SBA Policy Notice

TO:	All SBA Employees	**CONTROL NO.:**	5000-1332
SUBJECT:	Revised Risk-Based Review Protocol for SBA Operations of Federally Regulated 7(a) Lenders	**EFFECTIVE:**	December 29, 2014

I. Introduction

SBA's Office of Credit Risk Management (OCRM) is updating its oversight of the SBA operations of Federally-regulated 7(a) Lenders. This revised Risk-Based Review (RBR) protocol is described as follows, and is intended to be flexible to take into account individual facts and circumstances. SBA will use this guidance along with judgment and Agency discretion in conducting 7(a) Lender RBRs.

II. PARRiS Risk Measurement Methodology

The revised RBRs feature a composite risk measurement methodology and scoring guide, "PARRiS," which SBA has developed for the oversight of 7(a) Lenders. PARRiS is an acronym for the specific risk areas or components that SBA reviews for these Lenders. The components and their measurement objectives are as follows:

Component	Measurement Objective
"P" - Portfolio Performance	Degree of financial risk to SBA that a Lender presents considering overall portfolio performance indicators and attributes.
"A" - Asset Management	Quality of the origination, servicing and liquidation practices in the Lender's SBA operation. This component also includes an assessment of the effectiveness of the Lender's SBA program management and related risks.
"R" - Regulatory Compliance	Lender's compliance with SBA Loan Program Requirements.
"Ri" - Risk Management	Overall institution risk and a Lender's use of an effective governance model to identify, understand, and mitigate risk exposure in its 7(a) portfolio.
"S" - Special Items	Additional key metrics or items that are not included in the other components but may pose risk to SBA or present program integrity concerns.

The PARRiS components cover the areas that SBA has traditionally reviewed: portfolio performance, credit administration, compliance with SBA Loan Program Requirements and SBA operations management under 13 CFR 120.1050(a). Each PARRiS component includes qualitative and quantitative performance factors. (See Appendix A for a list of the quantitative and qualitative factors currently being used for each PARRiS component.) The quantitative factors are benchmarked and scored against set risk tolerance levels established by SBA, producing a PARRiS Score (described below under Lender Profile Assessment). The qualitative factors will include, but not be limited to, consideration of: compliance with SBA Loan Program Requirements (as defined under 13 CFR 120.10), changes in Lender's loan policies, management and staff capabilities and any other aspect of the Lender's SBA program. Review of the qualitative and quantitative factors allows SBA to better identify a Lender's specific risk areas, assess the level of risk a Lender poses to SBA, and make recommendations for corrective action.

The PARRiS methodology also features "flags" that are intended to highlight additional areas that SBA will be monitoring in identifying risk. Flags do not contribute to a Lender's PARRiS Score but may factor into a Lender's Review Assessment or trigger a review when combined with other considerations. The PARRiS methodology, including but not limited to the factors and flags, may be revised from time to time.

III. Federally Regulated 7(a) Lender Revised Risk-Based Review Protocol

SBA's revised RBR protocol for Federally Regulated 7(a) Lenders features the following levels of review:

1. Lender Profile Assessment
2. Analytical Review
3. Targeted Review
4. Full Review
5. Delegated Authority Review
6. Other Reviews

A detailed discussion of each review level follows.

1. Lender Profile Assessment

The Lender Profile Assessment (LPA) is the first level of review. It is a data driven virtual review that serves as a diagnostic exercise performed on all Lenders. For purposes of this notice, virtual review means a review that is generally performed using electronic transmission and analysis of Lender information without the need to ask the Lender for additional information or visit the Lender's location. SBA primarily uses the Loan and Lender Monitoring System (L/LMS) data as the LPA platform. The LPA computes the quantitative factors for each PARRiS component and then scores them against certain benchmarks.[1] Currently, SBA scores a quantitative factor: "1" – for performance within a "Preferred" range, "3" for performance within an "Acceptable" range, and "5" for performance within a "Less Than Acceptable" range. The total score for all components (PARRiS Score) is calculated,[2] providing SBA with a high level assessment of the Lender. PARRiS Scores in this initial version of the LPA currently range between 15, indicating the lowest risk and 75, indicating the highest risk. The LPA template also populates automatically with other information on a Lender (e.g., portfolio size, delegated

[1] SBA is moving to benchmarks and away from peer group and portfolio averages for establishing risk tolerance levels. However, SBA will still provide peer group and portfolio average information.
[2] SBA may weight some quantitative factors more than others in totaling the quantitative factors.

authorities, capital ratios) and includes flags as discussed above. SBA may use the LPA to assist in determining the next level of review, if any, and in connection with delegated authority decisions. SBA is updating the Lender Portal screens to include the PARRiS Scores and the underlying metrics.

