

# **DISASTER LOAN FILE TRANSFER AND SERVICING DELAYS**

*Report Number: 08-17*  
*Date Issued: July 18, 2008*

**Prepared by the  
Office of Inspector General  
U. S. Small Business Administration**



U.S. Small Business Administration  
Office Inspector General

# Memorandum

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To: Herbert L. Mitchell, Associate Administrator for  
Office of Disaster Assistance

Date: July 18, 2008

Grady Hedgespeth, Director, Office of Financial  
Assistance

**/s/ Original Signed**

From: Debra S. Ritt  
Assistant Inspector General for Auditing

Subject: Report on the Audit of Disaster Loan File Transfer and Servicing Delays  
Report No. 08-17

This report summarizes significant risks identified during our ongoing audit of *Early-Defaulted Gulf Coast Hurricane Disaster Loans*. We initiated the audit in response to the increasing number of defaulted Gulf Coast disaster loans processed by the Small Business Administration (SBA). The audit determined whether defaulted Gulf Coast Hurricane disaster loans were serviced in accordance with loan provisions and regulations.

The issues discussed in the report were identified during site visits to the Fort Worth Processing and Disbursement Center (PDC), and the El Paso and Birmingham Loan Servicing Centers. We developed information on the file transfers and servicing delays through interviews with officials at SBA's Office of Disaster Assistance (ODA), Office of Financial Assistance (OFA), the Buffalo Customer Service Center (CSC), and the Office of the Chief Information Officer. We also obtained information from the PDC on loan files that had not been transferred to the servicing centers due to missing or insufficient documents.

We believe the deficiencies identified in this report, if not corrected promptly, could lead to a greater risk of loan defaults. Therefore, this report was prepared separately in order to expeditiously bring these existing risks to the attention of the Agency.

## BACKGROUND

SBA provides disaster loans to help homeowners, renters, businesses and nonprofit organizations return to pre-disaster condition. These loans are the primary form of Federal assistance for non-farm, private sector disaster losses and are the only form of SBA assistance not limited to small businesses. As of July 3, 2008, SBA had disbursed 119,656 loans totaling approximately \$6.5 billion to victims of the 2005 Gulf Coast hurricanes. Of these, 117,633 loans, or about 98 percent, have been fully disbursed.

During the Gulf Coast hurricanes, SBA's Office of Disaster Assistance underwent a major transformation, consolidating all of the disaster loan approval and disbursement processes from four offices into one loan processing center--the Fort Worth PDC. Simultaneously, SBA converted its obsolete disaster loan management system and paper-based credit and collateral files to a new Web-based system, called the Disaster Credit Management System (DCMS), creating an electronic filing system for its disaster loan application and disbursement processes. However, SBA retained paper copies of the original collateral documentation (i.e., collateral files), such as mortgages, deeds of trusts, lien filings, etc.

The PDC, which operates under the cognizance of ODA, is responsible for the approval and disbursement of all disaster loans. Until the loans are transferred to the appropriate loan servicing center, the PDC is also responsible for any necessary loan servicing actions. Under SOP 50 30, *Disaster Assistance Program*, these actions consist of: (1) monitoring disaster loan installment payments; (2) reviewing delinquency reports; (3) contacting past-due borrowers by telephone; (4) issuing collection notices; (5) encouraging prompt payment; (6) deferring payments; and (7) re-amortizing loans. Currently, the Buffalo CSC performs all collection actions (in steps in 1-5 above) for the PDC on all delinquent loans, whether fully or partially disbursed. However, management informed us that the center provides only "rudimentary servicing." Because there are no specific time frame requirements, the Buffalo center does not begin contacting borrowers until loans are at least 31 days past due.

Once the loans have been fully disbursed, loan files must be transferred to either the El Paso or Birmingham Loan Servicing Center for servicing. Loans made to borrowers in states that are west of the Mississippi River are assigned to El Paso, and loans for those borrowers east of this river are assigned to Birmingham. Both of these centers report to OFA and are subject to SOP 50 50, *Loan Servicing*, for business loans and SOP 50 52, *Consumer Loan Servicing and Collection for Disaster Home Loans*, for home loans.

In response to previous audit findings regarding the lack of specific time frame requirements for collection notices on delinquent disaster loans,<sup>1</sup> the OFA issued a directive, via email, to supplement the SOPs. This directive outlined when collection activities are required by the loan servicing centers. Based on this directive, the centers are required to contact borrowers and send collection notices when loans are 11, 25, 40, and 60 days past due. In addition, based on the directive, all unsecured and secured loans with a balance of \$25,000 or less should be charged-off by the time they are 120 days past due.

The audit was conducted between October 2007 and April 2008 in accordance with *Government Auditing Standards* as prescribed by the Comptroller General of the United States, and included such tests as was considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

## **RESULTS**

We identified two areas of concern related to the transfer of files from the PDC to the Loan Servicing Centers. First, due to the inadequate and untimely collection and filing of loan documentation, the PDC had not transferred either paper or loan files for 25,352 fully-disbursed loans to the Loan Servicing Centers. Many of these loans had been fully disbursed for at least a year. In June 2007, the PDC formalized specific guidelines for its File Forwarding team to research and resolve incomplete or inadequate collateral files prior to transferring them to the Loan Servicing Centers. Secondly, we found 5,325 loans that were transferred to the El Paso Center without physical collateral files were not serviced. Instead, the center held these loans in suspense awaiting receipt of the physical collateral files. Because the El Paso Loan Servicing Center had not initiated collection activities on these loans, loan defaults and loss to the Agency by increase.

