U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

ADVISORY MEMORANDUM
REPORT NO. 12-14

DATE: July 9, 2012

TO: John A. Miller
Director, Office of Financial Program Operations

SUBJECT: The Small Business Administration Did Not Maximize Recovery for $171.1 Million in Delinquent Disaster Loans in Liquidation

This advisory memorandum is to inform you of issues identified while assessing *the Liquidation of Disaster Loans at the National Disaster Loan Resolution Center (NDLRC).* Specifically, this memorandum addresses SBA non-compliance with the Debt Collection Improvement Act of 1996 (DCIA).

Our overall audit objective was to assess the NDLRC's effectiveness in managing disaster loans in liquidation to maximize debt recovery and minimize losses. One specific audit objective was to assess whether the NDLRC complied with the DCIA for disaster loans in liquidation status. This memorandum contains our findings relative to loans in liquidation status as of December 31, 2011. The provisions of the DCIA and other laws and regulations are included in guidance provided by the Department of the Treasury Managing Federal Receivables Guide, which states, "an agency must refer any eligible debt more than 180 days delinquent to Treasury Financial Management Service for cross servicing." We are bringing this issue to your attention so that management can take immediate action to fully comply with the DCIA.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit fieldwork necessary to test our other audit objectives is still in progress; however, we conducted the audit work pertinent to the results presented here from October 2011 to April 2012.

Background

With the passage of the Debt Collection Improvement Act of 1996 (DCIA), Congress provided Federal agencies with new and enhanced delinquent debt collection tools. The DCIA centralized delinquent debt collection at the Department of the Treasury (Treasury), requiring Treasury to pursue delinquent debts that are not actively being collected by Federal creditor agencies, a program known as "cross servicing." The DCIA also established a centralized offset process at Treasury, known as the "Treasury Offset Program, or TOP." The TOP offsets government payments due to borrowers, such as income tax refunds and social security payments, and redirects them to Federal creditor agencies to which the borrower owes a delinquent debt.

The DCIA requires that related debt collection activities be consolidated within the government, to the extent possible, to minimize the government's delinquent debt collection costs. To achieve this objective, the DCIA states that agencies must refer debts delinquent more than 180 days to Treasury Financial Management System (FMS) for cross servicing and offset. The DCIA does provide some exceptions to this requirement. For example, the DCIA does not require agencies to transfer debts in litigation or foreclosure to Treasury, even if these debts are over 180 days delinquent.

When Federal agencies refer delinquent debts to Treasury for cross servicing, the agencies relinquish all responsibility for servicing or collecting the debts, and Treasury fully assumes this responsibility. In order to effect referral of delinquent debts to Treasury for cross servicing, the SBA first charges off these debts. According to the Managing Federal Receivables Guide, it is an agency's responsibility to liquidate any collateral, when appropriate, prior to referral of the debt to FMS for cross servicing.

The SBA's Birmingham and El Paso disaster loan servicing centers are responsible for charging off delinquent, secured disaster loans with balances of $25,000 or less and loans not secured by collateral. In April 2006, the Associate Deputy Administrator of Capital Access designated the Santa Ana Disaster Home Loan Servicing and Disaster Liquidation Office as the National Disaster Loan Resolution Center (NDLRC). The NDLRC is responsible for charging off all delinquent disaster loans with collateral and loans with balances over $25,000. In addition, the NDLRC manages all delinquent debts in litigation.

The NDLRC can utilize a variety of debt collection strategies. When the NDLRC first receives a delinquent loan, the staff begins the process of evaluating any existing loan collateral to determine if the SBA can recover any portion of the delinquent debt through liquidation. Simultaneously, NDLRC staff make a final attempt to contact the borrowers and request they resume making regular payments. If a borrower is experiencing a hardship, the NDLRC can offer to work out special payment arrangements. However, if the borrower does not resume regular payments, the NDLRC has the ability to garnish wages or liquidate. Any delinquent debt collection strategies the agency adopts must take into account that all debts over 180 days delinquent must be referred to FMS for cross servicing and offset, unless the debt is specifically exempt.

