SBA'S 7(A) LOAN PROGRAM: A DETAILED REVIEW

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SBA'S 7(A) LOAN PROGRAM: A DETAILED REVIEW

WEDNESDAY, MAY 17, 2017

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

The Committee met, pursuant to call, at 11:00 a.m., in Room 2360, Rayburn House Office Building, Hon. Steve Chabot [chairman of the Committee] presiding.

Present: Representatives Chabot, Luetkemeyer, Brat, Radewagen, Knight, Kelly, Blum, González-Colón, Fitzpatrick, Estes, Velázquez, Evans, Clarke, Espaillat, and Schneider.

Chairman CHABOT. The Committee will come to order.

I want to thank everyone for being here today.

Around here we use the term "access to capital" a lot. It is an issue as old as entrepreneurship itself, coming up with the funds to get started. Even if we had a perfect economic environment with growth beyond our wildest dreams and overregulation a thing of the past, finding willing partners to finance a risk is one of the most significant hurdles a new small business must cross. The Nation's entrepreneurs and small businesses continue to experience a difficult lending environment, which is, at best, stagnant. Getting a loan to actually grow a business and create new jobs can be very challenging.

With limited options, small businesses are turning to the Small Business Administration 7(a) Loan Program in record numbers for their financial needs. The 7(a) Loan Program is the SBA's flagship program, whereby the SBA partners with financial institutions and guarantees the repayment of loans to small businesses that cannot obtain capital through conventional lending. The guarantee percentage ranges from 75 to 85 percent based on the size of the loan, which is capped at $5 million.

The SBA collects lender fees to run the program, which over the past 4 years have covered the cost and resulted in zero expense to the American taxpayer. As the 7(a) program grows in terms of loan volume, loan amount, and the congressionally authorized loan limit, we owe it to the taxpayers and the small businesses involved to conduct vigilant oversight. We have to make sure that American small businesses who are creditworthy, but cannot obtain capital elsewhere remain the priority.

In March, Chairman Trent Kelly and the Subcommittee on Investigations, Oversight, and Regulations, kicked off the conversation on oversight of the 7(a) Loan Program. In that discussion, their Subcommittee heard from lenders and financial institutions directly involved in the loan program.

We are building on that conversation today by examining the program from the SBA's perspective. Over the years, improvements have been made by the SBA when it comes to lender oversight. However, concerns need to be addressed to safeguard the American taxpayer dollar.

Today, I hope we can hear more about the resources available at the SBA and the Office of the Credit Risk Management to conduct lender oversight. We look forward to hearing about the risk-based models, monitoring systems, and the lender portals that help the SBA keep a close watch on the program. The conversation today will help guide us as we continue to examine the SBA's lending programs and how they may be improved.

We appreciate the witnesses for being here today. We look forward to your testimony, and I would now like to yield to the ranking member, Ms. Velázquez, for her opening remarks.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman. And welcome to the witnesses. Thank you for being here.

Access to capital is critical to the success of small businesses. If, as the saying goes, small businesses are the economy's backbone, then the flow of capital is the lifeblood. However, obtaining conventional credit remains a challenge for many small businesses. Startups, in particular, are still considered a risky bet by many lenders.

Through the 7(a) program, the SBA helps fill in the gaps in the capital markets, mitigating some of the risk to lenders by guaranteeing that these loans will be repaid. In turn, small businesses keep their inventory stocked, their employees paid, and their doors open.

In recent years, 7(a) loans have experienced unprecedented growth. In fiscal year 2016, over 64,000 loans totaling $24 billion were supported. With the prolific growth of the 7(a) program, it is critical that this initiative functions efficiently and effectively. For example, though SBA remains under its 7(a) lending authorization last year, it is crucial that SBA closely monitor loan volume and communicate to Congress in a timely manner concerns regarding reaching the cap.

In addition, while the overall number of 7(a) loans has increased, the percentage going to minority and women-owned firms has remained fairly consistent since 2010, and is lower than before or during the recession. This disparity is troubling. It must be addressed to enable creation and economic growth, particularly in traditionally underserved communities.

Other concerns have been raised by both borrowers and lenders alike related to the effectiveness of SBA's existing technology to facilitate lending. Technology is only helpful if we ensure it works efficiently for lending purposes. Recent OAG and GAO reports disclosing weaknesses in SBA lenders' oversight raised other concerns. Their analyses raised questions about whether the agency has adequate tools to manage the program.

It is the responsibility of this committee, and one we take seriously, to examine the internal controls of SBA lending programs. Absent adequate oversight, I am concerned that the program resources may be unnecessarily strained, potentially depriving other entrepreneurs of needed credit.

Overall, this committee seeks to ensure that the 7(a) program works for small business borrowers. I look forward to hearing from our witness today and gaining their insights on how we can improve the SBA flagship loan program.

I yield back, Mr. Chairman.

Chairman CHABOT. Thank you very much. The gentlelady yields back.

And if Committee members have opening statements, we would ask that they be submitted for the record.

And I would now like to take just a moment to explain our lighting system to the witnesses. I think you are probably already familiar with it, but we operate under the 5-minute rule. Each of you gets 5 minutes to testify, and then we will ask questions. And we will limit ourselves to 5 minutes, and it goes back and forth between a Republican and a Democrat up here.

And then there is a lighting system to assist you. The green light will be on for 4 minutes and then the yellow light will come on and let you know you have got a minute to wrap up. And then when the red light comes on, if you could wrap up as close to that as possible we would appreciate it.

And now I would like to introduce our distinguished panel here this morning.

Our first witness will be Linda Rusche. Ms. Rusche is the director of the Office of Credit Risk Management, which oversees the 7(a) Loan Program within the Office of Capital Access at the SBA, the Small Business Administration. She joined as a director in 2015, and previously served in numerous roles at the SBA, including as branch manager of the Kansas City Review Branch for OCRM, along with the assistant regional administrator for Finance and Investment in Region 7. And we appreciate you being here today.

And our second witness will be William Manger. Mr. Manger is the associate administrator for the Office of Capital Access at the SBA. Before his appointment, Mr. Manger served as the managing director at Brock Capital Group and Investment Bank in New York City. Prior to his time with Brock Capital, he served as associate administrator for field operations at the SBA from 2007 through 2009. And we also welcome you here today.

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

STATEMENTS OF LINDA RUSCHE, DIRECTOR, OFFICE OF CREDIT RISK MANAGEMENT, OFFICE OF CAPITAL ACCESS, UNITED STATES SMALL BUSINESS ADMINISTRATION; WILLIAM MANGER, ASSOCIATE ADMINISTRATOR, OFFICE OF CAPITAL ACCESS, UNITED STATES SMALL BUSINESS ADMINISTRATION

STATEMENT OF LINDA RUSCHE

Ms. RUSCHE. Good morning. And thank you, Chairman Chabot and Ranking Member Velázquez. Thank you for the opportunity to come and speak with you today and to testify before the entire Committee on the Office of Credit Risk Management of the Small

Business Administration. As director of OCRM, I am responsible for the oversight and the risk management of SBA's lending programs and the guaranteed loan portfolios delivered by our 7(a) and 504 lending partners.

SBA's administrator, Linda McMahon, has demonstrated leadership in championing small business lending while maintaining prudent lending standards. 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 authorized by the Small Business Act. The Office of Credit Risk Management is to effectively manage program risk, monitor lender performance, and enforce loan program requirements. In short, to maintain the integrity and the viability of the programs.

How does OCRM manage all 7(a) lenders and certified development companies and over $1 billion in credit? Our first step is through use of our loan and lender monitoring system which tracks monthly performance of every loans, assigns a quarterly credit score for each loan, and then rolls that into a quarterly purchase rating for each lender based on those loans. This provides an initial risk profile for each lender and CDC and allows OCRM to bucket higher risk lenders and CDCs for additional monitoring.

Next, OCRM uses our composite risk measurement methodology that we call PARRiS for 7(a) lenders, SMART for CDCs, to further diagnose our higher risk lenders. Benchmarks of historical and projected performance have been developed for PARRiS and SMART and provide relative measures of individual lenders' financial risk.

Third, OCRM conducts approximately 300 focused, risk-based exams and reviews every year using these protocols. OCRM also conducts over 1,200 assessments each year before renewing delegated authority status for those lenders and CDCs which have been granted enhanced authority by SBA. And we also conduct quarterly financial and capital assessments of our SBA supervised lenders, since SBA is generally their sole Federal financial regulator.

