

**RELEASE OF COLLATERAL BY THE DISASTER LOAN SERVICING
CENTERS**

Report Number: 11-15

Date Issued: June 3, 2011

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



U.S. Small Business Administration
Office Inspector General

Memorandum

To: John A. Miller
Director, Office of Financial Program Operations
/s/ Original Signed

From: Peter L. McClintock
Deputy Inspector General

Subject: Report on the Release of Collateral for the Disaster Loan Servicing Centers, Report No. 11-15

Date: June 3, 2011

This report summarizes our audit of the Small Business Administration's (SBA) Release of Collateral by the Disaster Loan Servicing Centers. The audit objective was to determine whether the servicing centers were appropriately and timely releasing collateral on disaster loans.

To evaluate the appropriateness of collateral releases, we reviewed a statistical sample of 120 collateral release decisions made on active loans by the Birmingham and El Paso disaster loan servicing centers during the period September 1, 2007 to May 31, 2010. We separately evaluated the timeliness of collateral releases at both servicing centers using a statistical sample of 30 collateral release decisions for loans that were paid in full.

To test whether the servicing centers appropriately released collateral, we interviewed the staff responsible for performing collateral releases to gain an understanding of the process and the rationale behind specific release decisions. We reviewed loan documentation from each servicing center and performed our own analysis of each collateral release decision in our sample. We reviewed Disaster Credit Management System (DCMS) and Centralized Loan Chronology System (CLCS) entries for each collateral release decision. In addition, we reviewed each state's legal requirements to determine whether collateral releases were timely and compared the actual collateral release time to that required by the state law. Our audit scope and methodology is further defined in Appendix I and our sampling methodology is detailed in Appendix II.

We conducted the audit between June 2010 and March 2011 in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

Results in Brief

We found that both servicing centers did not consistently make appropriate decisions to release collateral on active loans. Based on a review of a statistical sample of collateral releases, we determined that 55 of 120, or approximately 46 percent of the collateral release decisions made

by the servicing centers, for collective property values of at least \$3.1 million¹, were inappropriate. As a result, the remaining collateral for some loans was not sufficient to protect the Agency's interests because the loan balance exceeded the value of the property.

The inappropriate collateral release decisions occurred because the Agency did not perform a full collateral analysis. A full analysis would have included obtaining an appraisal or other acceptable property valuation, and evaluating whether the retained collateral value was sufficient in relation to the outstanding loan balance. As a result of these inappropriate collateral releases, we project that at least \$3.9 million of loan balances could be insufficiently protected, exposing the Agency to a higher risk of loss.

To effectively resolve these deficiencies, the servicing centers should consistently perform a full collateral analysis, in compliance with the Standard Operating Procedures, to ensure that the value of collateral retained is adequate to protect the loan balance. Further, servicing center personnel responsible for processing collateral releases should receive additional training to increase their proficiency.

For the second part of the audit objective, we determined that the collateral release for paid-in-full loans was not always timely; however, the impact to the Agency was not significant. We evaluated timeliness by reviewing a sample of 24 collateral releases. State laws dictate the required timeframe for releasing collateral upon loan payoff. We concluded that 10 of 24, or 42 percent, of the collateral releases were not processed within the time period specified by the state law in which the released collateral property was located. Therefore, we recommend that the Agency ensure that collateral is released within the time period specified by the applicable state law.

The audit also disclosed five other matters which merit attention. For some collateral releases, the SBA did not receive the net proceeds from the sale of damaged properties, proceeds from these sales were not always applied to the correct loan, some damaged properties were sold for less than fair market value, justifications for some collateral releases were misleading, and insurance coverage on the remaining collateral was not always verified as required.

In summary, we made six recommendations to improve the collateral release process. During the audit the servicing centers advised us that they had begun implementing procedures to correct some of the deficiencies identified. Overall, management agreed with our findings and concurred with our recommendations.

Background

The Office of Management and Budget's (OMB) Circular Number A-129, Policies for Federal Credit Programs and Non-Tax Receivables, states the Government can reduce its risk of default and potential losses through well managed collateral requirements. It also states that when real property serves as collateral for direct loans, Federal agencies should obtain appraisals of the real property and use loan-to-value (LTV)² ratios to ensure that borrowers assume an equity interest.

