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# SMALL BUSINESS ADMINISTRATION

## Progress Made but Improvements Needed in Lender Oversight

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Madam Chair and Members of the Committee:

I am pleased to be here today at this roundtable to discuss the results of our work on the Small Business Administration's (SBA) oversight of its 7(a) loan program lenders, particularly those who participate in the Preferred Lenders Program or PLP. SBA delegates full authority to preferred lenders to make loans without prior SBA approval. In fiscal year 2002, preferred lenders approved 55 percent of the dollar value of all 7(a) loans—about \$7 billion. Small businesses are certainly a vital part of the nation's economy. According to SBA, they generate more than half of the nation's gross domestic product and are the principal source of new jobs in the U.S. economy. In turn, SBA's mission is to maintain and strengthen the nation's economy by aiding, counseling, assisting, and protecting the interests of small businesses. Providing small businesses with access to credit is a major avenue through which SBA strives to fulfill its mission. Strong oversight of lenders by SBA is needed to protect SBA from financial risk and to ensure that qualified borrowers get 7(a) loans. SBA has a total portfolio of about \$46 billion, including \$42 billion in direct and guaranteed small business loans and other guarantees.<sup>1</sup> Because SBA guarantees up to 85 percent of the 7(a) loans made by its lending partners, there is risk to SBA if the loans are not repaid. SBA must ensure that lenders provide loans to borrowers who are eligible and creditworthy to protect the integrity of the 7(a) program.

Our statement today is based on the report we issued December 9, 2002, *Small Business Administration: Progress Made but Improvements Needed in Lender Oversight* (GAO-03-90). The report and our remarks will focus on our evaluation of (1) SBA's 7(a) lender oversight program and (2) SBA's organizational alignment for conducting oversight of preferred lenders and Small Business Lending Companies (SBLC).<sup>2</sup> In addition, we will comment on SBA's latest response to our findings and recommendations.<sup>3</sup> Our overall objective is to provide the Committee with information and perspectives to consider as it moves forward on SBA reauthorization.

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<sup>1</sup>As of September 30, 2002.

<sup>2</sup>SBLCs, which make only 7(a) loans, are privately owned and managed, nondepository, lending institutions that are licensed and regulated by SBA but not generally regulated or examined by financial institution regulators.

<sup>3</sup>Hector Barreto, SBA Administrator, letter to The Honorable Susan Collins, Chair, Committee on Government Affairs, U.S. Senate, March 12, 2003.

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In analyzing SBA's oversight of its preferred lenders, we defined oversight to include both SBA's reviews of preferred lenders for compliance with SBA rules and regulations and SBA's evaluations of lenders to decide their initial and continued participation in the PLP. We focused our reviews in part to follow up on recommendations made in our June 1998 report, where we found that SBA was doing few reviews of its preferred lenders.<sup>4</sup> We analyzed a sample of review reports and PLP guidance, and review and lending data to the extent that they were available. We also interviewed SBA headquarters and regional staff, PLP lenders, and representatives of the National Association of Government Guaranteed Lenders.

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## Summary

SBA has made progress in developing its lender oversight program, but there are still areas in need of improvement. While SBA has identified appropriate elements for an effective lender oversight program, it has been slow to change programs and procedures to fully incorporate all of these elements. In addition, financial risk management issues have become more critical for SBA, as its current loan programs focus on partnering with lenders, primarily banks, that make loans guaranteed up to 85 percent by SBA. However, our work showed that

- SBA had not yet consistently incorporated adequate measures of financial risk into the PLP review process or the SBLC examination program.
- The current PLP review process, which SBA uses to ensure compliance with the program mission, rules, and regulations, involves a cursory review of documentation maintained in lenders' loan files rather than a qualitative assessment of borrower creditworthiness or eligibility.
- SBA's standards for borrower eligibility (the "credit elsewhere" requirement) are broad and therefore subject to interpretation.
- SBA had not developed clear enforcement policies for preferred lenders or SBLCs that would specifically describe its response in the event that reviews discover noncompliance or safety and soundness problems.

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<sup>4</sup>U.S. General Accounting Office, *Small Business Administration: Few Reviews of Guaranteed Lenders Have Been Conducted*, [GAO/GGD-98-85](#) (Washington, D.C.: June 1998).

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- SBA had been slow to finalize and issue SBLC examination reports.<sup>5</sup> In addition, SBA had been slow to respond to recommendations for improving the SBLC examination program.

Without continued improvement to better enable SBA to assess the financial risk posed by 7(a) loans and to ensure that its lending partners are making loans to eligible small businesses, SBA will not have a successful lender oversight program.