OCRM has been at the forefront of identifying emerging risks, one of which involves the ongoing discussion of which businesses are in need of SBA financing. The Small Business Act, as amended, states that small business loan guarantees are to be provided only to those borrowers who cannot obtain needed credit on reasonable terms from other Federal sources—I am sorry, other non-Federal sources. With recent robust growth of the 7(a) program, OCRM has paid particular attention in its reviews to a lender's documented credit elsewhere reasons. We have identified some instances of lack of understanding on the part of lenders and occasionally poor internal controls within lender operations which contribute to some noncompliance. OCRM requires those lenders which demonstrating noncompliance to correct individual file deficiencies, and as needed, to alter policies, procedures, or internal controls to ensure full compliance. OCRM will continue to focus on this on this area in our upcoming reviews to ensure the mission of the agency is met in providing small businesses financing they cannot obtain elsewhere on reasonable terms.

Thank you for the opportunity to share this information. I will be happy to respond to your questions.

Chairman CHABOT. Thank you very much.

And Mr. Manger, you are recognized for 5 minutes. It is with a hard G, I understand, Manger? Okay.

Mr. MANGER. Correct. Thank you.

STATEMENT OF WILLIAM MANGER

Mr. MANGER. I would like to thank Chairman Chabot, Ranking Member Velázquez, and the entire House Small Business Committee for the opportunity to testify before you today. I had a great meeting in April with some of your staff and look forward to building a strong and open relationship with all of you moving forward.

It is an honor for me to be here and to have been appointed Associate Administrator for the SBA's Office of Capital Access by Administrator Linda McMahon. It has been 8 years since I last worked at the SBA as associate administrator for the Office of Field Operations in Washington, and prior to that I served as SBA's Regional Administrator in Region 2 in New York. From the very beginning of my time at the SBA, I was able to witness the positive impact our programs have on communities across the country. I can definitely say that I am very excited to have the ability to improve the services we provide and help small business owners and entrepreneurs grow to their full potential.

As Associate Administrator, I oversee the SBA's flagship 7(a) and 504 loan programs, as well as our Microloan and Surety Bond programs. The role that the SBA and the Office of Capital Access plays in our credit markets fills an important gap in the lending marketplace. Our agency aims to help small businesses obtain credit which is otherwise unavailable through conventional lending. As many of you know, oftentimes entrepreneurs have the will and drive to succeed but access to capital, unfortunately, proves to be an unsurmountable hurdle. That is where we come in. Our programs have been helping small businesses get on their feet and grow for decades, but as we all know, there is always room for improvement.

Administrator Linda McMahon has placed an emphasis on making sure our entire agency, and our Office of Capital Access, is running as efficiently and effectively as possible. That is exactly what I intend to do as Associate Administrator.

The Office of Capital Access is streamlining our standard operating procedures and plans to repeal unnecessary regulations that do not benefit small businesses aiming to start or expand. We will also place an emphasis on SBA loan center efficiency, which will decrease the time it takes for lenders to process, service, and collect SBA guaranteed loans.

As we work to recruit more lenders for our programs, we have stressed to our lending partners that we want to see more small dollar loans being made to entrepreneurs. Our focus will remain on helping those who need capital most before anyone else. That includes our veterans, women-owned businesses, minority-owned businesses, and rural communities.

In addition, the Office of Capital Access sees our 7(a) program in particular as a powerful tool for helping create and retain jobs for American workers. It is of paramount importance to me and our agency that our 7(a) and 504 flagship programs continue to operate at zero subsidy and remain a great deal for taxpayers. Having been serving as Associate Administrator for just less than 2 months now, I can assure you that our office is placing an incredible amount of emphasis on oversight to make sure our programs are being administrated properly. Linda Rusche plans a crucial role in that as director of our Office of Credit Risk Management.

The Office of Capital Access and the Office of Chief Financial Officer are also constantly monitoring our program level limits and SBA thanks the Committee for its assistance in raising the 7(a) program level to $27.5 billion in Fiscal Year 2017 from $26.5 billion Fiscal Year 2016.

While SBA is witnessing increased demand by the small business community this year, we are not currently in jeopardy of exceeding our capacity to meet such demands. However, to ensure that America's small businesses can fully benefit from the tools and resources provided by the SBA and that the support continues through the year uninterrupted, the administrator supports proposed legislation that would grant circumstantial authority to the Administrator to increase 7(a) lending authority by 15 percent when program subsidy is zero and appropriate notice is provided to Congress. The flexibility offered by the proposed statutory provision would offer greater certainty to our 7(a) lending partners and make additional assistance available to small businesses at no additional subsidy cost to the taxpayer.

While we continue to see job creation and responsible growth from all of our programs, I cannot stress enough how committed we are to proper oversight. I look forward to a transparent and collaborative relationship with this Committee to ensure we are fulfilling all aspects of our agency's mandate.

In conclusion, please know that in me you have someone that shares our administrator's vision of a stronger small business community in America and is committed to administering our programs both properly and in the best interest of the American taxpayer. Thank you.

Chairman CHABOT. Thank you. And I will now recognize myself to begin the questioning for 5 minutes.

My first question, we tape these Committee hearings and there are small business folks out there across the country who could be watching, you know, either now or down the road because the tapes are available online, and we put out, you know, what goes on in these meetings, so it gets out there. So let me ask both of you this. Let us say I am a small business person and I am listening to the testimony and I am thinking, well, do I qualify for a loan, a 7(a) loan which is the largest loan program that we have? Am I going to qualify? I heard them say something that I do not qualify for this, you know, if I am too qualified, unless if I can get a loan elsewhere then I am not supposed to go to them, but how do I know if I am not so qualified that I am overqualified to get a loan? And I do not necessarily want to make myself look too unqualified that they turn me down at the SBA and then I am really out because I do not qualify anywhere else and I am underqualified for the SBA, so I either cannot start my business in the first place or I cannot expand it. So what would you have to say to those folks that might be wondering about how qualified do they actually have to be or unqualified do they have to be?

So, Ms. Rusche, you were smiling a lot. I will let you go first.

Ms. RUSCHE. Thank you so much, Chairman Chabot.

Having been a loan officer in the field, that question gets asked a lot. And it is a perfect question. We appreciate the opportunity to elaborate on credit elsewhere.

Small businesses walk into lenders, into banks, to look for a loan. Often they do not recognize that it may become an SBA loan. There are challenges to receiving a loan when you are a small business, particularly if you are a startup, a small service firm, limited collateral. Those are the types of circumstances that are difficult for lenders to lend to without some additional enhancement or protection. Our SBA guarantee provides that benefit, so often it is the lender who steers the customer towards the SBA, as opposed to a customer walking in and saying, oh, I want an SBA loan. They just want a loan. They want the credit. And our credit elsewhere test requires the lender to consider first, can I make this loan in my current policies? And if I cannot, then I can turn to the SBA and document in the file why I need that guarantee from the SBA, and the loan is then made.

Chairman CHABOT. Thank you. That was a very good answer. Mr. Manger, I do not know if you wanted to add anything to it.

Mr. MANGER. I would just like to add a little bit. As the former Associate Administrator for Field Operations, I would like to put in a plug for the 68 district offices that exist across the country. Certainly, any aspiring small business owner and entrepreneur can go into any of those district offices, contact them electronically or by phone, and ask them specifically those questions—do you think my business would qualify for an SBA loan?

I would also put in a plug for our entrepreneurial development partners: SCORE, the women's business centers, the small business development centers. All of those will see any aspiring entrepreneur free of charge, and they can go in there and ask these questions. For example, is my business plan formulated enough? Do I have enough projections in here? Will the bank accept these? I think, again, we offer other services aside from just the loan programs that are very, very beneficial to small business owners.

You know, somebody that needs a longer term loan, that is an excellent entrepreneur for the 7(a) program. The average term of a 7(a) loan is 13 years. Most conventional loans made by a bank are only 3 to 5 years. So that business that needs a longer term in order to return payment on that loan really would benefit from the SBA 7(a) program. You know, and certainly any business that needs to make an acquisition, that is something usually that lenders are hesitant about making those loans, but with a 7(a) guarantee they are able to make that acquisition.

Chairman CHABOT. Thank you. I have got time for about one more question here before my time expires.

We hear from a lot of small businesses, everybody that is a member of this Committee, and one of the complaints that we hear from small business folks who try to get a loan through the SBA is how what a paperwork-intensive process it can be. And I have heard stories that sometimes during the course of the process that they kind of give up, unfortunately.

Now, in your testimony, Ms. Rusche, and I will quote, “We have plans to appeal unnecessary regulations that do not benefit small businesses aiming to start or expand.” So what specific regulations do you have in mind to make the process less burdensome than it is, and what regulations can we get rid of that will help small business folks?

