U.S. SMALL BUSINESS ADMINISTRATION OFFICE OF INSPECTOR GENERAL

SBA's Oversight of Non-Bank Lenders and Third-Party Service Providers Associated with PPP Loans

Evaluation Report

Report 25-04

November 13, 2024

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Pursuant to the James M. Inhofe National Defense Authorization Act for Fiscal Year 2023, Public Law 117-263, Section 5274, any nongovernmental organizations and business entities identified in this report have the opportunity to submit a written response for the purpose of clarifying or providing additional context as it relates to any specific reference contained herein. Comments must be submitted to AIGA@sba.gov within 30 days of the final report issuance date. We request that any comments be no longer than two pages, Section 508 compliant, and free from any proprietary or otherwise sensitive information. The comments may be appended to this report and posted on our public website.

U.S. Small Business Administration
Office of Inspector General

EXECUTIVE SUMMARY

SBA's Oversight of Non-Bank Lenders and Third-Party Service Providers Associated with PPP Loans (Report 25-04)

What OIG Reviewed

The Coronavirus Aid, Relief, and Economic Security (CARES) Act established the Paycheck Protection Program (PPP), an $813.7 billion program that provided forgivable loans to eligible borrowers.

Over 5,300 lenders, including bank and non-bank lenders, participated in the PPP. The primary distinction between the two is that non-bank lenders are not federally regulated. Both were allowed to partner with third-party service providers to assist in the PPP loan process.

Our objective was to assess the U.S. Small Business Administration's (SBA) oversight of non-bank lenders, including financial technology (fintech), and third-party service providers in the PPP.

What OIG Found

Opportunities exist for SBA to enhance its oversight of non-bank lenders, including fintechs, and service providers to promote program integrity and reduce financial loss. SBA had processes in place to approve non-bank lenders to become PPP lenders; however, it performed limited oversight of these lenders and was unaware of the extent of service providers' participation in the PPP.

SBA established a comprehensive plan to conduct risk-based reviews of lender PPP operations, which included non-bank lenders. However, SBA did not execute the plan, rather it focused its oversight on loan forgiveness and guaranty purchases.

Executive and legislative actions led SBA to reduce or eliminate barriers for PPP borrowers, resulting in a significant increase in loans being made by non-bank lenders, including fintechs. Additionally, hold harmless provisions protected lenders from consequences if the lender complied with applicable legal requirements. Reduced controls and limited oversight increased the risk of fraud.

We found non-bank PPP lenders made $14.2 billion in suspected fraudulent loans at a rate more than five times higher than loans made by traditional bank lenders. Over $6.1 billion of the $14.2 billion in suspected fraudulent non-bank PPP loans, or nearly 43 percent, were made by lenders categorized as fintechs and other State Regulated Finance Companies. Additionally, loans involving service providers had a suspected fraud rate more than three times higher than loans made without a service provider. Given SBA's expanding loan portfolio and increasing reliance on non-bank lenders, including fintechs, in other loan programs and increasing lender reliance on fintech service providers, effective oversight is vital to ensuring program integrity and mitigating fraud risk and financial loss.

What OIG Recommended

We made six recommendations for SBA to strengthen oversight of non-bank lenders and service providers.

Agency Response

SBA management agreed with recommendations 1, 3, 4, 5, and 6; and partially agreed with recommendation 2. Management's existing and planned actions satisfy the intent of our recommendations.

Office of Inspector General
U.S. Small Business Administration

Memorandum

Date: November 13, 2024

To: Isabella Casillas Guzman
Administrator

From: Hannibal "Mike" Ware
Inspector General

Subject: Evaluation of SBA's Oversight of Non-Bank Lenders and Third-Party Service Providers Associated with PPP Loans (Report 25-04)

This report presents the results of our review *SBA's Oversight of Non-Bank Lenders and Third-Party Service Providers Associated with PPP Loans*. We considered management's comments on the draft of this report when preparing the final report. SBA management agreed with five of six recommendations and partially agreed with one recommendation.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact me or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6586.

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Introduction

This report presents the results of our evaluation of the U.S. Small Business Administration's (SBA) oversight of non-bank lenders and third-party service providers (service providers) in the Paycheck Protection Program (PPP).

Background

The President signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act into law on March 27, 2020. Section 1102 of the CARES Act provided $349 billion to create the PPP under Section 7(a) of the Small Business Act. The PPP provided fully guaranteed SBA loans for certain eligible borrowers that could be forgiven if loan proceeds were used as required by law. Eligible expenses included payroll, rent, utility payments, and other covered operations expenditures. Subsequent acts provided additional funding for the PPP, increasing total program funding to $813.7 billion. The PPP closed for applications on May 31, 2021, after more than 5,300 lenders approved a combined 11.8 million loans, totaling $799.8 billion.[1]

SBA broadly categorizes lenders as either bank or non-bank. Generally, non-bank lenders 1) are not supervised by federal regulators such as the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, or Federal Reserve System; 2) have no depository relationships with their clients; and 3) have less lending experience than traditional banks. However, other federal agencies may sometimes oversee non-bank lenders. For example, SBA oversees non-bank Small Business Lending Companies.

