~~23388~~ 121581

BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Administrator Small Business Administration

SBA's Certified Lenders Program Falls Short Of Expectations

The Small Business Administration established the Certified Lenders Program to speed up loan approval decisions by relying more on private sector lenders to evaluate the creditworthiness of small business applicants. However, SBA remains responsible for the final credit approval.

The program has fallen short of expectations. Lenders frequently submit incomplete loan packages causing disruptions to processing time. They also frequently perform incomplete or inaccurate credit analyses.

GAO calls for terminating the Certified Lenders Program in its current form and recommends changes to SBA that will help protect SBA's interest in its loan guarantees.

UNITED STATES GENERAL ACCOUNTING OFFICE

GAO/RCED-83-99
JUNE 7, 1983

025821

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

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

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

B-211842

The Honorable James C. Sanders
Administrator
Small Business Administration

Dear Mr. Sanders:

This report evaluates the effectiveness of the Small Business Administration's (SBA's) Certified Lenders Program. We did this review to assess this aspect of SBA's overall effort to streamline its loan delivery system and maximize the role of its private sector lending partners.

The report contains recommendations to you on pages 29, 30, and 34. As you know, 31 U.S.C. § 720 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

In addition to the above committees, we are sending copies of this report to the Chairmen of the House and Senate Committees on Small Business.

Sincerely yours,

J. Dexter Peach
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE ADMINISTRATOR
SMALL BUSINESS ADMINISTRATION

SBA's CERTIFIED LENDERS PROGRAM FALLS SHORT OF EXPECTATIONS

DIGEST

The Small Business Administration (SBA) is not achieving the goals of the Certified Lenders Program (CLP). SBA expected CLP to provide borrowers with faster credit decisions by relying on the credit analyses of participating private sector lenders. CLP was also supposed to conserve personnel resources. However, GAO found that:

--Lenders often submitted incomplete loan application packages that contributed to substantial processing delays. (See pp. 7 to 9.)

--Lenders frequently prepared inaccurate or unreliable credit analyses, forcing SBA to perform its own analyses. (See pp. 10 to 16.)

--When SBA made faster decisions on CLP applications, it was primarily due to priority processing rather than a reduced involvement on SBA's part or better use of lender expertise. (See pp. 16 and 17.)

--SBA had not realized any material resource savings as a result of CLP. (See pp. 17 and 18.)

In addition to CLP, SBA started pilot testing a Preferred Lenders Program in March 1983. Under this program selected lenders will not only do credit analyses but will also make the final approval decision on a loan guaranty, without sending application packages to SBA. (See p. 3.)

GAO initiated this review to assess how well lenders are carrying out their CLP responsibilities and in turn providing SBA with the opportunities to achieve some personnel time savings. A further objective was to determine whether SBA's experience under CLP warranted further delegation of authority to lenders under the Preferred Lenders Program.

GAO/RCED-83-99
JUNE 7, 1983

INCOMPLETE SUBMISSIONS

SBA experienced frequent processing delays with CLP applications because lenders submit incomplete loan application packages. The information missing from these packages is mainly the type that SBA needs to make its credit or eligibility determinations. Consequently, SBA delays the processing of these incomplete loan applications until it can obtain the required information. (See pp. 7 to 10.)

GAO's review of 172 CLP loan guaranty approvals showed that SBA processes most application packages within a 3-day period. However, 50, or 29 percent, were delayed in processing an average of 9 working days. GAO found that 39 of these cases were delayed due to missing information. SBA lending officials were uncertain why lenders frequently submit incomplete loan packages. However, some SBA officials blame the high turnover rate of lender personnel. (See pp. 8 and 9.)

GAO found that about 81 percent of the missing items were of a critical nature in terms of reaching a loan approval/denial decision. The remaining 19 percent were not essential to such a decision. (See p. 10.)

DEFICIENT LENDER CREDIT ANALYSES

In addition to the missing information problem, in many instances CLP lenders submit inaccurate, improper, or incomplete credit analyses. Consequently, SBA frequently performs a more intensive review or analysis than was envisioned under the CLP concept.

GAO's review of 172 randomly selected CLP approvals disclosed that in more than half of the cases, lenders either did not prepare or inaccurately prepared important elements of the credit analyses. (See pp. 13 and 14.) SBA lending personnel generally attribute the poor analyses to (1) high turnover rate of trained loan officers, (2) a lack of incentive on the part of certified lenders due to limited risk exposure under the SBA guaranty, (3) a lack of adequate financial training, and (4) the fact that SBA loans require a more rigorous analysis than non-SBA loans because they generally have longer maturities.

PROCESSING TIME

SBA has reported that on the average it has achieved its CLP goal of arriving at an approval/denial decision in 3 days or less. However, these reported figures do not account for delays created by incomplete loan applications. For these applications, SBA stops the processing clock until it receives the information needed to continue processing. (See p. 16.)

GAO found that SBA generally processed complete loan packages in 3 days. However, this quick turnaround is primarily attributable to priority processing rather than a decrease in SBA's work. Once a loan package is complete, it generally only takes a specialist 4 hours or less to perform a credit analysis. Loan specialists at five of the six district offices GAO visited agreed that priority processing is the primary reason that SBA achieves its 3-day CLP processing goal. (See pp. 16 and 17.)

PERSONNEL SAVINGS HAVE BEEN LIMITED

GAO was unable to identify any significant SBA personnel savings resulting from a heavier reliance on credit analyses by CLP lenders. This lack of personnel savings can be attributed to several factors. The chief ones are (1) that the potential for personnel savings is limited since a credit analysis of a loan application package once it is complete generally takes about 2 hours longer than a credit review and (2) in most instances SBA has not even been able to realize this limited potential, since it has not been able to rely on lenders' credit analyses. (See pp. 17 and 18.)

RECOMMENDATIONS TO THE SBA ADMINISTRATOR

GAO recommends that the Administrator, SBA, terminate CLP as it presently exists because participating lenders have not merited the priority processing afforded them due to incomplete submissions and inadequate credit analyses. Additionally, SBA loan specialists should retain responsibility for performing a thorough credit analysis to include verifying all elements of a lender's analysis to ensure that loan applications meet SBA's loan quality standards.

In place of CLP, GAO recommends that the Administrator, SBA, should develop a modified program to provide expedited loan processing to all SBA lenders who merit it through adherence to application packaging requirements. As part of this modified program, SBA should:

--Develop lender guidance in the form of a comprehensive checklist that will facilitate the assembly of complete and well analyzed loan packages by all lenders.

--Apply preliminary screening procedures to all applications that would identify loan packages that are complete enough to qualify for expedited processing by SBA. (See pp. 29 and 30.)

Additionally, GAO believes that SBA's credit analysis is a worthwhile and inexpensive investment of time that assures loan quality. In view of this and lenders' poor performance under CLP, GAO recommends that the Administrator, SBA, terminate further consideration of the Preferred Lenders Program. GAO is aware that SBA is pilot testing the Preferred Lenders Program on a limited basis. However, unless this test surfaces compelling evidence that the program would be viable on an expanded basis and the problems identified in this report can be resolved, GAO recommends that SBA not give any further consideration to the program. (See p. 34.)

SBA COMMENTS AND GAO'S EVALUATION

Although SBA recognized that CLP has problems it completely disagreed with the report's conclusions and proposed corrective actions regarding CLP and the Preferred Lenders Program. SBA stated that CLP has contributed to a decrease in loan processing time and has resulted in material personnel savings. SBA also stated that CLP has resulted in better SBA/lender relations and has increased awareness of SBA in the small business community. In view of these perceived benefits, SBA stated that it would attempt to correct the problems cited by GAO rather than terminate CLP. Additionally, SBA did not accept GAO's proposal to terminate further consideration of the Preferred Lenders Program because it believes that the program could reduce its field offices' workload.

GAO continues to believe that its conclusions and proposed actions are valid and appropriate. Regarding SBA's position that CLP has reduced loan processing time, GAO recognizes that sometimes relatively faster SBA processing has been achieved under CLP. However, it is important to note that SBA's reported processing figures do not reflect the many processing delays encountered with incomplete CLP packages, because SBA generally does not count the time needed to obtain missing information. Additionally, to the extent that SBA was able to achieve somewhat faster processing on CLP packages, GAO found it was more attributable to the priority attention given them rather than a reduced amount of effort by SBA lending personnel.

SBA did not provide any data to support its belief that CLP has achieved material personnel savings. Information gathered by GAO shows that to date the savings have been minimal. Furthermore, the report points out that the potential for any such savings is very limited.

Given CLP's shortcomings, GAO believes that an SBA credit analysis is an inexpensive and worthwhile investment of time, particularly since SBA can guarantee up to $500,000 on a single loan.

SBA's belief that CLP has improved lender/SBA relations and has increased the small business community's awareness of the agency may be true to some extent, although SBA did not provide any information to indicate this is a widespread benefit. During the course of GAO field work, neither SBA nor lender personnel cited these benefits.

SBA's comments and GAO's evaluation of them are included at the end of the appropriate chapters. A complete set of SBA's comments is included as appendix III.

Contents

ABBREVIATIONS

CLP	Certified Lenders Program
GAO	General Accounting Office
SBA	Small Business Administration

CHAPTER 1

INTRODUCTION

The Small Business Administration's (SBA's) principal financial assistance program is the 7(a) Business Loan Program. Through this program, SBA either makes loans directly to small businesses or provides up to a 90-percent guaranty on loans made by private lending institutions. In recent years the program has emphasized guaranteed loans. SBA is authorized to guarantee 7(a) loans up to $500,000 for small businesses that are unable to obtain financing at reasonable terms without the SBA guaranty.

Due largely to current economic conditions, SBA has experienced a sharp decline in the number of 7(a) loans it has guaranteed. During fiscal year 1981 SBA reported that it approved 22,288 7(a) loan guarantees with a Government guarantee share of $2.8 billion. In fiscal year 1982 the agency reported 12,016 approvals with an SBA guarantee share of $1.5 billion. This represents about a 46-percent decrease both in the number and dollar value of loans.

The 7(a) guaranty loan delivery system consists of three principal parties--SBA, the small business borrower, and the private lender. The private lender, generally a commercial bank, plays the central role in the loan delivery system. Many recipients of 7(a) loans have no direct contact with SBA. Borrowers generally learn about their eligibility from their lenders. Borrowers also submit their applications to, receive the loan funds from, and make payments to their lenders.

CERTIFIED LENDERS PROGRAM

SBA established the Certified Lenders Program (CLP) in February 1979 to provide more timely credit decisions for borrowers using SBA's certified banks' services. Under this program, SBA expected to provide faster credit decisions by relying on the certified lender to determine a prospective borrower's creditworthiness. This procedure differs from standard processing that places the credit analysis function with SBA.

CLP guidelines call for the certified lender to determine that the loan application package is complete and to perform a credit analysis. According to SBA, a credit analysis should address, at a minimum, the following:

--A balance sheet and ratio analysis.

