

SBA'S OVERSIGHT OF BUSINESS LOAN CENTER, LLC

Report Number: 7-28

Date Issued: July 11, 2007

Report 7-28, SBA's Oversight of Business Loan Center, LLC, contains numerous redactions that were requested by the Small Business Administration (SBA) Office of General Counsel (OGC). The SBA OGC believes that this text is subject to the deliberative privilege and bank examiners' privilege and should not be disclosed under exemptions 5 and 8 of the Freedom of Information Act. Although the Office of Inspector General does not necessarily agree with the extent of these redactions, as a courtesy, we have agreed to redact this text. To the extent that these redactions make the report difficult to understand, the following summary of the report is provided.

The OIG initiated an audit of the SBA's oversight of Business Loan Center, LLC (BLX) as a result of a recent OIG investigation of allegations regarding fraudulent loans originated by BLX. The OIG investigation resulted in the arrest of a BLX Executive Vice President and 18 other individuals, not employed by BLX, for allegedly making over \$76 million in fraudulent loans to unqualified loan applicants.

The audit identified problems with the manner in which SBA addressed performance and compliance issues with BLX's lending activities and SBA's actions to protect government funds once deficiencies were identified. Since 2001, SBA's oversight activities identified recurring and material issues related to BLX's performance. Despite these recurring problems, SBA continued to renew BLX's delegated lender status and SBA took no actions to restrict BLX's ability to originate loans or to mitigate financial risks through the purchase review process. The audit also determined that the organizational placement of SBA's Office of Lender Oversight (OLO) presented a potential conflict because OLO did not have compatible goals with the organization to which it reports, and that SBA lacked clear enforcement policies. The OIG recommended that SBA take certain actions to mitigate the risk posed by BLX, identify actions to address the potential organizational conflict, and develop more definitive guidance on enforcement actions.



**U.S. Small Business Administration
Office Inspector General**

Memorandum

To: Michael Hager
Associate Administrator for Capital Access

Date: July 11, 2007

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: SBA's Oversight of Business Loan Center, LLC
Report No. 7-28

This is the first of two reports resulting from our audit of the Small Business Administration's (SBA) oversight of Small Business Lending Companies (SBLC). The audit was performed as a result of a recent Office of Inspector General (OIG) investigation of allegations regarding fraudulent loans originated by Business Loan Center, LLC (BLX), a subsidiary of a portfolio concern held by Allied Capital Corporation. The OIG investigation resulted in the arrest of a former BLX executive vice president and 18 other individuals, not employed by BLX, for allegedly making over \$76 million in fraudulent loans to unqualified loan applicants.

This report addresses whether: (1) SBA's oversight activities identified performance or compliance issues with BLX's lending activities that warranted attention; and (2) SBA acted appropriately to protect government funds once deficiencies were identified. Our audit focused on SBA's oversight of BLX from 2001 to 2006.

To determine whether SBA was aware of performance or compliance issues associated with loans originated by BLX, we reviewed quarterly risk ratings assigned the lender between June 2004 and November 2006 by SBA's Loan and Lender Monitoring System (L/LMS). We reviewed on-site examination reports issued between October 2001 and April 2006 by the Farm Credit Administration on SBA's behalf, and related corrective actions addressing reported deficiencies. We also interviewed a Farm Credit Administration examiner to gain an understanding of the scope and methodology used in the SBLC on-site examination process. Further, we reviewed field office input regarding renewals of BLX's delegated lender status and information on lender deficiencies noted in SBA's guarantee tracking system.

To determine if SBA acted appropriately to protect government funds once deficiencies were identified, we interviewed personnel in SBA's Office of Lender Oversight (OLO), Office of Financial Assistance (OFA), and commercial loan servicing centers. We assessed whether a corrective action plan established for BLX was effective in improving BLX's lending performance and evaluated SBA's decision-making process in renewing BLX's delegated lending authority over the past 6 years. Finally, we interviewed staff at the National Guaranty Purchase Center to determine whether performance issues associated with BLX were considered in decisions to purchase guarantees on loans originated by BLX. We conducted our audit between January and February 2007 in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

BACKGROUND

SBA is authorized under Section 7(a) of the Small Business Act (the Act) to provide financial assistance to small businesses in the form of government-guaranteed loans. SBA provides this assistance through approved lenders, some of which are also licensed by SBA as SBLCs. An SBLC is a non-depository lending institution that is wholly supervised, examined, and regulated by SBA, and subject to all applicable SBA regulations, including those governing 7(a) lenders.

BLX is a licensed SBLC and is certified as having preferred lender status under SBA's Preferred Lender (PLP), *SBAExpress*, and Community Express lending programs. As a lender with delegated authority, BLX processes, closes, services, and liquidates SBA-guaranteed loans with limited oversight.¹ Prior to May 2006, SBA designated the geographical areas in which lenders had delegated lending authority. After that date, SBA began granting delegated lending authority on a nationwide basis. Delegated lending authority must be renewed at least every 2 years. During the renewal process, SBA considers the lender's performance relative to performance benchmarks established for preferred lenders.

BLX has been among SBA's top 10 lenders in dollars disbursed for section 7(a) loans since calendar year (CY) 2002. As shown in Table 1, BLX originates PLP, *SBAExpress* and Community Express loans, with the bulk of its loan portfolio comprising PLP loans. Additional information about BLX's loan portfolio is provided in Appendix I.

¹ Lenders with delegated authority may originate loans without prior approval by SBA. SBA's oversight of these loans is limited to verifying the eligibility of the principal and the loan based on information provided by the lender.

*Table 1. Loans Originated by BLX in FYs 2001 to 2006
(\$ in millions)*

FY	All loans		PLP Loans		Express Loans		Community Express Loans		Regular 7(a) Loans	
	# of loans	Value	# of loans	Value	# of loans	Value	# of loans	Value	# of loans	Value
2001	678	\$341.4	524	\$264.9	n/a	n/a	n/a	n/a	113	\$76.5
2002	792	\$451.5	563	\$312.3	n/a	n/a	n/a	n/a	137	\$139.2
2003	496	\$251.8	361	\$183.3	15	\$1.8	n/a	n/a	120	\$66.8
2004	560	\$275.0	443	\$231.2	22	\$2.4	25	\$0.6	70	\$40.9
2005	1,594	\$238.4	316	\$189.2	1	\$0.1	1,231	\$24.4	46	\$24.8
2006	2,123	\$217.3	246	\$156.3	44	\$1.0	1,809	\$46.2	24	\$13.8

Source: SBA's Loan Accounting System

SBA's lender oversight responsibilities are divided among multiple offices—OLO, OFA, the Sacramento Loan Processing Center (Center), and commercial loan service and purchase centers. OLO and OFA are located within the Office of Capital Access (OCA). In addition, there is a Lender Oversight Committee consisting of representatives from each of the previously mentioned offices and SBA's Chief Operating Officer, Associate Administrator for Capital Access, and Chief Financial Officer. The committee is responsible for reviewing decisions on oversight strategy and voting on lender enforcement actions.

OLO has primary responsibility for managing loan program credit risk, monitoring lender performance, and enforcing lending program requirements. Its major oversight activities include:

- quarterly risk assessments of lenders through ratings generated by L/LMS;
- on-site reviews of lender operations that are conducted by the Farm Credit Administration and other contractors on OLO's behalf; and
- trend analyses and reviews of risk indicators to assess the quality of SBA's overall loan portfolio.

In September 2004 OLO assumed responsibility for granting and renewing delegated authority for high-risk lenders. Previously, this function was performed by OFA.

OFA is responsible for delegating loan origination authority to medium- and low-risk lenders and for managing SBA's credit programs. In managing the credit programs, OFA develops and recommends policies concerning business and economic development; establishes plans, operating procedures, and standards for the Agency's credit programs; and develops program goals and reviews program effectiveness.

SBA's Loan Processing Center in Sacramento and the commercial loan service centers oversee credit decisions and liquidation activities of the lenders. Specifically, the Sacramento Loan Processing Center is responsible for:

- evaluating the eligibility of, and issuing loan guarantee commitments for, sections 7(a) and 504 loans submitted using delegated lending authorities;
- providing recommendations for all lenders seeking nomination or renewal for their delegated lending status; and
- managing the execution of agreements between SBA and lenders for the delegated lending authority programs, maintaining the agreements, tracking agreement expirations, and initiating necessary actions prior to agreement expirations.

Responsibility for monitoring lender compliance with SBA liquidation requirements and for performing purchase reviews of defaulted loans belongs to the National Guaranty Purchase Center in Herndon, Virginia, and the commercial loan service centers in Fresno, California and Little Rock, Arkansas. The Herndon Center purchases guarantees made under the PLP and regular lending programs, while the Fresno and Little Rock centers purchase guarantees for *SBAExpress* and Community Express Loans.

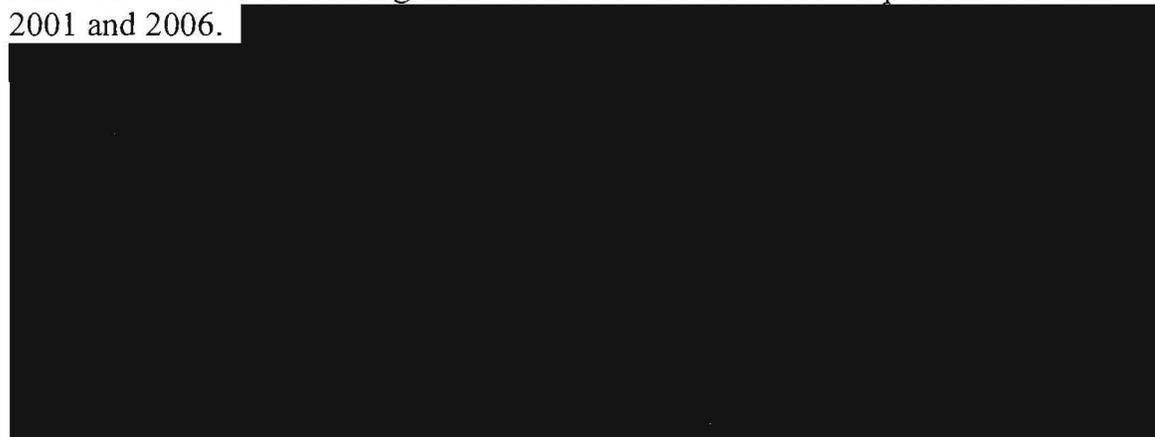
In conducting purchase reviews, the loan service centers examine lender purchase requests and relevant documentation to evaluate whether lenders materially comply with applicable regulations and operating procedures. This review, which is intended to minimize erroneous payments, is generally performed before purchases are made, but is done post-purchase when the loan has been sold on the secondary market. In the event of non-compliance by the lender, SBA may be released, in full or in part, from its liability on the loan guarantee. If SBA has already purchased the guarantee from a secondary market holder, it may seek recovery from the lender. Because substantially all of BLX's loans are sold on the secondary market, SBA performs reviews of BLX loan guarantees after they are purchased.

