

April 16, 2009

Congressional Committees

Subject: *Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009*

Due to recent turmoil in U.S. credit markets, many lenders have been reluctant to offer conventional loans—that is, loans that are not guaranteed by the federal government—to small businesses so that they can finance their operations and capital needs. While the Small Business Administration's (SBA) principal loan guarantee programs, the 7(a) and 504 programs, are intended to facilitate the capacity of small businesses to raise critical financing that they may have difficulty obtaining from other sources, the availability of such loans has also declined. Under the 7(a) program, SBA generally provides lenders guarantees on up to 85 percent of the value of loans to qualifying small businesses in exchange for fees to help offset the costs of the program. Under the 504 program, which generally applies to small business real estate and other fixed assets, SBA also provides certified development companies with a guarantee on up to 40 percent of the financing of the projects' costs in exchange for fees while the small business borrowers and other lenders provide the remaining 60 percent of the financing on an unguaranteed basis.¹ Many lenders, such as banks, that participate in the 7(a) or 504 programs frequently try to sell qualifying small business loans on the secondary markets to raise funds necessary for additional lending.² Since mid-2008, investors that typically purchase securities collateralized by the pools of 7(a) guaranteed small business loans³ and certain 504 loans largely have withdrawn from the secondary markets. As a result, many such loans remain on the balance sheets of broker-dealers that package the securities or the original lenders. According to SBA, lenders' origination of loans the agency guarantees, principally through the 7(a) and 504 programs, are trending below \$10 billion during 2009 after reaching about \$20 billion in 2008 due in part to weakness in the secondary markets.

¹In the financing of a typical 504 loan project, the small business borrower provides at least 10 percent of the funds, a third-party lender originates a mortgage, referred to as a first-lien mortgage to provide 50 percent of the funds, and a non-profit certified development company provides the remaining 40 percent of the funding through an SBA-guaranteed debenture.

²As described in this report, secondary markets have developed for the guaranteed portions of 7(a) loans and the guaranteed and unguaranteed portions of primarily real estate projects (including machinery and equipment) financed pursuant to the 504 program.

³The guaranteed portions of 7(a) loans may be bundled into guaranteed securities. In this report, we refer to these as pools of 7(a) guaranteed loans and 7(a) guaranteed securities.

Under the American Recovery and Reinvestment Act of 2009 (ARRA),⁴ Congress required SBA to implement a total of eight administrative provisions to help facilitate small business lending and enhance liquidity in the secondary markets. These administrative provisions include (1) temporarily requiring SBA to reduce or eliminate certain fees on 7(a) and 504 loans; (2) temporarily increasing the maximum 7(a) guarantee from 85 percent to 90 percent; and (3) implementing provisions designed specifically to facilitate secondary markets, such as extending existing guarantees in the 504 program and making loans to systemically important broker-dealers that operate in the 7(a) secondary market.⁵ Further, ARRA established deadlines for SBA to issue regulations that implement certain administrative provisions, such as those pertaining to facilitating secondary market activities. Specifically, ARRA required SBA to issue regulations extending the guarantee related to the 504 program within 15 days after enactment (March 4, 2009) and for making loans to systemically important broker-dealers within 30 days after enactment (March 19, 2009).

ARRA also mandates that we report within 60 days after the date of enactment, April 17, 2009, on SBA's initial efforts to comply with these provisions.⁶ In response, this report (1) summarizes key activities undertaken by the Administrator of SBA to implement the administrative provisions including establishment of project plans with timelines for fulfilling responsibilities, and (2) analyze whether the Administrator is accomplishing the purpose of increasing liquidity in the secondary markets for SBA loans. Because SBA's efforts are still in their early stages, we agreed with the staffs of the House and Senate Committees on Small Business to focus our work on four key administrative provisions for the purposes of this report. These four provisions are eliminating or reducing fees on 7(a) and 504 loans, extending the existing guarantee on 7(a) loans, and taking two specific steps to facilitate activities in the secondary markets: extending the guarantee on 504 financing and making loans to systemically important broker-dealers. However, consistent with ARRA's requirements, we are also providing information on the status of SBA's implementation of the other four administrative provisions.⁷

To address these objectives, we obtained and analyzed program regulations, policies, procedures, and SBA reports to Congress. We also analyzed available historical financial data on the 7(a) and 504 markets, including relevant data on secondary market activity. In addition, we interviewed senior SBA officials to obtain information on the agency's efforts to implement ARRA's administrative provisions,

⁴Pub. L. No. 111-5, Division A, Title V, 123 Stat. 115, 151-161 (2009).