Many banks and non-bank lenders rely on different types of financial technology (fintech) to gain efficiency while processing loans. Fintech is a term commonly used to describe certain lenders and service providers that rely heavily on financial technology in the processing of loans, including some that participated in the PPP. For this report, we consider fintech lenders to be a subset of certain non-bank lenders in line with SBA's categorization and public reporting of State Regulated Finance Companies as "Fintechs (and other State Regulated Companies)," according to SBA's PPP approvals report. These entities are distinct from other categories of banks and non-bank lenders that rely heavily on fintech companies as service providers in order to process loans. Overall, non-bank lenders, including fintechs, combined to make 2.96 million PPP loans totaling $61.1 billion (see Table 1).

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[1] SBA Office of Capital Access, Paycheck Protection Program Report Approvals through May 31, 2021, (2021).

Table 1: PPP Loans by SBA Lender Category[2]

SBA Lender Category	SBA Lender Type	Number of PPP Lenders	Number of PPP Loans	Dollar Value of PPP Loans
Lender	Bank	4,092	8,108,425	$713,967,849,185
Lender	Credit Unions	962	373,548	$15,430,746,571
Lender	Savings and Loans	82	29,620	$2,129,296,186
Lender Subtotal		**5,136**	**8,511,593**	**$731,527,891,942**
Non-bank Lender	Farm Credit Service Lenders	54	51,801	$2,289,901,825
Non-bank Lender	Fintechs and other State Regulated Finance Companies (SRFC)	47	1,322,679	$25,063,603,975
Non-bank Lender	Microlenders	36	489,866	$7,934,584,154
Non-bank Lender	Certified Development Company (CDC)	24	24,347	$826,071,773
Non-bank Lender	Small Business Lending Company (SBLC)	14	826,837	$20,499,692,302
Non-bank Lender	Certified Development Financial Institutions (CDFI)	10	241,187	$4,456,742,328
Non-bank Lender	Business and Industrial Development Company (BIDCO)	1	43	$1,089,324
Non-bank Lender Subtotal		**186**	**2,956,760**	**$61,071,685,681**
Total	—	**5,322**	**11,468,353**	**$792,599,577,623**

Source: SBA OIG analysis of non-cancelled PPP loan data

All existing SBA 7(a) lenders were authorized under the statute to make PPP loans. During the pandemic, SBA encouraged other bank and non-bank lenders that were not SBA 7(a) lenders at the time, including fintechs, to apply for approval to make PPP loans to increase the scope of PPP lending operations and the speed with which loans could be disbursed. SBA collaborated with the U.S. Department of the Treasury to admit new non-bank lenders into the program through a formal application and review process. Accordingly, the role of non-bank lenders in the PPP surged throughout the program. The PPP data shows that seven high-volume non-bank lenders

[2] Data presents PPP loans that have not been fully canceled, which is different from the number of loans SBA guaranteed.

relying on service providers that used financial technology combined approved more than 2.4 million loans, or more than 18,000 loans per day, at a speed of five seconds per loan in 2021, after having made fewer than 22,000 PPP loans in 2020.

SBA has also increased its reliance on non-bank lenders in its traditional SBA loan programs, such as the 7(a) loan program. For example, SBA converted all Community Advantage pilot program lenders to Community Advantage Small Business Lending Companies and expanded Small Business Lending Company licenses from 14 to 17, despite some of these lenders having a significantly higher suspected fraud rate on the PPP loans they made. While these are actions that SBA has already taken to expand access to capital, lenders and the service providers are also increasing their reliance on fintech, making regulation and oversight of fintech in SBA programs vital.

Both bank and non-bank PPP lenders were allowed to partner with service providers to assist in the PPP loan process, which can include fintech companies. Service providers can perform a variety of services in either the loan origination or forgiveness process including performing lender functions — such as determining eligibility — and providing technology and referral services. A service provider that assists a lender with lender functions in originating, disbursing, or servicing SBA loans is known as a lender service provider (LSP). For this type of service provider, SBA requires lenders to submit for acceptance an LSP agreement that meets all SBA requirements and denotes the lender's responsibility to exercise due diligence and perform prudent oversight of their LSP.

Although the PPP provided immediate relief to many American businesses, some bad actors took advantage of the program to fraudulently claim funds. In June 2023, we reported SBA lenders disbursed an estimated $64 billion in suspected fraudulent PPP loans.[3]

Oversight Responsibilities

PPP loans are authorized under Section 7(a) of the Small Business Act and subject to SBA's oversight as stated in its standard operating procedures.[4] These procedures require SBA to effectively manage program risk. SBA's Office of Credit Risk Management (OCRM) oversees the risk associated with SBA lenders' 7(a) lending and enforces loan program requirements to manage risk of individual lenders as well as the aggregate risk of SBA's loan portfolio. OCRM's oversight role includes, but is not limited to, portfolio assessment and risk-based reviews.

[3] SBA OIG, 23-09, *COVID-19 Pandemic EIDL and PPP Loan Fraud Landscape*, (June 27, 2023).
[4] SBA, Standard Operating Procedure (SOP) 50 10 6, Lender and Development Company Loan Programs, (October 1, 2020); SOP 50 53 (2), Supervision and Enforcement, (January 1, 2021).

SBA-Supervised Lenders — such as Small Business Lending Companies — are also subject to SBA-Supervised Lenders Safety and Soundness Examinations and Quarterly Condition and Certification of Capital Compliance Reviews.

Objective

Our objective was to assess SBA's oversight of non-bank lenders, including fintech lenders, and third-party service providers in the PPP.

