

EVALUATION OF CARES ACT DEBT RELIEF TO 7(A) BORROWERS

REPORT NUMBER 21-03 | DECEMBER 1, 2020





EXECUTIVE SUMMARY

EVALUATION OF CARES ACT DEBT RELIEF TO 7(A) BORROWERS

Report
No. 21-03

December 1, 2020

What OIG Reviewed

This evaluation examines SBA's implementation of debt relief for borrowers in the 7(a) Program, SBA's flagship loan guarantee program. Section 1112 of the Coronavirus Aid, Relief and Economic Security (CARES) Act provided \$17 billion in debt relief to borrowers in the 7(a), 504, and Microloan programs. Section 1112 does not include the Paycheck Protection Program. The Act was enacted on March 27, 2020 to alleviate the severe economic hardships and public health threat created by the Coronavirus Disease 2019 (COVID-19) pandemic.

Our objective was to determine whether SBA has effective internal controls to provide debt relief to 7(a) borrowers in accordance with CARES Act Section 1112 and internal policies and procedures.

What OIG Found

We found that SBA effectively ensured that more than 224,000 borrowers of 7(a) loans received \$2.6 billion in debt relief within the first 3 months of the CARES Act. By June 2020, SBA had verified that nearly all reported eligible 7(a) borrowers had received subsidy payments. This debt relief helped alleviate some of the economic hardship caused by COVID-19 on qualified small businesses.

Although we found that SBA accurately made payments on behalf of borrowers according to the data reported by lenders, we also found that opportunities exist to improve payment controls to ensure only eligible borrowers receive subsidy payments.

We identified issues with lender reported information that increased the risk of either making payments to ineligible borrowers or making excessive payments. We found \$43 million in subsidy payments went to borrowers that may have been ineligible.

Because of the urgency to issue the subsidy payments quickly, SBA relied heavily on lenders self-certifying the loan status and payment amount with limited verification procedures. Continuing to strengthen internal controls and oversight of the subsidy payments will help ensure that SBA provides debt relief only to eligible borrowers.

Office of Capital Access officials told us SBA maintains the right to demand return of any overpayments. The agency will establish policies and procedures, including using third-party payment auditing, to review certain payments. SBA's planned actions for post-transaction payment reviews represent a strong control to identify and remedy possible improper payments. Additional controls will be needed to improve the payment approval process.

OIG Recommendations

We recommended the Office of Capital Access and the Chief Financial Officer collaborate to incorporate additional verification procedures before approving subsidy payments. We also recommended that SBA establish post-payment audit procedures using a risk-based approach and recover any overpayments identified during the post-payment audit.

Agency Response

SBA management partially agreed with recommendation 1 and agreed with recommendation 2. SBA management plans to institute additional verification procedures before approving subsidy payments, including validating the total payment amount requested. Management has also contracted with an auditing firm to conduct a risk-based audit of all subsidy payments made to lenders. Management's planned actions resolved both recommendations.




Office of Inspector General

U. S. Small Business Administration

Final Report Transmittal
Report Number: 21-03

DATE: December 1, 2020

TO: Jovita Carranza
Administrator

FROM: Hannibal "Mike" Ware 
Inspector General

SUBJECT: Evaluation of CARES Act Debt Relief to 7(a) Borrowers

This report presents the results of our evaluation of CARES Act debt relief to 7(a) borrowers. We considered management comments on the draft of this report when preparing the final report. Management agreed with recommendation 2 and partially agreed to address recommendation 1.