--An analysis of repayment ability.

--An assessment of the applicant's management skill.

--An opinion regarding collateral, including an analysis of collateral adequacy.

--A comment on the lender's credit experience with the applicant.

--A schedule of insurance requirements, standby agreements and other requirements.

After completing the credit analysis, the lender submits the completed package, including the desired loan terms and conditions, to the appropriate SBA district office. SBA's goal is to review the lender's credit analysis and decide on the application within 3 working days. SBA's promise of a faster loan decision is a primary incentive for lenders to participate in the program. SBA selected lenders for program participation on the basis of:

--Past and present SBA loan volume.

--"Loss rate," or the number of unsuccessful SBA loans.

--SBA's overall relationship with the lender.

SBA initially certifies lenders for a 2-year period. At the end of this period, they are considered for recertification/decertification, depending on their past performance. In 1982, SBA reviewed 226 lenders for recertification and recertified 41 lenders for a full 2-year period. The agency granted only 1-year recertifications to another 150 lenders that did not fully meet all established criteria. Another 33 lenders were decertified because their performance records were insufficient to warrant continued program participation. Additionally, SBA lost two participants--one due to its merger with another CLP lender, and the other removed itself from any SBA participation status.

CLP, formerly the Bank Certification Program, began as a 7-month pilot program with 29 participating lenders. During the pilot, SBA reported that it met the 3-day goal for SBA review and loan approval on 77 percent of the loan applications and reached decisions within 5 days for 95 percent of the cases. Following an in-house evaluation at the end of the pilot, SBA decided to expand the program. As of June 1980, SBA had certified 251 lenders, and as of December 1982, it had approximately 488 certified lenders.

CLP is one of SBA's major initiatives to streamline the loan delivery system. SBA plans to eventually decrease its role in delivering guaranteed financial assistance by increasing the lending institutions' role. This would be accomplished by delegating to participating lenders the authority to make, service, modify, or liquidate loans and determine eligibility.

SBA began the pilot certification program within the limits of its existing statutory authority. SBA's legislation charged it with reviewing and approving all credit and other eligibility decisions before guaranteeing a loan already approved by a lending institution. In addition, SBA had to initiate collection action in the event of a default. Public Law 96-302, approved July 2, 1980, permits SBA to transfer more loan making and administration authority to participating lenders. This legislation was enacted partly on the basis of SBA's reported success of CLP. Under the act, the SBA Administrator

> "* * *may authorize participating lending institutions, in his discretion pursuant to regulations promulgated by him, to take such actions on his behalf, including, but not limited to, the determination of eligibility and creditworthiness and loan monitoring, collection and liquidation."

In January 1981 SBA formally proposed its Preferred Lenders Program. Under this proposal, SBA would designate its best and most reliable lending partners as preferred lenders. These lenders would be CLP graduates and would make many of the final decisions regarding loan processing, administration, and liquidation. Regarding the loan approval function, the preferred lender would be responsible for all decisions relating to eligibility, size, creditworthiness, and loan closing with no final review by SBA. The agency started pilot testing the Preferred Lenders Program with six lenders on March 1, 1983. Lenders submitting loan applications under this program will be limited to a 75-percent SBA guaranty rather than the usual 90 percent.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our overall review objectives were to

--determine the extent to which SBA is achieving its goal of processing CLP loans in 3 days or less,

--examine the quality of loan packages CLP lenders submit,

--examine SBA's basis for establishing and subsequently expanding CLP, and

--assess whether SBA's experience under CLP warrants the agency moving forward with the Preferred Lenders Program.

We relied primarily on case file reviews at six SBA district offices to determine how frequently SBA was achieving its 3-day turnaround goal and to assess the quality of lender submissions. To insure consistency in our case file reviews, we documented numerous pieces of information pertaining to lenders' credit analyses on a structured data collection instrument. This information was then entered into a computer and analyzed in various ways.

We drew our samples from CLP approvals made during the first 6 months of fiscal year 1982. We chose this period because we wanted to assess recent program experience. The following table shows the 7(a) loan volume for the 6-month period.

District office	Number of CLP approvals	Total number of 7(a) approvals	Percent of 7(a) loan approvals processed through CLP
Philadelphia, Pa.	22	87	25
Pittsburgh, Pa.	30	44	68
Boston, Mass.	58	145	40
Hartford, Conn.	30	87	34
Atlanta, Ga.	46	168	27
Nashville, Tenn.	32	84	38

Since loan volume dropped substantially in fiscal year 1982, we also reviewed a sample of fiscal year 1981 cases in the Philadelphia district office. We felt this sample would indicate how the program operates during periods of higher loan volume. For more specifics on our sampling methodology see appendix I.

To assess SBA's justification for establishing and periodically expanding the program, we interviewed SBA central office officials responsible for CLP. We asked these officials to comment on the success of the program as well as current program goals. We also reviewed various agency documents regarding this issue. These documents included the pilot program evaluation as well as program status reports and memoranda.

Regarding the issue of whether the Preferred Lenders Program should proceed as proposed, we supplemented our case file reviews with opinions from SBA officials and certified lender representatives. We discussed this subject and lender receptiveness of the proposed program with certified lender personnel.

We did our case file reviews and our SBA district office and certified lender interviews in SBA's Boston, Hartford, Philadelphia, Pittsburgh, Atlanta, and Nashville district offices. We selected these offices because they were amongst the highest volume CLP offices during the first quarter of fiscal year 1982. Additionally, the Chief of SBA's Financial Institutions Branch, which oversees CLP, told us that he believed the program was operating most effectively in States that permit branch banking. He said that branch banking States have fewer banks making SBA loans and therefore have more experience in preparing and reviewing SBA loan packages. All States we visited permit branch banking.

Our review was done in accordance with generally accepted government auditing standards.

PREVIOUS REPORT

In 1980, as part of a broader review, we obtained some preliminary information on CLP.[1] Because the program was relatively new, we did not attempt to do a comprehensive evaluation of its effectiveness. The review was directed primarily at obtaining and assessing the views of non-Federal participants in the 7(a) loan program--small businesses which seek the loans and the lending institutions. The objective was to identify disincentives that might discourage small businesses from using and lending institutions from participating in the 7(a) guaranty loan program.

1/"SBA's Pilot Programs to Improve Guaranty Loan Procedures Need Further Development" (CED-81-25, Feb. 2, 1981).

CHAPTER 2

CLP ACCOMPLISHMENTS HAVE BEEN LIMITED

CLP is not meeting SBA's expectations. The program was founded on the premise of placing greater reliance on the credit analysis capabilities of SBA's private sector lending partners. Shifting the analytical burden was intended to reduce SBA's involvement, thereby achieving faster processing and freeing SBA personnel for other duties. However, lender performance has been inconsistent and often unreliable with respect to (1) furnishing necessary information for timely processing and (2) performing the thorough and accurate credit analyses needed to ensure quality loan making. As a result, timely processing has been disrupted primarily because SBA loan specialists must acquire missing information from lenders and, contrary to CLP objectives, spend time reanalyzing loan applications.

Rapid SBA processing has sometimes been achieved under CLP, but not through increased use of lender resources as planned. SBA simply gives priority to CLP loans, sometimes at the expense of timely approval of regularly processed loans.

In addition, SBA's procedures for measuring and reporting CLP's performance give a false impression of almost universal program success. These procedures stress the importance of SBA's internal performance in achieving processing time goals without (1) measuring lending partners' effectiveness or (2) reporting the deficient aspects of their performance.

Throughout CLP's evolution, SBA has not recognized the primary cause of processing delays--inadequate loan documentation--and mistakenly focused on a secondary problem--credit analysis time. As a result, SBA's plan to shift the credit analysis responsibility to lenders overestimated the prospects for accelerating loan processing and CLP's potential for conserving personnel resources. SBA did not establish any qualitative criteria against which to measure lender performance in the way of complete and well-analyzed loan packages, and it did not quantify what it expected in the way of personnel savings. SBA's evaluation of its CLP pilot program similarly did not identify the limitations inherent in the program's concept.

CLP LENDERS ARE NOT FULFILLING THEIR LOAN PACKAGING AND ANALYTICAL RESPONSIBILITIES

SBA has often been unable to place the increased reliance on participating lenders contemplated by CLP. Loan application packages are often incomplete when submitted by lenders, preventing SBA from providing borrowers with expedited processing. Furthermore, insufficient and inaccurate lender credit analyses have often forced SBA to perform its own analyses.

Many loan applications submitted under CLP have experienced processing difficulties. During the first half of fiscal year 1982, only 59.4 percent of the CLP applications were approved as submitted to the six district offices without decline, delay, or conversion to standard 7(a) or another type of loan processing.

The following table illustrates the disposition of the applications submitted to the six district offices during the first half of fiscal year 1982.

Application disposition	Number of applications	Percent of total
Approved as submitted	161	59.4
Approved as CLP, but delayed:		
Withdrawn from processing by SBA, later approved	49	18.1
Initially declined, later resubmitted and approved	6	2.2
Approved as other than CLP:		
Converted to another type of processing	16	5.9
Not approved:		
Declined or ineligible	14	5.2
Withdrawn by lender	15	5.5
In withdrawn status as of 3-31-82	10	3.7
Total	271	100.0

Additionally, SBA found it appropriate to modify lenders' proposed loan terms or conditions such as amount, guaranty percentage, and maturity. We found modifications to almost one-third (33.1 percent) of the 172 sample CLP loans we examined. (See p. 32.)

Incomplete loan application packages

Processing delays have been due primarily to incomplete loan application packages. These packages principally lacked information SBA needed to reach a loan approval decision--for example, current financial statements and appraisals. We found that SBA encountered delays on 29 percent of our sample of 172 CLP applications approved under the program by the six district offices. The balance were processed without being removed from the processing cycle.

Incidence of Processing Delays
10-1-81 through 3-31-82

District office	Cases reviewed	Number of applications delayed	Percent of total	Average delay	Range Low	Range High
				(---work	days---)	
Philadelphia	22	15	68.2	13	2	90
Pittsburgh	30	5	16.7	10	3	18
Atlanta	30	1	3.3	2	2	2
Nashville	30	11	36.7	8	2	23
Boston	30	5	16.7	5	4	7
Hartford	30	13	43.3	7	2	22
Total	172	50	29.1	a/ 9	2	90

a/This 9-day delay is the actual average delay for all 50 loans that were delayed in processing.

The Atlanta district office's performance under CLP differs favorably from the other five districts we reviewed with respect to the frequency of processing delays experienced. In explanation Atlanta's Assistant District Director for Finance and Investment told us that CLP loan packages were sometimes submitted incomplete, but CLP lenders, because of their proximity to the district office and their rapport with SBA loan specialists, usually have been successful in providing missing information in a timely enough fashion to permit SBA to process CLP loans within a 3-day timeframe.

Of our 172 sample loans, 50 experienced processing delays. Of these delays 39 were due to missing information. See the following chart.

