RD AN No. 3959 (4279-A and 4279-B)
March 29, 2004

SUBJECT: Business and Industry Guaranteed Loan Program
Due Diligence

TO: State Directors, Rural Development

ATTN: Business Programs Directors

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance on the required due diligence of the Agency and of the lender. Results of a Management Control Review (MCR) and a Farm Credit Administration Review indicate there is not sufficient guidance in place to ensure the Agency is completing the necessary due diligence when underwriting Business and Industry (B&I) Guaranteed Loans.

The existing regulations, effective December 23, 1996, were developed to streamline and update the program. Upon implementation of these regulations, primary responsibility for loan documentation and analysis shifted from the Agency to the lender (as stated in the preamble of the proposed rule published February 2, 1996). While the lender has the primary responsibility to ensure the loan is creditworthy and meets the guidelines of the program, the Agency is responsible for a general review of the lender's analysis of the credit.

COMPARISON WITH PREVIOUS AN:

There is no previous AN on this subject.

IMPLEMENTATION RESPONSIBILITIES:

In accordance with RD Instruction 4279-B, section 4279.131, the lender is primarily responsible for determining credit quality. RD Instruction 4279-A, section 4279.30, clearly

EXPIRATION DATE:
March 31, 2005

FILING INSTRUCTIONS:
Preceding RD Instructions 4279-A and 4279-B

identifies the lender’s responsibilities for the successful delivery of the B&I Guaranteed Loan Program. Among other things, lenders are responsible for developing and maintaining adequately documented loan files, recommending only loan proposals that are eligible and financially feasible, following Agency regulations, and performing a thorough credit evaluation addressing all standard credit factors. The lender is required to have an adequate underwriting process to ensure that loans are reviewed by other than the originating officer. The Agency relies upon the lender to perform these and the other credit evaluation responsibilities outlined in the regulations.

However, the Agency has imposed additional internal review requirements in order to assure that it only guarantees quality loans. These requirements are solely for the benefit of the Agency and not the lender or the borrower. These requirements do not relieve the lender from performing any responsibilities contained in the regulations or the Conditional Commitment.

These requirements include a preliminary review pursuant to RD Instruction 4279-B, section 4279.101(d), to address eligibility concerns and whether the proposal meets the intent of the program. It further states, credit quality and collateral should be closely reviewed at this time. All issues and concerns should be openly addressed with the lender, as soon as possible, to avoid the expense, frustration and preparation of a full B&I application.

Further, RD Instruction 4279-B, section 4279.131(a), directs the Agency to review the lender’s analysis of cash flow, focusing on the historical operations of the business, to assess the repayment ability of the borrowers. Projections should be compared to industry averages for reasonableness. The Agency should document any concerns. Section 4279.131(b) directs the Agency to review and consider the type and value of the proposed collateral in addition to reviewing the lender’s policy on discounting the collateral. Section 4279.131(d)(3) directs the Agency to consider increasing the minimum tangible balance sheet equity for riskier loans. To determine the minimum tangible balance sheet equity requirement, the Agency should consider the current status of the industry, collateral coverage, personal or corporate guarantees, cash flow, and management. All conclusions should be well documented in the loan file.

Finally, in addition to the responsibility of ensuring the proposal meets the program intent and guidelines, the Agency is responsible for reviewing certain elements of the lender’s proposal for adequacy, including the responsibility to ensure the interest rate is no more than the rate customarily charged borrowers under similar circumstances when there is no guarantee, as stated in RD Instruction 4279-B, section 4279.125(e).

If you have any questions, please contact Debi Raygor, B&I Division, Processing Branch, (202) 205-0894.

(Signed by John Rosso)

JOHN ROSSO
Administrator
Rural Business-Cooperative Service