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REPORT
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SMALL BUSINESS LENDING OVERSIGHT ACT

DECEMBER 20, 2016.—Ordered to be printed

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

REPORT

[To accompany S. 2992]

The Committee on Small Business and Entrepreneurship, to which was referred the bill (S. 2992), to amend the Small Business Act to strengthen the Office of Credit Risk Management of the Small Business Administration, and for other purposes, having considered the same reports favorably thereon with an amendment and recommends that the bill (as amended) do pass.

i. introduction

The Act (S. 2992) was introduced by the Committee's Chairman, Senator David Vitter on May 25, 2016. Senator Vitter was joined by Senators Jeanne Shaheen, Kelly Ayotte, Gary Peters, James Risch, and Michael Enzi in introducing the bill.

The Small Business Lending Oversight Act 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 administrative penalties, including monetary penalties, on any 7(a) lender that knowingly and repeatedly violates the laws and regulations of the SBA's 7(a) loan guaranty program. The primary goal of this bill is to strengthen the SBA's ability to conduct effective lending oversight and to provide Congress with information regarding the SBA's oversight actions.

During the markup of the bill, an amendment by Senator Coons, for himself and Senator Risch, was agreed to by roll call vote as

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part of a manager's package. The Coons-Risch amendment provides the SBA authority to increase the 7(a) loan program level by up to 10 percent, as long as the Administration submits notification to the Senate and House Appropriators 45 days in advance of exercising the increase, and receives written approval from the committees. The bill, as amended, was approved by roll call vote. Senators Vitter, Risch, Rubio, Paul, Scott, Fischer, Gardner, Ernst, Ayotte, Enzi, Shaheen, Cantwell, Heitkamp, Markey, Coons and Peters voted for the bill, while Senators Cardin, Booker and Hirono voted against it.

ii. history (purpose & need for legislation)

The lack of access to affordable capital limits the creation, growth, and expansion of small businesses, and it 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 third 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 heightened collateral requirements. The 7(a) program, through government guaranteed loans made by private-sector lenders, provides small businesses with the capital they need for a broad range of purposes, from working capital for payroll and inventory to financing for buildings and equipment. The maximum loan size is $5 million, and the maximum term is 25 years. The SBA's Office of Credit Risk Management (OCRM) oversees the program and the lenders, however, their only method of enforcing compliance is to completely bar a lender from participation in the program. To protect the integrity of the SBA's 7(a) program, this bill provides graduated options for enforcement, rather than the current nuclear option of enforcement. The graduated options include civil penalties, which are based on the frequency and severity of program violations. This legislation provides the OCRM more flexibility in addressing issues within the program.

iii. hearings & roundtables

In the 114th Congress:

On May 26, 2016, the committee held a hearing entitled "Oversight of the SBA's 7(a) Loan Guaranty Program." The hearing's only witness was the Honorable Maria Contreras-Sweet, the Administrator of the U.S. Small Business Administration. The committee examined whether taxpayers and small businesses would receive adequate protection by reforming the 7(a) program to strengthen the Office of Credit Risk Management and by authorizing graduated enforcement options that provide regulators with greater flexibility. The committee also recognized the support for this reform from the American Bankers Association, the National Association of Government Guaranteed Lenders, and the Independent Community Bankers of America.

iv. description of bill

As part of their mission to promote and support small businesses, the Small Business Administration (SBA) manages multiple loan programs targeted at providing small business capital. SBA's flagship loan program, the 7(a) loan guaranty, provides an SBA guarantee on loans to small businesses for use in establishing a new business or to assist in the operation, acquisition, or expansion of an existing business. Since 2008, the program has seen growth of nearly 200%, with the annual growth rate from 2012 to 2016 averaging 15.9%. This growth has required 5 authorization cap increases in the past 3 years.

The bill's primary goal is to strengthen SBA's ability to conduct effective lending oversight and to provide Congress with information regarding the SBA's oversight actions. It would achieve that objective by bolstering the enforcement authority of the Office of Credit Risk Management and its director to conduct oversight of lenders within the program; lowering the split fee cap on secondary market sales from 110 percent to 108 percent; managing program risk, and redefining "credit elsewhere" to focus on the borrower's ability to obtain credit as opposed to a lender's ability to provide it.

Senators Coons and Risch put forward an amendment (see Section 7) designed to provide certainty in lending to small businesses that need financing through the SBA's largest loan program, known as the 7(a) Loan Guaranty program. The 7(a) program guarantees loans made by the private-sector to qualified small businesses "that might not otherwise obtain financing on reasonable terms and conditions." The program is funded entirely through fees paid by borrowers and lenders and does not require taxpayer funding for the loans. However, the volume of lending each fiscal year is established by Congress and requires legislation to change. The demand for capital through 7(a) loans has exceeded estimates in recent years and required emergency action by Congress to increase the program level and prevent a long-term shutdown of the program. To provide flexibility in addressing rapid growth in the future, the Coons-Risch amendment would provide SBA with the authority to increase the 7(a) loan program level by up to 10 percent, as long as the Administration submits notification to the Senate and House Appropriators 45 days in advance of exercising the increase, and receives written approval from the committees. The U.S. Department of Agriculture has similar authority for its loan guaranty programs. The Coons-Risch amendment adopted in Committee is similar to S. 2496, the "Help Small Business Access Affordable Credit Act," introduced on February 3, 2016, by Senators Coons, Risch and Shaheen.

V. COMMITTEE VOTE

In compliance with rule XXVI (7)(b) of the Standing Rules of the Senate, the following vote was recorded on June 8, 2016.