Results

Opportunities exist for SBA to enhance its oversight and guidance for non-bank lenders and service providers, particularly lender service providers, to promote program integrity and reduce financial loss. SBA, in collaboration with Treasury, had processes for non-bank lenders (including fintech lenders) to obtain approval to become PPP lenders, but performed limited oversight of these entities after approval and could have better assessed the risk of allowing them to continue to operate in the program. We found non-bank lenders, including fintechs, made $14.2 billion in suspected fraudulent loans at a rate more than five times higher than loans made by traditional bank lenders. We also found the rate of suspected fraudulent loans made by lenders using service providers was more than three times higher than the rate of loans processed by lenders that did not use a service provider.

Finding 1: Oversight of Non-Bank PPP Lenders

SBA's oversight of non-bank PPP lenders was the same as for bank lenders (i.e., federally regulated) in that it focused on loan forgiveness and guaranty purchase. This oversight was not sufficient to ensure program integrity and mitigate fraud risk and financial loss. Given SBA's expanding 7(a) loan portfolio and increasing reliance on non-bank lenders in not only the PPP but also other loan programs, considerable opportunities exist for the agency to strengthen its oversight of these entities.

As the PPP loan portfolio expanded, OCRM established a comprehensive plan to oversee all PPP lenders, which included performing risk-based reviews. However, OCRM did not execute this plan. Instead, it conducted limited oversight of all PPP lenders, including non-bank lenders, and did not perform risk-based reviews of any lenders' PPP operations during the program.

OCRM's initial oversight plan included compliance, testing, monitoring, risk-based reviews, increased supervision, and enforcement based on the type of PPP lender. However, SBA limited its oversight to screening loans to identify fraud and ensure compliance with eligibility requirements and analytical reviews of monthly PPP lender performance, PPP portfolio information by lender, and lenders with a high volume of customer complaints. This limited oversight adversely impacted program integrity and increased the risk of fraud and financial loss. Our analysis found that, overall, non-bank lenders combined to make approximately 715,000 suspected fraudulent loans totaling $14.2 billion, representing a suspected fraud rate of 24.63 percent for non-bank lenders (see Table 2), compared to 4.3 percent for traditional lenders. Of the suspected fraudulent PPP loans made by non-bank lenders, over 300,000, or 42 percent, totaling over $6.1 billion of the $14.2 billion (43 percent), were made by fintech or other State Regulated Finance Companies.

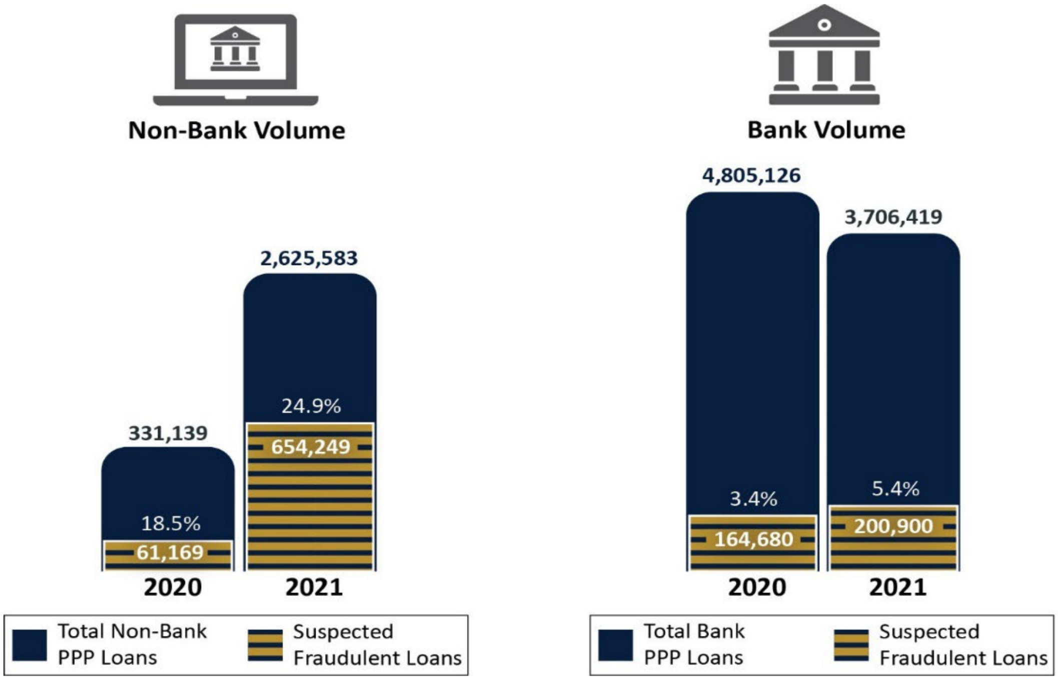
Table 2: Non-Bank Lender Loans Identified in SBA OIG Fraud Landscape

Lender Type	PPP Loans Made	PPP Loans in Fraud Landscape	Percentage of Loans in Fraud Landscape	Value of Fraud Landscape Loans
Fintechs and other SRFC	1,322,679	300,774	22.74%	$6,168,791,877
SBLC	826,837	213,592	25.83%	$4,415,470,130
Microlenders	489,866	117,415	23.97%	$2,036,540,466
CDFI	241,187	81,428	33.76%	$1,526,426,843
CDC	24,347	2,212	9.09%	$47,519,918
BIDCO	43	0	0%	$0
Total	**2,904,959**	**715,421**	**24.63%**	**$14,194,749,234**

Source: SBA OIG analysis of PPP loan data

Further, the percentage of PPP loans processed by non-bank lenders increased significantly from 6.5 percent in fiscal year (FY) 2020 to 41.5 percent in FY 2021. With that, the percentage of suspected fraudulent loans made by non-bank lenders increased to 24.9 percent in FY 2021. Banks, on the other hand, processed 58.5 percent of PPP loans in FY 2021 compared to 93.6 percent in FY 2020, with an estimated fraud rate of 5.4 percent in FY 2021 (see Figure 1).

