

SBA MANAGEMENT REVIEW: OVERSIGHT OF SBA'S ACCESS TO CAPITAL OFFICES

HEARING BEFORE THE COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES ONE HUNDRED FOURTEENTH CONGRESS SECOND SESSION

HEARING HELD
JANUARY 12, 2016



Small Business Committee Document Number 114-037
Available via the GPO Website: www.fdsys.gov

U.S. GOVERNMENT PUBLISHING OFFICE

98-248

WASHINGTON : 2016

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

HOUSE COMMITTEE ON SMALL BUSINESS

STEVE CHABOT, Ohio, *Chairman*
STEVE KING, Iowa
BLAINE LUETKEMEYER, Missouri
RICHARD HANNA, New York
TIM HUELSKAMP, Kansas
CHRIS GIBSON, New York
DAVE BRAT, Virginia
AUMUA AMATA COLEMAN RADEWAGEN, American Samoa
STEVE KNIGHT, California
CARLOS CURBELO, Florida
MIKE BOST, Illinois
CRESENT HARDY, Nevada
NYDIA VELAZQUEZ, New York, *Ranking Member*
YVETTE CLARK, New York
JUDY CHU, California
JANICE HAHN, California
DONALD PAYNE, JR., New Jersey
GRACE MENG, New York
BRENDA LAWRENCE, Michigan
ALMA ADAMS, North Carolina
SETH MOULTON, Massachusetts
MARK TAKAI, Hawaii

KEVIN FITZPATRICK, *Staff Director*
EMILY MURPHY, *Deputy Staff Director for Policy*
JAN OLIVER, *Deputy Staff Director for Operation*
BARRY PINELES, *Chief Counsel*
MICHAEL DAY, *Minority Staff Director*

CONTENTS

OPENING STATEMENTS

Hon. Steve Chabot	Page 1
Hon. Nydia Velázquez	2

WITNESSES

Ms. Ann Marie Mehlum, Associate Administrator of Capital Access, United States Small Business Administration, Washington, DC	3
Ms. Linda Rusche, Director of Office of Credit Risk Management, United States Small Business Administration, Washington, DC	5

APPENDIX

Prepared Statements:	
Ms. Ann Marie Mehlum, Associate Administrator of Capital Access, United States Small Business Administration, Washington, DC	16
Ms. Linda Rusche, Director of Office of Credit Risk Management, United States Small Business Administration, Washington, DC	19
Questions for the Record:	
None.	
Answers for the Record:	
None.	
Additional Material for the Record:	
None.	

SBA MANAGEMENT REVIEW: OVERSIGHT OF SBA'S ACCESS TO CAPITAL OFFICES

TUESDAY, JANUARY 12, 2016

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:02 a.m., in Room 2360, Rayburn House Office Building, Hon. Steve Chabot [Chairman of the Committee] presiding.

Present: Representatives Chabot, Velázquez, Chu, Hahn, Payne, and Meng.

Chairman CHABOT. Good morning. The committee will come to order. Last week we heard from both the Government Accountability Office, the GAO, and the Administrator of the Small Business Administration, the SBA, on troubling management challenges within the agency. What I heard led me to believe that this committee needs to fully review offices within the SBA to ensure that each one is meeting its mission.

We started a series of hearings just yesterday in both full committee and subcommittees to examine various SBA offices and find ways to overcome significant deficiencies. As the President's budget is due to be released next month, it is imperative that these hearings are held to ensure our decisions about funding various programs, and offices are well-informed.

Today's hearing will focus on the Office of Capital Access and the Office of Credit Risk Management. Access to capital continues to be challenging for small businesses. And these two offices have the competing tasks of both promoting the SBA's access to capital programs and ensuring those programs are free of waste, fraud and abuse.

In fiscal year 2015, SBA lending programs had a record year. Lending roughly \$23.5 billion in the 7(a) program and nearly \$4.3 billion in the CDC program, also known as the certified development companies, or the 504 loan program.

As the SBA's lending portfolio continues to grow, it will become even more vital that these two offices work together to establish clear guidance and ensure the integrity of the lending programs. As the committee of jurisdiction, we must ensure that we are conducting aggressive oversight and doing everything within our power to assist small businesses all across the Nation.

I want to thank our witnesses for being here today and we will be introducing you here shortly. At this time, I would like to yield to the ranking member, Ms. Velázquez, for her opening remarks.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman. Our small business sector has made great strides since the financial crisis. According to ADP, small firms with less than 15 employees created over 1.2 million jobs in the past year alone. However, traditional bank loans have only recovered to 85 percent of their pre-recession level, making the SBA's loan programs a critical component of the market.

To help fill the gap, the SBA assists American entrepreneurs and small business owners through a range of capital access programs. Today, we will be examining SBA's management of this initiative.

The 7(a) program is, by far, the largest and most active of all SBA programs. It guarantees general business loans that can be used for everything, from payroll to inventory. Last year, SBA made 63,000 7(a) loans totaling \$23.5 billion, a record for the agency. As SBA's portfolios grow, it is imperative the agency has people and systems in place to conduct necessary lender oversight and protect taxpayers' interests.

I will also note that lending volume on loans \$150,000 or less has shrunk to one-third of pre-recession levels. Similarly, small dollar loans used to account for 25 percent of all dollars approved. Today, that figure is just 10 percent. It is not just about setting loan volume records, it is about ensuring the type of businesses that cannot get credit elsewhere are gaining access to SBA's program. I look forward to hearing from Administrator Mehlum on this subject.

While providing more capital is laudable, it did not come without congressional intervention. Two years in a row, we were called upon, at the last minute, to increase SBA's 7(a) guaranty authority because it underestimated loan activity by 30 and 55 percent, respectively. In response, Congress included report language in the omnibus to ensure we are kept informed of loan activity going forward to prevent the need for emergency intervention in the future. How the agency adheres to this requirement is a top priority, and one I will be watching closely.