Although SBA has listed the oversight of its lending partners as an agency priority, the function does not have the necessary organizational independence or resources to accomplish its goals. In our past work analyzing organizational alignment and workload issues, we have described the importance of (1) tying organizational alignment to a clear and comprehensive mission statement and strategic plan and (2) providing adequate resources to accomplish the mission. However, two different offices—Lender Oversight and Financial Assistance, both of which are in the Office of Capital Access (OCA)—carry out SBA’s lender oversight functions (see fig. 1). OCA also promotes and implements SBA’s lending programs. This alignment presents a possible conflict because PLP promotion and operations are housed in the same office that assesses lender compliance with SBA safety and soundness and mission requirements. Additionally, split responsibilities within OCA and limited resources have impeded SBA’s ability to complete certain oversight responsibilities, which could result in heightened risk to its portfolio or lack of comprehensive awareness of portfolio risk.

Our report made recommendations to improve SBA’s oversight of its lenders. Specifically, we recommended that SBA:

- incorporate strategies into its review process to adequately measure the financial risk lenders’ portfolios of guaranteed SBA loans pose to SBA,
- develop specific criteria to apply to the credit elsewhere standard used to determine borrower eligibility,

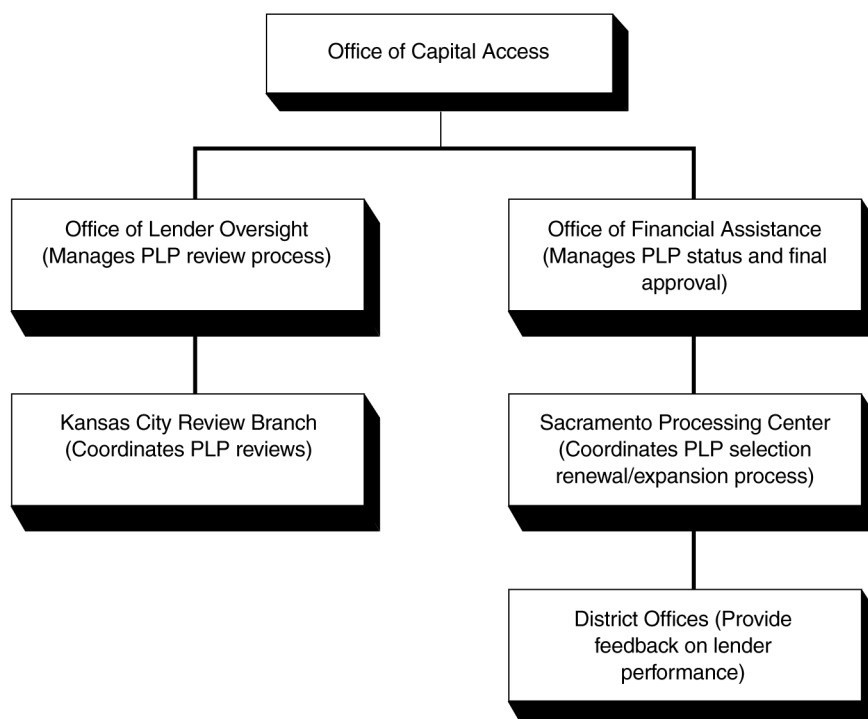
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<sup>5</sup>Since 1999, SBA has had an agreement with the Farm Credit Administration (FCA) to conduct safety and soundness examinations of the SBLCs. FCA is an independent agency within the executive branch; it regulates Farm Credit System institutions. FCA also contracts with other government agencies to provide examination services.

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- perform qualitative assessments of lenders' performance and lending decisions,
  - clarify its enforcement authority and specify conditions under which it would take enforcement action,
  - make the preferred lender program more accessible to large national lenders, and
  - better emphasize lender oversight in its organizational alignment to provide an oversight office with greater autonomy within SBA to match the growing importance of lender oversight.

SBA essentially disagreed with part or all of our recommendations for improving its assessments of lenders, said that it was “working to address” issues we raised about enforcement and accessibility of the preferred lender program, and disagreed with our recommendation to separate lender oversight functions and responsibilities from preferred lender program management functions.

**Figure 1: Preferred Lender Oversight Responsibilities within OCA**



Source: GAO analysis of SBA's structure.

## Background

The 7(a) loan program, which is authorized by Section 7(a) of the Small Business Act, is SBA's largest business loan program.<sup>6</sup> It is intended to serve small business borrowers who otherwise cannot obtain financing under reasonable terms and conditions from the private sector. In administering the 7(a) program, SBA has evolved from making guaranteed loans directly to depending on lending partners, primarily banks.<sup>7</sup> Under 7(a), SBA provides guarantees of up to 85 percent on loans made by participating lenders.