We appreciate the courtesies and cooperation extended to us during this evaluation. If you have any questions, please contact me or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6586.

cc: William Manger, Chief of Staff and Associate Administrator, Office of Capital Access
Christopher Gray, Deputy Chief of Staff
Stephen Kong, Acting Chief Operating Officer
Patricia Gibson, Senior Advisor
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Tami Perriello, Chief Financial Officer
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Table of Contents

Introduction.....	2
SBA 7(a) Loan Program.....	2
7(a) Loan Reporting Process	2
CARES Act Debt Relief.....	2
Prior Work.....	3
Objective.....	3
Finding 1: SBA Provided Debt Relief to Nearly All Reported Eligible 7(a) Borrowers.....	4
Debt Relief to Borrowers.....	4
Figure 1. Timeline of CARES Act Section 1112 Program	4
Table 1. 7(a) Loan Subsidy Payment Information.....	5
Finding 2: Opportunities Exist to Improve Subsidy Payment Controls.....	6
Risk of Payments to Ineligible Borrowers.....	6
7(a) Loans in Liquidation	6
7(a) Loans that Should Have Been in Liquidation.....	7
7(a) Loans in Deferred Status.....	7
Table 2. Payments with Risk Factors for Improper Payment.....	7
Irregular Subsidy Loan Payments.....	7
Accuracy of Reported Status	8
Planned Actions.....	8
Conclusion	8
Recommendations.....	9
Analysis of Agency Response.....	10
Summary of Actions Necessary to Close the Recommendations.....	10
Recommendation 1	10
Recommendation 2	10
Appendix I: Objective, Scope, and Methodology.....	11
Use of Computer-Processed Data.....	11
Appendix II: Management Comments.....	12

Introduction

The President signed the Coronavirus Aid, Relief and Economic Security (CARES) Act into law on March 27, 2020 to alleviate the severe economic hardships created by the Coronavirus Disease 2019 (COVID-19) pandemic. The CARES Act includes emergency assistance for small businesses through SBA lending programs.

Section 1112 of the CARES Act provided up to \$17 billion in debt relief to borrowers in the 7(a), 504, and Microloan programs. This debt relief was separate from the Paycheck Protection Program, but still reached hundreds of thousands of small businesses. Part of this provision requires SBA to pay the principal, interest, and associated fees owed on covered loans to lenders for a 6-month period.

This debt relief represents the first time SBA has made direct payments on behalf of borrowers for loans in SBA's \$143.5 billion outstanding small business loan portfolio. This review focuses on implementation of this debt relief for borrowers in SBA's 7(a) Program.

SBA 7(a) Loan Program

The 7(a) Program is SBA's flagship loan program with more than \$95 billion of outstanding debt, representing two-thirds of SBA's loan guarantee portfolio. SBA is authorized under the Small Business Act to provide financial assistance to small businesses in the form of government-guaranteed loans. SBA's loan guarantee programs require personal guarantees from borrowers and share the risk of default with lenders by making the loan guarantee less than 100 percent. SBA offers loan guarantees to encourage lenders to provide loans to small businesses that cannot obtain credit elsewhere.

The 7(a) loan is the most flexible of SBA's guaranteed loans. Borrowers can use 7(a) loan proceeds for a variety of general business purposes including working capital, machinery, equipment, furniture, fixtures, land, building, and debt refinancing. Loan maturity is generally up to 10 years for working capital and equipment but can be up to 25 years for purchasing land and buildings.

7(a) Loan Reporting Process

SBA requires lenders to report the monthly status of all loans in their active 7(a) portfolio through a contracted fiscal transfer agent. The fiscal transfer agent acts as a connection between lenders and SBA. Lenders submit status changes and pay any guarantee fees through the website the fiscal transfer agent provides. SBA relies on the internal policies of lenders to determine how to handle troubled loans, when to place a loan in default, and when to begin the liquidation process.

If a borrower makes regular loan payments on a 7(a) loan that a lender has fully disbursed, the loan is reported as in "regular servicing status." When it becomes clear to a prudent lender that a borrower has defaulted and cannot, or will not, continue making payments, then the 7(a) loan goes into liquidation status. SBA encourages lenders to make a good faith effort to help troubled borrowers avoid liquidation. For temporary relief, lenders can defer, or delay, payments if the lender determines that the borrower is able to recover from short-term problems.