Ms. RUSCHE. Thank you for that question. I am actually the regulatory overseer of most of the lenders who deliver the program and, therefore, we believe we have reasonably adequate regulations. We do not have any plans to repeal any specific ones related to lender oversight; however, we are looking very thoroughly at the regulations for applying for the loan, and that is another jurisdiction within the Office of Capital Access. I would like to invite my boss, Bill Manger, to speak to that comment.

Chairman CHABOT. Yeah, we would welcome him, but keep it to a minute if you would so we do not go over.

Mr. MANGER. Sure. Yes. So one of the first things I did, Mr. Chairman, when I came in as the Associate Administrator for Capital Access, was speak to all my directors and say we need to simplify our processes to make it easier for borrowers and lenders to access the capital that we are providing. To do that, I have instructed the directors to look at all of the SOPs, especially the one that concerns the loan processes, and we are streamlining those SOPs to make it as simple as possible, but also for the clarity so that a lender knows exactly what is required of them in order to get the benefit of the SBA guarantee. We are also looking at some of the regulations, as Ms. Rusche said, in the Office of Capital Access, to determine which of those we can eliminate in some cases just to make it easier for, again, our borrowers to access the lending programs.

Chairman CHABOT. Thank you very much. Thank you. We appreciate that.

And I will now recognize the ranking member, Ms. Velázquez, for 5 minutes.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Mr. Manger, I am pleased to hear that you are emphasizing to lenders that they need to make smaller loans. When we look at the portfolio of the 7(a) Lending program, we found that in 2015, the average 7(a) loan was $371,000. In fiscal year 2016, it was $376,000. Yet the maximum size of the 7(a) loan has increased to $5 million. My question to you is what is SBA doing to promote small dollar loans?

Mr. MANGER. Thank you very much for that question.

As you said, I am working very diligently with our lending partners. In fact, I met with many of them last week to encourage them to make those smaller dollar loans available.

Ms. VELÁZQUEZ. Okay. So what are you doing, or the agency, to implement the lender mission rating from the January 4, 2017, policy notice?

Mr. MANGER. I can actually ask Linda Rusche to help answer that.

Ms. VELÁZQUEZ. Sure.

Mr. MANGER. We are still reviewing that, though.

Ms. RUSCHE. The mission rating that we have developed for 7(a) lenders is built upon information that we receive from applications. Nothing additional needs to be prepared by a lender or a borrower. It is part of the basic information we receive. We have published that document. We have not yet fully implemented the protocol within our electronic system and we are working to do that, but also evaluating the data upon which it is based. Some of that data is voluntarily submitted as opposed to being mandatorily required, and we want to ensure we have a good rating that is well constructed and valid before we implement it fully.

Ms. VELÁZQUEZ. And how long do you think this process is going to take? Let me just share with you the frustration that we face on this committee because I have seen so many administrators come in here to testify and we raise the issue of smaller loans, and when we look at the 7(a) portfolio, there is a need for smaller loans. How long will it take for you to get the data you need in order to implement the policy?

Ms. RUSCHE. Thank you for allowing me to clarify that. We have the data but we are ensuring that it is fully accurate before we publish that rating. That rating will actually be given to each individual lender. It is not a list of mission-rated lenders that we would publish. It is based on confidential information provided to us, but the lenders will each know where they stand in that system. And we have been reviewing it literally the last couple of weeks.

Ms. VELÁZQUEZ. Okay. Thank you.

Mr. Manger, again, many congressional hearings and we constantly hear from women, minority firms, rural America, the fact that on average, it is very difficult for them to get the lending they need. When we look at the 7(a) program, pre-recession levels was $17 billion; today it is $27 billion. Yet, lending for women, minority, and rural America, has seen a decrease compared to pre-recession levels. What are you doing to address that issue?

Mr. MANGER. That is an excellent question, and I would just like to say that our Express program, which is for loans under $350,000, 46 percent of our units are done by Express under $350,000. And we also have a segment of the 7(a) program that is known as Community Advantage. It is still in a pilot, but this is for loans under $250,000, with an average of $130,000. So we do have programs that are being effective, and actually, those programs are increasing.

Ms. VELÁZQUEZ. What are you doing to encourage more lenders to take seriously their responsibility to provide assistance to underserved communities?

Chairman CHABOT. The gentlelady's time is expired, but you can answer the question.

Mr. MANGER. Yeah. No, again, Congresswoman, it is a very good question. We are doing as much outreach to our lending partners because the lenders are the ones that are making the loans. We are guaranteeing them, but we need to work with our lending partners. I am glad to see that we have a couple of people from NAGGL here so they hear me loud and clear that we are looking to see more loans to women, minorities, veterans, and rural communities, and we are working very vigorously in order to achieve that goals.

Ms. VELÁZQUEZ. Thank you.

Chairman CHABOT. Thank you. The gentlelady's time is expired.

The gentleman from Missouri, Mr. Luetkemeyer, who is the vice chairman of this Committee, is recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. And welcome to our guests today.

The National Federation of Independent Business has a recent study out that shows that a lot of large banks and large businesses are doing well. But it also shows that a lot of small banks and small businesses are not, from the standpoint that it is more difficult for them to do business, their capital is strained, and as a result we have got basically what they call a two-speed economy going on, where part of the economy is going well, part of it is not.

So it is interesting to hear, and I am glad to hear, Ms. Rusche, that you made the comment that we have robust growth in the 701 program, so I think it begs the question, why are we experiencing a growth there? Are we changing lending standards or is there a demand for the banks? Are the banks becoming more engaged? Small business becoming more engaged? Why are we suddenly seeing this interest in the 701 program and the growth?

Ms. RUSCHE. Thank you for the opportunity to share that. We are pleased that there is robust growth in the program. There is growth in both the large and the small loans involved, and a wide breadth of all lender varieties that are applying for the guarantees in our program.

We are seeing the economy improve as well, and we find that to also be of assistance in our growth of the 7(a) program. But again, it is the lenders who come to us as opposed to us telling the lender. The lender must know what applicant needs that they have.

Mr. LUETKEMEYER. Okay. But one of the key points that I am trying to get to here is there is no loosening of lending standards to get more growth.

Ms. RUSCHE. Thank you for that clarification. And no, there are no loosening of lending standards.

Mr. LUETKEMEYER. But just more of a demand?

Ms. RUSCHE. But we are seeing more of a demand.

Mr. LUETKEMEYER. Okay.

Ms. RUSCHE. And may I——

Mr. LUETKEMEYER. Okay. You made the comment about prudent lending standards as a way to provide some oversight. Can you define what prudent lending standards would be in your mind? What are you looking for when you go in and you look at something? I mean, because are you not approving the loan anyway? I mean, the bank gives you the loan and you are looking at it. So why would you be looking at prudent loan lender standards. That, to me, would be a standard operating procedure.

Ms. RUSCHE. Prudent lending standards are an operating procedure. That would require consideration of the equity investment of the customer, the projections proposing for repayment ability, cashflow needs of the business while that repayment ability is met, and strong management of the business to ensure that there is good management.

Mr. LUETKEMEYER. Okay. So there is nothing beyond the normal way that you look at a loan from a standard point of those important criteria that make up the loan that you are trying to make and why you approve it or disapprove it?

Ms. RUSCHE. I am unclear of the question.

Mr. LUETKEMEYER. Well, I am kind of a concerned about when you say "prudent loan standards." Is there something there that is a red flag that you are looking at that somebody is not looking at? Because whenever you are looking at a bank making the loan and then you are guaranteeing it, it seems to me like it would be kind of cookie cutter. You have got a basic way of application to you. He has to have certain documents, and so it has to adhere to certain stands. So why would you have to look then at prudent loan standards? I would think that would be an inherent part of what you are doing already.

Ms. RUSCHE. Prudent lending standards are an inherent part of what we do.

Mr. LUETKEMEYER. Okay.

Ms. RUSCHE. We look at loan files to ensure it has been individually and then we have our robust metrics to ensure that on a portfolio-wide basis we retain that good performance.

Mr. LUETKEMEYER. Okay.

Mr. Manger, this is kind of a specific question, but we have had an entity come to us with regards to a franchisee. And you have issued some sort of an addendum that you ask the franchisor to sign in order for the franchisee to qualify for an SBA loan. And it is becoming very cumbersome for the franchisor in certain situations. Can you elaborate on that? Are you aware of what I am talking about?

Mr. MANGER. Yes.

Mr. LUETKEMEYER. Okay.

Mr. MANGER. That did happen prior to my coming aboard, again, at the SBA, but yes. The lenders actually asked us to try and simplify the process for borrowers that wanted loans for the acquisition of a franchise, the startup of a franchise. So in our office, they put together basically a one-page form that had to be completed in order to make sure that the franchise would be eligible for an SBA guarantee. Actually, I would say that the program was more cumbersome prior to that for the majority of franchises because it took a lot of time from when it was submitted to the Office of Capital Access, to go through our Office of General Counsel, and to get a response as to whether that franchise was eligible or not.