Within 7(a), there are three classifications of lenders—regular, certified, and preferred. SBA evaluates and grants preferred lender status to 7(a)

<sup>6</sup>15 U.S.C. § 636 (2000).

<sup>7</sup>Other types of financial institutions, such as savings banks, are lending partners. In this statement, we refer to all financial institutions that make 7(a) loans as banks.

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lenders after receiving nominations and reviews from its 70 district offices and a regional processing center. Of the three categories, preferred lenders have the most autonomy in that they can make loans without prior SBA review or approval. Most preferred lenders are banks that have their own safety and soundness regulators, such as the Office of the Comptroller of the Currency. Those regulators, however, may not focus on the 7(a) loans that SBA guarantees when they examine the bank. The other preferred lenders, which are SBLCs, have no regulator other than SBA—making SBA oversight more critical. As of August 2002, SBA had over 400 preferred lenders. To give you an idea of this program’s scope, in fiscal year 2002, 7(a) loan approvals totaled approximately \$12.2 billion, of which preferred lenders approved \$6.7 billion. However, preferred lending activity is concentrated in a few larger institutions. Less than 1 percent of 7(a) lenders account for more than 50 percent of 7(a) dollar volume outstanding. According to SBA, most of these lenders are preferred lenders.

Two offices within SBA have primary responsibility for 7(a) lender oversight—the Office of Lender Oversight (OLO) and the Office of Financial Assistance (OFA). OLO is responsible for many oversight functions, such as managing all headquarters and field office activities regarding lender reviews. However, OFA has retained some oversight responsibilities. OFA’s current role in lender oversight is to provide final approval of lenders’ PLP status. Lenders are granted PLP status in specific SBA districts for a period of 2 years or less. OFA collects information about the lender prepared by the Sacramento Processing Center, with input from one or more of SBA’s 70 district offices, and decides whether to renew a lender’s PLP status or to grant status in an additional district. OFA may also discontinue a lender’s PLP status.

Other lenders participating in the 7(a) program are subject to a different oversight regime. Specifically, SBA divides SBLC program functions between OLO and OFA. OLO is responsible for SBLC on-site examination, and OFA handles day-to-day program management and policymaking. Ultimate responsibility for enforcement of corrective actions rests with OCA. As participants in the 7(a) program, SBLCs are subject to the same review requirements as other 7(a) lenders, and they are also subject to safety and soundness oversight by SBA.

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## Lender Oversight Is Not Achieving All of Its Goals

SBA has identified goals for its lender oversight program that are consistent with appropriate standards for an oversight program; however, SBA had not yet established a program that is likely to achieve them. Since our last review, SBA had made progress in developing its lender oversight program, but there are still areas in need of improvement if SBA is to develop a successful program. SBA has highlighted risk management in its strategy to modernize the agency; however, PLP reviews are not designed to evaluate financial risk, and the agency has been slow to respond to recommendations made for improving its monitoring and management of financial risk—posing a potential risk to SBA’s portfolio. PLP reviews are designed to determine lender compliance with SBA regulations and guidelines, but they do not provide adequate assurance that lenders are sufficiently assessing eligibility and creditworthiness of borrowers.

Although SBA has identified problems with preferred lender and SBLC lending practices, it has not developed clear policies that would describe enforcement responses to specific conditions. Thus, it is not clear what actions SBA would take to ensure that preferred lenders or SBLCs address lending program weaknesses. Although the process for certifying lenders for PLP status—another means by which SBA oversees lenders—has become better defined and more objective, some lenders told us they continue to experience confusing and inconsistent procedures during this process due to varying recommendations from field offices.

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## SBA Has Made Progress in Developing Its Lender Oversight Function

Since our June 1998 report, SBA has responded to a number of recommendations for improving lender oversight by developing guidance, establishing OLO, and doing more reviews. SBA developed “Standard Operating Procedures” (SOP) for oversight of SBA’s lending partners and the “Loan Policy and Program Oversight Guide for Lender Reviews” in October 1999.

SBA established OLO in fiscal year 1999 to coordinate and centralize lender review processes for PLP and SBLC oversight. OLO created a “Reviewer Guide” for personnel engaged in PLP reviews and does training for all SBA staff involved in conducting preferred lender reviews. OLO officials said that to effectively oversee and monitor SBA lenders, they also evaluate lender-generated risk to the SBA portfolio, work with SBA program offices to manage PLP oversight operations, and plan to conduct regular and systematic portfolio analysis using a new loan monitoring system. Additionally, to minimize the number of visits SBLCs receive during a year, OLO combined PLP reviews with SBLC examinations performed by FCA.

