

**Congress of the United States**  
**U.S. House of Representatives**  
**Committee on Small Business**  
2361 Rayburn House Office Building  
Washington, DC 20515-0515

**MEMORANDUM**

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**To:** Members, Committee on Small Business  
**From:** Chairwoman, Nydia M. Velázquez  
**Date:** February 5, 2020  
**Re:** Full Committee Hearing: SBA Management Review: Office of Credit Risk Management

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The Committee on Small Business will meet for a hearing titled, “SBA Management Review: Office of Credit Risk Management.” The hearing is scheduled to begin at **11:30 A.M. on Wednesday, February 5, 2020 in Room 2360 of the Rayburn House Office Building.** The hearing will allow Members to learn about the SBA Office of Capital Access’ Office of Credit Risk Management (OCRM), which was codified last Congress as part of the Small Business 7(a) Lending Oversight Reform Act of 2018. Members will also be able to explore the current administrative challenges facing OCRM and ways to continue strengthening the Office and its operations. The witness will be:

**Panel 1:**

- Ms. Susan Streich, Director for the Office of Credit Risk Management, U.S. Small Business Administration, Washington, DC

**Introduction**

Access to capital is critical to the success of America’s small businesses and entrepreneurs. The Small Business Administration (SBA) administers a number of loan guaranty programs designed to encourage lenders to provide loans to small businesses that might not otherwise be able to obtain financing on reasonable terms and conditions.<sup>1</sup>

The 7(a) Loan Guaranty Program (the “7(a) program”) is the Agency’s flagship program that provides government-backed loans to help these small businesses who face challenges getting approved for conventional bank loans. The SBA is not a direct lender; rather, it relies on private-sector lenders to offer loans. The lenders are mostly banks, but some are non-depository lenders, including small business lending companies.<sup>2</sup> The guarantee assures the lender that if a borrower defaults on a loan, SBA will purchase the loan and the lender will receive an agreed-upon portion of the outstanding balance.<sup>3</sup> For the majority of 7(a) loans, SBA relies on lenders with delegated

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<sup>1</sup> Cong. Res. Serv., *Small Business Administration 7(a) Loan Guaranty Program*, R41146, Oct. 15, 2019.

<sup>2</sup> GAO, *Patriot Express: SBA Should Evaluate the Program and Enhance Eligibility Controls*, GAO-13-727, Sep.12, 2013 [hereinafter “GAO Patriot Express”].

<sup>3</sup> GAO Patriot Express, *supra* note 2.

authority to process and service loans and to ensure that borrowers meet the program’s eligibility requirements.

SBA also administers the 504/CDC Loan Guaranty program (the “504 program”). Authorized by the Small Business Investment Act of 1958, the 504 program backs long-term fixed-rate loans up to \$5.5 million to support investment in major fixed assets, such as land, buildings, heavy equipment, and machinery.<sup>4</sup> The program is delivered by local Certified Development Companies (“CDCs”), which are private, nonprofit corporations established to promote economic development within their communities.<sup>5</sup> CDCs are certified and regulated by SBA, and they must be in good standing and in compliance with all laws and tax requirements in the state they have been incorporated in and in any state they do business.<sup>6</sup> CDCs work in partnership with SBA and participating private-sector lenders (typically banks) to provide affordable financing to small businesses. As of January 28, 2020, there are 241 CDCs nationwide, each with its own geographically defined area of operations.<sup>7</sup>

In FY2019, the SBA approved more than 58,000 loans in the 7(a) and 504 loan programs, providing more than \$28 billion to small businesses and supporting approximately 550,000 jobs.<sup>8</sup>

### **SBA Office of Capital Access**

SBA’s Office of Capital Access administers the 7(a) and 504 loan programs as part of its mission to enhance small firms’ ability to access affordable capital. To do so, it partners with a growing network of more than 2,500 banks, credit unions, and other financial institutions that offer guaranteed lending.