¹ We were unable to obtain released property values for 27 of the 55 exceptions due to the time elapsed since the release.

² Loan-to-value is defined as the ratio of the amount of a loan to the value of the property securing the loan.

According to SBA regulations (13 CFR 123.11), borrowers must pledge available collateral to the SBA to secure the loan whenever the approved loan amount exceeds \$5,000 for economic injury disaster loans, or exceeds \$14,000 for disaster home loans or physical business loans. Previously, the unsecured loan limit was \$10,000 for home and physical business loans, but this limit was raised to \$14,000, effective for disasters declared after May 22, 2008.

Loan collateral is released when the loan is paid in full. Additionally, collateral may be released upon borrower request, although the loan has a remaining balance. The collateral for a disaster home loan may include the damaged property, a relocation property, and other property owned by the borrower. A borrower may request a full or partial release of the loan collateral, or may request that different property be substituted for existing collateral.

Standard Operating Procedure (SOP) 50 52, Consumer Loan Servicing and Collection for Disaster Home Loans, allows the servicing centers to release collateral before the loan is paid in full “as long as what remains is sufficient to secure the loan.” When the SBA receives a request from the borrower to release collateral, the servicing center sends the borrower a form letter requesting specific information required by the SOP. The borrower must provide appraisals (not older than six months), or if not available, then “other forms of valuations, such as comparable sales, market analysis or a property tax assessment.” In addition, the SOP requires SBA to verify flood and hazard insurance and ask for any repayment of over-disbursements, prior to releasing collateral. The SOP also requires that when the damaged property is sold, net proceeds (after payment of costs of sale and any existing prior liens) must be applied to the SBA disaster home loan.

Business loan collateral may include multiple properties, as well as things such as machinery and equipment, furniture and fixtures, and receivables. The requirements for releasing business disaster loan collateral, provided by SOP 50 50, Loan Servicing, are similar to the home loan requirements, with some exceptions. For example, real estate appraisals on business property are required to be “recent,” rather than being tied to a specific term of six months, as required for home loans. Also, for business assets, either the net book value or an internal valuation is acceptable for releasing collateral.

Loan servicing officials use the SBA Form 327, Modification or Administrative Action, to document the release of collateral and “must provide a summary analysis of the SBA’s collateral position before and after the requested change.” A Loan Servicing Assistant reviews the documentation submitted by the borrower and prepares the SBA Form 327 to recommend approval or denial of the release. The Form 327 is submitted to legal counsel for concurrence and then to a supervisor or team leader for approval. Once an approval is granted, the documents needed to release the lien are sent to the borrower, a title company, or the borrower’s attorney to be recorded, as needed.

Results

Servicing Center Collateral Release Decisions were not Always Appropriate

The servicing centers did not consistently make appropriate decisions to release collateral on loans that were not paid in full. We determined that 55 of the 120, or approximately 46 percent, of the sampled collateral release decisions made by the servicing centers were inappropriate. We considered releases inappropriate if the summary analysis, necessary to determine if there was sufficient remaining collateral to secure the loan after release, was not accurate or complete. Specifically, in some instances, the servicing centers did not obtain an appraisal or other property valuation, or correctly compute the value of remaining collateral. A current appraisal or valuation, needed to perform the summary collateral analysis, was missing for all but two of the inappropriate collateral releases.

According to the SOPs, a summary collateral analysis includes the following components: (1) obtaining a valuation of the property, (2) adjusting the property value to account for liquidation costs, (3) determining SBA's lien and equity position, and (4) obtaining an estimated closing statement for actions involving the sale or refinance of collateral. The property valuation may be an actual appraisal prepared by a licensed appraiser, or if an actual appraisal is not available, an alternative such as a market analysis or tax assessment may be used. The appraisal, or valuation, is essential to perform the collateral analysis. Without a current property valuation, it is difficult to determine whether the Agency has sufficient collateral to secure the loan.

The table below summarizes the impact and causes of the inappropriate releases.