CARES Act Debt Relief

To provide debt relief to 7(a) borrowers affected by COVID-19, lenders submit payment requests through the fiscal transfer agent. All borrowers with 7(a) loans that were in regular servicing status and were not considered uncollectable before the pandemic are eligible for debt relief. The fiscal transfer agent works with SBA's Office of Capital Access to verify that lender certified 7(a) loans are reported in regular servicing status before submitting the consolidated payment information to

SBA. The SBA Office of the Chief Financial Officer then verifies the payment routing information before generating payment files to be paid out by the U.S. Department of the Treasury.

Prior Work

SBA OIG Report 20-11, *White Paper: Risk Awareness and Lessons Learned from Prior Audits of Economic Stimulus Loans (April 3, 2020)*. Earlier this year, we published a white paper on lessons learned from previous audits of economic stimulus loans for SBA's consideration when establishing new programs to provide economic relief to those affected by the COVID-19 pandemic. We identified three significant areas of risk: (1) promptly publishing regulations, (2) requiring supporting documentation, and (3) establishing proper controls. The white paper listed key considerations that addressed these risks to ensure program integrity and reduce the risk of financial loss.

SBA OIG Report 12-08, *SBA's Lender Loan Reporting Process Has Systemic Reporting Issues and Data Control Weaknesses (February 23, 2012)*. In 2012, we reported on systemic reporting issues and data control weaknesses in SBA's process for reporting 7(a) loan status and balance. In response, SBA made significant changes to improve lender compliance with loan reporting requirements. These changes included daily updates of submitted status reports, using error reports to address corrective action needs, and factoring status report submission rates into the overall risk ratings of lenders.

Objective

Our objective was to determine whether SBA has effective internal controls to provide debt relief to 7(a) borrowers in accordance with CARES Act Section 1112 and internal policies and procedures.

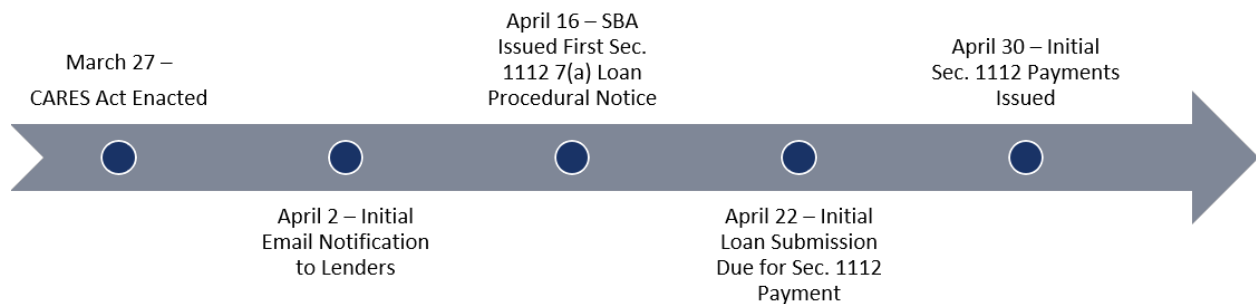
Finding 1: SBA Provided Debt Relief to Nearly All Reported Eligible 7(a) Borrowers

SBA effectively ensured that eligible 7(a) loan borrowers received \$2.6 billion in subsidy payments within the first three months after the CARES Act took effect. SBA officials from multiple offices collaborated and used systems already in place to identify eligible 7(a) loans. As a result, by June 2020, nearly 100 percent of reported eligible 7(a) borrowers received timely debt relief.

Debt Relief to Borrowers

On March 31, 2020, SBA sent the fiscal transfer agent and SBA district offices an initial email to notify lenders not to collect April payments from borrowers because of the upcoming subsidy payments. Within a month of the CARES Act enactment at the end of March, SBA issued guidance for loan payment data submission, received loan payment information, and submitted its first Section 1112 loan data to Treasury for payment.