Reasons for delay	Applications delayed in processing	Percent of total
Missing information	23	46
Multiple reasons including missing information	16	32
Reasons unrelated to missing information	11	22
Total withdrawn	50	100

Missing information was the reason for delays in processing for 78 percent of the loan applications. SBA loan processing personnel confirmed this situation during our discussions. Some of them believed that lender personnel experience a high turnover rate and are consequently unfamiliar with or inattentive to SBA requirements.

CLP loan documentation requirements are specified in "The Information Book for the SBA Bank Certification Program" furnished to participating lenders and on the application forms themselves. However, the requirements are not summarized in their entirety in the form of a comprehensive checklist that might facilitate the assembly of a loan application package.

We were able to classify most of the information missing from loan applications delayed in processing into three broad categories.

--Information needed to reach eligibility or credit decisions.

--Documentation required by law or Executive Order.

--Information not essential to an approval decision but required under the 7(a) program or CLP.

The 39 delayed applications involved 125 items of missing information. SBA needed most of the missing items to reach a loan approval decision, as shown below.

Nature of missing information	Number of missing items	Percent of total
Decision-critical information	101	80.8
Information not critical to a loan approval decision	24	19.2
Total	125	100.0

Each of the 39 delayed applications involved at least one item of information needed to reach an approval decision, indicating that SBA was not arbitrarily delaying processing for insignificant reasons. Examples of decision-critical information include such items as financial statements, appraisals of borrower collateral for securing the loans, tax returns, and credit reports. Unessential items for an approval decision include items such as unsigned financial exhibits.

Inadequate lender credit analyses

A premise of CLP was that responsibility for credit analyses would be shifted from SBA to participating lenders, thereby eliminating duplicative SBA analyses and conserving SBA loan processing personnel resources. However, lenders frequently do not fulfill their analytical responsibilities, necessitating in many instances, an intensive review or analysis by SBA personnel. As a result, SBA has been unable to disengage itself from the credit analysis function to the extent originally envisioned under CLP.

SBA guidance to CLP lenders--the information book for CLP and the "Lenders Application for Guaranty or Participation" (SBA Form 4-I)--sets forth the parameters of the credit analyses lenders must perform. This guidance identifies certain elements that must be addressed, basic methodology to be used, and the specific ratio analyses to be performed. The reverse side of the lender application contains a suggested, but not mandatory, format for lender use. (See app. II.)

In essence, lenders are to address the borrower's

--repayment ability--by analyzing borrowers' past and projected future earnings and fixed obligations;

--current position--by examining borrowers' post-disbursement liquidity positions through a working capital and current ratio analysis;

--equity position--by comparing borrowers' postdisbursement debt position to their investment in the business through a debt to net worth ratio analysis;

--collateral securing the loan--by determining a value for the property pledged considering a current appraisal and prior liens on the collateral items;

--credit experience--by examining borrowers' credit history with the lender and obtaining credit reports;

--management skills--by commenting on borrowers' skills, evidencing their ability to manage the business; and

--insurance requirements--by determining flood, life, and hazard insurance requirements.

These are the same basic elements of analysis that SBA loan specialists normally address as part of their credit analysis of a regularly processed non-CLP 7(a) loan.

The primary vehicle for carrying out much of the credit analysis is the financial "spread" analysis described on the reverse side of the SBA Form 4-I. In essence, the spread analysis is based on the borrower's current balance sheet position and incorporates adjustments reflecting the borrower's assumption of the SBA loan obligation and the use of loan proceeds. Other adjustments reflecting changes in the borrower's debt and equity positions related to the loan are also incorporated into the spread analysis. The spread, thus reflecting the borrower's postdisbursement position, is used as the basis for the financial ratio analyses of the borrower's current and debt-to-equity positions.

To permit analysis of repayment ability, the spread analysis must also include the borrower's recent historical earnings experience, if any, and projected earnings and fixed obligations. Lenders are directed to comment on the results of their analyses on the application itself or an attachment.

Lenders' credit analyses are frequently deficient

CLP lenders credit analyses are often deficient with respect to important financial analyses--the financial spread analysis and the current and debt to net worth ratio analyses. On our 172 sample loans, we examined lenders' credit analyses contained on the Form 4-I and attachments to ascertain whether the required spread analyses and associated financial ratios (1) had been made, (2) had been done on a postdisbursement basis, and (3) were accurately calculated based on borrowers' supporting financial information and reflected proper adjustments as a result of the loan transaction. We found that these analyses were usually either

--not performed;

--not properly performed on a postdisbursement basis, as SBA guidance requires; or

--inaccurately performed, as shown below.

	Not performed	Improperly performed	Inaccurate	Total poorly analyzed
	- - - - - - - - -	(percent)	- - - - - - - - -	
Financial spread analysis	10.5	5.8	32.6	48.9
Current ratio analysis	26.7	19.8	16.3	62.8
Debt to net worth analysis	21.5	20.3	19.2	61.0

These elements are integral parts of the credit analysis to be made on each loan. Our analysis of lender performance in these areas clearly supports the contentions of many SBA loan specialists regarding CLP lenders' deficient credit analyses.

Lenders also did not properly evaluate collateral in many instances. SBA guidance directs that lenders make or obtain an appraisal of the collateral backing each loan and then comment on the lender's lien position and adequacy of the collateral as security. Lenders, however, often do not put a value on the collateral to be pledged or provide the required comments. The following table summarizes the frequency of deficiencies we noted in lenders' collateral analyses for our 172 sample loans.

Nature of deficiencies	Percent of sample cases
Collateral value not established	40.7
Lien position not discussed	16.8
No comment as to adequacy	37.8

SBA's policy states that inadequate collateral is not by itself a sufficient cause to decline a loan. Nevertheless, thorough analysis is necessary to fully protect the interests of the lending partners. Collateral is a primary means of loan repayment in case of default and has assumed increasing importance in today's unstable economy in which loan defaults are sharply increasing.

We found that lenders' analyses, in many instances, do not lend themselves to SBA's credit review because they do not clearly state conclusions. Without a clearly stated conclusion, these analyses are incomplete and of limited assistance to SBA loan specialists in formulating a credit decision. As a result, the loan specialists may be forced to perform an independent analysis, contrary to CLP's intent.

SBA guidance calls for comments on key elements of the credit analysis. Lenders, however, often inadequately address these elements by offering only inconclusive information and comments, while stopping short of drawing conclusions concerning reasonableness or adequacy.

We examined lenders' conclusions concerning key elements of their credit analyses for the 172 loans in our sample. The following table illustrates that lenders frequently did not provide supported conclusive comments for SBA's review.

Elements of analysis	Percent of sample cases in which lenders did not provide clear-cut or well-supported conclusions
Balance sheet and ratio analysis:	
Debt to net worth ratio	48.8
Current ratio	50.6
Repayment ability, including earnings projections (note a)	18.6
Collateral adequacy	37.8
Management skill	8.7
Credit experience	18.6

a/SBA specifically requires lenders' commentary on the reasonableness of borrowers' earnings projections--an essential component of repayment ability.

Lenders' frequent omission of clear-cut or well-supported conclusions concerning key elements of their analyses often leaves the SBA analyst with little choice but to analyze a loan package in depth in order to formulate a credit recommendation. The following examples of lender analyses regarding repayment ability contrast a well-supported conclusion from our sample with one that is of little value to SBA.

Informative conclusion

"[Borrower] projects total volume in the first year at $165,000 or an average of $13,791 per month. This dollar volume would equate to approximately 71 full time equivalent enrollment. He anticipates net income of $47,847 on that basis. We believe there is a strong likelihood that this enrollment level will be achieved by September (assuming construction is complete).

"Our breakeven point analysis indicates that enrollment can be as low as 51 full time equivalent in order for the operation to breakeven and be able to pay this debt (at interest rate of 20%). In other words there is a 28% margin for error, and we are comfortable that this level is achieveable."

Uninformative conclusion

"As long as projection figures are valid business should be able to pay loan."

SBA does not regularly call lenders attention to the shortcomings of their analyses by returning them for correction. Rather, in the interest of expediting loan processing, SBA generally performs the analysis necessary to compensate for lenders' deficiencies.

SBA loan specialists often do more than a credit review

CLP's basic premise of shifting the credit analysis responsibility to participating lenders anticipates a lesser degree of analytical involvement on SBA loan specialists' part. However, SBA loan specialists often perform credit analyses rather than the less intensive credit reviews called for under CLP.

In practice SBA district offices differ with respect to their involvement in the credit analysis function, and their willingness to rely on lenders' analyses. District practices vary from performing credit analyses, much like those done on non-CLP 7(a) loans (in the Philadelphia district office), to doing a more superficial review closely approximating that contemplated by CLP (in the Pittsburgh district office). In some districts, such as Atlanta and Boston, the depth of SBA review or analysis depends on the quality of the analysis the lender performed.

Differences in district office credit analysis practices can best be illustrated by the frequency with which they independently performed balance sheet and ratio analyses--tasks required to be performed by CLP lenders and relied upon by SBA in arriving at a credit decision--on the 172 loans in our samples.

District office	Financial spread analysis performed	Current ratio analysis performed	Debt to net worth analysis performed
	(------percent of total	cases	-------)
Philadelphia	90.9	86.4	100.0
Pittsburgh	10.0	0.0	0.0
Atlanta	63.3	50.0	70.0
Nashville	36.7	33.3	36.7
Boston	20.0	26.7	40.0
Hartford	56.7	50.0	73.3

We found that SBA was regularly doing a credit analysis of its own in the Philadelphia district and frequently doing such analyses in the Hartford, Atlanta, and Nashville districts. The Boston district also made credit analyses fairly frequently. Only the Pittsburgh district regularly complies with the CLP credit review requirement and rarely performs a credit analysis.

The Philadelphia district, for all practical purposes makes the same credit analysis on its CLP loans as it does on its regularly processed 7(a) loans. Philadelphia loan processing personnel cited the following reasons for their variance from the CLP concept:

--Lenders credit analyses are not up to CLP standards and cannot be relied upon.

--Loan specialists' CLP credit analyses responsibilities are clouded by conflicting instructions.

--Little difference exists in practice between a "review" and an "analysis"--both require examinations of the complete package to ensure an accurate analysis.

--The difference in time required to perform a review or an analysis is not significant.

In contrast, the Pittsburgh district performs a credit review and relys more heavily on CLP lenders' analyses. A credit analysis is not performed by Pittsburgh loan specialists unless lenders' analyses are obviously faulty. Interestingly, the Pittsburgh loan specialist expressed reservations concerning the quality of CLP lenders' credit analyses even though the Pittsburgh district adheres to CLP principles.

Loan specialists in other districts also expressed doubts about the quality of lenders' credit analyses. Consequently, some of these loan specialists are also reluctant to rely on lenders' analyses and regularly do their own credit analyses.