Number of Inappropriate Releases	Impact of Inappropriate Collateral Release	Cause of Inappropriate Release	Total Dollar Value of Inappropriately Released Collateral	Unsecured Loan Amount Due to Inappropriate Releases
16	No Remaining Collateral	Improper Practice	Unknown	\$132,432
1	No Remaining Collateral	Did Not Adhere to SOP	\$682,000	\$144,037
8	Insufficient Remaining Collateral	Did Not Adhere to SOP	\$798,216	\$401,723
20	Remaining Collateral Position <i>Acceptable</i>	Did Not Adhere to SOP	\$1,583,962	\$ 0
10	Remaining Collateral Position <i>Unknown</i> ³	Did Not Adhere to SOP	Unknown	Unknown

No Remaining Collateral

We determined that for 17 of 55 inappropriate collateral releases, all collateral was released leaving the loans unsecured. Sixteen of these occurred due to the practice of routinely releasing

³ OIG was unable to determine the value of remaining collateral at the time of release due to the amount of time elapsed.

collateral upon borrower request, if the loan balance was below the unsecured threshold. These 16 inappropriate releases left loans with total balances of \$132,432 completely unsecured. In one case, the servicing center personnel advised the borrower to pay down the loan balance so that collateral could be released. The borrower requested lien subordination, not a collateral release, on a loan with a balance of \$23,170. The servicing center advised the borrower to pay down the loan balance below the unsecured threshold in order to release the collateral, rather than subordinate it. As a result of the borrower paying down the loan balance, the servicing center released all of the loan collateral, leaving the loan unsecured. This practice conflicts with the SOPs which state that collateral may not be released unless sufficient collateral is retained to protect the loan balance. In another case, SBA's decision resulted in an unsecured loan balance of \$144,037 and occurred because servicing center personnel did not perform an accurate collateral analysis.

Insufficient Remaining Collateral

For eight inappropriate releases, although some collateral was retained, what remained was not sufficient to protect the loan balances totaling \$401,723. This generally occurred because servicing center personnel were unaware of the SOP requirements to obtain a property valuation, or did not perform a complete and accurate summary collateral analysis prior to collateral release.

Remaining Collateral Position Acceptable

For 20 inappropriate releases, based upon tax assessment valuations we obtained during the audit, we determined that either there was sufficient collateral remaining to protect the loan, or SBA's collateral position improved following the release. There were 15 releases in which there was sufficient collateral remaining to protect the loan balance. For the other five releases, the remaining collateral coverage was insufficient, however, SBA's equity position improved following the release of collateral, because net proceeds from the collateral sale resulted in a reduction of the loan balance. Guidelines in SOP 50 52 specify that the Agency should not decline a servicing action if the action is in the best interest of the borrower and lack of collateral is the sole reason for the decline, provided that the result of the action leaves SBA in a like equity position. Although our analysis determined that these 20 collateral releases did not expose the Agency to an increased risk of potential loss, the releases should not have been performed without first analyzing the collateral coverage, in accordance with the SOPs.

Remaining Collateral Position Unknown

For ten of the inappropriate collateral release decisions, we were unable to determine whether there was sufficient collateral in place to protect the loan balance after the collateral release was approved. In these cases these, the SBA did not obtain a recent valuation before the collateral was released. OIG was also unable to obtain a tax assessment valuation, primarily because of the time elapsed since the release decision was made or due to the type of business asset involved. Because the SBA did not obtain a valuation and did not perform a collateral analysis prior to the release of collateral for these ten loans, there is a risk that the corresponding loan balances could be insufficiently secured.

Projecting our sample results to the universe of 2,706 collateral releases, there were at least 979 improper releases of loan collateral for properties with values of at least \$33.7 million. As a result, loan balances of \$3.9 million could be insufficiently secured, exposing the Agency to a higher risk of loss. In order to correct this deficiency, we recommend that the servicing centers obtain appraisals or valuations and perform collateral position analyses, including applying the pertinent liquidation discount factors, prior to releasing collateral.

As a result of this audit, the servicing centers began documenting the collateral position analysis on the Form 327 and ceased automatically releasing all collateral on loans with balances below the unsecured threshold.

