U. S. Small Business Administration

WYOMING LENDER ALERT

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Your Small Business Resource

Recovery Act Gives SBA Tools to Boost Small Businesses

The Administration is determined to employ the American Recovery and Reinvestment Act and the Small Business Administration to make a big dent in the small business credit crunch.

The goal for SBA is jump-starting job creation, re-starting lending, and promoting investment in small businesses.

The Recovery Act provides SBA with $375 million to temporarily eliminate loan fees and raise guarantee limits up to 90 percent on most types of 7 (a) loans. It temporarily eliminates 504 loan fees for both borrowers and lenders. SBA estimates these provisions will apply to approximately $8.7 billion in 7(a) loans and $3.6 billion in 504 loans and last through calendar year 2009.

To help small businesses compete for construction and service contracts, the Act allows SBA to more than double the amount it can offer for SBA-backed surety bonds – from a previous $2 million maximum to $5 million.

An element already in place–SBA's Microloan program–received additional funding for up to $50 million in new loans. This capital is available today for new loans of up to $35,000 and accompanying technical assistance through SBA's non-profit, community-based lenders.

In another step, the Treasury Department plan has committed up to $15 billion in TARP funds to help unfreeze small business lending by purchasing existing and new SBA-backed loans made by banks. This will free up capital for lenders to use for future lending, particularly benefiting small, community and non-bank lenders.

The Recovery Act authorizes the SBA to use its 504 program in various ways: to refinance existing loans for fixed assets in a business expansion project; to use its guarantee authority to establish a secondary market; and to make loans to broker-dealers who buy 504 loans from lenders.

Significant interest has been shown in a new program funded by the Act – tentatively called America's Recovery Capital, or "ARC" Stabilization Loans. Once in place, this temporary program funded to $255 million, will offer deferred-payment loans 100 percent guaranteed by SBA for up to $35,000 to viable small businesses that need help making up to six months' worth of payments on existing, qualifying, non-SBA backed loans.

The Act also helps to make venture capital available to smaller businesses by raising the funds SBA-licensed Small Business Investment Companies can receive if they raise small business investments by five percent.

SBA staff is working hard to implement the rest of the Recovery Act's programs. Although there are many moving parts, SBA's aim is to implement these programs quickly and effectively for as rapid an affect on small business credit markets as possible.

Let me emphasize that all of SBA's existing programs are open for business. We back new loans and provide training, technical and contracting assistance to entrepreneurs every day.

Be assured the SBA is working overtime. We know small businesses have a proven ability to create new jobs and commerce. The next phase of our economic recovery rests in their hands.

Calendar of Events

May 5	Women's Roundtable, Newcastle
May 6	Women's Roundtable, Casper
May 7	Women's Roundtable, Laramie/Jackson
May 19	Lunch & Learn, Cody
May 20	Women's Roundtable, Wheatland
May 21	Lunch & Learn, Powell
May 28	Women's roundtable, Worland

Detecting Fraud in Small Business Administration Lending programs

This Notice provides information, tips and recommendations to detect and deter fraud in the Small Business Administration (SBA) business loan programs. All District Offices and Centers are asked to forward this Notice on to lenders and Certified Development Companies in their area as lending officials are often the first line of defense in identifying and reporting fraud to the SBA Office of Inspector General (OIG).

Every year, the OIG obtains multiple convictions of borrowers and loan agents that have committed fraud in the SBA business loan programs. The OIG's concerns about potential fraud have increased in light of the recent passage of the American Recovery and Reinvestment Act, which implements new lending programs and is intended to expand significantly SBA loan volume.

Detecting and reporting fraud is in the best interest of all program participants. Fraud undermines public confidence in the public benefits of SBA lending programs, which support economic opportunity, small business growth and job creation. In addition, fraud can lead to higher program costs for borrowers and lenders, alike.

The SBA OIG would like to make you aware of fraud patterns that we continue to see in our loan fraud investigations so you can be on the lookout for such fraud. Lenders and other program participants are urged to exercise a high level of diligence if there is suspicious activity and to report suspected fraud to the OIG through the contact information at the end of this Notice.

Listed below are some of the most common types of fraud identified in SBA loan fraud investigations.

A. Loan Agent Fraud

A prospective borrower or a lender sometimes pays a loan agent (e.g., loan brokers/packagers) to prepare documentation for an SBA loan application and/or refer the borrower to a lender. Loan agents can provide a useful function in bringing borrowers and lenders together and facilitating loan transactions. However, OIG investigations during the past ten years have identified fraud schemes perpetrated by loan agents in the hundreds of millions of dollars.