### **Fully Disbursed Loans Were Not Transferred Timely to Servicing Centers**

As of February 8, 2008, the PDC was holding 25,352 fully disbursed loans, which it had not transferred to the servicing centers. Fully disbursed loans are held by the File Forwarding team at the PDC when one or more documents are needed to complete the collateral file are missing. On average, 401 days had passed since the loans' final disbursement. Over 180 days had passed since the final disbursement for 21,027, or 82 percent of these loans.

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<sup>1</sup> Office of Inspector General (OIG) Report No. 05-09, *Management Advisory Report on Pre-Demand and Demand Letters for Delinquent 9/11 Disaster Loans*, January 11, 2005.

Further, of the 25,352 loans held at the PDC, 944 were either past due, delinquent, or in liquidation. Table 1 provides a breakdown of the status of all of the held loans as of February 8, 2008.

**Table 1.**  
**Status of Fully Disbursed Loans at the PDC**  
**as of February 8, 2008**

Status	Number of Loans
Current (less than 10 days past due)	23,383
Paid In Full	829
Past Due (10 to 59 days past due)	596
Delinquent (60 days or more past due)	295
Deferred	196
In Liquidation	53
<i>Total</i>	25,352

Source: Database provided by SBA Office of the Chief Information Officer

Because the 891 loans that were either past due or delinquent had been held by the PDC, they did not always receive proper servicing by ODA at the specified time frames established by the servicing centers' operating procedures. Although OFA requires the servicing centers to contact borrowers at specified points of delinquency, ODA has no such requirement. In addition, 10-day collection letters, which are automatically generated and sent to borrowers for loans assigned to the servicing centers, were not sent for the loans held by the PDC. Even though the PDC is subject to the servicing requirements for loans in its possession as set forth in SOP 50 30, which require that past due borrowers are contacted and provided appropriate collection notices, the SOP does not contain specific time frames for servicing actions. Additionally, the PDC did not consistently service the fully disbursed loans reviewed.

The PDC provided a detailed summary of the missing documents, listed in Table 2 below.

**Table 2.**  
**Missing or Insufficient Documents for Loans Held at the PDC**

<b>Missing Documents or Information</b> (Listed in descending order by number of loans per category)	<b>Number of Loans</b>
Hazard insurance on real estate	1,115
Flood insurance on real estate	1,003
Hazard insurance on personal property	985
SBA endorsement for hazard insurance	951
Flood insurance on personal property	944
Property title work	915
Assignment of insurance proceeds	818
Recorded mortgage	746
SBA endorsement for flood insurance	745
Relocation hazard insurance on personal property	701
Other	16,429
<i>Total</i>	<i>25,352</i>

Source: *Fully Disbursed Daily File Report* provided by the Fort Worth PDC

Although the categories above indicate documentation deficiencies in the loan collateral files, we believe none represented a valid reason to postpone the transfer of loan files to the servicing centers.

We found that the Buffalo CSC did not properly monitor and service the delinquent loans that were being held for transfer to the servicing centers. The Buffalo center placed phone calls and sent reminder letters to delinquent borrowers, but did not consistently initiate collection actions when delinquency extended beyond 31 days. Consequently, loans were not properly and timely serviced. The risk to the Agency is compounded by the fact that some loans were severely delinquent when finally transferred to the appropriate loan servicing center.

Early communication with borrowers is critical to prevent loans from defaulting. A recent report<sup>2</sup> by the Office of Inspector General at the U.S. Housing and Urban Development (HUD) noted that the success of resolving delinquent loans was directly tied to how promptly a lender initiated collection action. The report also noted that a Federal Housing Administration lender found that if a workout arrangement was not made within 7 months of the delinquency, the lender had only a 10 percent success rate of preventing the loan from defaulting. However, if a workout was processed within the first or second month of delinquency, the

<sup>2</sup> HUD OIG Report No. 2002-DE-0001: *Follow-Up Nationwide Review - Department of Housing and Urban Development's Loss Mitigation Program*, February 28, 2002.

success rate of the workout increased to more than 45 percent. This review noted that the longer a loan remained in delinquency, the harder it became to reinstate the loan because the likelihood that the borrower would give up or pursue other actions, like filing for bankruptcy, increased.

We acknowledge the importance of obtaining complete supporting documentation to protect the government's interest, as noted in two recent SBA OIG audit reports, *Securing Collateral for Disaster Loan Disbursements*,<sup>3</sup> and *Review of the Adequacy of Supporting Documentation for Disbursement*.<sup>4</sup> These reports highlighted the fact the Agency did not always perfect collateral and obtain other supporting documents, such as verification of hazard or flood insurance coverage. However, these documents are not needed to initiate collection actions and many pre-liquidation servicing actions. As previously discussed, fully disbursed loans can only receive adequate servicing if they are transferred timely to the appropriate servicing center, or if serviced in accordance with the guidelines used by the disaster loan servicing centers.

### **Loans Were Not Adequately Serviced by the El Paso Loan Servicing Center**

We found that the 5,325 loans being held in suspense were not actively serviced by the El Paso Loan Servicing Center because they were transferred to the center without their collateral files. The El Paso Servicing Center placed the transferred files on hold until after collateral files were received instead of assigning them to a team for servicing. The only servicing activities that had occurred were borrower-initiated actions, such as deferments or 10-day delinquency notices to borrowers that were automatically system-generated. No other servicing or delinquency monitoring was initiated by the El Paso center. As a result of our audit, in January 2008, the El Paso center mailed demand letters to borrowers for 378 loans held at the center that were over 65 days delinquent. However, this was a one-time action, and all other loans less than 60-days delinquent were not addressed.

As shown in Table 3 below, approximately 1,120 of these loans were past due, delinquent, or in liquidation.