⁵ARRA authorizes the SBA Administrator to extend the agency's guarantee to pools of first-lien mortgages that are packaged into securities and sold to third party investors who participate in secondary markets for small business loans. The intent of this administrative provision is to help facilitate secondary market activity for such securities, which largely collapsed during current turmoil in credit markets.

⁶The mandate also directed us to analyze whether the activities are accomplishing the purposes of increasing liquidity in the secondary market for SBA loans.

⁷ARRA has four additional SBA provisions including (1) providing guarantees on loans to small businesses that have qualifying small business loans and are experiencing immediate financial hardship, (2) granting SBA authority to refinance a limited amount of certain existing loans as new 504 loans, (3) increasing the leverage of Small Business Investment Companies, and (4) increasing the maximum amount for contracts that qualify for SBA-guaranteed surety bonds.

including efforts to coordinate relevant activities with the Department of Treasury and the Federal Reserve. We also contacted the Treasury to discuss its SBA coordination efforts. Finally, we interviewed representatives of trade groups that represent SBA lenders as well as certain broker-dealers that participate in the 7(a) and 504 secondary loan markets to obtain their perspectives.

We conducted our work from February 2009 through April 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings based on our audit objectives.

Results in Brief

SBA has implemented two of the four key administrative ARRA provisions as defined for purposes of this report, and plans to have the two secondary market provisions finalized by June 2009. On March 16, 2009, SBA issued policy notices to eliminate certain fees on 7(a) and 504 loans and to extend the maximum guarantee on 7(a) loans from 85 percent to 90 percent. According to SBA officials, eliminating fees and extending lender protections on certain 7(a) loans should provide incentives for small businesses to apply for additional loans and lenders to originate them. However, SBA has not met its statutory requirement to issue regulations associated with extending existing guarantees on 504 projects (which were due by March 4, 2009) and making loans to systemically important broker-dealers that participate in the secondary market for 7(a) loans (which were due by March 19, 2009). According to SBA officials, issuing the regulations for these ARRA provisions is complicated and time consuming because it involves establishing new programs and related infrastructure, such as establishing policies and procedures, hiring and training staff, developing information systems, and establishing risk mitigation strategies as well as resolving critical policy issues. For example, an SBA official said that the agency must determine the extent to which broker-dealers and perhaps small business lenders would be required to share in the potential losses associated with extending the guarantee in the 504 program.⁸ While requiring broker-dealers and lenders to share in potential losses could help ensure sound loan underwriting and thereby limit SBA's potential exposure, it could also lessen their willingness to participate and thereby fail to facilitate secondary market activity as ARRA intended. SBA officials and trade groups we contacted also said that ARRA's array of requirements may also place strains on the agency's staff resources, and our previous work has also concluded that limited resources and pending retirements could affect its capacity to implement programs such as those specified in ARRA.⁹ To address these and other challenges, SBA has established an intra-agency process to implement ARRA's provisions,

⁸ARRA requires broker-dealers that participate in the secondary market for 504 first-lien mortgages on which SBA guarantees may be extended, to assume at least 5 percent of the potential losses on securities established under the provision. SBA, in its discretion, could require broker-dealers to assume more of the potential risk.

⁹GAO, *Small Business Administration: Opportunities Exist to Build on Leadership's Efforts to Improve Agency Performance and Employee Morale*, GAO-08-995 (Washington, D.C.: Sept. 24, 2008).

including the appointment of relevant project teams, and indicated it has consulted with Treasury and Federal Reserve officials on its responsibilities. According to SBA, the draft rules for the secondary market provisions are now undergoing internal SBA review, and those rules are expected to be sent to the Office of Management and Budget (OMB) for its review and finalized by June 2009.

Largely because SBA has not yet implemented its key secondary market administrative authorities, it is not possible at this time to assess their effect on the secondary markets for SBA loans. Such an assessment will only be possible when the regulations are issued and fully implemented and market participants have had some time to evaluate them and decide whether to participate or not. According to SBA officials, the agency is considering a variety of potential performance measures to assess ARRA's administrative provisions once they are implemented. For example, an official said that the agency might collect and analyze financial data on 7(a) and 504 loan originations and related secondary market activity, such as the percentage of such loans that are sold in secondary markets over time. However, it may be very difficult for SBA to isolate the effects of ARRA's administrative provisions from other federal initiatives that are currently being implemented to support small business finance. For example, on March 16, 2009, Treasury announced plans under the Troubled Asset Relief Program (TARP) to directly purchase up to \$15 billion in SBA guaranteed 7(a) and 504 securities to help unclog secondary markets. Because this Treasury program, and a related joint Federal Reserve and Treasury program, are potentially far larger than SBA's initiatives under ARRA, it may be very difficult to discern the effects of SBA's various administrative provisions on small business finance and secondary markets once they are finalized. Going forward, SBA officials said they will continue to coordinate with Treasury and the Federal Reserve as the programs to facilitate small business finance are developed. Such coordination is important to maximize the potential overall effect of these programs.