On average, the NDLRC receives approximately 350 new delinquent disaster loans monthly, or 4,200 loans per year. As of December 31, 2011, the NDLRC had 3,958 delinquent disaster loans with principal balances totaling approximately $420.3 million in inventory. During the five-year period beginning in June 2006 when SBA created the NDLRC, through June 2011, the NDLRC charged off 9,035 loans with principal balances totaling approximately $762.7 million.

Results

The SBA was not fully complying with the Debt Collection Improvement Act (DCIA) of 1996. Our analysis found that approximately 1,553 of 3,958 disaster loans (39 percent) in liquidation status as of December 31, 2011, were delinquent over 180 days and not in active litigation status, foreclosure status, workout, or otherwise exempt from transfer to Treasury FMS for cross servicing. The Santa Ana National Disaster Loan Resolution Center (NDLRC) should have charged off the debts after 180 days to transfer them to Treasury for cross servicing. As of December 31, 2011, the SBA had not referred disaster loan balances totaling approximately $171.1 million to Treasury for cross servicing when the loans were over 180 days delinquent.

The DCIA states that agencies must refer debts delinquent more than 180 days to Treasury for cross servicing and offset, however, it does provide some exceptions to this requirement. The DCIA does not require that agencies transfer debts to Treasury within 180 days that are in litigation, foreclosure, or otherwise exempt by law or official action from Treasury. On January 3, 2000, Treasury provided the SBA with an exemption from mandatory transfer of disaster and regular business loans that are in active workout. On August 18, 2005, Treasury provided all creditor agencies with an exemption that applies to debts the agency collects through administrative wage garnishment (AWG). This exemption excludes debts from mandatory transfer if: (1) the Agency has received actual collections from AWG prior to the debt becoming eligible for mandatory cross servicing; and, (2) the Agency expects the debt to be collected through AWG within three years from the date of the first AWG collection.

The NDLRC did not charge off 736 of the 1,553 delinquent loans (47 percent) because the loans had collateral designated for potential foreclosure. However, the NDLRC had not yet initiated foreclosure. The NDLRC set these loans aside because the loans had collateral with value and the NDLRC could liquidate this collateral in the future, if desired. These loans ranged from 183 to 4,827 days delinquent and had principal balances totaling approximately $80.2 million. If the associated collateral had been in foreclosure through a court proceeding or non-judicially, the loans would have been exempt from referral to Treasury for cross servicing.

The Agency did not transfer these debts to Treasury for cross servicing as required by the DCIA because management interpreted a portion of the January 3, 2000 Treasury letter exempting loans in workout status to imply that if the loan had collateral, the debt was exempt from transfer to Treasury. However, we contacted Treasury to determine whether all loans with collateral were exempt from mandatory transfer for cross servicing. Treasury confirmed that the SBA was required to transfer all debts delinquent over 180 days for cross servicing, unless the loans met one of the criteria for exemption. According to Treasury, the exemption criteria did not include the existence of collateral. While there is no statute of limitations applicable to a foreclosure action by the government, the SBA could not obtain a judgment to collect any deficiency remaining on the delinquent loan, post-foreclosure, if the six-year statute of limitations for suit on the loan has passed.

The table below contains an aging schedule for the loans designated for foreclosure in the current inventory on December 31, 2011:

Table 1: Schedule for Loans Designated 4Close

AGING SCHEDULE FOR LOANS DESIGNATED "4CLOSE"		
Year Loan Entered Liquidation	**Number of Loans Designated "4CLOSE"**	**Total Principal Balance**
<2006	58	$7,530,210
2006	14	1,875,228
2007	30	3,041,676
2008	155	15,003,592
2009	154	13,954,504
2010	210	26,553,767
2011	115	12,228,437
Total	**736**	**$80,187,413**

