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E. *The Registered Holder will transmit to the State Director:* 1. Request for substitution together with the original Contract of Guarantee.

2. Copies of the notes with lender's identification numbers. (All requirements of the Lender's Agreement will be complied with before any new notes are issued.)

3. Certification that the loan is current and in good standing.

4. Certification of outstanding principal amount of the loan.

5. Executed Lender's Agreement. (FmHA or its successor agency under Public Law 103–354 provides form to Lender).

6. Executed Form FmHA or its successor agency under Public Law 103–354 1980–19. (See § 1980.21 of Subpart A of this part for calculation of fee due).

7. Payment for appropriate guarantee fee.

F. *State Director will:* 1. Review all the requirements of Paragraph E of this section.

2. Verify the submitted request and if in order, send the guarantee fee and Form FmHA or its successor agency under Public Law 103–354 1980–19 to Finance Office with a notation of the date the new Loan Note guarantee will be issued. (Note: The substitution of a Loan Note Guarantee for the Contract of Guarantee is not to be considered as a new loan for recordkeeping purposes).

3. Complete the Loan Note Guarantee (appropriate number for attachment to each note), date and sign the instrument. The following statement will be entered at the top of the form: ''This Loan Note Guarantee is issued in substitution of Contract of Guarantee dated _____.'' The State Director will transfer from the Contract of Guarantee all information pertaining to the Loan Note Guarantee.

4. Execute Lender's Agreement.

5. Cancel the original Contract of Guarantee.

6. Transmit to the lender the original Loan Note Guarantee and a copy of executed Lender's Agreement and retain in the loan file copies of the Loan Note Guarantee with attached original cancelled Contract of Guarantee, a copy of Form FmHA or its successor agency under Public Law 103–354 1980–19 and the original Lender's Agreement.

All applicable provisions of this subpart and Subpart A of this part apply to the loan when the Loan Note Guarantee is signed.

G. *Alternate Procedure:* If the Registered Holder does not want to deliver the original contract of Guarantee with his/her request for substitution, the State Director will accept a copy of the Contract of Guarantee and proceed as above. However, the Loan Note Guarantee will be delivered only upon receipt of the original Contract of Guarantee.

H. *Par (b)(3) of Subpart A, § 1980.61.* For reporting purposes where multi-notes are issued, the loan to the borrower will be counted as one loan regardless of the number of notes issued.

I. *Par (b)(4) of Subpart A, § 1980.61.* The State Director will notify the Finance Office of the transaction.

J. *Par (d) of Subpart A, § 1980.61.* A copy of Form FmHA or its successor agency under Public Law 103–354 449–36 will be kept and a copy of executed Lender's Agreement retained in loan file along with copies of the Loan Note Guarantee with attached original cancelled Contract of Guarantee, copy of Guarantee Fee Report and the original Lender's Agreement.

K. *Par (e) of Subpart A, § 1980.61.* State Director signs all Forms FmHA or its successor agency under Public Law 103–354 449–13, ''Denial Letter.''

L. *Par (g) of Subpart A, § 1980.61.* The State Director will: 1. Review Form FmHA or its successor agency under Public Law 103–354 1980–19 for completeness.

2. Deposit the guarantee fee through concentration banking and include the amount in the total collections on the Daily Activity Report.

3. Submit Form FmHA or its successor agency under Public Law 103–354 1980–19, Guaranteed Loan Closing Report with the Daily Activity Report and other attachments to Finance Office in the salmon envelope marked ''CR''. This form is used *in lieu of* the 451–2, ''Schedule of Remittance.''

4. On the Daily Activity Report, Form 1980–19 will be counted as one in the item count as if it were a card or coupon.

5. Ascertain that originals or copies, as appropriate, are retained in the FmHA or its successor agency under Public Law 103–354 Loan file.

§§ 1980.462—1980.468 [Reserved]

§ 1980.469 Loan servicing.

The lender is responsible for loan servicing and for notifying the FmHA or its successor agency under Public Law 103–354 of any violations in the Lender's Loan Agreement. (See Paragraph X of Form FmHA or its successor agency under Public Law 103–354 449–35).

