



SBA Policy Notice

TO: All Employees

CONTROL NO.: 5000-831

SUBJECT: 7(a) Loan Guaranty Purchase Policy

EFFECTIVE: 10/2/2002

Background

This notice provides policy for processing 7(a) loan guaranty purchases, and was derived from feedback obtained through the Guaranty Purchase Review Program (“GPR”) and other sources. The first section of this notice provides general guidance and instructions for purchase procedures, and references a new Guaranty Purchase Checklist (copy attached), which replaces the current checklists found in SOP 50 50 4, Appendix 26, SOP 50 51 2, Appendix 17, and SOP 70-50 3, Appendix 5a. The second section of the notice provides guidance and instructions related to specific purchase issues. The procedures and issues discussed in both sections are intended to improve the quality, consistency and timeliness of guaranty purchase decisions.

The general policy for guaranty purchases is to reach a fair decision based on a thorough review of the purchase request and all relevant documentation. If a lender has been deficient in its handling of a loan, the SBA office processing the purchase should attempt to reach an equitable resolution. A denial of liability or litigation for recovery should be considered when the lender is not negotiating in good faith, is unwilling to agree to a monetary adjustment that reflects the harm caused to the SBA, or when the lender’s actions are sufficiently serious that a repair would be inappropriate.

I. General Guidance and Instructions on Purchase Procedures

A. Timely Processing

The SBA should process guaranty purchases expeditiously with the ultimate objective of determining in the most effective manner the Agency’s liability with respect to a particular loan guaranty. Where the SBA has purchased the guaranteed portion of a loan from the secondary market, Agency staff must always complete the post-purchase review prior to inclusion of a loan in an asset sale or prior to charge-off.

B. Purchase Review Scope and Responsibilities

1. Purpose of Review

The purpose of a pre-purchase or post-purchase review is to determine whether the SBA should honor a purchase request, seek a repair, deny liability in full or in part on the Agency’s guaranty, or seek recovery from the lender if the SBA has already purchased from the secondary market holder or the lender itself. The purchase review is a process that serves to minimize

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SBA Form 1353.1 (12-93) MS Word Edition; previous editions obsolete
Must be accompanied by SBA Form 58

erroneous payments by ensuring that SBA purchases only those loans which were originated, closed, serviced and liquidated in accordance with the loan authorization, prudent lending standards, SBA regulations, and other Agency requirements. The review process must always include a thorough analysis of the lender's administration of the loan, particularly in complicated cases or if there are questions about lender misconduct. The review examines whether the lender has: (1) complied materially with the loan authorization, statute, SBA regulations, SOPs, and other SBA requirements; (2) made, closed, serviced, and/or liquidated the loan in a prudent manner; (3) misrepresented or failed to disclose a material fact to the SBA; or (4) put the SBA's guaranty at risk.

2. Recommendations for Full or Partial Denial of Liability

Generally, a full denial of liability under 13 C.F.R. § 120.524 would be appropriate if the lender's misconduct resulted in the SBA guaranteeing a loan that should not have been made (e.g., if the loan was ineligible), or if the lender's imprudent actions resulted in a total, or near total, loss on the loan. A partial denial, as permitted by § 120.524(a), is generally appropriate if the lender's failure resulted in a quantifiable loss with respect to a specific piece of collateral (e.g., if the lender failed to obtain the required lien position on that collateral).

3. Repairs and Burden of Proof

Field offices are encouraged to resolve lender deficiencies through agreements with lenders (known as "repairs"); however, *field offices should not agree to a repair if the settlement amount is insufficient to compensate the Agency for its losses or if the lender's actions are sufficiently serious that a full denial of liability is warranted.* If there appear to be grounds for a full denial, field offices should ask the lender to agree to the cancellation of the guaranty by the SBA, or to repay the SBA for a secondary market purchase. If less than a full denial is appropriate, and the lender will not agree to an adequate repair, the field office should send a recommendation for a partial denial to Headquarters and withhold payment on the remaining portion of the guaranty until Headquarters has made a decision on the recommended action.

The SBA may be released from a loan guaranty if a lender's imprudence or failure to comply with an SBA loan requirement resulted in, or may result in, substantial loss on the loan. It is the lender's burden to show that it has satisfactorily complied with its duties and is entitled to receive payment on the guaranty. These concepts have been upheld in court. Thus, unless a lender can demonstrate that its misconduct did not result in any loss or possible loss to the SBA, a full or partial denial of liability may, depending upon the circumstances, be appropriate if the lender's actions potentially caused, or were likely a contributing factor to, significant loss on the loan.