Now, that being said, there are many franchises that had prearranged agreements with SBA from prior to January and we are maintaining those. So any franchise that had an agreement with SBA prior to January can continue to use that. It really is new franchises that want to be eligible for an SBA loan that are to comply with the addendum, but we did that at the lenders' request because they thought that it was a simpler way to do it and it would save a lot of time in actually getting the loan to the borrower for the franchise.

Chairman CHABOT. The gentleman's time is expired.

Mr. LUETKEMEYER. Thank you very much for your response.

Chairman CHABOT. Thank you.

The gentleman from Illinois, Mr. Schneider, who is the ranking member of the Subcommittee on Agriculture, Energy, and Trade, is recognized for 5 minutes.

Mr. SCHNEIDER. Thank you. And I want to thank both Mr. Manger and Ms. Rusche for being here, for making your time available, but also for all you are doing to try to help promote small business in our country.

As you know better than most, it is small business that drives our economy and it is these entrepreneurs and people who are looking for capital to grow that will allow us to create the jobs we need.

Mr. Manger, I appreciate very much your testimony. You laid out a clear vision and a number of goals for what you are hoping to accomplish in your tenure in this position. I would like to take it a step further from goals to actually strategy for achieving these goals and the steps you are planning to take, in particular as it relates to increasing lending to underserved populations as you have talked about: minorities, women, veterans, rural. Do you have specific actions you are planning to take to try to grow their numbers?

Mr. MANGER. Yes. And thank you, Congressman, for the question.

What we are doing is we are working with our not-for-profit partners who make the smallest loans. For example, our Microloan program, which is, again, loans under $50,000, the average size of those loans is $13,000. It is a much better option for a borrower than to, say, put that on several credit cards where they would be paying a much higher rate. The Community Advantage program, while it is still in pilot until 2020, we will be reviewing this in the next year to determine whether we should make that program permanent. Again, that is loans $250,000 or less, average size $130,000. Both of those programs are made available to different constituencies through our not-for-profit partners. When I have looked at lists of cities across the country that show where we are very effective, we are very effective in Philadelphia, New York, St. Louis. The reason for our effectiveness is the strength of the not-for-profit partner in that city. Cities where we are not doing as well are ones where the not-for-profit partner is not as vibrant.

So we are going to be targeting not-for-profits in different cities across the country to come on board with the program to increase our Microloan and Community Advantage programs, especially to focus on minorities, veterans, and women-owned businesses. I think with, again, reinvigorating the partners, the not-for-profit partners that must be part of the equation, we will be able to get more loans out and penetrate those markets.

Mr. SCHNEIDER. Are there specific profiles of a successful not-for-profit partner? What do they look like? What are they doing in particular that makes them stand out?

Mr. MANGER. That is a very good question.

So in Missouri, we work with Justine Peterson. Justine Peterson is really an exemplary not-for-profit. What they do is they help entrepreneurs build a credit-risk profile by making money available to them first on a very small basis, you know, several hundred dollars. And when they show that they repay that, they increase the loan a little bit more. This is building a credit history for that aspiring entrepreneur, small business owner, and they can continue them up the continuum to a larger and larger loan.

And we have seen them do amazing work out in Missouri, St. Louis, Ferguson. It is incredible what they have been able to do. And so we would actually like that model to be replicated by other not-for-profits in other cities because we think that is really a very powerful model and really works. We have seen people actually graduate from the Microloan program to the Community Advantage program because they have been able to build a stronger and stronger credit history.

Mr. SCHNEIDER. Let me take back the time. I would love to talk more about that offline.

But it is not just in the Microloan area. How do we expand the reach to these underserved populations in the larger loans, cultivating an environment or a culture of entrepreneurship, helping them getting the skills and attributes they need to have businesses of size that are going to have a $200,000 or $500,000 loan?

Mr. MANGER. Again, a lot of it has to do with financial literacy. We want to make sure that these aspiring entrepreneurs have the tools at their disposal and the knowledge of how to build a sound business that is going to be successful. We do that through our entrepreneurial development partners. The SBDCs again are offering counseling free of charge. Our women's business centers are doing that. The SCORE partners are doing that, and our district offices. We do many, many outreach events trying to explain to them what is necessary really to build a strong business and what foundation is necessary, what type of business plan, what type of projections are necessary so that they have a successful business.

Mr. SCHNEIDER. Great. Well, thank you. I am out of time. I will just again emphasize I appreciate the vision, grateful for the goals. Goals have to have numbers behind the goals and we need strategies and actions. I look forward to working together to try to achieve these. Thank you.

Chairman CHABOT. Thank you. The gentleman's time has expired.

The gentleman from Mississippi, Mr. Kelly, who is the chairman of the Subcommittee on Investigations, Oversight, and Regulations, is recognized for 5 minutes.

Mr. KELLY. Thank you, Mr. Chairman. And thank both of you for being here today and testifying.

As Chairman Chabot said, we kicked off this conversation in March with lenders that provide 7(a) loans. During that hearing we discussed the credit elsewhere test. I want to follow up with you today on that. Can you both describe the credit elsewhere test? And can you define it and how lenders specifically administer it?

Ms. RUSCHE. Thank you for the question and the opportunity to elaborate on our credit elsewhere test. This is from the Small Business Act as it is periodically amended that requires that we provide guarantees to customers who cannot otherwise obtain credit without the guarantee applied to the loan. As I earlier mentioned, in most cases the borrower comes to the lender and requests a loan, but the lender sees some credit weakness that generally things like they need a longer term for cashflow, collateral is insufficient, it is a startup business, it is a change of ownership and there is new management, and the lender requires that that additional enhancement be placed on the loan because they otherwise would not make it. And that is the key piece. The guarantee allows the lender to make a loan that otherwise would not be available to the customer.

Mr. MANGER. Yeah. I would just add again that many times it has to do with the sector or the industry sector that the small business is in. For example, we all know that the restaurant business is a risky business. Many lenders are not willing to make a loan to somebody who wants to start up a restaurant, but with an SBA guarantee, it mitigates their risk and they are willing to make that capital available so that someone can start a restaurant or a business again that has a riskier profile.

Mr. KELLY. Thank you. And to follow up, are lenders, to your knowledge, running afoul of this credit elsewhere test?

Ms. RUSCHE. If I could take the opportunity to answer that one. We review lenders periodically. I have mentioned the onsite reviews that we conduct where we look at the files and identify what the reasons are that are fully documented. We could always do a better job of educating or lender population as to the requirements, and we do that in our oversight reviews, as well as through our regular policies. And improving our streamlining processes in the SOP. We are mindful of that and continually work to identify any deficiencies we have in educating our lenders, but generally speaking, the lenders understand this test and conform to it appropriately.

Mr. KELLY. And this program at its core runs on behalf of the small businesses and not the lenders' bottom line, so are there small businesses that have the ability to obtain conventional lending utilizing the 7(a) program and what is SBA specifically doing about this? So not from the lenders' standpoint, but small businesses'. You know, it is for the small businesses. So what are you doing to ensure that small businesses are not getting into the SBA program when they should be conventional lending?

Ms. RUSCHE. We carefully review every loan file that we look at in our review processes to ensure that that is not happening, and when we see any indication that there might be confusion about that we provide direction and guidance to require the lender to correct any mistakes in that area.

Mr. KELLY. And Mr. Manger, do you have anything to add?

Mr. MANGER. You know, I would just say that the SOP rewrite that we are going through right now will clarify to a great extent, I think, the credit elsewhere test. And I would also just add that certainly if we have a loan that needs to be purchased by the SBA, unfortunately, and we find that that loan did not meet the credit elsewhere test, that we will not be paying out the guaranteed portion of that loan. So there is a risk, obviously, to any lender that does not properly document the credit elsewhere memo.

Mr. KELLY. And just going back very briefly, and this is just a comment, but I would like both of you, especially you, Mr. Manger, going back to the chairman's comment to start the hearing, it is imperative that we make this process simple enough that people can use it and get through it and get the credit that they need and deserve and not tied up with all these regulations and paperwork and additional addendums and all those things. I closed loans a long, long time ago as a lawyer, and people did not know what they were signing and there was no way to explain it. So you add all this, but it does not add any benefit to the person who is receiving that loan. They need to understand what they are signing, what they are doing, so simplify it as much as you can.

And with that, I yield back, Mr. Chairman.

Chairman CHABOT. Thank you very much. The gentleman yields back.

