CHAPTER 7 - LENDER OVERSIGHT

The SBA Office of Lender Oversight (OLO) is responsible for overseeing lenders that participate in the 7(a) and 504 SBA loan guaranty programs. OLO's mission is to support SBA's lending programs through an assessment of the SBA-guarantee risk associated with 7(a) and 504 loans and by monitoring lenders' adherence to applicable legal and regulatory requirements.

OLO identifies and analyzes the risk profile of each lender. OLO also conducts off-site assessment and monitoring of all lenders, and periodic on-site reviews of lenders that represent significant risk to SBA in terms of dollars guaranteed and loan portfolio credit quality.

LOAN AND LENDER MONITORING

OLO's loan and lender monitoring activities include a database of information about SBA's loans and lenders which is used to monitor lender and portfolio performance. Analytical data generated from the loan monitoring system significantly enhances OLO's ability to measure and evaluate the guarantee risk within SBA's small business guaranteed loan portfolio.

OLO's intent is to focus its attention on lenders that, in SBA's judgment, present the highest guarantee risk profiles and to tailor monitoring and reviews to identify and address high risk lending activity.

Lender Risk Assessment Process

OLO evaluates all lenders quarterly on issues related to loan portfolio credit quality, SBA exposure, and other factors. This quarterly assessment is a deciding factor in determining the level of oversight a lender receives. Oversight can range from off-site monitoring to on-site lender reviews on a 12 to 24 month cycle. Utilizing available information, OLO calculates a projected purchase rate for each lender. OLO then ranks lenders based on the percentage of the lender's SBA loan portfolio that presents a guarantee risk to SBA. The lender risk assessment process also may consider a variety of other quantitative data as well as other pertinent information to assess the lender's ability to evaluate, process, close, disburse, service and liquidate its portfolio in a manner that will minimize the guarantee risk to SBA. OLO's risk-based monitoring program consists of two interrelated activities: off-site assessment activities and on-site reviews.

Off-Site Lender Assessment and Monitoring

OLO conducts off-site monitoring based on quarterly assessments of lenders and their loan portfolios. In addition to credit quality assessments, the quarterly analysis also includes performance analysis and peer group comparisons and evaluates loan portfolio performance as it relates to demographic criteria, which may include geography, industry,

lender size, and SBA program activity. The off-site assessment allows OLO to identify those lenders whose risk profiles have changed significantly since the last assessment; identify lenders that merit special attention in order to mitigate potential problems and SBA-guarantee losses; and monitor those lenders with higher risk profiles between on-site reviews.

The off-site monitoring approach is designed to have limited impact on lender operations. However, in cases where off-site monitoring identifies performance issues or concerns, OLO staff will follow-up directly with the lender to ascertain the reasons for and implications of changed performance. OLO may ask the lender to forward information and data to explain its SBA lending activity. Information requested may include a lender's SBA-guaranteed loan business profile; growth, expansion or contraction plans related to its SBA business; and/or loan liquidation activities. OLO may gather additional information through review of publicly-available annual reports and regulatory reports concerning the lender.

The off-site assessment also allows OLO to monitor lenders that are less active in terms of SBA-guaranteed loan volume. As a result of OLO's off-site assessment, OLO assigns a lender rating based on the level of risk OLO determines that a lender represents to SBA. The lender rating will determine the type of monitoring a lender will receive in the future. Off-site monitoring is an ongoing dynamic process.

On-Site Lender Reviews

OLO also conducts on-site reviews of SBA's more active lending partners. OLO uses a risk-based process to allocate its review resources to correspond with SBA guarantee exposure, resulting in more intensive and more frequent on-site review of those lenders with higher levels of risk and a less frequent and less intensive on-site review of lenders with relatively lower levels of risk.

These reviews are operational reviews and are not designed to duplicate the safety and soundness examinations that federally insured financial institutions are subject to by their primary regulators.

ON-SITE REVIEW PROCESS

Objectives of the On-Site Review

The on-site review process allows OLO to make an informed analysis of a lender's SBA-guaranteed loan program portfolio characteristics and lending operations, including loan originations, servicing, troubled asset management, and assessments of borrower eligibility. This information assists OLO in determining the level of program-related risk to SBA posed by that lender and its SBA-guaranteed loan portfolio and whether that level of risk is acceptable to SBA.