Figure 1: Suspected Fraudulent Loans by Lender Type and Fiscal Year



Source: OIG analysis of PPP data

SBA provided the same PPP oversight of non-bank lenders as it did for bank (i.e., federally regulated) lenders that generally focused on reviewing individual loan forgiveness and guaranty purchase requests. SBA did not tailor its oversight approach to consider lender portfolio risks such as the regulatory (e.g., compliance with the Bank Secrecy Act and Know Your Customer requirements) and control environment of non-banks and online institutions with few or no physical locations, despite indications of elevated fraud risk involving these types of lenders. Lenders sometimes directly reported to and discussed with SBA elevated fraud risks, particularly regarding loans made to certain borrowers who used IRS Form 1040, Schedule C.

According to SBA, it limited oversight of PPP lenders, including non-bank lenders, because of the significant hold harmless provisions in the CARES Act and Economic Aid Act, which protected lenders from consequences related to a borrower's failure to comply with program criteria if the lender acted in good faith and complied with applicable legal requirements. Further, in March 2021, SBA, in consultation with Treasury, issued an interim final rule that allowed self-employed individuals, independent contractors, and sole proprietors who filed an IRS Form 1040, Schedule C, to calculate their maximum loan amount using gross income rather than net income. This change reduced barriers to accessing the PPP for sole proprietors, independent contractors, and self-employed individuals, resulting in a significant increase in loans, the majority being made by non-bank lenders.

SBA's responsibility to effectively manage program risk as mentioned in its standard operating procedures[5] is also mandated by the U.S. Government Accountability Office, which states that managers should identify, analyze, and respond to risks related to achieving their objectives, including the potential for fraud. Managers' responsibilities include using risk factors to identify fraud risk and effectively mitigating risk through their response.

After the PPP closed for applications, SBA initiated targeted reviews of lenders with identified issues to assess their Bank Secrecy Act/Know Your Customer program structure and compliance with PPP requirements. Consequently, the lenders agreed to temporarily halt their delegated authority and increase their PPP reporting.

Effective oversight for all SBA loan programs is necessary to promote program integrity and to mitigate fraud risk and financial loss.

Recommendations

To improve SBA's oversight of non-bank lenders, we recommend the Administrator direct the Associate Administrator for the Office of Capital Access to:

Recommendation 1: Ensure that future application review processes for non-bank PPP lenders (including fintechs) requesting to participate in traditional SBA loan programs include conducting reviews of the lender's compliance with PPP requirements.

Recommendation 2: Enhance existing risk-based oversight plans to ensure adequate oversight of high-risk non-bank lenders, including fintechs.

Finding 2: Oversight of Third-Party Service Providers

SBA and lenders could improve oversight of service providers, including lender service providers, to mitigate fraud risk and financial loss. SBA has policies for how lenders should manage service providers in its traditional 7(a) loan program and lenders participating in the PPP were expected to adhere to the policies. However, SBA was unaware of the extent of service providers' participation in the program and the related risks. SBA's limited oversight of lenders increased the risk of fraud and financial loss.

[5] SBA, SOP 50 10 6, Lender and Development Company Loan Programs, (October 1, 2020); SOP 50 53 (2), Supervision and Enforcement, (January 1, 2021).

While lenders bear full responsibility for their loan operations, we found that loans made using service providers had a higher likelihood of being fraudulent. Our analysis revealed that, overall, lenders using service providers had a 16.2 percent suspected fraudulent loan rate, which was three times higher than the 4.9 percent rate for lenders that did not use a service provider (see Table 3).

Table 3: Suspected Fraudulent Loans With/Without a Service Provider

Data Type	Total Number of PPP Loans	Total Number of Suspected Fraudulent Loans	Percentage of Suspected Fraudulent Loans
Loans With a Service Provider	4,576,366	743,613	16.2%
Loans Without a Service Provider	6,891,901	337,676	4.9%
Total	**11,468,267**	**1,081,289**	—

Source: SBA OIG analysis of PPP loan data

Lender Service Provider Oversight

A service provider that performs lender functions in originating, disbursing, or servicing SBA loans is known as a lender service provider (LSP). Lenders contract with LSPs for many reasons, including insufficient resources or inexperience. Given the risks associated with lenders relying on LSPs, SBA developed several requirements that lenders must adhere to, which include maintaining the ultimate responsibility for ensuring loan quality and compliance with SBA requirements and submitting and obtaining SBA's acceptance for all LSP agreements. However, we found SBA was unaware of the extent of LSP participation in the PPP and the related risk because it did not implement sufficient controls to ensure lenders obtained acceptance for LSP agreements, as required.