RESULTS IN BRIEF





Despite recurring problems, SBA continued to renew BLX's delegated lender status and to honor the lender's guarantee purchase requests. For example, SBA renewed BLX's PLP lending status in each of the five renewal periods between 2001 and 2006.



A chronology of key actions regarding BLX renewals is provided in Appendix III. SBA officials believe their actions to extend BLX's delegated authority were appropriate



SBA also continued to honor guarantee requests on loans originated by BLX, purchasing \$272.1 million in guarantees between 2001 and 2006. Although  SBA did not increase its scrutiny of purchase requests from BLX or single out those BLX offices with the most purchase requests for increased oversight attention. Further, our review of 39

² Loans for which full repayment is doubtful and some degree of loss will occur.

BLX loans, originated between January 1999 and May 2004, disclosed that [REDACTED]. We found no evidence in SBA's loan files that SBA resolved the deficiencies or obtained a repair or denial of the guarantees.

Although SBA personnel believe they took appropriate actions, in our opinion, more stringent steps should have been taken to hold BLX accountable for its noncompliance with SBA regulations and to mitigate risks posed by the lender's portfolio. We believe SBA took limited action because:

- it lacked clear enforcement policies describing circumstances under which it would suspend or revoke delegated lending authority and did not have procedures directing how suspension or revocation would be done.
- the lender oversight responsibilities of OLO and OFA are not compatible with OCA loan production goals which presented a potential conflict or at least the appearance of a conflict, between the desire to encourage lender participation in PLP and the need to evaluate lender performance and take enforcement action.
- discontinuing BLX's participation in PLP and other delegated lending programs would have significantly increased the volume of loans to be processed by SBA field offices at a time when SBA was reducing its loan processing staff in field offices. Also, SBA was attempting to establish the Standard 7(a) Guaranty Loan Processing Centers in Hazard, Kentucky and Sacramento, California, and may not have believed that sufficient staffing would be available to manage the increased loan volume.

In January 2007 an OIG investigation led to criminal indictment of a former BLX officer in BLX's Troy, Michigan office. To address issues identified in that investigation, SBA executed an agreement with BLX that requires BLX to repay SBA for purchased guarantees on loans associated with the Michigan fraud case [REDACTED]

SBA management generally was not receptive to the audit findings and recommendations, partially agreeing with recommendation 1, neither agreeing nor disagreeing with recommendation 2, providing a conflicting and unclear response to recommendation 4, and disagreeing with recommendations 3 and 5. Management believes it has stepped up its oversight and enforcement of BLX as it has identified the risks associated with BLX and moved to monitor and mitigate those risks. [REDACTED]

[REDACTED] Management's comments and our corresponding response are discussed in more detail in the Agency Comments and Office of Inspector General Response section of the report. Management's response is presented in its entirety in Appendix IV. As a result of management's comments, we modified recommendation number 1, and plan to obtain a management decision on all five recommendations through the audit resolution process.

RESULTS

[REDACTED]

SBA has authority to suspend or revoke a lender's PLP status for reasons that include unacceptable loan performance, failure to make a sufficient number of loans under SBA's expedited procedures, and violations of statutes, regulations and SBA policies.³ In determining whether to renew lenders, SBA measures each lender's performance against four Agency benchmarks:

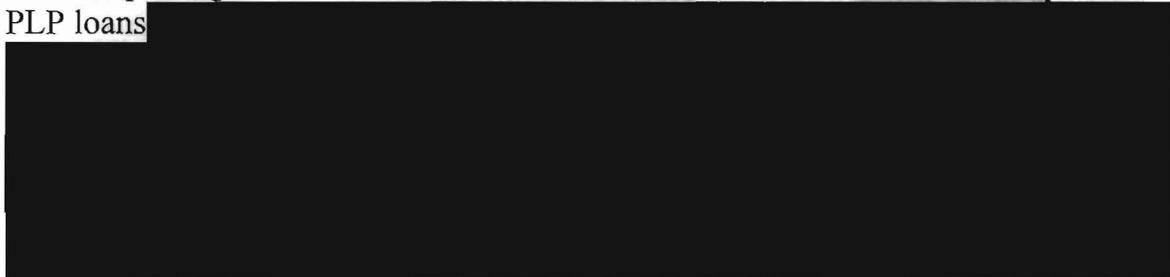
- Currency Rate – the dollar amount and number of loans that are between 0 to 30 days past due in scheduled loan payments;
- Loss Rate – the dollar amount and number of loans charged off relative to the total dollars and number of loans disbursed;
- Purchase Rate – the dollar amount and number of loans purchased by SBA relative to total disbursements; and
- Liquidation Rate – the outstanding gross dollars and number of loans in liquidation relative to the dollar amount and number of loans outstanding.

As shown in Table 2, [REDACTED]

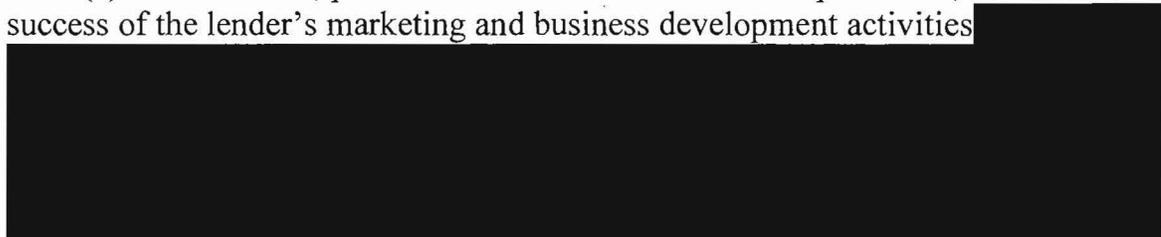
³ 13 C.F.R. 120.455.



In addition to the performance statistics needed to qualify for renewal, lenders also must originate at least four new PLP loans since their last renewal in each of the geographical areas where they had PLP status. For the June 2001 renewal, 16 of the 59 reporting field offices indicated that BLX had made less than the required 4 PLP loans



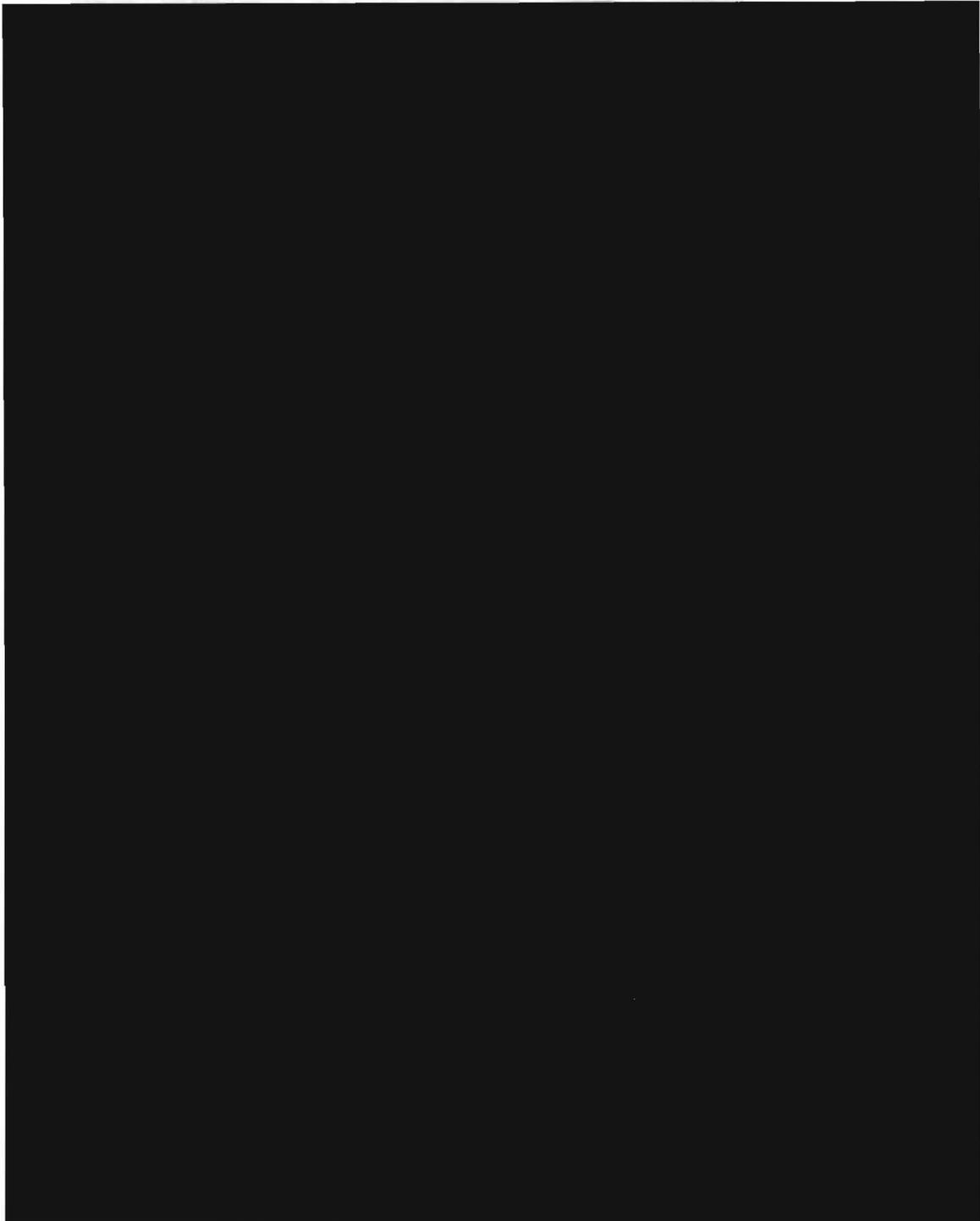
The Center is responsible for processing nominations and renewals for delegated lending authority and for making a recommendation to OFA on each lender. Prior to May 2006, field offices evaluated lender performance and provided the Center renewal recommendations. Field office evaluations assigned numerical scores to lenders based on their compliance with SBA policies and procedures, recent PLP and 7(a) loan volumes, performance of loans in their SBA portfolios, and the success of the lender's marketing and business development activities





On-site Examinations Noted Material Deficiencies and Instances of Noncompliance with SBA Regulations





In September 2003, SBA initiated L/LMS to measure risk to the Agency from lender and loan portfolio performance. In assigning risk ratings SBA segregates lenders into peer groups based on the dollar value of their guaranteed loans, and scores them from 1 to 5 (with 1 being the lowest and 5 being the highest risk) based on their performance.

