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SMALL BUSINESS YEAR 2000 READINESS ACT

FEBRUARY 23, 1999.—Ordered to be printed

Mr. BOND, from the Committee on Small Business, submitted the following

REPORT

[To accompany S. 314]

The Committee on Small Business, to which was referred the bill (S. 314) to provide for a loan guarantee program to address the Year 2000 computer problems of small business concerns, and for other purposes, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

The Committee on Small Business reported S. 314, a special program to provide loans to small business concerns to repair or replace their computer systems in preparation for the Year 2000 (Y2K) and to provide relief from economic injury incurred by small business concerns as a result of direct and indirect Y2K computer problems.

I. INTRODUCTION

The Small Business Year 2000 Readiness Act (S. 314) is a bill that addresses the Y2K computer problems that are confronting small business concerns. On February 5, 1999, the Committee on Small Business conducted a mark-up of bills pending before the Committee. The Committee voted by unanimous consent to report favorably S. 314.

The Committee is concerned that most small businesses are not adequately prepared for the problems they may face from Y2K computer problems. The Y2K problem is the result of programmers over the years writing computer code that used only two digits to represent years. This means that certain computers and processors in automated systems will fail because such systems will not recognized the Year 2000 in date-dependent data.

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This legislation draws on testimony given before the Committee over the past year, from reports received by the Committee and from meetings held with small business owners, financial institutions, consultants, the Small Business Administration (SBA) and other persons with an interest in the small business community's compliance with the Y2K computer problem. On June 2, 1998, the Committee held a hearing on the impact of the Y2K computer problem on small businesses. The testimony of the witnesses was alarming. The Committee received testimony that the companies most at risk from Y2K failures are small and medium-sized firms, not larger companies. Witnesses testified that this anomaly is caused by two factors. First, many small companies have yet to realize the extent the Y2K computer problem affects their businesses. Second, many small companies may not have the access to capital to cure such problems before they cause disastrous results.

A study entitled "Small Business and the Y2K Problem," sponsored by Wells Fargo Bank and conducted by the National Federation of Independent Businesses found that an estimated four and three-quarter million small employers are exposed to the Y2K problem. While many small businesses are likely to be affected by the problem, relatively few have become compliant. The Gartner Group, an international information technology consulting firm in Connecticut, has estimated that only 5% percent of small companies had remediated their Y2K computer problems as of the third quarter of 1998 and that between 50% and 60% of small companies would experience at least one mission critical failure as a result of Y2K computer problems.

One of the major obstacles to small businesses becoming Y2K compliant is their difficulty obtaining the necessary capital to upgrade their information technology and other automated systems. The Committee has received information indicating that many small businesses will face large expenditures to remediate their Y2K problems. A recent survey conducted by Arthur Andersen's Enterprise Group on behalf of a nationwide small business trade association, National Small Business United, found that to become Y2K compliant 29% of small businesses will need to purchase additional hardware, 24% will have to replace existing hardware and 17% will need to convert their entire computer system. When then asked about their most difficult challenge relating to their information technology, more than 54% of the businesses surveyed cited "affording the cost."

The Committee is very concerned about the impact that the Y2K computer problem may have on the economy and, in particular, on small business owners and their employers. In the 105th Congress, the Committee responded by approving the Year 2000 Readiness and Small Business Programs Restructuring and Reform Act of 1998 (H.R. 3412, 105th Cong., 2d Sess.) which would have established a similar loan program specifically designed to assist small businesses in becoming Y2K compliant. While that bill passed the Senate by unanimous consent on September 30, 1998, the House of Representatives did not adopt it prior to adjournment. So that a loan program established to assist small businesses would be available to as many small businesses as possible, the Committee approved S. 314 at the earliest practical date in the 106th Congress.

II. DESCRIPTION OF THE BILL

S. 314 requires the SBA to establish a limited-term loan program (hereinafter referred to as the "Y2K loan program") pursuant to which the SBA would guarantee loans made by private lenders to assist small businesses in correcting Y2K computer problems. The bill permits a financial institution originating loans under the Y2K loan program to process the loans in accordance with the requirements of any existing loan program established under the SBA's 7(a) business loan program in which such lender is eligible to participate.

Small businesses may only use loan proceeds for two purposes. First, a small business may use loan proceeds to correct the Y2K computer problems affecting its own information technology systems and other automated systems. For example, a small business is permitted to use loan proceeds to purchase or repair hardware or software or pay for consultant services to diagnose and remedy Y2K problems with such hardware or software. Second, a small business may use loan proceeds to provide relief from economic injuries suffered as a direct result of its own Y2K computer problems or some other entity's Y2K computer problems. The Committee intends that the SBA use its existing rules and procedures for the Disaster Loan Program, as they relate to borrower eligibility and use of loan proceeds, as a model for its guidelines governing economic injury loans made under the Y2K loan program, except to the extent they would be inconsistent with the provisions of this bill.