4. Loss Cannot be Specifically Quantified

Questions have arisen during purchase reviews as to the Agency's ability to deny liability when it is difficult to quantify the exact amount of loss that is attributable to the lender's actions. The fact that the amount of loss cannot be exactly quantified should not preclude a repair or denial as long as it is possible to make a reasonable estimate or approximation of the loss. It may also be appropriate to deny liability in full if multiple instances of misconduct by a lender with

respect to a particular loan are reasonably believed cumulatively to have caused, or potentially to have caused, significant loss on a loan. For example, it might not be possible to quantify the loss resulting from a lender's failure to verify an equity injection and the use of loan proceeds, or its failure to take any steps to determine whether collateral was available to secure a loan prior to closing. Even though one of these individual actions might not, in and of itself, warrant a denial, depending on the specific circumstances of the loan, a full or partial denial due to several lender failures may be appropriate.

5. Program Integrity Considerations

Even in the absence of actual loss or potential financial loss, courts have upheld SBA denials of liability if a lender has failed to comply with an SBA requirement which is deemed material to the soundness and integrity of the 7(a) program. Examples of material requirements where a full denial of liability may be appropriate include, but are not limited to instances where: (1) the loan was ineligible; (2) the lender used a significant portion of the loan proceeds to repay its existing debt without SBA approval; or (3) the lender conferred a preference on itself or breached SBA's conflict of interest regulations. This is not an exhaustive list, and the importance of other failures should be evaluated on a case-by-case basis.

Courts have also upheld denials of loan guaranties if the lender failed to disclose, or misrepresented, material facts to the Agency. A fact should generally be considered material to the loan if the accurate disclosure of the fact would have caused the SBA to deny an application for a guaranty, or if the SBA would not have approved the application without requiring the lender to take additional steps to obtain protection from the risk of loss. For example, a full denial of liability would generally be warranted if the lender fails to disclose to the SBA that an adverse change has occurred after the SBA issues a loan authorization but prior to loan disbursement, and the SBA would either have withdrawn the authorization, or disallowed disbursement until the change was properly addressed.

6. Role of Field Counsel

Field counsel will be responsible for advising the field office whether the Agency is, or is not, legally obligated to honor its guaranty (either in whole or in part) after consultation with the appropriate finance officials. Counsel should limit its review to determine whether there has been material noncompliance by a lender. The dollar amount of a loss and other credit issues are to be determined by SBA financial staff with input from SBA counsel as to any legal issues that may affect the loss calculation. If the financial and legal staff of a field office are unable to agree on whether a full or partial denial is appropriate, the matter must be referred to the Office of Portfolio Management for resolution in consultation with the Office of General Counsel. All recommendations for full or partial denial of liability must also be referred to Headquarters.

7. Post-Purchase Reviews

If a post-purchase review determines that a full or partial denial of liability would have been warranted and the lender does not reimburse the SBA for its guaranty payment or agree to a repair that sufficiently compensates the Agency, the field office should recommend that litigation be brought to recover all or part of the paid guaranty from the participating lender. Post-

purchase reviews must be clearly identified as such on the Guaranty Purchase Control Log and in any action that is referred to Headquarters.

C. Purchase Checklist and File Documentation

Agency staff must use the attached Guaranty Purchase Checklist. This checklist must be retained in the loan file with all supporting documentation. This checklist replaces both the portfolio management and legal checklists currently set forth in Agency SOPs. Items pre-checked on the list are mandatory for all purchase reviews (such as the loan authorization signed by the lender, transcript of account and settlement sheets). For the remaining items on the checklist, you must determine the necessity for the item based on the specific loan authorization, SBA policy and the particular circumstances of the loan. Only documents that are necessary to determine the SBA's liability for the purchase should be required from the lender. For example, you do not need to obtain evidence of flood insurance if there was no flood and loan collateral has been sold. However, if a checklist item required by the loan authorization is not considered relevant to the purchase being processed, you must note the reason on the SBA's copy of the checklist (or an attachment). In a case involving early loan problems or an early default, as discussed below, or when significant deficiencies are discovered that indicate the lender may have materially breached its obligations, additional checklist items may be deemed to be relevant.

