MANAGEMENT ADVISORY REPORT
PRE-DEMAND AND DEMAND LETTERS FOR
DELINQUENT 9/11 DISASTER LOANS

REPORT NUMBER 5-09
January 11, 2005

Washington, D.C.

The finding in this report is the conclusions of the Office of Inspector General's Auditing Division based on testing of SBA operations. The finding and recommendations are subject to review, management decision, and corrective action in accordance with existing Agency procedures for follow-up and resolution. This report may contain proprietary information subject to the provisions of 18 USC 1905 and must not be released to the public or another agency without permission of the Office of Inspector General.

U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416

MANAGEMENT ADVISORY REPORT
Issue Date: January 11, 2005
Report Number: 5-09

To: James E. Rivera
Associate Administrator, Office of Financial Assistance

From: Robert G. Seabrooks
Assistant Inspector General for Auditing

Subject: Management Advisory Report on Pre-Demand and Demand Letters for Delinquent 9/11 Disaster Loans

Attached is a copy of the subject management advisory report. The purpose of this advisory report is to inform you of an issue identified during our on-going review of delinquent disaster loans that were made in response to 9/11 attacks on the World Trade Center and the Pentagon, as well as expanded economic injury loans made nationwide.

The review of selected loans is being accomplished to determine if they were approved, disbursed, and serviced appropriately and/or contained indicators of fraud. In those instances where potential fraud is disclosed, the loan is referred to our Investigations Division for further review.

Our review disclosed that program officials were not always sending pre-demand and demand letters to delinquent borrowers. The finding in this report is the conclusions of the Office of Inspector General's Auditing Division. The recommendations are subject to review and implementation of corrective action in accordance with existing Agency procedures for audit follow-up.

Please provide your management decision for each recommendation addressed to you within 30 days from the date of this report using the attached SBA Forms 1824, Recommendation Action Sheet.

Should you or your staff have any questions, please contact Garry Duncan, Director, Credit Programs Group, at (202) 205-[FOIA Ex.2].

Attachments

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Objective

The objective of the ongoing review is to determine if delinquent 9/11 disaster loans were approved, disbursed, and serviced appropriately and/or contained indicators of fraud. Since our review was limited in scope, we did not perform steps necessary to assess whether problems existed with all problem loans.

Background

An on-going Office of Inspector General review was conducted of disaster loans made in response to 9/11 attacks on the World Trade Center and the Pentagon. The review also included expanded 9/11 economic injury loans made nationwide. As of September 30, 2004, 1,495 of these loans valued at $208.8 million were delinquent.[1]

Office of Management and Budget (OMB) Circular A-129 provides policies on Federal credit program delinquent debt collection. It states that agencies shall promptly act on the collection of delinquent debts, using all available collection tools to maximize collections. Each agency shall develop a systematic process for the collection of delinquent accounts. Collection strategies shall take full advantage of available collection tools. For instance, as soon as an account becomes delinquent, agencies should send demand letters to the debtor. The demand letter must give the debtor notice of each form of collection action and type of financial penalty the agency plans to use in collecting the debt.

Standard Operating Procedure (SOP) 50 51 1 titled "Loan Liquidation and Acquired Property", dated July 6, 1993, discussed the use of demand letters. Demand letters were to be considered an important part of the liquidation process. The specific requirement for demand letters, however, was eliminated when this SOP expired in December 1997.

The current SOP 50 51 2 includes very general guidance on loan debt collection actions. Specifically, the SOP states that a loan should be placed in liquidation when all reasonable alternatives to collect the debt have been exhausted. More specific guidance is included in the Home Loan Servicing SOP 50 52 1 which states collection efforts on loans at the earliest stages of delinquency should be standardized as much as possible.

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[1] ***Delinquent loans are those that have been charged off, in liquidation, or are at least 61 days delinquent.***

Standardization includes the development and use of increasingly emphatic collection letters.

Pre-demand and demand letters not always sent

An on going review of 37 delinquent 9/11 disaster loans disclosed that pre-demand or demand letters should have been sent to borrowers of 17 loans. SBA, however, did not send letters to 13 borrowers. The loans had been delinquent for an average of 279 days. The attachment to this report identifies the loans and SBA offices responsible for liquidation actions. Demand letters were not needed for the remaining 20 loans because of bankruptcy, offer-In-compromise, legal actions, or under 90 days delinquent.

The Liquidation Center's liquidation program guidance outlines requirements for contacting delinquent borrowers. The program includes calling the borrower, if possible. If borrower contact is not made, a pre-demand letter would be sent. If the borrower does not respond to this letter, a demand letter is then issued.