The legislation requires the SBA to establish specific guidelines governing the Y2K loan program within 30 days of enactment. So that the availability of economic injury loans does not serve as a disincentive to small businesses to fix their Y2K computer problems, the Committee believes that it is reasonable for the SBA to require in its guidelines that a borrower, as a condition of receiving loan funds, certify as to its knowledge about its Y2K problems and the efforts it undertook to correct such problems. The Committee intends that such certification would require the borrower to certify that it either took good faith efforts to identify and correct its Y2K computer problems or that it was not aware that its equipment contained Y2K problems. As applicable and except to the extent inconsistent with the legislation, the Committee further intends that existing SBA rules and procedures governing the 7(a) business loan program also govern the Y2K loan program.

The bill also establishes three specific requirements for the Y2K loan program, relating to underwriting standards and the terms and conditions of loans, that differ from the existing 7(a) business loan program guidelines. First, the bill requires that the SBA provide maximum flexibility in the establishment of terms and conditions of loans under the loan program so that such loans may be structured in a manner that enhances the ability of the applicant to repay the debt. The primary consideration in SBA's loan making process is whether the borrower is able to repay the debt with available cash flow. Because many small businesses operate on a slim profit margin and the costs of making Y2K corrections may be unexpected and unbudgeted, the Committee believes that flexibility

in the structuring of loans must be permitted to assure that those small businesses in need of financing are given every reasonable opportunity to obtain loans that meet their current and projected cash flows. To realize this goal, the Committee intends that the SBA permit financial institutions, when appropriate, to structure loans in a manner consistent with the borrower's ability to service the new debt. Such structures may include, but are not limited to, offering balloon features, providing for longer maturities than customary, and refinancing existing SBA loans over longer maturities. The Committee recognizes that the needs of each borrower will be different and, therefore, intends that financial institutions be permitted to examine each borrower's individual economic circumstances and structure individual loans in a manner that is reasonable and appropriate given the economic circumstances of each borrower. The goal of this legislation is to promote the continued economic health of small businesses dealing with Y2K problems, and loans under this program should be structured to that end. If a particular loan structure, such as a balloon feature or a longer maturity, is inconsistent with a borrower's individual long-term economic viability, it is not the intention of the Committee that such a structure be utilized.

Second, the bill permits a financial institution to defer principal payments on a loan for up to one year beginning on the date of the origination of the loan, if appropriate to facilitate repayment. Third, the bill requires that reasonable doubts regarding an applicant's ability to service the debt be resolved in favor of the applicant. Similar statutory language exists for the SBA's Defense Economic Transition Assistance loan program in section 7(a)(21) of the Small Business Act. While the Committee intends that small businesses be provided the benefit of the doubt in underwriting decisions on loans originated under the Y2K loan program, the Committee also intends that SBA's guidelines require that small businesses still evidence an ability to repay such loans. As private financial institutions will retain risk on every loan and will initially determine whether or not financing is granted, the Committee believes that there are reasonable assurances that the program will not generate a substantial number of unwarranted loans.

The bill further provides that each lender eligible to participate in the SBA's 7(a) loan program is eligible to participate in the Y2K loan program. This would include more than 6,000 lenders nationwide. The Y2K loan program would sunset after December 31, 2000, which is the last day that such loans could be approved for disbursement.

The Committee intends that this bill will serve the dual purpose of providing small businesses with the means to continue operating successfully after January 1, 2000, and making financial institutions and small firms more aware of the dangers that lie ahead if Y2K problems are not addressed. The Committee believes that awareness by lenders of the availability of this loan program is of paramount importance. The Committee understands that, pursuant to the Year 2000 Workprogram Phase II, the Federal Financial Institutions Examination Council has established procedures for federal regulators to use when examining federally supervised financial institutions for Y2K preparedness. These examination proce-

dures include determining if financial institutions have evaluated the Year 2000 readiness of their borrowers and implemented controls to mitigate risk from the potential financial difficulties of such borrowers. The Committee believes that to comply with these examination procedures and to mitigate losses to their loan portfolios, financial institutions will contact their small business customers to ensure that they are compliant and to make them aware of the problems that may arise from noncompliance. The Committee has determined that the existence of a separate Y2K loan program will give financial institutions a specific aid to offer small companies that may not be eligible for additional private capital to fund Y2K corrections and will focus the attention of financial institutions and, in turn, their small business customers to the Y2K problem. Accordingly, the legislation requires SBA to market aggressively the availability of this program to all lenders eligible to participate.