In general, SBA is performing a more intensive credit analysis on CLP loans than called for under the program because loan specialists do not believe they can rely heavily on lender analyses. SBA loan specialists perform credit analyses of their own to compensate for lenders' inadequacies and to ensure quality loan making. According to loan specialists, SBA credit analyses require little extra time and are a good, inexpensive investment of SBA resources to protect the Government's interest.

LOAN PROCESSING TIME IS SOMETIMES IMPROVED--BUT NOT IN THE MANNER ENVISIONED

SBA has periodically reported an overall loan turnaround time of better than the 3-day goal for CLP. However, we found that these reported figures do not include the processing delays encountered with incomplete application packages. SBA's procedures almost insure that this 3-day or less turnaround time will be reported regardless of what is happening in the program. Specifically, SBA's standard operating procedures state that when a preliminary screening of a CLP package indicates that it cannot be processed in 3 days, the SBA loan specialists should convert the application to standard 7(a) processing or temporarily withdraw it from CLP processing. In the latter situation, the clock stops running until the package is complete and generally processible within the 3-day period.

As we pointed out previously, 50 applications in our sample of 172 CLP approvals were delayed in the processing cycle. (See p. 8.) These loans, which SBA withdrew from the processing cycle, experienced an average processing delay of 9 days.

Those CLP packages that SBA does not withdraw from processing are generally processed within 3 days. However, this overall faster processing time seems to be largely due to the priority attention afforded them (CLP loans are processed before other types) rather than a shifting of the credit analysis function to the lender. We found that once a loan package is complete, an SBA loan specialist requires only a minimum amount of time to perform a credit analysis. SBA lending officials in five of the six district offices we visited agree that priority processing is the primary factor contributing to a 3-day or less turnaround on CLP packages. Lending officials estimate that it takes them the following amount of direct time to review or analyze applications once loan packages are complete.

	CLP	Non-CLP
Atlanta	2 hrs.	4 hrs.
Nashville	2 hrs.	4 hrs.
Philadelphia	4 hrs.	4 hrs.
Pittsburgh	2 hrs.	6 hrs.
Boston	1/2 hr.	1-1/2 hrs.
Hartford	2 hrs.	2+ hrs.

Based on the above estimates, with the exception of Philadelphia, it takes only about 2 hours longer to do a credit analysis on non-CLP applications versus a credit review on CLP applications. Philadelphia estimates the same average amount of processing time for both types of packages as long as they are complete. This equivalent processing time results from the fact that Philadelphia loan specialists perform a complete credit analysis on all loan applications regardless of whether they are CLP or non-CLP. Although Philadelphia does this complete credit analysis on CLP applications, it nevertheless meets the 3-day turnaround goal because it gives them priority attention.

PERSONNEL SAVINGS HAVE BEEN LIMITED

Although SBA never quantified its expectations for personnel time savings under CLP, at the time of our review it did not appear that CLP had resulted in any significant processing time savings for SBA loan specialists. Nevertheless, we recognize that any savings is a plus.

SBA has been able to shift some loan specialists to functions other than loan processing. This action, however, seems largely attributable to a substantial decrease in loan volume. The two factors inhibiting achievement of substantial SBA time savings under CLP are the limited potential for such savings and the fact that loan specialists often need to reanalyze lenders' credit analyses.

CLP's limited potential for achieving substantial time savings for SBA loan specialists results from the fact that loan specialists spend much of their time performing duties other than direct loan processing. A Philadelphia district office study shows that its loan specialists spend less than 40 percent of their time on the direct processing of loans. Another factor that limits CLP's potential for achieving significant time savings is the relatively small amount of time it takes to do a credit analysis. Using the credit analysis time estimates from this page and the loan approval volume at the six district offices we visited, we found that the potential for time savings is very limited. During the first 6 months of fiscal year 1982, the six district offices approved a total of 615 7(a) loans. If every loan had been subjected to an SBA credit analysis, it would have required little more than one staff year of effort.

Assuming that a credit review takes half as much effort as a credit analysis, the potential credit analysis time savings for 6 months at the six district offices would have been one-half staff year if all loans were processed through CLP. However, to the extent that some loan specialists perform their own analyses, SBA's realization of even this limited potential is diminished. We found that the Philadelphia, Hartford, Atlanta, and Nashville districts perform a considerable amount of documented independent reanalysis.

CLP's LIMITED SUCCESS CAN BE ATTRIBUTED TO CONCEPTUAL WEAKNESSES AND UNSUCCESSFUL TRAINING

SBA created CLP on the premise that it could rely on the credit knowledge of participating lenders. However, we found that lenders' non-SBA loan portfolio has significantly different characteristics than SBA loans, particularly in terms of loan maturity and loan amount. Consequently, lenders do not routinely make the type of credit analyses required on SBA loans, and this may account in part for the inadequate analyses submitted to SBA. Additionally, SBA's training and guidance to lenders has not resulted in quality loan packages. Although SBA conducted a pilot program and evaluated it, the evaluation did not address this problem specifically nor did it address as major problems the related weaknesses with CLP, such as the poor quality of lender submissions and the limited potential for SBA personnel savings.

Lender credit analysis experience is not consistent with SBA's requirements

We found that the characteristics of SBA loans differ from lenders' non-SBA loan portfolio. These different characteristics indicate that non-SBA loans do not require as extensive credit analyses as SBA guaranteed loans. For example, SBA loans tend to have a much longer maturity than non-SBA small business loans, thus requiring repayment projections further into the future. As part of another GAO review,[1] we found that only 2 percent of lenders' SBA loans have a maturity of less than 1 year, whereas 52 percent of lenders' non-SBA small business loans have a maturity of less than 1 year. On the other hand, 74 percent of lenders' SBA loans have a maturity of

1/"SBA's 7(a) Loan Guarantee Program: An Assessment of Its Role in the Financial Market" (GAO/RCED-83-96, April 25, 1983).

6 or more years, whereas only 15 percent of their non-SBA small business loans fall into this category.

Another characteristic that indicates that SBA loan applications may require a more extensive credit analysis than non-SBA small business loans is the fact that they are for larger amounts. In the same GAO review referred to above, we found that the average SBA loan is more than 100 percent larger than the average non-SBA small business loan--$118,000 compared with $58,000. Finally, we found that a large number of SBA loans are either for new business starts or the purchase of existing businesses. In these cases, the credit analyses would have to rely mostly on forecasting rather than on the historical track records of the businesses. In our sample of 172 CLP approvals, we found that 60 loans were for new business starts and 25 were for the purchase of existing businesses.

SBA's pilot program and its evaluation

SBA's pilot program and its subsequent internal evaluation did not surface the above-mentioned conceptual flaw with CLP nor did it assess the quality of lender submissions and the overall potential for resource savings. The primary input to the evaluation were comments solicited from the 29 pilot lenders and the 27 SBA field offices that participated in the pilot program. Lender comments on the pilot were generally positive, with overall agreement that the program should not only be continued, but expanded. For the most part, lenders felt that CLP had provided them with the ability to service borrowers with an immediate capital need.

SBA field offices' comments varied. Most of the field offices expressed the opinion that the program should be expanded. However, several offices did refer to the problem of incomplete packages, and several offices attributed the faster CLP processing to priority attention. For example, one of the moderately active offices stated that it encountered some problems with loan documentation and that it did not believe the program actually shortened loan processing time. Another office also stated that it did not believe the program cut down on its loan officers' processing time.

SBA's guidance and training have not resulted in quality submissions by lenders

SBA conducts formal training sessions for lenders when they become certified. Some of the district offices we visited provide informal training as well as formal guidance. Also, SBA provides a CLP handbook to certified lenders that addresses many of the application requirements under the program. Despite this training and guidance, certified lenders continue to submit incomplete and inaccurately analyzed loan application packages. SBA has provided relatively little guidance to its loan specialists, particularly with respect to what constitutes a credit review. Consequently, the district offices have not been consistent in their implementation of the program.

SBA loan personnel attribute the poor lender performance to several factors. Lending personnel at all six district offices we visited consider trained loan officer turnover at the certified lenders to be a problem. Other causes mentioned by lending officials included:

1. A lack of incentive on the part of certified lenders since they generally obtain a 90-percent loan guaranty from SBA.

2. A lack of financial training and education on the part of CLP loan officers.

3. The fact that CLP analytical requirements are not consistent with the type of credit analyses lenders perform on their non-SBA small business loan portfolio.

In addition to the above observations, we found that all application requirements are not laid out in one place. The requirements are either contained on the borrower and lender application forms or in the CLP instruction book. The types of information we found missing from application packages were listed as requirements in these documents. However, we believe that including all application requirements in one place may facilitate the preparation of more complete and better analyzed loan packages by all lenders. This document, or checklist, could incorporate the requirements listed on the borrower's application form as well as the items addressed in the lender's application form. It could also emphasize or elaborate on some of the weaker credit analysis areas that we have identified. For example, on page 12, we show that in a number of instances lenders did not prepare the financial spread analysis or certain financial ratios on the basis that the loan had been disbursed. A comprehensive checklist could emphasize that this procedure should be used.

Regarding the amount of guidance provided to SBA loan specialists, we found that it is limited and has resulted in inconsistent implementation of CLP. Because SBA has not defined the difference between a credit review and a credit analysis, the amount of SBA-documented analysis on CLP packages varies among the district offices.

The lack of program guidance was the primary issue addressed in a report on a preliminary review of CLP issued by

SBA's Office of Inspector General.2/ This report points to the fact that the handbook used by certified lenders implies that SBA's credit review involves less work than an analysis. However, it does not otherwise tell specifically what limited efforts are needed in doing a credit review. The report goes on to point out that in 1980 SBA provided some additional guidance to its personnel in the form of standard operating procedures. However, this guidance provided few additional specifics on the difference between a credit review and a credit analysis. It only states that the SBA loan officer's credit decision will be based on a review of the lender's credit analysis and only when the lender's analysis contains an obvious error or contradictory statement is the loan officer expected to conduct a credit analysis.

In view of this finding, the Office of Internal Audit recommended that SBA develop procedures that specifically define for SBA loan officers what a credit review is to consist of and how it is to be used in expediting the processing of CLP applications. Officials from the Office of Associate Administrator for Finance and Investment concurred with the recommendation and stated that procedures for SBA loan specialists as well as participating lenders would be developed and included in the CLP handbook that is currently being revised.

CONCLUSIONS

CLP has fallen short of SBA's expectations. Also, SBA's reported successful operation of the program has not identified a number of program weaknesses.

Lender performance under CLP has not frequently met SBA's standards and requirements for ensuring loan quality. CLP lenders often submit incomplete loan application packages or their submissions contain inaccurate and/or insufficient credit analyses. In the former situation, SBA frequently must withdraw applications from processing for a number of days and await the missing information before it can proceed with the loan decision process. In the second situation, SBA generally proceeds with processing, but in effect must perform an independent credit analysis in order to assess loan quality.