When working with loan agents, we encourage lenders to consider the following potential fraud indicators:

a. The loan agent has a record of early defaults,

b. The loan agent controls all of the communication between the lender and the borrower,

c. The loan agent threatens to "shop" the loan elsewhere,

d. The loan agent provides a high number of "qualified" borrowers in a short period of time,

e. The loan agent's apparent ease in resolving seemingly difficult questions or problems with a loan,

f. The loan agent steers the lender to specific appraisers or title companies,

g. The borrower replies "no" when asked if a "packager" was paid to prepare the loan application, when it is known a loan agent is involved in the process,

h. Multiple loan applications are submitted simultaneously to different lenders for the same borrower, as indicated in credit reports, and

i. The loan agent charges excessive fees.

To protect against a potentially corrupt loan agent, lenders are encouraged to:

- Track loan agent participation in their portfolios to determine whether agents are bringing an unusually high number of loans that experience early defaults or other significant problems,
- Ask loan agents for references from officials at other lending institutions,
- Search public databases to identify problems (e.g. bankruptcies/revocation of business licenses) and check Better Business Bureau records,
- Communicate directly with borrowers about the loan and loan application, loan agent performance and fees, and
- Use a reputable appraiser and title company known to the lender (loan agent fraud has often been found to involve collusion with title and other companies).

B. Borrower Fraud

Borrowers, whether acting alone or in collusion with others, may intentionally provide false information to SBA and lending institutions during the loan application process as detailed below:

(Continued on page 3)

Every year, the OIG obtains multiple convictions of borrowers and loan agents that have committed fraud in the SBA business loan programs.

(Continued from page 2)

1. False Equity Injection

Based on OIG loan fraud investigations, false equity injection is a significant and recurring problem. False documents submitted to verify the required equity injection often include:

a. False gift letters or gift affidavits,

b. False promissory notes and standby agreements,

c. False financial statements, or

d. False bank statements and cashier checks.

Indications of fraudulent equity injection to watch out for include:

a. Gift letters and gift affidavits (investigation often proves such "gifts" to be false – either the money does not exist, or it is never paid into the business, or it is subsequently repaid to the donor),

b. Tax returns reporting income that does not seem to support the required equity injection,

c. Bank statements that upon close inspection appear to have been altered,

d. Bank account records showing a recent, unexplained, large dollar deposit into the borrower's account, and

e. Credit reports showing a poor credit history for a borrower who claims to have substantial cash.

There are many ways a borrower or loan agent may attempt to falsify the equity injection or conceal the actual source of funds. OIG investigations have often determined that the cash injected was actually borrowed, and that the related debt was not disclosed to the lender or SBA. As a reminder, lenders are expected to comply with the equity injection verification requirements contained in SBA Standard Operating Procedures (SOP) 50-10-5(A) Chapter 4, and SOP 50-51© Chapter 13. When lending officials are suspicious that equity injection verification documents may be false, it is suggested that lenders take affirmative steps to detect and deter such fraud such as the following:

- If a gift letter is involved, have both the donor and the borrower sign an affidavit detailing the alleged gift and stating that the gift does not have to be repaid or returned, and request that the borrower provide a copy of a bank statement showing the injection was made prior to disbursement,
- If funds are being transferred by wire (especially from a foreign country), request a copy of the wire transfer and include it in the loan file, and
- If an inheritance is cited, verify that the funds exist by obtaining a copy of the inheritance bank statement showing the funds exist prior to disbursement.

Once obtained, these documents should be carefully reviewed.

The OIG encourages lenders to take proactive steps in order to reduce fraud, including such measures as having borrowers sign a certification at closing detailing the equity injection requirements for the SBA loan, and specifically how they have been met, and verifying with bank records that the equity injection is actually put into the business prior to disbursement, and used by the business.

2. Other Types of Borrower Fraud

Lenders should also be aware of these significant types of borrower fraud found in OIG investigations:

a. Overstating income,

b. Understating or failing to disclose liabilities and debts,

c. Overvaluing collateral,

d. Failing to disclose criminal record,

e. Making false claims of U.S. citizenship,

f. Failing to disclose true ownership of the business,

g. Using false Social Security numbers to conceal poor credit histories,

h. Submitting altered tax returns,

i. Providing fraudulent standby agreements, and

J. Creating false work histories.

Lender Internal Controls to Deter and Detect Fraud

The vast majority of lending officials are honest, and the SBA OIG has identified very few instances of fraud by loan officers and other lender employees. However, even one corrupt lending official can damage the institution's reputation and profitability as reflected in the recent conviction of a loan officer for fraud involving approximately $85 million in SBA-guaranteed loans. Therefore, vigilance is needed to prevent fraudulent practices within the lending community. Although many lenders have undoubtedly implemented processes to identify potential fraud and improper activities, the SBA OIG recommends consideration of the following practices and internal controls to deter and detect suspicious lending activity:

Borrowers, whether acting alone or in collusion with others, may intentionally provide false information to SBA and lending institutions during the loan application process.