Agency staff must perform a thorough review of a lender's documentation submitted in connection with a purchase review, using the purchase checklist, prior to requesting additional documents from the lender. You must identify all additional documents needed to complete the purchase review on the checklist, and you must expeditiously request this documentation from the lender in a single communication, if possible. It is important to minimize subsequent requests for additional documents once lenders are initially advised concerning required documentation; however, there may be instances where subsequent requests are necessary. Field offices must note on their guaranty purchase logs the date they requested information from the lender, and the date the lender provided a complete purchase package.

Various field offices have reported difficulties in obtaining purchase documentation from lenders. The SBA's requirement that lenders provide sufficient documentation so that the Agency can determine whether the lender has complied with all of its obligations is material to the integrity of the 7(a) program. Thus, *field offices must not purchase a guaranty if a lender fails to provide sufficient documentation to allow for an adequate purchase review, unless the lender submits a satisfactory written explanation for any missing documentation.* Field offices should provide lenders 30 calendar days to furnish the SBA the requested information. If, during the course of a pre-purchase review, a lender fails to provide an adequate response to an Agency request for documentation, the field office may advise the lender in writing that it is placing the purchase request in an inactive status until an adequate response is received by the SBA.

If during a post-purchase review, a lender fails to provide necessary documentation requested by the SBA within 30 calendar days of the request, and fails to provide a satisfactory written explanation as to why it cannot provide the requested information, this can be considered a material failure to comply with SBA loan requirements and can serve as a basis for a

recommendation to bring suit to recover from the lender the amount paid under the guaranty. Similarly, missing documentation can support a partial recovery to the extent that the documentation in question relates to specified collateral or other loan requirements. The SBA's request for documentation should advise the lender that its failure to provide the requested items could result in a recommended recovery action.

D. Referrals to the Office of Lender Oversight (OLO)

Field office purchase reviews may identify lending weaknesses or patterns of deficiencies for a particular lender that may not rise to the level of a denial or repair for a specific loan. These problems should be referred to the OLO in writing with a copy placed in the loan file, and brought to the attention of the lender.

E. Referrals to the Office of Inspector General (OIG)

Field offices must refer irregularities on the part of the lender or borrower to the OIG as required in SOP 50 50 4, Chapter 14, and SOP 50 51 2, Chapter 24.

F. Early Defaults/Early Loan Problems

For purposes of guaranty purchase reviews, the term "early default" means, generally, a default or business failure that occurs either prior to final disbursement of the loan, or within 18 months from the date of final disbursement. A default includes a failure to make a payment in accordance with the terms of the note, as well as events that would place a loan in liquidation status (see SOP 50 51 2, Chapter 4, Paragraph 6). Early loan problems are indicated when, either prior to final disbursement or within the first 18 months after final disbursement, a borrower consistently makes late payments or partial payments, or funds monthly payments through the sale of collateral, or the lender has deferred two or more consecutive scheduled payments. If the guaranty purchase request involves a loan that experienced early loan problems or an early default, the field office should review the documentation submitted with the guaranty purchase request with a very high degree of scrutiny. In these situations, Agency personnel must determine whether a deficiency by the lender in making or closing the loan contributed to or allowed the early default or early loan problems.

G. Purchase Reviews of Preferred Lender Program (PLP) Processed Loans

1. Review of PLP Eligibility Determination

13 C.F.R. § 120.452(c) states that the PLP lender is responsible for PLP loan decisions regarding eligibility. Subsection (b) indicates that the SBA approves PLP loans subject to an eligibility review. SOP 50 10(4)(E) Subpart D, Chapter 3, Paragraph 7b(2) elaborates that the SBA eligibility review is a "quick look," based on the lender's assertions regarding the business and the loan, intended to protect the SBA and the lender from making ineligible loans for which the SBA could not honor its guaranty. The SOP further states that if an SBA loan number is assigned, and the SBA later determines that the loan is not eligible, the Agency still may deny liability on its guaranty if warranted.

In order to determine that a PLP processed loan was eligible, field office staff must request and review on all guaranty purchases a copy of the documentation used by the lender to support its eligibility determination. Factors that the field may consider in determining whether to request the lender to release the guaranty include whether the eligibility determination was a close call and involved a reasonable judgment by the PLP lender as to the applicant's eligibility, and whether the relevant SBA regulation or SOP provision was sufficiently clear so that the lender had adequate notice of the eligibility requirements (if SBA guidance is not clear, this should be reported through appropriate channels to the Office of Financial Assistance). If a PLP processed loan is found to be ineligible, the field office should request that the lender voluntarily release the guaranty (or repay the SBA if the Agency has already purchased), and recommend a full denial (or litigation) if the lender refuses.