PPP lenders were subject to the same SBA oversight as traditional 7(a) loans, including requirements for lenders partnering with LSPs.[6] SBA requires lenders partnering with an LSP to submit for acceptance a lender service provider agreement that meets all SBA requirements and to exercise due diligence and perform prudent oversight of their LSPs.

[6] SBA, SOP 50 10 6, Lender and Development Company Loan Programs, (October 1, 2020).

We found SBA did not implement sufficient upfront system access controls or perform planned risk-based reviews to ensure lender compliance with program requirements. Specifically, SBA relied on lenders to perform due diligence of their service providers and submit LSP agreements for acceptance, as necessary. We found that 18 of the 20 lenders we reviewed did not have an accepted LSP agreement outlining the relationship with their service provider. Based on our understanding of the services provided and discussions with SBA officials, many of these service providers likely were LSPs and should have had a required LSP agreement to ensure the lender's relationship with their service provider complied with SBA requirements.

While SBA expected PPP lenders to follow SBA requirements for managing LSPs, including those in their standard operating procedures, SBA's primary method of communicating PPP guidance to lenders, the Interim Final Rules and Frequently Asked Questions, did not clearly reference this responsibility. For example, this guidance did not reference lenders' use of service providers or explicitly state that lenders were to follow SBA requirements for managing service providers.

To determine whether there was an SBA accepted LSP agreement in place, we identified 20 lenders that had partnered with service providers to make at least 25,000 loans. While our scope of work did not include reviewing the specific services provided in each of these relationships, there were indications the service providers were involved with originating, disbursing, or servicing loans, which suggests an LSP agreement would likely have been required, substantiating SBA officials indicated perspective that they likely were LSPs. Some of the relationships involved service providers that identified themselves as providing only technology services or a platform to lenders, but who SBA suspected of having a more substantial role in the lending process. Regardless, the lender is responsible for complying with applicable banking regulations and SBA requirements.

For example, in one instance a lender and service provider partnered to make a significant number of PPP loans. The lender initially submitted an LSP agreement detailing the relationship with the service provider, which included functions that likely met the definition of an LSP. SBA did not accept the agreement because it did not contain all requirements outlined in SBA's policy.[7] However, SBA did not inform the lender that they had rejected the agreement until late May 2021, as the PPP closed. We identified over 100,000 loans made by the lender and service provider, totaling $1.8 billion, as suspected fraudulent.

SBA did not use key system access controls typically used in its traditional loan programs to ensure only LSPs with accepted agreements could submit PPP loan applications to SBA. Generally, SBA reviews a lender's relationship with service providers during risk-based reviews of

[7] SBA, SOP 50 10 6, Lender and Development Company Loan Programs, (October 1, 2020).

lenders but may also review a lender's compliance with LSP agreements separately.**Error! Bookmark not defined.** SBA did not perform risk-based reviews of lender PPP operations during the program or perform detailed reviews of lenders' compliance with LSP agreement submission and third-party monitoring requirements. SBA also did not review PPP lenders compliance with accepted LSP agreements outside of risk-based reviews, which created a lack of awareness and oversight of service provider relationships.

After the PPP closed for applications, SBA took administrative action to prevent service providers with identified issues from participating in its loan programs.

As evidenced by our analysis, loans made using service providers had a higher likelihood of being identified as suspected fraudulent. Effective oversight for all SBA loan programs is necessary to promote program integrity, mitigate fraud risk and financial loss, and ensure only accepted service providers participate and benefit from future SBA economic stimulus programs.

Recommendations

To address SBA's limited oversight of service providers, we recommend the Administrator direct the Associate Administrator for the Office of Capital Access to:

Recommendation 3: Ensure internal controls designed to restrict access to only lender service providers with accepted agreements to submit loan applications remain in place to promote program integrity in all lending programs.

Recommendation 4: Improve monitoring of lender/service provider relationships to better determine the extent of services being performed by service providers to ensure compliance with SBA requirements.

Recommendation 5: Reinforce existing guidance to lenders on reporting lender service provider relationships to SBA to ensure only accepted lender service providers are participating in and benefiting from SBA programs.

Other Matter: SBA Guidance on Service Provider Oversight

Based on our review of existing SBA guidance to lenders regarding their oversight of lender service providers, we noted opportunities exist for SBA to enhance its guidance to mitigate risks associated with lender service providers and align with guidance issued by other federal agencies in 2023. Specifically, other agencies (e.g., Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Federal Reserve System) collaborated to develop interagency guidance to lenders related to managing risks associated with third-party relationships in administering loans. The interagency guidance includes topics such as how a lender should conduct due diligence, lender's consideration of third party's risk management, and prior experience providing the services. SBA updating its existing lender service provider guidance to align with the interagency guidance could help ensure that lenders better understand and mitigate risks associated with lender service providers.

Recommendation

To enhance SBA's guidance to lenders regarding oversight of service providers, we recommend the Administrator direct the Associate Administrator for the Office of Capital Access to:

Recommendation 6: Update guidance on lender requirements for managing risks associated with lender service provider relationships to align with 2023 Interagency Guidance.