(a) All B&I guaranteed loans in the lender's portfolio will be classified by the lender as soon as it is notified by the State Office to do so and again whenever there is a change in the loan which would impact on the original classification. The State Director will notify the lender of this requirement for all existing loan guarantees, when new Loan Note Guarantees are issued to a lender and/or when the State Office becomes aware of a condition that

would affect the classification and justification of the classification will be sent to the State Office. The loans will be classified according to the following criteria:

(1) *Substandard Classifications.* Those loans which are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans in this category must have a well defined weakness or weaknesses that jeopardize the payment in full of the debt. If the deficiencies are not corrected, there is a distinct possibility that the lender and FmHA or its successor agency under Public Law 103–354 will sustain some loss.

(2) *Doubtful Classification.* Those loans which have all the weaknesses inherent in those classified Substandard with the added characteristics that the weaknesses make collection or liquidation in full, based on currently known facts, conditions and values, highly questionable and improbable.

(3) *Loss Classifications.* Those loans which are considered uncollectible and of such little value that their continuance as bankable loans is not warranted. Even though partial recovery may be effected in the future, it is not practical or desirable to defer writing off these basically worthless loans.

(b) There is a close relationship between classifications; and no classifications category should be viewed as more important than the other. The uncollectibility aspect of Doubtful and Loss classifications are of obvious importance; however, the function of the Substandard classification is to indicate those loans that are unduly risky which may result in future claims against the B&I guarantee.

(c) Substandard, Doubtful and Loss are adverse classifications. There are other classifications for loans which are not adversely classified but which require the attention and followup of the lenders and FmHA or its successor agency under Public Law 103–354. These classifications are:

(1) *Special Mention Classification.* Those loans which do not presently expose the lender and FmHA or its successor agency under Public Law 103–354 to a sufficient degree of risk to warrant a Substandard classification but do possess credit deficiencies deserving the lender's close attention. Failure to correct these deficiencies could result in greater credit risk in the future. This classification would include loans that the lender is unable to supervise properly because of a lack of expertise, an inadequate loan agreement, the condition of or lack of control over the collateral, failure to obtain proper documentation or any other deviations from prudent lending practices. Adverse trends in the borrower's operation or an imbalanced position in the balance sheet which has not reached a point that jeopardizes the repayment of the loan should be assigned to this designation. Loans in which actual, not potential, weaknesses are evident and significant should be considered for a Substandard classification.

(2) *Seasoned Loan Classification. A loan which:* (i) Has a remaining principal guaranteed loan balance of two thirds or less of the original aggregate of all existing B&I guaranteed loans made to that business.

(ii) Is in compliance with all loan conditions and B&I regulations.

(iii) Has been current on the B&I guaranteed loan(s) payments for 24 consecutive months.

(iv) Is secured by collateral which is determined to be adequate to ensure there will be no loss on the guaranteed loan.

(3) *Current Non-problem Classification*—Those loans that are current and are in compliance with all loan conditions and B&I regulations but do not meet all the criteria for a Seasoned Loan classification. All loans not classified as Seasoned or Current Non-problem will be reported on the quarterly status report with documentation of the details of the reason(s) for the assigned classification.

Administrative

Refer to Appendix G of this subpart (available in any FmHA or its successor agency under Public Law 103–354 Office) for advice on how to interact with the lender on liquidations and property management.

A. While the lender has the primary responsibility for loan servicing and protecting the collateral, the State Director is responsible for seeing that servicing as required by the Lender's Agreement and regulation is

properly accomplished. Loan servicing is intended to be a preventive rather than a curative action. Prompt followup on delinquent accounts and early recognition of potential problems and pursuing a solution to them are keys to resolving many problem loan cases.

B. *Paragraph II of the Lender's Agreement.* 1. The Loan Note Guarantee is unenforceable by the lender to the extent any loss is occasioned by violation of usury laws, use of loan funds for unauthorized purposes, negligent servicing, or failure to obtain the required security regardless of the time at which FmHA or its successor agency under Public Law 103–354 acquires knowledge of the foregoing. As used herein, the phrase ''use of loan funds for unauthorized purposes'' refers to the situation in which the lender in fact agrees with the borrower that loan funds are to be so used and the phrase ''unauthorized purposes'' means any purpose not listed by the Lender in the completed application as approved by FmHA or its successor agency under Public Law 103–354.