We provided SBA a draft of this report for review and comment. In written comments, which are reprinted in enclosure I, the SBA Administrator said that the draft report presented a fair and balanced discussion of the agency's efforts thus far in implementing ARRA's administrative provisions. The Administrator also provided additional information to demonstrate SBA's commitment to implementing the administrative provisions, organizational effort to do so, and improvements resulting from provisions already implemented. For example, she stated that SBA has kept the Congress, other oversight authorities, and the public informed of SBA's progress as well as establishing project and support teams with specific implementation responsibilities. In addition, the Administrator stated that the impact of actions taken four weeks ago to increase guarantee percentages and lower program fees appears to be strong with both the 7(a) and 504 loan programs experiencing some growth in loan volume over this period. SBA also provided technical comments, which were incorporated as appropriate.

Background

Under the 7(a) loan program, SBA guarantees loans made by commercial lenders to small businesses for whom credit is not otherwise available on reasonable terms from non-federal sources and do not have the personal resources to provide financing

themselves.¹⁰ The guarantee assures the lender that if a borrower defaults on a loan, the lender will receive an agreed-upon portion (generally between 50 percent and 85 percent) of the outstanding balance. Loan proceeds may be used for working capital and other general business purposes. To be eligible for the 7(a) program, a business must be an operating for-profit small firm (according to SBA's size standards) located in the United States. To offset some of the costs of the program, SBA assesses lenders two fees on each 7(a) loan, an up-front guarantee fee that may be passed on to the borrower and an annual servicing fee.

The 504 loan program provides long-term, fixed-rate financing to small businesses for expansion or modernization, primarily of real estate (including land and new building construction, existing building purchases or renovation, and machinery and equipment).¹¹ Financing is delivered through certified development companies (CDC), private nonprofits established to contribute to the economic development of their communities. In a typical 504 loan project, a third-party lender provides 50 percent or more of the financing pursuant to a first-lien mortgage, a CDC provides up to 40 percent of the financing through a debenture that is fully guaranteed by SBA, and a borrower contributes at least 10 percent of the financing. The borrower must meet eligibility requirements similar to those for 7(a) program borrowers, and a project generally must create or retain at least one job for every \$50,000 guaranteed by SBA. Like the 7(a) program, lenders, small business borrowers, and CDCs in the 504 program are required to pay various fees to offset the costs of the program.

Over the years, the development of secondary markets for both 7(a) and 504 loans facilitated the capacity of lenders to originate such loans and small businesses to apply for them. By selling loans to investors via secondary markets, among other benefits, lenders can receive additional funds, or liquidity, to make more loans. In the 7(a) secondary market, lenders sell the SBA guaranteed portions of the loans to investors, with the participation of broker-dealers and other market participants, and generally retain the non-guaranteed portion in their portfolios. The broker-dealers assemble the guaranteed portions of 7(a) loans from lenders into securities and manage the sale of such securities to investors. Lenders, broker-dealers, and other secondary market participants make profits from the premiums that investors pay for the securities, through various fees, and through servicing the loans over time. Due to the structure of 504 loans, there are two separate secondary markets. There is a secondary market for the SBA-guaranteed, or debenture, portion of 504 loans and another market for the first-lien mortgage portion.

A significant decline in SBA-guaranteed lending and related secondary markets activity has accompanied the deterioration of credit markets and the decline in economic activity. As discussed previously, the origination of SBA-guaranteed loans, principally 7(a) and 504 loans, is trending below \$10 billion during 2009 from about \$20 billion in 2008, according to the agency. SBA data also indicate that there has been a recent and sharp decline in secondary market activity. For example, table 1 indicates that the guaranteed portion of 7(a) loans sold on the secondary market averaged about 45 percent from 2006 through most of 2008, but declined to an average of about 23 percent from October through December 2008 before recovering

¹⁰Section 7(a) of the Small Business Act, as amended, codified at 15 U.S.C. § 636(a); see also 13 C.F.R. Part 120.