The ratings are based on four factors, two of which are predictive in nature and two of which are based on historical data. The first predictive factor, the Small Business Predictive Score (SBPS), measures the likelihood of a borrower's severe delinquency within the next 18 to 24 months. The second predictive factor, the projected purchase rate, measures the percentage of a lender's loan portfolio dollars expected to be purchased by SBA. The historical performance factors, the 12-month purchase rate (percentage of outstanding loan guarantees purchased within the past 12 months) and the problem loan rate (loans delinquent for 90 days or more and all loans in liquidation) are based on information extracted from SBA's data base.

BLX is in the peer group of SBA's largest lenders—those whose loan portfolios total \$100 million or more in SBA guarantees. Of the 54 lenders in this peer group, 7 are SBLCs. [REDACTED]

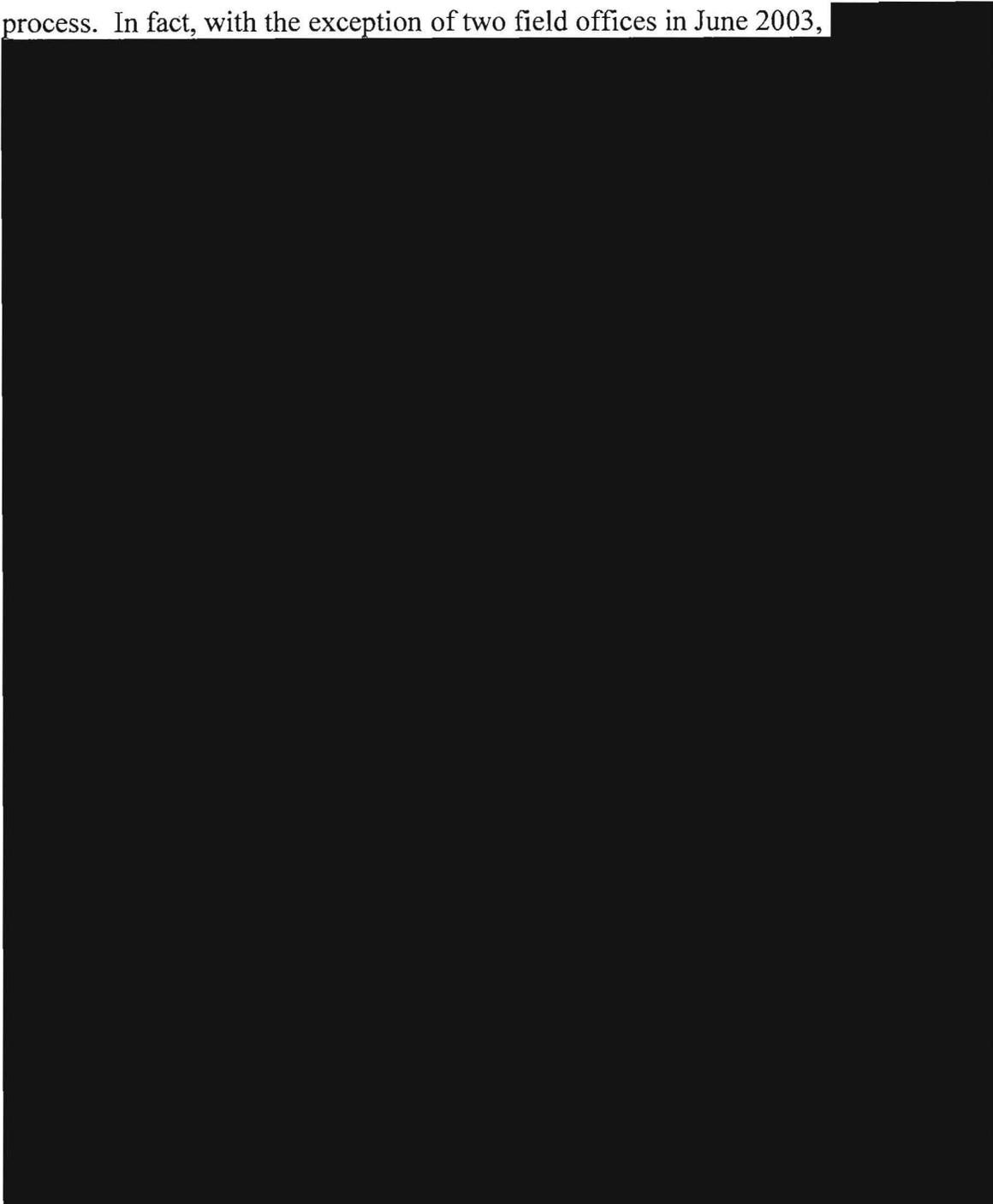
SBA Continued to Renew BLX's Delegated Authority and to Purchase Loans

[REDACTED]

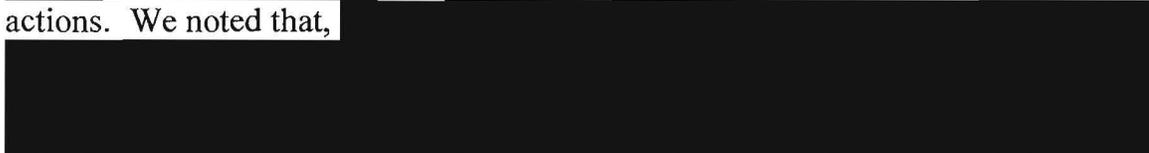
[REDACTED] SBA took no actions to restrict BLX's ability to originate loans or to mitigate financial risks through the purchase review

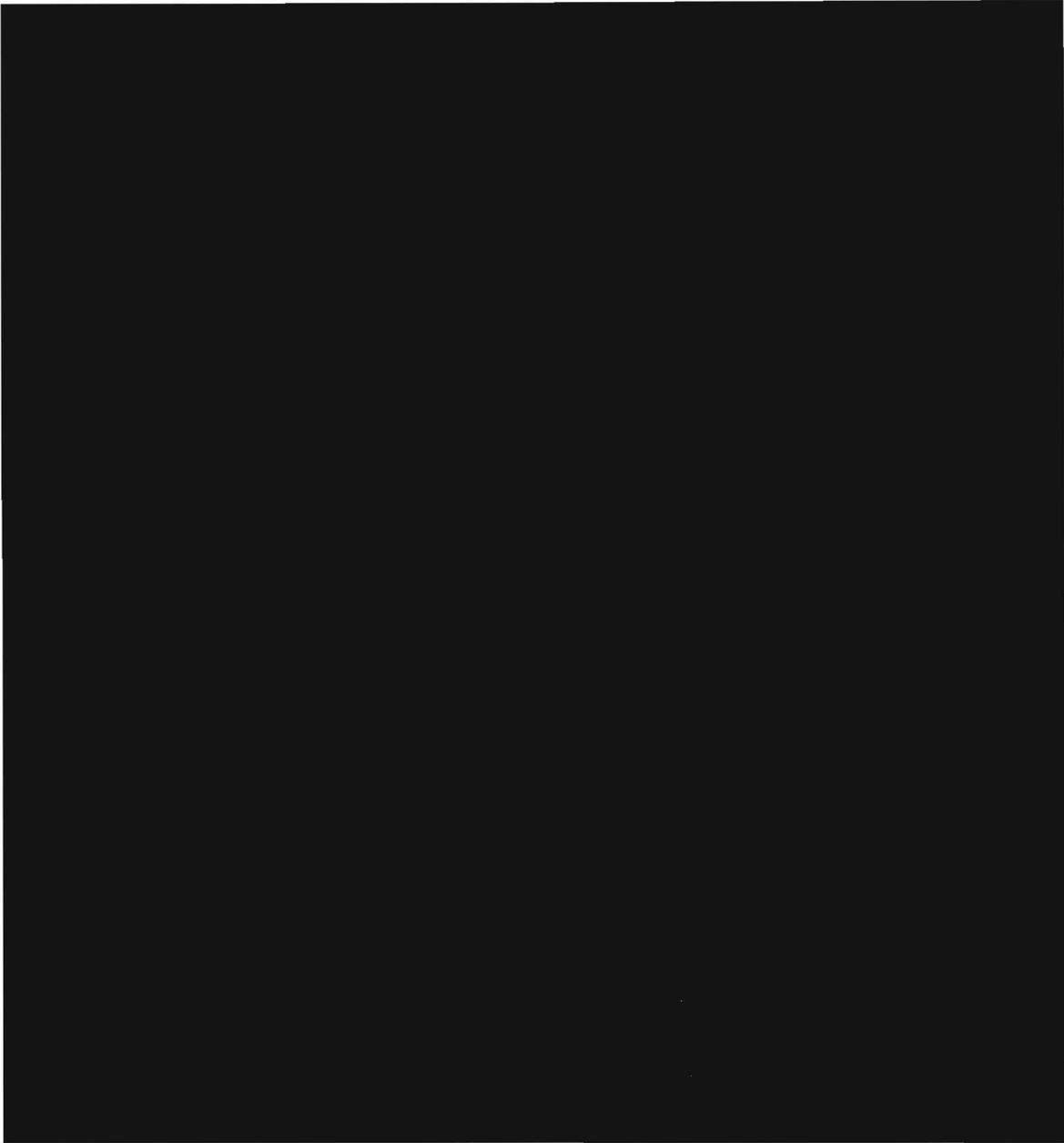
[REDACTED]

process. In fact, with the exception of two field offices in June 2003,



actions. We noted that,  However, due to the limited time that has passed we could not assess the effectiveness of BLX's 





SBA Has Not Developed Clear Enforcement Policies for Preferred Lenders

SBA has authority to suspend or revoke a lender's PLP status for reasons including unacceptable loan performance, failure to make a sufficient number of loans under SBA's expedited procedures, and violations of statutes, regulations or SBA policies. Further, standard operating procedure (SOP) 50 10 requires SBA to

