Rules of the Senate, it is the opinion of the Committee that there would be no regulatory impact created by the implementation of this bill.

VIII. SECTION-BY-SECTION ANALYSIS

Section 1. Short title

This section provides the short title for the Act, the "Small Business 7(a) Lending Oversight Reform Act of 2018".

Sec. 2. Definitions

This section defines the meaning of "Administration" and "Administrator".

Sec. 3. Codification of the Office of Credit Risk Management

This section creates two new sections within the Small Business Act by codifying the Office of Credit Risk Management (OCRM) and the Lender Oversight Committee (LOC), and their respective duties.

SEC. 47. OFFICE OF CREDIT RISK MANAGEMENT.

This Office of Credit Risk Management (OCRM) within the Office of Capital Access (OCA) at SBA is charged with the oversight of the SBA lending programs, including the 7(a) program, the 504 program, and the microloan program, as well as lending partners categorized as small business lending companies or non-federally regulated lenders. While this bill provides guidance related to 7(a) compliance, the other oversight functions of OCRM are intended to continue. Though OCRM plays an integral role in the oversight of SBA's lending programs, OCRM's oversight responsibilities are outlined only in Standard Operating Procedure (SOP) 50 53 (A) and Agency Regulations, specifically 13 Code of CFR § 120.1000–1600. To strengthen oversight of the SBA's loan programs and provide OCRM with additional enforcement authority, S. 2283 codifies OCRM and its oversight duties, specifies the director of OCRM must be a career appointee in a Senior Executive Service (SES) position, and provides a clear delineation of the informal and formal enforcement actions the director may take.

One of the vital roles of OCRM is to conduct reviews of lenders to ensure participants are adhering to the requirements of the program. SBA conducts reviews in a number of ways, including onsite and virtual reviews, and largely utilizes third party contractors to conduct these reviews. Industry participants have reported a large number of instances in which the contractor conducting the review is not familiar with SBA programs. Knowledge of the programs is important to conduct a thorough review and ensure appropriate oversight; therefore, S. 2283 requires an SBA full-time employee to lead every onsite and virtual review. This will ensure the integrity of the review process and provide quality feedback to the lender.

Once a review is completed, the SBA does not currently have a timeline the lender can rely on to receive their review findings report. Industry participants have reported wait times as long as 18 months to receive their report. The long wait times for reviews create a number of problems, including the fact that the lender may need to take corrective action based on findings in the review, but are unable to do so until the report is received. To address this issue, the bill includes a timeline for the review process, which will take effect on January 1, 2019. This process requires the SBA to complete and submit its report within 60 days: it is the Committee's intent that the report be submitted within 60 days of the completion of the file review. If the SBA is not able to meet that timeline, the bill allows for the SBA to notify the lender, in writing, of the reason for the delay and the expected submission date of the report. This section is not intended to become an indefinite delay of the report by the SBA, but provide a concrete and timely date in which the lender will receive their report. In turn, if the SBA requires action or response from the lender, the bill specifies that the lender has 45 days to comply with the request and return the necessary documents to SBA.

In codifying OCRM, S. 2283 outlines the informal and formal enforcement actions of the director. These actions are largely outlined in SOP 50 53 (A), with the exception of an enforcement action added in this bill: the use of a civil monetary penalty with the maximum penalty of $250,000. Any civil monetary penalty collected in the course of enforcement is intended to be returned to the United States Treasury Department as a "miscellaneous receipt" used for general support of the government in a process similar to the manner in which the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) penalties are managed. The informal and formal enforcement actions of OCRM apply to all programs OCRM oversees, and not exclusively the 7(a) program.

Informal enforcement actions are generally used when problems are narrow in scope and are correctible and SBA is confident of a lender's Board of Directors and management commitment and ability to correct the issue. The following are examples of informal enforcement actions: SBA supervisory letter, headquarters meeting, board resolution or commitment letter, voluntary actions (e.g., agreement not to sell loans into Secondary Market), or other voluntary agreements between SBA and the lending partner.