Figure 1. Timeline of CARES Act Section 1112 Program



Source: OIG analysis

SBA issued guidance to instruct lenders how to request payments for 7(a) loans that met the CARES Act criteria and explain the subsidy is restricted to 6 months of installments. SBA directed the fiscal transfer agent to report how many lenders had not submitted payment requests for eligible 7(a) borrowers. In the first month, SBA identified nearly 3,000 7(a) borrowers that had not received the initial subsidy payment, and the agency then contacted lenders that had not requested payment. As of the end of June 2020, SBA made payments for more than 224,000 borrowers totaling more than \$2.6 billion for 7(a) loan payments and identified only 348 eligible 7(a) borrowers that had not received the subsidy payment (see Table 1). Since then, SBA has continued its outreach efforts to notify these lenders of the subsidy payments.

Table 1. 7(a) Loan Subsidy Payment Information

	April 2020	May 2020	June 2020
7(a) Borrowers Receiving Subsidy	197,952	216,695	224,032
Amount of Section 1112 Debt Relief to Borrowers	\$ 803,313,040	\$ 906,552,618	\$ 878,959,250
Number of Loans from Lenders Who Did Not Request Debt Relief*	2,948	415	348

Source: SBA Capital Access Financial System Database and information provided by the Office of the Chief Financial Officer. Total loan numbers by date provided by SBA Office of Capital Access

The fiscal transfer agent reported the number of unpaid 7(a) loans by counting the number of loans from lenders that did not make any payment requests. This method is reasonable because each loan has unique terms and conditions, including different payment schedules. For lenders that submitted any payment request, the fiscal transfer agent reported all loans from the lender to have been properly considered for the Section 1112 debt relief.

To ensure all eligible borrowers received subsidy payments, on July 28, 2020, SBA issued a procedural notice informing all lenders that SBA can deny lenders the guaranteed portion of 7(a) loans should borrowers default because they did not receive subsidy payments. Additionally, on September 18, 2020, SBA notified all remaining 7(a) lenders that had not submitted for borrower subsidy payments that lenders must submit the subsidy payment request for borrowers and the potential consequences to the lender for not doing so.

Finding 2: Opportunities Exist to Improve Subsidy Payment Controls

Overall, SBA successfully and accurately made payments for 7(a) borrowers according to the data reported by lenders. However, SBA could implement additional controls to ensure only eligible borrowers receive subsidy payments. We found inconsistencies with the lender reported information that could have led to payments to ineligible borrowers or making excessive loan payments. For example, we found payments that may be improper, based on certain risk factors. The total value of the payments in the first 3 months of 7(a) debt relief that we identified for additional review is more than \$43 million.

To provide immediate debt relief to small businesses affected by COVID-19, SBA relied on lenders to certify their own reported data. SBA performed limited testing of the lender reported loan information, which decreased the likelihood that SBA would be able to identify lender reporting errors before approving payments. For example, we identified instances of lenders not accurately updating the status of 7(a) loans, a requirement for receiving subsidy payments.

Strengthening the verification procedures of lender reported loan information and using a risk based approach to identify improper payments will help ensure SBA provides debt relief only to qualified borrowers and reduce the risk of funds being used for ineligible loan payments.

Risk of Payments to Ineligible Borrowers

SBA quickly implemented an effective payment process to relieve the economic distress of small businesses in the pandemic. As part of that process, SBA required lenders to ensure that borrowers did not have 7(a) loans that were uncollectable before the pandemic. Now that the initial emergency has passed, SBA has the opportunity to improve controls to reduce the risk of payments to ineligible borrowers.

SBA relied on the fiscal transfer agent to ensure that all subsidized 7(a) loans were reported in regular servicing status and perform other verification testing. Lenders could submit up to a total of six payment requests for each 7(a) loan in their portfolio reported in regular servicing status. Lenders also were required to certify with every payment request that the 7(a) loan was in regular servicing status.

7(a) Loans in Liquidation

We found SBA's controls effectively prevented lenders from submitting payment requests for borrowers with 7(a) loans reported in liquidation status. Although lenders did submit payment requests for 100 7(a) loans totaling \$384,182 that were later placed in liquidation status in the same month they were paid, the payments represented only a fraction of a percent of the total payments to 7(a) borrowers (See Table 2).