Unfortunately, while the 7(a) program is setting records, the 504 program is struggling, and has been on the decline for the past several years. In an effort to spur growth, the 504 refinancing program was recently reauthorized in the 2016 omnibus. These bipartisan accomplishments will help many businesses improve cash flow, expand operations and hire more workers, thereby improving the communities around them.

This is not to say that the 504 CDC program does not have outstanding issues. In fact, six GAO recommendations on program oversight remain open nearly 2 years after the report was issued. I would like to hear how they are being addressed.

It is the responsibility of this committee and one we take very seriously to examine SBA's management practices and ensure that adequate internal controls are in place to administer the capital access programs. While more work remains to be done, I look forward to hearing from today's witnesses on their plans to address these outstanding issues.

With that, Mr. Chairman, I yield back.

Chairman CHABOT. Thank you very much. The gentlelady yields back. I would ask that any committee members who may have opening statements submit them for the record. I will take

just a moment to explain the rules here and the lighting system. You are probably both familiar with it, but we operate under the 5 minute rule. You will each have 5 minutes to testify, and we will ask questions for 5 minutes. And there is a lighting system, the green light will let you know, it will be on for 4 minutes, the yellow light will come on when you have got a minute to wrap up, and the red light will come on and we ask you to complete by the time the red light come on, if at all possible. I may give you a little leeway, but not a whole lot so try to stay within those parameters, if you wouldn't mind.

I will now introduce brief introductions for two witnesses here this morning. Our first witness is Ann Marie Mehlum, who is the Associate Administrator of Capital Access within the Office of Capital Access at the SBA, the Small Business Administration. We appreciate you being with us today.

Our second witness will be Linda Rusche, who is the Director of the Office of Credit Management, also at the Small Business Administration. We welcome you both here and look forward to your testimony.

And Ms. Mehlum, you are recognized for 5 minutes.

STATEMENTS OF ANN MARIE MEHLUM, ASSOCIATE ADMINISTRATOR OF CAPITAL ACCESS, UNITED STATES SMALL BUSINESS ADMINISTRATION; AND LINDA RUSCHE, DIRECTOR OF OFFICE OF CREDIT RISK MANAGEMENT, UNITED STATES SMALL BUSINESS ADMINISTRATION.

STATEMENT OF ANN MARIE MEHLUM

Ms. MEHLUM. Thank you, Chairman Chabot and Ranking Member Velázquez. Thank you so much for giving me the opportunity to testify today before this committee.

As the associate administrator for capital access, I am responsible for the SBA's loan and surety bonds guaranty program, which consists of the 7(a), the 504, the Microloan and Surety Bond Programs. As a former community banker who relied on these tools for many years, I have seen firsthand how they programs help support small businesses and working families across America. My time at SBA has only deepened my respect for the programs and their direct impact.

At SBA, we view our role as one of filling an unmet need in the lending marketplace. The goal is to help small businesses access credit when a conventional loan is otherwise unavailable, due to insufficient collateral or equity, startup status, or a host of other credit challenges.

Administrator Contreras-Sweet has asked my office to focus on ways to streamline and modernize our programs, recruit new lending partners, increase our service to minorities and underserved markets, and develop policies that are in line with the experience of small businesses in today's economy.

Last year, as both the chairman and the ranking member have noted, our flagship 7(a) program approved over \$23.5 billion in gross loans, a record loan volume in SBA's history. However, there is still much work that needs to be done.

I want to extend my gratitude to this committee for leading Congress in providing additional authorization to meet this marketplace need in 2015. SBA's growth in small dollars, or loans of \$150,000 or less is also worth highlighting. Studies show that nearly 90 percent of business loan applications are for these small loans. And with gaps in the lending marketplace, many of the Nation's underserved small businesses often rely upon higher cost alternatives. Under the Administrator's leadership, SBA has actively encouraged lenders to expand access to these loans. And I am pleased to report that since last year, small dollar loans have increased by 22 percent.

SBA's commitment to underserved lending is also evident in our recent extension of the Community Advantage Pilot Program. Created in 2012, lenders participating in community advantage are required to make at least 60 percent of these loans in underserved markets. SBA's Microloan Program completed a rule change effective July 2015 that, for the first time, allows microloans to be made to individuals on parole and probation. This new rule aligns with White House and interagency initiatives to make capital available to credit-ready individuals in some of our hardest-to-reach communities.

Last year, we launched SBA One, and end-to-end modernization of 7(a) loan programs accounting platform. Its goal was to make doing business with the government easier by reducing the cost, time and uncertainty in submitting a loan guarantee application. SBA One incorporates electronic signatures to complete documentation, interactive online decisioning logic to determine a small business's eligibility for a loan guarantee, as well as autopopulated forms to reduce redundant processing.

We have consulted our lending partners in developing and refining SBA One; we have enrolled hundreds of lenders to use the systems; and we reviewed over 1,000 loans via SBA One since its launch. We continue to encourage small business growth by encouraging new lenders join our program. Currently, a little more than one-third of the Nation's banks are active participants in SBA's lending programs. Despite recruiting many lenders since 2014, there is opportunity for better coverage by increasing this participation level.

We continue to clarify and simplify our rules in standard operating procedures for our lending programs without adding additional financial risk.

For the 504 development company loan program, we are working hard since the passage of the 2016 omnibus to implement 504-Refi. And finally, we continue to improve the oversight function for SBA's loan programs, which will be addressed in more detail by my colleague, Linda Rusche, the Director of the Office of Credit Risk Management.

We must keep these programs relevant and cost effective for lenders. For both programs in 2016, we have returned to zero subsidy. That's a huge win for the taxpayer. I am confident, with the continued support of this committee, SBA will continue to improve its service to America's small businesses, which will result in more jobs and economic growth. Thank you.

Chairman CHABOT. Thank you very much. Ms. Rusche, you are recognized for 5 minutes.

STATEMENT OF LINDA RUSCHE

Ms. RUSCHE. Thank you, Chairman Chabot and Ranking Member Velázquez, for the opportunity to be here today and testify before the committee regarding the Office of Credit Risk Management at SBA. As the president of OCRM, I am responsible for the oversight and risk management of SBA's lenders and loan guaranty portfolios of the 7(a) and the 504 development company loan programs.