During SBA's program planning and expansion phases, SBA did not address unsatisfactory lender performance and the resulting processing delays. Consequently, the program was directed at the wrong problem. It focused on reducing SBA's direct credit analysis time as a means of achieving a quicker decision on CLP applications. It should have focused on the real problem--

---

2/"Report of Internal Audit on Preliminary Review of Certified Lenders Program" (Audit Report No. 4-82, Aug. 4, 1982).

incomplete loan packages. SBA's reporting on program operations also has not addressed these weaknesses. As a result, SBA has inflated the program's success and has not taken corrective actions regarding poor lender performance.

Although SBA has provided training to certified lenders, it has not resulted in quality loan application submissions. SBA's written guidance appears to address most of the loan application requirements. However, they are not presented in one document in the form of a comprehensive checklist. The existing written guidance spells out what components of a credit analysis it wants the lenders to address. However, it does not include the specific mechanics of performing a credit analysis.

CLP may produce an unwanted side effect, particularly during periods of higher loan volume. Since CLP priority processing is the primary reason for a quicker approval/denial decision, CLP may unfairly delay the applications of borrowers who unknowingly select a nonparticipating lender.

SBA COMMENTS AND OUR EVALUATION

SBA commented extensively on this chapter. Although SBA recognized that CLP has some problems, the agency opposed our conclusions and proposals for the program and requested that we consider a number of points in finalizing the report. SBA's comments are summarized below by subject area along with our evaluation of them.

Incomplete loan packages and inadequate lender analyses

SBA concurred that not all loan packages are complete and that some lenders submit inaccurate and unreliable credit analyses. However, based upon its field offices' comments, SBA concluded that CLP loan packages are more complete and more accurate than non-CLP packages.

Our report does not address the issue of whether CLP application packages are of higher quality than non-CLP packages. Rather, our intent was to assess whether CLP packages were complete and accurate enough to justify SBA reliance on credit reviews rather than credit analyses. We believe the report clearly demonstrates on pages 7 to 14 that the completeness and accuracy of CLP packages falls far short of SBA's requirements. Also, a comparison between CLP and non-CLP applications is not valid since SBA does not place the same packaging and credit analysis requirements on non-CLP applications as it does on CLP packages. For example, SBA does not require lenders to perform credit analyses on non-CLP applications.

Regarding processing delays that were caused primarily by incomplete loan packages, SBA stated that our use of a 9-day average delay is somewhat misleading in that Philadelphia's 13-day average delay skews the data. Additionally, SBA commented that our statement that only 59.4 percent of the CLP applications were approved as submitted is not a proper portrayal. Rather, SBA stated that 79.7 percent of CLP submissions were approved as such by SBA--59.4 percent had no changes; 18.1 percent with some delay; and 2.2 percent after SBA's reconsideration.

We disagree that our statistics are misleading. The table on page 8 of the report clearly shows the makeup of the 9-day average processing delay by district office and by number of loans. Even if the Philadelphia district were entirely eliminated from this computation, the actual average processing delay for the remaining five districts would be over 7 days, or more than double SBA's goal for processing CLP packages. As to SBA's second point, we must also disagree. The table on page 7 clearly shows the disposition of all CLP submissions during the first 6 months of fiscal year 1982. We believe it would be inappropriate and misleading to combine the categories of "approved as submitted" and "approved as CLP, but delayed," as suggested by SBA.

Processing time

SBA stated that it did not concur with the finding that CLP does not decrease processing time. The agency maintained that average processing time had decreased since the implementation of CLP and consequently small business is being served better and more quickly. SBA also questioned our methodology for determining processing time on a CLP loan application versus a non-CLP application. The agency stated that our asking those employees whose job is most likely to be negatively affected by a successful CLP is somewhat naive.

Regarding SBA's first point, page 6 of the report does recognize that relatively rapid SBA processing has sometimes been achieved under CLP. However, it is important to note that SBA's reported processing figures do not account for the many processing delays encountered with CLP packages, nor do they reflect the extent to which faster processing is the result of priority attention rather than a reduced amount of work for SBA loan personnel. As we concluded on page 22 of the report, the higher priority afforded CLP packages may, during periods of higher loan volume, unfairly delay the applications of borrowers who unknowingly select a nonparticipating lender.

In response to SBA's criticism of our methodology for determining average processing time, we must point out that none of the lending officials we contacted in the six district offices expressed any concern that CLP would result in a loss of their jobs. Also, program documents do not indicate that the program will result in staff reductions. On the contrary, they state that CLP should free up SBA resources to do intensive servicing of troubled loans, more lender relations efforts, more advocacy efforts, and more outreach work.

On a matter related to processing time, SBA did not concur with our finding that the agency had not achieved material resource savings as a result of CLP. SBA stated that CLP not only saves time in the loan processing department, but also in the loan servicing and liquidation departments. SBA contended that CLP lenders are more likely to perform servicing actions and liquidations, with less SBA assistance, than are non-CLP lenders.

Regarding resource savings in the loan processing department, we believe pages 17 and 18 of the report demonstrate that not only have savings been limited, but the potential for resource savings is minimal. Throughout its comments on our report, SBA took the position that it wanted to step up its training efforts in an attempt to correct the problems identified in the report. However, SBA did not appear to recognize that a major training effort, along with a planned monitoring effort, may not only cancel out any limited resource savings, but could possibly outweigh such savings. It is important to keep in mind that a credit analysis generally takes only a couple of hours longer than a credit review. With regard to SBA's contention that CLP has achieved resource savings in the loan servicing and liquidation departments, the agency did not provide us with any data to support this belief. Additionally, program documents regarding CLP only emphasize the goal of resource savings within the loan approval processing function.

Comments on our proposals

SBA disagreed with and commented on each of the five proposals in this chapter. SBA's comments on each of our proposals and our evaluation of them follows.

Terminate CLP as it presently exists

Our draft report proposed that SBA terminate CLP as it presently exists because participating lenders have not merited the priority processing afforded them due to incomplete submissions and inadequate credit analyses. SBA's position is that this proposal cannot be accepted because SBA personnel levels are decreasing and the agency's program responsibilities are not decreasing in the same proportion. SBA also stated that it did not find this proposal to be fully supportable or substantiated.

We recognize that limited staff can be a problem. However, we believe that this report demonstrates that CLP is not the appropriate means for solving this problem. We show that the potential for resource savings from CLP is very limited because it is directed at the wrong problem--credit analysis time. To the extent that SBA loan specialists have had to exert effort in obtaining additional information for loan packages and correct deficient credit analyses, realization of this limited potential has been further diminished.

In view of our finding that an SBA credit analysis is not a time-consuming function, coupled with the fact that lenders have not met SBA's requirements, we continue to maintain that SBA's credit analysis is a worthwhile and inexpensive investment of time in the interest of assuring loan quality. SBA loan specialists estimate that it takes only about 2 hours longer to do a credit analysis versus a credit review. This additional investment of time apears minimal considering that SBA guarantees up to $500,000 on its 7(a) loans and often carries 90 percent of the risk should a borrower default.

Based on a reassessment of our survey data, which included information from 172 random case files at six district offices, we believe this proposal is entirely supportable and substantiated. SBA did not provide any data that disputed the facts leading up to this proposal.

<u>Provide expedited processing to all lenders that adhere to SBA's packaging requirements</u>

Our draft report suggested that SBA develop a modified program to provide expedited loan processing to all SBA lenders who merit it through adherence to application packaging requirements. SBA disagreed with this suggestion. SBA stated that with its available personnel it would be physically impossible to provide personal guidance to all of its 11,000 participating lenders. However, the agency did say it plans to do a better job of communicating its application requirements to CLP lenders.

Our suggestion says nothing about providing personal training or guidance. Rather, it states that all SBA lenders that adhere to SBA's loan packaging requirements should receive priority processing on their loan applications.

SBA seemingly misinterpreted the report by saying it suggests that the agency should do a better job of communicating application requirements to certified lenders. What the report does propose is that SBA provide better written guidance on its application requirements to all of its participating lenders, and not just a select number.

Develop lender guidance

Our draft report proposed that SBA develop lender guidance in the form of a comprehensive checklist that would facilitate the assembly of complete and well analyzed loan packages by all lenders. SBA also disagreed with this proposal. It stated that the SBA Form 4-I provides a list of the items on which the lender is required to comment and that a checklist would be a redundant document and would not teach the lenders to do a proper credit analysis.

We fully agree that SBA's Form 4-I provides a list of the items on which the lender is required to comment. However, it does not contain a checklist of items to be included in a complete loan package, nor does it elaborate on what it expects from the lender in the way of a credit analysis. (See app. II.) For example, it does not include items required of the borrower such as current financial statements and collateral appraisals. These items often were missing from application packages we reviewed.

Establish loan application screening procedures

Our draft report suggested that SBA establish screening procedures to identify loan packages that are complete enough to qualify for expedited processing. Regarding this suggestion, SBA stated that all field offices are supposed to have screening procedures in place already. The agency stated that the present CLP process had a screening aspect and that our report describes it.

We recognize that the CLP process has screening procedures in place. Our proposal is directed at applying this immediate screening process to all loan applications, and we have clarified this point in the wording of our final recommendation. We have also reformatted this chapter's final recommendations to emphasize that our proposals are premised on the termination of CLP in its present form.

Require SBA loan specialists to retain credit analysis responsibility

Our draft report proposed that SBA require SBA loan specialists to retain responsibility for performing a thorough credit analysis, verifying all elements of a lender's analysis to ensure that loan applications meet SBA's loan quality standards. SBA strongly opposed this suggestion. It stated that the agency's current goal is to delegate more of the loan processing activity to the lenders. SBA felt that with proper training lenders would provide credit analyses that are suitable for a credit review by SBA personnel. SBA said it has already directed its field offices to begin returning incomplete and improperly analyzed loan packages to CLP lenders.

We disagree with SBA's position for several reasons. First, the potential for SBA resource savings from CLP is limited since a thorough credit analysis does not require an extensive amount of an SBA loan specialist's time. Secondly, to the extent that lenders' loan officer turnover is a problem, SBA would have to establish and maintain a continuous training effort. As we noted earlier in this evaluation of SBA's comments, such a training effort may not only cancel out SBA's limited resource savings, but could conceivably outweigh any such savings. Bearing these two points in mind, along with the extent of deficient lender performance identified by this report, we conclude that the added cost of SBA credit analyses constitute a worthwhile investment of SBA resources to ensure loan quality.

Other SBA comments

SBA asked that we consider several other points in finalizing this report. The agency's first point was that the report did not make any mention of its CLP recertification/decertification process. Under this process SBA reviews each certified lender's performance every 2 years and decides whether to recertify the lender for a full 2 years, for 1 year, or decertify the lender. During a 1982 review of 226 CLP lenders, SBA decertified 33 lenders and recertified 150 lenders for only 1 year. SBA also stated that it planned to place greater emphasis on quality lending practices and less emphasis on loan volume in future recertifications.

