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STATEMENT OF  
J. DEXTER PEACH  
DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION  
BEFORE THE  
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER  
HOUSE COMMITTEE ON ENERGY AND COMMERCE  
ON  
THE U.S. URANIUM ENRICHMENT SERVICES PROGRAM

Mr. Chairman and members of the Subcommittee, we appreciate this opportunity to discuss the current status of the U.S. uranium enrichment program and a number of recent DOE initiatives and proposals some of which are designed to improve the program's viability. GAO has done a number of reviews of the uranium enrichment program in recent years and over the last several months, at your request, has been examining DOE's costing, pricing, marketing and contracting practices for uranium enrichment. We recently issued reports to you covering DOE's allocation of enrichment costs and the effect of the secondary enriched uranium market on the program's sales and revenues.<sup>1</sup>

Before I discuss DOE's initiatives and proposals, it is important to set in perspective the fundamental problems which have developed over the last several years for the uranium enrichment program. These problems clearly demonstrate the need for a broad reevaluation of the purpose and structure of the U.S.

<sup>1</sup>The reports referred to are DOE's Allocation of Costs for Uranium Enrichment Services (GAO/RCED-84-64, dated Nov. 15, 1983) and Lost DOE Sales to the Secondary Enriched Uranium Market Have Resulted in Reduced Revenues (GAO/RCED-84-76, dated Jan. 26, 1984).

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uranium enrichment program. Such a reevaluation, in our opinion, will have to consider the continued viability of full cost recovery pricing in today's highly competitive enrichment market environment and the related implications for U. S. efforts to upgrade our uranium enrichment technologies and retain a substantial share of the world uranium enrichment market.

Let me briefly describe the important changes that have occurred in the uranium enrichment market and the impact of these changes on DOE's program, before commenting on DOE's initiatives and proposals.

PRICING DOE'S ENRICHMENT SERVICES  
IN A CHANGING MARKET ENVIRONMENT

Since 1969, the U.S. government has been providing services to enrich privately-owned uranium furnished by domestic and foreign utilities. At that time and for several years thereafter, our government was the only free-world provider of these services. The legislative requirement then in existence stated that prices for enrichment services should provide reasonable compensation to the government.

The term "reasonable compensation," however, was quickly challenged. During 1969-70 there was considerable congressional debate over whether the term meant the government's prices could be set to recover more than cost. The Congress, through the sponsorship of the former Joint Committee on Atomic Energy, determined that enrichment prices should not result in a profit. Thus, in 1970 the Congress enacted section 161(v) of the Atomic Energy Act of 1954 which provides that the government's prices for enrichment services shall be on the basis of recovering the

government's costs over a reasonable period of time. This is generally referred to as the program's full-cost recovery requirement.

During the 1970s, however, the United States lost its monopolistic position in uranium enrichment. Beginning in the mid-1970s, competition developed as two European consortiums and the Soviet Union began supplying foreign nuclear facilities with enriched uranium. By 1983, these suppliers had captured about 60 percent of the total foreign market. Our prior work in the nuclear nonproliferation area<sup>2</sup> indicates that the early success of these suppliers may be attributed in part to customers' interest in diversifying their sources of supply for enrichment services.

It was also during this period that prospects for the nuclear power industry in this country changed dramatically as a result of reduced consumer demand for electricity and concern over nuclear proliferation, health, and safety issues. As a result, many nuclear plants were delayed and/or cancelled. Also the nuclear programs of other nations generally have not expanded as was once anticipated.

By the late 1970's, utilities, both foreign and domestic, found themselves committed to long-term contracts for enrichment services they no longer needed. According to DOE estimates, a worldwide surplus of about 39 million separative work units currently exists which represents nearly four times DOE's total

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<sup>2</sup>Evaluation of Selected Features of U.S. Nuclear Non-Proliferation Law and Policy (EMD-81-9, dated Nov. 18, 1980).

enrichment production during fiscal year 1983. DOE expects this surplus to grow to about 45 million units by fiscal year 1988. This, in turn, has led to the emergence of a secondary market in which those utilities holding surplus inventories have been willing to sell to other utilities generally at discounted prices.