I have spent the better part of two decades in this activity, lender oversight and loan program risk management, first, from the Kansas City review branch, and, for the last 2 years, here in Washington.

SBA's Administrator Contreras-Sweet is a leader in championing small business lending, while maintaining prudent credit standards in our loan programs. SBA's particularly interested in balancing the growing credit needs of America's small businesses with prudent lending, always ensuring that we are meeting the requirements of our mission in accordance with the Small Business Act.

SBA's role is to fill an unmet need in the marketplace to help creditworthy small businesses access credit when a conventional loan is not available. SBA also is critical in providing credit to underserved markets. As of September 30, 2015, we monitored a 7(a) loan portfolio in excess of \$70 billion and approximately \$26 billion in 504 debenture guarantees. We monitored all 7(a) lenders and CDCs using our loan and lender monitoring system, what we call LLMS, which tracks the monthly performance of all 7(a) and 504 loans and assigned a quarterly risk rating to each loan.

OCRM also updated our methodology for oversight of the SBA operations of federally regulated 7(a) lenders and of CDCs this past year. These methodologies feature a composite risk measurement and a scoring guide known as PARRiS for 7(a) program and SMART for the CDC, or 504 program. Benchmarks of historical and projected performance have been developed for PARRiS and SMART, and provide relative measures of lenders financial risks, specific to each program. By using both predictive and historical performance measures, OCRM obtains a holistic picture of lender risk upon which we consider oversight activities as needed.

Other accomplishments in 2015 include conducting over 1,200 assessments to renewed delegated authority for our 7(a) and 504, or CDCs; completion of over 145 corrective action assessments from previous review activities; and approval of our 100th community advantage lender.

Turning to supervision and enforcement, OCRM issued six increased supervision actions to 7(a) lenders and CDCs this past year for a failure to follow loan program requirements, and debarred or suspended over 30 agents or representatives from conducting further business with SBA.

In fiscal year 2016, OCRM will continue to conduct a portfolio diagnostic of every lender using historical performance, predictive credit scores, and the PARRiS and SMART methodologies. OCRM

also will continue to monitor lenders through programmatic risk-based review.

In 2016, OCRM plans to conduct in-depth analysis using our SBA loan database to investigate existing risk, identify developing risk areas, and to inform program changes under consideration. And SBA also continues in active discussion with primary Federal regulators on such topics as information sharing and vendor management. Through exchange of information, we can bring improved oversight and monitoring to our activities and theirs, minimizing duplication.

I thank you for the opportunity to share this information, I will be happy to respond to any questions.

Chairman CHABOT. We thank you very much for your testimony also, and now we will turn to the committee and I will begin with myself here. I recognize myself for 5 minutes.

Ms. Mehlum, let me start with you. Last year, Congress had to act very quickly when the 7(a) program reached its lending cap to ensure that small businesses would be able to continue receiving loans from that important program. What are ways that the SBA is currently managing the 7(a) program to ensure that this doesn't occur, or does occur, that Congress is notified in a more timely manner so that we don't bump up against, literally, the program closing down. And a lot of small businesses—we got, I'm sure a lot of us, especially the ranking member and myself, got a lot of calls from constituents all over the country who were afraid the program was going to end. Congress, for a change, got its act together and worked with the administration, and the House and Senate worked together in conjunction with the SBA. But we would like to avoid that, if at all possible the next time, so we would like to hear how we can avoid that from happening?

Ms. MEHLUM. Yes. We would like to avoid that as well, because that was unsettling at the end of the year last year. We watch those numbers every single day. We didn't really have a formal mechanism last year. We started talking, I think, informally with members here, probably 6 months before the end of the year. This year, as you know, you have asked us and we are working on the first report. We will be reporting to you the numbers each quarter. So far we are looking like we are within our need for 2016, but we will work with you and report those numbers every quarter and work together to ensure that we don't have kind of a last minute fire drill. We would like to avoid that as well.

Chairman CHABOT. Good. Yeah, I think we should be working together on this to make sure it doesn't happen again. Ultimately, it got taken care of.

Ms. VELÁZQUEZ. Mr. Chairman, may I ask a question related to this?

Chairman CHABOT. I will yield to the ranking member.

Ms. VELÁZQUEZ. So how much 7(a) capital is the SBA estimating it will provide in fiscal year 2016?

Ms. MEHLUM. I think our estimation for this year is \$26.5 billion, which is what we have in the 2016 omnibus.

Ms. VELÁZQUEZ. Thank you.

Chairman CHABOT. Reclaiming my time.

Last year, Congress took a good idea from the SBA regarding waiving upfront fees on express loans to veterans. Are there other SBA initiatives underway within your offices that you think the committee should be aware of which could bolster access to capital for small firms across the country? Would you like to take that again?

Ms. MEHLUM. This year we are continuing with our no fees on loans under \$150,000, that is, no fees to lenders and no fees to borrowers. We know that those small loans that the ranking member pointed out really do serve the underserved markets the best. We have higher percentages in all the underserved markets in the smaller loans. So we are trying to keep making these loans attractive for lenders to make. They are very costly for lenders to make, so we work hard to make those loans attractive. We also have a smaller fee on veterans' loans over \$350,000, which was in addition to the app that you provided us late last year for veterans fees under \$350,000.

Chairman CHABOT. Thank you. As you know, the GAO did a report and we had a couple hearings on this last week. And, you know, I brought up the point that we have seen the IRS, and OPM, and the State Department, even the White House hacked recently within the last year or so. According to the report, there were some concerns about how the SBA is protecting sensitive information, which they certainly have access to a lot of stuff that the business community, small businesses wouldn't want to be out there to either their competitors or the Chinese or anybody else. So could you tell us how quickly you intend to improve in that area?