2. Analytical Review

The Analytical Review is the second level of review. Here, SBA analyzes a Lender's LPA which includes the quantitative and qualitative factors for each PARRiS component. Analytical Reviews are generally performed on higher risk Lenders and/or in connection with a Delegated Authority Review. In selecting Lenders for an Analytical Review, SBA may consider, for example, a Lender's Risk Rating, LPA/PARRiS Score, last review assessment, delegated authority expiration date, whether the Lender has been reviewed recently, and other risk criteria such as rapid growth. In addition, SBA may perform an Analytical Review on a population of randomly selected Lenders.

Analytical Reviews are generally a virtual review. An Analytical Review generally will include a review of a Lender's 7(a) loan portfolio data rather than 7(a) loan files. SBA may also solicit additional information from the Lender, such as credit and internal control policies, and copies of audit reports. The results of an Analytical Review may conclude the process or may indicate the need for a subsequent level of review, such as a Targeted or Full Review.

3. Targeted Review

Targeted Reviews are generally narrow in scope. In a Targeted Review, SBA generally reviews one or more PARRiS components or other areas of concern (including program integrity concerns) identified by SBA as requiring a focused scope of review. For example, SBA may perform a Targeted Review of "Less Than Acceptable" factors or flags or other material non-compliance identified during an Analytical Review or Full Review. SBA may use a Targeted Review to confirm Lender's implementation of required corrective actions. In addition, a Targeted Review may be performed in conjunction with increased supervision or enforcement.

A Targeted Review may be conducted virtually and/or at Lender's location. A Lender selected for a Targeted Review will receive an engagement letter that advises the Lender of the review and requests certain information (e.g., loan files). For a Targeted Review that includes a loan file review, SBA may use random and/or judgmental sampling in selecting loan files.

4. Full Review

SBA conducts a comprehensive analysis of each PARRiS component in a Full Review. Full Reviews are generally conducted at Lender's location but may include a virtual portion. SBA intends to select Lenders that indicate the most risk for Full Reviews, considering the same factors set out in the Analytical Review analysis along with 7(a) loan portfolio size, whether SBA has performed a Full Review recently and program integrity concerns. SBA may also select a random sample of Lenders to receive Full Reviews.

A Lender selected for a Full Review will receive an engagement letter and request for certain information (e.g., loan files, loan policies and procedures, SBA lending organizational chart, and copies of audits). In a Full Review, the LPA diagnostic serves as the preliminary part of the review. Full Reviews include reviews of loan files. SBA generally performs a random and/or judgmental loan file selection that may, for example, include current, past due and delinquent loans, loans in liquidation and loans in active purchase.

5. Delegated Authority Renewal Review

SBA performs a Delegated Authority Renewal Review prior to the delegated status expiration date. Examples of delegated status are Preferred Lender Program, SBA Express, and Export Express. In general, SBA works to coordinate Delegated Authority Renewal Reviews with the timing of a Lender's PARRiS Analytical or Full Review, if one is to be performed. Delegated Authority Renewal Reviews are generally every two years. However, Lenders with shortened renewals (e.g., those under Increased Supervision due to a Cease and Desist Order or other Regulatory Agreement or those triggering other risk, compliance, or program integrity concerns) may have Delegated Authority Renewal Reviews more frequently. The Delegated Authority Renewal Review will analyze the LPA along with the other Delegated Authority criteria as set forth in SBA regulations and SOP 50 10 5. A Delegated Authority Renewal Review may result in the granting or denial of continued delegated authorities.

6. Other Reviews

OCRM may employ other types of reviews from time to time. These include, for example, Lender Self-Assessments and Agreed Upon Procedure Reviews (AUP). For the Lender Self-Assessment or AUP, the Lender is responsible for conducting the review. SBA might utilize these as an alternative method to confirm corrective actions required or review a matter or deficiency of low to moderate risk. The Self-Assessments or AUP reviews are performed by third-party practitioners or an independent office within the Lender (e.g., internal audit), to which SBA and the Lender agree, that follow a review protocol as prescribed or approved by SBA. SBA may review the Self-Assessments or AUPs to confirm that review "assertions" and "objectives" were met, testing and results were accurate, and the report was reliable.

The RBR review protocol, like the PARRiS methodology, may be revised and is subject to periodic adjustment. SBA will use judgment and discretion and may consider matters such as risks identified, changing economic conditions, and Agency resources in making periodic adjustments.