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In another effort to improve the lender review process, SBA developed an automated, 105-item checklist that is designed to make its analysis more objective. The questionnaire addresses lender organizational structure, policies, and controls, but the answers are provided in a “yes-no” format and generally refer to the presence or absence of specific documents. SBA noted that the format makes assessments of lenders more consistent and objective. However, we note that without a more substantive method of evaluating lender performance, this approach does not provide a meaningful assessment.

SBA also has increased the number of PLP reviews performed. In June 1998, we reported that SBA had not reviewed 96 percent of 7(a) lenders, including preferred lenders, in the districts we visited. SBA reviewed 385 reviews of 449 preferred lenders in its 2001– 2002 review year.<sup>8</sup>

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### **SBA’s Lender Oversight Does Not Adequately Focus on Financial Risk**

While elements of SBA’s oversight program touch on the financial risk posed by preferred lenders, including SBLCs, weaknesses in the program limit SBA’s ability to focus on, and respond to, current and future financial risk to their portfolio. Neither the PLP review process nor SBA’s off-site monitoring efforts adequately focus on the financial risk posed by preferred and other lenders to SBA. SBA oversight of SBLCs is charged with monitoring how SBLCs administer their credit programs, identifying potential problems, and keeping SBA losses to an acceptable level. However, SBA’s progress in reporting examination results in a timely manner and implementing other program improvements limits the effectiveness of SBA’s SBLC oversight.

SBA officials stated that PLP reviews are strict compliance reviews that are not designed to measure the lenders’ financial risk. Our review and that of SBA’s Inspector General (IG) confirmed this. The PLP review serves as SBA’s primary internal control mechanism to determine whether preferred lenders are processing, servicing, and liquidating loans according to SBA standards and whether such lenders should participate in the programs. While the review has questions that touch on the financial risk of a given loan, review staff are not required to answer them; and SBA guidance explicitly states that the answers to the questions are for

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<sup>8</sup>SBA’s review year runs from April 1 to March 31. SBA officials explained that the initial date of its contract with the vendor that conducts PLP reviews began on April 1, and they have since used this as the beginning of their review year.

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research purposes only and are not to be considered in making any determinations about the lender. By not including an assessment of the financial risk posed by individual lenders during PLP reviews, SBA is missing an opportunity to gather information that could help predict PLP lenders' future performance, thereby better preparing SBA to manage the risk to its portfolio. The SBA IG also suggested that financial risk and lender-based risk should be considered as part of a comprehensive oversight program.<sup>9</sup>

SBA's off-site monitoring efforts do not adequately assess the financial risk posed by PLP and other lenders. SBA currently uses loan performance benchmarking and portfolio analysis to serve as its primary tools for off-site monitoring. While SBA officials stated that loan performance benchmarks are based on financial risk and serve as a measure to address a lender's potential risk to the SBA portfolio, we found that the benchmarks were not consistently used for this purpose.<sup>10</sup> In addition, we found that OLO does not perform routine analysis of SBA's portfolio to assess financial risk. At the time of our review, staff produced ad-hoc reports to analyze aggregate lending data to look for trends and to try to anticipate risk.

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### SBA Has Not Eliminated Weaknesses in SBLC Oversight That Pose a Threat to the SBA Portfolio

Currently, FCA staff responsible for SBLC safety and soundness examinations also perform PLP reviews at SBLCs—these reviews are the same ones that SBA contractors perform at preferred lenders and employ the same review checklist.<sup>11</sup> Upon the completion of its examinations, FCA provides a draft report to SBA for comment, incorporates any changes, and then provides a final report to SBA, which, in turn, issues a final report to the SBLC.

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<sup>9</sup>The SBA Inspector General defines financial risk as the composite risk posed by loans and guarantees actually booked to SBA's portfolio and how they perform over time, and defines lender-based risk as the potential financial injury due to the lender's failure to perform its role properly. U.S. Small Business Administration, Office of Inspector General, *Audit Report PLP Oversight Process*, Report Number 1-19, (Washington, D.C.: September 27, 2001).

<sup>10</sup>The five benchmarks are ratios for currency, delinquency, default, liquidation, and loss. Each is defined in SBA's SOP.

<sup>11</sup>FCA conducts broad-based examinations and evaluates each SBLC's capital adequacy, asset quality, management, earnings, and liquidity. The examinations are similar to safety and soundness examinations performed by bank and government-sponsored enterprise regulators.