If lenders believed the reported 7(a) loan status was not accurate, lenders could change the status and request a subsidy payment, increasing the risk that ineligible borrowers already undergoing liquidation proceedings before the pandemic could receive payments. We identified 660 7(a) loans reported in liquidation in February and placed back into regular servicing status between March and June. SBA had a policy requiring lenders to submit supporting documentation for the loans. However, the Office of Capital Access officials did not receive the required documentation for most of the 7(a) loans and no control was in place to require justification before approving subsidy payments. Consequently, we found SBA made payments totaling nearly \$4.9 million for borrowers that were already in liquidation in February 2020, before the pandemic (See Table 2).

7(a) Loans that Should Have Been in Liquidation

Lenders were required to certify that no 7(a) loan they were requesting subsidy payment for should have been placed in liquidation status. This control was intended to prevent SBA payments on loans that were uncollectable but not reported accurately before impacted by COVID-19. However, SBA did not establish specific criteria for lenders to determine which loans should have been moved into liquidation because the 7(a) Program delegates this responsibility to the lenders themselves when they create the loan.

SBA did recommend generally that loans already 120 days past due should not be in regular servicing status, but the agency did not do any pre-payment checks based on this recommendation. As a result, we found that lenders received 1,890 payments for 931 borrowers already 120 days past due at the end of February. These payments represent more than \$10.5 million of funds going to loans that likely should have been liquidated before the pandemic and, therefore, at risk for being ineligible for CARES Act debt relief (See Table 2).

7(a) Loans in Deferred Status

We found that lenders received nearly \$27.2 million in subsidy payments for 4,502 7(a) borrowers reported in deferred status (See Table 2). Before the CARES Act, SBA recommended lenders defer loan payments for borrowers adversely affected by the COVID-19 pandemic. SBA guidance allowed borrowers to elect whether they wanted to stay on deferment and receive payments later or end deferment early and receive payments right away. Borrowers who remained in deferred status were not eligible for subsidy payments until after the deferment period ended.

Even if lenders reported a borrower's payments were deferred, they could still certify that their 7(a) loans were in regular servicing status and request payment. As a result, there were no controls in place to prevent lenders from requesting and holding payments until the deferment period ends, effectively giving the lender an interest free loan.

Table 2. Payments with Risk Factors for Improper Payment

Risk Factors for Subsidized Loans	April 2020		May 2020		June 2020	
	Number of Loans	Payment	Number of Loans	Payment	Number of Loans	Payment
In Liquidated Status When Paid	9	\$23,957	23	\$69,251	69	\$290,973
In Liquidation Status in February and Now in Regular Servicing Status When Paid	189	\$779,453	315	\$1,755,631	427	\$2,337,576
120 Days Past Due in February, Never Liquidated, and Paid	342	\$1,698,115	692	\$4,250,733	856	\$4,598,701
In Deferment Status When Paid	890	\$6,444,393	1,253	\$7,874,894	2,359	\$12,870,912

Source: SBA Capital Access Financial System Database and information provided by Office of the Chief Financial Officer.

Irregular Subsidy Loan Payments

Of the 638,679 subsidy payments SBA made during the first 3 months of 7(a) debt relief, we identified at least 1,635 payments that varied by thousands of dollars and were at least five times

larger than other payment requests submitted for the same 7(a) loan. SBA allowed lenders to include more than one monthly installment in a single payment request. SBA also allowed lenders to request missed payments that were due prior to the CARES Act. To verify the accuracy of the irregular loan payments, SBA would need detailed payment information to analyze payment trends.

Lenders submitted payment requests for borrowers to the fiscal transfer agent that included only the gross loan payment amount, the month of payment, and the number of monthly installments requested. However, the gross loan payment amounts requested did not show a breakdown of principal, interest, and fees because SBA did not require it. Further, SBA did not require the fiscal transfer agent to submit the number of monthly installments needed to identify which payment requests covered more than one installment. Consequently, SBA was restricted in what could be independently verified before approving subsidy payments.

