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Bulletin

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Substitution of personal and corporate guarantees under the SBLA/CSBFA

(Reference: Item 6.1 Section B, CSBF Guidelines, Section 22 of the CSBF Regulations)

In the past, a number of lenders have requested clarification of the **value** of the personal or corporate guarantee to be replaced or substituted. Some have also requested clarification of the policy when more than one guarantor is involved.

The Small Business Loans Aministration considers that the **value** of a guarantee is the **amount** for which the guarantor is liable under the terms of the guarantee. The replacement guarantee will therefore be for the same **amount** as the original guarantee. The amount can also be increased, however the amount of the personal guarantee can not exceed 25% of the loan amount disbursed.

The replacement guarantee can be made irrespective of:

a) the number of guarantors that remain liable subsequent to the substitution;

b) the aggregate net worth of the replacing guarantor(s) compared to the aggregate net worth of the original guarantor(s); and

c) the loan principal amount outstanding subsequent to substitution, even though the principal amount outstanding may have been substantially reduced.

In accordance with due diligence requirements, the lender is expected to evaluate the worth and collectibility of the replacing guarantee using the same care and criteria that it would for a conventional loan. The substitution of any guarantee should not result in a decreased ability to realize on the guarantee. An example will help illustrate this point.

Suppose a lender originally obtained a $30,000 joint and several guarantee signed by four persons (this guarantee represents 12% of the original loan amount). The total net worth of guarantors equals $700,000. After some time, two of the original guarantors have decided to leave the small business and would like to be released from their guarantee. The net worth of the remaining guarantors is $100,000. The loan which was originally made for an amount of $250,000 has been reduced to $175,000.

In this situation the lender can obtain a new guarantee from the remaining guarantors for an amount not less than $30,000 (original amount of the guarantee) and not exceeding $62,500 (25% of the original loan amount). Although the net worth of the remaining guarantors is considerably less than the original $700,000 the amount has been judged sufficient by the lender to ensure full collection in the event of default.

The same rules would apply for other scenarios such as if all four of the original guarantors left and were replaced by one new guarantor.

Season's Greetings

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