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SBA has not eliminated weaknesses in SBLC oversight, which were cited by us and the SBA IG. We, and the SBA IG, found that final SBLC examination reports were not issued in a timely manner. SBA's IG reported that final reports for fiscal year 2001 SBLC examinations were not issued until February 2002, 10 months after OLO received the first draft report from FCA.<sup>12</sup> Our work confirmed these findings. We found that OLO does not maintain standards for the timely issuance of examination reports. However, OLO has recently developed draft customer service goals calling for SBLC examination reports to be finalized within 90 days of receipt of a draft report from FCA. However, as of August 2002, none of the examination reports from fiscal year 2002 had been issued. According to the IG, because of the delays in finalizing the reports and SBA's policy to delay any necessary enforcement actions until final reports are issued, two SBLCs were allowed to continue operating in an unsafe and unsound manner, despite early identification of material weaknesses during fiscal year 2001 examinations. The effectiveness of any examination program is measured, to a large degree, on its ability to identify and promptly remedy unsafe and unsound conditions. By delaying reporting and remedial action, SBA has significantly limited the effectiveness of its SBLC oversight program.

SBA has been slow to implement recommendations from FCA for improving the SBLC examination program. In addition to examining SBLCs, FCA was asked by SBA to provide recommendations for changes in the SBLC program. Each year FCA provides its views in a comprehensive report. FCA's September 1999 report made 15 recommendations, 12 of which SBA agreed to implement.<sup>13</sup> We reviewed the reports for fiscal years 2000 and 2001, in which FCA made additional recommendations with which SBA agreed. Yet, the 2001 report still lists 8 recommendations from the 1999 report and 2 from the 2000 report. SBA officials explained that limited resources have contributed to the delay in implementation of many of these recommendations.

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<sup>12</sup>U.S. Small Business Administration, Office of Inspector General, *Improvements Are Needed in the Small Business Lending Company Oversight Process*, Report No. 2-12 (Washington, D.C.: March 20, 2002).

<sup>13</sup>We listed the 15 recommendations in our November 2000 report. See U.S. General Accounting office, *Small Business Administration: Actions Needed to Strengthen Small Business Lending Company Oversight*, [GAO-01-192](#) (Washington, D.C.: November 2000).

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## PLP Reviews Do Not Provide Adequate Assurance That Lenders Are Sufficiently Assessing Eligibility and Creditworthiness

Assessing whether a borrower is eligible for 7(a) assistance is difficult because the requirements are broad and variable, making a qualitative assessment of a lender's decision by a trained reviewer all the more important. SBA regulations require a lender to attest to the borrower's demonstrated need for credit by determining that the desired credit is unavailable to the borrower on reasonable terms and conditions from nonfederal sources without SBA assistance.<sup>14</sup> These "credit elsewhere" provisions are particularly difficult to assess and must be determined prior to assessing other credit factors.<sup>15</sup> SBA guidance also requires preferred lenders to certify that credit is not otherwise available and to retain the explanation in the borrower file.<sup>16</sup> SBA does provide guidance on factors that may contribute to a borrower being unable to receive credit elsewhere. Factors that lenders should consider include the following:

- The business requires a loan with a longer maturity than the lender's policy permits;
- The requested loan exceeds either the lender's legal limit or policy limit, regarding amounts loaned to one customer;
- The lender's liquidity depends upon selling the guaranteed portion of the loan on the secondary market;
- The collateral does not meet the lender's policy requirements because of its uniqueness or low value;
- The lender's policy normally does not allow loans to new ventures or businesses in the applicant's industry; and
- Any other factors relating to the credit that in the lender's opinion cannot be overcome except by receiving a guaranty.

Based on these criteria, the credit elsewhere test could always be satisfied by structuring an SBA guaranteed loan so that its terms and conditions differ from those available on the commercial market. As a result, these

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<sup>14</sup>The SBA regulations do not further define "reasonable terms and conditions." See also 13 C.F.R. Section 120.101.

<sup>15</sup>Section 7(a) of the Small Business Act states that "no financial assistance shall be extended if the applicant can obtain credit elsewhere." 15 U.S.C. Section 636(a).

<sup>16</sup>SBA SOP 50-10(4)(E).

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loans could be made available to businesses that could obtain credit elsewhere on reasonable market terms and conditions, although not the same terms and conditions offered with the SBA guarantee.

SBA officials stated that the credit elsewhere requirements are designed to be broad so as to not limit a lender's discretion and allow flexibility, depending upon geographic region, economic conditions, and type of business. For example, SBA officials said that when credit is more readily available, businesses that require SBA assistance might be held to a different standard, thereby making it more difficult to obtain the SBA guarantee than when credit is tighter. Nonetheless, the flexibility that lenders have along with the difficulty in assessing lenders' credit elsewhere decisions further support the need for developing specific criteria for a credit elsewhere standard. These changes would facilitate a more qualitative assessment of eligibility decisions made by preferred lenders.