The 1980s so far have been marked by stiff price competition. During this period, DOE's prices for enrichment services, which currently range from \$138.65 to \$149.85 per separative work unit, have generally been the highest in the world. Foreign suppliers reportedly are providing comparable services at prices ranging from \$100 to \$117 per separative work unit and prices on the secondary market are even much lower with some transactions taking place at prices as low as \$90 per unit.

#### IMPACT ON DOE'S ENRICHMENT PROGRAM

This changing market environment has led to a steady deterioration of the U.S. uranium enrichment program. Since 1979 DOE has lost about \$5 billion in enrichment sales. About 70 percent of this loss was due to customers who terminated their contracts with DOE to sign contracts with foreign suppliers. Nearly 30 percent is attributable to customers who terminated in order to take advantage of discounts offered on the secondary market. Furthermore, as we pointed out in our January 26, 1984 report to you on the secondary market, it was considered quite likely that if current price discounts continue to be offered on the secondary market through fiscal year 1988, DOE could lose an additional \$3 billion in sales.

## DOE'S NEW CONTRACT

On January 18, 1984, DOE offered its existing and prospective customers a new type of enrichment contract, which it believes will enable it to stem the continual decline in its share of the worldwide enrichment market. The new contract, called the utility services contract, contains a number of provisions which differ from those currently available to DOE customers.

While we are currently examining certain of these provisions in our ongoing work, we believe one provision, a guaranteed 10-year, \$135 per separative work unit ceiling price (adjusted annually for power cost increases and inflation), could hinder DOE's ability to satisfy the program's requirement for recovering its enrichment costs over a reasonable period of time. Currently DOE's cost is substantially greater than \$135 per separative work unit and DOE has been unable to provide us with an explanation as to how the \$135 per separative work unit ceiling price will permit recovery of its costs. DOE has, however, indicated that they are pursuing operating changes and accounting modifications which will permit them to overcome anticipated shortfalls in revenue and also reduce the costs charged to the enrichment program. Certain of the key changes and our initial reactions are discussed in the next section of my testimony.

## OPERATING CHANGES

DOE anticipates a decrease in 1985 enrichment revenues of more than \$400 million from 1984. To cope with this situation, and to keep revenues and expenses reasonably in balance, DOE is

looking at several operational changes which could reduce its enrichment costs. These include:

- Reducing the production levels planned for 1985. Much of the savings from this action would result from decreased power costs which account for about 48 percent of DOE's enrichment costs. Anticipated lower demand in 1985 and an excess of enriched uranium in DOE's inventory which can be used to supply customer requirements make a reduction possible. DOE currently has more than 550 days of inventory on-hand whereas they have determined that 120 days is an ideal amount.
- Deferring all construction beyond the first two buildings of the planned eight building gas centrifuge enrichment plant now under construction in Portsmouth, Ohio, until after fiscal year 1985. This deferral reduces DOE's planned expenditures by \$236 million from the 1984 level.
- Decreasing 1985 research and development pertaining to the advanced gas centrifuge and atomic vapor laser isotope separation technologies. DOE plans to decrease such expenditures by about \$39 million from the 1984 level in part to reflect its decision to advance its selection of the new enrichment technology from 1987 to mid-1985. This initiative is designed to eliminate the costs of funding two technologies as opposed to one.

I would like to point out that while these initiatives could provide DOE with the possibility of long-term improvements in efficiency and some short-term budgetary savings, we have not fully evaluated the merits of these actions.

## ACCOUNTING MODIFICATIONS

In addition to operating changes DOE is considering several accounting modifications which would, in general, have the effect of reducing costs now recovered through enrichment prices. DOE believes that the accounting modifications allow it to stay within the contract price ceiling of \$135 per separative work unit and for the most part, still meet the program's full-cost recovery requirement. None of these accounting modifications have received final DOE approval. The accounting changes under consideration include:

- partial depreciation of the existing gaseous diffusion plants,
- devaluation of natural uranium feed costs used in support of enrichment operations,
- change in the depreciation method used for the gas centrifuge enrichment plant,
- elimination from enrichment prices demand charges for electricity under contract but not used,
- removal of imputed interest from the enrichment price, and
- allocation of maintenance expenses associated with enrichment facilities over longer periods of time.

