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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D C 20548

CIVIL DIVISION

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JUL 3 1 1969

Dear Mr. Sandoval:

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We have surveyed the efforts of the Small Business Administration (SBA) to increase participation by private lending institutions in SBA's business loan program.

Our survey was conducted at the Washington, D.C., headquarters and the Seattle regional office of SBA. The survey included also correspondence and discussions with various lending institutions in the State of Washington. The results of our survey relate to activities of Washington headquarters and the Seattle regional office and are not intended to represent an evaluation of the business loan program, or the efforts of SBA regional offices, other than Seattle, to obtain participation by private lending institutions.

BACKGROUND

In implementing the lending authority granted by the Small Business Act (15 U.S.C. 631), SBA regulations provide that financial assistance is deemed to be available elsewhere on reasonable terms, unless specific conditions are satisfied. Included among these conditions are requirements that the applicant's bank of account has declined to approve a loan and that other sources of funds such as equity financing and personal resources have been considered and are not obtainable under reasonable circumstances.

Consistent with these regulations, SBA encourages participation by private lenders in its business loan program. In an immediate participation loan, either the participating institution or SBA makes the loan and the other participant purchases immediately upon disbursement its agreed percentage of the loan. For guaranteed loans, the participating institution makes and disburses the entire loan. SBA executes an agreement that, upon default by the borrower, it will purchase an agreed percentage of the unpaid balance of the loan within a stated period.

Business loans of about $4.3 billion have been approved by SBA since the inception of the business loan program in fiscal year 1954 through April 1969. Since the inception of SBA, the annual amount of funds provided by private lenders has increased from $15.4 million in fiscal year 1954, to $346.9 million through the first 10 months of fiscal year 1969 of which $11.2 million and $249.1 million have been guaranteed by SBA respectively. The extent to

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which private lenders have participated in the program has varied from a low of about 20 percent in fiscal year 1961 to a high of about 78 percent through the first ten months of fiscal year 1969.

EFFORTS TO OBTAIN INCREASED PRIVATE PARTICIPATION

Our survey revealed that between fiscal year 1961 and the first 10 months of fiscal year 1969, SBA has significantly increased the participation by banks in its business loan program. We believe, however, that opportunities to obtain additional participation by nonbank sources such as insurance companies, credit union, and pension funds merit greater attention.

Since 1961 numerous steps have been taken by SBA to increase participation by private lenders. To achieve this end, SBA has developed new approaches and refined existing programs. For example, SBA initiated a Simplified Blanket Loan Guaranty Plan, which provides for the execution of a master guaranty agreement between private lending institution and SBA. It enables participants to process an indefinite number of loans under a single basic guaranty agreement.

SBA also implemented the Simplified Bank Loan Participation Plan and the Simplified Early Maturities Participation Plan, both of which were designed to encourage private lenders to participate in loans to small firms. The Simplified Bank Loan Participation Plan minimized the procedures for processing and closing loans, and reduced the amount of paperwork required from banks. The Simplified Early Maturities Participation Plan permitted the banks to be completely repaid their share of the loans before SBA received repayments on its share of the loan. SBA has also followed a program of visiting banks in the Seattle regional office to encourage their participation.

Participation by nonbank lending institutions at time of loan approval

Although it is SBA's stated policy to obtain greater private participation in its loan programs, we believe that SBA has not made significant efforts to encourage nonbank lending institutions to participate in the regular business loan program.

In a memorandum to the Area Administrators and Regional Directors dated December 29, 1967, the Associate Administrator for Financial Assistance stated that:

> "* * * Every reasonable avenue of private participation should be pursued before applications are accepted, * * *.

"* * * the key to our meeting adequately the needs of the small businessman lies in achieving greater private participation."

In discussing this matter with SBA Washington officials, we were advised that they have investigated nonbank sources of long-term capital at the Washington level, but that their efforts to obtain participation from these sources had been largely unsuccessful. We were further advised that since participation from commercial banking institutions has been favorable, SBA has concentrated its efforts in this area. However, the officials were unable to furnish us specific information on the extent of their efforts to identify and attract participation from nonbank sources. Except for general statements of policy, we found little evidence of efforts by SBA headquarters to encourage its regional offices to explore and utilize sources of participation other than banks.

Our review of records available at the Seattle regional office indicated that commercial banking institutions have been the primary source of private participation. The records examined by us showed that seven loans had been made in participation with lenders other than commercial banks from the inception of the program through 1968. Seattle regional officials advised us that they had not actively explored nor solicited participation from nonbank sources of long-term capital.

We discussed the SBA loan program with representatives of the State of Washington Insurance Commissioner's Office, selected insurance companies, the Washington Credit Union League, savings and loan associations, and a pension fund in the Seattle area. Most representatives of the institutions advised us that they had not been aware of the features of the SBA program, but as a result of our discussion, expressed an interest in the programs. They also indicated that participation in the programs might be appropriate now or at some future time, depending upon the circumstances involved. Insurance representatives expressed uncertainty about the legality of their participation under the Washington State statute, but the other representatives of the nonbanking institutions were unaware of any legal provisions which would preclude their participation.

Accordingly, it appeared on the basis of our survey that long-term capital for small businesses might be available from nonbank sources.

Secondary financing by nonbank lending institutions

Seattle regional officials advised us that they had not explored sources of secondary participation.

Secondary financing is an arrangement by which a participating institution sells the SBA guaranteed portion of the loan to other financial institutions such as credit unions, pension funds or insurance companies. This provides the primary participating institution with capital for new loans which increases the utilization of additional sources of long-term capital.

SBA Washington officials stated that secondary financing had been used to a limited extent by SBA in the past through the efforts of various regional offices. They stated that nonbank sources such as insurance companies, credit unions and pension funds are potential sources of secondary financing.

Although SBA Washington officials have urged regions to explore and utilize nonbanks as sources of secondary financial participation, we found little evidence of direction by Washington headquarters to assist the Seattle region to obtain such participation. For example, in August 1968, a Washington headquarters official, in a memorandum to all regional officials, urged the promotion of secondary participation and stated that a monthly survey would be made of the results of such efforts. We noted in a memorandum by a Washington official, in November 1968, that the survey was discontinued because of a reported lack of interest by nonbank sources in secondary participation.

Conclusion and recommendations

It appears from our survey that SBA has significantly increased the rate of private bank participation in the business loan program over the years. However, it appears also that additional efforts to encourage nonbank sources to participate in the regular business loan program may be appropriate.

Accordingly, we recommend that SBA increase its efforts to identify nonbank sources of primary and secondary long-term capital and to ascertain the extent to which such capital is available or can be made available.

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We plan no further reporting of the matters at this time. We would appreciate your comments and advice on any action taken on the matters presented in this letter. We appreciate the courtesy and cooperation given to our representatives during this review.

Sincerely yours,

Henry Eschwege

Henry Eschwege
Associate Director

The Honorable Hilary Sandoval, Jr.
Administrator, Small Business
Administration