Evaluation of Agency Response

SBA management provided formal comments to the draft report, which we considered when preparing this final report. Management agreed with recommendations 1, 3, 4, 5, and 6; and partially agreed with recommendation 2. Management's planned actions are sufficient to resolve our recommendations. We also noted that, for several of the recommendations, the managers stated they have already implemented the recommended actions; however, during our review, management did not provide specific evidence of these processes and procedures. Management will need to provide evidence that these actions are fully implemented for us to close the recommendations. Finally, in subsequent correspondence, management stated the targeted final action date for all recommendations is June 30, 2025. See Appendix 2 for management's comments in their entirety.

Summary of Actions Necessary to Close the Recommendations

The following section summarizes the status of our recommendations and the actions necessary to close them.

Recommendation 1

Ensure that future application review processes for non-bank PPP lenders (including fintechs) requesting to participate in traditional SBA loan programs include conducting reviews of the lender's compliance with PPP requirements.

Status: Resolved

SBA management agreed with the recommendation, stating they have a process in place to confirm a PPP lender's compliance with PPP requirements. The SBA Office of Capital Access has a history of assessing the entity's participation in other business loan programs. For the PPP, the assessment includes the entity's 1) Net Approvals; 2) Paid-in-Full/Forgiven; Charge-Offs; 3) Outstanding Loans with Open Fraud Holds; and 4) Outstanding Loans without Open Fraud Holds. Further, effective August 2023, policy established that SBA reserves the right to deny any applicant from becoming a Non-Federally Regulated Lender or Small Business Lending Company at its sole discretion.

This recommendation can be closed when SBA provides evidence it implemented a review process for PPP lenders requesting to participate in traditional SBA loan programs that includes conducting reviews of the lender's compliance with PPP requirements.

Recommendation 2

Enhance existing risk-based oversight plans to ensure adequate oversight of high-risk non-bank lenders, including fintechs.

Status: Resolved

SBA management partially agreed with the recommendation, stating they perform lender oversight using a process of continuous improvement and closely monitor all SBA Supervised Lenders. Management further stated the Office of Capital Access has a history of continuously improving risk management based on changes in the program and industry, which includes advances in technology, increased staffing for the Office of Credit Risk Management (OCRM), and modifications to the scopes used for risk-based reviews. OCRM determines the review scope based on the risk such as rapid portfolio growth, agent usage, and portfolio performance.

In addition, managers stated they have recently redeveloped the Lender Risk Rating System to improve the accuracy and transparency of the rating. Further, OCRM now conducts at least one risk-based review per fiscal year of lenders with SBA share dollars greater than $10 million and with an elevated risk profile.

As stated in the report, we found SBA did not perform risk-based reviews of non-bank PPP lenders, including fintechs. Moving forward, SBA should ensure it conducts adequate oversight of non-bank lenders across all loan programs to ensure program integrity and mitigate financial loss.

This recommendation can be closed when SBA provides evidence of enhanced risk-based oversight plans to ensure adequate oversight of high-risk non-bank lenders, including fintechs.

Recommendation 3

Ensure internal controls designed to restrict access to only lender service providers with accepted agreements to submit loan applications remain in place to promote program integrity in all lending programs.

Status: Resolved

Management agreed with our recommendation and stated that controls are in place to restrict an LSP’s access to SBA’s Capital Access Financial System on a lender’s behalf unless there is an active LSP agreement in place.

As stated in the report, SBA did not use existing key access controls typically used in its traditional loan programs during the PPP to ensure LSPs had an accepted agreement prior to submitting PPP loan applications to SBA. We found that 18 of the 20 lenders we reviewed were able to submit applications without an accepted LSP agreement. Moving forward, SBA should ensure its controls to restrict LSP access to its loan systems remain in place across all loan programs to promote program integrity, mitigate fraud risk and financial loss, and ensure only accepted service providers participate in and benefit from future SBA economic stimulus programs.

This recommendation can be closed when SBA provides evidence that the internal controls designed to restrict access to only lender service providers with accepted agreements are currently in effect and working as intended.

Recommendation 4

Improve monitoring of lender/service provider relationships to better determine the extent of services being performed by service providers to ensure compliance with SBA requirements.

Status: Resolved

Managers agreed with our recommendation and stated they have a long-standing risk-based review process that requires subject lenders to disclose third-party activities in the origination, servicing, and liquidation of 7(a) loans. SBA indicated that supporting documentation was provided to SBA OIG in May 2024. SBA's reviews also include a specific questionnaire related to a lender's use of an LSP. In addition, SBA indicated that in January 2024, it made changes to its LSP agreement review/acceptance process for lenders to have a better understanding of their responsibilities of SBA program requirements when using LSPs.

While SBA provided documentation related to its risk-based review process and LSP questionnaire, as noted in the report, it did not perform risk-based reviews of lender PPP operations or perform detailed reviews of lenders' compliance with LSP agreement submission during the PPP. Regarding the change made in January 2024, an OCRM official indicated during our review that this new process was in beta testing for 180 days and, therefore, was not fully implemented.

This recommendation can be closed when management provides evidence of improved monitoring of lender/service provider relationships to better determine the extent of services being performed by service providers to ensure compliance with SBA requirements. This should include evidence related to the beta process being fully implemented and evidence of completed reviews of lenders use of a service providers during the risk-based review process.

Recommendation 5

Reinforce existing guidance to lenders on reporting lender service provider relationships to SBA to ensure only accepted lender service providers are participating in and benefiting from SBA programs.