And the gentleman from Pennsylvania, Mr. Evans, who is the ranking member of the Subcommittee on Economic Growth, Tax, and Capital Access, is recognized for 5 minutes.

Mr. EVANS. Thank you, Mr. Chairman.

Mr. Manger, thanks to the chairman and our ranking member, a great deal of discussion has been around the access of capital, and I heard you mention Philadelphia. And I am from the city of Philadelphia. I represent the Philadelphia Montgomery County.

I am very much interested in a very specific way about access of people of color taking advantage of these opportunities as well as newly upstart. Because we start about growth for the economy. It is always talked about the aspect of women, African American, Hispanics, and others getting into the marketplace. Talk to me a little bit about people understanding, taking advantage of this opportunity, because I heard you mention, you know——

Mr. MANGER. Yes. And I did mention Philadelphia. And really because we have some not-for-profit partners in Philadelphia who have——

Mr. EVANS. Such as?

Mr. MANGER. You know, I will have to get you those names, Congressman. I will get those for you.

Mr. EVANS. Okay.

Mr. MANGER. But the results have been really quite amazing in Philadelphia among all of our American cities. And it really is because those not-for-profits that work in the inner city are making those available to women-owned businesses, businesses of color. You know, your congressional district this year up until April 30th has had 59 loans made for about $11.5 million. That is a little bit down from last year, but last year the full year there were 116 loans made for just over $30 million. So we are getting money out into your specific district. And again, we are going to continue to work to do that across the country.

The dollars that actually were getting out to women this year as a whole on the 7(a) program is up 7.2 percent. The dollar amount to African Americans is actually up 22.2 percent in the 7(a) program. And actually, we are seeing upticks in all of those areas except for veterans, but the good news on veterans is that for loans under $150,000 in the 7(a) program, the dollar amount to veterans is up 10.3 percent.

Mr. EVANS. So, one, I would greatly appreciate if you would provide the information of who the organizations are, because I am interested and the question is the strategies. Because in the same district we have a poverty number of about 28.1 percent. Translate that in numbers, about 195,000 people. And to me, the number one issue is the growth of businesses and jobs. So that is why I asked you that question in terms of growth and development. I heard you mention a little bit about the difficulty of restaurants. Do you also see that with supermarkets, retail in general?

Mr. MANGER. Congressman, I do not have the specific statistics on those other businesses. We can certainly get those for you, but, you know, there are definitely certain businesses that lenders realize have a higher risk profile and they are more hesitant to make that capital available to somebody who wants to start one of those businesses and that is really where the SBA comes in. We are able to, with a government guarantee on that loan, be able to make the bank see that the risk is mitigated to a level that is agreeable to them so that they can actually make that loan available.

And you are absolutely right. We are wanting to see more capital out to all segments of the American society because we understand obviously that that is really one of the biggest creators of job growth. I mean, there is a correlation between access to capital and the hiring of more employees. That has clearly been shown in several studies and we want to make sure that capital is accessible to all because we realize that that is again where we are going to create more jobs. As you know, two out of three net new jobs are created by a small business, and so we want to continue to increase that as much as possible.

Mr. EVANS. And that is kind of why I am spending all of my time asking you that question because since I have been on this Committee, you know, everybody talks about the access of capital as the number one issue and that is what I hear constantly. So I just wanted to be clear, are you and your particular agency doing all it needs to do in terms of outreach to make that happen?

Mr. MANGER. Congressman, we can always do a better job, and we are looking to improve ways in which we deliver our services and programs to everybody in the country. And I can assure you that while I am here as Associate Administrator, that will be our goal and our mission and we will continue that.

Mr. EVANS. I thank the chairman and yield back the balance of my time.

Chairman CHABOT. Thank you. The gentleman yields back.

The gentleman from Iowa, Mr. Blum, who is the chairman of the Subcommittee on Agriculture, Energy, and Trade, is recognized for 5 minutes.

Mr. BLUM. Thank you, Chairman Chabot.

The loan portfolio, 7(a) loan portfolio, how large today in billions?

Mr. MANGER. Today, the 7(a) program total loan portfolio is $80 billion.

Mr. BLUM. And the default rate on that?

Mr. MANGER. Is just under—2 percent is the loss purchase rate.

Mr. BLUM. So if I can do my math correctly that is a big number every year.

Mr. MANGER. And it is being supported by the zero subsidy on which the program is running. The fees that pay for the program are paying for those losses.

Mr. BLUM. Which is great. That is unusual.

Mr. MANGER. We really like the zero subsidy and we will do everything to maintain the zero subsidy for the program.

Mr. BLUM. We would hope so.

Mr. MANGER. Yes.

Mr. BLUM. What happens when somebody defaults vis-a-vis asset recovery?

Mr. MANGER. So first, the lender works as hard as they can to make sure that they can recoup as much from the borrower as possible. If at the end of the day it has to be purchased by the SBA, which is a last resort, that loan is sent to our office in Herndon, Virginia, where we do all of the loan processing for the purchases, and again, it is reviewed, and if everything is in accordance with SBA policy, we make good on the guaranteed portion. Now, at the end of that, if there is anything further that can be done, we are required to send that loan over to the Department of the Treasury for any final collections that could occur by them, but that is the process.

Mr. BLUM. What percentage of the loans that default do we get some type of asset recovery on?

Mr. MANGER. You know, I do not have that exact number, but I do know that we are recouping obviously a good portion, but I do not have that exact number. I will get it for you.

Mr. BLUM. I think someone said in previous testimony here today that the loans are reviewed quarterly. Is that correct? Or is it the lenders that are reviewed quarterly?

Ms. RUSCHE. What I mentioned was that we have a quarterly purchase rating. That is an analytic rating that we establish for every lender that is based upon their existing loan portfolio that helps us bucket them into degrees of risk based on the performance of their loans so that we can attend to the higher risk lenders.

Mr. BLUM. Buckets of risk, that was it. I was on a bank board for 18 years, in charge of the board of directors' commercial credit review. We would have what we would call suspect loans based on the review of those loans. Do you have something similar to that? Do you know how many loans currently are at risk or suspect of not paying back or of default?

Ms. RUSCHE. We would actually expect our lenders to manage the individual loan credits in their portfolios, and if they come to the point where a purchase or an honoring of the guarantee is necessary, that is when it comes into the SBA space. But we have lending partners and those partners are the ones who actually work with the customers through payment issues and payment problems. Our analytics do help those lenders identify their individual loans by buckets of risk as well and we share that with those lenders to help them improve that process.

Mr. BLUM. Okay. So our lenders, the SBA lenders are only organizations that are reviewed by outside organizations such as a State banking association or the Federal Reserve, is that correct?

Ms. RUSCHE. We have several groups of lenders. One group of those is lenders that are regulated by entities such as FDIC, OCC, or the Fed. We have another population of lenders that are primarily regulated by the Small Business Administration, and we tailor our review processes to those facts. So we are a little more extensive on our examination reviews and oversight of the lenders for which there is no other entity. We do not want to duplicate what already exists.

Mr. BLUM. And I have one last question here and a minute. In 2015, GAO did a report and they said lender oversight is a "long-standing management challenge" of the SBA. I am sure—I do not have the report in front of me—they offered recommendations. How are we doing on those recommendations? Have they been accomplished? What percentage of them have not been addressed? Because we are sitting here 2-1/2 years later.

Ms. RUSCHE. Thank you very much for that question. I have been the director of OCRM for 2 years and we have closed all but one of the recommendations and we are working actively on it.

Mr. BLUM. Very good. I appreciate you being here for your testimony today, and I yield back 15 seconds of my time, Mr. Chairman.

Chairman CHABOT. All right. The gentleman yields back. Thank you very much. And we will go to a second round quickly here, and we will recognize the ranking member for up to 5 minutes.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Mr. Manger, I come back to you because, when you leave this hearing, I want you to understand my concern regarding the gap in financing loans below $360,000 in the 7(a) program. The fact of the matter is that while the overall number of 7(a) loans has increased, the percentage going to minority and women-owned firms has been fairly consistent to the levels of 2010.

So my question is, why is it that minority lending and women lending has not rebounded as well as the rest of the 7(a) portfolio? I do not want to hear your answer; I just want to see the numbers the next time around and I am going to be paying attention to that.

I have a question regarding lenders closely monitoring the 7(a) authorization cap because emergency supplemental authority was required in fiscal year 2014 and 2015. So could giving SBA flexibility to increase the 7(a) lending authority beyond the congressionally authorized cap provide assistance in this situation?

Mr. MANGER. Yes. I would like to answer that, Congresswoman.