2. PLP Early Default Review

For all guaranty purchase reviews involving a PLP processed loan that has gone into early default or experienced early loan problems, the lender must submit a copy of its credit memorandum with all supporting documentation, and a complete copy of the borrower's application for the loan, along with SBA Form 912 (Statement of Personal History) for each principal. The field office must review these materials to determine if any deficiency by the lender in making the loan contributed to or allowed the default or problems. A denial based upon a PLP lender's underwriting may be appropriate if: (1) a PLP lender failed to comply with an SBA lending requirement in making or closing the loan, which placed the Agency at financial risk; or (2) the lender was clearly negligent by failing to account for an obvious fact that could likely affect the borrower's ability to repay the loan. Examples of the latter would be if the borrower's projected expenses greatly exceeded projected revenues, without any other source of income, or if the lender made a loan to a startup business without comparing projected revenues against either an industry standard or some other reliable objective measure (this could include the lender's experience in making loans to similar businesses). In this regard, SBA's regulations (§ 120.150) state that applicants must be creditworthy and that loans must be so sound as to reasonably assure repayment. If a PLP lender has reasonably used its judgment to evaluate and document repayment ability, a denial would be inappropriate. If a field office is uncertain whether a PLP lender's actions warrant a denial, it should consult with the Office of Portfolio Management.

H. Streamlined Procedure for Small Loan Balance Purchases

If the outstanding principal loan balance is \$10,000 or less (SBA share), except in cases of early default or early loan problems or where there is suspicion of fraud or misrepresentation, the lender must provide only the following documents for the purchase review:

- Written demand that the SBA honor its guaranty, including date of default, interest-paid-to date, interest rate at time of default, and next installment due date;
- Wire transfer instructions;

- Complete certified transcript of account signed by the lender;
- Lender's documentation of eligibility (PLP and LowDoc loans only);
- Copies of note, authorization and any guaranties; and
- Risk Management Database information.

If the lender has completed liquidation on the account, the lender must also submit:

- Lender certification that liquidation is complete and that all avenues of collection have been exhausted; and
- Final wrap-up report.

I. Exercise of Judgment

The SBA staff performing purchase reviews are frequently required to exercise judgment in evaluating the materiality of guaranty purchase issues or in calculating repairs. The GPR has discovered that these judgments may be insufficiently documented in the Form 327 action for the purchase review or elsewhere in the loan file, making it difficult to ascertain the basis for the decision. When this policy notice references the exercise of judgment in situations such as assessing the materiality of a lender's actions or in calculating a repair or partial denial, the judgment must be thoroughly explained and justified in the 327 action for the purchase review with relevant supporting documents as appropriate.

J. Calculating a Repair or Partial Denial

For most repairs or partial denials where collateral is involved, the SBA financial staff should calculate the loss to the Agency using the forced sale equivalent (liquidation value) as found in SOP 50 51 2, Chapter 17, Paragraph 9(a). In certain early default situations, discussed in Section II of this notice, the repair or partial denial may be equivalent to the original cost of the items in question. All repair or partial denial calculations must be included in the Form 327 action for the purchase review, or in an attachment, even when it is determined that the forced sale (liquidation) value is nominal.

K. Transfer of Servicing from Lender to the SBA

Loan documents submitted in connection with a purchase review must only be assigned to the SBA if loan servicing is transferred from the lender to the SBA. The transfer of servicing from the lender to the SBA should occur by exception only, and the district director or designee must approve the transfer. See SOP 50 51 2, Chapter 8, Paragraph 1(b).

L. Transcripts

A lender must submit a certified transcript of account to the SBA for all guaranty purchase requests. The transcript must reflect all transactions on the borrower's account, including liquidation proceeds and expenses, and the lender must certify that the transcript is a true and correct copy (SOP 50 50 4A, Chapter 9, Paragraph 4(b)). The GPR found a few

instances where significant corrections were made to the lender's transcript by the field office, but the lender did not certify the revised transcript. Any changes to the certified transcript that alter the amount of the guaranty payment must have the lender's re-certification.