Discussions with the Director, loan officers, and supervisors at the National Disaster Liquidation Center in Santa Ana indicated that the above procedure would be followed if sufficient staff were available. However, the Center generally does not send letters to seriously delinquent borrowers. Instead, the staff is used to accomplish servicing actions such as bankruptcy, collateral activities, and/or borrower initiated offers of compromise. The use of staff for these required servicing activities appears to adversely affect SBA's ability to issue pre demand and demand letters as required under OMB Circular A-129 as discussed above.

Pre-demand and demand letters are instruments that servicing centers should aggressively use in an attempt to collect debt owed on defaulted disaster loans including the $208.8 million balance owed on delinquent 9/11 disaster loans.

Recommendation

We recommend that the Director, Office of Financial Assistance take the following actions:

1A. Revise Standard Operating Procedure 50 51 2 to direct servicing centers send timely pre-demand and demand letters to delinquent borrowers. Such letters should be maintained in the loan file.

1B. Ensure that sufficient staff resources are devoted to Center activities to fulfill the timely issuance of pre-demand and demand letters as required by OMB A-129 requirements.

Management Comments

In response to recommendation 1A the Office for Financial Assistance agreed to revise Standard Operating Procedure 50 51 2 to direct service centers to send out timely pre-demand and demand letters. Appropriate acceleration and demand language will be re-inserted into SOP 50 51 2 to ensure that more complete instructions are available to collect delinquent debt.

OFA added that it is not clear from the report that the OIG reviewed all agency records including the PMQD26 screens before concluding that servicing centers failed to properly issue pre-demand and demand letters. Evidence that pre-demand letters were sent is included in the agency's electronic DLCS/PMQD 26 system for each loan but not maintained in the physical loan file. The agency considers the DLCS chronology system an official record and often centers do not print and place pre-demand letters in loan files but only reference those letters in the "chron" record. With regard to disaster home loan servicing, all borrowers are called within one week after being classified as past due for 11 days. If the borrower is non-responsive, these calls continue for 59 days. After day 60, a written pre-demand letter is sent via certified mail to ensure delivery. Again, copies of these letters are not usually printed and placed in the loan file but are referenced in the chron record. If the borrower is still non-responsive the loan is sent to the Treasury Offset Group for further collection efforts.

In response to recommendation 1B the Office of Financial Assistance takes exception with the recommendation saying that open-ended discussions with servicing/liquidation personnel does not support the need for a given level of additional employees. They further stated that such an inquiry to the staff of any SBA office would elicit a similar answer.

The entire management response is included at Appendix A.

OIG Evaluation of Management Comments

Management comments to recommendation 1A are responsive.

Management stated that it is not clear from the report that the OIG reviewed all agency records including the PMQD 26 screens before concluding that servicing centers failed to properly issue pre-demand and demand letters. Our loan review, in fact, did include a review of PMQD 26 screens for each delinquent loan. We found no PMQD 26 references showing pre-demand or demand letters had been sent for loans identified as needing such letters.

Management added that the agency considers the DLCS chronology system an official record and that often centers do not print and place pre-demand letters in loan files but only reference those letters in the "chron" record. While our audit did not focus on whether demand letters should be maintained in the SBA loan file, OMB Circular A-129 states that accurate and complete documentation is critical to providing proper servicing of the debt and perusing collection of delinquent debt. The circular also states that the demand letter must give the debtor notice of each form of collection action and type of financial penalty the agency plans to use in collecting the debt. We suggest that the actual demand letter would be the best evidence, in a court of law, that the borrower received legally sufficient notice.

Management submitted, with their management comments, a demand letter template that the Fresno Commercial Loan Service Center issues on all disaster loans 70 days or more delinquent. None of the 13 loans identified, however, were serviced by the Fresno Commercial Loan Center or any of the Home Loan Service Centers. The loans referenced in the report were serviced by the Little Rock Commercial Loan Service Center or the National Disaster Liquidation Center in Santa Ana.

Management comments to recommendation 1.B are partially responsive.

Management stated that an open-ended discussion with servicing/liquidation personnel does not support the need for a given level of additional employees. Recommendation 1.B does not require an increase in employment levels, but rather suggests that sufficient Center staff resources be devoted to the timely issuance of pre-demand and demand letters. Management should determine the actions needed to accomplish the recommendation.