While all the changes have a basis in accounting theory and practice, most of them would result in transferring enrichment costs currently being recovered from the enrichment customer to the government. In general most of the changes raise questions with regard to the program's full-cost recovery requirement.

An example of the proposed accounting changes best illustrates this effect. DOE is considering removing portions of the depreciation cost from consideration as an enrichment expense needed to be recovered through the enrichment price. DOE plans to reduce the government investment by 60 percent of the \$2 billion of undepreciated value in the existing enrichment plants, and thus reduce the amount of depreciation costs to be recovered through enrichment sales. DOE believes it is justified in excluding these depreciation costs because it is only obligated to recover "appropriate" depreciation amounts, and since the plants now are only producing 40 percent of their full capacity, an exclusion of 60 percent is "appropriate." Almost all of the \$2 billion of undepreciated enrichment plant value was expended over the last 10 years as part of a program to upgrade and improve the existing enrichment facilities for the benefit of commercial customers.

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In summary, the market environment in which DOE's program must operate today is considerably different from the one existing at the time full-cost recovery was established. The lower prospects for growth in the nuclear power industry coupled with foreign competition and the emergence of a secondary market for enriched uranium are all effecting the program. With prices that in the past few years have been the highest in the world, the program's competitive position has been steadily deteriorating.

To cope with this situation and stem any further deterioration in the program, DOE has taken, or plans to take a number of initiatives. While we have not fully evaluated these



initiatives, our preliminary evaluation indicates that some initiatives, such as the ceiling price under the new contract and the depreciation write-off may conflict with the program's requirement to recover full costs.

Because of the market changes and the constraints imposed by full cost recovery pricing in the current market environment, we believe that the executive branch and the Congress together will need to reexamine the fundamental purpose and structure of the uranium enrichment program. Such a reexamination must consider our nation's objective for serving the domestic and international uranium enrichment markets and provide adequate flexibility in pricing policies to allow effective competition with foreign suppliers.

Mr. Chairman, that concludes my prepared remarks. I will be happy to respond to any questions at this time.

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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY  
EXPECTED AT 10:00 A.M.  
TUESDAY, MARCH 6, 1984

STATEMENT OF  
JOHN LUKE, ASSOCIATE DIRECTOR  
RESOURCES, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE  
COMMITTEE ON SMALL BUSINESS  
UNITED STATES SENATE  
ON

THE SMALL BUSINESS ADMINISTRATION'S  
SECONDARY MARKET PROCESS



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WE WELCOME YOUR INVITATION TO DISCUSS OUR APRIL 25, 1983, REPORT (GAO/RCED-83-96) ON THE SMALL BUSINESS ADMINISTRATION'S (SBA'S) 7(a) LOAN GUARANTEE PROGRAM AND ITS ROLE IN THE FINANCIAL MARKET. WE ARE PLEASED TO SEE THAT S. 2375 COVERS SEVERAL ISSUES WHICH WERE ADDRESSED IN OUR REPORT.

OUR REVIEW SHOWED THAT A VIABLE SECONDARY MARKET IN SBA GUARANTEED LOANS BENEFITS SMALL BUSINESSES AND HAS ADVANTAGES FOR LENDERS. HOWEVER, THE FULL POTENTIAL OF THE SECONDARY MARKET PROCESS HAS NOT BEEN REALIZED PARTLY BECAUSE SOME LENDERS ARE NOT FAMILIAR WITH THE PROCESS, SOME MAKE FEW SBA LOANS, AND SOME DO NOT HAVE LIQUIDITY PROBLEMS.