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<sup>3</sup> Report No. 07-22, May 9, 2007

<sup>4</sup> Report No. 08-07, January 29, 2008

**Table 3.**  
**Status of Loans Held at El Paso Center**  
**as of December 5, 2007**

Status	Number of Loans
Current (less than 10 days past due)	4,205
Past Due (10 to 59 days past due)	567
Delinquent (over 60 days past due)	550
In Liquidation	3
<i>Total</i>	5,325

Source: Database provided by SBA Office of Chief Information Officer

In contrast to servicing issues identified at El Paso, the Birmingham center was servicing loans transferred to it immediately after the PDC forwarded the electronic loan files. Management at the Birmingham center stated that the center did not wait for receipt of physical collateral files to commence servicing and collection actions when these files were not needed for these actions. The continuation of unmonitored delinquent loans being held at the El Paso center poses a risk of increased loss to the Agency.

## RECOMMENDATIONS

We recommend that the Associate Administrator for the Office of Disaster Assistance:

1. Transfer all electronic loan files held by the PDC to the appropriate loan servicing center for timely servicing and collection activities once the loans are fully disbursed. The PDC should continue to obtain and perfect all required documentation prior to shipping the paper collateral files.
2. Revise current policy to identify specific time requirements for the transfer of physical electronic files from the PDC to the loan servicing centers.
3. Adopt current servicing standards used by the El Paso and Birmingham Servicing Centers for loans that have not been transferred from the PDC.

We recommend that the Director, Office of Financial Assistance:

4. Direct the El Paso Loan Servicing Center to automatically assign all loans to a servicing team upon receipt of electronic loan files from the PDC and to complete servicing of the 5,325 unassigned loan files.
5. Revise current policy to include specific time requirements for collection actions on delinquent loans.



## **AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

On May 15, 2008 we provided OFA and ODA with a draft of the report for comment. On June 13, 2008, ODA submitted its formal response and on June 12, 2008, OFA submitted its response. These comments are contained in their entirety in Appendix II. ODA disagreed with recommendations 1 and 2, but provided an alternative course of action to address the intent of the recommendations. ODA also generally disagreed with the audit findings, and commented on several general issues raised in the report. OFA agreed with the audit findings and recommendations 3 and 4, but commented on the accuracy of one reported figure in the first recommendation.

### **Recommendations 1 and 2**

#### *Management Comments*

Management agreed with the underlying objectives of the two recommendations, but disagreed with the specific actions recommended. ODA stated that it would be in the best interest of the Agency and borrowers to have the PDC, with support from the Buffalo Customer Service Center (CSC), service these loans with incomplete collateral files until all documentation has been obtained and perfected. ODA believes it is better positioned than OFA in terms of resources, expertise, and tracking systems to quickly cure deficiencies in the loan files. Further, the servicing centers cannot update data in DCMS once the files are transferred to them; and once the files are transferred, the PDC would be severely limited in the updates it could make to DCMS.

However, ODA acknowledged that if it kept the loan files, it would need to adopt the same loan servicing and collection guidelines as the Disaster Loan Servicing Centers. As a result, ODA made a counterproposal to adopt the procedures and processes established by the servicing centers.

#### *OIG Response*

The OIG believes that ODA's adoption of the procedures used by the Disaster Loan Servicing Centers should remedy the deficiencies noted in the audit. This action should ensure that calls and letters to borrowers are made at the intervals established by OFA. However, ODA did not specify in its response when these procedures would be adopted. Therefore, we have added recommendation 3 to ensure that the PDC takes the alternative action it has proposed. Additionally, we believe that the PDC should expeditiously ready the loans files for transfer to the

servicing centers within reasonable time frames to preserve the PDC's resources for originating and disbursing ongoing disaster loans.

#### **Recommendation 4 (formerly Recommendation 3)**

##### *Management Comments*

OFA agreed with the recommendation, and stated that it has already taken action to ensure loans are automatically assigned to a servicing team upon receipt of the electronic loan files and that the loans are serviced. OFA added that the El Paso Center has made substantial improvements in servicing the loans awaiting collateral files, reducing the number of loans needing servicing from 5,325 to 2,792 as of May 27, 2008.

##### *OIG Response*

OFA's comments are responsive to the recommendation.

#### **Recommendation 5 (formerly Recommendation 4)**

##### *Management Comments*

OFA agreed with the recommendation and stated that it has already addressed this matter. OFA has reviewed and revised its policy that governs the sequence of collection actions, which includes time frames for completing those actions.

##### *OIG Response*

OFA's comments are responsive to the recommendation.

#### **General Comments**

Additionally, ODA and OFA made five general comments on various facts and findings in the report, which are summarized below, along with our responses.

##### *Comment 1*

ODA did not agree that the deficiencies identified by the OIG were severe enough to create greater risk of loan defaults, if not corrected.

ODA acknowledged that their current servicing process was not as vigorous and frequent as that of the loan servicing centers, but stated it had collected some

payments as a result of contacts it had made with delinquent borrowers. ODA also reported that it had removed some loans from delinquency status by extending or deferring the repayment periods, and providing other forms of relief to borrowers.

### *OIG Response*

The OIG believes that ODA's comments conflict with basic loan servicing guidelines that were established to minimize defaults in the disaster loan program. The timelines established for servicing disaster loans indicate that early and frequent attempts should be made to either re-establish payments, or to negotiate workout arrangements. Further, the benefits of early servicing have been illustrated by other agencies' OIG reports. For example, the HUD OIG reported in 2002 that the success of resolving delinquent loans was directly related to how promptly collection actions were initiated. In contrast, ODA has provided no evidence to support its position that servicing does not mitigate the risk of loan defaults. Also, if ODA's assertions that delays in servicing loans will not increase the risk of loan defaults were true, it would call into question not only the efficiency of OFA's servicing standards, but the need for many of the current activities of the loan servicing centers.