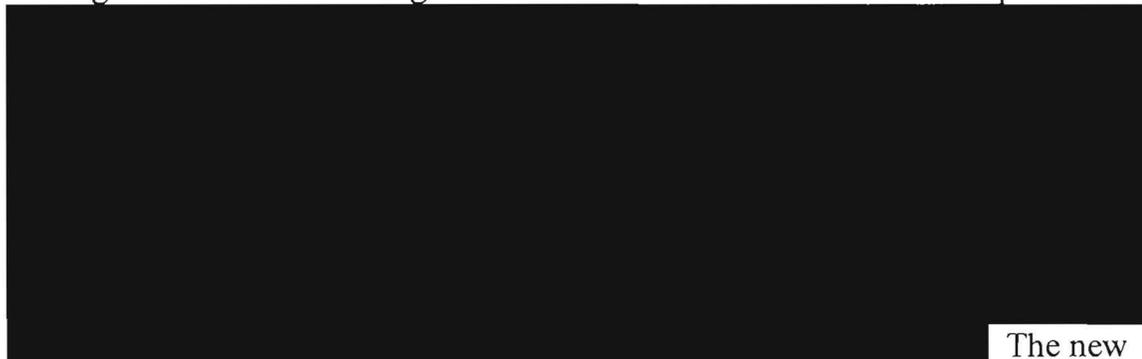
⁵ The percentage and dollar amount of loans purchased each CY was computed by dividing the disbursed loans and dollar amounts purchased applicable to each CY by the loans and dollar amounts disbursed for that year. As time elapses it is likely that the percentage of loans and dollars purchased applicable to each year will increase.

consider whether the lender has a satisfactory performance history and is in compliance with applicable SBA statutes, regulations, and policies.⁶

However, SBA has not developed policies and procedures that describe when it will suspend or revoke PLP authority or how it will do so. Although the current version of Title 13 of the Code of Federal Regulations and SBA's SOPs contain some enforcement actions, the guidance does not provide direction concerning when and under what circumstances the enforcement actions should be implemented. Also, the guidance does not state the applicability of the individual enforcement actions to the various violations. Potentially, this could result in inequitable and inconsistent treatment of lenders.

SBA also does not have guidance on specific follow-up procedures to target and address performance issues for PLP lenders that receive poor risk ratings. According to SBA officials, and as previously reported by the Government Accountability Office (GAO),⁷ SBA wants to encourage lenders to participate in the PLP. Therefore, it prefers to work out problems with lenders, and has not been quick to terminate or revoke PLP status. For example, in the first 6 months of FY 2007, SBA denied only 91 of 1,142 applications (8 percent) for new or renewed PLP and SBAExpress delegated lending authorities. Only 23 of the denials were due to poor performance.⁸ It should be noted that BLX's delegated lending authority was renewed during the same period. Because terminations and non-renewals have not been frequent, lenders can essentially ignore SBA's delegated lending authority requirements without suffering any material consequences. Therefore, without consistent implementation of enforcement policies, lenders cannot be certain of the consequences of certain ratings; and in addition, they may not take SBA's oversight seriously.

In April 2007, SBA internally circulated proposed rules to establish lender oversight and enforcement regulations in accordance with its clearance process.



⁶ The guidance for SBAExpress and Community Express delegated lending authorities contains similar language.

⁷ GAO-03-90, *Small Business Administration: Progress Made but Improvements Needed in Lender Oversight*, December 9, 2002.

⁸ This data provided by management is unaudited and outside our audit scope. It is provided to demonstrate how infrequently SBA has denied delegated lending authority.

regulations were approved by the Administrator in July 2007 and submitted to the Office of Management and Budget for approval. SBA will need to develop an SOP to address their specific implementation.

Potential Conflicts Exist in Organizational Structure and Resources for Lender Oversight

Lender oversight functions are carried out by two different offices (OLO and OFA). Both offices are within OCA, which is responsible for the direction and administration of SBA's lending programs, including working with lenders to deliver programs, promoting delegated lending authorities, and setting loan production goals, among other functions. Because the lender oversight role involves taking necessary enforcement actions against lenders and revoking PLP status when needed, these responsibilities of OLO and OFA are not compatible with OCA's role of promoting SBA's lending programs and growing the Agency's loan portfolio. Thus, this organizational arrangement presents a potential conflict or at least the appearance of a conflict, between the desire to encourage lender participation in PLP and the need to evaluate lender performance and take enforcement action.

To illustrate, with the exception of one fiscal year during our review period, OCA's loan production goals increased each year both in terms of the number and dollar value of loans it wanted to have in the Agency's loan portfolio. Because BLX has been among the top 10 SBA lenders since 2001, any actions that would appropriately mitigate BLX's risk, such as suspending its delegated lending authority, also would have been detrimental to achieving SBA's loan production goals.

 by SBA field offices and the recently-established Standard 7(a) Guaranty Loan Processing Centers in Hazard, Kentucky and Sacramento, California. Lenders not using delegated lending authority must submit their loans to an SBA field office for review and approval by SBA personnel. During the period of our audit, SBA reduced the number of loan officers in the field offices, and in 2007 opened the Hazard and Sacramento centers to centralize the processing of non-delegated loans. There may have been insufficient capability at the field offices to absorb the increase in loans that would have occurred if BLX's delegated lending authority had not been renewed.

SBA Has Recently Taken Action to Mitigate Losses Resulting from Loans Involved in Alleged BLX Fraud Scheme

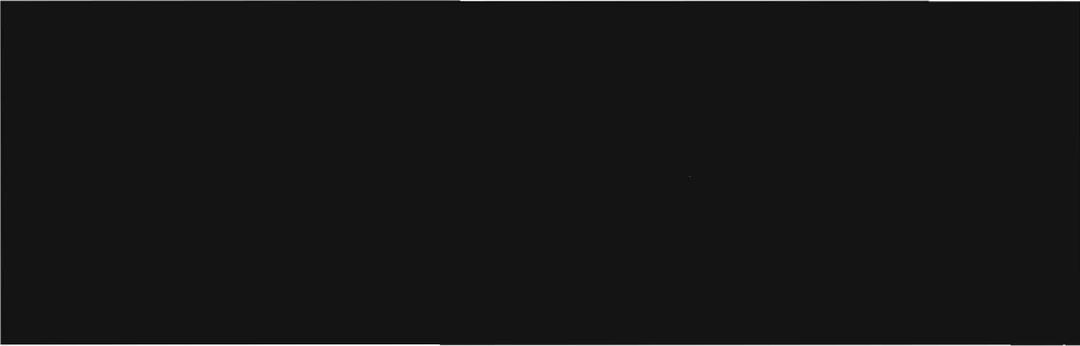
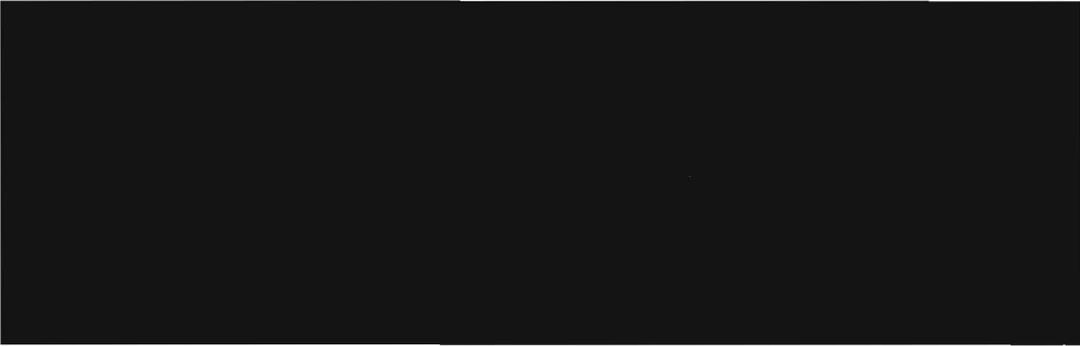
As a result of a recent criminal indictment of a former BLX officer, on March 6, 2007, SBA executed an agreement with BLX to recover guarantees that were inappropriately paid to the lender. This agreement was also intended to prevent the payment of guarantees on future loan defaults that are associated with the criminal indictment.



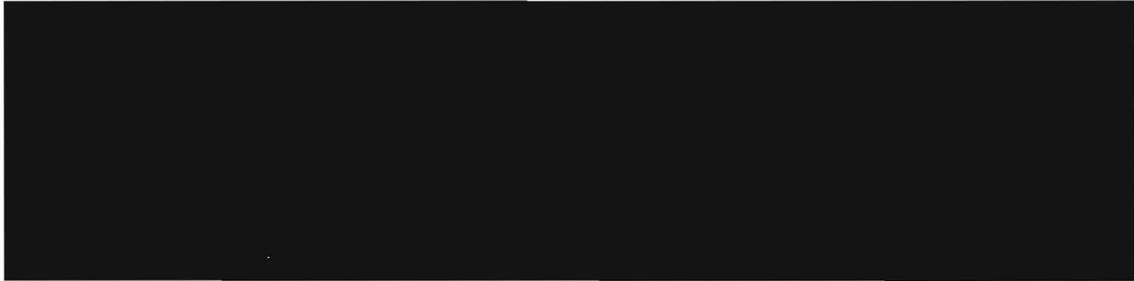
While the agreement will allow SBA to recover funds relating to improperly originated loans paid to BLX and to mitigate future losses, SBA still needs to address the immediate impact of BLX's performance issues. SBA has not specified what performance levels BLX must achieve to renew its delegated authority at the end of 2007.

RECOMMENDATIONS

We recommend that the Associate Administrator for Capital Access take further action to mitigate the risk posed by BLX and to promote consistent and uniform enforcement actions by:

1. 
2. 
3. 
4. Developing standard operating procedures to complement revised 13 CFR that describe circumstances under which it will suspend or revoke PLP authority and how it will do so.
5. Identifying actions needed to address the potential conflict resulting from OLO's and OFA's placement in OCA.