¹¹15 U.S.C. §§ 695 *et seq.*

somewhat in January and February 2009. According to representatives from SBA and broker-dealers we contacted, there was a significant decline in secondary market activity during the fourth quarter of 2008 for 7(a) loans and securities collateralized by first-lien mortgages, which are unguaranteed, that are issued in connection with the 504 program. However, some broker-dealer representatives said there had been a marginal improvement in secondary market activity in the first quarter of 2009.

Table 1: Proportion of 7(a) Guaranteed Loans Sold on the Secondary Market

(Dollars in thousands)

Time period	Guaranteed portion of 7(a) loans approved	Guaranteed amount sold on secondary market	Proportion sold on secondary market
FY 2006	\$10,234,585	\$4,531,992	44.3%
FY 2007	10,015,068	4,373,174	43.7%
FY 2008	9,051,727	4,095,595	45.2%
July 2008	879,139	393,997	44.8%
August 2008	592,895	277,546	46.8%
September 2008	764,744	310,038	40.5%
October 2008	485,190	114,133	23.5%
November 2008	409,925	111,025	27.1%
December 2008	510,232	94,656	18.6%
January 2009	348,309	84,513	24.3%
February 2009	382,013	135,259	35.4%

Source: GAO analysis of SBA data.

Note: Many lenders sell the guaranteed portion of the 7(a) loans in the secondary market. The proportion sold refers to the guaranteed portion of loans.

SBA Has Finalized Some but Not All Key ARRA Provisions to Facilitate Small Business Lending

Tables 2 and 3 show the status of SBA's efforts to implement ARRA's eight administrative provisions that were generally established to facilitate small business lending and related secondary markets. Table 2 indicates that SBA has implemented two key provisions (as defined for purposes of this report) but has missed the statutory deadlines for issuing regulations in two others pertaining to facilitating secondary market activity. On March 16, 2009, SBA issued a policy notice temporarily eliminating the up-front guarantee fees for eligible 7(a) loans, as well as the third-party participation fees and CDC processing fees for eligible 504 loans. SBA also issued a policy notice implementing the temporarily increased guarantee percentage on eligible 7(a) loans from 85 percent to 90 percent.¹² According to SBA officials, lowering the costs associated with 7(a) and 504 loans and affording additional protections to 7(a) lenders is intended to encourage small businesses to apply for such loans and make lenders more willing to originate them. However, SBA has not yet implemented other administrative provisions considered critical to reviving secondary markets for small business loans that the agency guarantees. Specifically, SBA has not implemented the provision to extend the guarantee to pools of 504 first-lien mortgages, which serve as the collateral for securities

¹²Prior to the signing of ARRA, the maximum guaranty percentage for all 7(a) loan programs, ranged from 85 percent for loans of \$150,000 or less to 75 percent for loans greater than \$150,000.

that are sold on the secondary market, or established a program to make loans to systemically important broker-dealers that operate in the 7(a) secondary market. Regarding the four other administrative provisions shown in table 3, SBA has issued an information notice increasing the maximum amount for contracts that qualify for SBA guaranteed surety bond to \$5,000,000, issued a notice to announce the amended job creation eligibility requirement for the 504 program, missed a statutory deadline to issue regulations for a new program to guarantee loans of \$35,000 or less to small business concerns suffering immediate financial hardship, and has rulemakings underway to develop a program to refinance certain 504 loans and increase the leverage of Small Business Investment Companies.¹³

Table 2: Status of SBA's Implementation of Key Administrative Provisions in ARRA

Provision number and title	Primary requirements and sunset provisions	SBA's actions, as of April 16, 2009
501 Fee Reductions	Permits temporary reduction or elimination of fees, until September 30, 2010, for 7(a) and 504 loans until \$375 million of appropriated funds are expended.	Operational on March 16, 2009.
502 Economic Stimulus Lending Program	Permits SBA to guarantee up to 90 percent of qualifying 7(a) loans made by SBA lenders. No loan guarantees under this provision can be made 12 months after the date of enactment or until appropriated funds are expended.	Operational on March 16, 2009.
503 Establishment of SBA Secondary Market Guarantee Authority	Allows the SBA Administrator to establish a secondary market guarantee for pools of first-lien 504 loans to sell to third-party investors. This authority terminates 2 years after enactment. Under emergency rulemaking authority, requires the Administrator to issue regulations within 15 days after enactment.	Missed deadline of March 4, 2009. In process of clearing regulations.
509 Establishment of SBA Secondary Market Lending Authority	Authorizes the SBA Administrator to make loans to systemically important broker-dealers that operate in the SBA 7(a) secondary market. Under emergency rulemaking authority, requires the Administrator to issue regulations within 30 days after enactment. This authority terminates 2 years after enactment.	Missed deadline of March 19, 2009. In process of drafting regulations.