II. Guidance and Instructions on Specific Purchase Issues

The following are the most common guaranty purchase issues identified by the GPR, with guidance and instructions on how to evaluate them:

A. IRS Tax Return Verification

On October 7, 1994, the SBA established the requirement that lenders must verify financial information submitted with a loan application using IRS Form 4506. See SBA Policy Notices 9000-941 and 5000-462 as incorporated in SOP 50 10 4(B), Subpart A, Chapter 6, Paragraph 4(f). Except as provided in SBAExpress procedures, this requirement applies regardless of whether it is specifically included in the authorization. See the SOP and related notices for a complete statement of Agency policy concerning tax return requirements. The SBA should consider the following when determining whether to request a repair or seek a full/partial denial when the IRS tax return verification is absent from the file.

1. Early Default/Early Loan Problems

If there is an early default or there are early loan problems, and the lender fails to provide evidence of required verification of financial information or a credible explanation for its absence, then a full denial of liability would generally be warranted unless the lender can clearly show that the failure of the business was due solely to factors unrelated to any financial difficulties of the borrower that the lender would have identified through the IRS verification process. If the business was in operation for 18 months or more without any payment problems, the failure to obtain IRS verification may not be significant, and denial or repair may not be appropriate. The exercise of judgment is required.

2. Change of Ownership

Most change of ownership situations require verification of the seller's financial information. If it was not obtained, the above criteria apply. See SOP 50 10 4(B), Subpart B, Chapter 1, Paragraph 3c.

3. IRS Delay

SBA Notice 5000-753 addresses situations where the lender encounters IRS delays after requesting tax transcripts.

B. Verification of Use of Loan Proceeds

The SBA's Form 1050 Settlement Sheet requires that lenders (except for SBAExpress loans) document disbursement of loan proceeds through the issuance of joint payee checks, except for working capital and cash to reimburse borrowers for evidenced expenditures. Prudent

lending involves reasonable measures to verify use of loan proceeds. Thus, as a general rule, a lender that does not use joint payee checks to evidence the use of loan proceeds should provide copies of receipts, invoices or other supporting documentation clearly showing that the proceeds were used in accordance with the loan authorization. The GPR program identified a number of deficiencies in this area, including missing Form 1050 Settlement Sheets, no verification of assets purchased, no joint payee checks, or no credible evidence verifying expenditures (e.g., paid invoices or receipts). Judgment must be exercised when documentation is either lacking or insufficient for some or all of the loan proceeds. An example of insufficient documentation would be an affidavit from the borrower as the only evidence from the lender to show that it had verified the use of loan proceeds. On the other hand, an invoice marked paid supported by copies of cleared checks, or bank statements showing that the checks cleared, would be sufficient. The OIG has found numerous instances where invoices marked paid were later unsubstantiated.

The SBA should consider the following when determining whether to seek a repair or deny liability when evidence of the authorized use of proceeds is absent from the file:

(1) Failure to verify use of loan proceeds that contributed to an early default or early loan problems. A full denial is called for if the business failed because required assets were not purchased. A failure to account for the use of loan proceeds may indicate that the borrower did not purchase machinery or equipment needed for the business, with resulting operational problems. In the event that a loan goes into early default or if early loan problems occur, and the lender is unable to verify the use of loan proceeds or locate required collateral at liquidation, an inquiry should be made to determine whether the business failed or experienced problems due to the absence of the collateral.

(2) Collateral available at liquidation. If a lender fails to provide adequate verification of loan proceeds intended to purchase machinery, equipment or other collateral securing the loan, and the collateral in question is found on the borrower's premises during a pre-liquidation site review, a denial of liability or repair on this basis may be inappropriate. A credible inventory of items at default or an auction/appraisal report will suffice to indicate items purchased with loan proceeds. Also, liquidation proceeds received should bear a reasonable relationship to the amount disbursed for specific collateral, adjusted for forced sale value and expenses.

(3) Establishing loss if collateral is missing at liquidation.

- Early default. When there is no evidence that assets required by the authorization were in fact purchased (i.e., no joint payee checks or paid invoices/receipts), and the collateral that was to be purchased with loan proceeds is not present at the pre-liquidation site visit, a repair or a partial/full denial may be appropriate. An example of evidence that collateral was actually purchased might consist of documentation provided by the vendor showing delivery and payment for the collateral. Generally, the forced sale value of the collateral may be used to determine loss unless it is reasonable to conclude that the collateral, if available and sold, would have recovered the initial cost or current market value because it was new or nearly new.