WE REPORTED THAT THE SECONDARY MARKET PROCESS NEEDED IMPROVEMENTS IN A NUMBER OF AREAS TO FURTHER BENEFIT SMALL BUSINESSES. I WILL NOW SUMMARIZE THE MAJOR BENEFITS AFFORDED SMALL BUSINESSES THROUGH THE SECONDARY MARKET, THOSE AREAS WHERE WE REPORTED THAT IMPROVEMENTS COULD BE MADE, OUR RECOMMENDATIONS FOR MAKING THESE IMPROVEMENTS, SBA'S ACTIONS TO IMPLEMENT OUR RECOMMENDATIONS AND OUR COMMENTS ON S. 2375.

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## BENEFITS OF THE SECONDARY MARKET

OUR REVIEW SHOWED THAT THE SALE OF SBA-GUARANTEED LOANS IN THE SECONDARY MARKET BENEFIT SMALL BUSINESSES IN FOUR WAYS. FIRST, IT INCREASES THE LIKELIHOOD OF LENDERS WITH LIQUIDITY PROBLEMS MAKING LOANS TO SMALL BUSINESSES. NOT SURPRISINGLY, WE FOUND THAT THE ISSUE OF LIQUIDITY BECOMES INCREASINGLY IMPORTANT AS BANKS GET SMALLER. ABOUT 54 PERCENT OF SMALL BANKS USING THE SECONDARY MARKET INDICATED THAT, TO A GREAT EXTENT, LIQUIDITY WAS THE FACTOR THAT CAUSED THEM TO SELL. IN CONTRAST, ONLY 17 PERCENT OF LARGE BANKS USING THE SECONDARY MARKET INDICATED THAT, TO A GREAT EXTENT, LIQUIDITY WAS A FACTOR. THE SECONDARY MARKET ALSO OFFERS LENDERS A HEDGE AGAINST FUTURE LIQUIDITY PROBLEMS. OVER 20 PERCENT OF SMALL BANKS SAID THAT, TO A GREAT EXTENT, THEY USE THE SECONDARY MARKET FOR THIS PURPOSE.

SECOND, THE SECONDARY MARKET ENABLES LENDERS TO LEVERAGE CAPITAL AND MAKE MORE SMALL BUSINESS LOANS THAN OTHERWISE WOULD BE POSSIBLE. FOR EXAMPLE, DURING FISCAL YEARS 1979 THROUGH 1981, ABOUT \$1.5 BILLION IN SBA GUARANTEED LOANS WERE SOLD IN THE SECONDARY MARKET. AS A RESULT, WE ESTIMATED THAT ABOUT \$400 MILLION MAY HAVE BEEN RECYCLED TO SMALL BUSINESSES. THIS IS PARTICULARLY IMPORTANT BECAUSE THESE ADDITIONAL FUNDS WERE MADE AVAILABLE FROM INVESTORS, SUCH AS PENSION FUNDS AND INSURANCE COMPANIES, THAT DO NOT TYPICALLY INVEST DIRECTLY IN SMALL BUSINESSES.

THIRD, THE SECONDARY MARKET HAS THE POTENTIAL TO HELP SMALL BUSINESSES OBTAIN FIXED RATE LOANS. BECAUSE OF THE PROBLEMS THAT VARIABLE RATE LENDING CAUSES SMALL BUSINESSES DURING PERIODS OF VOLATILE INTEREST RATES, LENDERS HAVE USED THE SECONDARY MARKET TO MAKE FIXED RATE LOANS. THIS ALLOWS THE SMALL BUSINESS BORROWER TO

BUDGET FOR INTEREST EXPENSES MORE ACCURATELY. SOME LENDERS OFFER BORROWERS FIXED RATE FINANCING BY ARRANGING FORWARD PRICING COMMITMENTS WITH INVESTORS BEFORE MAKING THE LOAN TO THE SMALL BUSINESS. UNDER THIS ARRANGEMENT, THE INVESTOR AGREES TO PURCHASE THE LOAN AT A SPECIFIED RATE FOR A CERTAIN PERIOD.

FOURTH, THE SECONDARY MARKET PROCESS COULD LOWER INTEREST RATES. UNFORTUNATELY, OUR REVIEW DISCLOSED THAT THIS POTENTIAL BENEFIT HAS NOT OCCURRED TO ANY GREAT EXTENT DUE PRIMARILY TO A LACK OF SBA CONTROLS OVER BANK PROFITABILITY ON SECONDARY MARKET SALES. I WILL DISCUSS THIS POINT LATER ON IN MY STATEMENT.