Other Matters

This audit also disclosed five other matters which merit attention:

- *Net Proceeds from Sale of Damaged Property Not Received* - For two inappropriate collateral release decisions, the servicing centers released collateral without receipt of all net proceeds from the sale. These releases did not comply with SOP 50 52, which requires that net proceeds be applied to the SBA disaster home loan when the damaged property is sold. The servicing centers permitted the borrowers to retain the sales proceeds, rather than remit them to SBA based upon their conclusion that doing so was “in the best interest of the borrower.” Although the SOP permits the release of collateral when it is “in the best interest of the borrower,” it also requires that the action leave the SBA in a like equity position. As a result of not adhering to Agency policy, the servicing centers released the collateral without collecting the net proceeds of \$294,561 due upon sale.
- *Sales Proceeds Misapplied to Companion Loans* - For two of the five collateral releases that occurred after the properties were sold, the SBA credited the borrower’s companion loan, not the loan for which the collateral was sold and released. This resulted in the application of \$157,818 to incorrect loan balances. This also occurred because the servicing center believed it was acting “in the best interest of the borrower.”
- *Sales of Damaged Properties for Less than Fair Market Value* - In two instances, damaged properties were sold to related parties for less than fair market value. Although the SBA received the net proceeds due upon sale, the sales prices were significantly less than the fair market values of the properties based upon tax assessments we obtained. Additionally, the remaining collateral was not sufficient to protect the loan balance. For one of these collateral releases, the land value alone was \$10,800. The property was sold for \$1,000 to the borrower’s family member; however, the Agency could have received an additional \$9,800 from the sale to reduce the borrower’s loan balance and improve the Agency’s equity position in the remaining collateral. The Agency should not agree to release damaged property collateral when the property sales price is far below market value, unless the remaining collateral is adequate to secure the loan.

- *Justification for Release was Sometimes Misleading* - From the sample we reviewed, 22 collateral release decisions were executed by the servicing centers based upon decisions made at the Processing and Disbursement Center during loan origination. In these instances, the Form 327 stated that remaining collateral was “sufficient,” although no valuation was obtained and no analysis was performed. The Form 327 actions should accurately reflect the actions taken by the servicing center.
- *Lack of Verification of Flood and Hazard Insurance* - During the audit, we noted that for 43 collateral releases, there was no evidence that the servicing center verified that the borrower had flood insurance prior to the release. There were an additional 50 releases for which there was no evidence that the servicing center verified that the borrower maintained hazard insurance.

Recommendations

We recommend that the Director of the Office of Financial Program Operations:

1. Provide official written notification to direct the Servicing Centers to discontinue the practice of automatically releasing collateral upon borrower request when the loan balance falls at or below the unsecured threshold.
2. Provide additional training to servicing center staff to increase proficiency in performing appropriate release of collateral.
3. Instruct the approving official to only approve collateral releases that comply with the SOP requirements.
4. Instruct the servicing centers to apply net proceeds from the sale of damaged properties to applicable SBA disaster loans.
5. Instruct servicing center personnel that when releasing collateral in order to execute a determination initiated by the Processing and Disbursement Center, they accurately report and document the decision.
6. Instruct servicing center personnel execute the release of collateral on paid-in-full loans in a timely manner as required by the specific state laws in which the property is located.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On May 9, 2011, we provided the Office of Financial Program Operations (OFPO) with the draft report for comment. On May 27, 2011, OFPO submitted its formal response which is contained in Appendix V. Management agreed with our findings and concurred with our recommendations. A summary of management's comments and our response is as follows.

Recommendation 1

Management Comments

During the audit, OFPO immediately discontinued releasing collateral if the loan balance was at or below the secured threshold and agreed to incorporate this guidance into SOP 50 52, which is under revision.

OIG Response

Management's comments are responsive to the recommendation.

Recommendation 2

Management Comments

OFPO agrees that as part of an ongoing process improvement project, it will initiate a training manual that will serve as a detailed reference source with a planned final draft deadline of August 31, 2011.

OIG Response

Management's comments are responsive to the recommendation.