### **Office of Credit Risk Management Prior to 2018**

In 1999, SBA established an Office of Lender Oversight (renamed the Office of Credit Risk Management in 2007) within the office of Capital Access.<sup>9</sup> OCRM is responsible for the oversight of SBA lenders and its \$120 billion 7(a) and 504 loan portfolio.<sup>10</sup> Specifically, it conducts a continuous, risk based, off-site analysis of SBA’s lending partners through the Loan/Lender Monitoring System.<sup>11</sup> In addition, the Office performs strategic on-site reviews of lending partners’ activities including the performance of their SBA lending operations and compliance with program rules and regulations.<sup>12</sup> OCRM also assesses the quality of the overall SBA loan

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<sup>4</sup> Cong. Res. Serv., *Small Business Administration 504/CDC Loan Guaranty Program*, R41184, Oct. 23, 2019 [hereinafter “CRS 504”].

<sup>5</sup> CRS 504, *supra* note 4.

<sup>6</sup> CRS 504, *supra* note 4.

<sup>7</sup> U.S. Small Bus. Admin. website CDC locator.

<sup>8</sup> U.S. Small Bus. Admin. *Agency Financial Report Fiscal Year 2019*, available at [https://www.sba.gov/sites/default/files/2019-12/SBA\\_FY\\_2019\\_AFR-508.pdf](https://www.sba.gov/sites/default/files/2019-12/SBA_FY_2019_AFR-508.pdf).

<sup>9</sup> U.S. Small Bus. Admin. Office of Inspector General, *Audit of SBA’s Oversight of High-Risk Lenders*, Report No. 20-03 [hereinafter “SBA OIG Report 20-03”].

<sup>10</sup> SBA OIG Report 20-03, *supra* note 9.

<sup>11</sup> *U.S. Small Bus. Admin. Office of Credit Risk Management*, available at <https://www.sba.gov/offices/headquarters/ocrm/about-us> [hereinafter “OCRM website”].

<sup>12</sup> OCRM website, *supra* note 11.

portfolio.<sup>13</sup> Through trend analysis and assessment of other analytical risk indicators, the Office seeks to better understand lender and portfolio performance.<sup>14</sup>

### *The Small Business 7(a) Lending Oversight Reform Act of 2018*

Beginning in approximately 2012, the 7(a) program began experiencing rapid growth. In FY2012, the program approved \$15.2 billion in loans.<sup>15</sup> By FY2017, that number had ballooned to \$25.4 billion.<sup>16</sup> As loan approvals continued to climb, the 7(a) program reached its authorized lending authority limit, which sets a maximum level on the amount of lending that can be administered in the 7(a) program.<sup>17</sup>

At that same time, the SBA Office of Inspector General (OIG) identified lender oversight as a serious management challenge for SBA.<sup>18</sup> Because SBA relies on lenders that make the loans to process and service the loans, concerns were raised that OCRM was not always performing effective oversight to identify and mitigate risks.<sup>19</sup>

The unprecedented growth in the program, combined with concerning program evaluations by watchdog groups, prompted a more thorough examination of the tools available at SBA to ensure comprehensive lender oversight is achieved.<sup>20</sup> Accordingly, this Committee held three hearings in the 115th Congress on the issue of SBA's oversight of the 7(a) program.<sup>21</sup> After those hearings, then-Chairman Steve Chabot and then-Ranking Member Nydia Velázquez introduced H.R. 4743, the Small Business 7(a) Lending Oversight Reform Act of 2018 (the "Oversight Act"), which sought to enhance SBA's oversight capabilities to ensure the integrity of the program for small businesses while protecting American taxpayer dollars.<sup>22</sup>

In 2018, Congress passed and President Trump signed into law the Oversight Act, which strengthened the ability of SBA to conduct effective oversight of the lending programs. More specifically, the Oversight Act codified OCRM and required SBA to provide Congress with regular updates regarding its oversight actions and the performance of its portfolios.<sup>23</sup> These reforms were enacted to ensure that SBA will have the resources and authority it needs to keep pace with the rapid growth of the 7(a) program.

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<sup>13</sup> OCRM website, *supra* note 11.

<sup>14</sup> OCRM website, *supra* note 11.

<sup>15</sup> U.S. Small Bus. Admin., *FY2018 Congressional Budget Justification and FY2016 Annual Performance Report*, p. 27 (2019).

<sup>16</sup> U.S. Small Bus. Admin., *FY2020 Congressional Budget Justification and FY2018 Annual Performance Report*, p. 30 (2019).

<sup>17</sup> U.S. House of Representatives, Committee on Small Business, Report No. 115-655, (2018) [hereinafter "Committee report on Oversight Act"].