2. With respect to the negligent servicing and use of loan funds for unauthorized purposes, the Loan Note Guarantee is unenforceable by the lender to the extent any loss is occasioned by negligent servicing and use of loan funds for unauthorized purposes regardless of the time FmHA or its successor agency under Public Law 103–354 acquires knowledge of the negligent servicing or use of loan funds for unauthorized purposes by the lender. Only the amount of the loss caused by negligent servicing or use of loan funds for unauthorized purposes can be withheld from the final loss claim submitted by the lender. The dollar amount withheld from the final loss claim must be ascertainable. In order to determine the final loss amount, the guaranteed loan collateral and any collateral of the guarantor(s) must be liquidated and settled or a settlement with the guarantor(s) reached. In the event there is reason to suspect the lender of negligent servicing or use of loan funds for unauthorized purposes during the life of the loan, the lender should be notified in writing that (a) the acts of negligent servicing and/or use of loan funds for unauthorized purposes will cause the guarantee to be unenforceable by the lender to the extent these acts cause a loss; (b) any decision not to honor any part of the guarantee is not possible until the loan has been liquidated and a loss established; (c) if any loss occurs FmHA or its successor agency under Public Law 103–354 will consider whether negligent acts of the lender caused a loss after the liquidation is complete; and (d) at the time FmHA or its successor agency under Public Law 103–354 determines a loss has occurred as the result of negligent servicing the lender may appeal any adverse decision.

3. When facts or circumstances indicate that criminal violations may have been committed by an applicant, a borrower, or third party purchaser, the State Director will refer the case to the appropriate Regional Inspector General for Investigations, Office of Inspector General (OIG), USDA, in accordance with FmHA or its successor agency under Public Law 103–354 Instruction 2012–B (available in any FmHA or its successor agency under Public Law 103–354 office) for criminal investigation. Any questions as to whether a matter should be referred will be resolved through consultation with OIG for Investigations and the State Director and confirmed in writing. In order to assure protection of the financial and other interest of the government, a duplicate of the notification will be sent to the Office of General Counsel (OGC). After OIG has accepted any matter for investigation, FmHA or its successor agency under Public Law 103–354 staff must coordinate with OIG in advance regarding routine servicing actions on existing loans. A borrower or lender can be sued even though criminal fraud is present. If FmHA or its successor agency under Public Law 103–354 has good reason to believe that, for example, a borrower or a lender made a false statement to obtain a loan or guarantee, or a lender submitted a loss claim to FmHA or its successor agency under Public Law 103–354 which was false or fraudulent, it should promptly call the matter to the attention of OGC—even if no payment of the loss claim has occurred yet. (This would include those situations in which a borrower lied to the lender in order to get the loan, the lender believed the borrower and made the loan—which was guaranteed by FmHA or its successor agency under Public Law 103–354—and then the lender presented a loss claim to FmHA or its successor agency under Public Law 103–354 for payment after the borrower defaulted on the loan.) Sometimes it might be necessary to ask OIG to do an investigation to establish all the aspects of the fraud. If at all possible, this should then be done prior to referral to OGC.

4. There are two methods the Government could use to seek relief for the fraud. One of the ways the Government could seek redress for the fraud is to sue under the False Claims Act (31 U.S.C. sections 3729–3731). If fraud is proven to have occurred, the False Claims Act provides for the recovery of double damages and a $2,000 penalty (and the costs of one civil suit) for each act involving, for example: (a) Knowingly submitting to a Government employee of false or fraudulent claim for payment or approval, (b) knowingly making or using a false record or statement to get a false or fraudulent claim paid or approved, or (c) conspiring to defraud the United States by getting a false or fraudulent claim allowed or paid. Suit under the False Claims Act must be filed within six

years from the date of the commission of the act (e.g., presentation of the claim to FmHA or its successor agency under Public Law 103–354 for payment). The double damage feature ought to be a good incentive to convince OIG to undertake necessary investigations to help establish the fraud.