The Committee understands that some small businesses may have already remedied their Y2K computer problems and may have received SBA-backed financing under less favorable terms and conditions than those authorized under this legislation. Therefore, in cases where the borrower would benefit from the types of terms and conditions authorized by this legislation and seeks to do so, the Committee encourages SBA to restructure loans that were made to address Y2K problems which were approved after October 1, 1998. In cases where such loans have been sold in the secondary market and, therefore, cannot be restructured, SBA should permit refinancing of such loans only when the vast majority of loan proceeds were used to correct Y2K problems and when the small business borrower will receive a clear and substantial benefit from such refinancing. The Committee recognizes that refinancing has the effect of using 7(a) loan authority twice for the same loan purpose, so should be employed only when clearly warranted for the benefit of the borrower.

III. COMMITTEE VOTE

In compliance with rule XXVI(7)(b) of the Standing Rules of the Senate, the following vote was recorded on February 5, 1999.

After a quorum was established pursuant to Committee rules, a motion by Senator Bond to adopt the Small Business Year 2000 Readiness Act was approved by unanimous consent.

IV. EVALUATION OF REGULATORY IMPACT

In compliance with rule XXVI(11)(b) of the Standing Rules of the Senate, it is the opinion of the Committee that no significant additional regulatory impact will be incurred in carrying out the provisions of this legislation. There will be no additional impact on the personal privacy of companies or individuals who utilize the services provided.

V. CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirement of section 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

VI. COST ESTIMATE

In compliance with rule XXVI(11)(a)(1) of the Standing Rules of the Senate, the Committee estimates the cost of the legislation will be equal to the amounts indicated by the Congressional Budget Office in the following letter.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, February 22, 1999.

Hon. CHRISTOPHER S. BOND,
Chairman, Committee on Small Business,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 314, the Small Business Year 2000 Readiness Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Mark Hadley.

Sincerely,

BARRY B. ANDERSON
(For Dan L. Crippen, Director).

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

S. 314—Small Business Year 2000 Readiness Act

Summary: Assuming appropriation of the necessary amounts, CBO estimates that implementing S. 314 would cost about $20 million over the 2000–2001 period; however, the actual costs could be substantially higher or lower depending on the severity of economic injury associated with year 2000 computer problems.

S. 314 would amend existing law to allow the Small Business Administration (SBA) to guarantee loans to small business to address costs associated with year 2000 computer problems. Small businesses would use those loans either to repair information technology or to provide relief for economic injury associated with such problems. The bill would allow SBA to relax credit standards for small businesses applying for year 2000 loans.

S. 314 would not affect direct spending or receipts; therefore, pay-as-you-go procedures would not apply. S. 314 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, or tribal governments.

Estimated cost to the Federal Government: The estimated budgetary impact of S. 314 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

[By fiscal year, in millions of dollars]

	2000	2001	2002	2003	2004
SPENDING SUBJECT TO APPROPRIATION					
Estimated authorization level	16	4	0	0	0
Estimated outlays	10	10	0	0	0

Basis of estimate: S. 314 would allow SBA to guarantee loans under the 7(a) general business program for year 2000 computer problems and associated economic injuries. Under current law, many small businesses that will be affected by such problems will be able to receive general business loans. The federal costs associated with S. 314 would result from guaranteeing loans to small businesses that would not qualify for loans under current law. CBO estimates that implementing S. 314 would cost about $20 million over the 2000–2002 period for about $500 million in additional SBA guarantees at an average subsidy cost of about 4 percent of the guaranteed amounts.

Loans under S. 314 would differ from regular 7(a) general business loans in five respects:

S. 314 would require that any reasonable doubts regarding a small business' ability to repay a loan be resolved in favor of the borrower.

Most small businesses can borrow no more than $750,000 under the 7(a) general business program. Small businesses would be able to borrow up to $1 million under S. 314.

Under the 7(a) general business program, SBA guarantees as much as 80 percent on loans of $100,000 or less and 75 percent on loans of more than $100,000. Under S. 314, SBA would guarantee as much as 90 percent on loans of $100,000 or less and 85 percent on loans of more than $100,000.

S. 314 would require that SBA be as flexible as possible when establishing terms and conditions of loans.

Finally, S. 314 would provide for a one-year moratorium on principal repayments.

The first three factors would likely allow SBA to guarantee loans with higher risks of default than the agency would guarantee under current law. Resolving all reasonable doubts in favor of prospective borrowers would have such an effect. Also, historical default data from SBA show that larger loans are more likely to default than small or average size loans. Thus, increasing the maximum amount a small business could borrow would increase the risk of loss. Finally, by increasing the percentage of a loan that SBA would guarantee, S. 314 would decrease the risk that a bank must bear and increase the likelihood of higher-risk lending.