Source: GAO analysis of ARRA administrative provisions and SBA information.

Note: Defined as key administrative provisions for purposes of this report.

¹³SBA can guarantee bonds for contracts covering bid, performance, and payment bonds for small and emerging contractors who cannot obtain surety bonds through regular commercial channels. Small Business Investment Companies, which are licensed by the SBA, are privately owned and managed investment funds that use their own capital and funds borrowed at favorable rates through the federal government to provide venture capital to small independent businesses.

Table 3: Status of SBA's Implementation of Other Administrative Provisions in ARRA

Provision number and title	Primary requirements and sunset provisions	SBA's actions, as of April 16, 2009
504 Stimulus for Community Development Lending	<p>Authorizes SBA to refinance a limited amount of certain existing loans as new 504 loans.</p> <p>Changes an eligibility criterion for 504 loans from creating one job for every \$50,000 guaranteed to one job for every \$65,000 guaranteed.</p> <p>The refinancing program and job creation goals are permanent changes to the 504 loan program.</p>	<p>Issued notice on April 2, 2009, to announce the amended job creation eligibility criterion/requirement followed by publication in the Federal Register on April 10, 2009.</p> <p>In process of analyzing remaining issues and clearing regulations.</p>
505 Increasing Small Business Investment	<p>Increases the maximum amount of outstanding leverage made available to a small business investment company (SBIC), to the lesser of 300 percent of the SBIC's private capital or \$150,000,000. In addition, leverage allowed for two or more SBICs operated under common control (as determined by the Administrator) and that are financially sound cannot exceed \$225,000,000.</p>	<p>In process of analyzing remaining issues and clearing regulations.</p>
506 Business Stabilization Program	<p>Creates a new program that allows SBA to guarantee loans of \$35,000 or less to small business concerns that have existing qualifying small business loans and are suffering immediate financial hardship.</p> <p>Under emergency rulemaking authority, requires the Administrator to issue regulations within 15 days after enactment.</p> <p>The program ends on September 30, 2010.</p>	<p>Missed deadline of March 4, 2009.</p> <p>In process of clearing regulations.</p>
508 Surety Bonds	<p>Increases maximum contract amount for SBA bond guarantee to \$5,000,000 and up to \$10,000,000 if a federal agency contracting officer certifies the necessity.</p> <p>Establishes conditions of SBA's liability up to \$5,000,000</p> <p>Requires SBA to study and report on the program's current funding structure.</p> <p>Provisions remain in effect until September 30, 2010.</p>	<p>Issued notice on March 27, 2009, to increase maximum contract amount for SBA bond guarantee to \$5,000,000.</p> <p>In process of analyzing remaining issues and drafting regulations.</p>

Source: GAO analysis of ARRA administrative provisions and SBA information.

Implementing ARRA's Secondary Market Administrative Provisions Involves Challenges

SBA officials cited several factors to explain why the agency had implemented some ARRA administrative provisions but had missed statutory deadlines for issuing regulations for other provisions. For example, SBA officials said that temporarily eliminating or reducing fees for 7(a) and 504 loans and temporarily increasing the

maximum guarantee on 7(a) loans to 90 percent are relatively straightforward administrative decisions that pertain to existing agency programs. In contrast, they said that other provisions in ARRA require the establishment of new programs, which is more complex and must be done on a deliberative and measured basis to help ensure that ARRA's intent is carried out while managing the government's exposure to losses. For example, SBA officials cited the ARRA administrative provisions designed to facilitate secondary market activity as such new programs: section 503 pertaining to extending the guarantee to pools of 504 first-lien mortgages and section 509 pertaining to loans to systemically important broker-dealers. SBA officials said that establishing policies and procedures, hiring and training staff, developing information systems and establishing risk mitigation strategies for new programs, among other activities, can be complicated and time consuming.