Responsible Office for Issuing Demand Letters

	Loan Number	Office Assigned
1	501 388 4003	Little Rock Commercial Loan Service Center
2	505 531 4005	Little Rock Commercial Loan Service Center
3	517 089 4010	Little Rock Commercial Loan Service Center
4	523 369 4007	Little Rock Commercial Loan Service Center
5	512 196 4000	Little Rock Commercial Loan Service Center*
6	512 206 4003	Little Rock Commercial Loan Service Center*
7	528 711 4003	Little Rock Commercial Loan Service Center*
8	496 270 4003	Santa Ana Liquidation Center
9	552 872 4000	Santa Ana Liquidation Center
10	521 285 4008	Santa Ana Liquidation Center
11	566 857 4005	Santa Ana Liquidation Center
12	526 437 4008	Santa Ana Liquidation Center
13	496 951 4008	Santa Ana Liquidation Center*

* *Loan transferred to an SBA District Office for bankruptcy or other legal actions.*

Appendix A

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

DATE: December 27, 2004

TO: Robert G. Seabrooks,
Assistant Inspector General for Auditing

FROM: James E. Rivera, Ex. 6
Associate Administrator for Financial Assistance

SUBJECT: Response to OIG Draft Advisory Report on Pre-Demand and Demand Letters for Delinquent 9/11 Disaster Loans

This memo is in response to the above referenced advisory report issued December 1, 2004 regarding the debt collection efforts of the Office of Financial Assistance. You have requested a written response within 30 days.

With regard to Recommendation 1A "Revise Standard Operating Procedure 50 51 2 to direct servicing centers send timely pre-demand demand letters to delinquent borrowers," the Office of Financial Assistance (OFA) will, by June 30, 2005, re-insert appropriate Acceleration and Demand language into SOP 50 51 2 in order to ensure that more complete instructions are available to collect delinquent debt. However, OFA would like to affirm that its servicing centers follow all SOP requirements for notification of borrowers holding non-current loans.

It is not clear from the Office of Inspector General advisory memorandum report that the Investigations Division staff reviewed all official agency records before concluding that servicing centers failed to properly issue pre-demand and demand letters to many delinquent disaster borrowers. Attached is a demand letter template that the Fresno Commercial Loan Service Center issues on all disaster loans 70 days or more delinquent. The pre-demand letter is referenced in the agency's electronic DLCS/PMQD 26 system for each loan but not maintained in the physical loan file. The agency considers the DLCS chronology system an official record and often centers do not print and place pre-demand or demand letters in loan files but only reference those letters in the "chron" record. With regard to disaster home loan servicing, all borrowers are called within one week after being classified as past due for 11 days. If the borrower is non-responsive, these calls continue for 59 days. After day 60, a written pre-demand letter is sent via certified mailed to ensure delivery. Again, copies of these letters are not usually printed and placed in the loan file but are referenced in the chron record. If the borrower is still non-responsive the loan is sent to the Treasury Offset Group for further collection efforts.

With regard to Recommendation 1B "Ensure that sufficient staff resources are devoted to Center activities to fulfill the timely issuance of pre-demand and demand letters as required by OMB A-129 requirements," OFA believes that the informal methodology used by the OIG investigators to determine that the Centers do not have sufficient staff to comply with OMB A-129 collections requirements predisposed certain responses. Open-ended "discussions with the Director, loan officers and supervisors..." do not support the need for any given level of additional employees. Such an inquiry to the staff of any office within SBA would likely elicit a similar answer.

If you have any questions regarding this response, contact Walter Intlekofer at 205-Ex. 2

UNITED STATES SMALL BUSINESS ADMINISTRATION
COMMERCIAL LOAN SERVICING CENTER
2719 North Air-Fresno Drive, Suite 107
Fresno, California 93727-1547
559-487-5136 559-487-5803 FAX

October 27, 2004

FINAL NOTICE BEFORE REFERRAL FOR LIQUIDATION

REFERENCE: DELINQUENCY — SBA Loan #

Dear Borrower:

You have failed to respond to our previous telephone calls and letters regarding your delinquent loan. This is your final opportunity to avoid the adverse consequences of nonpayment.

Your loan will be referred to liquidation unless you immediately remit funds in the amount of $***AmountDue. You must also contact me ***within 10 days from the date of this letter*** to confirm the status of your loan. If you fail to comply with these instructions your loan will be transferred to a liquidation office.

Liquidation of your loan may include any or all of the following:

- ✓ a lawsuit against you for the full balance of the loan;
- ✓ foreclosure against real and/or personal property collateral;
- ✓ seizure of any IRS tax refunds owed to you;
- ✓ garnishment of any wages you earn;
- ✓ a lawsuit against any and all guarantors of your loan;
- ✓ report your name, Taxpayer Identification Number and other information to a database of delinquent federal debtors. Once you are in this system, you may be disqualified from obtaining any loan, loan insurance, or loan guarantee from SBA or any other federal agency;
- ✓ disclose your delinquent debt to credit reporting agencies. This may adversely affect your credit rating and hinder your ability to obtain future credit, loans, and other financing from private and public sources;
- ✓ transfer your account to the U.S. Department of the Treasury for further collection action, including referral to collection agencies and/or the U.S. Department of Justice. All fees associated with such transfer will be added to your loan balance as provided by law.

If I do not hear from you by ******10DaysDate***, your loan will be transferred to a liquidation office.

Sincerely,

***InsertSignature

Appendix B

AUDIT REPORT DISTRIBUTION

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