Recovery Act—Treatment of Cancellations of Loans Approved Prior to the Recovery Act

On March 16, 2009, SBA Policy Notice No. 5000-1097 announced changes in SBA 7(a) and 504 program fees. On the same date, SBA issued Policy Notice No. 5000-1098 to announce changes to the maximum guaranty for 7(a) loans. These fees and maximum guaranty percentages were changed by the American Recovery and Reinvestment Act of 2009 (the "Recovery Act") (P.L. 111-5) (February 17, 2009). The purpose of the Recovery Act is to stimulate new economic activity, and assist in our nation's economic recovery. The fee changes apply to 7(a) loans approved on or after February 17, 2009 and to 504 loans approved or pending approval on or after that date. The guaranty percentage changes apply to 7(a) loan applications (except SBA Express loans) received by SBA on or after March 16, 2009.

The question has arisen from the SBA lending industry as to whether an SBA loan approved before February 17, 2009, may be cancelled and resubmitted to receive the benefit of the change in fees. In addition, the question has arisen as to whether loans approved prior to March 16, 2009 (the implementation date of Section 502 of the Recovery Act), may be cancelled and resubmitted to take advantage of the increase in the maximum guarantee percentage of up to 90 percent.

In both scenarios cancellation and resubmission of the same loan would use the limited appropriations made available under the Recovery Act to provide fee relief and/or an increased guaranty on loans already approved without the need for the provisions of the Recovery Act and would be contrary to the intent of the new law to stimulate new lending.

Therefore, SBA will not permit cancelled 7(a) and 504 loans that were approved by SBA prior to February 17th to be resubmitted as reduced-fee Recovery Act loans, unless the resubmitted loan is not a replacement for the original loan, as determined by SBA on a case by case basis. Similarly, SBA will not permit cancelled 7(a) loans approved prior to March 16, 2009 (the implementation date for Section 502 of the Recovery Act) to be resubmitted as Recovery Act loans eligible for a maximum guaranty of up to 90 percent, unless the resubmitted loan is not a replacement for the original loan as determined by SBA on a case by case basis. Requests for such consideration must be submitted by the lender to the Standard 7(a) Loan Guaranty Processing Center in Citrus Heights, California. The request will be reviewed and a recommendation will be forwarded to the Director/Office of Financial Assistance for approval.

In making a case by case determination on resubmitted loans, the existence of one or more of the following factors will make it more likely that SBA will approve the request: i) the loan was cancelled for reasons other than the passage of the Recovery Act (e.g., the loan was cancelled because the location for the new business was not available; subsequently another location became available and a new loan was requested); ii) the new loan is for a different purpose (e.g., the original loan was for working capital but the new loan is for the acquisition of real estate); iii) the new loan is likely to achieve additional economic stimulus (e.g., the previous loan would have preserved jobs but the new loan will also create new jobs); or, iv) the new loan could not be made but for the provisions of the Recovery Act (e.g., the loan was cancelled because the borrower failed to meet a key provision (e.g., appraisal value) in the original loan authorization and, therefore, the lender would not make the loan now but for the higher guaranty level.) Based on past cancellation experience in SBA's loan programs, SBA expects that only a limited number of borrowers with cancelled loans will meet the criteria for a new loan with reduced fees and/or a higher guaranty.

It is possible for a lender to apply for a waiver for one part of the Recovery Act (e.g., 90 percent guaranty) without seeking a waiver for the other. In general, waivers for fee relief, simply to save the borrower the expense, will not be approved.

In addition, changes to all loans approved prior to February 17, 2009, including loan increases, will be processed as changes to the original loan in accordance with SBA's standard practice, and loan fees will be assessed under the rules in effect at the original approval date.

Finally, if limited debt refinancing is added to a project under the 504 Development Company Program as permitted by the Recovery Act, changes will be processed as amendments to the original loan and not as a new loan, in accordance with SBA's standard practice.

If you have any questions, please contact the Wyoming Small Business Administration at 307 261-6500 or email sbawyo@sba.gov.