



U.S. Small Business  
Administration

**Statement of Joseph Shepard  
Associate Administrator  
Office of Investment and Innovation  
U.S. Small Business Administration**

**before the  
Senate Committee on Small Business and Entrepreneurship**

**Hearing on “Reauthorization of SBA’s Small Business Investment  
Company Program”**

**June 26, 2019**

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**Associate Administrator**  
**U.S. Small Business Administration**

Chairman Rubio, Ranking Member Cardin, and members of the committee, thank you for the opportunity to discuss the reauthorization of SBA's Small Business Investment Company (SBIC) program and the state of the SBIC program.

I am the United States Small Business Administration (SBA) Associate Administrator for the Office of Investment and Innovation (OII), which oversees the SBIC program. Prior to the SBA, my business career has included leadership positions in consulting, investment banking, venture capital, private equity, and investment fund management for such organizations as KPMG, Texas Pacific Capital, Principal Financial Securities, Banc One Capital Markets, as well as a previous tenure in public service at the SBA.

Upon my arrival, I completed an initial assessment of the overall operating environment within the SBIC program and began identifying areas for modernization and improvement – including technology, examination processes and risk management, and personnel. We owe it to the American taxpayer to manage program risk and provide appropriate oversight.

During my time at SBA, I have worked with the SBA team to identify challenges faced by the SBIC program and together we have endeavored to make improvements. During this time, I have enjoyed the support and leadership of former Administrator Linda McMahon and I greatly appreciate the hard work of our team and my colleagues at SBA. Following is a summary of select improvements made within the SBIC program.

*Technology – Improving SBA's Information*

Technology plays a key role in improving effectiveness and efficiency. During my tenure, I've focused on opportunities to leverage technological improvements to modernize the SBIC program's information technology infrastructure to streamline processes, increase security, and facilitate information sharing throughout the SBIC life cycle.

To manage the SBIC program effectively, SBA needs to move its software and tools into the 21st century. My first action in FY 2017 was to seek collaboration with SBA's Office of the Chief Information Officer (OCIO) to assist in replacing SBA's legacy systems associated with the SBIC program. Our first action was to transition the legacy SBIC web system to the OCIO. For the remainder of FY 2017, we conducted an extensive review of the SBIC program's existing technology and legacy systems. In FY 2018, we then procured a new off-the-shelf cloud-based Software as a Service (SaaS) software platform to assist with modernizing the SBIC program. In FY 2019, the SBA began the configuration of the software platform to provide fully modernized oversight and risk management tools in OII to utilize in connection with all aspects of the SBIC program. The single platform will be used to manage the entire life cycle of an SBIC, from the initial inquiry regarding a potential SBA license, the licensing application process, operations oversight during the 10+ year period of an SBIC's life cycle, coordination of regulatory examinations, and finally, the wind-up or

liquidation of SBICs. The solution has been deployed in SBA's cloud environment, which will ensure the solution complies with the Federal Risk and Management Program requirement. Furthermore, consolidating the data from different workflows into a single structured data warehouse increases data integrity and information asset protection.

The introduction of this new software will allow the SBA to improve the information associated with the SBIC program and dramatically enhance SBA's data security, risk management, and oversight capabilities.

#### *Examinations – Improving SBA's Oversight*

In September 2013, the Office of the Inspector General issued its Audit Report 13-22, "Improved Examination Quality Can Strengthen SBA's Oversight of Small Business Investment Companies." The report identified deficiencies in the management of the SBIC examination process after it sought to determine the extent to which the SBA: (i) conducted SBIC examinations in accordance with the law, rules and regulations, and SBA policies and procedures; (ii) used SBIC examinations to mitigate the risk of financial loss; and (iii) managed the SBIC examination process effectively and efficiently.

The Small Business Act requires that SBICs be examined at least every two years. SBA began FY 2017 with 178 of all 313 SBICs (56.9%) in statutory compliance. In FY 2017, I implemented an immediate response to the problem through an intense focus on examinations. I'm pleased to announce statutory compliance improved dramatically and is now at 100%.

Additionally, to better mitigate current and future credit risk in the SBIC program, the SBA enhanced its credit standard to require examinations within an 18 month time period for all SBICs with SBA-guaranteed leverage. By the end of FY 2018, SBA credit standard compliance improved to 69.3%.

In FY 2018, I commissioned an evaluation to determine how the SBIC examination process can be streamlined, the potential role of technology in streamlining this process, and whether the program's current organizational structure optimally supports the examination process. SBA will review the forthcoming evaluation results and will begin implementing processes to enhance SBA's oversight capabilities.

#### *Risk – Improving SBA's Subsidy Model*

During the post-recession period from FY 2010 to FY 2018, the SBIC program experienced charge-offs for debentures totaling \$281.098 million, and for participating securities totaling \$1.384 billion. To account for annual cash in-flows and out-flows associated with charge-offs and determine fees needed to operate the program, SBA has used an historic-averages subsidy model for the past 27 years.

In an effort to improve the model used to calculate the cost for the SBIC program, I initiated the creation of a new econometric model to enhance forecasting of future performance and

losses associated with the SBIC program. The new model, created in collaboration with OCFO and OII, still considers past loan performance, but now and into the future incorporates assumptions associated with macro-economic factors, private equity elements, and private equity fund characteristics. The result is an improved model that is reflective of the inherent risk associated with present day private equity investing and we believe will more accurately project future losses and long-term costs of the current SBIC program to taxpayers. Importantly, the econometric model can more easily be revised in future years as changing conditions warrant reexamining model assumptions. The new and improved SBA subsidy model will be implemented beginning in fiscal year 2020.

#### *SBIC Program Costs – Improving SBA’s Fee Collection*

The SBIC program has a total operating cost each year that is not covered by subsidy. The program’s costs consist of direct costs from the operating budget, including contracts; compensation and benefits; agency-wide costs, such as rent and telecommunications; and indirect costs. SBA’s total cost to operate the SBIC program during FY 2018 was \$27.337 million. The only fees currently collected by the SBIC program to reduce the amount are licensing and examination fees. In FY 2018, these fees totaled \$1.692 million.

Since my arrival, I’ve focused on ways to reduce taxpayer costs associated with these SBIC program expenses. In 2017, SBA increased licensing fees paid by SBIC applicants and examination fees paid by operating SBICs. In FY 2018, SBA began collecting the increased fees, which will increase gradually until FY 2020.

#### *Personnel – Improving SBA’s Workforce*

SBA will continue to hire additional staff to fill current and future vacancies. New positions are also being created and filled, including an IT Project Manager, IT Data Scientist, Senior Examiner, Senior Risk and Investment Policy Officer, and an Investment Accounting and Analytics Officer. I’m committed to hiring for an organization that can support the program of the future.

#### *Conclusion*

Actions taken over the last two years have improved the SBIC program. As a result, the SBIC program is in a better position today to face the challenges of the future. SBA will continue to address challenges and make improvements in the SBIC program.