NAGGL Gets Conferences

Catching Up on SBA's Office of the Inspector General Activities

Training & Events
Advocacy
Membership
Industry Service
Updates and Insights from the SBA’s OIG

NAGGL Conference - May 2016
Recent OIG Work

- OIG Report 15-06, issued March 12, 2015
  - Improvement is Needed in the SBA’s Oversight of Lender Service Providers

Highlights
- LSPs can provide a real and valuable service to promote 7(a) lending
  - Vast majority of LSPs and lenders want to comply with SBA requirements
- Significant growth in the service industry
  - SBA has received over 900 LSP agreements since Sept. 30, 2012 (currently at 1,700)
  - Approximately 100 different LSPs (currently at 170)
- Ability to track LSP involvement is limited and referrals require action
  - SBA can now identify LSP assistance at the loan level and evaluate performance

Impact and Takeaways
- Lender Accountability – Lender bares the risk of outsourcing functions
- Relationships in policy (limited to assistance) vs. practice
  - Lender’s need to demonstrate day-to-day control for SBA program operations
  - Lenders can’t outsource functions and solely rely on the work of LSPs
- OCRM/OIG have observed multiple violations of lender/LSP agreements

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Recent OIG Work (cont’d)

  - SBA Needs to Improve its Oversight of Loan Agents

Highlights

- Important role and types of loan agents
  - Connect borrowers with lenders
  - Loan agents include brokers, packagers, lender service providers, referral agents

- Increased risk of default and fraud
  - At least 22 cases with confirmed loan agent fraud totaling at least $335 million
  - Referred 7(a) loans defaulted at a rate 28% higher than those with no referral fee

- Loan agent fraud not exclusive to SBA

Impact and Takeaways

- Lenders should control agent relationships
  - Certain transactions, industries, demographics may require increased due diligence

- SBA efforts include:
  - Monitoring Form 159 data more closely and issuing a notice to clarify requirements
  - Impact to guaranty and lender risk rating if Form 159s not submitted

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Recent OIG Work (cont’d)

OIG High Risk 7(a) Loan Review Program

- Reports 15-09, 15-17, 16-08, 16-11
- Recommended recovery of $4.1 million on 5 loans
- Referred 3 loans to investigations due to suspicious activity

Highlights

- OIG has established a program dedicated to reviewing risky loans
  - Independent function to fill in gaps within the SBA environment on complex cases
  - Goal is to protect taxpayer dollars, highlight risks and improve SBA operations
- Targeting the highest risk loans
  - Highest risk for lender negligence and potential fraud conducted by borrowers and/or agents
- OIG developed scoring model (knowledge and statistically driven)

Impact and Takeaways

- Complete transparency between OIG and OFPO
- Focused on lender material non-compliance with SBA requirements
  - Practice due diligence on riskier transactions and support your assumptions (i.e. underwriting)
- SBA agreed with all recommendations for recovery
Case Studies
(SBA OIG High Risk 7(a) Loan Review Program)

- **Case Study 1 – Change of Ownership**
  - $1.3 million loan to finance change of ownership
  - Defaulted within 9 months with only 7 P&I payments
  - Lender used insufficient independent business valuation
    - Unreliable seller financials: No depreciation recorded for significant assets
    - Inconsistent asset values in the purchase agreement vs. lender credit memo
    - Independent business valuation noted that an appraisal of the fixed assets may result in a market value that is materially different than the book value
  - No Site Visit Conducted
    - Evidence supported that assets, majority of which were vehicles, were old at origination and in poor condition
    - Market value of assets at origination (May 2013) was $1 million vs. liquidation value of $56,000 (August 2014)
  - OIG Recommended a recovery of $299,318 from the lender
Case Studies (cont’d)
(SBA OIG High Risk 7(a) Loan Review Program)

Case Study 2 - Construction of New Business Location

- $2.7 million loan to finance leasehold improvements
- Defaulted after only making 5 interest payments
- Lender did not comply with multiple SBA construction financing requirements:
  - Lender did not obtain final plans and specifications from borrower
  - There was no evidence of a material change agreement
  - There was no evidence lender conducted pre-closing or post disbursement site inspections
  - Construction monitoring firm was not used and lender relied solely on lien waivers and borrower statements
  - Landlord financing due to cost overruns resulted in borrower/lender relinquishing control of project
- Borrower never opened for operation
- Industry publication issued shortly after OIG report reiterated SBA construction requirements
- OIG recommended recovery of $2 million from the lender
Case Studies (cont’d)
(SBA OIG High Risk 7(a) Loan Review Program)

- **Case Study 3** - Suspicious Activity on Change of Ownership
  - $800,000 loan to finance a change of ownership
  - Defaulted after only making 2 P&I payments
  - Equity injection of over $100,000 required by lender for the transaction
    - Financed by third party check dated four months prior to deposit in borrower’s account (suspicious)
    - Check appeared to be from services provided to third party client from borrower’s existing business
    - This amount accounted for 67% of borrower’s annual revenue (suspicious)
  - Referred to Investigations
    - Determined that the equity injection was returned to the third party after 7(a) loan closing
    - Active case

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Ongoing and Planned Projects

- High Risk 7(a) Loan Review Program (Ongoing)
  - Assessing and selecting new loans for examination
  - Targeting loans that indicate highest risk in the current SBA environment

- Planned Projects (and Purpose)
  - SBA’s Oversight of Secondary Market Participation
    - Average loan amounts 160% greater & default rate of 10.3% vs. 7.6% for unsold loans
    - Post-purchase review backlog of over 1,000 loans totaling over $400 million (SBA’s share)
  - Improper Payments in 7(a) Loan Guaranty Purchases Program
    - OIG continues to identify improper payments while NGPC reported less than 1% IP rate
  - SBA’s Oversight of High Risk Lenders
    - Lenders with historic issues and poor performance
  - Community Advantage Program
    - Extended thru 2020, small number of lenders make majority of loans
  - RISE Recovery Opportunity Loans (depends on activity)
    - $150,000 and 85% guaranty (Express)
    - Recapture by SBA (including OIG) is limited to 6 months from purchase
    - Congress has high level of interest in this program along with others (IDAP, PDAP, etc.)
OIG Resources and Q&A

- **Hotline**
  - (800) 767-0385

- **Audit Reports / Investigations Monthly Updates / Press Releases**

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- **Questions??**