Ms. MEHLUM. Well, I appreciate that question, because one of the big accomplishments of last year was that we managed to get all the loan systems on to a new platform that has passed total muster with our auditor, which audited the system. It has also been tested and viewed by all the major banks that interface with us. So the loan system is on a new system. It is not on the system that had been criticized in the past in GAO audits. We are very excited about that. We feel not that we are not continuing to monitor it and looking at what we need to do to make sure that we have as tight a security as possible, but that system got totally migrated onto a new system last year.

Chairman CHABOT. Let me squeeze in one more question here. I am almost out of time here. One challenge we heard repeatedly is that the SBA's loan process takes too long, that people literally give up. What are you doing to modernize the program? We heard the computer systems don't talk to each other, and been pretty much a mess, frankly. You really need to step up on that. What action are you involved in at this time to improve that?

Ms. MEHLUM. Chairman Chabot, I love that question because I am a former banker. All my life, I was in lending. My last job, I was a CEO of a bank that really was a business bank in Oregon. And I loved having the SBA tools in my tool box, but even my little bank got to the point where it was tough for us to ask for an SBA guaranty on a small loan because of the process. And that is one of the reasons why I accepted this assignment was because I wanted to sure that the SBA loans can be processed in a cost-effective way by lenders.

So we are attacking it in a number of ways. One is modernization through technology. We have talked about SBA One. It is a platform that allows lenders to apply for a guarantee in an interactive interface online. It is kind of like TurboTax, it is an online iterative approach. It also helps, therefore, with eligibility issues and you don't have to go to the 300-page SOP to find the solution. A lot of that is right built into the system.

The other thing that we are doing, that we are working on all the time, and we have got a couple of major initiatives going on right now, is simplifying, simplifying and clarifying our requirements. We are working hard on clarifying our affiliation and our franchise rules, for example, as we speak. So both in terms of technology and in terms of simplifying and streamlining our process, those are the things that I feel like I spend 99 percent of my time on.

Chairman CHABOT. Thank you. My time has expired, but I would just urge you to do everything possible to reduce the amount of time that it actually takes a small business to get through the system, because it is one of the largest areas of complaints I hear as chair of the committee. I'm sure my colleagues do, too.

I will now recognize the ranking member for 5 minutes.

Ms. VELÁZQUEZ. Thank you. So Ms. Mehlum, the system that you said passed muster in terms of loan processing, is that SBA One?

Ms. MEHLUM. SBA One is on that same platform. But also SBA One—the thing that is new with SBA One is that is the interface with the lender. The accounting system behind that, which keeps track of our guarantee in every single loan wherever it is, is the fiscal transfer agent system, and that system that entire system has been moved to the new platform.

Ms. VELÁZQUEZ. So you are telling us today that you are on a better path compared to LLMA's past decade experience?

Ms. MEHLUM. Yes.

Ms. VELÁZQUEZ. In delays, and cost overruns, and questionable results, you are saying we are in a better—

Ms. MEHLUM. Yes. It was a huge accomplishment, it was really an initiative that took several years.

Ms. VELÁZQUEZ. So let's talk about last week's GAO report to us. Mr. Bill Shear talked about the 504 loan program. In 2014, GAO pointed out to some recommendations. Two years later, those recommendations are still open. Can you explain to us why that is?

Ms. MEHLUM. The only recommendation that I am aware of regarding the 504 program is still open. And keeping in mind that it takes time sometimes when we complete a recommendation for them, then, to get back to us and agree that we have completed it. But the one that I am aware of that is still open has to do with economic—the requirements for CDCs to invest in economic development in their communities. And we have just issued a notice to get public feedback on how we do that requirement, how we are going to meet that requirement. So we are on the path to complete that GAO—

Ms. VELÁZQUEZ. Have you met with GAO to discuss ways to close those recommendations?

Ms. MEHLUM. My team has met with them recently. I have met with them, but it has been probably 6 months since I've personally met with them. But my team meets with them, and our team meets in OCA every other week and talks about completing the GAO audit items. We actually completed a whole bunch of them last year. I have been here for 2 years, we have completed more GAO audit items than we have created. That is my goal, is to get them responded to and handled.

Ms. VELÁZQUEZ. In response to GAO's recommendation that SBA conduct more program evaluations, SBA said it is currently restricted from collecting data from small business resource partners, or does not have adequate information collection systems making evaluations difficult. Can you elaborate on that?

Ms. MEHLUM. That is something I am going to have to look into, Ranking Member Velázquez. I am not aware of that particular issue, but I will get back to you on it.

Ms. VELÁZQUEZ. Because if that is the case, then you need to tell us how can we improve your ability to collect data so that you could perform the type of evaluations that are important.

Ms. MEHLUM. I agree, and I will get back to you on that.

Ms. VELÁZQUEZ. Thank you.

Director Rusche, in its March 2014 report, GAO stated that SBA had planned to implement its new SMART process for assessing the CDC program by June 1st, 2014. Has SMART been fully implemented? And have you conducted any analysis of its impact today?

Ms. RUSCHE. Thank you so much for that question, because I am pleased to tell you that yes, SMART is fully implemented. We are conducting assessments of CDCs in accordance with those protocols. We issued a notice in August of this year to formalize that to all individuals. We have not conducted a formal assessment of the results of SMART itself, but we are conducting oversight and further management activities with CDC's relative to the results of the SMART reviews, which allow us both onsite and offsite capability to interact with them and keep costs low while activities efficient.

Ms. VELÁZQUEZ. Thank you. I yield back.

Chairman CHABOT. The gentlelady yields back. The gentlelady from California, Ms. Chu is the ranking member of the Economic Growth, Tax and Capital Access Subcommittee, is recognized for 5 minutes.

Ms. CHU. Ms. Mehlum, I am thrilled to say that at the end of 2015, Congress made permanent a program that I had been championing with my bill, the CREED Act for the past two Congresses. It is the 504 CDC debt refinancing program that allows small business owners to refinance existing commercial debt with long-term fixed rate financing so that they can create jobs and boost economic growth. In its trial year of 2012, over 2,700 businesses refinanced nearly \$7 billion in old expensive debt, so it was clearly a very popular program, but then allowed to expire at the end of 2012.