In February 2011, in order to address the backlog of loans designated "4CLOSE," [1] the NDLRC director formed a team to evaluate the loan collateral and determine whether it had recoverable value. Beginning with the oldest loans, the Team screened the collateral to determine whether there was recoverable equity, and then issued a foreclosure letter to the borrower if the collateral had sufficient recoverable value. In January 2012, the NDLRC staff informed us that they had initiated foreclosure for approximately 20 of the loans; however, the staff was unable to provide documentation to support the filing of the foreclosures. In February 2012, the foreclosure team implemented a process to monitor and track the foreclosures initiated. These efforts have resulted in a number of borrowers making an initial "good faith" payment and committing to resume making regular payments to avoid foreclosure. According to the NDLRC director, the NDLRC foreclosure Team Lead will monitor the loans for six months to ensure that the borrowers continue to make regular payments.

The NDLRC management believed that 216 of the 1,553 loans with principal balances totaling approximately $14.3 million were exempt from transfer for cross servicing because these loans were designated "AWG," meaning that the NDLRC was garnishing the borrower's wages. However, according to Treasury, the use of this collection strategy does not exempt the delinquent debt from transfer unless actual collections from AWG have been received prior to the debt becoming eligible for mandatory cross servicing and the Agency expects the debt to be collected through AWG within three years from the date of the first AWG collection.

We analyzed the 216 loans in wage garnishment status in the NDLRC inventory as of December 31, 2011 to determine if they met the Treasury criteria and, therefore, were exempt from transfer for cross servicing. We determined that 214 of the 216 loans were not exempt and should have been transferred to Treasury for cross servicing. The SBA was not receiving wage garnishments from the borrower's for four loans designated "AWG," therefore; these loans were not exempt from transfer to Treasury for cross servicing. Additionally, we determined that the SBA could not recover 210 loan balances via wage garnishment within three years based upon the amounts garnished from the borrower's wages. Therefore, these loans also were not exempt from transfer to Treasury for cross servicing. One loan with a principal balance of $21,551 met the Treasury criteria and was exempt from transfer. One additional loan was exempt because the loan balance was paid in full in October 2011, although the loan was assigned to "AWG" and remained in inventory at the NDLRC on December 31, 2011.

The NDLRC did not transfer the remaining 601 (of the 1,553) loans delinquent over 180 days to Treasury as required because management believed that it complied with the DCIA by referring the debts to Treasury for offset. Referral for offset is not the same as referral for cross servicing. In addition, management believed they would comply with the DCIA by resolving or charging off debts delinquent over 270 days by the end of each fiscal year. Standard Operating Procedure (SOP) 50 51 2 provides guidance on SBA's liquidation process, however, it does not address the DCIA requirements.

Conclusion

As of December 31, 2011, the SBA had not referred disaster loan balances totaling approximately $171.1 million to Treasury for cross servicing when the loans were over 180 days delinquent, in accordance with the DCIA. As a result, the SBA did not maximize recovery on these delinquent disaster debts in liquidation status.

---

[1] "4CLOSE" is the designation the NDLRC gives to loans with potential recoverable real estate collateral value.

Recommendations

We recommend that the Director of the Office of Financial Program Operations direct the Santa Ana NDLRC to:

1. Take the following actions for disaster loans in liquidation status delinquent over 180 days that are secured by collateral, but not specifically exempt from referral to Treasury:
   - Evaluate whether prompt foreclosure is feasible.
   - Initiate foreclosure proceedings promptly on loan collateral for which the NDLRC has determined that foreclosure is feasible.
   - Charge off loans for which the NDLRC has determined that foreclosure on the collateral is not feasible and ensure transfer of the debts to Treasury FMS for cross servicing.

2. Immediately charge off all disaster loans in liquidation status delinquent over 180 days and not secured by collateral, or specifically exempt from referral to Treasury.

3. Update all pertinent SOPs to provide guidance to NDLRC management and staff regarding the requirements of the DCIA and the Treasury Managing Federal Receivables Guide to ensure that loans are transferred to Treasury, as required.