Moreover, because it is a cursory review of documents in the file, the PLP review also does not qualitatively assess a lender's credit decision. Preferred lenders are required to perform a thorough and complete credit analysis of the borrower and establish repayment terms on the loan in the form of a credit memorandum. SBA guidance requires, at a minimum, discussion in the credit memorandum of a borrower's capitalization or proof that the borrower will have adequate capital for operations and repayment, as well as capable management ability.<sup>17</sup> SBA officials said that lender review staff focus on the lender's process for making credit decisions rather than the lender's decision. SBA officials said that it is unlikely that the review would result in a determination that the loan should not have been made. An SBA official stated that review staff would not perform an in-depth financial analysis to assess the lender's credit decision and that a lender's process would only be questioned in the case of missing documentation. For example, review staff would cite a lender if it did not document the borrower's repayment ability.

Some lenders we interviewed criticized the lack of technical expertise of contract review staff. The lenders stated that review staff was unable to provide additional insight into material compliance issues during the review because of a lack of technical knowledge of the underwriting process and requirements. For example, one lender said he was cited for

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<sup>17</sup>SBA SOP 50-10(4).

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not signing a credit elsewhere statement, but the reviewer did not evaluate a financial statement in the file substantiating the credit elsewhere assessment.

To improve PLP and SBLC oversight, we recommended that SBA incorporate strategies into its review process to adequately measure the financial risk lenders pose to SBA, develop specific criteria to apply to the credit elsewhere standard, and perform qualitative assessments of lender performance and lending decisions. SBA stated that it believes the existing statutes, regulations, policies, and procedures provide sufficient guidance to lenders. These are the same sources we analyzed and found to be broad, making a qualitative assessment of a lender's decisions difficult. SBA has responded that it does measure financial risk of SBLCs through the safety and soundness examinations conducted by FCA and that the PLP lender reviews do estimate some degree of financial risk. We had noted both of these measures in our December 9, 2002 report. We also noted that SBA had not acted on suggestions that FCA had made to enhance SBA's oversight of SBLCs. Only 3 of 15 preferred lender review reports that we reviewed provided any evidence of such an assessment. And, we note, SBA's review guidance does not require such a review. Thus, our recommendations remain open.

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### **SBA Has Not Developed Clear Enforcement Policies for Preferred Lenders and SBLCs**

SBA has authority to suspend or revoke a lender's PLP status for reasons that include unacceptable loan performance; failure to make enough loans under SBA's expedited procedures; and violations of statutes, regulations, or SBA policies.<sup>18</sup> However, SBA has not developed policies and procedures that describe circumstances under which it will suspend or revoke PLP authority or how it will do so. SBA guidance does not include specific follow-up procedures for PLP lenders that receive poor review ratings, but it does discuss recommended patterns of follow-up. SBA officials said that, in practice, they request action plans to address deficiencies for any ratings of "minimally in compliance" and "not in compliance." In addition, lenders with ratings of not in compliance are to receive follow-up reviews. SBA officials explained that because they want to encourage lenders to participate in PLP, they prefer to work out problems with lenders, and therefore rarely terminate PLP status. And, where a lender persists in noncompliance, SBA will generally allow the status to expire, rather than terminating it. However, without clear

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<sup>18</sup> 13 C.F.R. § 120.455 (2002).

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enforcement policies, PLP lenders cannot be certain of the consequences of certain ratings and they may not take the oversight program seriously.

In November 2000, we recommended that the SBLC examination program could be strengthened by clarifying SBA's regulatory and enforcement authority regarding SBLCs. Although it has the authority to do so, SBA has yet to develop, through regulation, clear policies and procedures for taking supervisory actions. By not expanding the range of its enforcement actions—which it can do by promulgating regulations—SBA is limited in the actions it can take to remedy unsafe and unsound conditions in SBLCs. SBA regulations only provide for revocation or suspension of an SBLC license for a violation of law, regulation, or any agreement with SBA. Without less drastic measures, SBA has a limited capability to respond to unsatisfactory conditions in an SBLC. Unlike SBA, federal bank and thrift regulators use an array of statutorily defined supervisory actions, short of suspension or revocation of a financial institution's charter or federal deposit insurance, if an institution fails to comply with regulations or is unsafe or unsound.

We recommended that SBA provide, through regulation, clear policies and procedures for taking enforcement actions against preferred lenders and SBLCs in the event of continued noncompliance with SBA's regulations. Most recently, SBA has responded that it does have clear policies and procedures; however, the agency intends to expand upon them. We will continue to followup and monitor SBA's response to this recommendation.

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### SBA's Process for Administering PLP Status Presents Lenders with Challenges

SBA's preferred lender certification process begins when a district office serving the area in which a lender's office is located nominates the lender for preferred status or when a lender requests a field office to consider it for PLP status. The district will then request performance data regarding the lender from SBA's Sacramento Processing Center. The processing center then provides the district office with data required to fill in part of a worksheet developed for the nomination process. The district office sends the completed worksheet, along with other required information, back to the processing center. The processing center analyzes the nomination and sends it with a recommendation to OFA for final decision.