IV. Review Fees

Under 13 CFR § 120.1070, SBA currently charges 7(a) Lenders fees for: (1) the quarterly off-site/monitoring reviews conducted through the Loan and Lender Monitoring System (L/LMS), (2) the on-site reviews that are conducted of Lenders generally with $10 million or more in outstanding SBA loan guarantees or Lenders with smaller portfolios where SBA's off-site monitoring indicates additional risk to SBA, and (3) the on-site safety and soundness examinations that are conducted of SBA's Small Business Lending Companies and large Non-Federally Regulated Lenders. Under 13 CFR § 120.1070(a)(4), SBA may also assess a fee to cover the costs of other Lender oversight activities.

With the advent of new technologies, generally less costly and less burdensome virtual reviews, like Analytical and Targeted Reviews, may cover much of that which was previously performed in and within the scope of on-site reviews, diminishing the distinction between off-site and on-site reviews. Under the revised RBR protocol, Lenders will pay for each level of review conducted. For example: all 7(a) Lenders will be charged for the LPA, L/LMS and other Lender oversight activity fees; if an Analytical Review is conducted, the Lender will be assessed a separate fee; if a Targeted Review is performed, the Lender will be assessed a separate fee; if a Lender has Delegated Authority, a review fee will be charged. With the updates to the RBR protocol described in this Notice, the fees will now be assessed as set forth below.

a. LPA, L/LMS, and Other Lender Oversight Activities

The LPA and L/LMS are off-site reviews that will be updated at least annually for each Lender. SBA will also charge Lenders for other lender oversight activities (e.g., contractor technical assistance and analytics to support the monitoring and review program). These fees will be based on SBA's contractor's costs and will be assessed annually based on each Lender's portion of the total dollar amount of 7(a) guarantees in SBA's portfolio as of the end of the prior fiscal year. For FY 2015, SBA estimates the combined fees to be approximately $136 for every $1 million in 7(a) guaranteed dollars a Lender has outstanding, of which approximately $2 is attributable to the LPA and other lender oversight activity costs.

b. Analytical Reviews

In the past, SBA has conducted this type of review on-site at the Lender's location, but with new technologies, SBA will be able to conduct this review remotely through virtual capabilities. Such virtual reviews may reduce costs to Lenders. These reviews will be conducted with the assistance of SBA's contractors, and the Lender will be assessed a fee to cover the contractor costs that SBA incurs in relation to the review. For FY 2015, SBA estimates the cost of an Analytical Review to range between approximately $5,000 and $10,000.

c. Targeted Reviews

In the past, SBA may have conducted a Targeted Review on-site at the Lender's location, but going forward this review may be conducted either virtually or at the Lender's location depending on a Lender's technological capabilities and other review specific needs. These reviews will be conducted with the assistance of SBA's contractors, and the Lender will be assessed a fee to cover the contractor costs that SBA incurs in relation to the review. For FY 2015, SBA estimates the cost of a Targeted Review to range between approximately $2,500 and $20,000.

d. Full Reviews

This review will be conducted on-site with the assistance of SBA's contractors (but may include a virtual portion), and the Lender will be assessed a fee to cover SBA's contractor costs. For FY 2015, SBA estimates the cost of a Full Review to range between approximately $30,000 and $45,000 plus expenses incurred in relation to the review.

e. Delegated Authority Reviews

These reviews will be conducted with the assistance of SBA's contractors. The total annual contractor cost will be apportioned among Lenders with delegated authority based on each such Lender's portion of the total dollar amount of 7(a) guarantees in the SBA loan portfolio for all delegated Lenders. For FY 2015, SBA estimates the cost of this fee to be approximately $24 for every $1 million in 7(a) guaranteed dollars a Lender has outstanding.[3]

f. Other Reviews

SBA may determine on a case-by-case basis and depending on the nature of the review whether and how to assess fees for Other Reviews.

g. Billing

For the Analytical Reviews, Targeted Reviews, and Full Reviews, SBA will bill each Lender for the amount owed following the completion of the review. For the LPAs, L/LMS, Other Lender Oversight Activities, and Delegated Authority Reviews, SBA will bill each Lender for the amount owed on an annual basis.