WITH THESE BENEFITS IN MIND, I WILL NOW BRIEFLY COMMENT ON THOSE AREAS WHERE OUR REVIEW SHOWED THAT THE SECONDARY MARKET PROCESS COULD BE IMPROVED.

ADMINISTRATIVE PROBLEMS  
AND INVESTOR CONCERNS  
WITH THE SECONDARY MARKET

WE REPORTED THAT SBA DID NOT HAVE SPECIFIC GOALS AND OBJECTIVES FOR THE SECONDARY MARKET PROCESS NOR WERE CLEAR LINES OF AUTHORITY AND RESPONSIBILITY FOR ITS OVERSIGHT ESTABLISHED. THIS CAUSED CONFUSION OVER WHO WAS RESPONSIBLE FOR DIFFERENT ADMINISTRATIVE FUNCTIONS AND WHAT THE SECONDARY MARKET PROCESS CAN AND SHOULD ACCOMPLISH.

WE ALSO REPORTED THAT SBA WAS USING A MANUAL SYSTEM TO RECORD AND ACCOUNT FOR SECONDARY MARKET TRANSACTIONS. WE FOUND THAT THE REPORTING ACCURACY OF LOANS SOLD VARIED WIDELY AMONG SBA FIELD OFFICES AND IN AGGREGATE UNDERSTATED ACTUAL SALES BY ABOUT 20 PERCENT. MORE IMPORTANTLY, HOWEVER, WAS OUR FINDING THAT THE

FORMAT USED TO REPORT SECONDARY MARKET TRANSACTIONS CONTAINED ONLY LIMITED INFORMATION AND GENERALLY WAS NOT USED FOR MANAGEMENT OVERSIGHT.

WE FOUND THAT INVESTORS WERE ENCOUNTERING PROBLEMS WITH THEIR SBA LOANS THAT HURT THE REPUTATION OF THESE LOANS IN THE SECONDARY MARKET AND CAUSED SOME INVESTORS TO RECONSIDER PURCHASING ADDITIONAL LOANS. WE REPORTED THAT THE MOST SIGNIFICANT INVESTOR PROBLEM WAS RECONCILING PAYMENT DIFFERENCES BETWEEN THEIR RECORDS AND THOSE OF SBA'S FISCAL TRANSFER AGENT WHICH HANDLES ABOUT 50 PERCENT OF ALL SBA SECONDARY MARKET TRANSACTIONS. RECONCILIATION PROBLEMS WERE CAUSED PRIMARILY BY THE LACK OF A UNIFORM METHOD FOR COMPUTING INTEREST AND BECAUSE THE FISCAL TRANSFER AGENT HAD NO AUTHORITY TO GUARANTEE THE TIMELY PAYMENT OF INTEREST AND PRINCIPAL IN THE EVENT BANKS FAILED TO MAKE COMPLETE OR TIMELY PAYMENTS TO THEM. A SMALL BUSINESS COMMITTEE ON CAPITAL ACCESS, ASSEMBLED IN THE SUMMER OF 1982 UNDER THE DIRECTION OF THE SBA ADMINISTRATOR, STUDIED THE CONCERNS OF INVESTORS AND MADE SEVERAL RECOMMENDATIONS THAT, IF PROPERLY IMPLEMENTED, SHOULD ADDRESS MOST INVESTOR PROBLEMS.

SECONDARY MARKET'S EFFECT ON  
SMALL BUSINESS BORROWING COSTS

SBA EXPECTED THAT, OVER TIME, USE OF THE SECONDARY MARKET WOULD RESULT IN LOWER BORROWING COSTS TO SMALL BUSINESSES. HOWEVER, OUR COMPARISON OF INTEREST RATES ON LOANS SOLD IN THE SECONDARY MARKET WITH THOSE NOT SOLD SHOWED NO SIGNIFICANT OVERALL DIFFERENCE IN THESE RATES.