According to SBA's SOP, in making its decision, OFA considers whether the lender (1) has the required ability to process, close, service, and liquidate loans; (2) has the ability to develop and analyze complete loan packages; and (3) has a satisfactory performance history with SBA. OFA also considers whether the lender shows a substantial commitment to

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SBA's "quality lending goals," has the ability to meet the goals, and demonstrates a "spirit of cooperation" with SBA.

OFA and district office staff said that although district offices do not provide final approval of PLP status for lenders in their districts, they generally play an important role and district input is given significant weight. Most of the district office staff we interviewed believed that they had considerable influence on OFA's decision regarding a lender's PLP status.

A PLP lender may request an expansion of the territory in which it can process PLP loans by submitting a request to the Sacramento Processing Center. The processing center will obtain the recommendation of each district office in the area into which the PLP lender would like to expand its PLP operations. The processing center will forward the district recommendations to OFA for a final decision.

Lenders we interviewed had varying experiences in gaining and maintaining their PLP status. While some lenders expressed general satisfaction with the process and their understanding of it, others cited problems. For example, several PLP lenders we interviewed said that they had their PLP status declined in a specific district, although they had already achieved PLP status in other districts. In some instances, lenders said that they did not understand why they had been turned down, in light of their proven performance. These lenders commented that some district offices were not open to working with lenders from outside their districts while others were. In our interviews with district offices, we sometimes heard differing descriptions from district office officials on the level of commitment required of a lender who wished to gain PLP status in their district. Some district officials said that a lender had to maintain a physical presence in the district, while others disagreed. However, all district office officials expressed the need for some regular discussion with a lender to understand the lender's commitment to the district.

Larger lenders, as well as the National Association of Government Guaranteed Lenders (NAGGL), noted the administrative burden of maintaining relationships with many of the 70 district offices to maintain PLP status. The lenders noted that to receive and maintain PLP status in a given district, it is generally necessary to meet at least annually with district office staff to discuss status and plans for future lending. For some large national lenders, this can amount to 40 or more visits per year. In response to this concern, NAGGL has recommended a national PLP status based on a uniform national standard to ease the administrative burdens

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on large national lenders that account for the largest volume of PLP lending.

District office officials that we interviewed generally acknowledged that they want to understand a lender's plans for their district before agreeing to endorse a lender that wishes to gain PLP status in their district. District officials explained that PLP status is an important marketing tool for lenders. As advocates for the credit needs of small businesses in their districts, the district office officials see PLP status as a "carrot" to encourage lenders to make a sufficient volume of loans to their district. They suggest that a "national" PLP lender might make a large volume of PLP loans nationwide, but none in their district. The officials reason that without a district-by-district PLP status, district offices would lose an important tool for encouraging lenders to respond to credit needs in their districts.

To hold lenders to a uniform national standard while maintaining individual district office's preferences and reinforcing their relationships with PLP lenders, SBA developed a formula-driven lender evaluation worksheet to facilitate the nomination, expansion, and renewal processes. The worksheet replaces the former procedure that involved written recommendations from district officials; however, it continues to award points based on sometimes subjective criteria, such as the district office's assessment of the lender's SBA marketing and outreach efforts, rather than the formulas in the spreadsheet. Where this is the case, district office staff are required to provide written justification for the points awarded.

SBA has a Lender Liaison program, managed by its Office of Field Operations (OFO), to assist large national lenders in managing relationships with SBA. The program involves the assignment of a single SBA official, generally a district director, to act as a liaison to a large national lender. In the event that a large lender should experience difficulty in managing its PLP status, it would have a single SBA official to call to assist in resolving any problems. OFO staff said that feedback they have received from lenders indicated that they like the program, finding it useful for resolving difficulties. Two of the lenders we interviewed participated in the program, and both expressed satisfaction with it. SBA has designated lender liaisons for 20 PLP lenders and, at the time of our review, intended to expand the program to 50 additional lenders. OLO identified 70 lenders who have PLP status in 6 or more districts and could benefit from the program.

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We recommended that SBA continue to explore ways to assist large national lenders to participate in the PLP. SBA has indicated that they are reviewing the issues we identified with regard to large national lenders and considering the best approach to address the issues. We will continue to followup with SBA and monitor its response on this matter.