Office of Capital Access officials told us they could not track whether payment amounts were consistent when approving subsidy payments. They also said the control filters were meant to only identify obvious outliers and that additional verification would come with later post-transaction payment audits. Because of short time to meet the statutory deadline and the limited information available, SBA officials did limited verification of the data provided by the fiscal transfer agent.

SBA did require lenders to certify all information submitted was true and correct with every payment request to provide some assurance. SBA officials relied on lender self-verification and the possibility of post-transaction payment audits to ensure the accuracy of subsidy payments. Without additional controls on lender submitted data, there remains a significant risk of SBA making excessive payments.

Accuracy of Reported Status

We found that lenders did not update the current status for 14,783 borrowers after they received subsidy payments in the monthly loan status report. If a lender does not update the loan information, the 7(a) loan may appear as past due or delinquent despite having all installments paid to date. While the errors specifically identified would not affect a borrower's eligibility, they do raise questions about the reliability of lender reported information without independent verification.

SBA relied on lender reported information to ensure the proper amount was paid to 7(a) loans only in regular servicing status. Inaccurate loan status information may also be a cause of a number of the payments we identified with risk factors. Without accurately reported loan data, SBA is at risk of either making payments to unqualified loans or making excessive payments.

Planned Actions

Office of Capital Access officials told us SBA maintains the right to demand return of any overpayments and will establish policies and procedures, including using third-party payment auditing, to review certain payments after borrowers receive all 6 months of payments. The officials said in September 2020, SBA plans to award a contract to a third-party company that will use 7(a) loan origination data and compare previously reported data to identify total subsidy loan payments that do not fall within an acceptable range for review.

Conclusion

SBA quickly provided debt relief to small businesses with 7(a) loans during the first 3 months of the COVID-19 pandemic in accordance with CARES Act Section 1112. However, additional internal controls are needed to ensure subsidy payments were accurately paid out to only eligible 7(a) loans. Although lender certification added assurance that payment requests complied with the CARES Act and SBA procedural notices, self-certification must be adequately reviewed using

appropriate procedures. SBA's planned actions for post-transaction payment reviews represent a strong control to identify and remedy possible improper payments if effectively implemented. Further controls could also be incorporated to improve the payment approval process.

Recommendations

We recommend the Administrator require the Associate Administrator for the Office of Capital Access and the Chief Financial Officer to:

1. Incorporate procedures to verify the accuracy and reasonableness of the loan status, principal, interest, and any fees of loans before approving subsidy payments.
2. Establish post-payment audit procedures, using a risk-based approach, to verify the accuracy and completeness of all subsidy payments to lenders and include reviews of payments made to loans that changed from liquidation status to regular servicing status, and remedy improper payments in accordance with the Payment Integrity Act of 2019.

Analysis of Agency Response

SBA management provided formal comments to the draft report (see Appendix II). SBA management agreed with one recommendation and partially agreed with the other recommendation. Management provided target dates for final action in follow-up correspondence. However, we believe management's proposed corrective actions resolved both recommendations.

Summary of Actions Necessary to Close the Recommendations

The following details the status of our recommendations and the actions necessary to close them.

Recommendation 1

Resolved. SBA management partially concurred with this recommendation. SBA management agreed to institute additional procedures to verify the accuracy and reasonableness of loan status and payment amount before approving subsidy payments. SBA management said requiring lenders to report separate amounts for principal, interest, and fees instead of reporting gross payment amount would create an unnecessary burden on lenders. SBA managers believe they can address this recommendation by requiring additional steps to validate the gross payment amount based on the terms of the loan. Management plans to complete final action on this recommendation by January 31, 2021. This recommendation can be closed when management provides evidence that they implemented additional procedures verifying the accuracy and reasonableness of loan status and gross payment amount before approving subsidy payments.