Formal enforcement actions usually include, but are not limited to, the imposition of a portfolio guaranty dollar limit, suspension or revocation of secondary market sales or purchase authority, suspension or revocation of delegated authority, suspension or revocation from SBA program participation, agreement or Memorandum of Understanding (MOU) between SBA and the lending partner, debarment, all other actions available under SBA Loan Program Requirements, and all other actions available under law.

The legislation also creates an appeals process for lending partners who receive an enforcement action from SBA by allowing lenders to challenge the action through the Office of Hearings and Appeals, or in federal court. The Committee believes that lenders should have an appeal option within SBA since litigation in federal court can be prohibitively expensive and time consuming.

Additionally, because the SBA uses the Standard Operating Procedure (SOP) process often, the bill includes a specific requirement for SBA to go through the traditional rulemaking process to ensure the informal and formal enforcement actions are put into regulation in a timely manner.

S. 2283 requires the SBA to conduct an annual analysis of the overall program risk of the 7(a) program and provide that information, and other data points, in an annual report to Congress. The Committee believes that the integrity of the 7(a) program and the protection of taxpayer's liability is an important part of the Committee's oversight mandate. An annual report issued by OCRM's Director will give a useful overview of the entire program and will include information that is currently available only on a decentralized and ad hoc basis. This report should include an analysis of the program's risk separately by industries, an analysis of the risk created by lenders who are responsible for lending one percent or more of the gross loan value of the total program, and the actions that the Administrator has taken to mitigate risk. Finally, the report will include the number of lenders, the gross and net number of loans and their values, the number and value of defaults and purchases and the total amount of recoveries made by SBA, the number and type of enforcement actions recommended by the Director, the number and type approved and disapproved by the LOC, and the number and value of all civil monetary penalties assessed. All of these requirements will greatly improve OCRM's transparency.

Finally, it is crucial OCRM has the resources it needs to conduct meaningful oversight of SBA's lending programs. Transparency to Congress of OCRM's budget for salaries and expenses separate from the Office of Capital Access is appropriate to ensure OCRM has the resources it needs to operate effectively and independently. The bill requires a separate internal budget justification for OCRM be submitted to the Administrator. This justification must include salaries and expenses, as well as estimated lender oversight fees, and be kept on file at SBA for public review. This justification will allow Congress to ensure that appropriate resources are provided to oversight functions and these resources are appropriately accounted for.

SEC. 48. LENDER OVERSIGHT COMMITTEE.

An SBA Delegation of Authority document created the Lender Oversight Committee in 2005. This document charged the LOC with reviewing reports on lender oversight activities, reviewing enforcement action recommendations, and voting to recommend or not recommend an action to the Administrator. The LOC's duties were further outlined in SOP 50 53 (A). The Committee believes that establishing the LOC in statute is important to codify their advisory role to OCRM and ensure a checks and balances is in place for enforcement actions. In addition, S. 2283 makes some modifications to the LOC and its operations, including requiring the LOC to meet at least quarterly and report to the Administrator the details of each meeting, including decisions made on enforcement actions.

In order to maintain the current functions and references to OCRM and the LOC at SBA in regulation, Standard Operating Procedure, or other document, the bill includes language to transfer the functions of OCRM and LOC to Sections 47 and 48 of the Small Business Act. This section clarifies that though OCRM and LOC have not been previously included in statute, they will not be terminated and re-chartered.

The SBA currently has the authority to adjust lender fees to provide for improved oversight, as designated in 13 CFR 120.1070 and in 5(b)(14) of the Small Business Act. This authority allows SBA to amend their fee structure to adhere to the provisions in S. 2283. Congress intends for SBA to communicate with lending partners on changes to the fee structure to provide for enhanced oversight.