To illustrate the challenges involved in establishing new programs under ARRA's administrative sections, SBA officials cited section 503's provisions that extend the guarantee to pools of 504 first-lien mortgages, which serve as the collateral for securities that are sold on the secondary market. This provision authorizes SBA to guarantee up to \$3 billion on the first-lien mortgage portion of 504 financing packages. While SBA has long guaranteed the debenture portion of such loans and has data on the risks and costs associated with doing so, the agency lacks information on the performance of the first-lien portion. Accordingly, SBA has requested data from at least one broker-dealer that operates in the secondary market for the 504 first-lien mortgages, to assess the performance of such loans over time, including their default rates. It is essential for SBA to evaluate the potential risks associated with extending the guarantee to 504 first-lien mortgages and determining appropriate fees to offset such risks because ARRA requires that the program not result in a net cost to the government under the Federal Credit Reform Act of 1990.¹⁴ SBA officials also said that the agency has to resolve key policy issues associated with extending the guarantee in the 504 program. For example, an SBA official said that determining the extent to which broker-dealers and perhaps small business lenders share in any losses associated with extending the guarantee on pools of first-lien mortgage loans has also been challenging. The official said that risk-sharing among SBA loan guarantee program participants is a critical principle and necessary to help ensure prudent underwriting. While ARRA mandates that broker-dealers that assemble first-lien mortgages under the 504 program into securities retain at least 5 percent of the potential losses, the SBA official said that it may be appropriate for the final rule to require broker-dealers to assume more than 5 percent of the potential losses to better ensure sound underwriting. For similar reasons, the SBA official said it may be appropriate to require lenders, as is the case in the 7(a) program, to assume responsibility for at least some portion of the associated risks on extending the guarantee in the 504 program. However, the SBA official also said that requiring broker-dealers and lenders to assume additional risk could limit their participation in the program and thereby limit its capacity to generate activity in the secondary market.

Resource constraints and staff expertise are other challenges that SBA may face in finalizing the administrative provisions in ARRA and managing the associated programs over time. For example, SBA officials said that the array of requirements under ARRA and associated rulemaking deadlines have placed a strain on the

¹⁴Federal Credit Reform Act of 1990, as amended, Pub. L. No. 101-508, 104 Stat. 1388-609 (1990), codified at 2 U.S.C. §§ 661-661f.

agency's existing staff and other resources. Similarly, officials from some trade groups representing lenders and broker-dealers expressed concerns that SBA lacked staffing necessary, particularly in the Office of Capital Access, to carry out ARRA's provisions. We also previously reported on SBA's reduced staffing levels and the impending retirement eligibility of a large portion of its workforce by the end of fiscal year 2009.¹⁵ In addition, the agency's Chief Financial Officer (CFO) as well as individuals in the CFO's office that developed estimates used to meet Federal Credit Reform Act requirements have recently left the agency. SBA officials said that the agency has appointed an acting CFO and they are currently reviewing applications for a permanent replacement. In addition, SBA officials said the agency posted a credit subsidy specialist job announcement and are currently using contractors to perform related work. Generally, the potential loss of expertise through retirements and turnover in key positions, coupled with the introduction of new and complex programs could challenge the agency's efforts to achieve the desired purposes.

SBA Has Various Planning and Coordination Activities Underway and Plans to Complete Secondary Market Rulemakings by June 2009

To help manage the challenges associated with implementing ARRA's administrative provisions, SBA officials said that they have established an intra-agency process that is designed to leverage existing resources and expertise and ensure effective communication within the agency. Specifically, SBA officials said that they have established project teams to address each of the administrative provisions in ARRA as well as relevant support teams. The officials told us that each project team is responsible for assessing the specific administrative provisions under ARRA, including their intended benefits and potential costs, and develop policies, procedures, or regulations to implement these provisions. They also told us that the support teams perform a variety of activities. For example, the communications team works across the agency and with each project team to ensure that information about SBA's implementation of the administrative provisions is clear to key constituencies including internal staff and the agency's resource partners, lenders, and trade groups. According to SBA officials, an agency steering committee that includes representatives from five key offices--Capital Access, the Chief Information Officer, Chief Financial Officer, General Counsel, and Communications--oversees the work of the teams and is responsible for the final approval of all decisions that pertain to the implementation of ARRA's administrative provisions.

SBA officials also said that they are working closely with the Department of the Treasury and the Federal Reserve to implement certain of ARRA's administrative provisions and related federal initiatives to facilitate small business lending. For example, SBA officials said that they have consulted with Treasury and provided data to the department regarding the implementation of Treasury's planned purchases under the TARP of up to \$15 billion in SBA-guaranteed securities. Another SBA official said that the agency has worked with the Federal Reserve on its efforts to promote small business lending.

¹⁵ GAO-08-995.

According to SBA, the draft rules for the secondary market provisions are currently undergoing internal SBA review. SBA officials said that they expect the OMB review process to be complete and the rules issued by June 2009.

