

Standard Operating Procedure (SOP)

SOP 50 53

Office of  
Credit Risk Management

Lender Supervision and Enforcement

October 1, 2010

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## **Chapter 1. Introduction**

### **1. Introduction**

- a. This SOP establishes SBA's procedures for supervision of and enforcement actions for SBA's 7(a) lenders, Certified Development Companies (CDCs), and Microloan Intermediaries, (collectively referred to as Lending Partners) as it relates to their SBA lending operations. The SOP describes appropriate actions in response to violations of law, rules, regulations, final agency notices and/or unsafe and unsound practices or conditions for these entities. This SOP also addresses monitoring of Non-Lending Technical Assistance Providers (NTAPs) along with enforcement procedures for NTAPs and Loan Agents that participate in SBA financial assistance programs. For purposes of this SOP, Loan Agents refer to an Agent under 13 CFR 103.1(a) of an applicant or participant in SBA's business loan programs.
- b. The SBA has an active program of monitoring and oversight of Lending Partners. The purpose of the monitoring and oversight activity is to:
  - i. Maximize the efficiency of SBA's lending programs by effectively managing program credit risk, monitoring lender performance, and enforcing loan program requirements to ensure the long-term viability of SBA lending;
  - ii. Identify unacceptable risk profiles and encourage and, as appropriate, enforce program lending requirements so as to improve and manage the risk of individual Lending Partners as well as the aggregate risk of SBA's loan portfolios; and
  - iii. Promote responsible credit gap lending that supports SBA's mission to increase access to capital to small businesses.
- c. General Principals for Application of Monitoring, Increased Supervision and Enforcement with respect to Lending Partners.
  - i. Risk-based to best utilize limited resources.
  - ii. Graduated processes with flexibility to administer appropriate supervisory actions earlier to address progressively serious risk concerns.
    1. Routine monitoring. Most problems and weaknesses should be identified and addressed through routine monitoring.
    2. Intensive monitoring. Many other issues should be addressed through increased supervision, e.g., corrective action process.

3. Enforcement actions. Anticipate that following routine and intensive monitoring only a smaller number of problems/issues will remain and need to be addressed through enforcement actions.
  - iii. Identify and address risk-based concerns, and, ultimately, if necessary, make determinations about a Lending Partner's continuing participation in SBA's lending programs.
  - iv. SBA has a responsibility to appropriately manage and oversee its loan programs and the requirements it places on Lending Partners.
  - v. Processes and procedures are evolutionary. Because programs develop, markets are fluid, and technologies are evolving, SBA's approaches will adapt with them.
- d. Oversight and Type of Lender: The extent of monitoring, increased supervision and enforcement will depend upon the type of SBA Lending Partner overseen, e.g., SBA Supervised Lenders versus 7(a) lenders regulated by Federal Financial Institutions, and the extent to which SBA may rely on or coordinate oversight with another bank regulator. For lenders regulated by the Federal Financial Institution Regulators, as defined in 13 CFR 120.10, references in this document to SBA supervision and SBA supervisory activities or actions refer to the Lending Partners' SBA operations.
- e. Documentation: Supervisory and enforcement actions are supported through documentation provided by the Financial Analyst (FA).
- f. This SOP provides guidance on how the Office of Credit Risk Management (OCRM):
  - i. Groups and prioritizes actions into "large" and "small" dollar-magnitude risk categories;
  - ii. Conducts supervisory activities both on-site and off-site, generally based on the dollar-magnitude risk categories;
  - iii. Selects the action or combination of actions best suited to effectively supervise Lending Partners in a consistent manner while preserving flexibility for specific circumstances; and
  - iv. Selects enforcement actions.
- g. This SOP provides general internal guidance on how SBA conducts supervision and enforcement responsibilities. It is intended to be flexible to take into account individual facts and circumstances. It does not intend that every consideration factor or step must always be applied. SBA will use this guidance along with judgment

and Agency discretion in making supervisory and enforcement determinations. Therefore, this SOP is not intended to, does not, and may not be relied upon to, create rights, substantive or procedural for Lending Partners or any other party enforceable at law or in any administrative proceeding against SBA.

## **2. Notice of Implementation**

- a. This SOP is effective beginning October 1, 2010.
- b. This SOP is supplemented by SOP 51 00 “On-Site Lender Reviews and Examinations” which details SBA standard operating procedures for on-site reviews and examinations for 7(a) lenders and CDCs.

## **3. Authority**

The following statutory and regulatory citations provide authority for this SOP: 15 USC § 650; 15 USC § 634 note, citing, Public Law 104-208, Division D, Title I, §103(h); 15 USC § 634(b)(14); 15 USC § 634(b)(7); 15 USC § 636(a)(31) and (m); 15 USC 633(b)(3); 15 USC 634(f); 15 USC § 687(f); 15 USC § 696(3)(A); 15 USC § 697(a)(2); 15 USC § 697e(c)(8); 15 USC § 634(b)(6); 13 CFR Parts 103 and 120; 70 FR 21262, April 25, 2005 (Delegations of Authority); and 72 FR 27611, May 16, 2007 (Final Notice on Risk Rating System) as amended by 75 FR 9257 (March 1, 2010). See also 120.10 for key lender oversight definitions.

