Small Business 7(a) Lending Oversight and Reform Act of 2018

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Introduced on January 9, 2018 the House and Senate Committees on Small Business introduced the Small Business 7(a) Lending Oversight Reform Act of 2018 (H.R. 4743 and S. 2283 respectively). Hill conversations regarding oversight have been ongoing for the past three years, and while the concern shared by Members of Congress is nothing new, their current approach to the topic is a departure from the past.

As a point of reference, in FY 2014 the 7(a) program's **authorization cap** was set at $17.5 billion. (The authorization cap is annually debated, set and passed by Congress to determine the amount that 7(a) lenders may lend each fiscal year.) For FY 2018, should we see a full appropriations bill pass Congress to fund the government for the rest of the year, the program's authorization cap will likely be set at the level the House and Senate agreed upon months ago: $29 billion. **That is an almost 66% increase** over the last four years.

NAGGL is the first voice cheering from the sidelines, applauding the growth that enables tens of thousands of small businesses to create hundreds of thousands of jobs. We are an advocacy force in Washington, DC working on behalf of our members fighting for increases to the authorization cap every year to support increasing borrower demand. But, Congress is hesitant to allow a growing authorization cap without a serious piece of legislation that makes certain that all parties involved—Congress, SBA, lenders, borrowers, the taxpayers—are assured that as Congress increases the program's lending cap, it also has taken steps to ensure that any potentially increasing risk would be mitigated.

Of course, NAGGL's concerns go beyond raising the authorization cap. The goal of quality lender oversight is not lost on anyone in our industry: it ensures program health and integrity, as well as its ongoing availability. It is Congress' responsibility to oversee SBA and its programs and to assure that OCRM has the resources and processes in place to monitor the incredible growth in the 7(a) program.

NAGGL's bedrock mission is to protect the integrity and stability of the 7(a) program, and Congress invited NAGGL to sit at the table every step of the way. As Congress explored ideas to improve and modernize SBA lender oversight, our primary objective was to ensure that any proposals supported the 7(a) program mission and did not impede lenders from continuing to make loans to eligible and creditworthy borrowers, or create duplicative efforts with current oversight from either SBA or other regulators.

In January, CEO and President, Tony Wilkinson, testified before the House Small Business Committee. In March, there was a "markup" of the bill in both the Senate and

House, a formal process of both the House and Senate Small Business Committees that amends and tweaks the bill. Both H.R. 4743 and S. 2283 were passed unanimously out of both Committees—meaning that all of the Members agreed to the bill's final language. On June 5, 2018, H.R. 4743 passed out of Congress and on June 21, 2018 was signed into law by the President.

NAGGL believes the bill strengthens oversight of SBA's 7(a) loan program in the following ways:

- **Creates a streamlined process to prevent a shutdown of the program**. A proposal NAGGL drafted and has fought for since 2015 when the program faced a mid-fiscal year shutdown. Similar to authority available to USDA, the bill establishes a notification process by which SBA can increase the 7(a) lending cap (up to 15% and limited to once a year). Currently, if the 7(a) program hits its lending cap, Congress must act legislatively to raise the program level. Finding a timely legislative vehicle is difficult and the uncertainty can trigger a market 'frenzy.' In FY2015 when the program reached its authorization cap in July ahead of the end of the fiscal year on September 30, it caused a program shutdown. Having a streamlined process to allow swift action tempered by appropriate controls will provide stability and certainty to borrowers and lenders should demand for 7(a) financing exceed the program level.

- Modernizes the **definition of the Credit Elsewhere test**. The credit elsewhere test is the cornerstone of the 7(a) program, created to ensure that SBA backs only loans to qualified borrowers that, but for the guaranty, would not be made conventionally. If enacted, the statute will make clear the types of eligible, creditworthy small business applicants that cannot access credit without the SBA guaranty — including newer businesses, those with less collateral, those requiring longer maturities to better match the repayment terms to the cash flow from their operations, etc. The bill also reinforces OCRM's existing duty to ensure lenders use the credit elsewhere test for the benefit of the borrower and not the lender, and reaffirms OCRM's authority to substantiate how lenders determine and document the credit elsewhere test.

- **Improves the quality of lender reviews and examinations**. To address concerns that contract employees conducting reviews are not fully knowledgeable about SBA lending, OCRM would be required to provide an SBA employee who has expertise in 7(a) lending to supervise all lender reviews and be present for onsite reviews. NAGGL has long called for full-time employees (FTEs) of SBA to lead each team of reviewers. This is critical to ensure the highest level of oversight for the program and provides lenders assurance that the payments they make to cover the costs of their reviews go toward financing a review process that is thorough and meaningful.