SEC. 4. Definition of credit elsewhere

The credit elsewhere test is the entry point to the 7(a) program and as such, its determination and documentation is of utmost importance. It is essential to ensure that SBA is only guaranteeing loans that would not be made under conventional market standards. The test was last updated in statute in the 1990s and since that time, SBA has released regulation and a Standard Operating Procedure (SOP 50 10) that offer more updated requirements for lenders. However, these differing requirements have caused confusion amongst lenders about what is required of them to properly comply with the credit elsewhere test.

Therefore, S. 2283 updates the statute by codifying many of the provisions outlined in SOP 50 10 5 (J), and defines credit elsewhere as the availability of credit on reasonable terms and conditions from non-federal, non-state, or non-local government sources—an expansion of the definition, which currently precludes non-state or non-local government sources—and considering factors associated with conventional lending practices, including: the business industry of the applicant, whether the business has been in operation for less than two years, adequacy of collateral, the loan terms necessary to assure the repayment of the loan, and, any other factors that cannot be overcome without a federal loan guarantee under prudent lending standards. The other factors category is meant to ensure borrowers who would benefit from the program are able to access it if their inability to obtain credit elsewhere is not one of the four categories explicitly outlined in the legislation. SBA should consider guidance to lenders on the use of this category, as well as collect data to better understand borrower needs and lender use of this category.

This section also clarifies in statute the necessity for the Administrator to verify the credit elsewhere determination of lenders. The Committee believes it is necessary to explicitly state that the Administrator has the statutory power to oversee the verification of credit elsewhere and therefore, should be verifying the documentation of the credit elsewhere test for every loan.

SEC. 5. Authority for the Administrator to increase amount for general business loans

The 7(a) authorization cap is the total volume of loans that SBA can guarantee each year. Appropriators set the authorization level each year with input from the Senate Committee on Small Business and Entrepreneurship, and the House Small Business Committee. As the program has experienced exponential growth, Congress has raised the authorization cap four times in the past four years. Those increases proved insufficient in 2014 and 2015, when the program reached its congressionally set authorization cap prior to the end of the fiscal year. In 2014, the authorization cap was forecasted to be reached and required swift legislative action to increase it. In 2015, the cap was reached months before the end of the fiscal year and the program was shut down for four days, which required Congress to pass emergency legislation to reinstate lending. Because this program is market driven, it is difficult to predict how much lending will be done in a fiscal year, in particular when these estimates are made 18 months in advance in order to be submitted in the President's annual budget request. When lending nears the cap, it can cause lenders to push loans through at a faster pace and has the effect of creating further uncertainty in the program. The intent of Congress is to create certainty for the program in the long term and prevent a shutdown of the program in the future.

This section gives the Administrator the authority to increase the authorization cap for the 7(a) program by up to 15 percent of the authorized cap if it is determined the cap will be reached before the end of a fiscal year. This authority may only be exercised once per fiscal year and requires notification and approval from the House and Senate Committees on Appropriations and the House Committee on Small Business and Senate Committee on Small Business and Entrepreneurship.

The Office of Management and Budget (OMB) has requested this change in the last three Presidential budget requests.

SEC. 6. Disclosure of waivers

This provision is intended to ensure a documentation process exists at SBA in which any waiver of regulation shall be in writing and kept on file at SBA, and is also accessible to Congress. This process could identify trends in waivers, and will provide transparency to Congress to better understand the types and frequency of these waivers. This section clarifies that this requirement applies only to the regulations under the Office of Capital Access at SBA and does not create any new waiver authority for the Administrator. Neither is this section intended to preclude SBA from working with lenders to waive regulations when prudent and on a case-by-case basis.

SEC. 7. Improved oversight of 7(a) Loans to Poultry Farmers

This section requires OCRM's first portfolio risk analysis report to Congress to include information detailing how the Office of Capital Access complied with the recommendations from the SBA IG report, *Evaluation of SBA 7(a) Loans Made to Poultry Farmers* (Report Number 18–13, published March 6, 2018).

○