We want to make sure, and the Administrator, Linda McMahon, made it very clear to me when I first came into the agency, she said, "The last thing I want to have happen is the program shut down." And I pledged to her that we will watch it on a daily basis to make sure that at the first instance that we think that there is a problem that we are going to hit that authorization level, that we will notify OMB and Congress immediately so that we can rectify that situation because we do not want the program to shut down.

And with that I would also say that, as you know, Linda McMahon has asked Congress to give her the ability to increase the cap by 15 percent if it does not affect the zero subsidy, no effect to the budget, so that we could increase that cap upon notification of Congress if we think again we are getting close to that level. It would give our lending partners a little breathing room so they know that there would be no issue with the cap being reached and, again, the program having to shut down. So we would really like, and Linda McMahon stressed to me this morning before I came up here, she said, please make sure you mention to them that we are asking for that relief.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman. I yield back.

Chairman CHABOT. Thank you. And I will recognize myself.

First of all, Mr. Manger, I will go to you if I can. Some lenders—Manger, I am sorry—some lenders utilize the secondary market with the 7(a) loans. Would you describe the process of a lender using the secondary market?

Mr. MANGER. Sure. And I think Ms. Rusche could help with this as well. But basically, when a loan is made, we do allow some lenders to be able to sell that loan into the secondary market. Now, the thing that is most important to remember, though, they can only sell the guaranteed portion of the loan. The originating lender must maintain on average 25 percent of the value of that loan on their books. So they still have skin in the game, as they say. So we allow that. It is something that our lenders appreciate, but they realize that they do maintain skin in the game. They are only selling the guaranteed portion that is guaranteed by the SBA.

Chairman CHABOT. Thank you.

Ms. Rusche, to follow up on our previous discussion about the enforcement measures, are there enforcement actions that are available to the Office of Credit Risk Management? Are they strong enough to protect lender noncompliance?

Ms. RUSCHE. We have strong protocols in place. We have a Lender Oversight Committee, a collection of officials from the SBA, who assist OCRM in ensuring that we have sufficient resources, and when we need to take action, they have a say in taking that action so it is done appropriately. We would certainly enjoy working with your Committee to review additional possible authorities that we may want to consider, but we do think we have strong protocols in place at the present time.

Chairman CHABOT. Okay. Thank you.

And back to you, Mr. Manger. Ms. Rusche's testimony earlier states that staff is supplemented by support contractors for reviews and exams and enforcement activities. Can you talk about that? Are we hiring outside contractors for these roles or just how does that work?

Mr. MANGER. Yes. So in the Office of Credit Risk Management under the Office of Capital Access we have 27 full-time equivalents working on lender oversight. We augment that with contracts. For example, we do have a large contract with Dun and Bradstreet. Dun and Bradstreet supplies us amazing metrics on the lenders in our program. In fact, I believe Linda Rusche has one of the pages that they supply to us, and it really is broken down to a fantastic degree so that we get a clear picture of exactly what is going on with that lender. That would be very difficult to get some of that information that D&B provides us without having that contract. So we are very happy to have that contract. They provide us a great amount of information. And then again, those 27 FTEs in the office do the work onsite that we need to have done.

Chairman CHABOT. Okay. Thank you.

And then my final question, and I would invite either one of you that would like to take this to do it, you know, we have talked about the 7(a) Loan Program here today in some considerable detail, but that is not the only loan program obviously the SBA has. We have the 8(a) Loan Program, the Microloan program, the 504 Loan Program. For those, again, who might be out there wondering what they might qualify, could you sort of just give us a one or two or three-sentence idea of what the various programs are and how they fit in? Who would they appeal to?

Mr. MANGER. Sure. And that is a great question, and I hope people are listening out there because this would be very helpful to them.

So the 7(a) program is really our flagship program. It is our largest program; $80 billion is in the total portfolio size. That loan can be used for anything, including working capital. It is a great loan for a startup. It really is the program that we most use and I am happy to report that the increase this year in the usage of that program is up 9.7 percent. So it is being used. But what is even more interesting, Congressmen, and I think you will find this interesting, Mr. Chairman, is that the 504 program, which is for fixed asset acquisition, so any types of bricks and mortar, land, buildings, equipment, heavy equipment for a business, the 504 program has actually increased this year by 13.8 percent. And there are really two reasons for that.

One, with the 504 program you are guaranteed a fixed rate for a long term, 20 years, for example, on a 504 loan. In a rising interest rate environment, which we have today, there are many people that are interested in being able to acquire those fixed assets at a fixed rate. Certainly, with the economy doing as well as it is recently, we also find many small businesses are willing to go out and make that expensive equipment purchase. The 504 Loan Program is perfect for that type of small business owner that needs to acquire a big piece of equipment, fixed assets. The size of that loan goes up to $5.5 million, and again, we are seeing an increase in that program greater than 7(a) this year, 13.8 percent.

The Community Advantage program is actually a subset, a pilot subset of the 7(a) program, and that was started in 2011 for loans under $250,000. Again, average size $130,000, and that program is up 19 percent this year. So that is a subset of 7(a), but it is doing extremely well and we will be looking at that to possibly make that permanent in the future. The pilot runs through 2020.

And finally, the Microloan program. Again, this is something that is done in conjunction with our not-for-profit lending partners, lending intermediaries, and those loans are under $50,000, average size $13,000. They have great impact for that person that only needs a small amount of money, and that program has seen an increase even greater than the 7(a) program this year. In fact, demand for Microloans has gone up since the election. That is up 10.3 percent this year.

Chairman CHABOT. Thank you very much. My time is expired.

The gentlelady from Puerto Rico, Ms. González-Colón, is recognized for 5 minutes.

Ms. GONZÁLEZ-COLÓN. Thank you, Mr. Chairman. I just want to make just one question. And it is going to be does the SBA encourage the banks to operate in the secondary market?

Ms. RUSCHE. Thank you very much for that question.

I think encourage is probably not the correct word we would use. We allow under our protocols for a lender to participate in selling the guaranteed portions of loans in a secondary market. It is the lender's choice.

Ms. GONZÁLEZ-COLÓN. So it is going to be a choice. It is not that you are encouraged to do that?

Ms. RUSCHE. No, we are neutral on it.

Ms. GONZÁLEZ-COLÓN. And what is the premium paid to acquire a guaranteed loan in the 7(a)?

Mr. MANGER. Are you asking about what the interest rate is?

Ms. GONZÁLEZ-COLÓN. Mm-hmm.

Mr. MANGER. It is 2-3/4 above prime for the regular 7(a) program.

Ms. GONZÁLEZ-COLÓN. Thank you, sir. I yield back.

Chairman CHABOT. Okay. The gentlelady yields back. We want to thank our—oh, she does? Okay. Thank you very much.

All right. The gentlelady from American-Samoa, Ms. Radewagen, who is the chairman of the Subcommittee on Health and Technology, is recognized for 5 minutes.

Mrs. RADEWAGEN. Thank you, Mr. Chairman. And I want to add my welcome to the panel today.

The Microloan program that was mentioned, I have been really very fascinated with that. That tends to work for us out in American Samoa, and perhaps my staff can work with your staff to find out more about it because they do not even need under 50K loans. You are talking about $1,000 or $2,000. It makes a whole difference and they build these little businesses and they are just burgeoning all over the islands, and I wanted to just mention that.

So thank you, Mr. Chairman, I yield back.

Chairman CHABOT. Thank you. The gentlelady yields back. And on that point that the gentlelady raised, if somebody out in American Samoa or in Cincinnati, Ohio, or anywhere else wanted to know more about these programs, would you suggest they go to your website and they would find information there on these things?

Mr. MANGER. Certainly. Our website has a lot of information.

Chairman CHABOT. And what would that website be?

Mr. MANGER. SBA.gov.

Chairman CHABOT. SBA.gov.

Mr. MANGER. You got it. But, you know, I would also encourage those to reach out to our district offices. They are really on the frontlines throughout the United States and the territories, and they provide a great service and I would also point anyone to them as well.

I would also just like to mention, though, the LINC program. I am not sure if we have spoken about LINC here today, but LINC was a setup a few years ago at the SBA to pair up lenders with particular borrowers. And LINC to date has generated over 200 emails from borrows looking for financing at SBA-participating lenders. And to date as a result, we have had 70,000 unique borrowers receive a match from a lender and they are proceeding with financing. There are over 1,200 participating lenders on LINC.

And Mr. Chairman, I would just like to mention that we are actually enhancing LINC right now. And within the next month we are going to be relaunching it under the new name Lender Match. And certainly, if you and your staff would be interested, we would like to show you a preview of that before it is launched.

Chairman CHABOT. Excellent. We would be very interested in that.