The revised fee structure is shown below:

	Previous Fees	***Revised Fees***
Charge per $ Million		
L/LMS	$123.39	$133.50
Delegated Authority Review*	N/A	$23.95
LPA	N/A	$1.17
Other Lender Oversight Activities	N/A	$1.17
Charge per Review		
Onsite Risk-Based Review	$30,000 - $45,000	N/A
Analytical Review*	N/A	$5,000 - $10,000
Targeted Review*	N/A	$2,500 - $20,000
Full Review*	N/A	$30,000 - $45,000
*if applicable		

V. Review Report and Assessment Categories

RBRs, particularly Analytical, Targeted and Full Reviews, generally culminate in a Report of Review (Report). In general, the Report will include a summary assessment and may include individual assessments for each PARRiS component. The summary assessment generally bears a close relationship to the component assessments. However, the summary assessment may not be derived from computing an arithmetic average of the component assessments because some components may be given more weight than others. In addition to the current assessment categories of: (i) "Acceptable"; (ii) "Acceptable with Corrective Action Required"; and (iii) "Less Than Acceptable with Corrective Action Required", SBA has added a

[3] We note that SBA may also perform and charge for a Delegated Authority Review when a Lender is first nominated or initially applies for Delegated Authority.

fourth category of "Marginally Acceptable with Corrective Action Required". A Lender in the "Marginally Acceptable with Corrective Action Required" category requires close supervisory attention and monitoring to promptly correct the serious compliance and risk management practices in the Lender's SBA loan operations that, if not corrected, will negatively impact the Lender's SBA loan operations and expose SBA to an unacceptable level of financial and/or program risk. SBA will use judgment and discretion in assigning review assessments.

A separate notice covering the revised RBR protocols for SBA Supervised Lenders and Certified Development Companies will be issued.

Questions
Questions on this revised RBR protocol may be directed to Adrienne Grierson, Deputy Director, Office of Credit Risk Management at Lender.Oversight@sba.gov.

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Administrator

Appendix A – Current PARRiS Component Factors

The quantitative[4] and qualitative PARRiS factors currently analyzed for each component include, but are not limited to:

"P" - Portfolio Performance

Quantitative Factors	Qualitative Factors
• 5-year cumulative net yield	• Loan acquisition impact
• 12-month default rate	• Local/regional economic conditions
• 5-year default rate	• Changes in loan policies and practices
	• Geographic distribution of Lender's 7(a) portfolio and Lender's management of that distribution
	• Composition of portfolio

"A" - Asset Management

Quantitative Factors	Qualitative Factors
• High risk origination rate	• Credit administration (e.g., creditworthiness, repayment ability, closings, IRS transcripts)
• Early problem loan rate	• Servicing (e.g., current borrower financials, insurance renewals, borrower visits, UCC filings)
• Stressed loan rate (Past Due + Delinquent + Deferred Loans)	• Liquidation and resolution risk (e.g., action plans, active purchases management)
	• Mission risk (e.g., risk associated with particular lending program)

R"- Regulatory Compliance

Quantitative Factors	Qualitative Factors
• Loans in default status over 3 years rate	• Loan eligibility
• 1502 reporting rate	• Accurate SBA Form 1502 submission
• 24 month repair/denial rate	• Timely and accurate remittances such as liquidation proceeds, guarantee fees, receivables and SBA Form 172 payments
	• Accurate SBA Form 159 reporting submission
	• Packaging and referral fees
	• Compliance with required corrective actions
	• Lender Service Provider (LSP) Agreements, where required

[4] SBA will provide definitions for each of the quantitative factors on the Lender Portal.

“Ri” - Risk Management

Quantitative Factors	Qualitative Factors
• Lender Purchase Rating (LPR)[5]	• Board approved internal control policies and practices, including independent loan review and loan classification system
• Primary Federal Financial Institution Regulator total risk-based capital rate	• Management and staff capabilities
• Non-performing asset ratio	• Day-to-day responsibility for SBA program management
	• Oversight and management of LSPs (if applicable)
	• Operating plan and strategy
	• Adherence to credit and operating policies and LSP Agreements (the latter if applicable)

“S”- Special Items

Quantitative Factors	Qualitative Factors
• Average SBPS score (weighted)	• Loan participations and pledges
• Recovery rate (over last 5 years)	• Fraud, waste and abuse matters
• Most recent regulatory action (Public Corrective Action with Regulator) (no/yes indicator)	• Evaluation of regulatory orders for impact on SBA portfolio and program risk
	• Other items of concern

The PARRiS methodology also features “flags” that are intended to highlight additional areas that SBA will be monitoring in identifying risk. Currently, the PARRiS flags include: (1) loan agent rate over last 5 years; (2) industry concentration rate; (3) franchise rate; (4) sold or secondary market sale rate; (5) acquired loan rate; (6) loans greater than $2 million approved over the last 12 months; (7) rapid portfolio growth; and (8) early default. These flags are subject to change based on risks identified in the portfolio.

[5] Formally known as the Lender’s Risk Rating. See, Lender Risk Rating System Notice, 79 FR 240-53, April 29, 2014.