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



Recommendation 1

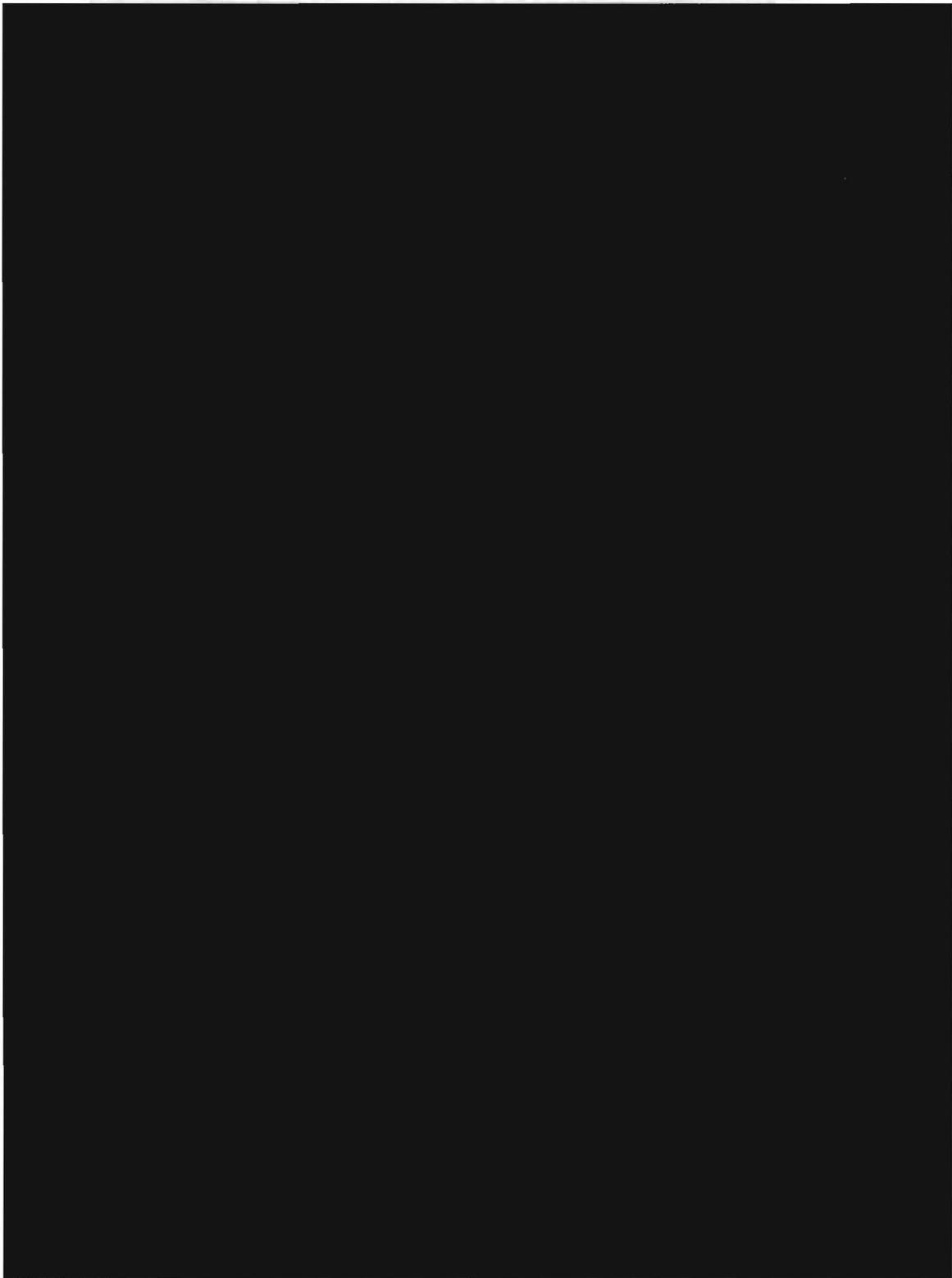


Recommendation 2



Recommendation 3



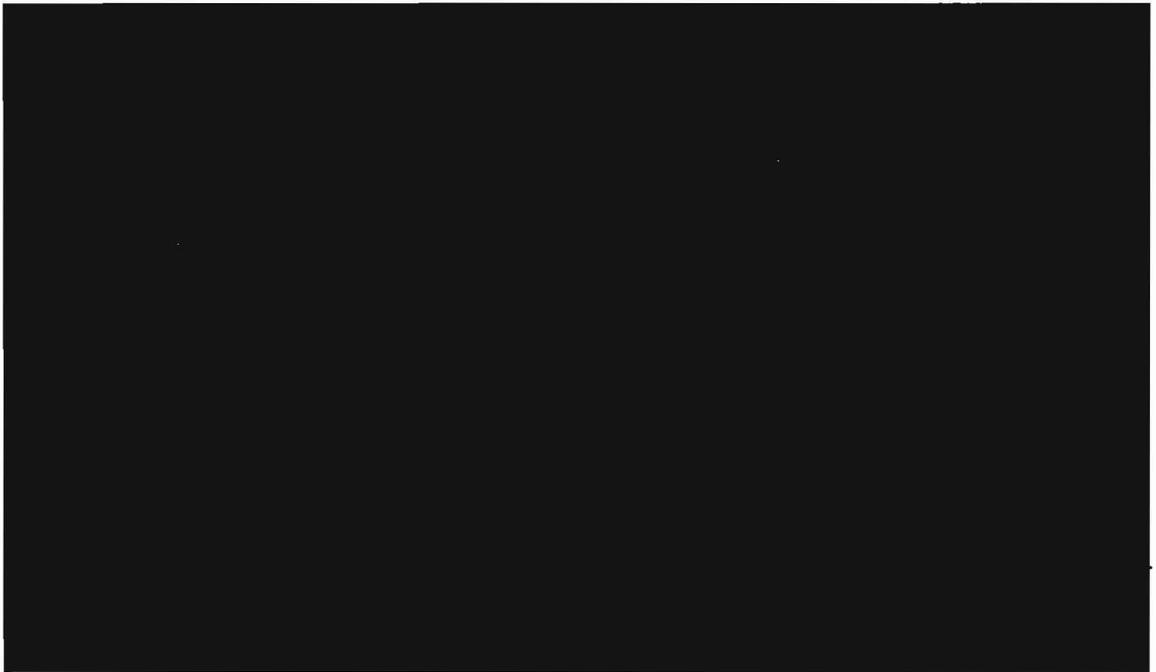


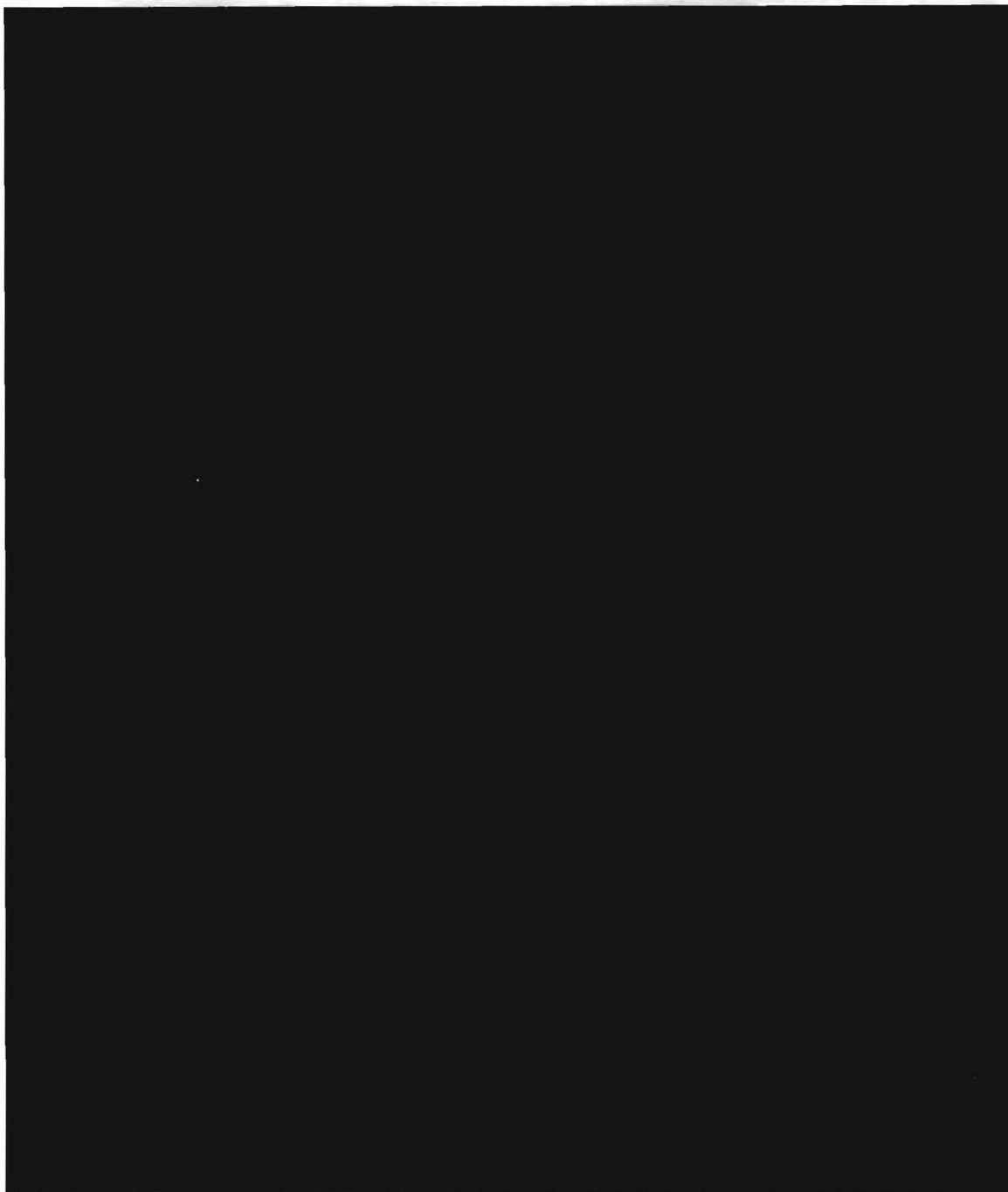
Recommendation 4





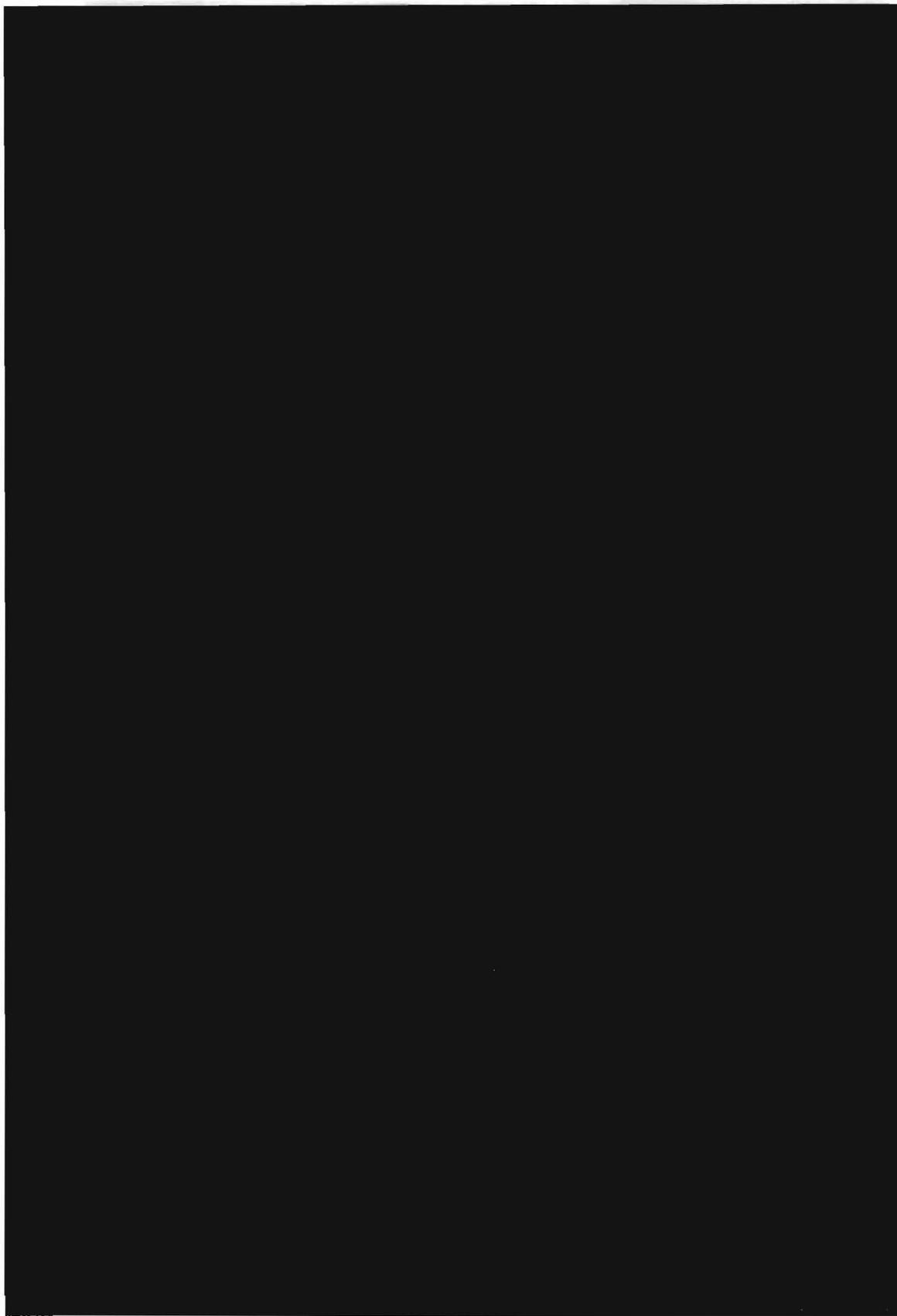
Recommendation 5

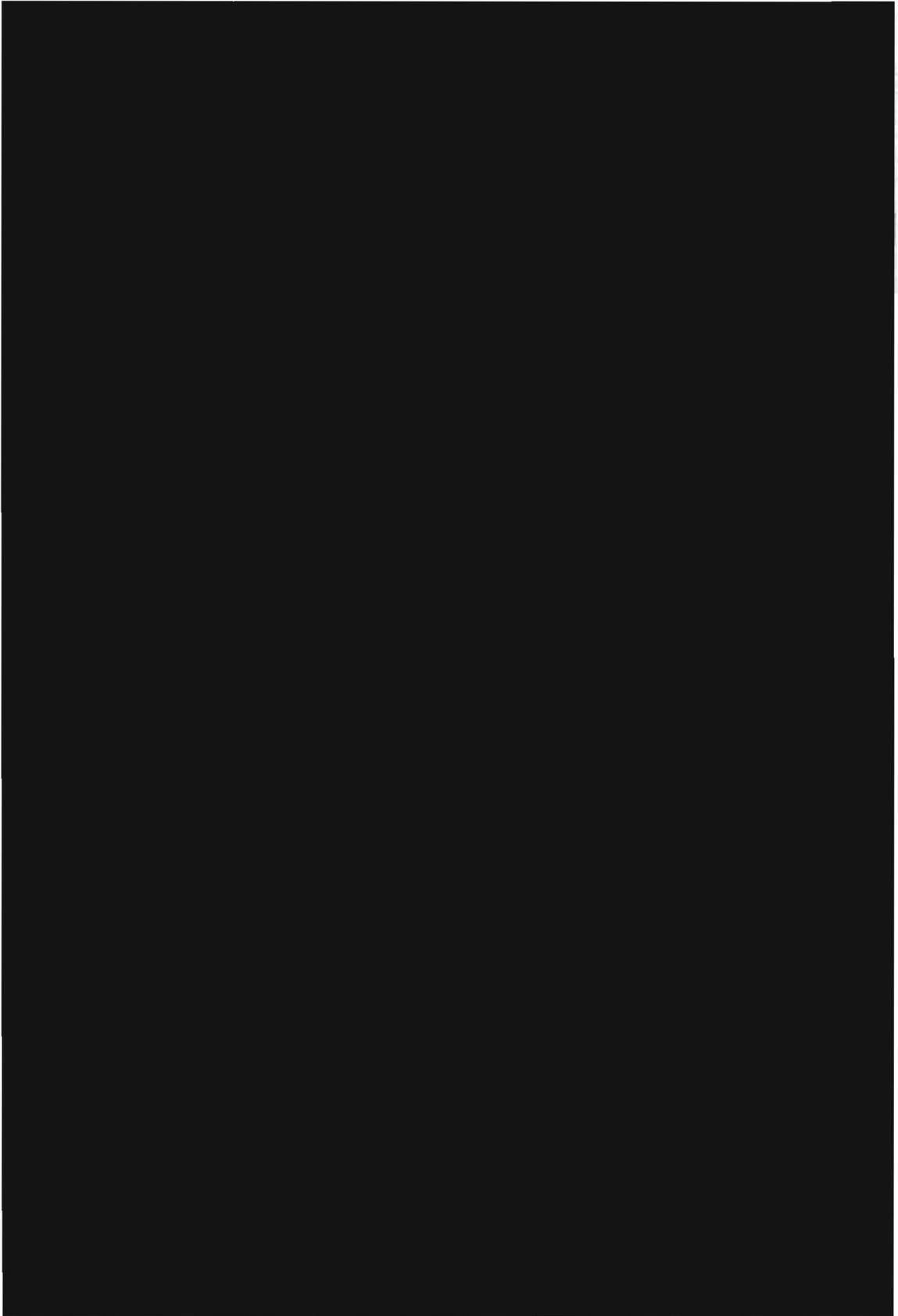




Additional Comments







ACTIONS REQUIRED

We plan to obtain management decisions on the recommendations through the audit resolution process because management's comments were not fully responsive.