Recommendation 3

Management Comments

OFPO has taken action to improve the collateral analysis process and will re-affirm compliance with the existing SOP 50 52 through a memorandum to be completed by June 30, 2011.

OIG Response

Management's comments are responsive to the recommendation.

Recommendation 4

Management Comments

OFPO concurred with this recommendation and will issue a memorandum by June 30, 2011 to staff reminding them that net proceeds are applied to the correct loan associated with the sale of the damaged property.

OIG Response

Management's comments are responsive to the recommendation.

Recommendation 5

Management Comments

OFPO concurred with the recommendation and stated that it had taken action to improve upon documentation for all transactions. OFPO issued a December 13, 2011 memorandum stating that any transactions related to collateral should be captured in the comments section of the Disaster Credit Management System (DCMS). OFPO has teamed with the Office of Disaster Assistance to develop a "servicing" specific comments identifier in DCMS. Additionally, OFPO issued a memorandum on April 22, 2011 reinforcing a thorough review of any SBA Form 327 actions and a reminder to include all relevant analysis and supporting documentation in the loan file.

OIG Response

Management's comments are responsive to the recommendation.

Recommendation 6

Management Comments

OFPO concurred with this recommendation and will issue a memorandum by June 30, 2011 reinforcing timely analysis and adherence of specific state laws regarding release of collateral for paid in full loans.

OIG Response

Management's comments are responsive to the recommendation.

Actions Required

Please provide your management decision for each recommendation on the attached SBA Forms 1824, Recommendation Action Sheet, within 180 days from the date of this report. Your decision should identify the specific action(s) taken or planned for the recommendation and the

target date(s) for completion. We appreciate the courtesy and cooperation of the Office of Financial Program Operations during the audit. If you have any questions regarding this report, please contact me at (202) 205-7203 or Craig Hickok, Director, Disaster Assistance Group, at (817) 684-5341.

APPENDIX I. AUDIT SCOPE AND METHODOLOGY

The audit objective was to determine whether the servicing centers were appropriately and timely releasing collateral on disaster loans.

To satisfy this objective, we reviewed loan documentation from each servicing center pertaining to the collateral release decisions and performed our own analysis of each collateral release. We reviewed Disaster Credit Management System (DCMS) and Centralized Loan Chronology System (CLCS) entries related to each collateral release decision in our sample. We also interviewed staff from each servicing center to obtain an understanding of the collateral release process and their rationale for specific release decisions.

We obtained a population universe of 2,706 collateral releases, including 2,039 releases processed by the El Paso servicing center, and 667 releases processed by the Birmingham servicing center during the period September 1, 2007 to May, 31, 2010. From this population universe, we randomly selected a statistical sample of 74 releases processed by the El Paso servicing center and 61 releases processed by the Birmingham servicing center for review. Fourteen of the El Paso sample collateral releases and one of the Birmingham releases did not meet our selection criteria. These samples were not considered because they fell outside our audit criteria. As a result, we reviewed 60 collateral releases processed by each of the two servicing centers.

We performed an independent collateral release evaluation for each of the 120 releases in the sample and compared our decisions with those made by the servicing center. We considered a collateral release to be inappropriate if the remaining collateral was not sufficient to protect the loan balance. We also considered the release to be inappropriate if no valuation of the property was obtained prior to release, or no summary analysis was performed, regardless of whether the remaining value of the collateral was adequate to secure the loan. Based upon our review, we concluded 35 El Paso and 20 Birmingham collateral releases were inappropriate, or a total of 55 releases were inappropriate.

We also tested the timeliness of collateral releases performed at each of the two servicing centers by reviewing a sample of 15 collateral releases made at each of them. To evaluate whether the releases were processed timely for the sample of 30 releases, we compared the actual processing time to the time period required by the state law in which the released collateral property was located.

