GAO Highlights

Highlights of GAO-18-421, a report to congressional committees

June 2018

SMALL BUSINESS LOANS

Additional Actions Needed to Improve Compliance with the Credit Elsewhere Requirement

Why GAO Did This Study

SBA's 7(a) program is required to serve creditworthy small business borrowers who cannot obtain credit through a conventional lender at reasonable terms. The Joint Explanatory Statement of the Consolidated Appropriations Act, 2017 includes a provision for GAO to review the 7(a) program.

This report discusses, among other things, (1) how SBA monitors lenders' compliance with the credit elsewhere requirement, (2) the extent to which SBA evaluates trends in lender credit elsewhere practices, and (3) lenders' views on the credit elsewhere criteria for 7(a) loans.

GAO analyzed SBA data on 7(a) loans approved for fiscal years 2007–2016, the latest available, and reviewed literature on small business lending; reviewed standard operating procedures, other guidance, and findings from SBA reviews performed in fiscal year 2016; and interviewed lender associations and a nonrepresentative sample of 7(a) lenders selected that concentrated on larger lenders.

What GAO Recommends

GAO recommends that SBA (1) require its on-site reviewers to document their assessment of lenders' policies and procedures related to the credit elsewhere documentation requirement, (2) collect information on lenders' use of credit elsewhere criteria, and (3) analyze that information to identify trends. SBA generally agreed with the recommendations.

View GAO-18-421. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

What GAO Found

For its 7(a) loan program, the Small Business Administration (SBA) has largely delegated authority to lenders to make 7(a) loan determinations for those borrowers who cannot obtain conventional credit at reasonable terms elsewhere. To monitor lender compliance with the "credit elsewhere" requirement SBA primarily uses on-site reviews conducted by third-party contractors with SBA participation and oversight, and other reviews. According to SBA guidance, lenders making 7(a) loans must take steps to ensure and document that borrowers meet the program's credit elsewhere requirement. However, GAO noted a number of concerns with SBA's monitoring efforts. Specifically, GAO found the following:

- Over 40 percent (17 of 40) of the on-site lender reviews performed in fiscal year 2016 identified lender noncompliance with the requirement.
- On-site reviewers identified several factors, such as weakness in lenders' internal control processes that were the cause for lender noncompliance.
- Most on-site reviewers did not document their assessment of lenders' policies or procedures, because SBA does not require them to do so. As a result SBA does not have information that could help explain the high noncompliance rate.

Federal internal control standards state that management should design control activities, including appropriate documentation, and use quality information to achieve the entity's objectives. Without better information on lenders' procedures for complying with the documentation requirement, SBA may be limited in its ability to promote compliance with requirements designed to help ensure that the 7(a) program reaches its target population.

SBA does not routinely collect or analyze information on the criteria used by lenders for credit elsewhere justifications. SBA recently began collecting some information on lenders' use of the criteria, but this information is limited, and SBA does not analyze the information that it does collect to better understand lenders' practices. Federal internal control standards state that management should use quality information to achieve the entity's objectives. Without more robust information and analysis, SBA may be limited in its ability to understand how lenders are using the credit elsewhere criteria and identify patterns of use by certain lenders that place them at a higher risk of not reaching borrowers who cannot obtain credit from other sources at reasonable terms.

In general, representatives from 8 of 11 lenders that GAO interviewed stated that SBA's credit elsewhere criteria are adequate for determining small business eligibility for the 7(a) program. These criteria help them target their lending to small businesses that would otherwise have difficulty obtaining conventional credit because they are often new businesses or have a shortage of collateral. However, they also said that other factors—such as lender policies and economic conditions—can affect their decisions to offer 7(a) loans. In January 2018, SBA issued revised guidance for the 7(a) program and has provided training on this new guidance to lenders and trade associations. Lenders told GAO they are still in the process of understanding the new requirements.