We did not discuss the recertification process in the report because it is essentially a revalidation of the original certification process using similar criteria. We have however, in response to SBA's comment, added mention of the 2-year recertification process in the introduction chapter. We would certainly endorse SBA's plan to emphasize quality in the recertification process if we believed CLP were a viable program. However, as we previously pointed out, we believe the report demonstrates that CLP has very limited potential and that SBA's credit analysis on its guaranteed loans is an inexpensive, worthwhile investment of time.

In its comments SBA mentioned the importance of CLP lenders to its lending programs. For example, it stated that these fewer than 500 lenders represent less than 5 percent of their lending partners but do approximately 35 percent of all their guaranty lending. SBA also pointed out that approximately 20 percent of their more recent guaranty loan approvals were accounted for by the CLP process.

We did not question that CLP lenders are SBA's most active lending partners. Since high loan volume is one of the criteria for obtaining certification, these statistics are not surprising. SBA's comments implied that in the absence of CLP, the agency would be ignoring the importance of its most active lending partners. We disagree that this would be the case. Certainly, we endorse a strong lender relations program that promotes cooperation between SBA and its lending partners. Specifically, our proposal to provide expedited processing to <u>any</u> lenders that adhere to SBA's loan packaging requirements should foster a positive relationship between SBA and its lending partners that submit the most complete packages.

Another point raised by SBA is that the problems identified in our report may be partially attributable to the SBA offices not being firm enough or clear enough in their instructions to the lenders. The agency stated that this was a correctable problem.

We recognize that to some extent these problems are correctable, particularly the incomplete packaging problem. However, to the extent that lenders experience loan officer turnover, SBA would have to establish a continuous training effort on credit analysis preparation that would diminish the realization of CLP's limited potential. Lending personnel at all six district offices we visited attribute turnover of trained lending personnel as contributing to CLP's problems.

SBA also commented on the statement in the report that our work was done in branch banking States. It stated that we may wish to clarify this, in that not all of these States have statewide branching.

Our report does not say that we did our work in statewide branching States. The report states that we did our work in States that permit branch banking--and that is an accurate statement. Recognizing that States have varying degrees of branch banking, the States we visited had a considerable number of branches.

SBA stated that our criticism that it needs to make a clearer distinction between a credit review and a credit analysis is well taken and that the agency will take corrective action. Although we do make the point that SBA had not made this distinction for its loan specialists, we are not proposing that they do so. In view of the fact that we are recommending termination of CLP, such a proposal would be inappropriate.

SBA took exception to our statement that no quantifiable goals were established against which to measure the program's success with respect to lender performance or SBA personnel savings. The agency stated that the CLP does have quantifiable criteria for certification, recertification, and decertification. SBA gave examples such as loan purchase rates, loss rates, and volume.

SBA may have misunderstood the point we are making with this statement. What we are saying is that the agency never quantified what it expected to achieve in the way of personnel savings nor did it establish qualitative criteria against which to measure lender performance with respect to complete and well-analyzed loan packages. Had SBA done so, the problems identified in this report may have surfaced at an earlier stage. We have clarified what we mean by this point on page 6 of the report.

SBA also stated that CLP has resulted in better SBA/lender relations and has increased the small business community's awareness of SBA. While this may be true to some extent, SBA did not provide any information to indicate this is a widespread benefit. Additionally, during the course of our field work, these benefits were never cited by SBA or lender personnel.

Finally, SBA stated that CLP is fully consistent with the Administration's desire to leverage government resources by shifting some of the authority/responsibility of program operations to the private sector. It is not our intention to be critical of the leveraging concept. However, in view of our findings regarding CLP, we believe we have demonstrated that this program cannot effectively contribute to the leveraging objective.

RECOMMENDATIONS

We recommend that the Administrator, SBA, terminate CLP as it presently exists because participating lenders have not merited the priority processing afforded them due to incomplete submissions and inadequate credit analyses. Additionally, SBA loan specialists should retain responsibility for performing a thorough credit analysis, verifying all elements of a lender's analysis to ensure that loan applications meet SBA's loan quality standards.

In place of CLP, we recommend that the Administrator, SBA, develop a modified program to provide expedited loan processing to all SBA lenders who merit it through adherence to application packaging requirements. As part of this modified program, SBA should:

--Develop lender guidance in the form of a comprehensive checklist that will facilitate the assembly of complete and well analyzed loan packages by all lenders.

--Apply preliminary screening procedures to all applications that would identify loan packages that are complete enough to qualify for expedited processing by SBA.

CHAPTER 3

IMPLEMENTATION OF THE PREFERRED LENDERS PROGRAM IS NOT JUSTIFIED

A number of factors strongly indicate that SBA should not proceed with its implementation of the Preferred Lenders Program (see p. 3.), under which lenders have final loan approval authority. SBA's implementation of the Preferred Lenders Program should be based on CLP's successful operation. However, we found that CLP has a number of inherent weaknesses. Secondly, the Government would forfeit its opportunity to ensure loan quality and its ability to protect its interest by identifying loan terms and conditions that may need restructuring. Additionally, for the Preferred Lenders Program to operate properly, it needs to be well received by both participating lenders as well as SBA personnel. However, we found that to some degree, both lenders and SBA personnel are not very enthusiastic about the program. Finally, the amount of resource savings SBA would accrue is questionable since any savings in terms of lending personnel would be offset to some extent by a required monitoring function.

CLP EXPERIENCE RAISES QUESTIONS ABOUT THE PREFERRED LENDERS PROGRAM

We recognize that our review only addresses the loan approval function, whereas under the Preferred Lenders Program, SBA would delegate to lenders additional responsibilities in the area of loan liquidations. However, unless SBA can effectively transfer to preferred lenders the benefit of final loan approval authority, it is highly questionable whether they would be willing to take on the added responsibilities for liquidating defaulted loans. In essence SBA would be asking preferred lenders to bear the burden of additional servicing and liquidating costs without providing them with the compensating benefit of having final authority over loan guarantee approvals.

In view of lenders' performance under CLP and considering our recommendation that SBA retain the credit analysis function, it would not be prudent for SBA to go forward with the Preferred Lenders Program. SBA will be forgoing its opportunity to ensure that lenders consider all pertinent information and properly analyze it before approving a loan guaranty. As demonstrated in chapter 2, CLP lenders frequently submit incomplete packages or fail to adequately address certain elements that SBA considers important in reaching a loan guarantee decision. Under the Preferred Lenders Program, SBA's only opportunity to assess lender performance would be through a monitoring program that would only surface lender weaknesses after the fact.

SBA will also be giving up its opportunity to assure that loan terms and conditions meet with its approval. We examined the district offices' experience with respect to modifying loan terms and conditions on our 172 sample CLP loans. By comparing the terms and conditions the lender recommended with those contained in the loan authorization after SBA's review, we found that proposed loan terms and conditions were frequently restructured as shown below.

Terms and conditions	Percent of loans restructured all districts sampled
Loan amount	4.1
Loan maturity	5.2
Guaranty percent	9.9
Working capital requirements	7.0
Use of proceeds	8.1
Equity requirements	5.2
Standby agreements	8.7
Collateral requirements	8.7

Overall, we found that almost one-third (33.1 percent) of our sample loan cases had been restructured with respect to one or more of the terms and conditions listed above. These opportunities to restructure loan terms and conditions would have been foregone if the loans had been processed under the Preferred Lenders Program without an SBA credit review or analysis.

Generally, neither SBA officials nor some of the CLP lenders we spoke with are very receptive toward the Preferred Lenders Program. Most of the SBA lending officials agree that SBA would be subjecting itself to a greater risk and that at a minimum SBA would need to establish a monitoring system. One district office director said he believes the Preferred Lenders Program is the most dangerous program that SBA could implement. Most lenders said they would expect to participate in the program if for no other than competitive reasons. Nevertheless, some of the same lenders had reservations about their increased responsibilities under the program, particularly regarding liquidations and their associated costs.

An important component of the Preferred Lenders Program would be a monitoring system that would be designed to help ensure quality performance by participating lenders. Any resources that SBA commits to this function would, of course, offset any savings that the Preferred Lenders Program offers in the way of loan specialists or other activities pertaining to the lending process.

CONCLUSIONS

Poor lender performance under CLP indicates that SBA should not proceed with the Preferred Lenders Program. Additionally, some lenders and SBA officials are not receptive to the Preferred Lenders Program concept. Finally, it is questionable how much resource savings SBA would realize since any savings in lending personnel would be offset, at least partially, by a monitoring effort.

SBA COMMENTS AND OUR EVALUATION

SBA had several comments on this chapter. The agency completely opposed our proposal to terminate further consideration of the Preferred Lenders Program. In addition, SBA asked us to consider several other points in finalizing this chapter.

Although SBA opposed our proposal to terminate the Preferred Lenders Program, its only rationale was that SBA is searching for methods to leverage existing resources and this program is a means for accomplishing this objective. SBA does not address our point that CLP experience indicates it would not be prudent for SBA to go forward with the Preferred Lenders Program. Additionally, SBA did not address the other points we raise in support of our proposal.

--SBA would be giving up its opportunity to assure that loan terms and conditions meet with its approval.

--Generally, neither SBA officials nor some of the CLP lenders we spoke with were very receptive toward the program.

SBA stated that paragraph two of this chapter is incorrect because it suggests that SBA is trying to get the lender to accept additional servicing and liquidating responsibility without receiving the final loan approval authority. SBA also stated that the report should be corrected to reflect that there are six banks, not five, in the pilot Preferred Lenders Program. A third point made by SBA was that we should indicate that the maximum SBA guaranty under the Preferred Lenders Program is 75 percent rather than the usual 90 percent. Finally, SBA stated that it planned to continue the pilot Preferred Lenders Program under close monitoring.

Regarding SBA's comments on servicing and liquidating, we recognize that the Preferred Lenders Program gives the lender final loan approval authority. However, the facts in this report raise serious questions about whether this authority should be turned over to lenders. Our report states that unless this benefit can effectively be transferred to lenders, it is questionable whether lenders would take on the other preferred lenders' responsibilities of loan servicing and liquidating.

In response to SBA's second point, we have corrected the report to indicate that the pilot Preferred Lenders Program has six participating banks. We have also added the fact that the maximum guaranty on a loan which is processed through the Preferred Lenders Program is 75 percent.

RECOMMENDATIONS

We recommend that the Administrator, SBA, terminate further consideration of the Preferred Lenders Program. Recognizing, however, that SBA is conducting a limited pilot test of the program, we recommend that SBA monitor and evaluate the following aspects of the program before considering further expansion.

--The quality of lender credit analyses when compared with SBA standards and requirements.

--The completeness of loan application packages.

In its assessment of benefits, we also recommend that SBA compare any personnel time savings it expects from an expanded Preferred Lenders Program against any additional efforts required in training lenders and monitoring their performance. These recommendations will not be costly for SBA to implement, since the pilot test involves only six lenders.

Unless the Preferred Lenders Pilot Program surfaces compelling evidence that the program would be viable on an expanded basis and the problems identified in this report can be resolved, we recommend that SBA not give any further consideration to this program.