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## SBA's Organizational Alignment Does Not Adequately Support SBA's Lender Oversight Functions

In our past work analyzing organizational alignment and workload issues at SBA and other agencies' efforts to improve management and performance, we have described the importance of tying organizational alignment to a clear and comprehensive mission statement and strategic plan. By organizational alignment, we mean the integration of organizational components, activities, core processes, and resources to support efficient and effective achievement of outcomes. For example, we noted how agency operations can be hampered by unclear linkage between an agency's mission and structure, but greatly enhanced when they are tied together.<sup>19</sup> We have identified human capital management challenges in key areas, which include undertaking strategic human capital planning and developing staffs whose size, skills, and deployment meet agency needs.<sup>20</sup> We have also noted the importance of separating safety and soundness regulation and mission evaluation from the function of mission promotion. While SBA's role regarding PLP lenders is slightly different from that of a safety and soundness regulator, two principles still apply to SBA. First, oversight and program evaluation functions should be organizationally separate and maintain an arm's-length relationship from program promotion. And second, in evaluating program compliance, SBA needs to weigh the financial risks to the federal government along with the 7(a) program's mission to provide credit to those who cannot get it elsewhere.

SBA officials have said and written that lender oversight is becoming an increasing priority for SBA; however, the function is not housed in an independent office with the exclusive role of providing lender oversight. OLO was created within OCA in fiscal year 1999 to ensure consistent and

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<sup>19</sup>U.S. General Accounting Office, *Small Business Administration: Current Structure Presents Challenges for Service Delivery*, [GAO-02-17](#) (Washington, D.C.: October 2001).

<sup>20</sup>Also included are leadership continuity and succession planning, and creating results-oriented organizational cultures. U.S. General Accounting Office, *Managing For Results: Next Steps to Improve the Federal Government's Management and Performance*, [GAO-02-439T](#) (Washington, D.C.: February 15, 2002).

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appropriate supervision of SBA's lending partners; however, OCA has other objectives, including the promotion of PLP to appropriate lenders. OFA, also part of OCA, is responsible for providing overall direction for the administration of SBA's lending programs, including working with lenders to deliver lending programs, including 7(a), and developing loan policies and standard operating procedures.

OFA's lender oversight role is to provide final approval of lenders' PLP status and to take necessary enforcement actions against SBLCs. Yet, in its promotion role, OFA works with lenders to deliver lending programs. Thus the only explicit enforcement authority—the authority to revoke PLP status—resides with OFA rather than OLO. The presence of both OFA and OLO within OCA does not afford the oversight function an arm's-length position from the promotion function. The organizational arrangement presents a potential conflict, or at least the appearance of a conflict, between the desire to encourage lender participation in PLP and the need to evaluate lender performance (with the potential for discontinuing lenders' participation in PLP).

Evidence of overlapping responsibilities and poorly aligned resources also can be seen in delays SBA has experienced in completing certain tasks associated with lender oversight. As noted previously, these delays could hamper effective PLP and SBLC oversight by delaying corrective action that might arise from review findings. Since some, but not all, responsibility for the lender oversight function migrated from OFA to OLO, both offices continue to mingle responsibilities for certain functions. The division of responsibility between OFA and OLO has created the need for more interoffice coordination to complete certain tasks. For example, we found substantial delays in finalizing PLP review reports and, as noted earlier, in SBLC examination reports.

SBA's IG concluded that the delays in completing SBLC reports were at least partially due to poor coordination between OLO and OFA, both of which were involved in reviewing the reports. OLO and OFA, respectively, are responsible for oversight and management of the SBLC program. OLO is responsible for SBLC on-site examination and off-site monitoring, while OFA handles day-to-day program management, policymaking, and enforcement of corrective actions. Coordination between the two offices, however, was not formally established and simply evolved over time. The IG said that this informal structure contributed, in part, to the delays in issuing the fiscal year 2001 examination reports. OLO staff said that limited staffing also contributed to delays. For example, OLO began

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operations with 3 headquarters staff in fiscal year 2000, a number that increased to 12 by December 2002.

We recommended that SBA separate lender oversight functions and responsibilities from OCA, including those currently done by OFA. This would provide an oversight office with greater autonomy within SBA to match the growing importance of lender oversight in achieving SBA's goal of ensuring that PLP lenders make loans to eligible borrowers while properly managing the financial risk to SBA. While SBA did not respond directly to this recommendation prior to the December 2002 publication of our report, it recently stated in a response to congressional committees that it believes OLO has adequate independence. In addition, SBA maintains there is an advantage to having both OLO and OFA within the same office and working in concert. SBA did state, in March 2003, that it was in the process of drafting policies and procedures governing OLO program responsibilities. We plan to follow-up with SBA on its response to this recommendation.

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Madam Chair, Members of the Committee, this concludes my prepared statement. I would be happy to answer any questions at this time.

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## Contacts and Acknowledgments

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