Further, while we acknowledge that the PDC has realized some benefits from its servicing actions, we question whether the PDC could have further reduced the Agency's losses if it had more promptly initiated collection activities. We noted that 7 of the 16 loans reviewed, or 44 percent, serviced solely by the PDC were missing evidence of contact during the first 60 days and none were serviced at all during the first 30 days of delinquency. If the PDC follows the collection standards set by the loans servicing centers as it has agreed to do, it may achieve better results.

### *Comment 2*

ODA disagreed with the OIG's assertion that loans assigned to the File Forwarding Team were not adequately monitored to ensure that they were timely researched and forwarded to the Disaster Loan Servicing Centers for servicing.

ODA believes it has made tremendous progress from June 2007 to date. It claims that 73,000 loan file transfers have been completed in the 49 weeks since that time; and that organizational changes, process reviews and improvements have led to increased transfers. ODA also asserts that, contrary to the statement in the report, it has made major progress since June 2007.

### *OIG Response*

We acknowledge that ODA has made progress in reducing the backlog of loans assigned to the File Forwarding Team, although the backlog was not eliminated by February 8, 2008, as planned. Further, between February 8, 2008 and June 23, 2008, ODA had reduced the backlog of loans from 25,352 to 13,925. Although our audit showed that the PDC had not timely forwarded loans to the servicing centers, we have removed references in the report to the PDC's lack of monitoring of loans assigned to the File Forwarding team.

### *Comment 3*

ODA disagreed that 891 loans were past due or delinquent, stating that 162 of these loans had already been transferred to loan servicing centers. Therefore, 729 is the correct number of past due, delinquent or liquidated loans.

ODA also took exception with the report's assertion that it does not consistently service fully disbursed loans. It believes that its process is very similar to the process performed by the servicing centers with the exception of the 11-day collection letter. Further, ODA believes that its process has been effective in maintaining the currency of its portfolio.

### *OIG Response*

We have correctly reported that 891 loans were past due or delinquent, which was verified by the Office of Chief Information Officer. This number was derived by matching the 25,352 fully disbursed loans reported in DCMS as of February 8, 2008 with status information contained in SBA's Loan Accounting System. This step was necessary because DCMS does not capture the delinquency status of loans. We are unclear why ODA believes the number of delinquent loans as of February 8, 2008 should be 729. We believe that the difference may be attributable to ODA's use of a different cut-off date than that used by the OIG. Therefore, the number reported by the OIG will remain unchanged.

We reported that the PDC's servicing process was inconsistent with that of the servicing centers because it does not follow the same servicing standards as the centers. ODA acknowledged this fact in its formal comments to the report. ODA does not begin looking at delinquent loans until they are 31 days or more past due. Even then, ODA is inconsistent in the delivery of letters and calls to borrowers. OFA requires weekly calls to borrowers for loans that are 11 to 59 days delinquent and that letters be sent at 11, 25, 40 and 60 days delinquent. ODA has no such

requirements, nor was there any evidence that calls were made or letters sent at the above stated intervals by the PDC.

*Comment 4*

ODA disagreed that the Buffalo CSC did not properly monitor and service delinquent loans that were being held for transfer to the servicing centers. ODA stated that the CSC adjusted its procedures for Gulf Coast Hurricane loan files to provide more lead time to the PDC when requesting transfer of delinquent loans to the servicing offices. ODA stated that the CSC has also taken further steps to cure delinquent loans and collect payments by acquiring the ability to accept loan payments over the phone, and that it had collected nearly \$4 million in loan payments since November 2007. Additionally, ODA's greatly reduced its delinquent loan portfolio over the past 18 months, in part, due to CSC's diligent collection process.

*OIG Response*

Our observations regarding the CSC's actions were based on information recorded in the Agency's Centralized Loan Chron System, and a spreadsheet provided to us by the CSC that documented CSC's collection actions on the loans reviewed. This information showed that CSC did not attempt to contact any borrowers before loans were 31 days delinquent. Also, for 7 of the 16 loans, the CSC made no attempt to contact borrowers in the first 60 days of delinquency. ODA has not provided the OIG any information that would indicate that the CSC's spreadsheet was incorrect.

Further, the fact that ODA has collected some payments on delinquent loans is not, in and of itself, a measure of the effectiveness of ODA's collection actions, because it is unknown how much it would have collected had it more timely contacted borrowers.

*Comment 5*

OFA stated that recommendation 4 incorrectly termed 5,325 loans as delinquent, when Table 3 showed them as unassigned.

*OIG Response*

We agree with OFA, and have revised the recommendation to show that loans were unassigned, rather than delinquent.

## **ACTIONS REQUIRED**

We request that by August 1, 2008, ODA provide the OIG a proposed timeline for implementing recommendation 3 that identifies when it will adopt collection procedures similar to that of the loan servicing centers.

We appreciate the courtesies and cooperation of the Office of the Associate Administrator for Disaster Assistance and the Office of the Associate Administrator for Financial Assistance during this audit. If you have any questions concerning this report, please call me at (202) 205-[FOIA Ex. 2] or Pamela Steele-Nelson, Director, Disaster Assistance Group, at (202) 205-[FOIA Ex. 2].

## **APPENDIX I. SCOPE AND METHODOLOGY**

The audit objective was to determine whether defaulted Gulf Coast Hurricane disaster loans were serviced in accordance with loan provisions and regulations.