Recommendation 2

Resolved. SBA management concurred with this recommendation and stated that SBA is in the process of implementing post-payment audit procedures. SBA has contracted with an auditing firm to conduct a risk-based audit of all subsidy payments made to lenders. SBA will focus audit resources on loans that changed from liquidation status to regular servicing status just before or during the period covered by Section 1112. Management plans to complete final action on this recommendation by January 31, 2021. This recommendation can be closed when management provides evidence that they implemented post-payment audit procedures.

Appendix I: Objective, Scope, and Methodology

This report represents the results of our evaluation of CARES Act debt relief to 7(a) borrowers. Our objective was to determine whether SBA has effective internal controls to provide debt relief to 7(a) borrowers in accordance with CARES Act Section 1112 and internal policies and procedures.

The scope of this evaluation included all active 7(a) loans reported between February and July 2020 that received SBA subsidies from April 30, 2020, through June 30, 2020.

To meet our objective, we reviewed the CARES Act, the Small Business Act, SBA procedural notices, and SBA policies and procedures involving 7(a) loan servicing and status reporting. We interviewed SBA officials and personnel in the Office of Capital Access and Office of Chief Financial Officer involved in the CARES Act subsidy implementation and payment process. We also interviewed National Association of Government Guaranteed Lenders officials and selected lenders to determine if there were any widespread issues related to the Section 1112 subsidy payments.

In addition, we used data for all active 7(a) loans between February 1, 2020, and June 30, 2020, to determine whether all subsidized loans were reported to be in regular status when paid. We reviewed the loan status history for loans that received SBA subsidy payments. When considering the previous past due or liquidation status of borrowers who received subsidies, we purposely did not include status changes reported after February 2020 because of possible impact by COVID-19.

Finally, we met with the fiscal transfer agent official to determine the controls implemented, the loan validation process, and any issues involved with implementation of the Section 1112 subsidy payments. We also reviewed the methodology used by the fiscal transfer agent to determine the number of eligible 7(a) loans that had not received the subsidy payment. We determined the methodology reasonable based on the incentives of the lenders to receive payment and the controls reiterated by SBA in their July 28 procedural notice. However, we were unable to independently verify whether all eligible loans from responsive lenders were sufficiently subsidized because of insufficient reported information.

Use of Computer-Processed Data

We relied on information from SBA's loan accounting system to determine loan status and payment history. Previous OIG work has verified that the information maintained in this system is reasonably reliable. We used system extracts taken monthly for historical record purposes; the 7(a) origination loan data remained consistent. As a result, we believe the information is reliable for the purposes of this evaluation.

We also relied on payment information collected by the fiscal transfer agent. We compared this payment information with accounting data reported by SBA and payment reports sent to SBA monthly. The payment information was determined to be reasonably reliable for the purposes of this evaluation.

We conducted this evaluation in accordance with the Council of the Inspectors General on Integrity and Efficiency's quality standards for inspection and evaluation. Those standards require that we adequately plan and perform the evaluation to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objective. We believe that the evidence we obtained provides a reasonable basis for our conclusions based on our objective.

SBA RESPONSE TO EVALUATION REPORT

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



TO: Hannibal M. Ware, Inspector General
Office of Inspector General

THRU: William M. Manger
Chief of Staff and Associate Administrator, Office of Capital Access

Tami Perriello
Chief Financial Officer, Office of Chief Financial Officer

FROM: John A. Miller
Deputy Associate Administrator, Office of Capital Access

SUBJECT: Response to Draft Report entitled “Evaluation of CARES Act Debt Relief to 7(a) Borrowers”

DATE: November 16, 2020

Thank you for providing the Office of Capital Access (OCA) the opportunity to respond to OIG’s Draft Report entitled, “Evaluation of CARES Act Debt Relief to 7(a) Borrowers” (Project Number 20016), dated October 16, 2019. OIG’s audit objective for this report was to determine whether SBA has effective internal controls to provide debt relief to 7(a) borrowers in accordance with CARES Act Section 1112 and internal policies and procedures.

