



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

June 3, 2008

The Honorable John F. Kerry
Chairman
Committee on Small Business and Entrepreneurship
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Thank you for your letter to the Administrator regarding the recent Office of Inspector General (OIG) Report on Oversight of SBA's Supervised Lenders. SBA is committed to maintaining appropriate lender oversight standards that enable us to meet our statutory mission while mitigating risks. We appreciate your comments and are writing to address the concerns and questions raised in your letter.

As the Inspector General and SBA have noted in recent lender oversight hearings, over the last several years SBA has made and continues to make great strides in improving its lender oversight program. The significant improvements we have made include implementing a sophisticated risk-based off-site review/monitoring program, significantly increasing the numbers of on-site reviews, issuing comprehensive standard operating procedures for on-site reviews, and developing a lender portal to share peer and portfolio information with lenders. We testified to these and other improvements in November and are seeing the results.

Your letter suggests that SBA has not made improvements to the lender oversight program since the last OIG audit. We respectfully note that no such conclusion should be drawn from this audit report as the audit period covered, for the most part, the same timeframe as the prior audit. Therefore, it should not be expected that the OIG report findings would differ. In fact, in addition to the progress noted above, we also have published a comprehensive proposed rule which would incorporate SBA's risk-based oversight and enforcement program into SBA regulations.

In our response to the recent audit report, we noted our concern that the report characterized certain facts in a misleading way. For example, the purchase and loss numbers cited in the report are taken out of context and, as a result, can be misleading. The net negative cash flow cited in the report and in your letter reaches back nearly 20 years, well beyond the four year period of the audit, and includes many years during which lending programs operated at a positive subsidy rate. By including the years of positive subsidy, the report distorts the net negative cash flow calculation for the four lenders because the Federal appropriation or subsidy is reflected as part of the negative cash flow calculation. Another figure emphasized gross purchases for the four lenders, without noting that this amount is offset by lender fees and recoveries. The audit failed to put either of these figures into perspective and implied that losses from these lenders during

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the audit period were significantly higher than they actually were. In addition, we disagree with the audit report's contention that SBA's actions with regard to the audited lenders were insufficient. SBA took appropriate actions and as a result these lenders' risk profiles improved.

We understand that the Inspector General is concerned about the placement of the Office of Credit Risk Management (OCRM) within the Office of Capital Access (OCA). However, SBA believes that housing both the Office of Financial Assistance and Office of Credit Risk Management under the Office of Capital Access is critical. To run a strong loan program there has to be open communication between these key offices that can only be achieved if they operate in tandem. Close proximity ensures that the lender oversight staff will be current and well versed in SBA program requirements. It also allows for frequent feedback from lender oversight to the program office to facilitate safe and sound policy development. OCA is charged with a shared vision for balancing the need for lender supervision with the need to provide capital to small businesses. We believe that keeping these responsibilities tied together is the best way to ensure that they are both met.

In your letter, you commented on the costs of the program to lenders. SBA believes that the program as currently structured at zero subsidy provides the Agency with predictable budgetary resources to manage the 7(a) program, without the risk of a shutdown of the program in the event appropriated funds are unavailable. Lender oversight fees similarly ensure that SBA has the required level of resources to provide balanced, predictable and appropriate oversight. SBA recognizes, however, that it needs to make its programs more efficient and less costly to its lenders, and the Agency is working hard to do so.

Your letter also posed several questions on the proposed Lender Oversight Rule. As you know, we extended the formal period for written comments on the proposed rule. We also held eight public meetings across the country to allow and encourage public comment. We strongly believe in transparency and wanted to make sure that we heard and understood the comments and concerns of our program participants and other interested parties. As a result, we received many positive and constructive comments. The comments will be very helpful in SBA's rulemaking. After the general framework outlined in the rule is in place, we plan to issue standard operating procedures to further detail the processes described.

Finally, please find below our responses to your nine questions on the proposed Lender Oversight Rule:

1. Although the introductory paragraph states that the rule "would establish the role and responsibilities of [OCRM]," it appears that OCRM has been given just one express power under the rule. (See, Section 120.1005, 72 FR 61778.) Explain with specificity the enforcement power(s) granted to OCRM under the proposed rule.