4. Train all Santa Ana staff to manage Federal receivables in accordance with the Debt Collection Improvement Act of 1996 and the Treasury Managing Federal Receivables Guide.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On May 10, 2012, we provided a draft of this report to the Director, Office of Financial Program Operations (OFPO). On June 20, 2012, the Director of OFPO submitted formal comments, which are included in their entirety in Appendix I. The director disagreed with the finding but generally agreed with three recommendations and disagreed with one.

A summary of management's comments and our response follows.

Agency Comments

Management disagreed with OIG's finding that the National Disaster Loan Resolution Center was not complying with the Debt Collection Improvement Act. Their disagreement centers on a letter from Treasury dated January 3, 2000 that states

> *I approve SBA's request for an exemption from mandatory transfer of disaster and regular business loans over 180 days delinquent that are in active workout…. The exemption request was evaluated based on standards and factors described in FMS' rule concerning the Transfer of Debts to Treasury for Collection, published in the Federal Register on April 28, 1999. Based on that evaluation, we determined that mandatory transfer of these debts would interfere with program goals, and, in the case of collateralized debt, would not be in the best interests of the United States.*

The letter further states:

> *Once SBA determines that a workout is not feasible and, in the case of collateralized loans, completes its liquidation/foreclosure, any remaining delinquent debts remain subject to the DCIA's mandatory transfer provisions. Additionally, all other debts over 180 days delinquent are subject to mandatory transfer to Treasury under the DCIA, unless a specific statutory or regulatory exemption applies.*

Management interpreted that this letter granted the Agency an exemption from transferring any loans in workout status *and any* loans with collateral to Treasury for cross servicing. Thus, it is management's opinion that SBA operates the NDLRC in compliance with the DCIA.

To support this opinion, management stated that unsecured loans and secured loans under $25,000 are referred to Treasury offset and cross servicing within 180 days of delinquency. According to management, the servicing centers transfer all secured loans with balances over $25,000 to the NDLRC for liquidation and the NDLRC refers them for Treasury offset within 180 days of delinquency. Further once liens are liquidated, the remaining balance on the loan is transferred to Treasury for cross servicing, conforming to the Treasury exemption. Management believes that it is acting in compliance with provisions of the Treasury exemption letter, therefore, they disagree with OIG's finding that the Agency does not comply with the requirements of the DCIA.

Management also stated that the specific language of the Treasury letter could be subject to differing interpretations, and that any difference of opinion as to the meaning of the memorandum does not evidence a failure to comply with the DCIA. Management further stated that it is clear that the Treasury memorandum exempts SBA from the obligation to transfer all disaster loans more than 180 days delinquent to Treasury for cross servicing.

Management relies on a second letter from Treasury, dated August 18, 2005, regarding the obligation to refer loans to Treasury when SBA is pursuing recovery through administrative wage garnishment. That letter states

> *After careful consideration, we have decided to exempt from mandatory cross-servicing debts that are being collected at the creditor agency through the use of administrative wage garnishment (AWG) if the following conditions exist: (1) actual collections from AWG have been received prior to the debt becoming eligible for mandatory cross-servicing; and (2) if the creditor agency expects the debt to be collected through AWG within three years from the date of the first collection by AWG.*

Based upon this Treasury letter, management believes all loans in wage garnishment status are exempt from mandatory transfer for cross servicing. The Agency further advised that it is currently in discussion with Treasury regarding the second requirement and the extended repayment period.

In summary, management believes it is exempt from transferring all loans in workout status, all loans with collateral, and all loans with wage garnishment collections to Treasury for cross servicing.

OIG Response

We respectfully disagree with the Agency's position that it is fully complying with the DCIA. We consulted with Treasury to determine if it had granted the SBA any exemptions to the mandatory transfer of debts 180 days delinquent. Treasury confirmed that only loans in active workout or wage garnishment meeting the conditions outlined above were exempt from transfer. Therefore, we believe that the Agency's interpretation that it is exempt from transferring loans with collateral to Treasury for cross servicing is incorrect.