The Office of Capital Access (OCA) and the Office of Chief Financial Officer (OCFO) have the following comments with respect to the recommendations:

Recommendation 1 – SBA Partially Agrees

Incorporate procedures to verify the accuracy and reasonableness of the loan status, principal, interest, and any fees of loans before approving subsidy payments.

Although SBA agrees that additional procedures can be incorporated to verify the accuracy and reasonableness of the loan status and payment amount before approving subsidy payments, SBA does not agree that it is necessary to verify the accuracy of the amounts of principal, interest and any fees, prior to approving subsidy payments for three reasons. First, this recommendation is based on the IG finding that, of the 638,679 subsidy payments SBA made during the first 3 months of 7(a) debt relief, 1,635 payments varied by thousands of dollars and were at least five times larger than other payment requests submitted for the same 7(a) loan. This finding represents only .25% of all payments during this period, and SBA does not believe that the additional administrative burden imposed by requiring Lenders to breakdown each monthly loan

payment into principal, interest and fee amounts is a cost effective approach to addressing the finding. SBA has thousands of 7(a) lending partners that monthly notify SBA of the required subsidy payment amount and this amount covers both the guaranteed and non-guaranteed portions of each 7(a) loan in their portfolio. Requiring the lenders to retool their systems to split out the exact amount of principal, interest and fees for a given payment, as opposed to the total payment amount itself, would be unnecessarily burdensome.

Second, SBA would expect that in the early months of the Section 1112 program there would be variations in the amount of the monthly payments because Lenders could include eligible past due amounts in their request for payment. As the program has progressed, SBA would expect that variations in the payment amounts attributable to these past due amounts would have decreased and that variations have become even a lower percentage of all payments. SBA would also expect that there would be some variations in the amounts of the monthly payments because Lenders were directed in SBA Procedural Notice 5000-20023 to adjust loan payment amounts in a subsequent month to account for differences in any loan payments that they submitted that were incorrect. The subsequent month's section 1112 loan payments would be increased to cover the amount of underpayments or decreased to credit the amount of the overpayments from a previous month. Lenders must maintain a written explanation of the circumstances justifying the correction in their loan files and, if a variation in the amount of the payments raises questions, SBA may request it at any time.

Third, SBA loan payments are simple interest, that is, interest is collected to the date of receipt of the payment, with the remaining amount of the payment applied to principal. The payment due date varies with each 7(a) loan, but the Lenders must submit the monthly Section 1112 report to SBA by the 10th day of the month. SBA makes that month's payment by the 25th day of each month, but Lenders do not know the exact date that SBA will make the payment. Thus, Lenders would not be able to provide the exact allocation of the payment that should be attributed to principal and interest at the time they submit the monthly Section 1112 report.

SBA believes that it can proactively address this recommendation by instead focusing on taking additional steps to validate the total payment amount requested by a 7(a) lender by comparing it to the anticipated payment amount as calculated by the terms of the loan. In addition, SBA's Office of Credit Risk Management will be reviewing lenders' administration of Section 1112 when reviewing lenders during the normal course of business. To the extent that these reviews take place prior to payment of Section 1112 payments, this could be considered a review prior to payment. In any regard, whether pre- or post-subsidy payment, it is an important control SBA is implementing.

Recommendation 2 – SBA Agrees

Establish post-payment audit procedures, using a risk-based approach, to verify the accuracy and completeness of all subsidy payments to lenders and include reviews of payments made to loans that changed from liquidation status to regular servicing status, and remedy improper payments in accordance with the Payment Integrity Act of 2019.

SBA agrees with this recommendation and was already in the process of implementing it when this report was issued. SBA has contracted with an auditing firm to conduct a risk-based audit of all subsidy payments made to lenders. SBA will also focus audit resources on loans that changed from liquidation status to regular servicing status just prior to or during the Section 1112 covered period.