SAMPLING METHODOLOGY

We randomly selected a sample of 30 CLP case files at each district office. If the universe of CLP approvals for the first half of fiscal year 1982 was less than 30, we reviewed all case files. These CLP cases were reviewed with respect to both loan processing time and credit analysis quality. We also randomly selected 30 non-CLP cases from all non-CLP approvals during the first 6 months of the fiscal year. If the number was less than 30, we reviewed all the cases. These cases were reviewed for the purpose of comparing processing time with CLP loans. Only five random cases in each of these latter samples were reviewed for credit analysis quality.

Finally, we randomly selected 25 CLP and 25 non-CLP loan approvals from the Philadelphia district office's fiscal year 1981 loan approvals. We wanted to assess loan processing time during periods of higher volume, and loan volume was substantially higher in fiscal year 1981 than in fiscal year 1982.

The following table shows the specifics of our district office samples.

	FY 1982 (first 6 months)					
	CLP			Non-CLP		
	Universe	sample	Percent of universe	Universe	Sample	Percent of universe
Philadelphia	22	22	100	65	30	46
Pittsburgh	30	30	100	14	14	100
Boston	58	30	52	87	30	34
Hartford	30	30	100	57	30	53
Atlanta	46	30	65	122	30	25
Nashville	32	30	94	52	30	58
Total	218	172	79	397	164	41

APPENDIX II

Form Approved
OMB No. 3245 0016

2 SBA Office Code

U.S. SMALL BUSINESS ADMINISTRATION
LENDER'S APPLICATION FOR GUARANTY OR PARTICIPATION
(Numbers in circles or squares are SBA codes only)

SBA Loan Number ( )

Name of Applicant
30

WE PROPOSE TO MAKE A (Check One)

Guaranteed Loan	Lenders Share %	SBA Share %	Term of Loan Years	Monthly Payment $
Immediate Participation Loan (Lender to make and service)	Lenders Share %	SBA Share %	Lenders Interest Rate % Per Annum	Payment Beginning ____ Months from Date of Note

Amount of Loan $

If Interest Rate is to be Variable
Base Rate: Spread: Rate Adjustment: Quarterly / Other (Specify) Base Rate Source

TERMS AND CONDITIONS OF LENDER *(Attach additional sheets if more space is needed.)*

I approve this application to SBA subject to the terms and conditions outlined above. Without the participation of SBA to the extent applied for we would not be willing to make this loan, and in our opinion the financial assistance applied for is not otherwise available on reasonable terms. I certify that none of the Lender's employees, officers, directors or substantial stockholders (more than 10%) have a financial interest in the applicant.

Signature: Title Date

Name of Lender 40 | Telephone (Inc A/C) | Financial Institution I.D. Code 41

Street Address 42 | City 43 | State 44 | Zip 45

FOR SBA USE ONLY

Loan Officers Recommendation — Approve / Decline State Reason(s)

Signature: Title: Date 3

Other Recommendation, if Required — Approve / Decline State Reason(s)

Signature: Title Date

THIS BLOCK TO BE COMPLETED BY SBA OFFICIAL TAKING FINAL ACTION

Approve / Decline State Reason(s)

Signature: Title Date

BUSINESS LOANS ONLY

4 Program Struct. Code	8 MTY (MOS)	9 SMR	46 No. of Employees	47 Franchise Code	48 New Bus 1 No 2 Yes	49 Women 1 No 2 Yes	50 Viet Vet 1 No 2 Yes	51 Organ. Code 1-Indiv. 2-Part. 3-Corp.
10 City Code	11 State Code	12 Loan Type (1) Dir. (4) IPSBA (3) IPBK (7) Guar	52 SIC Code	53 Location 1 Urban 2-Rural	54 EOL Family Income ($ Only) $	55 Poll. Code	56	

13 Sub Program Code	14 County Code	15	SBA LOAN PAY OFFS LIST ALL SBA LOANS BEING REFUNDED			
Loan Amount Approved	% Participation	Interest Rate	(15a) Loan Number	(15b) Loan Type	(15c) Loan Status	(15d) Amount
16 SBA	19 %	21 %	cc 11 20	cc 21 (1) Direct (2) Part (3) Guar	cc 22 (1) Curr (4) C/D (2) P/O (5) Liq (3) Del	$
17 Bank	20 %	22 %	cc 29 38	cc 39 (1) Direct (2) Part (3) Guar	cc 40 (1) Curr (4) C/D (2) P/O (5) Liq (3) Del	$
18 Total			cc 11 20	cc 21 (1) Direct (2) Part (3) Guar	cc 22 (1) Curr (4) C/D (2) P/O (5) Liq (3) Del	$
23 Minority Code	24 O/S SBA Loan 1-No 2-Yes	25 Const. Cont. Amt. $	IF MORE THAN 3 LOANS ARE PAID OFF ENTER TOTAL OF REMAINING LOANS			(16) $
26 New Construction 1-No 2-Yes	27 Real Collateral 1-No 2-Yes	28	PRIOR SBA LOANS LIST LOAN NUMBERS OF ALL PRIOR SBA LOANS TO BORROWER (17a) cc 11 20	(17b) cc 21 30	(17c) cc 31 40	
29	31 Soc. Sec. No.					
33 Employer ID No.		35 Borrower Alpha Code				

SBA Form 4-I (0-51) REF SOP 50 10 1 PREVIOUS EDITIONS ARE OBSOLETE

INSTRUCTIONS: The information requested below must be supplied with the application package.

FINANCIAL SPREAD

BALANCE SHEET	As of	Fiscal Year Ends	AUDITED ☐	UNAUDITED ☐
		DEBIT	CREDIT	PRO FORMA
Assets				
Cash	$	$	$	$
Accounts Rec.				
Inventory				
Other				
Total Current Assets				
Fixed Assets				
Other Assets				
Total Assets	$	$	$	$
Liabilities & Net Worth				
Accounts Payable	$	$	$	$
Notes Payable				
Taxes				
Other				
SBA				
Total Current Liabilities	$	$	$	$
Notes Payable	$	$	$	$
SBA				
Other				
Total Liabilities	$	$	$	$
Net Worth	$	$	$	$
Total Liab. & Net Worth	$	$	$	$
Profit & Loss	YEAR	YEAR	YEAR	YEAR
Sales	$	$	$	$
Depreciation				
Income Taxes				
W/D Officer Comp.				
Net Profit After Tax/Deprec.	$	$	$	$

PRO FORMA SCHEDULE OF FIXED OBLIGATIONS

	YEAR 1	YEAR 2	YEAR 3	YEAR 4
	$	$	$	$

Lender should comment on the following (Continue on separate sheet if needed):

1. Balance sheet and ratio analysis - comment on trends, debt to worth and current ratio.
2. Lenders analysis of repayment ability.
3. Management skill of the applicant.
4. Collateral offered and lien position, and analysis of collateral adequacy.
5. Lenders credit experience with the applicant.
6. Schedule of insurance requirements, standby agreements and other requirements.

Landers Analysis:

SBA Form 4-I (9-81)

☆ U.S. Government Printing Office 1981-352/853/5574

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

MAR 23 1983

Mr. J. Dexter Peach
Director
Resources, Community and Economic Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

This is in response to your February 15, 1983, letter which forwarded for our review and comment your DRAFT report entitled, "SBA's Certified Lenders Program Falls Short of Expectations."

We appreciate your willingness to accept our comments even though this response is a few days late. As you know, our response has been delayed for several reasons, including our heavy travel and conference schedules. Also, we felt that our field offices should have input into this response, so my Financial Institutions Branch forwarded copies of the DRAFT report to each of our ten (10) regional offices and requested that they review its content with their district office personnel and submit consolidated replies to us. Though this process took some time, we believe the end products are worth having waited for. As an enclosure to this reply, you will find quoted material from the responding offices. Many of the thoughts and recommendations from those memoranda are contained in this reply to you.

It should be noted that the Certified Lenders Program and the pilot Preferred Lenders Program were major topics of discussion at our March 15-17 District Directors Conference, at the Xerox Training Center near Leesburg, Virginia. Senior managers from Central Office and the Regional Administrators and District Directors were in attendance at these sessions. Your report was discussed. Copies of the material distributed at the District Directors Conference are enclosed.

In general, SBA recognizes that there are problems in the CLP that need immediate attention, but we completely disagree with the conclusions of your report. SBA is concerned that the GAO report did not demonstrate a complete understanding of the Lender/SBA relationship. It appears that GAO did not investigate the situation that led to the development of CLP in order to understand the variety of benefits that SBA has received from the program. Lender relations have improved significantly. CLP has caused many more SBA/Lender meetings than would have been held without the existence of the program.

Communication between Lenders and SBA personnel has increased. Problems that were formerly handled by a volley of letters often are now solved over the telephone and/or by face-to-face discussion of mutual problems. Field offices report that CLP lenders are more likely to perform servicing actions and liquidate loans on a unilateral basis than are non-CLP lenders. This is a savings of time and effort for SBA servicing personnel.

The substantial amount of press coverage of CLP has increased the awareness of SBA in the small business community. It has also helped improve SBA's image and demonstrated that SBA is trying to improve its service to the public.

The Certified Lenders Program is fully consistent with this Administration's desire to leverage government resources by shifting some of the authority/responsibility of program operations to the private sector. SBA cannot and will not reverse its direction toward greater utilization of private sector resources in our financial programs.

SBA does concur with some of the GAO's findings. We agree that not every application package received is 100% complete. However, we do not share GAO's feeling that a 29% incomplete package factor is reason to terminate the program. We also concur that some of the lenders are sometimes submitting inaccurate and unreliable credit analyses. However, based upon the field offices' input, our conclusion is that CLP loan packages are more complete, more adequate and more accurate than are non-CLP packages. We believe that these problems are correctable by revising some of the operating documents of the program and by conducting more and better training sessions for both SBA personnel and Lenders.

We do not concur with the finding that CLP does not decrease processing time. Average processing time has decreased since the implementation of CLP. These decreases occurred prior to the dramatic decline in loan demand. When average processing time decreases, the small business community is better served. We believe that the GAO's draft report gives shortshrift to this very important point---small business is being served better and more quickly due, at least in part, to CLP.

We also do not concur with the finding that there is no material resource saving. As mentioned before, CLP not only saves time in the loan processing department, but also in the loan servicing and liquidation departments. CLP lenders are more likely to perform servicing actions and liquidations, with less SBA assistance, than are non-CLP lenders.

The Agency is skeptical of GAO's methodology of determining average processing time for a CLP loan application versus a non-CLP application. Asking those employees whose job is most likely to be negatively affected by a successful CLP is somewhat naive. Some of our loan officers apparently see CLP (and PLP) as threats to their job security, though their fears are exaggerated. It is interesting to note that the Philadelphia office (which apparently feels it must completely analyze---as opposed to review---all packages submitted under CLP) has a purchase rate for CLP loans that is approximately 180% higher than that of the Pittsburgh office (which told GAO that it adheres to the CLP concept of a credit review).