The issues discussed in the report were identified during site visits to the Fort Worth Processing and Disbursement Center (PDC), and the El Paso and Birmingham Loan Servicing Centers. We developed information on the file transfers and servicing delays through interviews with officials at SBA's Office of Disaster Assistance (ODA), Office of Financial Assistance (OFA), the Buffalo Customer Service Center (CSC), and the Office of the Chief Information Officer.

We reviewed information in SBA's Loan Accounting System on loan approval dates, approved loan amounts, and outstanding loan balances, and conducted tests to verify the accuracy of this data. We also obtained information from the PDC on loan files that had not been transferred to the servicing centers due to missing or insufficient documents.

The audit was conducted between October 2007 and April 2008 in accordance with *Government Auditing Standards* as prescribed by the Comptroller General of the United States, and included such tests as was considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

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

Date: June 13, 2008

To: Debra S. Ritt  
Assistant Inspector General for Auditing

From: Herbert L. Mitchell  
Associate Administrator  
for Disaster Assistance

Subject: **OIG Draft Report - Disaster Loan File Transfer and Servicing Delays**  
(Project No. 8305)

FOIA Ex 6

We have reviewed the draft audit report regarding the Disaster Loan File Transfer and Servicing Delays. Thank you for the opportunity to respond to the Draft Report. The Draft Report identifies two areas of concern related to the transfer of files from the Processing and Disbursement Center (PDC) to the Office of Financial Assistance Loan Servicing Centers (Servicing Centers). This response only addresses the areas that pertain to the Disaster Loan(making) Program. Per your request, our response indicates our concurrence/non-concurrence with your recommendations. In addition, our response also addresses comments in the body of the Draft Report, used in support of the recommendations, to which we take exception. Our comments are noted below:

### OIG RECOMMENDATIONS:

*We recommend that the Associate Administrator for Disaster Assistance:*

- 1. Transfer all electronic loan files held by the PDC to the appropriate loan servicing center for timely servicing and collection activities once the loans are fully disbursed. The PDC should continue to obtain and perfect all required documentation prior to shipping the paper collateral files.*
- 2. Revise current policy to identify specific time requirements for the transfer of physical electronic files from the PDC to the loan servicing centers.*

### ODA RESPONSE:

We do not concur with either recommendation for the reasons set forth below. We understand the underlying objective of the recommendations to be the servicing and collection of disaster loans in accordance with the standards of the Servicing Centers. ODA agrees to adopt those standards



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ODA believes that it is in the best interest of the agency and the borrowers for the PDC, with support from the Customer Service Center (CSC), to transfer the electronic file and the paper collateral file once all documentation has been obtained and perfected. The PDC should retain responsibility for servicing these loans and will ensure that all of the procedures and processes in place in the Servicing Centers are adhered to as well.

On balance, ODA is better positioned in terms of resources, expertise and tracking systems, to effectively and quickly cure deficiencies in these files. Together with ODA's agreement to conduct all servicing and collection activities in full compliance with established Servicing Center standards, the objective underlying the Recommendations can and will be effectively addressed. Further, we offer details, explained below, as to how proceeding with Recommendation #1 would significantly impair efforts to resolve file deficiencies, and may create confusion for borrowers and adversely impact established relationships, expectations and understandings with the Servicing Centers.

There are technological issues that would impact both Servicing Centers and ODA under the proposed procedures in Recommendation #1. Servicing Centers utilize DCMS in a "read only" capacity, making no updates to DCMS once transfer of the electronic file is accomplished. The PDC uses DCMS for all file activities, including image storage, comments, modifications, updating document received status and file location and contents. It is also the source of reports on production, including progress on addressing file deficiencies. Once a file is transferred to the Servicing Center, the ability of the PDC to update DCMS records is severely limited. The consequence is that if the file is transferred while the PDC continues to conduct activity (such as curing deficiencies in documents or file contents), DCMS no longer is useful to either operation. If a document is sent to the PDC, the receipt cannot be properly logged into DCMS (it would be forwarded to the Servicing Center), and likewise if a document is received in a Servicing Center related to curing deficiencies, DCMS cannot be updated and the PDC would not be aware of this unless a manual system was created. Further, if a loan modification action in servicing changed the loan, negating the need for some documentation, staff in the PDC would still see the loan record unchanged and still in need of activity to secure the document. Accordingly, as a matter of practicality and efficiency, sending the electronic file to the Servicing Center while retaining responsibility to cure file deficiencies is not a good solution, as DCMS needs to be the PDC's record of what is needed, and the Servicing Center should ideally take control of the DCMS record in as complete a state as possible so that future use of the read-only loan record is accurate.

New procedures implemented in March of this year have placed responsibility for shipping review and file compliance with the Case Manager and Team Attorneys, so it is addressed on an ongoing basis throughout the life of the loan and does not involve a separate team or group. Files are completely transferred (electronically and paper collateral) in a matter of several weeks after full disbursement. Accordingly, current file forwarding procedures for all non-KEW files have virtually eliminated time delay issues. Since implementation of the revised process the PDC has successfully shipped approximately 1286 files to the Servicing Centers with the average number of days between full disbursement and shipping to servicing being 13 days.

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### COMMENTS

#### Opening Page

In the opening page of the report, the third paragraph opens with the following conclusion:

*"We believe the deficiencies identified in this report, if not corrected promptly, could lead to a greater risk of loan defaults."*

ODA does not believe that the findings of the OIG report are of a nature or severity to justify a conclusion that they will create a greater risk of loan defaults. The key findings of this audit, as it affects ODA, can be summarized as OIG concern at the delay in transferring electronic loan files and physical collateral files to the Servicing Centers, and the concern that efforts at addressing delinquencies for files in ODA control were not the same as the procedures in the Servicing Centers.