CBO estimates that the default rate of borrowers that are approved under S. 314 but that would not receive approval under current law would be about 18 percent, which is 20 percent higher, on average, than the default rate for the 7(a) general business program. This higher rate is similar to the default rate that SBA expects for the defense loan and technical assistance program, which has loan conditions similar to those stipulated in S. 314. This rate also reflects the general risk that the effects of the year 2000 problems pose to all businesses.

The last two of the five factors listed above could allow SBA to guarantee loans with lower chances of recovery from defaults. The one-year grace period on principal payments would allow virtually all businesses to delay defaults. Most small businesses have assets that quickly decline in value, and computer equipment declines in value more quickly than other assets. The one-year grace period on

principal payments would delay the time when SBA begins liquidating loans, and thus may result in lower recoveries.

The requirements for more flexible terms may make it possible for a small business to receive a loan with a balloon payment, so long as that structure does not increase the risk of default. CBO assumes that borrowers wish such loans that eventually default would generally be able to make their interest payments until balloon payments were nearly due. Thus, SBA would not begin liquidating defaulted loans for many years, reducing the probability of recovery. CBO estimates that recoveries from year 2000 loans with normal amortization schedules would be 25 percent lower than recoveries from 7(a) general business loans, and that recoveries from year 2000 loans with balloon payments would be negligible.

We expect that the fees SBA would collect on year 2000 loans would be higher than those SBA would collect on 7(a) general business loans. The fees that SBA charges to originate a loan increase with loan size, and S. 314 would allow for larger loans than under current law. In addition, SBA charges a 0.5 percent fee on the outstanding balance of general business loans. Year 2000 loans would generally have higher outstanding balances than normal 7(a) general business loans because of the grace period on principal payments and the possibility of balloon payments. This factor would partially offset the increased cost of the loans made under S. 314.

On balance, CBO estimates that year 2000 loans would cost more to guarantee than 7(a) general business loans. The Federal Credit Reform Act of 1990 requires appropriation of the subsidy costs and administrative costs for credit programs. The subsidy cost if the estimated long-term cost to the government of a direct loan or loan guarantee, calculated on a net present-value basis and excluding administrative costs. Based on information from SBA and the Office of Management and Budget, CBO estimates that the 7(a) general business program will have a subsidy rate around 1.2 percent in 2000 and that the loans guaranteed under S. 314 that would not be funded under current law would have a subsidy rate of around 4 percent.

The total subsidy costs for implementing S. 314 largely depend on the demand for the year 2000 loans. Predictions of the impact of the year 2000 computer problem range from 1 percent of all businesses failing to global economic crisis. CBO estimates that small businesses would require about $500 million in SBA guarantees of year 2000 loans, assuming that small businesses will require about $1 billion in guarantees and that half of those businesses would not qualify for the 7(a) general business program. Therefore, CBO estimates that S. 314 would cost around $20 million over the 2000–2001 period, but the costs could be significantly higher or lower depending on the severity of the economic injuries associated with the year 2000 computer problem. CBO estimates that any impact on SBA's administrative costs would not be significant.

Pay-as-you-go considerations: None.

Intergovernmental and private-sector impact: This bill contains no intergovernmental or private-sector mandates as defined in

UMRA and would not affect the budgets of state, local, or tribal governments.

Estimate prepared by: Mark Hadley.

Estimate approved by: Robert A. Sunshine, Deputy Assistant Director for Budget Analysis.

SECTION BY SECTION

Section 1. Short title

This section entitles the legislation the "Small Business Year 2000 Readiness Act."

Section 2. Findings

This section sets forth Congressional findings on the affects the Y2K computer problem will likely have on small business concerns.

Section 3. Year 2000 computer problem loan guarantee program

This section requires the Small Business Administration to establish a limited-term loan guarantee program under which the SBA would guarantee loans made by private lenders to assist small businesses in correcting problems related to Y2K computer problems. The Act provides that loan proceeds may be used by a small business either to correct its own Y2K computer problems or provide relief from economic injuries sustained as a result of its own or another entity's Y2K computer problems. Each lender that participates in the SBA's 7(a) business loan program is eligible to participate in the Y2K loan program.

To ensure that the SBA can implement the loan program promptly, the Act permits a lender to process Y2K loans pursuant to any of the procedures that the SBA has already authorized for that lender under the 7(a) business loan program. The Act, however, mandates financing terms and underwriting standards for the Y2K loan program that are more flexible than the 7(a) loan program, so that small businesses are better able to repay the new debt with available cash flow.

To assure that the loan program is made available to those small businesses that need it and to increase awareness of the Y2K problem among small businesses and financial institutions, the legislation requires SBA to market this program aggressively to all eligible lenders. The Act provides that the loan program will sunset on December 31, 2000.

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