I would like to thank the chair and the ranking member for their support in getting this bill to be in the bill that was passed in 2015. So it's my understanding that SBA has begun to craft the regulations for this program. Can you provide an update on these regulations? Can you tell us how the process is going? And do you

have a timeline for the approval process for the regulation? And how long after the regulation's release do you think small businesses may be able to apply for the program?

Ms. MEHLUM. I can give you some rough information. We have been working on this with our general counsel and with OMB. We are officially trying to be ready to launch and be able to process refi loans in June, but my goal is to get it done before that. It's just all the steps of getting the rule out. One of the things that we are trying to do this time is to make the process as simple and less complicated. It was very complicated last time. We are trying to simply it where we can and still meet our regulations. So we are hoping to have it ready for prime time in June, but as I say, my goal is to get it done before that.

Ms. CHU. That sounds great.

Now what regulations do you anticipate may be different in the permanent program versus the previous temporary program?

Ms. MEHLUM. I think some of the regs that are different from the old program have to do with some changes that we have made during this last year. We had some look-back provisions. When a company refis its debt, in our old program we required them to show evidence of debt that might have been 5, 10, 15 years old. Between that old program and now, we have simplified some of those rules already. So we will be implementing that kind of streamlining in the new rules so that it is not so onerous on the borrower to have to show evidence of what the debt was on their books for. That is just one thing that comes to mind.

I would like to respond more carefully to your question and I would like to go back and ask my team for these details, if you would like me to.

Ms. CHU. They would still have to show debt, but the way in which they do it is more—

Ms. MEHLUM. If they have debt on their books, we have made it simpler. So if they show debt on their tax returns—and I don't want to go into the weeds because I will get it wrong—but if they show debt on their tax returns, rather than having them to have to dig back and show us the notes and the payment records of loans that are over 2 or 3 years old, we will take the fact that they have debt showing on their tax return and be able to refi that debt without them having to dig for a lot of old paperwork to confirm that that was actually debt that we are refinancing.

Ms. CHU. I see. That sounds good.

And in what form will these regulations be released? Standard operating procedure? Or interim? Final? Or what?

Ms. MEHLUM. This is one of the things we are looking at right now. My understanding is that there will be a reg to address a couple items, and then we will have to also make our standard operating procedures fit that reg and have the details that we need for processing, that's why it is going to take 4 months to 5 months to get this done.

Ms. CHU. And will you need additional staffing resources to help with this process and this program?

Ms. MEHLUM. That would be nice. Right now we are doing it with our existing staff. It is a high priority for the 504 program. One of the things that I did want to add is the 504 program has

lagged a little bit in the last few years, and we focused the last few years on governance of that program to make sure that the CDCs are operating in a healthy manner. This year we are really going help to focus on growing that program, helping market that program, streamlining so that that program can grow. It is a great program. I used it as a banker. I had many customers that were able to get into their own real estate because of that program. So in general, we are going to really focus on helping that program grow this year.

Ms. CHU. Thank you.

Chairman CHABOT. Thank you.

The gentlelady's time has expired. The gentlelady from California, Ms. Hahn, is recognized for 5 minutes.

Mr. HAHN. Thank you, Chairman Chabot, for holding this important hearing. It was interesting last week that Administrator Maria Contreras-Sweet testified to this committee; the extremely positive steps that she has taken to make the SBA a more accessible and efficient agency since taking on her role. She reported a record year in small business lending, a record year in investment, a record year in contracting, all with zero taxpayer subsidies needed to sustain this kind of momentum. I applaud her great record of helping the needs of small businesses across this Nation.

In your testimony, Administrator Mehlum, you stated that SBA loans to women and minority groups have increased by 20 percent each year under her leadership, and we find an even more impressive number achieved when it comes to loans to veterans, an increase of 103 percent. This is great for Los Angeles County where we come from. It has more women-owned businesses than any other county in the country, and where 55 percent of businesses are minority-owned. These statistics show that SBA is moving in the right direction, even under the oppressive sequestration.

We know that there is more work to do. And what I wanted to ask you, Ms. Mehlum, is one of the things that you said was that roughly one-third of our Nation's banks actively participate in SBA's lending programs. This is despite SBA working to recruit more lenders since 2014. In my district, there are dozens of different banks that businesses turn to for their banking needs. And many businesses have special relationships with their bank of choice and have a history of being long, loyal customers. So if only one-third of the banks are participating with SBA, then a majority of the businesses are likely banking with an institution that does not work in a lending partnership with SBA. So why do you think there is only a one-third of banks participating? What are you doing to increase that? And how do credit unions—how are they a part of this scenario?

Ms. MEHLUM. Okay. So, I really appreciate that question. Again, as a former banker, I thought that having the SBA guaranty, you know, a tool in my toolbox, was always a phenomenal way to help a customer that I just couldn't quite underwrite with depositors' dollars. And, really, the SBA guaranty loan programs epitomize to me the best of public and private partnerships because here we have lenders, regulated lenders in the field making loans, and the SBA just steps in to guarantee for the weakest of credit,

the weakest of borrowers, and at zero subsidy. So it is a fantastic program.

One of the problems over time that can happen in Federal Government is that the program became harder and harder to implement. Chairman Chabot has pointed out that he gets most of the complaints because it takes so long to get a loan guaranty approval, which is the problem that we are working to solve with automation, technology, and streamlining and simplifying our procedures. And the other thing that we have to do is we just have to get out to those banks and market to them and show them how SBA has changed and grown and improved.

But you are absolutely right. We have a lot of opportunity by bringing back and bringing in more lenders. We do have initiatives with credit unions right now, we are working with credit unions, especially those who do business lending, and we have increased participation among credit unions as well.