5. In order to decide whether to file suit, the Department of Justice will need to know such things as: What was the amount of the loan or the loss paid to the lender or holder? How much did the scheme cost the Government? What is the difference in money between what the Government paid out and what it should have paid out? Does the borrower or lender have enough assets to make it worth suing? If FmHA or its successor agency under Public Law 103–354 can answer these questions before referral to OGC—either on its own or by using OIG—than OGC can refer the matter that much more quickly to the Justice Department.

6. There is also a way to bring suit for civil fraud by alleging that ''common law'' fraud occurred. This would just involve proving that a borrower or a lender falsely represented by their words or actions, a matter of fact either by alleging something in a false or misleading manner or by concealing something that should have been disclosed; and that FmHA or its successor agency under Public Law 103–354 was deceived by this conduct, and relied on it to its detriment. Under ''common law'' fraud, only single damages could be recovered, and there would be no $2,000 penalty assessed. The action would generally have to be brought within three years from the date of the discovery of the fraud.

7. Neither the False Claims Act nor the right to bring a ''common law'' action for fraud precludes the Government from just suing to recover the money wrongfully or mistakenly paid by its employees. If the Justice Department decides not to pursue a civil frauds claim under the False Claims Act or ''common law,'' it will return the matter to OGC. Depending on what stage the proceedings were in when the matter was first referred, FmHA or its successor agency under Public Law 103–354 could then continue to negotiate with the lender or OGC could refer the case to Justice for any contract-based actions, including fraud or misrepresentation based on the terms of the guarantee.

C. *The State Director will assure that:* 1. [Reserved]

2. A timetable for routine site, borrower and lender visitations by FmHA or its successor agency under Public Law 103–354 personnel is established before the Loan Note Guarantee is issued. As a guide, visits to newly established borrowers with the lender represented should be scheduled monthly. Visits to established, nonproblem borrowers must be made at least annually except for seasoned loans which will be visited at least bi-annually. Special attention problem accounts should be visited as frequently as the need demands. If possible, these visitations should be coordinated with the lender's visits.

3. During or in preparation for field visits, the following functions are to be performed:

(a) Current financial information is obtained in advance and analyzed for trends.

(b) Any issues revealed or problems not resolved from the last visitation are included in the agenda.

(c) Collateral is observed and its condition, maintenance, protection and utilization by the borrower appears to be satisfactory.

(d) A report of the visit is made on Form FmHA or its successor agency under Public Law 103–354 449–39, ''Field Visit Review (Business and Industrial Loans),'' or otherwise documented and included in the loan file. The report should include an opinion of the borrower's status based upon observations made during the visit.

(e) Any instructions or directions to the lender should be confirmed by letter.

4. The Program Chief or Loan Specialist will conduct an annual meeting with each lender or its agent with whom a Loan Note Guarantee(s) or Contract of Guarantee(s) is outstanding. This cannot be redelegated. These meetings may be scheduled at the time FmHA or its successor agency under Public Law 103–354 makes periodic field inspections to the borrower's place of business. At the meeting, a review will be made of the lender's performance in loan servicing, including enforcement of conditions and covenants in the loan agreements. The observations and results of the meeting will be documented. Form FmHA or its successor agency under Public Law 103–354 449–39 may be used for this purpose. Servicing exceptions on the part of the lender which are noted by FmHA or its successor agency under Public Law 103–354 will be confirmed by letter to the lender.

5. The lender performs an adequate analysis of borrower financial statements for FmHA or its successor agency under Public Law 103–354. FmHA or its successor agency under Public Law 103–354 in turn will evaluate the lender's analysis and follow up with the lender on servicing action(s) required or negative observations not detected through the lender's analysis. The financial statement analysis of the lender, the financial statement and a memorandum reflecting FmHA or its successor agency under Public Law 103–354's analysis, including a comparison to previous and projected performance of the borrower, will be forwarded to the National Office, Attention: Business and Industry Division, only for the following loans:

(a) All loans within the first year of loan closing.