<sup>18</sup> SBA OIG Report 20-03, *supra* note 9.

<sup>19</sup> GAO, *Small Business Administration: Leadership Attention Needed to Overcome Management Challenges*, GAO-15-347, Sep. 22, 2015.

<sup>20</sup> Committee report on Oversight Act, *supra* note 17.

<sup>21</sup> Committee report on Oversight Act, *supra* note 17.

<sup>22</sup> Committee report on Oversight Act, *supra* note 17.

<sup>23</sup> Public Law No. 115-189.

### Status of the implementing regulations

The Oversight Act also required the SBA Administrator to promulgate new regulations implementing the new enforcement provisions. The Notice of Public Rulemaking comment period ended on August 20, 2019, and the SBA received 35 public comment letters.<sup>24</sup> According to the timetable posted on Regulations.gov, final action on the proposed regulation was expected in November 2019.<sup>25</sup> However, as of January 28, 2020, SBA has not finalized the regulation.

### Current challenges facing OCRM

In 2019, SBA's OIG conducted an audit to determine whether SBA performed effective oversight of high-risk lenders to identify and mitigate risks. The OIG found that OCRM did not always perform effective oversight, and, in fact, did not conduct 108 of 358, or 30 percent, of its planned high-risk lender reviews for Fiscal Years 2015-2017. Moreover, it did not recommend adequate and consistent risk management actions, which consist of corrective and enforcement actions, for most of the lenders they assessed. Finally, OCRM found deficiencies in the 7(a) loans they reviewed and SBA purchased, but OCRM failed to communicate the loan deficiencies to the SBA's loan centers.<sup>26</sup>

According to the OIG, these findings increase the risk that lenders with "repeated systemic deficiencies" will continue to participate in SBA's 7(a) and 504 loan programs and make ineligible loans. The OIG raised serious concerns that it could jeopardize the integrity of the programs and heighten the risk of financial loss. For example, the OIG analyzed 32 of 76 defaulted 7(a) loans, and did not find evidence that OCRM had validated whether lenders had corrected the material deficiencies identified by the OCRM reviews on 21 of those 32 loans. SBA honored its guaranties on the loans by purchasing the defaulted loans for approximately \$13.3 million.<sup>27</sup>

The OIG made 6 recommendations to SBA, which are all resolved. In response to the first recommendation, the OCRM Director noted that the OCRM review plan is merely a guide, allowing flexibility so that changes can be made as new risk patterns arise among lenders and in the 7(a) portfolio. OCRM wrote that some of the planned reviews for FY2015-2017 were not conducted, but more urgent reviews were conducted in their place. Furthermore, OCRM emphasized that the overall number of reviews conducted for that time period exceeded the number of originally planned review, and that OCRM actually performed nearly 13 percent more reviews than initially planned. OCRM wrote the result was more effective lender monitoring and oversight.<sup>28</sup>

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<sup>24</sup> See <https://www.regulations.gov/docket?D=SBA-2019-0007>; see also Implementation of the Small Business 7(a) Lending Oversight Reform Act of 2018, 84 Fed. Reg. 120 (proposed June 21, 2019) (to be codified at 13 CFR pts. 120 and 134).

<sup>25</sup> <https://www.regulations.gov/docket?D=SBA-2019-0007>.

<sup>26</sup> SBA OIG Report 20-03, *supra* note 9.

<sup>27</sup> SBA OIG Report 20-03, *supra* note 9.

<sup>28</sup> SBA OIG Report 20-03, *supra* note 9.

## **Conclusion**

SBA's OCRM plays a key role in ensuring the agency's capital access programs are being operated effectively by managing credit risk, monitoring lender performance, and enforcing lending program requirements. In recognition of its importance, the 115th Congress codified OCRM and gave it statutorily defined powers and enforcement mechanisms. However, any credit risk management function is only as effective as its oversight over the riskiest of lenders. In 2019, SBA's OIG found numerous shortcomings in OCRM's oversight of high-risk lenders in the 7(a) program. This hearing is therefore a timely opportunity for Members to further explore OCRM's role, the challenges it currently faces in managing SBA's credit risk, and how Congress can continue to support OCRM and strengthen its operations.