



CDC Licenses and the Liquidation Process A Tool to Help Lenders Differentiate CDCs

In June 2006, a column titled *The 504 Loan Process: Managing your CDC* (p. 4) described the changes in the 504 world and provided some rough guidelines for 7(a) lenders to use in considering CDC licenses with whom to participate in the 504 program. Most of the guidelines offered involved the making and processing of loans. However, as the sub-prime market has been so incessantly reminding us of late, the extension of credit *also* involves the *repayment* of said credit.

The final guideline in the 2006 article discussed the then forthcoming rule on loan servicing and liquidation for CDC licenses. Traditionally, the majority of CDC licenses were involved in the liquidation of problem loans only to the extent of turning them over to the appropriate parties in the SBA to work on their behalf, and had little or no further involvement. It was predicted that shifting the onus for liquidation to the specific CDC licenses directly would result in changes in the handling of credit approvals, servicing actions and portfolio postures that would affect the entire spectrum of CDC licenses. The final rule (Notice 5000-1017 addressing 13 CFR 120.180, 120.536, 120.540, 120.848 and 120.975 amongst others) just came into affect this May, so the long term impact is not yet discernable. There are anecdotes of specific CDCs being more concerned with portfolio exposures to specific industries, and some CDCs have begun to test and use more sophisticated credit scoring models for credit screening and portfolio management. While these issues play out, the immediate impact is that lenders now have another tool with which to differentiate CDC licenses.

The key to understanding the differentiation among CDC licenses is knowing that in SBA usage "in liquidation" also covers what a typical private sector lender would call a "workout". The first decision a lender makes when a loan encounters difficulties is 'stay or leave': are the borrower's difficulties resolvable with support, or is the

adage 'first loss, least loss' more applicable? In what is effectively a participated loan, the third party permanent lender *needs* to know the position and commitment of the CDC—a junior lienholder—to the process and the specific situation. Lenders must ask themselves:

- Will the CDC support a decision to attempt to workout a loan?
- Does the CDC have the means to evaluate the situation in a timely fashion?
- What regulatory limits apply to the CDC's choice of actions, and is the CDC fluent in navigating these limits?

Lenders can get a fairly good indication on this from a few simple questions of prospective CDC partners.

"While issues (resulting from the new liquidation rule) play out, the immediate impact is that lenders now have another tool with which to differentiate CDC licenses."

The new rule mandates the responsibility of CDCs to prepare liquidation and litigation plans, which mirror the existing SBA Form 1979 used by 7(a) lenders), and defines process responsibility for loans going into "liquidation" (SBA usage). CDC licenses that have PCLP designation (the loose equivalent of PLP status) and have approved a loan under PCLP are required to handle the liquidation. Non-PCLP approved loans on the books of PCLP CDC licenses will be handled on an Authorized CDC Liquidator (ACL) basis that will largely accrue to PCLP CDC licenses at the will of the SBA. (ACL status licenses have additional SBA consent requirements in liquidations—

similar to non-PLP lenders under the 7(a) program.) In effect, the SBA is telling PCLP CDC licenses the same thing PLP lenders have been told: if you have authority, *use it*. CDC licenses that have *not* been granted PCLP status can receive ACL status based on meeting certain standards of experience or training, or they may engage outside contractors. The SBA anticipates that approximately 80 of the 270 existing CDC licenses will apply for ACL status. Thus, there will likely come into being a handful of specialists who will handle CDC liquidations on a contract basis.

So what were those few simple questions that 7(a) lenders can use to differentiate a potential CDC partner?

- Do you have PCLP status?
- Do you have or have you applied for ACL status?, or
- Do you have an outside ACL contractor and who is it?

As with marketing considerations, PCLP status (held by a minority of the 270 licenses) becomes a quick way to distinguish levels of commitment to the program, and is at least an indicator of possible competence. Application for or the holding of ACL status is a reasonable surrogate for that commitment or competence, and the choice of contractor would be equally enlightening. At the end of the day, the lender participating in the 504 program needs to know not only their borrower, but also their CDC partner. ♦

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