## **Chapter 2. OCRM Monitoring**

### **1. Overview and General Policy**

- a. Generally, OCRM oversees SBA's Lending Partners to identify unacceptable risk profiles and, if appropriate, enforce loan program requirements so as to improve and manage the risk of individual Lending Partners as well as the aggregate risk of SBA's loan portfolio. This is accomplished in monitoring through:
  - i. Identifying those Lending Partners whose SBA program risk exceeds SBA's risk tolerance levels.
  - ii. Identifying problems and weaknesses in Lending Partners' SBA program performance, e.g., identify negative trends in lender performance or lending concentrations.
  - iii. Enabling Lending Partners to proactively manage their SBA programs through the lender portal.
  - iv. Assisting Lending Partners in correcting problems and weaknesses before they become serious problems, e.g., through on-site reviews, site visits, and off-site monitoring actions.
- b. For Lending Partners, OCRM generally conducts monitoring commensurate with the dollar level of lending and the relative risk to the Agency's portfolio, as determined by SBA, in its discretion. While SBA will generally follow the guidance set forth below on level and type of lender monitoring, SBA reserves the right to use judgment and discretion in making individual determinations, as appropriate.
- c. For Microloan Intermediaries, given the unique contribution of this program to SBA's mission, the potential program integrity and program reputational risk, and the relatively small dollar level of risk, OCRM will conduct its monitoring practices to reflect these aspects of the microloan portfolio.

### **2. Determining the Level of Monitoring**

- a. Level of monitoring is determined by relative magnitude of risk among individual Lending Partners within their respective loan programs. Larger dollar-volume Lending Partners are generally subject to greater monitoring, as they expose SBA to a greater level of potential risk than smaller dollar-volume Lending Partners.
- b. Level of monitoring is also tailored to the Lending Partner and designed to identify weaknesses in the Lending Partner's conformance with SBA Loan Program Requirements as defined in 13 CFR 120.10. For Microloan

Intermediaries, “Loan Program Requirements” refer to requirements imposed on the intermediary by statute, SBA regulations, any agreement the intermediary has entered into with SBA, SBA SOPs, official SBA notices and forms applicable to the Microloan program, as such requirements are issued and revised by SBA from time to time. Monitoring includes:

- i. SBA portfolio performance;
  - ii. Credit quality;
  - iii. Compliance with Loan Program Requirements and non-lending requirements, e.g., 1502 reporting and other monetary remittance and reporting requirements such as guarantee fees, receivables and 172 payments;
  - iv. Financial condition; and
  - v. Considers the relative extent of risk to SBA, e.g., dollar risk.
- c. To define groups of Lending Partners by dollar risk to SBA, the following peer groups have been established:
- i. For the 7(a) loan program lenders, peer groups are defined by outstanding dollars of SBA share, as follows:
    - Lenders with \$100 million or more;
    - Lenders with \$10 million to \$99,999,999;
    - Lenders with \$4 million to \$9,999,999;
    - Lenders with \$1 million to \$3,999,999;
    - Lenders with \$0 to \$999,999 with at least one SBA loan disbursed in the past 12 months, which is considered “Active”; and
    - Lenders with \$0 to \$999,999 and no SBA loans disbursed within the last 12 months, which is considered “Inactive”.
  - ii. For the 504 program CDCs, peer groups are defined by outstanding dollars of SBA debentures, as follows:
    - CDCs with \$100 million or more;
    - CDCs with \$30 million to \$99,999,999;
    - CDCs with \$10 million to \$29,999,999;
    - CDCs with \$5 million to \$9,999,999; and
    - CDCs with \$0 to \$4,999,999.
  - iii. For Microloan Intermediaries, no peer groups have been established at this time.

- d. Generally, the two largest 7(a) and CDC peer groups receive monitoring conducted through both on-site reviews and off-site reviews/monitoring, while the smaller peer groups typically receive monitoring conducted primarily through off-site reviews/assessments. When a smaller Lending Partner has higher risk characteristics, SBA may in its discretion increase the level of monitoring or supervision, including conducting on-site reviews.
- e. For Microloan Intermediaries, SBA's oversight will be structured to reflect the risks of this portfolio including those associated with program integrity and program reputation risks as well as the dollar level of risk.

### **3. Types of Lender Monitoring and Reviews**

- a. Reporting: Required regular reporting for all Lending Partners provides partial basis of monitoring. Required reporting includes the following, by type of Lending Partner.
  - i. All 7(a) lenders' and CDCs' monthly loan payment reporting, e.g. 1502 for 7(a) lenders, automatic ACH payments by Colson for 504 loans at CDCs.
  - ii. CDCs' required annual financial statements, including audited financial statements, depending on the size of the CDC's 504 loan portfolio.
  - iii. SBA Supervised Lenders required annual reports and quarterly reports on financial condition and quarterly capital certification.
  - iv. Microloan Intermediaries required monthly MPERS reporting, quarterly MRF and LLRF reporting and accompanying bank statements, quarterly technical assistance narrative reports, any special reports (e.g., Recovery Act Reporting) and annual financial audits.
  - v. NTAPs required quarterly technical assistance reports and annual financial audits.
- b. SBA Loan and Lender Monitoring System review (L/LMS). LLMS provides the following information, for example;
  - i. Quarterly risk ratings - "1" through "5" with a risk rating of "1" generally reflective of lower risk to SBA, and "5" generally reflective of greater risk to SBA, based upon the SBA loan portfolio credit quality.
  - ii. Historical performance measures, e.g., delinquencies, purchases.

- iii. Forecasted and anticipated portfolio performance.
  - iv. Other patterns of performance that indicate increased risk, e.g., early default, high delinquencies, high purchase rates, high net losses, etc.
  - v. Other relevant information on Lending Partner's lending practices and performance including non-lending requirements such as 1502 reporting and other monetary remittance and reporting requirements, e.g., guarantee fees, receivables and 172 payments.
- c. External information sources available for monitoring.
- i. Call Reports of federally-regulated Lending Partners reviewed for lender capital sufficiency and other measures.
  - ii. Other publicly available financial information compiled on federally-regulated Lending Partners; e.g., SNL Financial information services data.
  - iii. SEC reports for publicly-traded Lending Partners.
  - iv. Audited financial statements, where available.
  - v. Federal and state regulatory issuances (Orders, MOUs, etc.) for information regarding solvency as well as management and internal controls.
  - vi. Federal/State regulatory examinations, if available.
  - vii. Any other relevant external information that may affect the risk position of SBA will be considered.