The report recites general findings by HUD OIG, regarding the need for promptly initiating contact with delinquent borrowers and early workout agreements being implemented to create the best chance of avoiding default. While not as vigorous and frequent as the Servicing Center standard, much of it part of an automated process to which we do not currently have access, ODA does make contact with delinquent borrowers and can point to the collection of electronic payments (and other successes at collections) as evidence of the positive impact of our efforts. Loan modifications were undertaken to reduce payments, defer payments, extend maturity or otherwise grant relief to borrowers with legitimate difficulties. Loans subject to bankruptcy filings or foreclosure were expeditiously sent to Santa Ana. Delinquency reports did get addressed at least monthly in one form or another.

#### I. Results

##### Page 3, First Paragraph

*"In June 2007, the PDC formalized specific guidelines for its File Forwarding team to research and resolve incomplete or inadequate collateral files prior to transferring them to the Loan Servicing Centers. However, loans assigned to this team were not adequately monitored to ensure that they were timely researched and forwarded for servicing."*

ODA disagrees with the conclusion made in the last sentence of the excerpt above, and does not believe it is supported by a review of the facts and circumstances, or by the tremendous progress that was made from the June 2007 period through today. Organizational changes, process reviews and improvements, and focused resources initiated in June 2007 resulted in file transfer rates increasing dramatically, with over 73,000 transfers completed in the 49 weeks since. Contrary to the statement above from

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the report, the period since June 2007 was characterized by major progress, clear focus and as timely an effort as volume and resources permitted.

### II. Fully Disbursed Loans Were Not Transferred Timely To Servicing Centers

Page 4, Last Paragraph:

*"Because the 891 loans that were either past due or delinquent had been held by the PDC, they did not always receive proper servicing by SBA at the specified time frames established by the servicing centers' operating procedures. Although the Office of Financial Assistance requires the servicing centers to contact borrowers at specified points of delinquency, ODA has no such requirement. In addition, 10-day collection letters, which are automatically generated and sent to borrowers for loans assigned to the servicing centers, were not sent for the loans held by the PDC. Even though the PDC is subject to the servicing requirements for loans in its possession as set forth in SOP 50 30, which require that past due borrowers are contacted and provided appropriate collection notices, the SOP does not contain specific time frames for servicing actions. Additionally, the PDC did not consistently service the fully disbursed loans reviewed."*

Of the 891 past due or delinquent loans identified in the IG report showing in 9030 (i.e., in the PDC), our review of the location data indicates 162 of these loans were not in 9030, but instead were already electronically transferred to the servicing offices. The 162 files were assigned to and serviced by the corresponding Servicing Center. Therefore, the adjusted total for past due, delinquent and liquidated loans in 9030 should be 729 loans.

The IG report mentions the inability of Denver Finance to automatically send a 10 day past due letter to the borrower for files that are in 9030. We agree that adding 9030 to the automated process would benefit the Agency and Borrowers. We believe that the 10-day letters should be generated for any fully or partially disbursed file that is in repayment status and becomes delinquent, regardless of where the file is currently located. Other than the 10 day letter, the PDC process for following up with borrowers that have past due loans is very similar to the Servicing Center follow up procedures. In addition, CSC also performs collection activities on delinquent loans (loans more than 30 days past due) within the ODA portfolio. The Customer Service Center has proven to be very effective in maintaining the currency of ODA's portfolio. Finally, the CSC also has the ability to accept delinquent payments from borrowers over the phone (Pay.Gov). The Pay.Gov process is a considerable enhancement to ODA collection activities, and has been in use as an option since November 2007. The PDC closely coordinates with the CSC when the opportunity to collect over the phone arises to satisfy a delinquency. The process provides a means to reduce the risk of borrower default.

Page 5, First Paragraph after Table 2, and Page 6, First Paragraph:

*"Although these categories indicate documentation deficiencies in the loan collateral files, we believe none represent a valid reason to postpone the transfer of loan files to the servicing centers."*

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*"We acknowledge the importance of obtaining complete supporting documentation to protect the government's interest, as noted in two recent SBA OIG audit reports, Securing Collateral for Disaster Loan Disbursements, and Review of the Adequacy of Supporting Documentation for Disbursement. These reports highlighted that the Agency did not always perfect collateral and other supporting documents, such as proof of hazard or flood insurance policies. However, these documents are not needed to initiate collection actions and many pre-liquidation servicing actions. As previously discussed, fully disbursed loans can only receive adequate servicing if they are transferred timely to the appropriate servicing center. Because the PDC was holding over 25,000 loan files, we recommend that the PDC immediately transfer the electronic files of all fully disbursed loans to the appropriate servicing center, and continue finalizing the collateral files."*

ODA disagrees with the conclusions and rationales used by OIG in these statements. In the excerpt from page 5, the OIG assertion that "none [of the deficiencies shown in the chart] represent a valid reason to postpone the transfer of the loan files to the servicing centers" fails to take into account very relevant facts on both the PDC and the Servicing Center side.

A primary consideration is that once a file is transferred in DCMS, the PDC loses the ability to modify most screens and data fields. Such data entry may be necessary to issue modified loan closing documents for execution, create loan modifications to address issues, update or modify checklists, or reflect additions to the collateral file in DCMS. Further, any actions taken by the Servicing Center, including loan modifications or the receipt of critical documents which we are requesting, would not be updated to DCMS (Servicing Centers do not perform actions in DCMS, and use it on a read only basis).