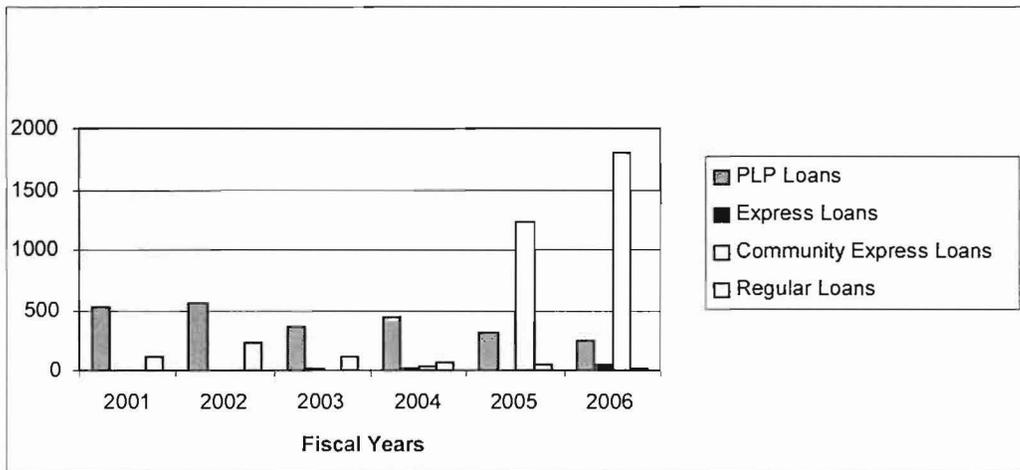
We appreciate the courtesies and cooperation of the Small Business Administration representatives during this audit. If you have any questions concerning this report, please call me at (202) 205-7203 or Robert Hultberg, Director, Credit Programs Group at (202) 205-7577.

APPENDIX I. BLX PORTFOLIO STATISTICS

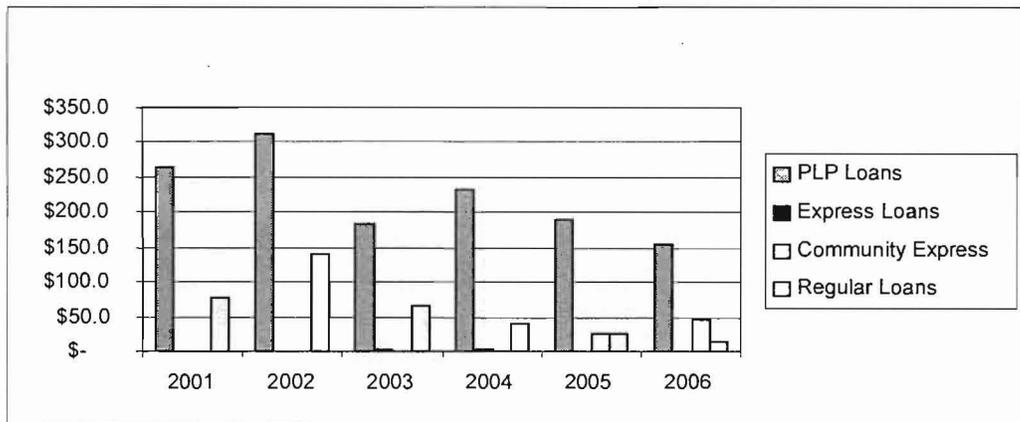


APPENDIX I. BLX PORTFOLIO STATISTICS

BLX Approved Loans



BLX Loan Dollars (Millions)



