Financial Services Management

SBA Reform

Small Business	Government Relations Action Item

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S. 2288

Small Business Lending Oversight and Program Performance Improvement Act of 2007

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Overview

The leadership of the Senate Small Business Committee has introduced legislation to force reforms in the Small Business Administration's (SBA) major loan-guarantee programs. In the short term, the reforms could make it more costly and difficult for lenders to retain their "preferred" status. Over time, new economic-performance measurements could increase pressure to revise or eliminate these SBA programs.

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Impact

Currently, the SBA has approximately $60 billion in outstanding loans, with program advocates arguing that this promotes employment and economic development by providing financing that would not otherwise be available through commercial banks. However, as SBA loan volume has grown, so has criticism of it, with the General Accountability Office (GAO) earlier this year arguing that the SBA has failed to implement needed controls to ensure that loan credit quality is protected and economic development enhanced.

Under questioning at a recent Congressional hearing, the SBA defended its practice, also noting recent improvements designed in particular to ensure that a lender granted preferred status can be trusted with all the delegated authority this provides. Congress was particularly concerned here because of a recent scandal at a preferred lender that resulted in substantial costs to the SBA.

The legislation would not only put the SBA under new pressure, but also have the same impact on lenders, especially those granted preferred status. At the outset, these lenders would be subject to new SBA examination fees, modeled after the assessments charged by some of the bank regulators. Although the bill instructs the SBA to make these fees as little burdensome as possible, there would still be a new cost of doing business as an SBA lender. For lenders housed in insured depositories, these fees would also be duplicative of the assessments related to their operations charged in OCC and OTS examinations. Development authorities receiving 504 funds would need to make new executive-compensation disclosures to the SBA, aimed at ensuring appropriate practice. This would reduce conflicts of interest and even corruption, but could also subject these entities to legal and reputational risk, along with possible reductions in 504 funding.

What's Next

S. 2288 was introduced on November 1 by the leadership of the Senate Small Business Committee, Sens. Olympia Snowe (R-ME) and John Kerry (D-MA). The panel held a hearing on broad SBA governance issues shortly thereafter and plans additional work next year. There is as yet no companion House legislation.

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Analysis

The legislation covers SBA's 7(a) and 504 programs. In general, the bill would be effective one year after enactment

A. Fees

The bill authorizes the SBA to assess lenders for fees related to enhanced oversight, although the agency is instructed to ensure these fees are not burdensome.

B. Performance Criteria

The SBA would need to publish portfolio-quality evaluation methods, with the legislation detailing the criteria to be included. These include:

- liquidation rates;
- currency rates;
- recovery rates;
- delinquency rates; and
- other risk indicators.

These criteria would then need to be used by the SBA to compare lenders and target examinations. Each lender would need to be given a score on each of the criteria noted above with these scores leading to a composite one that would then be presented to the lender. In addition, the SBA would need quarterly to review each lender to identify any material changes in these quality criteria, looking also at the degree to which the lender may have a concentration of loans to a particular industry segment. It would need to make its ratings system transparent and provide lenders with an array of data without charging a fee for doing so.

C. On-site Review

If these data and quarterly reviews are problematic, then the SBA would need to undertake an on-site review of the lender, with the bill detailing how this should be conducted.

Based on this examination and the views of the local SBA staff, the SBA Administrator would then need to evaluate whether preferred-lender status should be revoked.

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D. Default Rates

The SBA would also need to compile data on loan-default rates, differentiating the various 7(a) and 504 programs. The methodology for calculating these rates would also need to be made public. These default rates would then facilitate comparison of SBA default rates with those of other commercial loans.

E. Economic-Performance Evaluations

The SBA would also need to make public a method for evaluating and measuring the economic performance of each loan. These measurements would need to include:

- employees numbers;
- annual sales receipts;
- estimated federal income taxes;
- loan repayment;
- the number of businesses operating by loan recipients; and
- the degree to which new businesses are started by loan recipients.

Much of this information would be gathered in the course of loan applications, with the application information creating a "base year" for data that would then be compared to subsequent data provided over the next twelve years. SBA would need to start making a public report on these economic measures six years after enactment.

F. Executive Compensation

State and local development companies (other than those provided exemptions) receiving 504 loans would need written compensation policies that meet details specified in the legislation. These policies would need to be approved by the companies' boards of directors. The companies would also need to report annually to the SBA on the details of compensation packages for each highly-paid employee.

G. GAO Study

The GAO would need to undertake a study of the 7(a) program to determine, among other things, the scope of needed oversight taking into account other lender regulators. The study would also need to determine reasonable SBA examination fees. The study would be due one year after enactment.

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