ALTHOUGH SOME LENDERS HAVE USED THE PROCESS TO OFFER BORROWERS LOWER INTEREST RATES, OTHERS HAVE USED THE SECONDARY

MARKET TO SIGNIFICANTLY INCREASE THEIR YIELDS. YIELDS INCREASE BECAUSE INVESTORS ACCEPT A LESSER RATE OF INTEREST THAN THE BANK CHARGES THE BORROWER. THIS DIFFERENCE IS CALLED A SERVICING FEE. DEPENDING ON THE CIRCUMSTANCES OF THE SALE, YIELDS CAN BE VERY HIGH. FOR EXAMPLE, WE FOUND A SITUATION WHERE A BANK MADE A \$100,000 LOAN WITH A 90-PERCENT GUARANTEE. IN SELLING THE GUARANTEED PORTION OF THE LOAN, THE BANK RECEIVED ALMOST \$2,000 OVER THE FACE AMOUNT OF THE GUARANTEE (KNOWN AS A PREMIUM) AND A 3.3-PERCENT SERVICING FEE. THIS PREMIUM TOGETHER WITH THE SERVICING FEE TRANSLATED TO ABOUT A 60-PERCENT RETURN TO THE BANK DURING THE FIRST YEAR OF THE LOAN.

OUR CONVERSATIONS WITH BANK OFFICIALS DISCLOSED THAT THE AMOUNT OF LOAN SERVICING DONE VARIES FROM NEXT TO NOTHING TO DETAILED INVOLVEMENT WITH THE BORROWER. FURTHER, THE SERVICING FEE GENERALLY DOES NOT RELATE TO THE ACTUAL AMOUNT OF SERVICING DONE AND IN MOST CASES, IT IS SIMPLY THE DIFFERENCE BETWEEN THE INTEREST RATE CHARGED THE BORROWER AND THE RATE AT WHICH THE LOAN IS SOLD IN THE SECONDARY MARKET.

WE REPORTED THAT NO LIMITATION EXISTED ON THE AMOUNT OF SERVICING FEES THAT LENDERS CAN CHARGE ON SBA LOANS SOLD IN THE SECONDARY MARKET. OUR ANALYSIS OF OVER 3,000 LOANS SOLD IN THE SECONDARY MARKET DURING FISCAL YEARS 1979 THROUGH 1981 SHOWED WIDE VARIATIONS IN THE SERVICE FEES BEING CHARGED.

#### OUR RECOMMENDATIONS AND SBA ACTIONS

WE RECOMMENDED THAT THE SBA ADMINISTRATOR TAKE A NUMBER OF ACTIONS TO MAKE THE SECONDARY MARKET MORE EFFECTIVE IN HELPING SMALL BUSINESSES. SPECIFICALLY, WE REPORTED THAT THE SBA ADMINISTRATOR SHOULD:

- ESTABLISH CLEAR GOALS AND OBJECTIVES FOR THE SECONDARY MARKET AND CLARIFY STAFF RESPONSIBILITIES FOR OVERSEEING THEIR IMPLEMENTATION.
- DEVELOP IMPROVED RECORDKEEPING CONTROLS OF SECONDARY MARKET TRANSACTIONS, INCLUDING SERVICE FEES AND PRICES PAID BY INVESTORS, AND DECIDE WHETHER THIS COULD BEST BE ACCOMPLISHED INTERNALLY OR BY USING THE SERVICES OF THE FISCAL TRANSFER AGENT.
- DEVELOP A STRATEGY FOR USING THE SECONDARY MARKET TO OFFER SMALL BUSINESSES FIXED RATE FINANCING. THE STRATEGY SHOULD CONSIDER THE USE OF LOAN POOLING.
- IMPLEMENT THE CAPITAL ACCESS COMMITTEE'S RECOMMENDATION THAT LENDERS STIPULATE THEIR METHODS OF ACCRUING INTEREST AND CONTINUE TO REMIT FUNDS ON THIS BASIS.
- IMPLEMENT THE CAPITAL ACCESS COMMITTEE'S RECOMMENDATION TO REQUIRE THE FISCAL TRANSFER AGENT TO REMIT INTEREST TO THE INVESTOR ON A 30/360 BASIS, IF SBA HAS SUCH AUTHORITY.
- REQUEST THE FISCAL TRANSFER AGENT TO PROPOSE HOW IT COULD FUNCTION AS A CENTRAL PAYING AGENT AND DECIDE WHETHER THIS PROPOSAL OR REQUESTING LENDERS TO REMIT PRINCIPAL AND INTEREST ON A TIMELY BASIS IS MORE PREFERABLE.
- TEST THE FEASIBILITY OF CONTROLLING SERVICING FEES BASED ON SPECIFIC LOAN CHARACTERISTICS, SHOULD THE ADMINISTRATOR DECIDE TO CONTROL SERVICING FEES.

