

May 5, 2014

The Honorable Jeff Sessions  
United States Senate  
Washington, DC 20510

Dear Senator Sessions:

Administrator Contreras-Sweet has asked me to respond to your recent inquiry requesting information on the U.S. Small Business Administration's (SBA) 7(a) loan guarantee program. The enclosed CD contains available performance information which, together with the discussion below, addresses your request.

The SBA Office of Capital Access is charged with delivery and oversight of the 7(a) Program, and is committed to providing this access to capital in a prudent manner, in accordance with the Small Business Act. The SBA continually seeks ways to improve our delivery and management of this loan guarantee program, which provides capital to viable small businesses that would otherwise be unable to obtain funding through normal commercial channels.

SBA agrees that government programs must meet high standards for efficiency and effectiveness, and believes that the 7(a) Program is an example of an efficient and effective program. SBA's 7(a) loan portfolio includes 235,293 loans, in an aggregate amount of \$59.6 billion, of which SBA's guaranteed share is \$45.0 billion. Because 7(a) loans are guaranteed loans, no funds are advanced or disbursed by the Agency to make the loans; rather, the loans are made with the lender's own funds. In addition, for the past 2 fiscal years the 7(a) Program has operated at a zero subsidy rate while at a pace to deliver over \$17 billion in small business credit this fiscal year. Accordingly, no government funds are currently projected to be needed to support the performance of loans that were made through the Program during FY 2013 or 2014. SBA loan guarantee performance data, as reflected in the zero subsidy rate, demonstrates the 7(a) Program is strong.

Under the Small Business Act, SBA's 7(a) loan guarantee is required to be set at a specified percentage (generally 75% or 85%, depending on the size of the loan), unless a lower percentage is requested by the participating lender. 15 USC 636 (a)(2). These statutory percentages, together with the statutory loan limits, establish the degree of financial risk-sharing between lenders and the Agency.

As to the criteria for receiving a 7(a) loan, SBA's regulations published in Title 13 of the Code of Federal Regulations establish borrower eligibility requirements in §§ 120.100 – 120.105 and specific credit criteria in §120.150. The credit criteria reflect prudent

lending standards and include character, management experience, business strength, consideration of past and/or future earnings, demonstrated ability to repay the loan from the business, sufficient equity capital, long-term success potential, collateral, and impact from any affiliates.

In accordance with the Small Business Act, certain qualified lenders are granted permission to make SBA loan guarantee decisions unilaterally, on a delegated basis (e.g. Preferred Lenders), but only after prior determination of each lender's ability to assemble, process, close, service and liquidate (as applicable) SBA guaranteed loans. Delegated lending is specifically provided for in the Small Business Act. 15 USC 634(b)(7) and 636 (a)(2)(C)(iii). It allows SBA to optimize the use of Agency resources and reach more small businesses in need of capital. Lenders with delegated authority are routinely evaluated as their individual agreements are considered for renewal; SBA declines the renewal of several lender delegations each year.

You have also asked about sales and transferability of 7(a) guaranteed loans. Individual 7(a) guaranteed loans may be transferred from one 7(a) lender to another 7(a) lender, but only with SBA pre-approval. These whole-loan transfers are relatively infrequent. Bank mergers and acquisitions involve the transfer of 7(a) loan guarantee portfolios and, again, SBA approval is involved. As you have noted, a number of SBA lenders sell the guaranteed portions of their individual 7(a) loans on the secondary market; it is important to note, however, that the lender nevertheless retains responsibility for any improprieties in the making, servicing or liquidation of each such loan. In addition, the lender continues to service the entire loan and retains responsibility for the unguaranteed portion of the loan. As a result, the lender has a financial incentive to engage only in prudent lending and to ensure the active oversight of the small business borrower. SBA has also limited the authority of lenders to sell loan guarantees in the 7(a) secondary market when sales by such lenders would raise issues of concern to SBA.

SBA understands the importance of lender oversight in administering an effective 7(a) Program. SBA has made significant progress in instituting a comprehensive credit risk management program for its business loan programs. All lenders participating in the 7(a) Program are continually assessed and risk-rated to ensure that those considered to represent the highest risk receive the highest level of Agency attention.

In FY2013, SBA undertook approximately 24 lender supervision and enforcement actions. SBA has also suspended or debarred approximately 27 parties, including but not limited to, actions against loan agents and borrowers. SBA has developed and implemented a regulatory framework to support credit risk management, including the promulgation of lender oversight/enforcement regulations that establish the grounds and procedures for lender supervision and enforcement, lender oversight Delegations of Authority, Lender Risk Rating Standards, and Standard Operating Procedures for lender supervision/enforcement and reviews/examinations. SBA conducts lender supervision and enforcement through a separate Office of Credit Risk Management and a Lender

Oversight Committee comprised of senior Agency officials representing fiscal, credit risk, operations and legal areas.

The small business community is still recovering from the effects of an extremely tight credit market over the past several years. SBA default rates have been affected by this environment, and are typically higher than FDIC-insured banks, since SBA loan guarantees are extended to those borrowers that do not meet conventional commercial banking standards. Recognizing these risk issues, SBA's credit risk management program also continually assesses risk through metrics applied against the whole portfolio and portfolio segments, in addition to individual lender performance.

Franchise lending, for example, is a small but important segment of small business lending. It is appropriate for SBA to ensure franchise lending remains a viable resource for the small business community while also ensuring franchise loans are made prudently. Through credit risk management, SBA maintains awareness of, and responsiveness to, trends in franchise lending which may increase risk. Franchise lending is a specific analysis component of our existing 7(a) loan guarantee program's risk-based review protocol. We note that in 2013 the GAO performed a review of SBA loan guarantees to selected franchisees (GAO 13-759), and did not make any recommendations in its conclusion.

We appreciate your interest in the SBA, its 7(a) Program and the small business community we serve. We are committed to ensuring that all of our programs—including the 7(a) Program—have the highest possible level of integrity and transparency. If you or your staff have any further questions, please contact Nicholas Coutsos, SBA Assistant Administrator for Congressional and Legislative Affairs, at (202) 205-6335.

Sincerely,

Ann Marie Mehlum  
Associate Administrator  
Office of Capital Access

Enclosure