At issue are the 1,553 loans delinquent in excess of 180 days that we identified in the NDLRC current inventory as of December 31, 2011. These loans did not appear to be in an "active workout" status. The 736 loans designated for foreclosure in the current inventory include loans transferred to liquidation as early as 1999. These loans include 58 that were placed in liquidation prior to 2006, 14 placed in liquidation in 2006, 30 placed in liquidation in 2007, 155 placed in liquidation in 2008, 154 placed in liquidation in 2009, 210 placed in liquidation in 2010. When the SBA delays foreclosure, it could prevent the government from ultimately recovering amounts owed for the defaulted debts. While there is no statute of limitations applicable to a foreclosure action by the government, the government could not obtain a judgment to collect any deficiency remaining on the delinquent loan, post-foreclosure, if the six-year statute of limitations for suit on the loan has passed.

Further, we believe that management is broadly interpreting the Treasury AWG memorandum as allowing all debts with active AWG collection as being exempt from the referral requirement. However, it is our view that the exemption provided by Treasury for delinquent debts in AWG is actually much narrower because it only exempts SBA from the transfer requirement if both conditions specified in the memorandum are present: (1) that SBA has obtained a payment from AWG prior to the expiration of the 180-day limit; and (2) that there is an expectation that the complete debt can be recovered through AWG within three years. We found that SBA does not monitor or track collections received through wage garnishment. The NDLRC had no records to indicate that any of the loans currently in wage garnishment status had payments received prior to 180 days delinquent, or could be fully collected within three years.

Recommendation 1

Management Comments

The OFPO disagrees as the Treasury exemption letter states that transfer of collateralized debt would not be in the best interests of the government. OFPO has allocated resources and is actively managing the portfolio of collateralized debt through a foreclosure project, which must, of course, be subject to varying requirements of state law.

OIG Response

Management's comments are not responsive to the recommendation. The Treasury letter does not state that the transfer of all collateralized debt would not be in the best interests of the government. In fact, the Office of Inspector General believes that transfer of these debts to Treasury will lead to greater recoveries. The OFPO management is not acknowledging the existence of the problem, or taking corrective action so that the Agency will comply with the DCIA. The OIG is not recommending that SBA transfer collateralized debt to Treasury without first evaluating whether the Agency can recover the debt through foreclosure. The OIG is recommending that the NDLRC liquidate the collateral promptly and then transfer these debts to Treasury. As of December 31, 2011, the NDLRC had 621 loans designated "4CLOSE" that were placed in liquidation prior to 2011. Fifty-eight of these loans were placed in liquidation prior to January 2006.

Recommendation 2

Management Comments

OFPO concurs with this recommendation and confirms that this is already the existing procedure.

OIG Response

Management's comments are responsive to the recommendation.

Recommendation 3

Management Comments

OFPO concurs with this recommendation. However, the identified SOP 50 51 is undergoing revision with different parameters. The focus is now 7(a) loan servicing, workout and resolution. As a result, OFPO has already incorporated servicing, workout and resolution activities, including those mentioned in the recommendation, into the SOP 50 52 which is now titled, Disaster Loan Servicing and Resolution. The SOP 50 52 is in final draft. We expect issuance by the end of Fiscal Year 2012.

OIG Response

Management's comments are responsive to the recommendation.

Recommendation 4

Management Comments

OFPO concurs with this recommendation and has already taken the following actions:

- Developed a Foreclosure Checklist required to be completed by the assigned Loan Specialist on every foreclosure case.

In addition, OFPO will complete the following actions by September 30, 2012:

- Post updated SOP 50 52 and the Management Federal Receivables Guide to the disaster center intranet.
- Conduct DCIA agency-specific refresher training from Treasury for applicable center personnel at the NDLRC and other appropriate OFPO center locations.

OIG Response

Management's comments are responsive to the recommendation.

We appreciate the courtesy and cooperation of the Small Business Administration during this audit. If you have any questions concerning this report, please call me at (202) 205-7390 or Craig Hickok, Director, Disaster Assistance Group at (817) 684-5341.

