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Highlights

Highlights of GAO-04-610, a report to the Chair, Committee on Small Business and Entrepreneurship, U.S. Senate

SMALL BUSINESS ADMINISTRATION

New Service for Lender Oversight Reflects Some Best Practices, but Strategy for Use Lags Behind

Why GAO Did This Study

The Small Business Administration (SBA) has been challenged in the past in developing a lender oversight capability and a loan monitoring system to facilitate its oversight. While SBA has made progress in its lender oversight program, its past efforts to develop a loan monitoring system were unsuccessful. In 2003, SBA obtained loan monitoring services from Dun & Bradstreet.

GAO evaluated SBA's loan monitoring needs, how well those needs are met by the new service, and the similarities and differences for the purposes of credit risk management between SBA and private sector best practices.

What GAO Recommends

The SBA Administrator should (1) consider the applicability of best practices in developing policies for using the loan monitoring service, (2) develop enforcement policies to address noncompliance among lenders, (3) ensure adequate resources are devoted to developing policies, (4) explore using the service elsewhere in the agency, and (5) develop contingency plans in the event that the loan monitoring service contract is discontinued.

We obtained comments on a draft of this report from SBA's Associate Deputy Administrator for Capital Access. SBA generally agreed with the overall findings and recommendations, but stated that it should receive more credit for progress made.

www.gao.gov/cgi-bin/getrpt?GAO-04-610.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William Shear at (202) 512-8678 or shearw@gao.gov.

What GAO Found

Largely because SBA relies on lenders to make the loans it guarantees, the agency needs a loan and lender monitoring capability that will enable it to efficiently and effectively analyze its overall portfolio of loans, its individual lenders, and their portfolios of loans. SBA, along with Dun & Bradstreet, essentially identified these same needs as they obtained the loan monitoring service. In addition, they identified the importance of applying industry standards and best practices for loan and lender monitoring and the need to identify high-risk lenders. Based on our assessment of best practices, SBA's credit risk management efforts need to include a comprehensive infrastructure, appropriate methodologies, and policies.

The loan monitoring service could enable SBA to conduct the type of monitoring and analyses typical of best practices among banks and recommended by financial institution regulators, if SBA develops and implements appropriate policies. SBA's newly obtained service provides a credit risk management infrastructure and methodology that appear to be on par with those of many private sector lenders. For example, the database affords analytical capabilities based on common financial models that are used by major financial institutions. Although SBA obtained a useful service, it does not have comprehensive policies needed to implement best practices and address its needs as an agency with a public mission, especially regarding its need to use enforcement actions to address noncompliance. In addition, SBA does not have a contingency plan in the event the Dun & Bradstreet service is discontinued.

SBA, similar to private lenders, must determine the level of risk it will tolerate, but it must do so within the context of its mission and its programs' structures, which may consequently translate into different uses of its Dun & Bradstreet loan monitoring service. Since SBA is a public agency with a public mission, its mission obligations will drive its credit risk management policies. For example, different loan products in the 7(a) program have different levels of guarantees, and guarantees on 504 program loans have a different structure from 7(a) guarantees. These differences influence the mix of loans in SBA's portfolio and, consequently, would impact how SBA manages its credit risk. Furthermore, the structure of SBA's loan guarantee programs may also result in different credit risk management policies between SBA and major lenders. Private sector lenders manage credit risk at the loan level and the portfolio level. Since SBA relies on private lenders to originate and service the majority of the loans it guarantees, it also needs to manage the credit risk in its portfolio at the lender level.