Status: Resolved

Managers agreed with our recommendation and stated that they provide ongoing guidance to lenders regarding their reporting of LSP relationships and submission of LSP agreements for SBA review and acceptance during industry conferences and conference calls.

This recommendation can be closed when management provides evidence of actions taken to reinforce existing guidance to lenders.

Recommendation 6

Update guidance on lender requirements for managing risks associated with lender service provider relationships to align with 2023 Interagency Guidance.

Status: Resolved

Managers agreed with our recommendation, stating that they updated guidance incorporating the Interagency Guidance in January 2024. The guidance was previously reviewed with applicable parts confirmed to be in the LSP questionnaire (or subsequently added) and the Interagency Guidance was incorporated into the revised LSP agreement review process.

As stated in the report, during our evaluation, the 2023 Interagency Guidance was not incorporated into SBA's policies. An OCRM official indicated in May 2024 that they had reviewed the Interagency Guidance and were evaluating the overall changes necessary to fully integrate it into their policies. Additionally, the official indicated that new LSP agreement review process was in beta testing for 180 days and, therefore, was not fully implemented.

This recommendation can be closed when management provides evidence that guidance on lender requirements for managing risks associated with lender service provider relationships has been updated to align with 2023 Interagency Guidance. This should include evidence of appropriate revisions to the LSP agreement review process and the LSP questionnaire.

Appendix 1: Scope and Methodology

This report presents the results of our evaluation of the U.S. Small Business Administration's (SBA) process for overseeing non-bank lenders, including fintechs, in the Paycheck Protection Program (PPP). SBA's Office of Inspector General (OIG) conducted this evaluation to assess SBA's ability to mitigate fraud risks associated with PPP loans made by non-bank lenders and identify fraud risks of PPP loans associated with these entities. Our scope of work included PPP loans processed between April 2020–May 2021 that have submitted forgiveness applications.

To answer our objective, we reviewed pertinent federal, departmental, and SBA-specific regulations, policies, procedures, and guidance related to non-bank lender and third-party service provider participation in PPP. We interviewed SBA personnel from various offices in the Office of Capital Access, including the Office of Credit Risk Management, and the Office of Performance and Systems Management to gain an understanding of related processes, procedures, and system controls.

We analyzed PPP loan data to determine the number of lenders that participated in the program. Using SBA lender data that included SBA's categorization of lenders (i.e., lender or non-bank lender), we then determined the number and dollar amount of loans made by lenders categorized as non-bank lenders. We excluded Farm Credit Service Lenders from our analysis because they are categorized as non-bank lenders by SBA but are regulated by another federal agency.

To determine the number and value of suspected fraudulent loans made by non-bank lenders, we matched loans made by non-bank lenders to loans identified as suspected fraudulent in SBA OIG's white paper *COVID-19 Pandemic EIDL and PPP Loan Fraud Landscape* (Report 23-09, June 2023). The methodology for identifying suspected fraudulent loans in OIG's fraud landscape report included the analysis of data obtained through subpoenas from certain lenders and third-party service providers. Results of suspected fraudulent loans in this report do not include loans identified using subpoenaed data.

We also analyzed PPP loan data to determine if data indicated the use of a service provider to facilitate a loan and if so, the associated rate of suspected fraudulent loans. Additionally, we analyzed lenders that partnered with a service provider to make 25,000 or more loans to determine if lender service provider (LSP) agreements were in place by reviewing SBA's list of accepted LSP agreements during the program. We did not contact lenders or service providers to obtain agreements that were not submitted to SBA for review.

We conducted this evaluation in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*. These standards require that we adequately plan and perform the evaluation to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objective. We believe that the evidence provides a reasonable basis for our conclusions based on our objective.

Use of Computer-Processed Data

We relied on PPP data from SBA's electronic loan application system (E-Tran). We found data on the number and value of PPP loans to be reliable for our analysis of loans made by different lender types and analysis of loans suspected of fraud. We used the same data to analyze loans made using third-party service providers, which relied on a specific data field to identify the use of a third-party service provider. We found the field was often blank or listed the lender in the field. This field also could not be traced back to source documentation to determine if information in the field was accurate. Despite the likelihood of the data being incomplete or inaccurate we used it for analysis as it was the most complete data available.

Prior Audit Coverage

The following lists SBA OIG's previous audit coverage related to the objective of this report:

Report Number	Report Title	Report Date
23-09	*COVID-19 Pandemic EIDL and PPP Loan Fraud Landscape*	June 27, 2023
22-09	*SBA's Paycheck Protection Program Loan Review Processes*	February 28, 2022

Appendix 2: Agency Response

U.S. Small Business Administration

Response to Report

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

To: Hannibal “Mike” Ware
Inspector General
U.S. Small Business Administration

From: RL for Susan Streich, Director
Office of Credit Risk Management
Office of Capital Access

Date: November 4, 2024

Subject: Response to OIG Draft Report 23007 – “SBA's Oversight of Non-Bank Lenders and Third-Party Service Providers Associated with PPP Loans.”

We appreciate the role the Office of Inspector General (OIG) plays in working with management in ensuring that our programs are effectively managed, and for the feedback provided in this draft report. We offer the following comments to the draft and recommendations:

Recommendation 1 – Ensure that future application review processes for non-bank PPP lenders (including Fintechs) requesting to participate in traditional SBA loan programs include conducting reviews of the lender’s compliance with PPP requirements.