A motion to adopt S. 2992, the Small Business Lending Oversight Act, a bill to strengthen the Office of Credit Risk Management of the Small Business Administration and improve lender oversight, as amended by the Coons-Risch amendment, was approved by roll call vote as part of a manager's package. Senators Vitter, Risch, Rubio, Paul, Scott, Fischer, Gardner, Ernst, Ayotte, Enzi, Shaheen, Cantwell, Heitkamp, Markey, Coons and Peters voted for the bill, while Senators Cardin, Booker and Hirono voted against it.

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:

SEPTEMBER 19, 2016.

Hon. DAVID VITTER,
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. 2992, the Small Business Lending Oversight Act of 2016.

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. 2992—Small Business Lending Oversight Act

S. 2992 would direct the Small Business Administration (SBA) to establish an Office of Credit Risk Management to be responsible for reviewing certain entities that issue loans guaranteed by the SBA; developing risk analysis reports; and performing on-site reviews of such entities' operations. The SBA already has an Office of Credit Risk Management that performs similar functions. The bill would grant the office the authority to impose new sanctions and civil penalties against lenders for certain prohibited actions and would expand its reporting and review responsibilities. Based on an analysis of information from the SBA about the current activities of the office, CBO estimates that implementing this provision would require 17 new employees at an annual cost of about $120,000 each to perform additional on-site reviews and to meet additional reporting and enforcement requirements. Total cost would amount to $10 million over the 2017–2021 period, CBO estimates.

S. 2992 also would direct the SBA to conduct additional analyses of the loan portfolios of certain lenders and would restrict those lenders' ability to approve loans under certain conditions, such as if their portfolios contain loans that were concentrated in any one industry that exceeds thresholds in the bill. The SBA also would be required to conduct annual risk analyses of some of its loan portfolios and to issue an annual report on its findings, beginning in 2018. On the basis of information from the SBA, CBO estimates that implementing those provisions would cost $3 million over the 2017–2021 period for SBA to conduct additional analyses, issue reports to the Congress, and revise and write new regulations.

Enacting S. 2992 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 bill would not affect direct spending.

CBO estimates that enacting S. 2992 would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2027.

S. 2992 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, or tribal governments.

The CBO staff contact for this estimate is Stephen Rabent. The estimate was approved 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 no significant additional regulatory impact will be incurred in carrying out the provisions of this legislation. There will be no additional impact on the personal privacy of companies or individuals who utilize the services provided.

viii. section-by-section analysis

Section 1. Title

Section 2.

This bill amends the Small Business Act to establish within the Small Business Administration (SBA) an Office of Credit Risk Management (OCRM) to impose specified administrative penalties, including monetary penalties, on any loan-financing lender that knowingly and repeatedly:

- fails properly to determine and document that a small business loan is eligible for financing, including failure to document that a loan is eligible because the applicant is unable to obtain credit elsewhere (from non-federal, non-state, or non-local government sources);
- sells the guaranteed portion of a loan when the loan proceeds have not been fully disbursed in accordance with program requirements;
- imposes on a loan applicant a fee that the SBA has not specifically authorized; or
- re-amortizes a loan solely to make the loan appear current.

The SBA shall conduct annual risk analyses of its loan portfolio.

Section 3. The term "credit elsewhere" shall expand beyond non-federal sources to encompass credit to an individual loan applicant on reasonable terms and conditions from non-state and non-local government sources, including but not limited to:

- the business industry in which the loan applicant operates;
- whether the applicant is an enterprise that has been in operation for less than two years;
- the adequacy of the collateral available to secure the requested loan; and
- the loan term necessary to reasonably assure the applicant's ability to repay t he debt from the actual or projected cash flow of the business.

Section 4. The SBA shall assess a separate fee of up to 0.03% per year of the outstanding balance of the deferred participation share of each approved loan, whose proceeds shall be used solely to support OCRM operations.

The SBA shall collect a fee (currently discretionary) for any loan guarantee sold into the secondary market in an amount equal to 50% of the portion of the sale price that exceeds 108% (currently 110%) of the outstanding principal amount of the portion of the loan guaranteed by the SBA.

Section 5. The SBA shall also, at the end of each year, calculate the percentage of loans in a lender's portfolio made without a contribution of borrower equity when the loan's purpose was to establish a new small business concern, to effectuate a change of small business ownership, or to purchase real estate. This requirement applies only to a lender that makes loans under authority delegated to the lender as a participant in the Preferred Lenders Program. No new loan application without a contribution of borrower equity, except in certain circumstances, may be approved if more than 15% of the lender's loan portfolio is without such a contribution.

The SBA shall make end-of-year calculations, too, of industry concentrations for each such lender, using the applicable six-digit classification code under the North American Industry Classification System. No new loan application to a lender from a small business concern operating in a single industry, except in certain circumstances, may be approved if over 20% of the lender's loans are concentrated in that industry.

The SBA may not approve any loan if its financing is more than 100% of project costs.

Section 6. A lender may use an outside agent or lender service provider to assist in identifying potential applicants and with processing, disbursing, servicing, and liquidating a loan.

With respect to an SBA loan for plant acquisition, construction, conversion, or expansion, including the acquisition of land, material, supplies, equipment, and working capital, as well as a loan to any qualified small business concern, no lender may, without SBA approval, sell an amount higher than 85% of the loan, or the percentage guaranteed by the SBA, whichever is greater.

Section 7. General business loans

This section amends the Small Business Act provide the SBA authority to increase the 7(a) loan program level by up to 10 percent, as long as the Administration submits notification to the Senate and House Appropriators 45 days in advance of exercising the increase, and receives written approval from the committees.

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