APPENDIX II. SAMPLING METHODOLOGY AND PROJECTIONS

The universe consisted of 2,706 collateral releases, of which 667 were performed by the Birmingham servicing center and 2,039 were performed by the El Paso servicing center during the period September 1, 2007 to May 31, 2010. A statistical services consultant randomly selected a representative sample of collateral releases from each of the servicing centers for review. Our intention was to review approximately 60 samples from each of the servicing centers, however, we anticipated that some samples may not meet our criteria; therefore, we requested extra samples for review. During the review, we encountered 15 samples that did not meet our criteria. These samples were passed without review. Ultimately, we reviewed 60 samples from each of the servicing centers.

In statistical sampling, the projected estimates in the population have a measurable precision or sampling error. The precision is a measure of the expected difference between the value found in the sample and the value of the same characteristics that would have been found if a 100 percent review had been completed using the same techniques. Sampling precision is indicated by ranges, or confidence intervals, that have upper and lower limits and a certain confidence level. Calculating a 90 percent confidence level means the chances are 9 out of 10 that if we reviewed all of the loans in the total population, the resulting values would be between the lower and upper limits, with the population point estimates being the most likely amounts.

We consulted a statistician to obtain projections for the estimated number of inappropriate collateral releases and their total dollar value, based upon our audit results of the review of sample of 135 collateral releases performed during September 1, 2007 to May 31, 2010. The statistician calculated the projections using Stata v.11 software at a 90 percent confidence level.⁴ Projecting our sample results to the universe of 2,706 collateral releases, we estimate that at least 979 collateral releases, totaling approximately \$33.7 million, performed between September 1, 2007 and May 31, 2010, were inappropriate. As a result, at least 979 loans with balances of at least \$3.9 million⁵ were insufficiently collateralized, exposing the Agency to a higher risk of loss. The table below provides a breakdown of the projected number of improper collateral releases in the universe of releases based upon the audit results of the sample reviewed.

The table below contains a summary of the statistical projections for the sample of 120 collateral releases we reviewed.

¹ Stata v.11 is a standard, professional statistical software program.

² The estimates reported in this paragraph are the lower bounds of symmetric confidence intervals at 90% confidence.

APPENDIX II. SAMPLING METHODOLOGY AND PROJECTIONS

Table 1: Inappropriate Collateral Release Projections

	Occurrence in Sample of 12 Releases	Population Point Estimate	90 percent confidence Lower Limit	90 Percent confidence Upper limit
Number of inappropriate releases	55	1183	979	1387
Total Value of Collateral Inappropriately Releases	\$3,064,178	\$61,234,113	\$33,715,375	\$88752851
Total Unsecured and Under Secured Loan Amounts	\$678,192	\$14,857,876	\$3,940,803	\$25,774,950

The audit was conducted between June 2010 and March 2011 in accordance with *Government Auditing Standards* as prescribed by the Comptroller General of the United States, and included such tests considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

APPENDIX III. EL PASO LOANS WITH INAPPROPRIATELY RELEASED COLLATERAL

	Sample	Loan Number	Value of Collateral Inappropriately Released	Under Secured Loan Balance	Unsecured Loan Balance
1	ER- 1	[FOIA Ex. 2]	\$73,200	\$0	\$0
2	ER- 3		Unknown	\$0	\$6,913
3	ER- 4		Unknown	\$0	\$9,317
4	ER- 6		\$87,500	\$0	\$0
5	ER-11		\$27,000	\$0	\$0
6	ER-12		\$160,000	\$16,820	\$0
7	ER-16		Unknown	\$0	\$10,014
8	ER-17		Unknown	Unknown	\$0
9	ER-18		Unknown	\$0	\$9,593
10	ER-19		Unknown	\$0	\$8,209
11	ER-20		Unknown	\$0	\$9,911
12	ER-21		Unknown	\$0	\$3,455
13	ER-22		\$23,904	\$0	\$0
14	ER-23		\$215,000	\$14,305	\$0
15	ER-28		\$99,400	\$0	\$0
16	ER-29		Unknown	\$0	\$3,100
17	ER-30		Unknown	Unknown	\$0
18	ER-31		Unknown	Unknown	\$9,891
19	ER-35		\$37,320	\$0	\$0
20	ER-38		Unknown	\$0	\$9,870
21	ER-43		Unknown	\$0	\$7,664
22	ER-46		\$237,520	\$0	\$0
23	ER-53		Unknown	\$0	\$6,610
24	ER-56		\$371,350	\$0	\$0
25	ER-57		\$36,000	\$14,106	\$0
26	ER-59		Unknown	\$0	\$9,026
27	ER-61		\$160,860	\$83,610	\$0
28	ER-63		Unknown	\$0	\$9,951
29	ER-65		\$116,400	\$0	\$0
30	ER-67		Unknown	\$0	\$9,196
31	ER-68		Unknown	\$186,525	\$0
32	ER-70		\$9,800	\$0	\$0
33	ER-72		Unknown	\$0	\$9,712
34	ER-73		\$13,200	\$0	\$0
35	ER-74		Unknown	Unknown	\$0
		TOTALS	\$1,668,454	\$315,366	\$132,432