A second consideration is that the process of correcting deficiencies may involve many steps. This may include full review of all scanned documents for misnamed or incomplete documents, reconciliation of paper collateral file with electronic file, correction or re-issuance of loan documents for execution or re-execution, collection of fees for filing, legal opinion review to assess the validity of some documents or the true need for others, intense follow up and contact with borrower, insurance agents and title services, and constant documentation of all steps. DCMS is the only tool that accommodates these key steps, including documenting the efforts to cure deficiencies. With the file transferred, DCMS may be unavailable for use to a large degree. For the Servicing Center, looking at a file electronically transferred with deficiencies, the DCMS checklists or "File Location" tabs will never reveal whether or not the deficiencies were cured. We believe that all parties are better served by the PDC undertaking the efforts to cure deficiencies in-house, within the context of DCMS, and making every effort to send the Servicing Center complete, enforceable files to the highest degree possible.

As to the statements made in the excerpt from page 6, the OIG seems to presume that liquidation (or pre-liquidation efforts) can be accomplished in all cases with the deficiencies not addressed. Such decisions require a full understanding of the file including the current status of the efforts to cure deficiencies, particularly ones that affect

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collateral, since the availability of security will impact liquidation decisions. The PDC works closely with all loan servicing offices in addressing foreclosure and bankruptcy notices sent to either PDC or the Servicing Center, making sure they immediately have complete and up to date information.

Page 5, Second Paragraph

*"We found that the Buffalo Customer Service Center did not properly monitor and service the delinquent loans that were being held for transfer to the servicing centers. The Buffalo center placed phone calls and sent reminder letters to delinquent borrowers, but did not consistently initiate collection actions when delinquency extended beyond 31 days. Consequently, loans were not properly and timely serviced or liquidated. The risk to the Agency is compounded by the fact that some loans are severely delinquent when finally transferred to the appropriate loan servicing center."*

The CSC has been proactive in adjusting its procedures on KRW files to provide more lead time to the PDC when requesting transfer of delinquent loans to the servicing offices. The CSC has also taken further steps to cure delinquent loans and collect payments by acquiring the ability to accept loan payments over the phone. Since receiving this capability in November 2007, the CSC has collected nearly \$4 million in loan payments on behalf of the agency.

ODA's delinquent loan portfolio has been greatly reduced over the past 18 months, in part, as a result of the CSC's diligent collection process. In December 2006, there were more than 5,000 disaster loans over 30 days past due. This figure was reduced to approximately 1,500 in September 2007 and less than 700 files today. While much of these results are also attributable to the efforts of the PDC, the collaborative working relationship between the two offices has been critical.

In summary, the process of transferring files from the PDC to the Servicing Centers has been greatly improved and the PDC will follow OFA policies and procedures when it services loans that are awaiting transfer.

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DATE: June 12, 2008

TO: Debra Ritt  
Assistant Inspector General for Auditing

FROM: Grady Hedges [FOIA Ex. 6]  
Director, Office of Financial Assistance Y

SUBJECT: Response to the Office of Inspector General's Draft Report  
Titled Disaster Loan File Transfer and Servicing Delays  
(Project No. 8305)

Thank you for the opportunity to respond to the Draft Report on Disaster Loan File Transfer and Servicing Delays. The Draft Report identifies two areas of concern related to the transfer of files from the Processing and Disbursement Center (PDC) to the Office of Financial Assistance Loan Servicing Centers (Servicing Centers). This response only addresses the areas that pertain to the Office of Financial Assistance (OFA), outlined in recommendations three and four. Please find below OFA's responses to your recommendations.

### Responses to OIG Recommendations

3. Direct the El Paso Loan Servicing Center to automatically assign all loans to a servicing team upon receipt of electronic loan files from the PDC and to complete servicing of the 5,325 delinquent loan files that were less than 60-days delinquent.

Aside from the characterization above of the "unassigned" loans as "delinquent", OFA agrees with the recommendation and has already addressed this issue. At OFA's direction in March 2008, the 5,325 loans in the El Paso Center without collateral files were all assigned to team members for normal and full servicing activities. In addition, new loans transferred to the centers are consistently and automatically assigned to teams for complete loan servicing and collection activities, regardless of whether the physical collateral file is on hand.

As a point of clarification, the 5,325 unassigned loans are inappropriately characterized in the above recommendation as "delinquent." As detailed in Table 3 of OIG's report, 79% (4,205) of these loans were current and therefore should not be labeled as past due or delinquent in any way.

Overall, the center has made substantial improvements in managing loans that are awaiting collateral files. As of May 27, 2008,

- 2,792 loans remain awaiting collateral files
  - 93% (2,418) of those loans are current
  - 280 are past due (vs. 567 in December 2007), and
  - 94 are delinquent (vs. 550 in December 2007)

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*4. Revise current policy to include specific time requirements for collection actions on delinquent loans.*

OFA has already addressed this issue and so is in agreement with this recommendation. OFA reviewed and revised its policy that governs the sequence of collection actions which includes timeframes for those actions. The policy also outlines the automatic process of referring seriously delinquent disaster loans to Treasury for offset and collection to meet Agency and Debt Collection Improvement Act requirements. The attached version of this policy statement was issued in January 2008 and re-issued in May 2008.

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### Attachment 1

#### **SBA Disaster Loan Loss Mitigation and Recovery**

SBA's performance in the area of disaster loss recovery has resulted from a specific strategic positioning of SBA in this area beginning not long after the Agency was formed. This effort grew out of the need to collect debt owed the government in a timely, responsible and professional manner. SBA has continually enhanced and improved the Agency's debt collection processes and internal controls over the years.

SBA has undertaken a number of recent initiatives to further develop its disaster loan collection processes. These initiatives include:

- increasing efficiency and taking advantage of economies of scale through centralizing disaster loan servicing and collection in three centers across the country,
- improving customer service and debt collection through the use of electronic records, automated messaging capability and autodial systems in the centers, and
- providing for the rapid transfer of eligible loans to Treasury for offset and cross-servicing.