(b) Loans over one year old as determined by the State Director or a National Office assigned loan reviewer who is participating in a field review. In event of a disagreement between the State Director and an assigned loan reviewer as to which loans should be included, the assigned loan reviewer's decision will take precedence.

(c) All problem and delinquent loans.

(d) Loans that the State Director would like reviewed by the National Office.

6. Meetings are arranged between the lender, borrower and FmHA or its successor agency under Public Law 103–354 to resolve any problems of late payment, etc.

D. *State Director authorities.* 1. The State Director may delegate authority for the conduct of all functions listed in § 1980.469 Administrative B., except item C. 4. in Administrative B.

2. The State Director may approve B&I guaranteed loan servicing actions as authorized in separate written approval authorities issued in accordance with Subpart A of Part 1901 of this chapter.

3. Servicing actions on loans which exceed the State Director's loan approval authority are to be referred together with the State Director's recommendations to the Director, Business and Industry Division, for prior review and concurrence.

[52 FR 6501, Mar. 4, 1987, as amended at 53 FR 40403, Oct. 17, 1988; 60 FR 26350, May 17, 1995; 61 FR 18495, Apr. 26, 1996]

§ 1980.470 Defaults by borrower.

[See § 1980.63 of Subpart A, of this part.]

Administrative

Refer to Appendix G of FmHA or its successor agency under Public Law 103–354 Instruction 1980–E (available in any FmHA or its successor agency under Public Law 103–354 Office) for advice on how to interact with the lender on liquidations and property management.

A. In case of any monetary or significant non-monetary default under the loan agreement, the lender is responsible for arranging a meeting with the State Director, or its designee, and borrower to resolve the problem. A memorandum of the meeting, individuals who attend, a summary of the problem and proposed solution will be prepared by the FmHA or its successor agency under Public Law 103–354 representative and retained in the loan file. When the State Director receives a notice of default on a loan, he/she will immediately notify the National Office in writing of the details and will subsequently report the problem loan to the National Office on the quarterly status report. The State Director will notify the lender and borrower of any decision reached by FmHA or its successor agency under Public Law 103–354.

B. In considering servicing options, some of which are identified in paragraph X. A of Form FmHA or its successor agency under Public Law 103–354 449–35, the prospects for providing a permanent cure without adversely affecting the risks of the FmHA or its successor agency under Public Law 103–354 and the lender must become the paramount objective. Within the State Director's authority temporary curative actions such as payment deferments, moratoriums on payments or collateral subordination, if approved, must strengthen the loan and be in the best interests of the lender and FmHA or its successor agency under Public Law 103–354. Some of these actions may require concurrence of the holder(s). A deferral, rescheduling, reamortization or moratorium is limited by the period of time authorized by this subpart for the purpose for which the loan(s) is made or the remaining useful life of the collateral securing the loan. For example, if the promissory note on a working captial loan is scheduled to mature in 2 years the loan could be rescheduled for 7 years or the remaining life of the collateral whichever is the lesser of the two.

C. Subsequent loan guarantee requests will be processed in accordance with provisions of § 1980.473 of this subpart.

D. If the loan was closed with the multi-note option, the lender may need to possess all notes to take some servicing actions. In these situations when FmHA or its successor agency under Public Law 103–354 is holder of some of the notes, the State Director may endorse the notes back to the lender after the State Director has sought the advice and guidance of OGC, provided a proper receipt is received from the lender which defines the reason for the transfer. Under no circumstances will FmHA or its successor agency under Public Law 103–354 endorse the original Form FmHA or its successor agency under Public Law 103–354 449–34 to the lender.

E. The State Director's authority to approve servicing actions is defined in § 1980.469, Administrative D.2.

F. Consultant services may be recommended by the State Director to assist FmHA or its successor agency under Public Law 103–354 and the lender in determining which servicing action is appropriate. Requests for consultant services should be made by the State Director and addressed to the Administrator, Attn: Business and Industry Division. A full explanation of the loan history, an evaluation and scope of the proposed study and the need should be included in the request.

G. When the National Office determines it is necessary on individual cases, due to some special servicing requirements, it may, at its option, assume the servicing responsibility on individual cases.