APPENDIX IV. BIRMINGHAM LOANS WITH INAPPROPRIATELY RELEASED COLLATERAL

	Sample	Loan Number	Value of Collateral Inappropriately Released	Under Secured Loan Balance	Unsecured Loan Balance
1	BR- 1	[FOIA Ex. 2]	\$10,800	\$9,800	\$0
2	BR- 3		Unknown	Unknown	\$0
3	BR- 6		Unknown	Unknown	\$0
4	BR- 7		Unknown	Unknown	\$0
5	BR-18		\$25,000	\$0	\$0
6	BR-19		\$129,837	\$0	\$0
7	BR-23		\$98,900	\$0	\$0
8	BR-24		Unknown	Unknown	\$0
9	BR-25		Unknown	Unknown	\$0
10	BR-29		\$25,875	\$0	\$0
11	BR-30		\$7,756	\$0	\$0
12	BR-36		\$14,100	\$14,100	\$0
13	BR-40		Unknown	Unknown	\$0
14	BR-44		Unknown	Unknown	\$0
15	BR-47		\$682,000	\$144,037	\$0
16	BR-51		\$43,720	\$0	\$0
17	BR-52		\$21,600	\$0	\$0
18	BR-53		\$23,480	\$0	\$0
19	BR-58		\$201,456	\$62,457	\$0
20	BR-61		\$111,200	\$0	\$0
		TOTALS	\$1,395,724	\$230,394	\$0

APPENDIX V. AGENCY RESPONSE



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

MEMORANDUM

May 27, 2011

To: Peter L. McClintock
Deputy Inspector General

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

Subject: Response to Draft Report on the Release of Collateral by the Disaster Loan Servicing Centers, Project No. 10701

Thank you for the opportunity to review the draft report. We appreciate the role that the Office of Inspector General (OIG) plays in assisting management in ensuring that these programs are effectively managed. The OIG's primary issue in this audit was that SBA did not consistently conduct collateral analysis or complete a full collateral analysis before releasing the liens. Particularly, the OIG found situations where collateral was released when there was no remaining or insufficient collateral to secure the loan, the collateral position was unknown or unacceptable, and proper documentation was not obtained in the loan file. The Office of Financial Program Operations (OFPO) is confident that these concerns have been or are in the process of being addressed.

Following initial discussions with OIG on this audit, OFPO visited the El Paso Disaster Loan Servicing Center and the Birmingham Disaster Loan Servicing Center (collectively DLSCs) during October and November 2010. During these visits, OFPO staff requested briefings on the release of collateral process. At this time, OFPO was informed that collateral was released if the loan balance was at or below the secured threshold. As a result, OFPO informed staff that this is not an acceptable reason to release collateral and must be discontinued immediately. Additionally, in February 2011, OFPO initiated a process improvement project on the DLSCs. The process improvement effort includes standardizing letter and form templates for all transactions. Through the process improvement process, OFPO has initiated teams of SMEs to aid in the development of a standard release of collateral process. Once the collateral process is finalized, then it will be incorporated into the SOP 50 52 which is currently under revision.