Mr. HAHN. Well, I appreciate that. And that was really the nature of the only thing I really wanted to ask you. It is so interesting that from the time I have been on this committee, you know, sort of the number one issue with our small businesses is not really any oppressive regulations or, you know, other things that we might think are holding them back, it is access to capital. Many of them want to get, you know, even a small- or medium-sized loan. And we know that when they get that loan, you know, they will expand and they will hire. And I have seen that replicated many times in my own district. So we just need to get more banks, you know, with the program and show them that it is something positive for our economy.

And really one of the regrets I think—I wasn't here for the bailout of our banks, but I think one of the regrets is that in exchange for that taxpayer bailout, that we didn't put a little more requirement or obligation on their end to get back and lend those dollars back to—particularly the small businesses in this country who we know are really the backbone of this economy. So, thank you. We think you are going in the right direction, but we want you to get more banks with the program.

Chairman CHABOT. Thank you. The gentlelady's time has expired. I would just note, I certainly agree with the gentlelady from California's comment about the access to capital is a big problem, but I personally have heard lots and lots of examples of overregulation being a serious concern of small businesses across the Nation, too. But I would just note that for the record.

The gentlelady from New York, Ms. Meng, who is the ranking member of the Agriculture, Energy and Trade Subcommittee, is recognized for 5 minutes.

Ms. MENG. Thank you, Mr. Chairman, and thank you to our witnesses for being here today. I just want to piggyback a little bit off of what Ms. Mehlum's response to Congresswoman Hahn about the recent changes to the Office of Capital Access. At last week's hearing, we discussed a lot about the continuity at the agency during administrative transitions. Can you explain how these offices have been set up, or are improving in handling these transitions?

Ms. MEHLUM. Thank you for that question. It just so happens that our Administrator has already begun a process at the SBA. In

fact, we had a retreat last Friday to work with our career, as well as our appointed leaders to ensure that there can be a smooth transition, and that initiatives underway will continue. And I can tell you that in the Office of Capital Access, we have a wonderful team of executives, including Linda Rusche, who has been with the agency for—I won't tell how many years—who knows this program and given the right leadership from this committee and the right resources, will continue to run these programs effectively and positively for the taxpayer as well.

Ms. MENG. Thank you. Many businesses in my district have been able to avail themselves of 7(a) and 504 loans, which are critical sources of support for entrepreneurs. Despite the fact that many entrepreneurs are also immigrants, I hear that these minority-owned businesses often struggle to find the resources they need. And last week, the Administrator did talk about improvements that have been made. And I commend all of you for that.

What more can the Office of Capital Access do to ensure that you are reaching out to more and more entrepreneurs throughout all of our districts?

Ms. MEHLUM. Well, this is a main objective and initiative. We talk about it everywhere. We work with our trade partners. As you know, we have a real strong association with NAGGL. They have a committee that helps working with us to reach underserved markets, to find those borrowers who don't normally have access to capital. We are doing it with pricing, as I mentioned, by keeping the small dollar loans less expensive. We are doing it just with outreach and communication. We are doing it in the community advantage program by requiring that 60 percent of those loans go to underserved markets. We are also, you know, working very hard on our Microloan program, which is the starting point for all borrowers, as having a major impact on underserved market lending.

So we are working basically on several fronts, but it is top of mind, and we track it, and we follow it, and we talk about it. We look at numbers every single month. We talk about it at conferences, we talk about it in our training, and it is an important, important focus of the Office of Capital Access.

Ms. MENG. Thank you. I yield back.

Chairman CHABOT. Thank you. The gentlelady yields back. The gentleman from New Jersey, Mr. Payne, is recognized for 5 minutes.

Mr. PAYNE. Thank you, Mr. Chairman.

Ms. Mehlum, when I visit small businesses in my district, by far, one of the most heard concerns naturally is the barriers access to capital, and particularly accessing smaller dollar loans. While six in 10 SBA loans are for \$150,000 or less, this is still below the benchmark set in 2007. And this deficiency remains unchanged year after year. What steps is SBA taking to increase loans for businesses that need them the most, and, specifically, loans under 150,000?

Ms. MEHLUM. So that's the issue that I am trying to articulate that we are emphasizing very much making those loans. We have reduced fees on small dollar loans; we have initiatives with our veterans' business development group to ensure that we are reaching

veterans groups. We have a special office in the SBA that helps us reach women's groups.

In the Office of Capital Access, we have the Office of Economic Opportunity which is—our director there, Grady Hedgespeth, basically his team focuses full-time on ensuring that our loan products, all of them, 7(a), 504, community advantage and microloans are reaching into the underserved markets. It is a challenge, we have work to do, we are making good progress. It has been a priority of our Administrator, and it has been my priority, and we are going to see growth again next year. And if you can help us figure out how to do it better, we are definitely open for suggestions. But it is a priority, and we are trying to hit it on various fronts.

Mr. PAYNE. The information that I receive in terms of preparing for this hearing is, since 2007, there hasn't been much change.

Ms. MEHLUM. Well, you are talking about the percentages of those loans, but one of the things that has happened since 2007 is somewhere in there, the maximum loan size has gone up. I think it went up from \$2.5 million to \$5 million—was it 2010? I wasn't with the SBA then, and I don't recall exactly, but just by the very nature that we now do loans between \$2.5 million and \$5 million, I think excuse those statistics that you are looking at. For us, we made 22 percent more loans in 2015 than we did in 2014 in the size category of 150 and below.

Mr. PAYNE. Okay. Since you brought it up, I will ask this question: In the last year's budget justification, SBA stated they will continue implementing revised 504 regulations, but did not provide any details. What steps has the SBA taken to address these problems in the 504 CDC program?

Ms. MEHLUM. Could you be a little more specific? You are asking about 504 regulations that we did not implement?

Mr. PAYNE. Right. You state—it is stated in the justification that you will continue implementing revised 504 regulations, but you were not—it was not detailed.

Ms. MEHLUM. Okay. So I know this last year, we implemented a number of 504 regulations, most of them having to do with governance of CDCs, they were in effect in April, of 2015? 2014.

Ms. RUSCHE. Published in 2014.