***

John K. Needham
Assistant Inspector General for Auditing

APPENDIX I. AGENCY RESPONSE

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

MEMORANDUM
June 19, 2012

To: John Needham
Assistant Inspector General for Auditing

From: John A. Miller
Director, Office of Financial Program Operations

Subject: Response to Draft Advisory Memorandum, Project No. 11802

Thank you for the opportunity to review the revised draft Advisory Memorandum and provide you with our comments.

We wish to begin by noting that in a letter dated January 3, 2000, Treasury granted an exemption for cross-servicing of SBA debt over 180 days delinquent that is not otherwise specifically exempt from transfer. In that letter, Treasury's Under Secretary for Domestic Finance stated "…I approve your request for exemption from mandatory transfer of disaster and regular business loans over 180 days delinquent that are in active workout. The exemption request was evaluated based on standards and factors described in Financial Management Service's (FMS) rule concerning the Transfer of Debts to Treasury for Collection, published in the Federal Register on April 28, 1999. Based on that evaluation, we determined that mandatory transfer of these debts would interfere with program goals, and, in the case of collateralized debt, would not be in the best interests of the United States." Additionally, the exemption letter states, "Once SBA determines that a workout is not feasible and, in the case of collateralized loans, completes its liquidation/foreclosure, any remaining delinquent debts remain subject to the DCIA's mandatory transfer provisions. Additionally, all other debts over 180 days of delinquent are subject to mandatory transfer to Treasury under the DCIA, unless a specific statutory or regulatory exemption applies."

SBA operates the National Disaster Loan Resolution Center (NDLRC) in compliance with the Debt Collection Improvement Act (DCIA) and the Treasury exemption, so as to maximize recovery for the delinquent debts in the Disaster Loan Program.

An intra-agency compliance team for DCIA has been operational since FY2008. The team consists of members of the Office of Capital Access (OCA), Office of the Chief Financial Officer (OCFO), and Office of the Chief Information Officer (OCIO). The team meets biweekly to discuss and revaluate current system conditions to promote DCIA compliance. SBA also interacts frequently with Treasury, and coordinates directly with Treasury through the following communications: Agency Advisory Council meetings, Quarterly Creditor Agency/Cross-Servicing conference calls, Annual Debt Management Services (DMS) Conferences, Quarterly

Treasury Report on Receivables (TROR) submissions, and email and telephone contact with Treasury liaisons and subject matter experts, as needed. SBA utilizes reports extracted from FedDebt, including, the Adhoc Financial Activity Report, Return to Agency Report, Reconciliation Report, and New Case Report. SBA also extracts information from the FMS website, such as a report titled Comparison of Federal Program Agency Net Collections from the Treasury Offset Program, technical bulletins for the Treasury Offset Program (TOP) and Cross-servicing, the Managing Federal Receivables Guide, and Treasury's FMS emails.

The NDLRC is responsible for post-default workout and resolutions of all disaster home and business loans over $25,000 secured by real estate or other form of collateral. The servicing and pre-default workout of all home and business loans is conducted by the Birmingham and El Paso Disaster Loan Servicing Centers. Unsecured loans and secured loans under $25,000 are referred to Treasury offset and cross-servicing within 180 days of delinquency. All secured loans over $25,000 are transferred to the NDLRC for post-default workout and resolution and referred to Treasury offset within 180 days of receipt to allow adequate time for workout and resolution. Once workout is concluded and collateral is liquidated/foreclosed, the remaining balance on the loan is transferred to Treasury for cross-servicing, conforming to the Treasury exemption letter previously referenced. As SBA acts in compliance with provisions of the Treasury exemption letter, we disagree with the Advisory Memorandum's assertion that the Agency is not in compliance with the requirements of the DCIA. That statute specifically permits exemption by the Treasury for a specific class of debt, and, by its letter of January, 2000, Treasury extended such an exemption to SBA. While we understand that the specific language of the letter could give rise to questions regarding the meaning of particular phrases, we believe that any difference of opinion as to the letter's appropriate interpretation does not evidence a failure to comply with the DCIA. Once again, it is clear that the Treasury letter exempts SBA from the obligation to transfer all disaster loans more than 180 days of delinquency to Treasury for cross-servicing. It is our understanding that Treasury granted this exemption specifically to SBA in order to avoid interference with program goals, including the maximization of recovery.