Lending Partners that demonstrate weaknesses as identified i) usually in a public document by a federal/state regulator (e.g., Cease and Desist Order) or ii) by its primary auditor (e.g., in a Going Concern Opinion) receive additional monitoring and review including monitoring of secondary market activities.

- d. Other off-site lender reviews available for monitoring:
- i. Monitoring of specific performance measures (performance measures review) for all size Lending Partners, e.g., loss rates, growth, trend analysis, or for certain types of Lending Partners, e.g., SBA Supervised Lender capital levels.

- ii. Systematic off-site monitoring assessment that identifies and evaluates the risk characteristics of certain types of SBA Lending Partners.
  - iii. Delegated lender authority review conducted periodically to coincide with renewal dates.
  - iv. Preferred Lender Program (PLP) annual assessments (statutorily-mandated for all PLP lenders) which may take the form of on-site reviews, delegated lender authority reviews and/or systematic off-site monitoring assessment, as applicable per fiscal year.
  - v. Targeted off-site reviews which are discretionary, e.g., follow-up to ensure corrective action on large portfolios, to assess high risk concern expeditiously, or where medium risk warrants narrowing the scope of a particular review.
  - vi. Agreed upon procedures reviews (AUP) performed by third-party practitioners upon which SBA and the Lending Partners agree, who follow review protocol as prescribed by SBA. For example, to ascertain SBA Loan Program Requirements compliance for smaller Lending Partners that is not subject to routine on-site reviews.
  - vii. Bureau of Premier Certified Lender Program (PCLP) Oversight loan loss reserve monitoring.
  - viii. Microloan Intermediary loan repayment monitoring (monthly).
  - ix. Any other relevant information on a Lending Partner's lending practices and performance.
- e. Types of on-site reviews available for monitoring:
- i. On-site risk-based reviews (RBR). Generally the routine assessment performed for the two largest peer group sizes of 7(a) Lenders and CDCs. See SOP 51 00, "On-site Lender Reviews/Examinations", as amended.
  - ii. SBA Supervised Lender safety and soundness examinations (except Other Regulated SBLCs<sup>1</sup>). Generally, 12 to 24 month cycle. See SOP 51 00, "On-site Lender Reviews/Examinations", as amended.

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<sup>1</sup> Other Regulated SBLC is an SBA licensed SBLC that is directly regulated by a Federal bank regulator (usually a subsidiary of an FDIC insured bank)

- iii. Site visits. SBA conducts site visits periodically of SBA's Microloan Intermediaries and NTAPs.
  - iv. Targeted on-site reviews or evaluations (limited scope RBRs targeted to problematic issues). For example:
    - 1. Where information suggests a serious deficiency in a narrow area for a relatively large portfolio (e.g., enforcement order of other regulators);
    - 2. For any size Lending Partner where the circumstances warrant, as determined by SBA (generally a risk related or program integrity matter e.g., high purchase rate, early defaults, indications of deficiencies in technical assistance); or
    - 3. For Lending Partners in a new SBA program to identify best practices.
    - 4. For Microloan Intermediaries for specifically defined purposes based on off-site monitoring and/or to ensure program compliance.
  - f. Corrective action follow-up, e.g., letter or targeted on-site review, where there are serious findings and deficiencies, generally with very large size portfolio, perhaps warranting the next level of action if not resolved.
  - g. Watch list that identifies higher-risk SBA Lending Partners that warrant elevated oversight attention. SBA will determine the general parameters that demonstrate such higher-risk.
- 4. Timing and Frequency of Monitoring –** Monitoring is an on-going process. Generally Lending Partners with higher risk characteristics are monitored more intensively, and with higher level of direct interaction.

The tables below provide a summary guide for SBA risk-based monitoring actions of 7(a) lenders, CDCs, Microloan Intermediaries and NTAPs.

Table of Monitoring Actions

	<b>SBA Supervised Lenders</b>	<b>7(a) Lender largest 2 peer groups (excluding SBA Supervised Lenders)</b>	<b>7(a) Lender <u>not</u> in largest 2 peer groups &amp; &gt;\$4M (excluding SBA Supervised Lenders)</b>	<b>7(a) Lenders &lt;\$4M (excluding SBA Supervised Lenders)</b>	<b>CDCs in largest 2 peer groups</b>	<b>CDCs <u>not</u> in largest 2 peer groups</b>
Loan Payment Reporting (e.g., 1502s)	X	X	X	X		
Call Reports		X	X	X		
Other External Info as avail. (e.g., SNL, SEC, C&Ds)	X	X	X	X		
Annual Reports	X(audited)				X (audited)	X (and audited if ≥ \$20 M portfolio)
Quarterly Condition Reports & Capital Cert	X					
Other Reports (e.g., 120.464(a)(7) and 120.830(g)) <sup>2</sup>	Discretionary – as needed				Discretionary – as need	Discretionary – as needed
LLMS –quarterly off-site review/RR	X	X	X	X	X	X
Performance measures reviews	X	X	X	X	X	X
Systematic Off-site Monitoring Assessments	X	X	Discretionary (e.g., higher risk)	Discretionary (e.g., higher risk)	X	Discretionary (e.g., higher risk)
On-site Reviews	X (for smaller NFRLs and Other Regulated SBLCs)	X	Discretionary (e.g., higher risk)		X	X
On-site safety and soundness exam	X (SBLCs) <sup>3</sup> (Discretionary for NFRLs)					
Agreed Upon Procedures Review	Discretionary as needed	Discretionary as needed	Discretionary as needed	Discretionary as needed	Discretionary as needed	Discretionary as needed

<sup>2</sup> 13 CFR Sections 120.464 and 120.830 also reference some additional reports triggered by certain circumstances.

