

SBA's Guidance on Requests to Honor SBA's Guaranty of PPP Loan

July 21, 2021

The SBA recently issued its **Procedural Notice** on when a lender may request the SBA to honor its guaranty of a PPP loan. The PPP loan program has been in place for over a year and has provided billions of dollars of assistance to small businesses all over the United States. It is not surprising that some PPP borrowers have encountered continued financial difficulty, in some instances resulting in bankruptcy, dissolution, shutting their doors, or discovery of fraud-related issues. What is a lender to do?

Under the 7(a) program (PPP loans are a special part of the 7(a) loan program), a lender needs to service the PPP loan, just like it would service its other loans. When an SBA 7(a) loan goes into default, the lender typically needs to liquidate collateral, pursue guarantors, obtain judgments or seek recovery through a bankruptcy proceeding before requesting the SBA to honor its guaranty of the loan. These steps make less sense for an unsecured loan, particularly one that may be eligible for 100% forgiveness. Fortunately, the SBA has recognized this in its most recent guidance for PPP loans.

The lender must continue to service the PPP loan.

The lender must continue to service the PPP loan until the loan is paid in full, forgiven in full, or the SBA purchases the guaranty and charges-off any remaining balance. The procedural notice sets forth a number of actions that a lender must take to service a PPP loan.

When can a lender request the SBA to honor its guaranty?

A lender can request the SBA to make a guaranty purchase and charge-off the loan under the following circumstances:

- The loan is 60 days past due and not cured, but only after making demand for payment;
- The borrower has permanently closed and will not submit a forgiveness request;
- The borrower has filed for Chapter 7 bankruptcy, but only after the lender has filed a proof of claim (except that a proof of claim is not required for a Chapter 7 "no asset" bankruptcy) ;
- The borrower is a self-employed individual, sole proprietor, single member LLC or independent contractor, and the owner is deceased;
- The borrower or any 20% or more owner has been indicted or convicted of a felony related to the PPP loan; and
- 60 days have passed since the borrower has filed an appeal of a final SBA loan review decision with the Office of Hearings and Appeals.

In these situations, a lender does not need to exhaust remedies or incur expenses pursuing the borrower. Rather, the lender may ask the SBA to honor its guaranty of the PPP loan.

What if the PPP borrower files a Chapter 11, 12 or 13 bankruptcy proceeding?

When a borrower files a Chapter 11, 12 or 13 reorganization proceeding, the lender must give notice to the SBA, file a proof of claim, and continue to monitor the bankruptcy; but it is not required to take other steps in the bankruptcy beyond filing the proof of claim. The lender may then request the SBA to honor the guaranty only when the bankruptcy has been filed more than 60 days after the end of the payment deferral or any time after entry of the order confirming

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the plan if the plan does not provide for full payment of the PPP loan. There is a proviso on the order confirming the plan: if the confirmed plan calls for payment in full of the PPP loan, the lender must continue to service the PPP loan until it is paid in full, forgiven in full, or, upon a subsequent event that allows tendering to the SBA, the SBA purchases the loan and approves the charge-off.

The procedural notice confirms that a borrower who has filed for bankruptcy may file a forgiveness application. However, the procedural notice does not address whether the lender must file an objection to a sale of the ownership of the bankrupt borrower or to a liquidation sale of more than 50% of the assets. Under the SBA's **change of control procedural notice**, the borrower in certain circumstances must escrow sufficient cash to fully repay the PPP loan in full or have the buyer assume the PPP loan obligations.

What does the lender need to file with the SBA?

The lender of record must utilize the existing PPP platform to request both a guaranty purchase and a charge-off. The SBA encourages lenders to process both first draw and second draw PPP loans at the same time. The procedural notice details the information and documents the lender is required to file through ETRAN, the required lender certifications, lender document retention requirements, and how guaranty purchase payments will be made to the lender.

At this time, there is no new guidance on the timing for the SBA to honor its guaranty. The procedural notice notes that the SBA will pay interest through the payment deferral period plus up to 120 days of additional interest due to payment default. This might indicate that the SBA intends to process these requests within 120 days.

Per the procedural notice, the SBA's guaranty will expire 180 days after the maturity of the loan. This might present problems in some bankruptcy proceedings, as it is possible that a bankruptcy reorganization plan might not be confirmed until more than 180 days after the loan maturity date.

What if a borrower files an application for forgiveness?

It is possible that a borrower may file an application for forgiveness after the lender has requested a guaranty purchase. In that case, the lender is obligated to process the forgiveness application. If the SBA has not yet completed the guaranty purchase and charge-off, the lender must immediately withdraw the request and not re-submit it until after the SBA completes its forgiveness review. If the SBA has already completed the purchase and charge-off, the lender must still process the forgiveness application, but the SBA will not remit a forgiveness payment to the lender, and instead will apply the forgiveness amount to reduce the borrower's outstanding loan amount.

What if a lender receives a payment from a borrower after the purchase?

A lender may receive payments from or on behalf of a borrower after the SBA completes the guaranty purchase and charge-off. This could happen, for example, not only in a bankruptcy proceeding but also in a probate proceeding, other proceedings, or voluntarily. In that happy event, the lender is required to remit such payments to the SBA utilizing Pay.Gov.

What if a lender suspects fraud?

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The procedural notice directs a lender to report fraud, waste or abuse to the Office of Credit Risk Management and to the Office of the Inspector General. However, it gives no guidance on processing an application for forgiveness when fraud is suspected, let alone when a lender may request the SBA for a purchase guaranty and charge-off.

We anticipate further developments as PPP lenders start making requests to the SBA to honor its guaranties. If you have questions, please do not hesitate to contact one of the authors or your Miller Canfield attorney.