On August 18, 2005, Treasury issued an exemption from mandatory transfer to cross-servicing if debts are being collected through AWG by the creditor agency. The exemption letter states, "After careful consideration, we have decided to exempt from mandatory cross-servicing debts that are being collected at the creditor agency through the use of administrative wage garnishment (AWG) if the following conditions exist: (1) actual collections from AWG have been received prior to the debt becoming eligible for mandatory cross-servicing; and (2) if the creditor agency expects the debt to be collected through AWG within three years from the date of the first collection by AWG." We are currently in discussions with Treasury regarding the second requirement and the extended repayment period available in the case of SBA loans.

In light of the above, OFPO responds to the OIG recommendations as follows:

APPENDIX I. AGENCY RESPONSE

- **<u>OIG RECOMMENDATION #1:</u>**
- **Take the following actions for disaster loans in liquidation status delinquent over 180 days that are secured by collateral, but not specifically exempt from referral to Treasury:**
    - **Evaluate whether prompt foreclosure is feasible.**
    - **Initiate foreclosure proceedings promptly on loan collateral for which the NDLRC has determined that foreclosure is feasible.**
    - **Charge off loans for which the NDLRC has determined that foreclosure on the collateral is not feasible and ensure transfer of the debts to Treasury FMS for cross servicing.**

OFPO disagrees as the Treasury exemption letter states that transfer of collateralized debt would not be in the best interests of the government. Therefore, loans secured by collateral are currently exempt from transfer to cross servicing. OFPO has allocated resources and is actively managing the portfolio of collateralized debt through a foreclosure resolution project which must, of course, be subject to varying requirements of state law. As indicated in the above narrative, SBA operates the NDLRC in compliance with the DCIA and the Treasury exemption, so as to maximize recovery for the delinquent debts in the Disaster Loan Program.

- **<u>OIG RECOMMENDATION #2:</u>**
- **Immediately charge off all disaster loans in liquidation status delinquent over 180 days and not secured by collateral, or specifically exempt from referral to Treasury**.

OFPO concurs with this recommendation and confirms that this is already our existing procedures.

- **<u>OIG RECOMMENDATION #3:</u>**
- **Update SOP 50 51 2 to provide guidance to NDLRC management and staff regarding the requirements of the DCIA and the Treasury Managing Federal Receivables Guide to ensure that loans are referred to Treasury, as required.**

OFPO concurs with this recommendation. However, the identified SOP 50 51 is undergoing revision with different parameters. The focus is now 7(a) loan servicing, workout and resolution. As a result, OFPO has already incorporated servicing, workout and resolution activities, including those mentioned in the recommendation, into the SOP 50 52 which is now titled, Disaster Loan Servicing and Resolution. The SOP 50 52 is in final draft. We expect issuance by the end of Fiscal Year 2012.

- **<u>OIG RECOMMENDATION #4:</u>**

Train all Santa Ana staff to manage Federal receivables in accordance with the Debt Collection Improvement Act of 1996 and the Treasury Managing Federal Receivables Guide.

APPENDIX I. AGENCY RESPONSE

OFPO concurs with this recommendation and has already taken the following actions:

- Developed a Foreclosure Checklist required to be completed by the assigned Loan Specialist on every foreclosure case

In addition, OFPO will complete the following actions by September 30, 2012:

- Post updated SOP 50 52 and the Managing Federal Receivables Guide to the disaster center intranet
- Conduct DCIA agency-specific refresher training from Treasury for applicable center personnel at the NDLRC and other appropriate OFPO center locations

Again, thank you for the opportunity to review the draft Advisory Memorandum. Please let us know if you need additional information or have any questions regarding our response.