<sup>3</sup> If Other Regulated SBLC – then will have SBA on-site review instead of on-site safety and soundness exam.

	<b>SBA Supervised Lenders</b>	<b>7(a) Lender largest 2 peer groups (excluding SBA Supervised Lenders)</b>	<b>7(a) Lender <u>not</u> in largest 2 peer groups &amp;&gt;\$4M (excluding SBA Supervised Lenders)</b>	<b>7(a) Lenders &lt;\$4M (excluding SBA Supervised Lenders)</b>	<b>CDCs in largest 2 peer groups</b>	<b>CDCs <u>not</u> in largest 2 peer groups</b>
Del Auth Rev	X (if Del Auth)	X (if Del Auth)	X (if Del Auth)	X (if Del Auth)	X <sup>4</sup> (if Del Auth)	X <sup>4</sup> (if Del Auth)
PLP Ann Asses <sup>5</sup>	X (if PLP)	X(if PLP)	X (if PLP)	X (if PLP)		
Bureau PCLP LLR monitoring					X (if PCLP)	X (if PCLP)
Targeted off-site review	Discretionary – as needed	Discretionary – as needed	Discretionary – as needed	Discretionary – as needed	Discretionary – as needed	Discretionary – as needed
Targeted on-site review	Discretionary – as needed	Discretionary – as needed	Discretionary – as needed	Discretionary – as needed	Discretionary – as needed	Discretionary – as needed

<sup>4</sup> CDC delegated authority reviews performed by Office of Financial Assistance.

<sup>5</sup> Statutory requirement that is met through RBR, Off-Site Monitoring, or Delegated Authority Review.

Microloan Intermediary/NTAP Risk Based Lender Monitoring Chart<sup>6</sup>

	Microloan Intermediary	NTAPs
MPERS loan performance reports (monthly)	X	
MRF and LLRF (loan loss reserve) Reports (w/ Bank Statements) (Quarterly)	X	
Technical Assistance Report (Quarterly)	X	X
Annual Audit Reports	X	X
Recovery Act Quarterly Report to FederalReporting.gov	X	X
Other Reports	Discretionary – as developed by SBA	Discretionary – as developed by SBA
Targeted off-site review	Discretionary – as needed (e.g. poor performers)	Discretionary – as needed (e.g. poor performers)
Site Reviews	Discretionary - as needed	Discretionary - as needed
Agreed Upon Procedures Review	Discretionary - as needed	Discretionary - as needed
Targeted Site review	Discretionary – as needed	Discretionary – as needed

<sup>6</sup> Monitoring, site reviews and technical assistance oversight to be coordinated by OCRM with OFA and District Offices.

### **Chapter 3. OCRM Increased Supervision of Lending Partner's SBA Operations**

#### **1. Overview and General Policy**

- a. Increased Supervision of SBA operations may be applicable when, for example:
  - i. Monitoring identifies weakness or higher lender risk level;
  - ii. Modification of Lending Partner conduct or processes is necessary, as determined by SBA (e.g., to avoid unnecessary losses);
  - iii. Solution requires written commitment from the Board of Directors (BOD) or SBA department management regarding its corrective action plan; and/or
  - iv. Management and/or BOD demonstrate willingness to implement its corrective action plan.

#### **2. Determining Level of Increased Supervision**

- a. Supervisory responses are tailored to Lending Partner responses and issues observed, and may be conducted by application of multiple types of increased supervision concurrently. Supervisory responses are designed to improve or modify Lending Partner performance (numerical or qualitative improvement) so as to conform to SBA Loan Program Requirements.
- b. Factors (as considered by SBA based on expertise, judgment, and discretion)
  - i. Nature, extent and severity of problems and weaknesses (may include consideration of dollar magnitude of risk);
  - ii. Condition of the SBA loan portfolio (both current and projected);
  - iii. Ability of the Lending Partner to correct in a timely manner; and
  - iv. Level of BOD and management commitment to correct the identified problems and weaknesses within an appropriate time frame.
  - v. Response of the Lending Partner is also an important factor in determining which type of increased supervision should be undertaken or whether SBA will take enforcement action and the severity of that action.
- c. Evidence of increased supervision conducted, any earlier enforcement actions, failure to comply with the increased supervision or earlier enforcement action,

and the consequences for the Lending Partner of the failure to comply is an important part of establishing the record for more severe subsequent actions.

### **3. Types of Increased Supervision**

Below are examples of types of increased supervision SBA may undertake and some circumstances that may lead to them. If increased supervision is undertaken, Lending Partner will receive written notification of the action, including the rationale.

- a. Risk Rating Override Downgrade.
  - i. Issued for federal regulator Order or Consent Agreement affecting capital or commercial lending issues.
  - ii. Issued for Going Concern opinion issued by independent auditor.
  - iii. Issued for any identified condition that affects capital, solvency, or prudent commercial lending ability, including rapid growth, early loan default trends, and continued poor performance.
  - iv. Issued for substantially worse “net flows”, as defined by SBA in SBA’s lender portal.
  - v. Issued for other documented reasons that SBA may identify as part of its supervisory responsibilities.
- b. Secondary market sales evaluation.
  - i. When an SBA Lender (as defined in 13 CFR 120.10 and includes 7(a) Lenders and CDCs) is subject to a Cease & Desist Order, Consent Agreement affecting capital or commercial lending issues, Going Concern Opinion matter, or other supervisory action that cites unsafe and unsound banking practices or other items of concern to SBA and its potential risk to SBA through loan sales.
  - ii. Any 7(a) Lender that intends to sell in the secondary market must notify SBA within five business days (or as soon as practicable thereafter) of the issuance of any such action or opinion, including providing copies of the relevant documents to SBA for review, preferably prior to negotiating secondary market sales.
  - iii. SBA will evaluate the additional risk associated with the Lending Partner’s secondary market sales in determining whether to provide SBA’s prior written consent to a secondary market sale. SBA may require an escrow agreement or other financial assurances be provided to cover the potential losses that may occur from repairs and denials of SBA loan

guarantees. Any evaluation performed is solely for SBA purposes and should not be relied upon by others.