Ms. MEHLUM. Published in 2014. I am looking to my experts here. And we have implemented a number of 504 governance regulations since we last testified. Is that what you are referring to? I am sorry, I am not quite catching your question.

Mr. PAYNE. Well, you are familiar with the year's budget justification—

Ms. MEHLUM. Right.

Mr. PAYNE. —that you do that, right? And so, in it, you stated that you would continue to—implementing revised 504 regulations. Obviously, there are issues with the program, correct?

Ms. MEHLUM. Yes. I mean, we have issues everywhere, everybody—we have issues. We are working on our issues all the time. Yes, we did, just last year, do a number of implementing 504 regulations.

Mr. PAYNE. Okay. Well, obviously, there is still an issue about getting clarification and some specificity in what those changes are, because you are still having a problem right now being specific

about it. But we would hope that you would continue to work towards working on those issues, and I will yield back.

Chairman CHABOT. The gentleman yields back. I would like to thank you both for participating in the hearing this morning. The government has long recognized the need to aid entrepreneurs and small businesses across the Nation so that they have access to capital necessary to create jobs. And it is the principal thing, I think, the SBA does is the loan programs, the guaranties that you are responsible for. As you know, the GAO report released recently informed this committee that there is still some significant mismanagement issues at the SBA. For example, they had made 69 recommendations, and of those, only seven had been implemented. A lot of the committee members were quite concerned about that last week. And we urged rapid improvement on those recommendations. They have yet been implemented.

So, there is obviously still considerable room for improvement. This committee would urge you to take action on these items, because after all, the principal purpose of the SBA and the oversight responsibilities of this committee is to make sure that we are serving the small businesses all across this country. Please work very hard at this, and we will keep an eye on you. So thank you very much for your testimony here this morning.

I would ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record. And if there is no further business to come before the committee, we are adjourned. Thank you very much.

[Whereupon, at 10:54 a.m., the committee was adjourned.]

A P P E N D I X



U.S. Small Business Administration

TESTIMONY of

ANN MARIE MEHLUM

Associate Administrator, Office of Capital Access
U.S. Small Business Administration

House Small Business Committee

Tuesday, January 12, 2016

Thank you for the opportunity to testify before this Committee, Chairman Chabot and Ranking Member Velazquez. As the Associate Administrator for Capital Access, I am responsible for the SBA's loan and surety bond guaranty programs which consist of the 7(a), 504, Microloan, and Surety Bond Programs. As a former community banker who relied on these tools for many years, I have seen firsthand how these programs help support small businesses and working families across America. My time at SBA has only deepened my respect for the programs and their direct impact.

At SBA, we view our role as one of filling an unmet need in the lending market place—the goal is to help small businesses access credit when a conventional loan is otherwise unavailable due to insufficient collateral or equity, start-up status or a host of other credit challenges. Administrator Contreras-Sweet has asked my office to focus on ways to streamline and modernize our programs, recruit new lending partners, increase our service to minorities and underserved markets, and develop policies that are in line with the experience of small businesses in today's economy.

Last year, our flagship 7(a) program approved over \$23.5 billion dollars in gross loans—a record loan volume in SBA's history. However there is still much work that needs to be done. I want to extend my gratitude to this Committee for leading Congress in providing additional lending authorization to meet this market place need. Your action, which provided the necessary guarantee authority in 2015, helped SBA fulfill its mission and ensure small businesses continue to benefit as our economy recovers.

In addition in our Surety Bond Guaranty Program, SBA guaranteed 11,000 bonds representing some \$1.3 billion dollars in contracts awarded to small businesses. I am appreciative of this committee's support of the surety program changes in the National Defense Authorization Act. This law increased the guaranty percentage in the Surety Bond Preferred Program from 70 percent to 90 percent—a significant win for small businesses.

SBA's growth in small dollar loans, or loans of \$150,000 or less, is also worth highlighting. Studies show that nearly 90 percent of business loan applications are for these small loans, and with gaps in the lending market place, many of the nation's underserved small businesses often rely upon high-cost alternatives.

Under the Administration's leadership, SBA has actively encouraged lenders to expand access to these loans. And, I am pleased to report that since last year small dollar loans have increase **by twenty-two percent**. Similarly, there have been significant gains in 7(a) lending to underserved groups; specifically:

- Loans to women increased by twenty-percent over the previous year;
- Loans to veterans increased by 103 percent; and
- Loans to all minority groups increased by twenty three percent from 2014 to 2015.

SBA's commitment to underserved lending is also evident in our recent extension of the Community Advantage Pilot Program to 2020. Created in 2012, lenders participating in Community Advan-

tage are required to make at least 60 percent of CA loans in underserved markets. In FY2015 the program approved more than \$100 million in lending in just one year, surpassed \$200 million since its inception in 2012, and recruited its 100th lender.

SBA's Microloan Program completed a Rule change effective July 2015, that for the first time allows microloans to be made to parolees and probationers. This new rule makes aligns with White house and Interagency initiatives to make capital available to credit ready individuals in some of our hardest to reach communities.

Last year, we launched SBA One: an end-to-end modernization of the 7(a) Loan program's fiscal transfer agent system. Its goal is to make doing business with government easier by reducing the cost, time, and uncertainty in submitting a loan guaranty application. SBA One incorporates electronic signatures to complete documentation, interactive online decisioning logic to determine a small businesses's eligibility for a loan guaranty, as well as auto-populated forms to reduce redundant processing. We have consulted our lending partners in developing and refining SBA One, enrolled hundreds of lenders to use the system, and have approved over 1000 loans via SBA One since October 2015.

We can continue to encourage small business growth by encouraging new lenders to join the program. Currently a little more than 1/3 of the nation's banks are active participants in SBA's lending programs. Despite recruiting many lenders since 2014, there is opportunity for better coverage by increasing this participation level.

We continue to clarify and simplify our rules and Standard Operating Procedures for our lending programs without adding financial or reputation risk.