SBA Is Considering Various Performance Measures to Evaluate Potential Impacts on Secondary Market Liquidity once Authorities Are Fully Implemented

Because SBA has not completed ARRA's key secondary market provisions, it is not possible at this time to assess their impact on the secondary markets for small business loans. Such an assessment will only be possible when the regulations are issued and market participants have had some time to evaluate and decide whether to participate in the program. For example, broker-dealers that participate in the secondary market for SBA-guaranteed loans and may be designated by SBA as systemically important under ARRA section 509 will have to determine whether the terms SBA may establish for such loans, such as the rate offered and profit margin earned with selling securities to investors, are attractive.

According to an SBA official, the agency is considering various performance measures that might be used to assess the longer-term impacts of ARRA's administrative provisions on the finance market for SBA 7(a) and 504 first-lien mortgage loans, including the relevant secondary markets. For example, an SBA official said that the agency may collect relevant secondary market performance data, such as the percentage of 7(a) and 504 first-lien mortgage loans that are sold in secondary markets and premium and fee information for lenders, broker-dealers, and investors. Presumably, if the authorities are successful, then the percentage of 7(a) and 504 first-lien mortgage loans sold in the secondary markets will increase as will the premiums that investors are willing to pay for SBA-guaranteed securities. The SBA official also said that the agency may collect loan performance data over time, such as default data on 504 first-lien mortgage loans, to help determine whether the programs are being operated at a net zero cost to the government as required.

However, it may be difficult to isolate the effect of the ARRA provisions from general changes in the economy affecting the secondary markets or actions by other federal entities. Changes in the market for SBA loans could be affected by other security market activity such as competing sales of other asset-backed securities. Both Treasury and the Federal Reserve have also announced plans to directly purchase or help finance individual investors' purchase of billions of dollars in SBA-guaranteed securities. Specifically, as part of the Consumer and Business Lending Initiative, Treasury announced plans on March 16, 2009, to use TARP funds to purchase up to \$15 billion in securities backed by the guaranteed portions of 7(a) loans, securities packaged from 504 first-lien mortgages, and 504 first-lien securities that receive new SBA guarantees under ARRA. Also, under this initiative, the Federal Reserve with Treasury support plans to lend funds to investors through the Term Asset-Backed Securities Loan Facility (TALF) program to finance the purchase of a variety of asset-based securities, including SBA guaranteed securities. Given that the TARP and TALF programs are substantially larger than SBA's provisions under ARRA (e.g., Treasury's TARP program may involve the direct purchase of \$15 billion in SBA-guaranteed securities, whereas ARRA limits SBA's amount guaranteed on the first-

lien mortgage portions of 504 financing packages to \$3 billion), it may be very difficult to determine the extent that any pick up in small business lending activity may be attributable solely to the SBA ARRA initiatives.

Going forward, SBA officials said they will continue to coordinate with Treasury and the Federal Reserve as the programs to facilitate small business finance are developed. Such coordination is important to maximize the potential overall effect of these programs. While the TARP and TALF programs largely focus on the direct purchase of SBA-guaranteed securities in the secondary markets or providing incentives for private sector investors to do so, SBA under the ARRA provisions is largely focused on facilitating lenders' capacity to originate small business loans and broker-dealers capacity to increase their secondary market activities. To the extent that the federal entities involved in these initiatives—Treasury, the Federal Reserve, and SBA—experience delays in their program implementation efforts, then an opportunity to maximize small business financing as part of an integrated approach will be missed.

Agency Comments

We provided SBA a draft of this report for review and comment. In written comments, which are reprinted in enclosure I, the SBA Administrator said that the draft report presented a fair and balanced discussion of the agency's efforts thus far in implementing ARRA's administrative provisions. The Administrator also provided additional information to demonstrate SBA's commitment to implementing the administrative provisions, organizational effort to do so, and improvements resulting from provisions already implemented. For example, she stated that SBA has kept the Congress, other oversight authorities, and the public informed of SBA's progress as well as establishing project and support teams with specific implementation responsibilities. In addition, the Administrator stated that the impact of actions taken four weeks ago to increase guarantee percentages and lower program fees appears to be strong with both the 7(a) and 504 loan programs experiencing some growth in loan volume over this period. SBA also provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to interested congressional committees and other parties. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact me at (202) 512-8678 or shearw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report were Wesley Phillips, Paige Smith, Janet Fong, Tomas Garcia, Alexandra Martin-Arseneau, Ben Bolitzer, Tania Calhoun, Marcia Carlsen, and Barbara Roesmann.