- c. Shortened renewal of delegated lender authority - See 13 CFR 120.451(e) and SOP 50 10 5 for renewal criteria, e.g., less than acceptable SBA performance or regulatory actions that SBA determines are not significant enough for a non-renewal, etc.
- d. Non-renewal of delegated lender authority - See 13 CFR 120.451(e) and SOP 50 10 5 for renewal criteria. Upon renewal date, issued for any Lending Partner (For example;
  - i. That lacks good standing status with its primary regulator as determined by SBA, or has a Going Concern Opinion issued by an independent public accountant.
  - ii. For unsatisfactory SBA performance as determined by SBA.
  - iii. For any identified condition that materially affects capital, solvency or prudent commercial lending ability, as determined by SBA.
  - iv. For other risk-related information (e.g., considers rapid growth, inadequate capital, Cease and Desist Order) as determined by SBA.
  - v. For other basis under law for non-renewal.
- e. Required Corrective Action(s) process.
  - i. Issued for weaknesses or findings identified by any on-site or off-site review process.
  - ii. Written response to the findings and corrective actions required from Lending Partner's SBA department management or senior management (whomever parties have responsibility and authority for SBA lending within the institution) to include goals and milestones.
  - iii. Commitment by Board of Directors (BOD) may be required, as applicable to corrective action.
  - iv. Assessment of response is conducted by OCRM and response provided to Lending Partner. The three possible results are:
    - 1. Satisfactory;
    - 2. Satisfactory but additional reporting or monitoring will be required; or

### 3. Not satisfactory.

v. This assessment is made, taking into consideration, the level and frequency of past concerns and the Lending Partner's ability and willingness to correct them, e.g., repeat findings with no resolution may be considered more significant than first time finding(s), depending upon the nature of the finding(s). SBA may make adjustments to corrective action requirements based on such considerations as a Lending Partner's ability and willingness to address issues.

#### f. Increased Reporting

- i. When weaknesses or findings (generally identified in on-site or off-site reviews) are of a nature not easily or quickly resolved (e.g., change of personnel, necessary policy or procedure changes).
- ii. Long-term approach to solution requires continued reporting on milestones and achievements.
- iii. Confidence in the BOD and management is vital to acceptance by SBA of such an understanding.
- iv. Fixed time frame must be defined and as short as reasonably possible.
- v. Interim on-site evaluation by OCRM may be necessary to determine level of achievement.
- vi. Lending Partner will receive periodic letter(s) informing of status and any continued required reporting, information and/or other responses.

g. Capital Restoration Plan (SBA Supervised Lender only). See 13 CFR 120.462(e).

h. Accelerated scheduling of on-site or off-site review (often takes the form of a targeted review) or site visit.

i. Others, as defined periodically by SBA.

### 4. Proceedings Resultant from Increased Supervision

- a. Termination of Increased Supervision – satisfactory resolution, as determined by SBA in its discretion, of any issue triggering increased supervision, i.e. Regulatory Order dismissed, Corrective Actions resolved to SBA's satisfaction, etc.

- b. Initiation of Enforcement Action(s) – (See Chapter 4 of this SOP for further guidance). For example:
  - i) Lending Partner’s failure to correct deficiency or reduce risk to acceptable level within appropriate timeframe, as determined by SBA;
  - ii) Confidence not high in the BOD or management’s willingness to correct;
  - iii) Uncertainty regarding Lender Partner ability/competency to complete the remedial measures; or
  - iv) Other Chapter 4 listed factors or other negative indicators.

## **Chapter 4. OCRM Enforcement**

### **1. Overview and General Policy**

- a. This Chapter, as with the balance of the SOP, is intended to provide general guidance to SBA staff. It is intended to be flexible to take into account individual facts and circumstances. It does not mean every consideration factor or step must be applied. SBA will use this guidance along with judgment and agency discretion. Therefore, this SOP and Chapter are not intended to, do not, and may not be relied upon to create rights, substantive or procedural, for Lending Partners enforceable at law or in any other administrative proceeding against SBA.
- b. OCRM responsibility for enforcement is to take appropriate enforcement actions as determined by SBA against those Lending Partners that demonstrate unacceptable risk profiles and an inability or unwillingness to proactively or timely resolve the issues which create the unacceptable risk profile.
- c. Enforcement actions are taken to achieve the outcomes of:
  - i. Communicating problems and weaknesses to the highest level of Lending Partner's management;
  - ii. Satisfactorily resolving the risk factors that created the need for an enforcement action; and/or
  - iii. Limiting Agency risk where it exceeds risk tolerance levels.
- d. Strategy for enforcement actions, in general, is:
  - i. Progressive use of available enforcement actions;
  - ii. Flexibility in tailoring to the specific Lending Partner situation;
  - iii. Designed to correct deficiencies and return lender portfolio to safe and sound condition and/or limit risk; and
  - iv. To achieve the desired outcome in reasonable timeframe.