Reports prepared by OLO's on-site review team include a composite summary rating for the lender reviewed, supported by a detailed description and analysis of all material findings. As necessary, the report also will include recommendations for improvement and identify areas requiring the corrective action the lender must address.

Responsibility for Conducting On-Site Reviews

OLO's Kansas City Review Branch (KCRB) is responsible for managing and conducting on-site reviews and preparing review reports for SBA lenders, except for Small Business Lending Companies (SBLCs). SBLCs are subject to more intensive lender reviews conducted by the Farm Credit Administration on SBA's behalf.

KCRB maintains a staff of trained examiners on permanent duty. A review team led by an Examiner-In-Charge (EIC) will determine the scope of the review, identify special areas of interest, and select a sample of loan files to be reviewed. The EIC is an SBA employee and is guided in part by information obtained through off-site monitoring OLO previously has conducted for a lender and a comparative analysis to SBA portfolio performance.

KCRB also relies on outside resources to maximize effectiveness. Additional members of the review team are SBA employees and/or contractors, as needed, to accomplish the on-site review tasks. OLO and KCRB train all contract resources prior to their participation in on-site reviews.

Frequency of Review

Lenders subject to on-site reviews are initially identified through the quarterly loan and lender off-site assessment. On-site lender reviews are conducted on a 12 to 24 month cycle depending upon the level of risk a lender represents to SBA. The cycle may be accelerated based upon OLO's quarterly assessment of a lender and information that is obtained from other off-site monitoring activities.

Location of Review

Both the lender and the EIC will have input into determining the review site; however, the EIC will have final authority to decide on the location. The review will require access to the lender's senior management officials and a wide variety of data and information, including corporate governance and complete loan file documentation. Prior to commencement of the on-site review, the lender must deliver to the review site the material requested by OLO and the lender must put in place protocols that will permit its management to respond to OLO's inquiries in an effective and timely manner during the on-site review. This will result in the most effective use of OLO's lender review resources as well as the lender's resources.

Lender Notification

OLO will give lenders sufficient notification of the proposed review date to permit assembly of the necessary documentation and files. In setting the review date, the EIC will make an effort to select a date that is not unreasonably disruptive to the lender's operations.

Documentation and Files to be Reviewed

The EIC, on behalf of SBA, has regulatory authority to request and receive all documents and files deemed necessary to accomplish the objectives of the review. The EIC will provide the lender with a list of required documentation and loan files for on-site review approximately four weeks prior to the start of on-site activities. The EIC also may require the lender to provide additional documentation and files during the course of the review.

Exit Conference

Prior to the conclusion of the on-site review, the EIC will hold an exit conference with the lender. While the EIC will discuss with the lender the review team's observations and preliminary conclusions as the review progresses, the exit conference provides an opportunity for the EIC to summarize the observations and conclusions into one presentation. The exit conference also is designed to give the lender another opportunity to respond with additional information that could affect the review conclusions prior to SBA documenting the review results in a formal report.

Review Ratings

The primary outcome of an on-site review is to assess the overall quality of a lender's SBA lending activities. Based on this assessment, a lender rating is assigned. OLO will provide the lender with a Lender Review Report that discusses the review findings and recommendations and includes the rating assigned. OLO will distribute the report to the lenders as well as internally to those offices within SBA requiring such information. To the maximum extent allowed by law, SBA will maintain the strict confidentiality of all reports and associated ratings.

Report Distribution

A transmittal letter will accompany the hard copy of the report to the lender. The transmittal letter will clearly state the nature of any response and additional actions that OLO may require of the lender and the timeframe within which the lender must submit such response to SBA.

Action Plan (AP)

In certain cases, OLO may require a lender to submit an AP to address deficiencies identified during the course of the on-site review. OLO's transmittal letter will identify the requirements for an AP and the timeframe within which the lender must submit the AP to SBA. OLO will evaluate the adequacy of a lender's response and will notify the lender of the acceptability of the AP. OLO will monitor the lender's progress in meeting its AP, with the level of scrutiny appropriate for each deficiency cited in OLO's transmittal letter.

Cost of Reviews

SBA may charge lenders a fee to cover the cost of reviews, as appropriate.

SPECIAL PERFORMANCE ASSESSMENTS AND REVIEWS

In addition to regular on-site lender reviews, OLO also may conduct ad hoc or special performance assessments and reviews of a lender, as necessary. OLO will perform all such special assessments and reviews with full disclosure to and pa