APPENDIX II. BLX PERFORMANCE STATISTICS

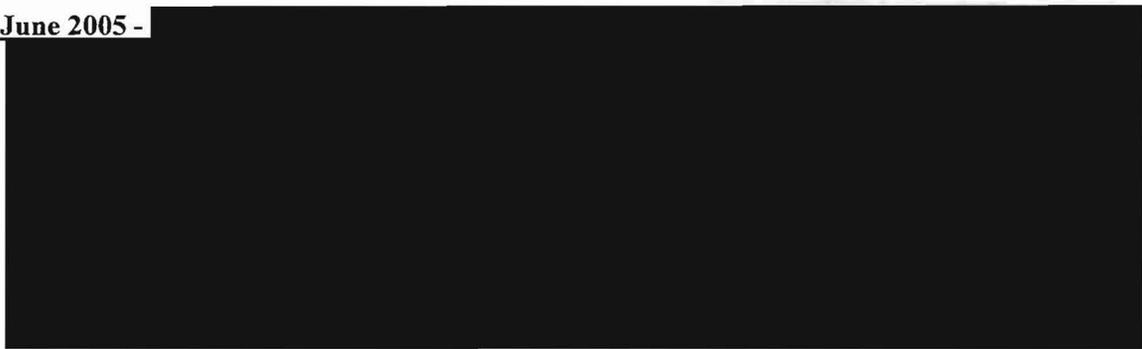


APPENDIX III. CHRONOLOGY OF EVENTS

June 2003 -



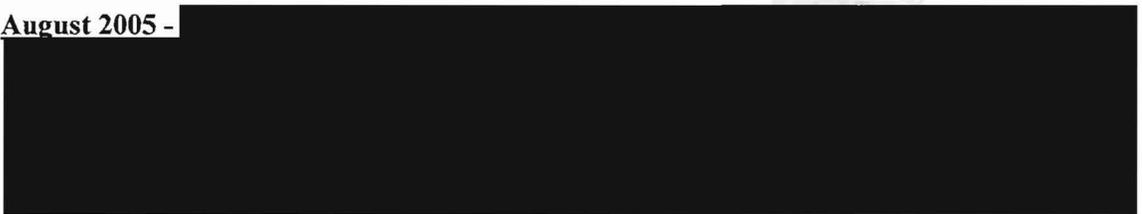
June 2005 -



July 2005 -



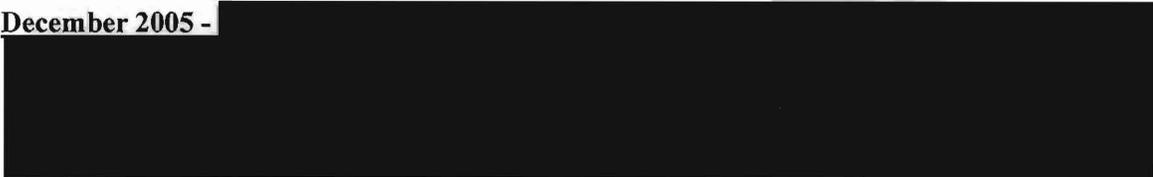
August 2005 -



September 2005 -



December 2005 -



February 2006 -



APPENDIX III. CHRONOLOGY OF EVENTS

March 2006 –

[REDACTED]

April 2006 -

[REDACTED]

July 2006:

[REDACTED]

July 2006 –

[REDACTED]

September 2006 -

[REDACTED]

December 2006 -

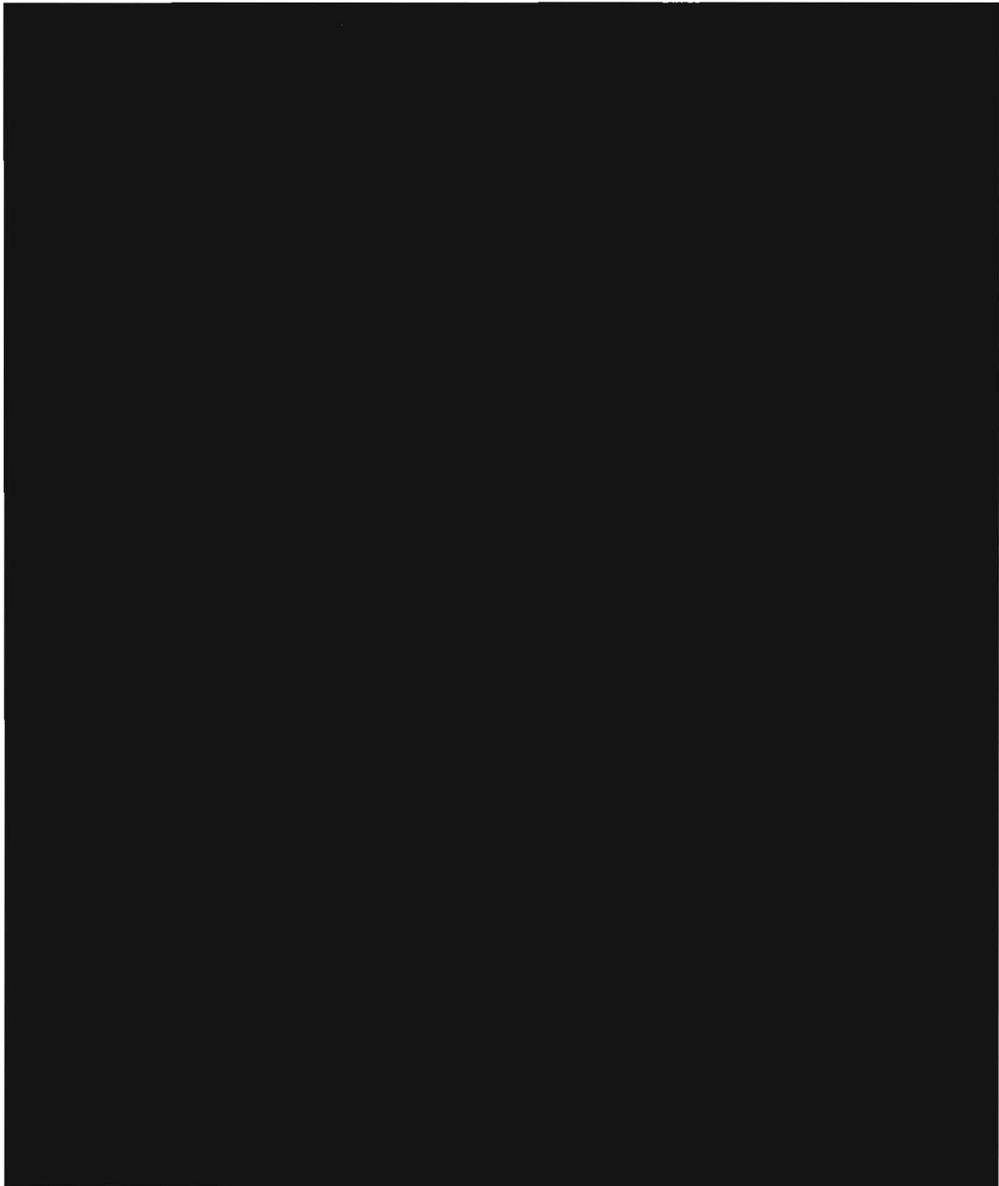
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APPENDIX IV. AGENCY RESPONSE