### **2. Determining Severity of Enforcement Action**

- a. Quantitative considerations
  - i. Performance measures which demonstrate that Lending Partner's performance is multiple times "worse" than portfolio or peer performance;

- ii. “Net flow” measures (as defined in SBA’s lender portal) that demonstrate negative impact on SBA programs;
  - iii. Percentage measures which demonstrate poor handling by Lending Partner of required competencies (e.g., high repair rate, high guarantee purchase rate, high default rate); or
  - iv. Repeated failures by Lending Partner to comply with applicable law, regulation and SBA Loan Program Requirements.
- b. Qualitative considerations
- i. Nature, extent and severity of problems (may include consideration of dollar magnitude of risk);
  - ii. Demonstrated commitment and ability of Lending Partner management and board to correct identified problems within appropriate timeframe;
  - iii. History of success implementing corrective actions;
  - iv. Previously identified unaddressed problems;
  - v. Fraud or false statements or indicators;
  - vi. Financial Condition or Insolvency (legal or equitable);
  - vii. Other outstanding enforcement actions by SBA or other authority; or
  - viii. Other relevant risk or program integrity related circumstances, as determined by SBA.
- c. Guiding Principles in Making Enforcement Determinations:
- i. Protection of the integrity of SBA’s loan programs and protection of taxpayers from Lending Partners who fail to comply with applicable law, regulations and SBA Loan Program Requirements are paramount.
  - ii. SBA’s evaluation of the impact of the identified grounds and the proposed corrective actions on the identified risk to the SBA loan portfolio of the Lending Partner. Usually, less severe impact will result in less severe enforcement.
  - iii. Ability and willingness of management and/or BOD to accomplish immediate action to mitigate the grounds will generally result in a less serious enforcement action, while demonstrated lack of ability or willingness generally dictates more severe enforcement action. Ability and willingness to address issues is also evaluated in terms of level and frequency of past concerns and the Lending Partner’s ability and

willingness to correct them, i.e., repeat findings with no resolution may be considered more significant than first time finding(s), depending upon the nature of the finding(s).

- iv. SBA will generally document such unwillingness or inability in its decision(s) in support of the magnitude of enforcement action(s).
- v. Certain grounds or circumstances dictate *immediate* enforcement action. This is considered a very severe enforcement action, and is generally taken when it is determined by SBA in its sole judgment and discretion that immediate action is needed to prevent impairment of the integrity of the applicable loan program (including risk of significant losses or potential losses as determined by SBA).

#### d. Mitigating Factors

- i. Very small Lending Partners whose performance measures may be unduly affected by one or two poorly performing loans relative to the size of the Lending Partner's total SBA portfolio;
- ii. Contribution to SBA mission as identified through a demonstrated commitment to credit gap lending and meeting the needs of underserved markets in a manner that does not significantly increase the risk of the SBA loan programs;
- iii. Local economic conditions;
- iv. Concentrations in sector experiencing economic downturn;
- v. Purchase of failed Lending Partner's SBA portfolio impact on portfolio performance statistics;
- vi. Acceptable review results as determined by SBA;
- vii. Other actions taken to already limit risk, e.g., Lending Partner has no delegated authority, no Secondary Market Sales or establishment of escrow agreement to support secondary market sales; or
- viii. Others, as identified by SBA.

### 3. Grounds for Enforcement Actions

- a. Circumstances which demonstrate that the Lending Partner is not in compliance with all terms, conditions and remedies in SBA Loan Program Requirements (as generally defined in 13 CFR 120.10 and further applied to Microloan Intermediaries).

- b. Ten general grounds for enforcement are established in SBA regulations at 13 CFR 120.1400 and apply to all SBA Lenders, with several additional or specific grounds applicable to certain types of SBA Lenders. See 13 CFR 120.1400(d) for SBA Supervised Lenders, (e) for SBLCs, and (f) for CDCs. The ten general grounds are:
- (1) Failure to maintain eligibility requirements for specific SBA program and delegated authorities;
  - (2) Failure to comply materially with any requirement imposed by SBA Loan Program Requirements, e.g., program fee requirements, program reporting requirements, maintenance;
  - (3) Making a material false statement or failure to disclose a material fact to SBA;
  - (4) Not performing underwriting, closing, disbursing, servicing, liquidation, litigation or other actions in a commercially reasonable and prudent manner;
  - (5) Failure within the time period specified to correct an underwriting, closing, disbursing, servicing, liquidation, litigation or reporting deficiency or failure in a material respect to take corrective action after receiving notice from SBA of deficiency and need to take corrective action. SBA will consider failure to take corrective action an example of a willful violation of the regulations/Act;
  - (6) Engaging in a pattern of uncooperative behavior or taking an action that SBA determines is detrimental to an SBA program, that undermines management or administration of a program, or that is not consistent with standards of good conduct (See 13 CFR 120.1400(c)(6) for additional guidance specific to this ground);
  - (7) Repeated failure to correct continuing deficiencies;
  - (8) Unauthorized disclosure of Reports, Risk Rating, or other Confidential Information, e.g., SBA Supervisory Information; including but not limited to, SBPS loan scores; loan level performance data; and review, examination and systematic off-site monitoring assessments;
  - (9) Any other reason that SBA determines in its discretion that may increase SBA's financial risk, e.g., repeated Less Than Acceptable Risk Rating (generally in conjunction with other indicators of increased financial risk),

Less Than Acceptable on-site review results, operating or other deficiencies that increase SBA's potential risk, or possible fraud; or

- (10) As otherwise authorized by law.
- c. Two general grounds for enforcement established in SBA regulations at 13 CFR 120.1425 that apply to all Microloan Intermediaries and NTAPs, with several additional grounds specific to either Intermediaries, e.g. failure to close and fund four microloans annually or failure to provide satisfactory technical assistance, or to NTAPs, e.g., requirement of ratio of 1 loan to 30 clients unmet. The two general grounds are:
  - (1) Violation of any laws, regulations, or policies of the program (e.g., SBA Loan Program Requirements); and/or
  - (2) Failure to meet any one of the following performance standards: coverage of service territory (including honoring boundaries), fulfillment of reporting requirements, manage program funds and matching funds in a satisfactory and financially sound manner, communicate and file reports within six months after beginning participation in the program, maintain a currency rate of 85% or more, maintain a cumulative default rate of 15% or less, maintain a staff trained in Microloan program issues and requirements, or any other reason that SBA determines in its discretion that may increase SBA's financial or program risk e.g., possible fraud.