SBA Response: SBA agrees and already has a process already in place to confirm a PPP lender’s compliance with PPP requirements.

- The Office of Capital Access has a history of assessing the entity’s participation in other business loan programs. Pertaining to PPP, the assessment includes the entity’s (1) Net Approvals; (2) Paid-in-Full/Forgiven; Charge-Offs; (3) Outstanding Loans with Open Fraud Holds; and (4) Outstanding Loans without Open Fraud Holds.
- If there are risks not captured in the above referenced data points, SBA SOP 50 56 1 (Effective August 1, 2023) established that SBA reserves the right to deny any applicant from becoming a NFRL or SBLC in its sole discretion. Examples of reasons to deny an applicant include historical performance measures (such as default, purchase and loss rate), and other performance data or program integrity concerns associated with the lender or its senior management team. For the 504 Loan Program, SOP 50 56 1 does not explicitly state that an application can be denied by SBA in its sole discretion; however, there is no

prohibition against using an applicant's activities in other business loan programs, such as PPP, as a reason for decline (and there is no appeal process for a final decision of decline).

Recommendation 2 – Enhance existing risk-based oversight plans to ensure adequate oversight of high-risk non-bank lenders, including Fintechs.

SBA Response: SBA partially agrees and performs lender oversight utilizing a process of continuous improvement. All SBA Supervised Lenders are closely monitored, not just those determined to be high-risk.

- The Office of Capital Access has a history of continuously improving risk management based on changes in the program and industry, which includes advances in technology, increased staffing for the Office of Credit Risk Management, and modifications to the scopes used for Risk-Based Reviews.

    - Examples of technology improvements include
        - E-Tran's risk mitigation framework that was implemented on August 1, 2023 and Lender Match's screening enhancements.
        - The Lender Risk Rating System was redeveloped to (i) improve the accuracy of the SBA Lender Risk Rating (LRR); (ii) ensure model reliability across economic conditions; (iii) increase transparency and usability to the SBA Lender; (iv) incorporate the latest SBA performance data; and (v) evaluate new variables that can provide additional insight into SBA Lender and portfolio risk.
        - Changes to the Lender Portal, notably an increase in the number of individuals within an entity that can access the data.
    - OCM Staffing
        - The most recent HR Roster reflects 39 full time employees (with at least one new hire scheduled to start later this month).
    - Risk-Based Reviews
        - For Lender's with SBA Share Dollars Greater than $10.0 million with an elevated risk profile, OCRM currently conducts at least one Risk-Based Review per fiscal year. The review scope is determined based on the risk (e.g., rapid portfolio growth, Agent usage, portfolio performance, etc.).

Recommendation 3 – Ensure internal controls designed to restrict access to only lender service providers with accepted agreements to submit loan applications remain in place to promote program integrity in all lending programs.

SBA Response: SBA agrees and already has these controls in place.

- The controls are in place as Lender Service Providers (LSPs) cannot access SBA's Capital Access Financial System (CAFS) on a Lender's behalf unless the Partner Information Management System (PIMS) reflects an active LSP agreement between the Lender and LSP.

Recommendation 4 – Improve monitoring of lender/service provider relationships to better determine the extent of services being performed by service providers to ensure compliance with SBA requirements.

SBA Response: SBA agrees and has a process already in place to monitor the services performed by LSPs for lender participants.

- OCRM has a long-standing Risk-Based Review process that requires the subject lender to disclose third-party activities in the origination, servicing, and liquidation of 7(a) loans in addition to specific questions about Lender Service Provider Agreements. This is done through both a series of questions that is part of the “Notification and Needs List” that is used to start a review and the “Lender Service Provider Questionnaire” which is build into the “Notification and Needs List.”
  - Supporting documentation was provided to SBA OIG via email on May 17, 2024.
- In addition to the long-standing practices, in January 2024, enhancements were made to the LSP agreement review/acceptance process to ensure Lender accountability and understanding of the requirements, along with the risk, associated with engaging a Lender Service Provider.

Recommendation 5 – Reinforce existing guidance to lenders on reporting lender service provider relationships to SBA to ensure only accepted lender service providers are participating and benefiting from SBA programs.

SBA Response: SBA agrees and provides ongoing guidance to lenders regarding their reporting of LSP relationships and submission of LSP agreements for SBA review/acceptance.

- This has been done through in-person presentations at various industry conferences and conference calls.
  - A specific example would be that the guidance was incorporated into a presentation led by OCRM titled “Vendor Management in 7(a) Lending” that given at the Southeastern Small Business Lender’s Conference in March 2024.
- This is also reinformed by the “Notification and Needs List” as well as Risk-Based Review Reports that provide actions the Lender must take based on information collected during a risk-based review (e.g., submit an LSP agreement to SBA for review; notify SBA that an LSP agreement has been terminated, etc.).

Recommendation 6 – Update guidance on lender requirements for managing risks associated with lender service provider relationships to align with 2023 Interagency Guidance.

SBA Response: SBA agrees, and effective January of 2024 updated the guidance incorporating the Interagency Guidance.

- The guidance was previously reviewed with applicable parts confirmed to be in the LSP Questionnaire (or subsequently added) and the Interagency Guidance was incorporated into the revisions to LSP Agreement reviews starting January 2024.