U.S. Small Business Administration

TESTIMONY of

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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, **M**anagement and Board Governance, **A**sset Quality and Servicing, **R**egulatory Compliance, and **T**echnical Issues and Mission.

Benchmarks of historical and projected performance have been developed for the PARRiS and SMART methodologies, and provide relative measures of lenders' financial risk specific to each program. 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 non-compliance 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.