Subpart I of the proposed rule codifies SBA's credit risk management/lender oversight program. Specific delegations of authority to the Office of Lender Oversight (now the Office of Credit Risk Management) are set forth in SBA's published Delegations of Authority at 70 FR 21262. These delegations will be updated to reflect the renaming of

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the office and to incorporate additional responsibilities codified in final oversight regulations.

2. It appears that very little responsibility would be vested in the newly-created Lender Oversight Committee (LOC), which directly contradicts the recommendations from each of the OIG's past three lender oversight reports. Describe the express powers that would be given to LOC under the proposed rule.

The Administration has already delegated certain responsibilities to the LOC in SBA's published lender oversight Delegations of Authority (70 FR 21262). SBA is in the process of reexamining those responsibilities and any changes will be published in the Federal Register.

3. Explain why the proposed rule would eliminate a lender's right to appeal to the SBA's Office of Hearing and Appeals, and instead would require a lender to appeal directly to a Federal district court.

In the proposed rule, SBA followed the Inspector General's recommendation (made in comments to the draft rule) to require lenders to appeal directly to Federal district courts. This is an area of the proposed rule that received public comment. We are currently evaluating the comments that we received.

4. Describe the SBA's rationale for granting OCA the power to decide when to require additional capital reserves from an SBA lender; it appears this should be properly determined by OCRM or LOC -- not OCA.

Under the current statute, only the SBA Administrator can decide when to issue a capital directive to an SBLC, and the Administrator may only delegate this function to an individual at the Associate Deputy Administrator level (currently titled as the Associate Administrator level).

5. Identify which SBA office will be charged with the responsibilities set forth in proposed Section 120.1000 et seq. For instance, proposed Section 120.1050 states that "SBA may conduct on-site reviews of the SBA loan operations of SBA Lenders." However, the rule fails to identify which SBA office will have that power. We assume the power will be vested in OCRM, but please confirm.

In general, OCRM is charged with the responsibilities set forth in the referenced sections, as published in Delegations of Authority.

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6. Explain why the SBA proposes to accelerate the deadline for submission of Certified Development Companies' annual reports from 180 to 90 days. (See, Section 120.830(a), 72 FR 61778.)

SBA has proposed this change in order to obtain critical financial data on CDCs in a more current manner. Since 90 days is the standard timeframe for submission of audited financial data to most federal agencies, SBA incorporated that deadline in its proposals. This is an area of the proposed rule that received public comment. We are currently evaluating the comments that we received.

7. Explain why "Other Regulated Small Business Loan Corporations" may be granted an exemption to certain provisions of the oversight rule, while similarly-situated "Non-Federally Regulated Lenders" cannot apply for such an exemption.

We are currently evaluating the comments that we received on the referenced provision.

8. Explain how the risk assessment tools that underlie the proposed rule are appropriate and effective for the SBA's direct microloan program.

SBA's risk assessment tools are particularly helpful in our efforts to monitor large numbers of small lenders. These tools help us prioritize oversight efforts on lenders that the tools indicate present the greatest risk to SBA. This system has been effective and successful for small 7(a) lenders. As Microloan lenders meet similar characteristics – small lenders with small loans – SBA believes it is appropriate to apply this best practice framework to the Microloan program. SBA, however, would tailor its assessment tools for the Microloan program, as necessary.

9. Explain how the proposed oversight rule could prevent another Business Loan Corporation type fraud and reduce the high rate of unnecessary purchases of guarantees on defaulted loans.

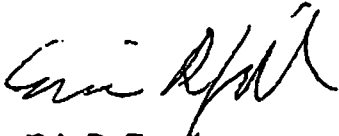
The lender oversight improvements we have made and are proposing to codify through the proposed rule are steps that will put us in a better position to identify suspicious activity and to refer the case to the Office of Inspector General for investigation. However, even with tightened lender oversight standards, it is not possible to prevent all fraud. Fraud is extremely difficult to detect even with the best available tools. As SBA's Inspector General testified last November, "No matter how sophisticated the fraud detection techniques are, not all fraud and abuse can be identified."

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Thank you for your comments on both SBA's proposed Lender Oversight Rule and on SBA's credit risk management/lender oversight program. We appreciate them and will place your proposed rule comments in the rulemaking record. A similar response is being sent to Senator Snowe. If you have any additional questions or comments, please call me directly at (202) 205-6657.

Sincerely,



Eric R. Zamikow
Associate Administrator
Office of Capital Access