United States Senate
COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
WASHINGTON, DC 20510–6350

June 5, 2008

Mr. Gene L. Dodaro
Acting Comptroller General of the United States
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Dodaro:

We are seriously concerned about the effectiveness of the Small Business Administration's (SBA) lender oversight activities. In 2002, the SBA began implementing its loan and lender monitoring system (L/LMS), an internal tool used by the SBA to assess the risk of 7(a) lenders and 504 Certified Development Companies. The result of those efforts was a risk rating system, designed by Dun & Bradstreet, to predict the likelihood of defaults in lenders' portfolios and identify the SBA's riskiest lenders. The system was supposed to enable the SBA to manage its loan portfolios and reduce loan defaults and losses.

As you may know, in June 2004, the Government Accountability Office (GAO) reported that the SBA's L/LMS reflected some best practices, but also indicated that the SBA had not developed an effective strategy for its use. At that time, the GAO recommended how the SBA could better use the L/LMS to develop and implement a successful oversight program. Unfortunately, since 2004, oversight difficulties have persisted in SBA lending. Recently, the SBA's Office of Inspector General (OIG) cited lender oversight and loan agent fraud as two of the nine greatest challenges facing the SBA. Separately, this month the OIG issued a report detailing how poor oversight of four lenders created a cumulative net loss of $329 million for the SBA's 7(a) loan program.

Since the SBA has utilized L/LMS for over 5 years, we request that the GAO validate the improvements, efficiencies, cost savings, and enhanced oversight outcomes the tool has created for the SBA's 7(a) and 504 loan programs. To that end, we request that the GAO evaluate the SBA's current lender oversight and loan monitoring processes and provide the Committee with answers to the following questions:

1. How reliable is the L/LMS and risk rating system at assessing and predicting the 7(a) and 504 lenders' portfolio performance?

2. How does the SBA's use of L/LMS and the risk rating system compare to the risk rating systems used by other private lenders and financial regulators which the GAO cited as industry best practices?

3. Does the L/LMS and risk rating system utilize information from the Fiscal and Transfer Agent (FTA) and Central Servicing Agent (CSA) for 7(a) and 504 loans? Given the information provided from the FTA and CSA to the SBA, what additional outcome and performance benefits are generated from the L/LMS and the risk rating system?

4. How relevant and accurate are credit scores in assessing the potential risk of the SBA's 7(a) and 504 loans that are more than $150,000? How does relying on credit scores to predict larger loans' performance impact the reliability of the SBA's "small business predictive score?"

5. What analysis has the SBA performed to ensure the predictive capability of the risk rating system? Was this analysis sufficient to accurately analyze the predictive capability of the score for all loan sizes?

6. How well does the SBA incorporate the results of L/LMS in its oversight practices, including onsite examinations of the SBA lenders and enforcement actions taken by the SBA with regard to higher risk lenders?

As part of your investigation, we encourage the GAO to meet with the SBA's OIG, the SBA's Office of Capital Access, as well as participating 7(a) and 504 lenders.

Thank you for your assistance on this matter. Please keep our staffs apprised of the GAO's progress on this request. If you have any questions, or need any additional information, please do not hesitate to call us. Your staff may contact Nick Coutsos with Senator Kerry's staff or Linda Le with Senator Snowe's staff at (202) 224-5175 on the Senate Committee on Small Business and Entrepreneurship.

Sincerely,

John F. Kerry
Chairman

Olympia J. Snowe
Ranking Member