We want to thank our witnesses for their testimony here today.

As the economy continues to recover and as access to capital continues to be a roadblock for the Nation's small businesses, it is imperative that this program that we have been discussing here this morning, the 7(a) Loan Program, is run in as efficient a manner as possible while, of course, safeguarding the American taxpayer dollars. And with the program experiencing such significant growth in recent years, we have a lot on the line, and so we want to thank you for what you do about this important program and making sure that it is run as efficiently as possible, and obviously follow up with the things. The ranking member asked for some additional information and we would urge you to provide that.

I would ask unanimous consent that members have 5 legislative days——

Ms. GONZÁLEZ-COLÓN. Mr. Chairman?

Chairman CHABOT. Yes?

Ms. GONZÁLEZ-COLÓN. Can I make just one more question?

Chairman CHABOT. Absolutely. The gentlelady is recognized.

Ms. GONZÁLEZ-COLÓN. Thank you, Mr. Chairman.

I understand that over 30 percent of the total amount of (7)a loans each year are made only for owner-occupied commercial real estate transactions. Is that true?

Mr. MANGER. I do not have that exactly number with me. I will have to get that for you.

Ms. GONZÁLEZ-COLÓN. Can you check that information?

Mr. MANGER. Yes.

Ms. GONZÁLEZ-COLÓN. And if that is true, can you tell us what percentage of those loans are used for business acquisition, partners' bios, working capital, debt consolidation startup capital, equipment financing, or real estate financing when you search for that information?

Ms. RUSCHE. We will review our analytics and develop that information and provide it.

I yield back.

Chairman CHABOT. So I would unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered. And if there is no further business to come before the Committee, we are adjourned. Thank you very much.

[Whereupon, at 12:15 p.m., the Committee was adjourned.]

APPENDIX

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

Wednesday, May 17, 2017

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 their SBA-guaranteed loan portfolios for the 7(a) and 504 Loan Programs. I have spent the last two decades involved in lender oversight and loan program risk management at SBA and I have been the Director of OCRM since 2015.

SBA's Administrator Linda McMahon has demonstrated leadership in championing small business lending while maintaining prudent lending 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 authorized by the Small Business Act and the Small Business Investment Act.

SBA's role is to fill an unmet need in the market place—to help creditworthy small businesses access credit when credit is not available elsewhere—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.

The Office of Credit Risk Management mission, and therefore my mission as its Director, is to effectively manage program credit risk, monitor lender performance, and enforce loan program requirements. In short, our mission is to maintain the integrity and viability of the 7(a) and 504 Loan Programs.

As of March 31, 2017, OCRM monitored a portfolio of 3,654 lenders that provide 7(a) guaranty financing in excess of $82.3 billion and 228 Certified Development Companies ("CDCs") responsible for approximately $26.8 billion in 504 debenture guarantees. This includes supervision of 14 Small Business Lending Companies ("SBLCs"), 27 Non-Federally Regulated Lenders ("NFRLs") and over 100 Community Advantage Lenders.

How does the Office of Credit Risk Management monitor all SBA 7(a) Lenders and CDCs and over $100 billion in credit? Our first step is through use of our Loan and Lender Monitoring System ("L/LMS"), the bedrock of our lender performance monitoring, 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. This provides an initial risk profile for each lender and CDC and allows OCRM to "bucket" higher risk lenders and CDCs for additional monitoring.

Next, OCRM uses our composite risk measurement methodologies and scoring guides, "PARRiS" for 7(a) Lenders and "SMART" for CDCs, to further diagnose higher risk lenders. PARRiS is an acronym for five components that focus our attention on **P**ortfolio Performance, **A**sset Management, **R**egulatory Compliance, **Ri**sk Management, and **S**pecial Items. The 504 program SMART components cover the following areas: **S**olvency and Financial Condition,

Management 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. These were most recently refreshed with updated performance information in early 2017. By using both predictive and historic performance metrics in the PARRiS and SMART methodologies, OCRM obtains a holistic picture of lender risk, upon which to consider additional oversight activities.

Third, OCRM conducts approximately 300 focused risk-based reviews and examinations using these protocols each year. These consist of multiple types including Analytical Reviews, Full Reviews, Targeted Reviews, and Safety and Soundness Examinations.

OCRM also conducts over 1,200 assessments each year before renewing delegated lending status for those lenders and CDCs which have been granted enhanced authority by SBA. We also conduct quarterly financial and capital assessments of our SBA Supervised Lenders, since SBA is generally their sole federal financial regulator. Also, we conduct reviews of CDC annual reports to determine whether CDCs have the financial ability to operate and are in compliance with loan program requirements.

In addition to its lender monitoring and supervision activities, OCRM has been at the forefront of identifying emerging risks, one of which involves the ongoing discussion of which businesses are in need of SBA financing. The Small Business Act, as amended, states that small business loan guarantees are to be provided to only those borrowers who cannot obtain the needed credit on reasonable terms from other non-federal sources. Over the years SBA has promulgated regulations and developed policy to assist lenders in making this determination and fully documenting it for each 7(a) loan approved.

With recent robust growth in the 7(a) program, OCRM has paid particular attention in its reviews to a lender's documented "credit elsewhere" reasons. We have identified some instances of lack of understanding on the part of lenders, and occasionally poor internal controls within lenders' operations, that contribute to their noncompliance with this requirement. OCRM requires lenders which demonstrate non-compliance to correct individual file deficiencies, and as needed, to alter policies, procedures or internal controls to ensure full compliance with the Act and all other applicable regulations and procedures. OCRM will continue to focus on this area in our upcoming reviews, to ensure the mission of the Agency is met in providing small businesses with financing they cannot obtain elsewhere on reasonable terms and conditions.

To accomplish our responsibilities, OCRM operates with a staff of 27 supplemented by support contracts for reviews, exams and enforcement activities. OCRM continuously assesses our internal operation to ensure we deliver our critical monitoring, supervision and enforcement activities with the most effective and efficient mix of these resources. We also continuously assess the functions of our contracts in the same manner, working continuously to improve consistency through retention of well-trained leaders.

In fiscal year 2017 and beyond, 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 benchmarks. OCRM will also continue to monitor lenders through programmatic risk-based reviews, using PARRiS and SMART to target existing and emerging risks, as identified.

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 our activities and theirs, minimizing duplication and burden.

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.

U.S. Small Business Administration

TESTIMONY of

WILLIAM MANGER

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

House Small Business Committee

Wednesday, May 17, 2017

I'd like to thank Chairman Chabot, Ranking Member Velazquez and the entire House Small Business Committee for the opportunity to testify before you today. I had a great meeting in April with some of your staff and look forward to building a strong and open relationship with all of you moving forward.

It is an honor for me to be here and to have been appointed Associate Administrator for the SBA's Office of Capital Access by Administrator Linda McMahon. It's been eight years since I last worked at the SBA as Associate Administrator for the Office of Field Operations in Washington and prior to that, I was also fortunate enough to serve as SBA's Regional Administrator for Region 2, based out of New York. From the very beginning of my time at the SBA I was able to witness the positive impact our programs have on communities across the country. I can definitely say that I am very excited to have the ability to improve the services we provide and help small business owners and entrepreneurs grow to their full potential.

As Associate Administrator, I oversee the SBA's flagship 7(a) and 504 loan programs, as well as our Microloan and Surety Bond programs. Just a couple of weeks ago this Administration had our first opportunity to take part in National Small Business Week. It was a tremendous success and showcased so many incredible entrepreneurs that have successfully utilized these programs and created jobs for American Workers.

National Small Business Week serves as a reminder of how crucial small enterprises are to our economy and it is a great time for our nation's leaders to reflect on how to better serve the small business community. I am very optimistic about this Administrations agenda in that regard. Recently, there has been a tremendous amount of optimism and confidence in our economy and our talented team of program directors and I will be working tirelessly to help deliver on the high expectations set by this Administration.

The role that the SBA and the Office of Capital Access plays in our credit markets fills an important gap in the lending marketplace. Our agency aims to help small businesses obtain credit which is otherwise unavailable through conventional lending. As many of you know, often time's entrepreneurs have the will and drive to succeed, but access to capital unfortunately proves to be an insurmountable hurdle. That is where we come in. Our programs have been helping small businesses get on their feet and grow for decades, but as we all know there is always room for improvement.

Administrator Linda McMahon has placed an emphasis on making sure our entire agency and our Office of Capital Access is running as efficiently and effectively as possible and that is exactly what I intend to do as Associate Administrator.

The Office of Capital Access is streamlining our Standard Operating Procedures (SOP's) and plans to repeal unnecessary regulations that don't benefit small businesses aiming to start or expand. As our SBA One system continues to be a success, we are in the process of modernizing the 504 lending system and bringing it up to speed technologically.