- Default or business failure that occurs more than 18 months after final disbursement. Under these circumstances, SBA staff should consider a number of factors including length of time the borrower was in business; the relative size of the SBA loan compared with the business assets to be purchased; the type of assets purchased; normal depreciation or obsolescence of machinery and equipment (M&E); and whether there has been replacement of M&E with leased M&E, or by M&E financed with a purchase money security interest. Repair or full/partial denial may or may not be appropriate depending on the circumstances. An exercise of judgment is required.

C. Change of Ownership

In cases where whole businesses are purchased, asset values may not reflect fair market value and may bring little recovery at liquidation, even a short time after disbursement. Each case requires the exercise of judgment based on the condition of the assets when purchased and normal depreciation in business operation prior to and subsequent to the change in ownership.

D. Borrower's Injection

Lenders are required to verify injections prior to disbursing loan proceeds and maintain evidence in their loan files. Lenders are expected to use reasonable and prudent efforts to verify that equity is injected and used as intended, and failure to do so may warrant a repair or partial/full denial. The SBA should consider the following in determining whether the lender has submitted sufficient evidence of borrower injection:

1. Cash Injection

Verifying a cash injection generally requires documentation such as a copy of a check along with evidence that the check was processed (e.g., a bank account statement dated prior to disbursement), or a copy of an escrow settlement with a bank account statement showing the injection into the business prior to disbursement. A promissory note, "gift letter" or financial statement alone is generally not sufficient evidence of cash injection. If a shareholder loan is used as an equity injection, the lender must produce a full standby agreement or evidence to show that loan payments were made from a source other than the borrower. The lender must also present credible evidence to demonstrate that the borrower did not use 7(a) loan proceeds to fund the required injection, such as a bank statement showing that the money was available prior to the disbursement of the loan. The sufficiency of evidence from a lender to demonstrate verification of a cash injection depends upon the size of the injection and length of time that a borrower was in business, as discussed below.

2. Asset Injection

Asset injections may be more difficult to verify than cash injections. Evidence is often located in the lender's application for guaranty, in the borrower's financial statements, or in the SBA loan processor's write-up, as applicable. SOP 50 10 4 requires lenders to carefully determine the value of non-cash assets injected into the business. See Subpart A, Chapter 4, Paragraph 1(f)(4).

3. Length of Time in Business

If there is an early default or early loan problems and a significant cash injection (see discussion below) is not properly documented, a direct link between business failure and the lack of injection should be assumed, and a full denial of liability may be appropriate. If the borrower went out of business either prior to or shortly after 18 months of operation, a lender's failure to verify a significant cash injection may be related to potential loss on the loan. If default occurs after 18 months of operation, an exercise of judgment is required based upon an analysis of the cause of business failure and the length of time the business remained open. For example, if the business was in operation for several years after disbursement, the lender may be able to demonstrate that the lack of borrower's injection did not play a significant role in the failure. In this situation, a repair or partial denial in the amount of the unverified cash injection would generally not be appropriate.

4. Size of Injection

The amount of the required injection and the size of the loan should be compared. A relatively large injection is generally more instrumental to the business' success than a small injection. Lack of evidence of a small injection usually is not a significant factor in the failure of the business unless this failure is combined with a number of other lender deficiencies.

5. Partial Verification of Injection

Judgment is required in cases where only a portion of the injection can be verified. If the evidence reveals less than substantial compliance with the authorization, then the field office must consider the factors mentioned above.

E. Expiration of Guaranty after Maturity

According to SBA regulations, if the lender fails to request purchase within 120 calendar days after loan maturity, the Agency may not be legally obligated to purchase the guaranty. Under certain circumstances, the relevant field office may request reinstatement of the guaranty and extension of maturity (or extension of the period during which the lender may request purchase) through the procedures set out in SOP 50 50 4A, Chapter 10, Paragraph 2(b)(3)(d). For example, reinstatement may be appropriate if the lender was actively servicing or liquidating the account with SBA knowledge or concurrence, and inadvertently failed to request purchase or extend the maturity.

F. Collateral/Lien Position

When the documentation reveals that the lender failed to obtain the proper lien position on collateral, you should consider whether the lender's failure caused, or could cause, a loss to the Agency. If the value of the collateral was negligible, and the SBA would not have recovered even with the required lien position, then no loss resulted and, generally, a repair or partial denial is not justified. If a loss resulted or could result, a repair or partial denial would generally be warranted in an amount equivalent to the reasonably expected recovery had a proper lien position securing the loan been obtained.

