



# SBA Information Notice

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**TO:** All SBA Employees and Federally-Regulated 7(a) Lenders      **CONTROL NO.:** 5000-1397

**SUBJECT:** Updated PARRiS Methodology for Oversight of SBA Operations of Federally Regulated 7(a) Lenders      **EFFECTIVE:** November 8, 2016

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## Introduction

SBA's Office of Credit Risk Management (OCRM) has updated its composite risk measurement methodology and scoring guide, "PARRiS," which SBA developed for the oversight of 7(a) Lenders, as first introduced in Policy Notice 5000-1332 dated December 29, 2014 (Policy Notice). This Information Notice provides notification that selected quantitative factors currently being used in the PARRiS components have been revised and the risk tolerance thresholds have been updated.

## PARRiS Methodology

As further described in the Policy Notice, PARRiS is an acronym for the specific risk areas or components that SBA reviews for 7(a) 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.  |

Each PARRiS component includes qualitative and quantitative factors. All quantitative factors are benchmarked and scored against risk tolerance thresholds established by SBA, producing a PARRiS Score. The qualitative factors include, but are not 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

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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 as needed.

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.

With this Information Notice, SBA is announcing that two PARRiS component quantitative factors have been revised, and is also providing notice that component risk tolerance thresholds have been updated to incorporate current performance of SBA’s 7(a) loan portfolio. The PARRiS methodology, including but not limited to the qualitative and quantitative factors and flags, may be revised from time to time.

**Updated PARRiS Methodology With Component Factors**

The quantitative<sup>1</sup> and qualitative PARRiS factors effective with the publication of this Information Notice include, but are not limited to, the following as set forth below. The changed factors are highlighted in **bold and underlined**.

“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) |

<sup>1</sup> SBA provides definitions for each of the quantitative factors and the updated risk tolerance thresholds in the PARRiS tab of SBAOne.

|   |   |
|---|---|
| <ul style="list-style-type: none"> <li>• Early problem loan rate</li> </ul>                                     | <ul style="list-style-type: none"> <li>• Servicing (e.g., current borrower financials, insurance renewals, borrower visits, UCC filings)</li> </ul> |
| <ul style="list-style-type: none"> <li>• Stressed loan rate (Past Due + Delinquent + Deferred Loans)</li> </ul> | <ul style="list-style-type: none"> <li>• Liquidation and resolution risk (e.g., action plans, active purchases management)</li> </ul>               |
|   | <ul style="list-style-type: none"> <li>• Mission risk (e.g., risk associated with particular lending program)</li> </ul>                            |

R”- Regulatory Compliance

| Quantitative Factors  | Qualitative Factors   |
|---|---|
| <ul style="list-style-type: none"> <li>• Loans in default status over 3 years rate</li> </ul> | <ul style="list-style-type: none"> <li>• Loan eligibility</li> </ul>  |
| <ul style="list-style-type: none"> <li>• 1502 reporting rate</li> </ul>                       | <ul style="list-style-type: none"> <li>• Accurate SBA Form 1502 submission</li> </ul>   |
| <ul style="list-style-type: none"> <li>• 24 month repair/denial rate</li> </ul>               | <ul style="list-style-type: none"> <li>• Timely and accurate remittances such as liquidation proceeds, guarantee fees, receivables and SBA Form 172 payments</li> </ul> |
|   | <ul style="list-style-type: none"> <li>• Accurate SBA Form 159 reporting submission</li> </ul>  |
|   | <ul style="list-style-type: none"> <li>• Packaging and referral fees</li> </ul>   |
|   | <ul style="list-style-type: none"> <li>• Compliance with required corrective actions</li> </ul>   |
|   | <ul style="list-style-type: none"> <li>• Lender Service Provider (LSP) Agreements, where required</li> </ul>  |

“Ri” - Risk Management

| Quantitative Factors   | Qualitative Factors  |
|--|--|
| <ul style="list-style-type: none"> <li>• <b><u>Forecasted Purchase rate (FPR) (replaces Lender Purchase Rating (LPR))</u></b></li> </ul> | <ul style="list-style-type: none"> <li>• Board approved internal control policies and practices, including independent loan review and loan classification system</li> </ul> |
| <ul style="list-style-type: none"> <li>• Primary Federal Financial Institution Regulator total risk-based capital rate</li> </ul>        | <ul style="list-style-type: none"> <li>• Management and staff capabilities</li> </ul>  |
| <ul style="list-style-type: none"> <li>• Non-performing asset ratio</li> </ul>   | <ul style="list-style-type: none"> <li>• Day-to-day responsibility for SBA program management</li> </ul>   |
|  | <ul style="list-style-type: none"> <li>• Oversight and management of LSPs (if applicable)</li> </ul>   |
|  | <ul style="list-style-type: none"> <li>• Operating plan and strategy</li> </ul>  |
|  | <ul style="list-style-type: none"> <li>• Adherence to credit and operating policies and LSP Agreements (the latter if applicable)</li> </ul>                                 |

“S”- Special Items

| Quantitative Factors  | Qualitative Factors   |
|---|---|
| <ul style="list-style-type: none"> <li>• Average SBPS score (weighted)</li> </ul> | <ul style="list-style-type: none"> <li>• Loan participations and pledges</li> </ul> |

|  |  |
|--|--|
| <ul style="list-style-type: none"> <li>• <b>5 year charge-off rate (replaces Recovery rate (over last 5 years))</b></li> </ul>                 | <ul style="list-style-type: none"> <li>• Fraud, waste and abuse matters</li> </ul>   |
| <ul style="list-style-type: none"> <li>• Most recent regulatory action (Public Corrective Action with Regulator) (no/yes indicator)</li> </ul> | <ul style="list-style-type: none"> <li>• Evaluation of regulatory orders for impact on SBA portfolio and program risk</li> <li>• Other items of concern</li> </ul> |

### The New Quantitative Factors

The **Forecasted purchase rate (FPR)** projects the percent of a 7(a) Lender’s portfolio that will be purchased over the next 12 months. It is calculated from the dollar-weighted loan-level predicted purchase rate for each loan. SBA is replacing the LPR (a/k/a Lender Risk Rating (LRR)) in PARRiS given that SBA already separately tracks the LPR/LRR and because the FPR as a rate can be used to provide further information (e.g., it can be used to project the dollar amount of a Lender’s purchases simply by multiplying the rate by the Lender’s SBA Share Dollars Outstanding).

The **5 year charge-off rate** measures the total dollars charged-off during the past 5 years as a percentage of the total Gross Dollars Outstanding plus total dollars charged-off during the past 5 years. SBA is replacing the Recovery rate metric in PARRiS with the more comprehensive charge-off rate that effectively provides a Lender’s portfolio loss rate. This measure is distinguished from the 5-year cumulative net yield in that the net yield takes into account the cash flow associated with loan fees.

The PARRiS methodology also features “flags” that are intended to highlight additional areas that SBA will be monitoring in identifying risk. These flags remain unchanged and, 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.

Except as revised by this Information Notice, Policy Notice 5000-1332 (dated December 29, 2014), Procedural Notice 5000-1351 (dated September 11, 2015), and Policy Notice 5000-1375 (dated March 23, 2016) remain unchanged and continue to be in effect. A separate notice covering the updated SMART methodology for Certified Development Companies participating in the 504 loan program is being issued.

#### Questions

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

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Office of Credit Risk Management

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