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Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Mary L. Landrieu
Chair
The Honorable Olympia J. Snowe
Ranking Member
Committee on Small Business and Entrepreneurship
United States Senate

The Honorable Richard J. Durbin
Chairman
The Honorable Sam Brownback
Ranking Member
Subcommittee on Financial Services and General Government
Committee on Appropriations
United States Senate

The Honorable Edolphus Towns
Chairman
The Honorable Darrell Issa
Ranking Member
Committee on Oversight and Government Reform
House of Representatives

The Honorable Nydia M. Velázquez
Chairwoman
The Honorable Sam Graves
Ranking Member
Committee on Small Business
House of Representatives

The Honorable José E. Serrano
Chairman
The Honorable Jo Ann Emerson
Ranking Member
Subcommittee on Financial Services and General Government
Committee on Appropriations
House of Representatives

Enclosure I: Comments from the Small Business Administration



OFFICE OF THE ADMINISTRATOR

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

April 15, 2009

Mr. William Shear
Director
Financial Markets and Community Investment
U.S Government Accountability Office
Washington, DC 20548

Re: Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009

Dear Mr. Shear:

As you know, the U.S. Small Business Administration (SBA) is committed to driving economic recovery by helping small businesses – the engine of job creation and economic growth – to succeed in the current economic environment. The Recovery Act programs will act as a catalyst to accomplish this goal.

Already, we are beginning to see the results of our efforts. Two of the programs highlighted in your Report on SBA's implementation of certain Recovery Act programs – the fee reduction and the 90% guarantee programs – have been available for four weeks, and already more than \$1.3 billion in new SBA loans have been approved. The impact of these programs appears to be strong, with loan volume increasing on average more than 20% for both 7(a) and 504 loans since the President's March 16 announcement that the programs were up and running.

Because all of these Recovery Act programs are critical, SBA appreciates the time and effort you and your team have devoted to the audit and Report, which we are pleased to note, contains no recommendations or suggestions concerning the Agency's implementation efforts. Your Report presents a fair and balanced discussion of our progress thus far, to which we would like to add some clarifying background and context so that the Agency's accomplishments in this unprecedented effort can be fully understood and appreciated.

I have been impressed by the intensity and level of commitment on the part of Agency staff to this important project. Senior managers across the Agency have been actively engaged in leading SBA's Recovery Act implementation with both urgency and appropriate care. The need to act with speed is being balanced with the need to assure that significant risks to the Agency that might arise through Recovery Act projects are systematically and effectively identified, evaluated, and addressed where appropriate. In doing so, we believe we are fulfilling our responsibility to small businesses, to our lending partners, and to the taxpayers.

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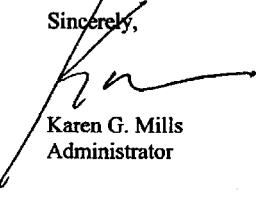
Mr. William Shear
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SBA continues to work diligently and expeditiously to implement all of SBA's Recovery Act provisions. As the Report suggests, a number of these programs require sophisticated financial modeling and/or legal documentation, and present challenging policy or structural issues, and therefore require additional time to implement. Throughout this process, SBA has kept its various oversight authorities informed of its progress and projected timeframes. This includes regular communication with multiple Congressional oversight committees, SBA's Office of Inspector General, and the Government Accountability Office. SBA also has kept the public informed through periodic updates on the Agency's Recovery Act website, fulfilling a key commitment of this Administration to transparency and communication. And, it has kept its commitment to its mission intact – to serve the interests of small businesses through the sound implementation and operation of Agency programs.

Our efforts in implementing the Recovery Act have been comprehensive and focused. Your Report briefly mentions our project and support teams. More specifically, we have established nine project teams, six cross-functional teams, and separate technology project teams to lead the different automation efforts provided by the stimulus. Each project team has responsibility for implementation of a single Recovery Act provision, and is comprised of representatives from the Agency's financial, legal, budget and financial modeling, communications, outreach, and risk management disciplines. Each cross-functional team is responsible for an important activity such as reporting requirements, systems technology, and risk management. The teams report to the SBA Recovery Act Steering Committee of senior managers, ensuring high level oversight, coordination, and policy direction. In addition, all notices, regulations and guidance documents have been reviewed and cleared through SBA's Office of Inspector General, affording SBA the benefit of an additional review for ways to help manage and prevent fraud, waste and abuse.

Thank you again for your Report and the opportunity to comment on it. We will continue to move forward with our efforts, remaining focused on a rapid, effective and responsible implementation of these critical programs that will put small businesses in the position to drive economic recovery and job creation across the country. We appreciate your thoughtful report and will look forward to working with you further.

Sincerely,



Karen G. Mills
Administrator

(250451)

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