#### **4. Enforcement Actions**

- a. Informal Enforcement Actions – generally used when problems are narrow in scope and are correctible and SBA is confident of BOD and management commitment and ability to correct, or while more fully assessing risk:
  - i. SBA Supervisory Letter.
  - ii. Headquarters Meeting.
  - iii. Board Resolution or Commitment Letter.
  - iv. Voluntary Actions (e.g., agreement not to sell loans into Secondary Market).
  - v. Other Voluntary Agreements between SBA and Lending Partner.
  - vi. For Microloan Intermediaries, withhold technical assistance grant funds until performance issues are adequately addressed.
  - vii. Others as defined periodically.

- b. Formal Enforcement Actions – usually include, but are not limited to, following informal enforcement actions where grounds under 13 CFR 120.1400 exist, there are significant problems in systems or controls, serious insider abuse or deceptive action, substantial law violation, serious compliance problem, material noncompliance with or insufficient corrective action commitment, fraud or suspected fraud, examiner access refused, or reporting failures, as determined by SBA. (Generally 13 CFR 120.1500 actions). SBA may use a formal action as an initial action based on risk and severity of problems, as determined by SBA in its discretion. The following formal enforcement actions apply to all SBA Lending Partners.
  - i. Imposition of portfolio guaranty dollar limit.
  - ii. Suspension or revocation of secondary market sales or purchase authority.
  - iii. Suspension or revocation of delegated authority.
  - iv. Suspension or revocation from SBA program participation.
  - v. Immediate suspension of delegated or SBA program authority.
  - vi. Agreement or Memorandum of Understanding (MOU) between SBA and Lending Partner.
  - vii. Debarment (procedures set forth in 2 CFR).
  - viii. All other actions available under SBA Loan Program Requirements.
  - ix. All other actions available under law (e.g., enforcement of SBA Loan Program Requirements in Federal District Court). SBA specifically reserves the right to proceed against Lending Partners in federal district court as and when SBA determines that it is in the best interests of SBA programs and in order to protect taxpayers from Lending Partners that fail to comply with applicable law, regulations and SBA Loan Program Requirements; e.g., actions under 15 USC 650(c) civil actions against SBLCs, under 15 USC 634(b)(1) agency authority to sue, under 13 CFR 120.535(d) loan document assignment when SBA takes over servicing.
- c. SBA Supervised Lender Specific Actions
  - i. Civil Monetary Penalties for Reporting Failures.
  - ii. Cease and Desist Order.
  - iii. Capital Directive (SBLCs only).
  - iv. Management Suspension or Removal.

- v. Civil Action (e.g., to Terminate SBLC License).
  - vi. Receivership.
  - vii. SBA Supervised Lender – increase of minimum capital level (factors and procedures separately set forth in 13 CFR 120.472 and 473).
- d. CDC Specific Actions
- i. Require transfer of CDC existing 504 portfolio and pending applications.
  - ii. Instructing the Central Servicing Agent (CSA) to withhold the payment of servicing, late and/or other fee(s) to a CDC.
  - iii. Liquidation of the Loan Loss Reserve Fund (LLRF) account, in whole or part, and application of the liquidated funds to any outstanding balance owed to SBA pursuant to the procedures in 13 CFR 120.847(i).
- e. Microloan Intermediary and NTAP Specific Actions (e.g., 13 CFR 120.1540)
- i. Accelerate reporting requirements.
  - ii. Accelerate loan repayment requirements for program debt to SBA.
  - iii. Imposition of a temporary lending or training moratorium, as applicable.
  - iv. Removal from the Microloan program, including:
    - 1. Liquidation of the MRF or LLRF accounts and application of the liquidated funds to any outstanding balance owed to SBA;
    - 2. Payment of outstanding debt to SBA;
    - 3. Forfeiture or repayment of any unused grant funds; or
    - 4. Debarment of the organization from receipt of federal funds;
  - v. Taking such other actions available under law.

## **5. Enforcement Procedures**

- a. The Internal responsibilities and decision authorities, in general, are:
- i) Financial Analysts will make enforcement recommendation;
  - ii) Team Leader will review recommendation and concur or non-concur with enforcement recommendation;
  - iii) Director OCRM:

1. Informal enforcement actions– approves or not approves.
  2. Formal enforcement actions (concur or non-concur with recommendation, as set forth in Lender Oversight Delegations of Authority, 78 FR 21262, April 25, 2005); except for Loan Agent Supervisions or Revocations.
  3. Loan Agent Suspensions or Revocations. With respect to matters arising under the Agency’s financial assistance programs, authority is delegated to the Director of OCRM to suspend or revoke the privilege of any Loan Agent to conduct business with SBA under 13 C.F.R. Part 103. This delegation may not be re-delegated.
- iv) AA/CA – approves or does not approve capital directive enforcement actions (e.g. Small Business Act Section 23(b) action).
- v) Lender Oversight Committee:
1. Approves final formal enforcement action decisions for SBA Lending Partners and NTAPs except those under Small Business Act Sections 23(b) (directive to increase capital for SBLC), 23(d) (revocation or suspension of loan authority for SBA Supervised Lenders, and 23(e) (Cease and Desist Order for SBA Supervised Lenders).
  2. Votes to recommend Small Business Act Sections 23(d) and 23(e) actions or another action or to vote to not recommend such actions to the Administrator.
  3. May establish subcommittees (e.g., to approve final decisions on certain enforcement actions, promote consistency in enforcement actions, or to work up enforcement action cases).
  4. Enforcement action approval/non-approval may be re-delegated (except SBLC capital directives, SBA Supervised Lender suspension/revocations and cease and desist orders are in accordance with Small Business Act Sections 23(b) (d) and (e)).
  5. Oversees supervision and enforcement efforts by OCRM to promote consistency and sufficiency of lender oversight efforts.
- b. Support for decisions will be documented (e.g., with presentation package, short-form minutes or other documentation).
- c. Content of enforcement action documents through suggested desk manual guidance.