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

DATE: June 18, 2007



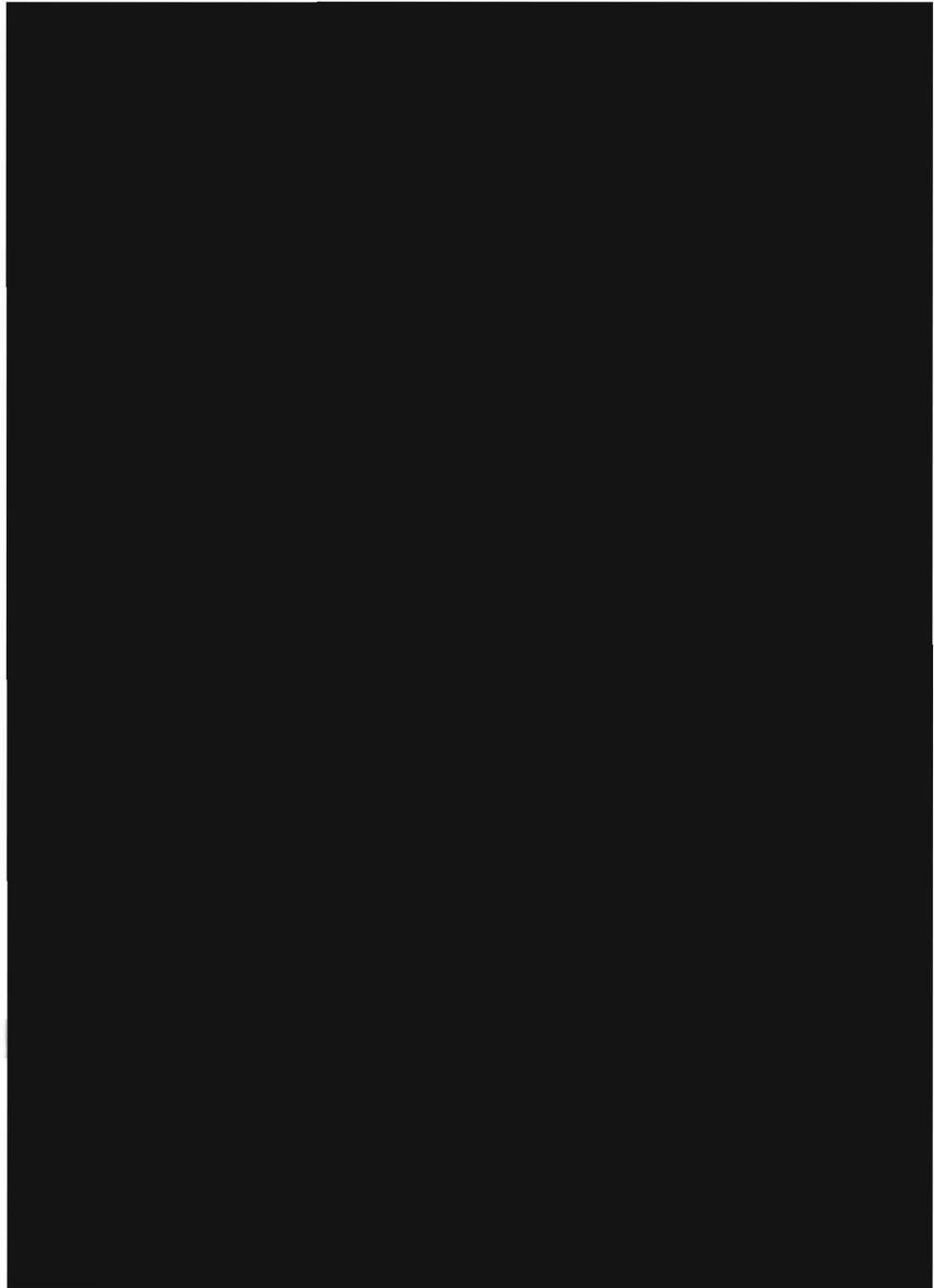
APPENDIX IV. AGENCY RESPONSE



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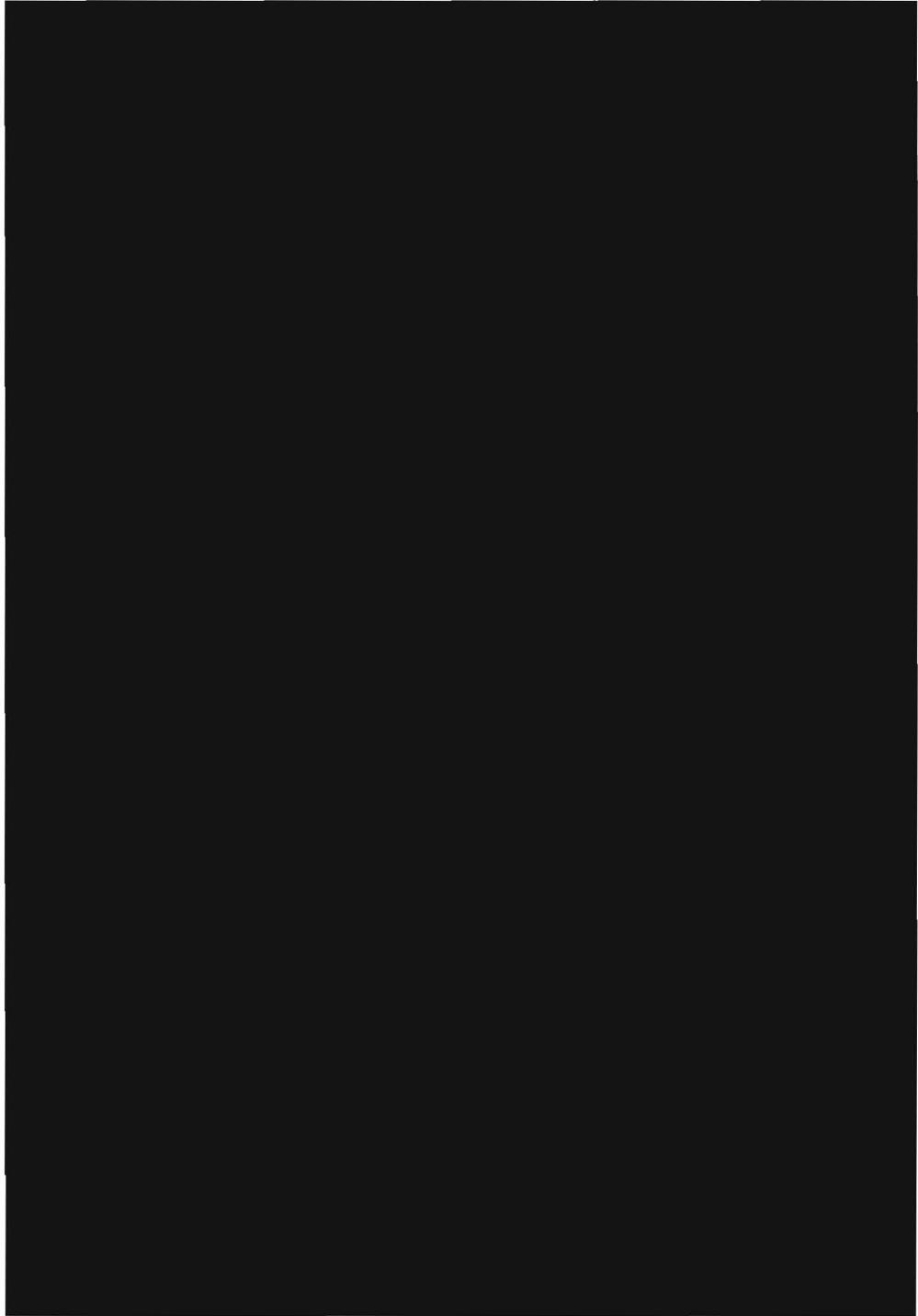
APPENDIX IV. AGENCY RESPONSE



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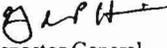
APPENDIX V. OIG COUNSEL OPINION



U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416

MEMORANDUM

TO: Debra S. Ritt
Assistant Inspector General for Auditing

FROM: Glenn P. Harris 
Counsel to the Inspector General

DATE: June 29, 2007

RE: Agency Authority To Reduce The Guaranty Percentages on SBA Loans

You have requested an opinion as to whether the Small Business Administration (SBA) has the legal authority to reduce the guaranty percentages for all new loans originated by a specific lender below the percentages identified in section 7(a)(2) of the Small Business Act (the Act). As discussed below, it is my opinion that SBA has such authority, based upon the relevant legislative history and SBA's regulatory interpretation of this provision.

Section 7(a)(2) of the Act states that guarantees made by SBA "shall be equal to" 85 percent of a loan that is under or equal to \$150,000, and 75 percent of a loan that is over \$150,000. 15 U.S.C. § 636(a)(2). Understanding the meaning of this provision requires that it be read in the context of the entire Act. "It is a 'fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.'" *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000) (quoting *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 809 (1989)). Thus, section 7(a)(2) must be read in conjunction with section 5(b)(7) of the Act, which gives SBA broad authority in administering the section 7(a) loan program by authorizing the SBA Administrator to:

"[I]n addition to any powers, functions, privileges and immunities otherwise vested in him, take any and all actions ... when he determines such actions are necessary or desirable in making, servicing, compromising, modifying, liquidating, or otherwise dealing with or realizing on loans made under the provisions of this chapter

15 U.S.C. § 634 (b)(7) (emphasis added). Thus, the question is whether Congress intended that the words "shall be equal to" in section 7(a)(2) operate so as to limit SBA's broad authority under section 5(b)(7) and absolutely prohibit the Agency from giving guarantees less than the percentages identified in the statute. Both the legislative history of section 7(a)(2) and SBA's regulatory interpretation of this section support the conclusion that this was not Congress' intention.

APPENDIX V. OIG COUNSEL OPINION

Prior to 1995, section 7(a)(2) stated that any guarantees offered by SBA “shall be ... not less than” specified numeric percentages identified in the statute (the percentages differed by dollar amount of the loan and loan maturity). SBA Legislative Handbook at 44. Similarly, the section stated that SBA “shall not ... reduce the percent guaranteed to less than the above specified percentums other than by determination made on each application.” *Id.* In 1995, Congress amended the section to provide that guarantees “shall be equal to” the identified percentages. The replacement of specific and mandatory language prohibiting lesser guarantees (“shall not be less than”) with arguably more ambiguous language (“shall be equal to”) suggests that Congress did not intend through the current wording to prohibit SBA’s authority to give guarantees lower than the percentages identified in the Act if this was determined to be necessary or desirable under section 5(b)(7).

Legislative history relevant to the 1995 amendment of § 7(a)(2) supports this interpretation. In addition to removing the “shall not be less than” language, Congress also reduced the percentage of a loan that SBA could guarantee. In the section-by-section analysis of the report, the Senate Committee on Small Business explained that the “provision also reduces the maximum percentage of a federal guarantee to 75 percent.” S. Rep. 04-129, 1995 U.S.C.C.A.N 318, 326 (1995) (emphasis added). By terming this percentage a “maximum,” Congress indicated that a lower percentage guarantee would also be acceptable.

SBA’s contemporaneous regulation implementing the amendment to section 7(a)(2) reflects a similar interpretation. As amended in 1996, the regulation provides:

SBA’s guarantee percentage must not exceed the applicable percentage established in section 7(a) of the Act. The maximum allowable guarantee percentage on a loan will be determined by the loan amount. As of October 12, 1995, the percentages are: Loans of \$100,000 or less may receive a maximum guaranty of 80 percent. All other loans may receive a maximum guaranty of 75 percent, not to exceed \$750,000, unless otherwise authorized by law.

13 C.F.R. § 120.210 (1996) (emphasis added).

In 2002, Congress raised the percentage that SBA could guaranty on smaller loans from 80 percent to the current 85 percent. P.L. 106-554 (2000) (114 Stat. 2763). SBA changed its regulations to reflect this change, offering the following explanation:

Previously, SBA was authorized to guarantee no more than 80 percent of a loan if the gross amount of the loan was \$100,000 or less, and no more than 75 percent of a loan over that amount. Section 202 of the 2000 Act amends the 7(a) business loan program by authorizing SBA to guarantee up to 85 percent of a loan if the gross amount of the loan is no more than \$150,000. Under the 2000 Act, the maximum SBA guaranty on a loan greater than \$150,000 is 75 percent except as otherwise authorized by law. To reflect these changes, SBA is amending § 120.210 of the regulations.

APPENDIX V. OIG COUNSEL OPINION

68 Fed. Reg. 51677 (emphasis added). The current wording of section 120.210 reflects SBA's continued interpretation that the percentages in section 7(a)(2) represent merely the "maximum" amount of a loan that the Agency can guarantee.

The Supreme Court has held that broad deference must be given to a regulation that interprets an agency's governing statute:

If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.... [C]onsiderable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations has been consistently followed by this Court whenever decision as to the meaning or reach of a statute has involved reconciling conflicting policies, and a full understanding of the force of the statutory policy in the given situation has depended upon more than ordinary knowledge respecting the matters subjected to agency regulations. If this choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned

Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843-45 (1984) (citations and quotation marks omitted).

Chevron also requires that any restrictions limiting agency discretion and authority to act under an organic statute to be clear. Without this clear language, an agency's interpretation must be given great deference, as long as it is reasonable. One must first inquire whether "the intent of Congress is clear" as to "the precise question at issue." If so, "that is the end of the matter." But "if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." Chevron, 467 at 842-44. "If the administrator's reading fills a gap or defines a term in a way that is reasonable in light of the legislature's revealed design, we give the administrator's judgment "controlling weight." NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 257 (1995) (citing Chevron, 467 U.S. at 844).

SBA's regulation interpreting section 7(a)(2) of the Act as merely establishing a ceiling on the percentage of a loan that the Agency can guarantee is certainly "reasonable in light of the legislature's revealed design" since it is entirely consistent with the legislative history of this section. Therefore, section 5(b)(7) appears to provide the SBA with the power to unilaterally reduce the percentage of loan guarantees below the percentages set forth in section 7(a)(2), if it is interpreted to be an action that is necessary or desirable with respect to a loan or loans under the 7(a) program.