

CARL LEVIN, MICHIGAN  
DANIEL K. AKAKA, HAWAII  
THOMAS R. CARPER, DELAWARE  
MARK L. PRYOR, ARKANSAS  
MARY L. LANDRIEU, LOUISIANA  
CLAIRE McCASKILL, MISSOURI  
JON TESTER, MONTANA  
MARK BEGICH, ALASKA

SUSAN M. COLLINS, MAINE  
TOM COBURN, OKLAHOMA  
SCOTT P. BROWN, MASSACHUSETTS  
JOHN MCCAIN, ARIZONA  
RON JOHNSON, WISCONSIN  
ROB PORTMAN, OHIO  
RAND PAUL, KENTUCKY  
JERRY MORAN, KANSAS

## United States Senate

COMMITTEE ON  
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS  
WASHINGTON, DC 20510-6250

MICHAEL L. ALEXANDER, STAFF DIRECTOR  
NICHOLAS A. ROSSI, MINORITY STAFF DIRECTOR

February 6, 2012

VIA U.S. MAIL & EMAIL (BagdoyanS@GAO.gov)

The Honorable Gene Dodaro  
Comptroller General  
U.S. Government Accountability Office  
441 G St., NW  
Washington, DC 20548

Dear Mr. Dodaro:

Between 2000 and 2010, the Small Business Administration (SBA) guaranteed over 47,000 franchise loans under its 7(a) and 504 programs, totaling \$18.1 billion. More than 20% of these franchise loans have failed. Not only does each default cost the U.S. taxpayer, but it also can represent a personal tragedy to the borrower, including bankruptcy and financial ruin.

The Senate Permanent Subcommittee on Investigations has become aware of troubling allegations that certain franchisees may have been misled by a franchisor, loan consultant, or bank into securing SBA-guaranteed loans that were unlikely to be repaid. According to the allegations, potential franchisees were given exaggerated revenue projections and directed to a particular bank to obtain loans guaranteed by the SBA. When the loans failed, the parties that encouraged the loans made significant money on fees, while the franchisees lost much, if not all, of their original investments.

SBA is charged with overseeing the lenders making SBA-guaranteed loans to prevent fraud and other abusive practices. In a recent report related to the above allegations, however, the SBA Office of Inspector General reported that a lender "disregarded relevant and available data, which indicated that the franchises' revenue projections were unrealistic." Yet, the same lender was given special trusted status by the SBA as a "preferred lender," meaning it was allowed to issue loans without prior SBA approval. The report found that twelve franchise loans issued by that lender over the course of a single year defaulted and required SBA to make loan guarantee payments totaling \$2.1 million.

The Subcommittee requests that GAO's Forensic Audit and Investigative Service team further investigate these allegations and, if appropriate, report its findings. We also request that GAO examine default rates and patterns for franchise loans; the role of franchisors, loan consultants, and banks in encouraging franchisees to obtain SBA-guaranteed loans; and any evidence showing exaggerated projected franchise revenues or other inducements used to encourage franchisees to apply for SBA-guaranteed loans. If GAO becomes aware of abusive practices, we request that you provide examples and past cases describing those practices as well as any indications of systemic fraud.

We further request that GAO identify and examine franchisors and SBA preferred lenders with reported high default rates and determine the extent to which abusive practices may have played a role in the defaults. In addition, we request that you select several franchisors and preferred lenders with low default rates to identify potential best practices. Finally, we request that GAO provide an assessment of SBA's oversight efforts and anti-fraud controls related to its guarantees of franchise loans.

Thank you for assistance with this matter. If you have any questions or need additional information, please contact Chris Barkley at 202/224-5633 on behalf of Senator Coburn or Kristin Gwin at 202/224-9505 on behalf of Senator Levin.

Sincerely,



Tom Coburn, MD  
Ranking Minority Member  
Permanent Subcommittee on Investigations



Carl Levin  
Chairman  
Permanent Subcommittee on Investigations