

Mr. Moot. Mr. Chairman, I think it is. I think it is good for the Government. What we have attempted to do is to posture ourselves so that we are taking a long-term loss and not the short-term loss. What we are really saying is that the Government will insure against an economic depression or recession situation, and the insurance industry will cover the normal vicissitudes of turnover of business.

The CHAIRMAN. Proceed, Mr. Hendricks.

Mr. HENDRICKS. Thank you.

In participating in this manner, SBA will be guaranteeing excess losses which may be associated especially with a severe economic recession. Thus, our reinsurance operates as a stabilizing influence in the insurance market by absorbing some of the impact of an economic dip which the carriers would be unable to underwrite.

We feel, however, that it is important for the insurance company to maintain a significant interest in the guarantee throughout its life.

We are prepared, however, to proceed with a direct program in the event private participation is not available.

Insurance industry reaction, to this point, has been largely that of cautious observation. As the program moves along, and after ground has been broken by smaller or innovative companies, the larger companies and groups will probably begin more seriously to consider participation. We are stressing the need for insurance industry participation, and this promotional activity has a high priority on our time and effort.

While progress in this direction has been slow, there have been some results. Three reinsurance treaties have been signed, and others are being negotiated.

The CHAIRMAN. Would you denominate them as treaties?

Mr. HENDRICKS. That is insurance company parlance, and we have become addicted to it, sir.

The CHAIRMAN. It must be a treaty with anybody doing business, I think, with some of the insurance companies.

Proceed.

Mr. HENDRICKS. It bears repeating that the law provides that no lease guarantee shall be issued directly or in participation "unless the Administration determines that there exists a reasonable expectation that the small business concern * * * will perform the covenants and conditions of the lease." This performance requires much more than a financial determination of an ability to repay the rent. To comply with this provision a grading or measurement system has been developed to evaluate the risk of default by the applicant.

After a careful examination of the principal sources of risk, there was general agreement among SBA officials and outside experts that the major sources of risk arose in four categorical designations. These were agreed upon as:

1. The ability and experience of management;
2. The financial position or structure of the organization represented by the lessee;
3. The viability of the location of the premises being leased; and
4. The appropriateness of the terms of the proposed lease.

In preparing a method or procedure for grading or measuring each of these sources of risk, consideration has been given to all the data and information which are basically taken into account in judging the character and ability of management, the soundness of the finan-