The OIG also identified "other matters" discovered during the audit process. These matters are that (1) Net proceeds from the sale of damaged property was not received, (2) Sales proceeds misapplied to companion loans, (3) Sales of damaged properties for less than fair market price, (4) Justification for release was sometimes misleading, and (5) Lack of verification of flood and hazard insurance. OFPO takes these other matters very

APPENDIX V. AGENCY RESPONSE

seriously. After review, OFPO believes that additional training and guidance is necessary to inform staff of proper procedures. With the aforementioned DLSCs process improvement project, OFPO also initiated a group of Subject Matter Experts (SMEs) to develop a training manual that will serve as a job aid and desk reference. The training manual will give detailed guidance on how to process and follow up on the administrative actions. This manual will compliment the SOP 50 52 as it generally focuses on training for new and existing employees on acceptable procedures to accomplish the action with existing systems and tools. The concern about flood and hazard insurance verification is currently being addressed with OCA management in collaboration with the OIG via Audit 10-1 Monitoring of Insurance Covered for Disaster Loan Recipients.

Moving forward, OFPO strives to maintain close partnership with the OIG. Taking into account the above narrative, OFPO is providing additional information in response to the OIG recommendations as follows:

1. Provide official written notification to direct the Servicing Centers to discontinue the practice of automatically releasing collateral upon borrower request when the loan balance falls at or below the unsecured threshold.

OFPO concurs with this recommendation. OFPO indicated to the DLSCs in late 2010 that no collateral may be released automatically because the loan balance falls at or below the unsecured threshold. This guidance will also be incorporated into the SOP 50 52 when it enters agency clearance.

2. Provide additional training to servicing center staff to increase proficiency in performing appropriate release of collateral.

OFPO concurs with this recommendation. Through the process improvement project referenced in the above narrative, OFPO will initiate a training manual that will serve as a detailed reference on servicing transactions. The training manual will be completed in final draft by August 31, 2011 and will enter any necessary concurrence processes at that time. In the interim, OFPO will identify training opportunities and instruct center management to re-affirm proper collateral release procedures.

3. Instruct the approving official to only approve collateral releases that comply with the SOP requirements.

OFPO concurs with this recommendation and has already taken action to improve collateral analysis. OFPO will re-affirm compliance with the existing SOP 50 52 via memorandum. The memorandum will be completed by June 30, 2011 and a copy forwarded to the OIG.

4. Instruct the servicing centers to apply net proceeds from the sale of damaged

APPENDIX V. AGENCY RESPONSE

properties to applicable SBA disaster loans.

OFPO concurs with this recommendation and will issue a memorandum to staff reminding them to take careful note that net proceeds are applied to the correct loan associated with the sale of the damaged property. The memorandum will be completed by June 30, 2011 and a copy forwarded to the OIG.

5. Instruct servicing center personnel that when releasing collateral in order to execute a determination initiated by the Processing and Disbursement Center, they accurately report and document the decision.

OFPO concurs with this recommendation and has already taken action to improve upon documentation for all transactions. The release of collateral must be fully documented, including a reference to the transaction form/letter number and date. OFPO issued an email memorandum on December 13, 2010 that any transactions related to duplication of benefits or real estate/collateral should be captured in the comments section of the Disaster Credit Management System (DCMS). OFPO has teamed with the Office of Disaster Assistance to develop a “servicing” specific comments identifier in DCMS. The DCMS review board has approved the request but OFPO is waiting on confirmation of its availability in the system. Currently, the DLSCs enter collateral changes under the customer service identifier in DCMS. Additionally, OFPO issued a memorandum on April 22, 2011 reinforcing a thorough review of any SBA Form 327 actions and a reminder to include of all relevant analysis and supporting documentation in the loan file.

6. Instruct servicing center personnel execute the release of collateral on paid-in-full loans in a timely manner as required by the specific state laws in which the property is located.

OFPO concurs with this recommendation and will issue a memorandum reinforcing timely analysis and adherence of specific state laws regarding release of collateral for paid in full loans. The memorandum will be completed by June 30, 2011 and a copy forwarded to the OIG. OFPO does acknowledge that due to the unpredictable disaster environment, work may be impacted at DLSCs particularly under very aggressive state deadlines. OFPO will work with the impacted centers during these situations to identify staff and budget needs in attempting to support the state-specific deadlines.

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