SBA has pursued the consolidation of internal functions to achieve greater efficiency in loan servicing activities and has made extensive use of all available debt collection tools. SBA's three large-scale disaster centers handle a portfolio of approximately 224,000 disaster loans with an outstanding balance of \$9 billion. Two of the centers (located in Birmingham, Alabama and El Paso, Texas) are responsible for current and early stage delinquent loans, and conduct rapid follow-up by phone and mail if accounts become delinquent.

Because of SBA's mission to assist disaster victims, the Agency's first recourse with past due loans is to attempt to get the accounts back into a paying status if possible. If a debt restructuring or other remedial action cannot be achieved, collateralized delinquent loans above \$25,000 are transferred to SBA's disaster loan resolution center in Santa Ana, California. Unsecured loans and secured loans with balances at or below this amount are charged-off and sent to Treasury for cross-servicing. The Santa Ana center pursues collection on secured loans above \$25,000 through foreclosure or litigation if there is worthwhile collateral or obligors who can be pursued in a cost-effective manner. The general collection process is outlined in the chart below.

#### *General Time Line: Delinquent Disaster Loan Servicing and Loss Recovery*

<i>Days Delinquent</i>	<i>Servicing/Recovery Milestone</i>
<i>1</i>	<i>Payment is one day past scheduled due date.</i>
<i>11</i>	<i>If no payment is received borrower is called. Automated message system</i>



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	(AMS) letter 05 is sent requesting payment of late installment. Sending of the letter is noted in delinquent loan collection system (DLCS) electronic chronological log. Weekly borrower calls commence through autodial system.
25	If no payment is received, weekly calls continue and AMS letter 021 is sent and automatically noted in the DLCS electronic chron log.
40	If no payment is received, weekly calls continue and AMS letter 022 is sent and automatically noted in the DLCS electronic chron log.
60	If no payment or satisfactory response is received, the borrower is called and final pre-demand AMS letter 024 is sent with a 15-day response time. The sending of the letter is automatically noted in the DLCS electronic chron log.
90-100	If there is still no response, loans above \$25,000 with collateral (including collateralized guarantees) and loans in litigation will be sent to the Santa Ana Disaster Loan Resolution Center for loss recovery. However, loans in any amount that are not in litigation and are unsecured (no collateral initially or all collateral released) or secured only by household goods, or secured but with a loan balance \$25,000 or below, will be charged off by Birmingham/El Paso to initiate the transfer process to Treasury Debt Management Services (DMS) for cross-servicing. These accounts will be automatically transferred to DMS after a 60-day due process letter, but loan files will remain at Birmingham/El Paso for the standard records retention period prior to being sent to a federal records center. SBA cannot work accounts transferred to DMS for servicing.
120	At 120 days delinquency all loans <u>not</u> charged off will be automatically sent a 60-day due process notice advising of possible referral for Treasury administrative offset (TOP). At 180 days, all loans (unless coded "do not refer" because of workout, bankruptcy, foreclosure, litigation) will be referred to TOP but SBA will continue servicing.
120-220	Acceleration of debt and demand for payment letter is sent to borrower by the Santa Ana center on liquidation cases sent from Birmingham/El Paso.
220+	Loss recovery liquidation actions continue on all cases at the Santa Ana center, including judicial or summary foreclosure on loans with collateral having worthwhile equity, and pursuit of deficiency balances from collectible guarantors. Litigation will usually be handled by a local SBA district office (through the office of the U.S. Attorney) in coordination with Santa Ana counsel. Loans are charged off when all cost-effective recovery actions have been concluded. All loans and loan guarantors that are still legally collectible will be automatically transferred to Treasury for servicing after charge-off following the issuance of the required 60-day due process letter.

As indicated, SBA begins aggressive collection action on disaster accounts as soon as they become overdue. The Agency has a large number of attorneys in its 70 state offices

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*that serve as Special Assistant U.S. Attorneys who help facilitate local litigation actions such as summary and judicial foreclosure on personal and real property, as well as litigation against guarantors and other loan obligors. These procedures are exemptions under the Debt Collection Improvement Act of 1996 (DCIA) from transfer to Treasury of accounts that are over 180 days delinquent.*

*As shown in the disaster loan servicing and recovery timeline above, SBA rapidly charges off and transfers to Treasury all unsecured loans and secured loans \$25,000 and below for inclusion in Treasury cross-servicing. In addition, collateralized loans above \$25,000 that have no cost-effective recovery potential through foreclosure on collateral or litigation against obligors/guarantors are also charged off and transferred to Treasury for participation in all collection and offset processes used by Treasury. SBA has in place automated systems that allow for the mass transfer of these accounts on a weekly basis. Further, other secured accounts are transferred to Treasury immediately upon completion by SBA of foreclosure and litigation procedures directed toward obtaining timely recovery from loan collateral and account obligors.*

*With regard to DCIA compliance, SBA received the following exemption in a letter dated January 3, 2000 from Treasury's Under Secretary for Domestic Finance:*

*"I approve your request for exemption from mandatory transfer of disaster and regular business loans over 180 days delinquent that are in active workout. [W]e 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. Once SBA determines that a workout is not feasible and, in the case of collateralized loans, completes its liquidation/foreclosure, any remaining debts over 180 days delinquent are subject to mandatory transfer to Treasury under the DCIA, unless a specific statutory or regulatory exemption applies."*

*SBA directives addressing disaster loan servicing are contained in Standard Operating Procedures 50 50 (Loan Servicing), 50 51 (Loan Liquidation) and 50 52 (Loan Servicing and Collection for Disaster Home Loans).*