- d. External formal enforcement action procedures - In general, procedures for formal enforcement actions against SBA Lenders, SBA Supervised Lenders, Other Regulated Small Business Lending Companies, Management Officials, Other Persons under Section 23 of the Small Business Act, Intermediaries, and NTAPs are governed by and found in 13 CFR 120.1600. SBA will generally follow the procedures in subsection (a) except for certain enforcement actions against SBA Supervised Lenders, Management Officials, and Other Persons as set forth in subsections (b) and (c) of 13 CFR 120.1600 or in the event SBA determines that it is appropriate to seek enforcement under any applicable section of the Small Business Act or any other applicable law or regulation. SBA will also generally follow 13 CFR 120.1600(a) procedures for suspension and revocation enforcement actions under 13 CFR Part 103 against Loan Agents under 13 CFR 103.1(a). Formal enforcement action procedures are generally summarized as follows: In general:
- i) Notice: Notice procedures are set forth in 13 CFR 120.1600(a). A formal enforcement action under subsection (a) generally begins with a written notice, which identifies the formal enforcement action SBA is initiating, when that formal enforcement action takes effect, a reasonably detailed recitation of the facts underlying the action, how to contest the formal enforcement action, and copies of the pertinent documents, if required under 13 CFR 120.1600(a) (1) (ii).
  - ii) Opportunity to Object: The Lending Partner, NTAP, or Loan Agent may object to a formal enforcement action by filing a written objection with the appropriate SBA official identified in the notice within the time limits established by SBA. 13 CFR 120.1600(a) (2).
  - iii) Requests for Additional Information: SBA may request further information from a Lending Partner, NTAP or Loan Agent. 13 CFR 120.1600(a) (3) (iii).
  - iv) Agency Decision: SBA will issue a written notice of final agency decision to a Lending Partner, or NTAP. The notice of final agency decision will comply with the applicable provision of 13 CFR 120.1600(a) (3) and (a) (4). A decision issued to a Loan Agent will follow 13 CFR 120.1600(a) (3) or (a) (4) depending upon whether the Loan Agent filed a timely objection to the suspension or revocation action.
  - v) Appeals: For Lending Partners and NTAPs, appeals of the final agency decision generally may only be filed in the appropriate Federal district court. See 13 CFR 120.1600(a) (5). For Loan Agents, see 13 CFR 103.3 for applicable appeal procedures.
  - vi) Emergency Actions. SBA will take emergency actions as necessary to protect the Agency from unnecessary risk. SBA may go directly to the

most severe formal actions as appropriate given the facts and circumstances being considered.

- vii) SBA Supervised Lenders (SBLCs and NFRLs): There are specific procedures for certain enforcement actions as detailed in 13 CFR 120.1600(b) and (c). These certain types of formal enforcement actions include suspension, revocation or cease and desist orders against SBA Supervised Lenders or Management Officials or Other Persons; immediate suspension or immediate cease and desist order against SBA Supervised Lenders; removal of Management Official; appointment of a receiver for, or certain transfers of assets or servicing rights of SBA Supervised Lenders; imposition of a civil penalty against an SBA Supervised Lenders; and issuance of capital directives against SBLCs. SBA also reserves the right to invoke any applicable section of the Small Business Act or any other applicable law if SBA determines it is appropriate in fulfilling its duties under the Small Business Act.
  - viii) Consultation with the Office of General Counsel (OGC): Enforcement actions involve complex legal issues. The General Counsel and his/her staff have primary responsibility at SBA for interpretation of applicable laws and regulations, and the drafting and review of legal documents related to oversight and enforcement actions. OCRM must seek assistance from OGC on the interpretation of regulations and in determining the appropriate enforcement action and procedure, as necessary.
  - ix) Excluded Parties List System (EPLS): The EPLS is a database of individuals and entities ineligible to take part in certain transactions with the Federal government. The EPLS contains, among other things, suspensions, debarments, statutory ineligibility determinations and other program exclusions. The EPLS system may be accessed at [www.epls.gov](http://www.epls.gov). If SBA imposes a suspension or revocation under Part 103, Title 13, Code of Federal Regulations, SBA will enter the affected Loan Agent's name in EPLS with a cause and treatment code identifying the scope and effect of the suspension or revocation. A suspension/revocation under Part 103 is SBA-specific; it does not prohibit the affected Loan Agent's participation in other Federal government programs. SBA may also post suspension and revocation decisions on its website.
  - x) Debarments: The procedures described in this paragraph "d" do not cover debarments. Debarment procedures are generally government-wide and covered in 2 CFR Parts 180 and 2700 and 48 CFR Part 9.6.
- e. Termination of enforcement action. OCRM may terminate an enforcement action if it determines, in its discretion, that the Lending Partner has complied with the actions and requirements established by SBA and that the risk to the Agency or

integrity of the loan program has been sufficiently mitigated. Lending Partners will receive written notice of the termination of the enforcement action

- f. Enforcement action tracking system. OCRM will track all enforcement actions, their status and final disposition.
- g. Enforcement process quality assurance. The Lender Oversight Committee will provide quality assurance through establishment of guidance to OCRM and from OCRM reporting on enforcement actions taken and their status.
- h. IG Referrals. Fraud or suspected fraud against the Government, a Lending Partner, or other governmental agents must be referred to OIG. Referral of a matter to the OIG is appropriate if there are facts that show or that give rise to a reasonable concern that a party engaged in misrepresentation of material facts with the intention of causing, or which actually caused, the Government or its agents (such as lenders issuing guaranteed loans) to take an action or to refrain from taking an action.