SBA BASICALLY AGREED WITH OUR RECOMMENDATIONS AND CORRECTIVE ACTIONS ARE EITHER PLANNED OR UNDERWAY. HOWEVER, SOME OF THESE ACTIONS WILL NOT FULLY RESOLVE THE PROBLEMS CITED IN OUR REPORT. FOR INSTANCE, SBA IS NEGOTIATING WITH THE FISCAL TRANSFER AGENT FOR MORE DETAILED REPORTING ON SECONDARY MARKET TRANSACTIONS. HOWEVER, ABOUT 50 PERCENT OF SECONDARY MARKET SALES ARE HANDLED WITHOUT THE FISCAL TRANSFER AGENT. ACCORDINGLY, REPORTING PROBLEMS ARE LIKELY TO PERSIST AS SECONDARY MARKET TRANSACTIONS WILL BE RECORDED UNDER DUAL REPORTING SYSTEMS WITHOUT THE NECESSARY ASSURANCES OF UNIFORMITY. SBA HAS ALSO PROPOSED LIMITING SERVICING FEES TO 3 PERCENT TO LOWER SMALL BUSINESS INTEREST RATES. HOWEVER, AS LONG AS LENDERS ARE PERMITTED TO CHARGE INVESTORS PREMIUMS, THE BENEFIT OF CONTROLLING SERVICING FEES CAN BE CIRCUMVENTED.

GAO VIEWS ON S. 2375

I WOULD LIKE TO CONCLUDE MY STATEMENT BY COMMENTING ON SEVERAL PROVISIONS OF S. 2375, WHICH PROPOSES CHANGES TO THE SECONDARY MARKET. FIRST, THE BILL PROVIDES FOR THE POOLING OF SBA LOANS. OUR REPORT RECOMMENDED THAT LOAN POOLING BE CONSIDERED AS A MEANS OF OFFERING SMALL BUSINESSES THE OPTION OF FIXED RATE FINANCING. THE POOLING PROCESS SHOULD BE FACILITATED THROUGH THE BILL'S PROVISION THAT GUARANTEES INVESTORS THE TIMELY PAYMENT OF PRINCIPAL AND INTEREST.

SECOND, THE BILL REQUIRES THAT SBA DEVELOP PROCEDURES FOR THE ADMINISTRATION AND PROMOTION OF SECONDARY MARKET OPERATIONS. WE ALSO RECOMMENDED THIS. WE HOPE THAT CLEAR GOALS AND OBJECTIVES AND CLARIFIED STAFF RESPONSIBILITIES WILL BE PART OF THESE PROCEDURES.

LASTLY, THE BILL REQUIRES SBA TO PROVIDE FOR A CENTRAL REGISTRY FOR ALL LOANS SOLD IN THE SECONDARY MARKET. THE ESTABLISHMENT OF A CENTRAL REGISTRY IS CONSISTENT WITH OUR RECOMMENDATION FOR IMPROVING RECORDKEEPING CONTROLS OVER SECONDARY MARKET TRANSACTIONS.

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MR. CHAIRMAN, THIS CONCLUDES MY PREPARED STATEMENT. WE WILL BE GLAD TO RESPOND TO ANY QUESTIONS.



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