We will also place an emphasis on SBA loan center efficiency, which will decrease the time it takes for lenders to process, service and collect SBA guaranteed loans.

As we work to recruit more lenders for our programs, we have stressed to our lending partners that we want to see more small-dollar loans being made to entrepreneurs. Our focus will remain on helping those who need capital most before anyone else—that includes our veterans, women-owned businesses, minority-owned businesses, rural communities and all of our emerging markets. In addition, the Office of Capital Access sees our 7(a) program in particular, as a powerful tool for helping create and retain jobs for American workers.

It is of paramount importance to me and our agency that our 7(a) and 504 flagship programs continue to operate at zero subsidy and remain a great deal for taxpayers. As we look to refine the programs within the Office of Capital Access—the continued zero subsidy status of our programs will absolutely be a major priority for this Administration.

Having been serving as Associate Administrator for just under two months now I can assure you that our office is placing an incredible amount of emphasis on oversight to make sure our programs are being administered properly and appropriately. Linda Rusche plays a crucial role in that as Director of our Office of Credit Risk Management.

The Office of Capital Access and the Office of Chief Financial Officer are also constantly monitoring our program level limits, and SBA thanks the Committee for its assistance in raising the 7(a) program level to $27.5 billion in FY 2017 from $26.5 billion in FY 2016. While SBA is witnessing increased demand by the small business community this year, we are not currently in jeopardy of exceeding our capacity to meet such needs. The Office of Capital Access works closely with the SBA Lending community to communicate that the agency is in good financial position with sufficient resources through the end of this fiscal year.

However, to ensure that America's small businesses can fully benefit from the tools and resources provided by the SBA and that this support continues through the year uninterrupted, the Administrator supports proposed legislation that would grant circumstantial authority to the Administrator to increase 7(a) lending authority by 15 percent when program subsidy is zero and appropriate notice is provided to Congress. The flexibility offered by the proposed statutory provision would offer greater certainty to our 7(a) lending partners and make additional assistance available to small businesses at no additional subsidy cost to the taxpayer.

While we continue to see job creation and responsible growth from all of our programs I cannot stress enough how committed we are to proper oversight—to date our 7(a) program lending is up 10% over last year.

I am glad to have the opportunity to testify before this committee today and demonstrate the work we are doing to help America's entrepreneurs attain the American dream. Under the leadership of

Administrator McMahon, the SBA is more dynamic and forward looking than ever before. Likewise, this committee's partnership is something our office views as invaluable to improving the sustainability of our programs.

I look forward to a transparent and collaborative relationship with this committee to ensure we are fulfilling all aspects of our agency's mandate.

Please know that in me you have someone that shares our Administrator's vision of a stronger small business community in America and is committed to administering our programs both properly and in the best interest of the American taxpayer.

Question for the Record

Committee on Small Business

SBA's 7(a) Loan Program: A Detailed Review

May 17, 2017

Responses by William Manger, Associate Administrator for Capital Access, SBA

Rep. Luetkemeyer to Mr. William Manger

• At our hearing you discussed the franchisee lending process and how it was changed with the intent to simplify and streamline lending. Notwithstanding these best intentions, my understanding is that the narrow scope of this rule is significantly hindering access to loans for small businesses and that some franchisors who previously had agreements are unwilling to sign the new addendum. In addition, I'm hearing that the new process is hurting the ability to access loans for some small business owners who are not franchisees, but may have an independent contractor relationship with another entity selling or distributing their products. Can you tell me what steps you've taken or plan to take to provide additional flexibility in the process and ensure that legitimate small businessmen and women can have access to lending in these franchise and non-franchise situations?

SBA Response:

Franchisees represent a significant portion of SBA's loan portfolio—in FY2016, loans approved to franchisees represented $4.68 Billion, or 16.2% of SBA's lending. For many entrepreneurs getting started in business, the purchase of a franchise can be the fulfillment of a lifelong dream to own and operate a business. Without the benefit of an SBA guarantee, and the financing it unlocks, many of those dreams might go unrealized.

SBA's franchise lending processes are designed to ensure that legitimate small businesses, whether franchisees or non-franchisees, have access to the capital that is not available elsewhere that they need to start, expand and grow the business. As you know, Congress has authorized SBA to provide financial assistance through its business loan programs only to independently owned and operated small businesses. Therefore, when SBA considers the size of an applicant for SBA financial assistance, it takes into consideration the size of the business together with all of its affiliated entities. A business's affiliated entities are those entities that control, are controlled by, or are under common control with the business. Affiliates may be identified through ownership, management, hiring practices or other similar means of control.

For franchisees seeking SBA financing, SBA has generally determined whether a franchisee is affiliated with its franchisor by reviewing the franchise agreement to ensure that the agreement is not so controlling as to create affiliation between the franchisor and the franchisee. If the franchisor and franchisee are affiliated, their size is aggregated to determine whether the application is "small" under the current SBA size regulations.

In the past, agreements were reviewed on a case by case basis. Effective January 1, 2017, however, SBA revised its franchise review process to provide for a more streamlined approach. The two main changes to the process were as follows:

1. Adopt the Federal Trade Commission (FTC) definition of a franchise. The intent was to reduce the number and types of agreements that SBA would consider franchises under its regulation.

2. Create a Standard Form Addendum to be used with all agreements that meet the FTC definition of a franchise. The intent was to reduce the required review of each franchise agreement to determine if there was affiliation between the franchisor and the applicant small business.

While the new process was embraced by some franchisors, SBA found that there were a number of franchisors that were unwilling to execute the SBA Standard Form Addendum. In order to address this problem, SBA amended its process in February 2017 to allow for the use of a previously negotiated addendum to be used in place of the Standard Form Addendum. This revised process allows a franchisor that had worked with SBA on a negotiated addendum in either 2015 or 2016, to use that addendum with any of their franchise agreements, in place of the required SBA Standard Form Addendum. This more flexible approach gives the franchisor a choice and as a result has improved the process, allowing many more small business franchisees the ability to access SBA financial assistance.

But we are not satisfied that we have adequately addressed the challenges in franchise lending to independently owned and operated small businesses, and we are not finished. A dedicated mailbox has been set up to receive comments and concerns from franchisors and lenders regarding the new process. A team of SBA employees from the Office of Capital Access and the Office of General Counsel responds to any queries and issues that are sent into the box. Through this and other means, we are gaining a better understanding of the issues and challenges that still exist in the SBA franchise lending area. We have seen that there is some confusion and uncertainty among SBA lenders about the FTC's definition of a franchise, particularly with respect to its applicability to certain independent contractor relationships. SBA has provided guidance to lenders and businesses as to whether these agreements meet the FTC definition of a franchise. SBA will continue to provide this type of assistance, and is considering the possibility of creating a national listing of reviewed agreements so lenders, franchisors and small business franchisees will know which agreements meet the FTC definition of a franchise. In addition, SBA will continue to provide training sessions to lenders to ensure that they understand the new process and can provide the correct guidance to their small business clients.

Credit Union National Association
CUNA

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May 17, 2017

The Honorable Steve Chabot
Chairman
House Committee on Small Business
Washington, DC 20515

The Honorable Nydia Velázquez
Ranking Member
House Committee on Small Business
Washington, DC 20515

Dear Chairman Chabot and Ranking Member Velázquez:

On behalf of America's credit unions, thank you for holding the hearing entitled, "SBA's 7(a) Loan Program: A Detailed Review." The Credit Union National Association (CUNA) represents America's credit unions and their 110 million members.

Credit unions are active participants in the Small Business Administration (SBA) loan programs, which provide America's small business owners with capital to start or expand their businesses. At the end of 2016, there were 400 credit union SBA lenders; collectively they reported $1.6 billion in SBA loans outstanding in 8,100 individual loans.

CUNA is a strong supporter of the SBA 7(a) loan program, and has advocated for the highest possible federal funding level in order to keep fee costs low and to make the program accessible to credit unions. CUNA believes that the greater the number of available sources of credit to small business, the more likely a small business will be able to secure credit and contribute to the nation's economy.

We encourage the SBA to simplify and clarify the language of its regulations, eliminate inconsistencies and conflicts that make rules more complex and confusing, allow electronic submission of standardized forms, and incorporate industry consensus standards into regulations as appropriate. These changes will allow credit unions to tap their considerable potential for increased SBA lending.

On behalf of America's credit unions, thank you for holding today's hearing. We look forward to continuing to work with you to find ways to improve the SBA 7(a) program and other SBA loan products.

Sincerely,

Jim Nussle
President & CEO