In general, SBA cannot accept GAO's recommendations that CLP be terminated and that the Preferred Lenders Program (PLP) be cancelled. We propose to take aggressive action in order to rectify the problems noted in the DRAFT report; in fact, that process has begun and is well underway.

Much of the CLP documentation is now in the process of revision. The CLP Information Book, the Supplemental Guaranty Agreement for the Certified Lenders Program, and the certification criteria will be revised with an emphasis on quality performance by the CLP lenders. District and Regional personnel will be informed that non-performing lenders should not be recertified. That message was emphasized at the March 15-17 District Directors Conference, verbally and in writing, and it will be reinforced.

The Central Office of SBA is currently planning a CLP training session in each of our 10 Regions. They will be held during May and June of this year. These sessions will include one day with SBA personnel describing the findings of the GAO report and the actions that have been and will be taken to correct the problems identified by GAO. The second day of the meeting will include SBA and Lender personnel. The Lenders will be informed of the emphasis on quality performance and will be given instructions for the proper completion of an SBA loan application package.

Each of your recommendations will be addressed below:

1. Terminate CLP as it presently exists...

   This recommendation cannot be accepted. SBA is in the process of increasing its reliance on the private sector. This decision was made in response to the fact that SBA personnel levels are decreasing, while Agency program responsibilities are not decreasing proportionately. Certain streamlining efforts and economies of scale must be found if SBA is to meet its legislative mandate with the resources it is provided. Furthermore, we do not find GAO's recommendation to be fully supportable or substantiated.

2. Develop a modified program to provide expedited loan processing...

   SBA participates with approximately 11,000 lenders. With the available personnel, it is physically impossible to provide personal guidance to every lender. SBA decided to target its efforts to a group of its most active and most proven lenders. The findings in the GAO report suggest that SBA must do a better job in communicating the application requirements to the CLP lenders. As to this latter point, we agree, and the actions described previously will go a long way towards this objective's accomplishment.

3. Develop lender guidance in the form of a comprehensive checklist...

   The SBA Form 4-I provides a list of the items on which the lender is required to comment. A checklist would be a redundant document and would not teach the lenders to do a proper credit analysis.

4. Establish screening procedures to identify complete loan packages...

   All field offices are supposed to have such procedures in place now. In fact, the present CLP process has a screening aspect, and your report describes it in considerable detail. Central Office will review the procedures in the field offices and have implemented screening procedures in those offices where such procedures do not now exist or do not appear to work as well as they should.

5. Require SBA loan specialists to retain responsibility for a thorough credit analysis...

   SBA cannot accept this recommendation. The Agency is trying to delegate more of the loan processing activity to the lenders. SBA feels that, with proper training, lenders will provide credit analyses that are suitable for a credit review by SBA personnel. Central Office is directing field offices to begin returning incomplete and improperly analyzed loan packages to CLP lenders. SBA Central Office does not intend for field personnel to clean up, on a regular basis, the mistakes of CLP lenders; rather, we expect our field personnel to insist that the CLP lenders do the necessary cleaning up. If a CLP lender will not or cannot maintain its end of the CLP bargain with SBA, that lender will be dropped from the CLP.

6. SBA Terminate Further Consideration of the Preferred Lenders Program...

   SBA would like to clear up an inconsistency between paragraph one and two of Chapter Three. The PLP lender does have the right to issue an SBA guaranty on a qualifying small business loan. Paragraph one is correct, while paragraph two is incorrect wherein it suggests that SBA is trying to get the lender to accept additional servicing and liquidating responsibility without receiving the final, loan approval authority.

   Your report should be corrected to reflect that there are six (6)---not five (5)---banks in the pilot PLP. Also, your report should note that, in PLP, the SBA's maximum guaranty is capped at 75% (not the usual 90%).

   SBA cannot accept this recommendation. As discussed above, SBA is searching for methods to leverage existing resources. PLP is a likely candidate to take some of the burden off of SBA field personnel. The Agency will continue with its pilot program. It is being monitored very closely by all parties concerned, and this will be the case throughout its duration.

We would like to have you consider the following points while preparing your final version of this report:

1. The DRAFT report does not include any mention of SBA's CLP re-certification/de-certification process. This process was initiated last year as we evaluated the CLP performance records of 226 CLP lenders (those whose two-year CLP contracts were up for renewal in 1982). The results of that process are shown in this chart:

FY'82 CLP Re-Certifications or De-Certifications

	2 Year Re-Certs	1 Year Re-Certs	De-Certs
*Nationally	41	150	33
Philadelphia	1	3	0
Pittsburgh	2	1	0
Boston	2	1	0
Hartford	1	2	0
Atlanta	0	4	1
Nashville	2	3	0
	8	14	1

* We also lost two (2) participants; one due to its merger with another CLP lender; the other removed itself from any SBA participation status, due to compliance problems with SBA's rules and regulations.

Two-year re-certifications were granted to those 41 lenders who fully met all of our established criteria. One-year re-certifications were granted to those 150 lenders who did not fully meet all of our established criteria, but who met them sufficiently well enough to warrant our allowing them to continue in CLP for an additional year. The 33 de-certifications resulted from those lenders' performance records as CLP lenders being insufficient to warrant their continued participation in the CLP.

During FY'83, we will be engaged in the same process, though the criteria will be revised somewhat. This year, we will be examining the performance records of all CLP participants, except those of the 41 lenders who were evaluated last year and received two-year recertifications. You can be assured that our revised criteria will be placing greater emphasis on quality lending practices and less emphasis on loan volume. Among the "quality" factors to be evaluated will be completeness of loan application packages, adequacy and accuracy of lender-performed credit analyses, and the lender's willingness and ability to satisfactorily describe their rationale as to why a particular loan guaranty request should be approved by SBA. All of these areas will be dealt with in our revised CLP materials and the training sessions.

2. With Point #1 in mind, it should be clear that SBA is determined to have in place an effective and efficient Lender Evaluations Program. Our Region I (New England) has been piloting this effort for the past six months, and we expect their final report within the next few weeks. We will evaluate their report and provide appropriate instructions and guidance to all of our field offices, so that we accomplish a nationwide Lender Evaluations endeavor this Fiscal Year. This is an integral part of our efforts to insure quality performances within the Certified Lenders and the Preferred Lenders Programs.

3. Your attention is drawn to the first chart contained in the enclosed package we distributed at the March 15-17 District Directors Conference, "Certified Lenders Program's Status and Trends [FY'80-FY'83 (First Quarter)]." This chart demonstrates the importance of CLP lenders to the SBA. Though these fewer than 500 lenders represent less than 5% of our approximately 11,000 lending partners, they do approximately 35% of all of our guaranty lending. Also, approximately 20% of our more recent guaranty loan approvals were accounted for by the CLP process. We believe that these figures can and will be improved upon, resulting in better and quicker service by SBA to our lenders and borrowers, and there should be greater resource savings within the SBA. The past record of CLP is not as bleak as your DRAFT report indicates, and the future record of CLP will be better.

4. Though your DRAFT report paints a fairly spotty picture of how the CLP lenders are keeping up their end of the bargain with SBA, thereby resulting in the SBA offices often having to do more than they are supposed to be having to do with CLP cases, it is important to recognize that part of this problem might be attributable to our offices not being firm enough or clear enough in their instructions to the lenders. As explained earlier, these are correctable problems, and they will be corrected. SBA will be much less willing to do for the CLP lenders the work which rightfully is theirs to perform, in a satisfactory manner, for us. De-certifications are a perfectly legitimate option for SBA's usage if better guidance and instructions to the lenders do not result in more satisfactory performance records.

5. Your DRAFT report noted that your sampling was done in "branch banking system" States (Connecticut, Massachusetts, Pennsylvania, Tennessee and Georgia). You might wish to clarify this, in that not all of these States have statewide branching. In other words, the sampled lending institutions' branch system networks are not as extensive as the DRAFT report might lead a reader to believe.

6. Your DRAFT report alleges (page 6) that, "No quantifiable goals were established against which to measure the program's success with respect to lender performance or SBA personnel savings." We must disagree. The CLP does have quantifiable criteria for certification, re-certification and de-certification. For instance, we stress that at

least 40% of a CLP participant's overall guaranty lending with the SBA should be processed via the CLP route. Also, we have quantifiable criteria as to loan purchase rates, loss rates, volume, etc. The fact is that the purchase rates/loss rates experienced by SBA with our CLP lenders and the CLP loans are lower than is the case with our non-CLP lenders and our non-CLP loans.

7. Your DRAFT report (page 7) states, "Only 59.4% of the CLP applications were approved as submitted..." We agree that this percentage should be higher, but it is not as unacceptable a figure as you portray it to be. Based upon your information on page 7, we find that 79.7% of CLP submissions were approved as such by SBA (59.4% had no changes; 18.1% with some delay; and, 2.2% after SBA's reconsideration).

8. The processing time delay's average of 9 days is somewhat misleading, in that Philadelphia's 13 day average delay skews the data. It should be pointed out that, of the 6 SBA offices sampled, 4 had average processing delays which were less than the overall average.

9. Your DRAFT report's discussion of the 3-day "turnaround" decision-making by SBA focuses on SBA's "priority" treatment of CLP loans, versus our ability to make 3-day decisions based upon the lender's submission's completeness and adequacy/accuracy. Though your discussion is hard to disagree with, we believe that you should give greater attention to the facts that the 3-day decision-making goal is usually being met and that the lenders and borrowers are receiving better and quicker service from the SBA, regardless of the reasons as to why that is possible.

10. Similarly, your discussion of the differences between a bank's normal commercial loan portfolio's characteristics, as contrasted with their SBA loan portfolio's, is interesting and undoubtedly true. However, the CLP's participants were selected based upon their proven "track records" with this Agency, in terms of their better than normal ability to handle SBA loans. Our "failing" in this regard is due to our not having assisted, as much or as often as we should have, the CLP's participant institutions in maintaining a well-trained cadre of qualified loan officers who are well-versed in SBA loans. As pointed out previously, we are in the process of correcting this situation.

11. Your criticism that we need better instructions for our field personnel is well taken. As discussed earlier in this response, the necessary corrective actions are being taken. CLP's material and training sessions will result in a much clearer distinction between credit analysis and credit review, among other matters which will be clarified and emphasized.

12. Your discussion of the pilot Preferred Lenders Program is not altogether accurate or complete, as we noted earlier in this response, and we feel that the recommendations and comments are premature.

Conclusion

SBA will work to improve the Certified Lenders Program. We are convinced that an improved CLP will lead to a more efficient SBA and successful Preferred Lenders Program.

If you have any questions, please feel free to contact us further. My Financial Institutions Branch's personnel are available to you: Dan Gibb (653-6076); Jim Hammersley (653-6268); Jean LaForce (653-6082); and Greg Brown (653-6269).

Yours truly,

James C. Sanders
Administrator

Enclosures

(077046)

25388

AN EQUAL OPPORTUNITY EMPLOYER

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

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE,$300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

THIRD CLASS