G. Collateral Lists at Time Loan is Made

The GPR found instances where lenders failed to obtain a listing of collateral at loan inception. Although often required by the loan authorization, it is also generally expected that prudent lenders will obtain a list of significant collateral that secures a loan prior to closing, including a description and serial number for items of a specified value. The collateral list greatly assists the lender in identifying collateral in the event of default and ensuing liquidation, and, when attached to a Uniform Commercial Code (UCC) financing statement, helps ensure that the lender will be able to establish the priority of its secured position in that collateral. Although losses resulting from the failure to obtain a collateral list at loan inception may be difficult to quantify, field offices should consider the following factors when determining whether to seek a repair or full/partial denial based on this failure.

1. Loss of Rights in Collateral

If collateral that secured the loan existed at default, but the lender by its failure to identify collateral at loan inception was precluded from asserting rights over the collateral (for example, if there are competing creditors or the borrower disputes the lien), a repair or partial denial is usually appropriate in an amount equivalent to the forced-sale value of the collateral.

2. No Resulting Loss

If a lender clearly demonstrates that no loss resulted from the lack of a collateral list, a repair or partial denial on this basis is usually inappropriate. For example, if the lender provides credible evidence to support abandonment, either due to the lack of value of the assets or due to the fact that the costs of removal would exceed reasonably expected recovery, the lender's failure to obtain the collateral list should be considered immaterial and a repair or denial is generally not warranted (assuming no other acts of imprudence or violation of SBA written requirements).

3. Liquidation Proceeds

If loan collateral is liquidated, and the items sold and liquidation proceeds appear reasonable given the nature and size of the business, then the lender's failure to obtain the collateral listing is generally immaterial, and repair or partial denial is usually not warranted.

H. Common Servicing and Liquidation Deficiencies

1. Site Visits and Collateral Inventory at Liquidation

Site visits are very important, and lenders should not omit them. SOP 50 51 2 requires lenders to perform site visits within specified timeframes and defines a meaningful collateral inspection (see Chapter 8, Paragraph 8). Lenders should prepare a comprehensive listing/inventory of collateral at default, usually completed when the site visit is conducted. SBA staff should consider whether the lender's site visit was conducted in a timely manner (i.e., as soon as possible after default if there is collateral of significant value that could be removed or depleted, or within 15 days of the occurrence of an event that would cause a loan to be placed in liquidation). Appraisals or third party inspections are acceptable to determine collateral value. If

there is reason to believe that collateral is missing or devalued as a result of a lender's failure to conduct a timely site visit or obtain a meaningful collateral inspection, a repair or partial denial is generally warranted (see above discussion of collateral lists for establishing an amount of the repair or partial denial).

2. Liquidation Sale

If items that were listed on the lender's post-default site visit inventory or appraisal are unaccounted for in the liquidation sale, a repair or partial denial is generally warranted unless the lender can show that it took reasonable and prudent efforts to secure and liquidate the collateral or can clearly show that no loss resulted from the unaccounted-for collateral (for example, the appraisal did not take into consideration costs of removing assets, which rendered the unaccounted-for assets worthless). Similarly, if a reconciliation of the post-closing inventory and post-default inventory reveals significant discrepancies, there may be grounds for a repair or partial denial unless the lender provides a reasonable explanation of the differences. An exercise of judgment is required.

I. LowDoc Eligibility

SOP 50 10(4), Appendix 5, Paragraph 4 states that all LowDoc loans are subject to the eligibility and credit requirements of the 7(a) program, and the lender must ensure that all applicants and proposed uses of proceeds are eligible. For all LowDoc guaranty purchase requests, the lender must provide a copy of the eligibility checklist and all supporting documentation used in the lender's eligibility determination.

J. Loans Flagged in the Guaranty Repair Tracking System (GRTS)

The SBA official processing a purchase request must address all problems on loans identified with a possible repair/denial issue in the GRTS. You will be alerted to such loans when you access the purchase processing computer screen (1128). Comments regarding the resolution of possible repair/denial issues must be included in the SBA Form 327 for the purchase.

If you have any questions about this notice, please contact Walter Intlekofer, 202-205-7543, or for legal questions, Eric Benderson, 202-205-6636, or Yolanda Swift, 202-205-6918.

Hector V. Barreto
Administrator

Expires: 10/1/2003