And, we continue to eliminate 'non-value add' tasks at our nine processing centers nationwide. This initiative for center efficiency is a multi-year undertaking which seeks to reduce the time it takes for lenders to process, service and collect SBA guaranteed loans.

For the 504 Development Company Loan Program, we are working hard since the passage of the FY 16 Omnibus to implement 504-Refi.

Finally, we continue to improve the oversight function for SBA's loan programs, which will be addressed in more detail by my colleague, Linda Rusche, who is the Director of the Office of Credit Risk Management.

We must keep these programs relevant and cost effective for lenders who make loans to small businesses. For 2016 both the 7a and 504 programs have returned to zero subsidy—a win for the taxpayer. I am confident that with the continued support this Committee has provided us, the SBA will continue to improve its service to America's small businesses, which will continue to provide jobs and economic growth.



U.S. Small Business Administration

TESTIMONY of

LINDA RUSCHE

Director, Office of Credit Risk Management
Office of Capital Access
U.S. Small Business Administration

House Small Business Committee

Tuesday, January 12, 2016

Good morning, Chairman Chabot and Ranking Member Velazquez, and thank you for the opportunity to testify before this Committee on the Office of Credit Risk Management (“OCRM”) of the U.S. Small Business Administration (“SBA”). As Director of OCRM, I am responsible for the oversight and risk management of SBA’s lenders and loan guaranty portfolios of the 7(a) and Development Company (or “504”) Loan Programs. I have spent the last two decades involved in lender oversight and loan program risk management at SBA, first from my hometown Kansas City, Missouri, and for the last two years here in Washington, DC.

SBA’s Administrator Contreras-Sweet is a leader in championing small business lending while maintaining prudent credit standards in our loan programs. SBA is particularly interested in balancing the growing credit needs of America’s small businesses with prudent lending, always ensuring that we are meeting the requirements of our mission as defined in the Small Business Act.

SBA’s role is to fill an unmet need in the market place—to help creditworthy small businesses access credit when a conventional loan is not available—generally due to lack of collateral, start-up business status, industry type, or other issues. SBA is critical in providing credit to underserved markets, in a commercially prudent and reasonable manner.

My mission, and that of the entire Office of Credit Risk Management, is to effectively manage program credit risk, monitor lender performance, and enforce lending program requirements. In short, our mission is to maintain the integrity and viability of the 7(a) and 504 Loan Programs.

As of September 30, 2015, OCRM monitored a portfolio of 3,949 lenders that provide 7(a) guaranty financing in excess of \$70.2 billion and 247 Certified Development Companies (“CDCs”) responsible for approximately \$26 billion in 504 debenture guarantees. This includes supervision of 14 Small Business Lending Companies (“SBLCs”), over 50 Non-Federally Regulated Lenders (“NFRs”) and over 100 Community Advantage Lenders.

During fiscal year 2015, the Office of Credit Risk Management monitored all SBA 7(a) Lenders and CDCs using our Loan and Lender Monitoring System (“L/LMS”) which tracks the *monthly* performance of all 7(a) and 504 loans and assigns a *quarterly* credit score for each loan. A quarterly purchase rating for each lender is also generated using this L/LMS data.

In fiscal year 2015 OCRM also updated our methodology for oversight of the SBA operations of Federally Regulated 7(a) Lenders, and of CDCs. These methodologies feature a composite risk measurement methodology and scoring guide known as “PARRiS” for 7(a) Lenders and “SMART” for CDCs. (The PARRiS components cover the following areas: **P**ortfolio Performance, **A**sset Management, **R**egulatory Compliance, **R**isk Management, and **S**pecial Items. The SMART components cover the following areas: **S**olvency and Financial Condition, **M**anagement and Board Governance, **A**sset Quality and Servicing, **R**egulatory Compliance, and **T**echnical Issues and Mission.)

Benchmarks of historical and projected performance have been developed for the PARRiS and SMART methodologies, and provide relative measures of lenders' financial risk specific to each program. By using both predictive and historic performance metrics, OCRM obtains a holistic picture of lender risk, upon which to consider additional oversight activities. OCRM also updated risk-based review protocols to align with PARRiS and SMART, and conducted 565 risk-based reviews and exams using these protocols during the recent fiscal year.

Other accomplishments from FY 2015 include conducting over 1,200 assessments to renew delegated lending authority for our delegated 7(a) Lenders and CDCs; completion of 147 Corrective Action follow-up assessments from previous review activities, and approval of the Agency's 100th Community Advantage Lender.

Turning to our supervision and enforcement responsibilities, OCRM issued 6 increased supervision actions to 7(a) Lenders or CDCs for failure to follow SBA Loan Program Requirements, debarred our suspended over 30 agents or representatives from conducting further business with SBA, and issued letters to 20 CDCs for failure to meet regulatory requirements for minimum loan activity. We continue to actively manage these actions, as appropriate.

To accomplish our responsibilities, OCRM operates with a staff of 27 supplemented by five support contracts for reviews, exams and enforcement activities. We also remain the primary user of the L/LMS contract service that provides credit scoring and the lender purchase rating.

In fiscal year 2016, OCRM will continue to conduct a portfolio diagnostic of every lender using historical performance, the predictive credit scores for all 7(a) or 504 loans, and the PARRiS and SMART methodologies to evaluate the relationship of each lender's metrics to established benchmarks. OCRM will also continue to monitor lenders through programmatic risk-based reviews, using PARRiS and SMART to target existing and emerging risk, as identified.

In 2016 OCRM plans to conduct in-depth analyses using SBA's loan database to investigate existing risk, identify developing risk areas, and to inform program changes under consideration. We will be publishing our Final Rule this fiscal year on Agent Revocation and Supervision authorities, to strengthen existing procedures and align them with other federal agencies.

SBA also continues in active discussions with primary federal regulators on such topics as information sharing and vendor management. Through exchange of information we can bring improved oversight and monitoring to both our activities and theirs, minimizing duplication.

Thank you for the opportunity to share this information today regarding how OCRM supports SBA's role of providing access to capital for small business owners of this great country. I will be happy to respond to your questions.