- Strengthens the **rights of lenders to get timely reports** of oversight reviews. The bill requires OCRM to provide a written report to a lender in fewer than 60 days. If OCRM is unable to meet the report deadline, it must provide written

notification and explain the reason for the delay. Lenders are expected to be responsive and prudent participants; the bill would require the agency to be equally responsive. Robust oversight requires timely communication between the lender and the agency so that errors on the part of lenders can be addressed as necessary. NAGGL fought for this provision based on feedback from its members.

- **Reinstates administrative appeal rights through SBA's Office of Hearing and Appeals** to contest a formal enforcement action, such as a civil monetary fee or suspension from the program. This right was stripped from the lending industry in 2009 and since then, a lender's only means of appealing decisions was to sue the agency in federal court—a particularly unrealistic proposition for small, community banks. NAGGL has been vocal about bringing this right back to lenders.

- **Codifies the Office of Credit Risk Management (OCRM) and its duties**. To date, OCRM only existed through regulations and SOPs. Congress felt that the office in charge of overseeing the agency's finance programs should have the formality of legislative authorization. OCRM's duties, functions, and scope are in no way altered from what they've always been: to oversee lenders and participants making loans through programs under the Office of Capital Access, including the 7(a) Loan Guaranty Program, the 504 Loan Guaranty Program and the SBA Microloan Program. OCRM will also continue to oversee Small Business Lending Companies and Non-Federally Regulated Lenders. Codifying OCRM will increase its stature and clarify its authority to exercise appropriate corrective or enforcement actions.

- **Ensures the Director of the Office of Credit Risk Management is qualified and non-partisan**. The bill requires that the Director be a career employee in the Senior Executive Service. This provides stability for the office between Administrations, bases the qualifications on expertise and allows SBA to offer a salary that can attract a high level of lending and management experience.

- **Defines the enforcement powers of the Director** – there literally is nothing new here; however, to date these authorities have been contained only in regulations and OCRM SOPs. For informal enforcement actions, such as issuing a warning or sending a letter to correct a lending violation, the Director has (as before) full authority to act. As is also currently true, for formal enforcement actions, such as suspending a lender from selling on the secondary market, the Director needs approval from the Lender Oversight Committee.

- **Clarifies that enforcement actions must be based on the severity and frequency of the violation**, a provision NAGGL was adamant about including to avoid lenders from being 'dinged' for minor errors. The only new additional enforcement action created by the bill, one that was felt necessary by SBA, is a civil monetary penalty that cannot exceed $250,000. NAGGL, along with other stakeholder partners, fought to ensure the penalty amount was not higher, but

commensurate with the existing penalty that SBA can issue for false statements on a loan application. The bill requires SBA to promulgate regulations on this language, allowing further industry engagement through the comment process.

- **Codifies the Lender Oversight Committee** (LOC or Committee), its membership, and duties. (Again the LOC already exists within SBA, however, most lenders are simply unaware of it.) The LOC currently serves as an additional deliberative group supporting OCRM's efforts. Congress took the exact language currently used by SBA to establish LOC; therefore, it would appear that there would be no change to the current system. As it currently is, the Committee will be made up of voting and advisory members, the majority of voting members must be career employees instead of political appointees to protect against partisan actions. The Committee must meet at least quarterly, review OCRM's oversight activities, and vote whether to reject or recommend enforcement actions to the Administrator. To ensure transparency, the LOC must also detail its meetings and votes to the Administrator.

- **Requires an annual report to Congress**. The OCRM Director must submit annually a report to Congress that provides a risk analysis of the overall program, an analysis of the most active lenders (top 1%), steps taken by the Administrator to address any risk identified, details on the enforcement actions taken and activities by the LOC. NAGGL previously had requested this report from SBA to aid participating lenders in better understanding their own portfolios and encourage prudence, as well as increased transparency.

- **Creates transparency in OCRM's budget and oversight fees**. To ensure that oversight fees on lenders are fair and correctly targeted and that OCRM budgets for sufficient resources to meet the growth of the loan programs, the OCRM Director will be required to prepare a budget justification of the salaries, expenses and oversight fees needed to operate the office on an annual basis. Each budget must be available for public view for at least five years. This will increase transparency between the lenders and SBA, as well as instill greater confidence on the Hill regarding SBA's management of the program's oversight.

- **Increases oversight of administrative waivers of regulations and procedures** by requiring that SBA annually publish information about regulatory waivers and requiring the Government Accountability Office (GAO) to review how often and why SBA has waived standard operating procedures and policy notices over the past five years. To NAGGL's knowledge, these waivers of SOPs and policy are issued with great caution and allow for flexibility in loan applications when appropriate. NAGGL is continuing to work to ensure that proposed process change does not deter agency from working with lenders to assure that policy exceptions are allowed when appropriate.