

Welcome to the new CSBFA

This booklet is intended to help you understand and use the *Canada Small Business Financing Act* (CSBFA).

The CSBFA is a continuation of the *Small Business Loans Act*, a federal program that has helped small businesses obtain financing for 38 years. Under the CSBFA, the federal government shares the risk on loans made by lending institutions.

In general, the CSBFA applies to loans:

- up to \$250 000
- to Canadian businesses with annual gross revenues of \$5 million or less
- to finance the purchase or improvement of eligible assets
- for terms of up to 10 years
- registered with the Small Business Loans Administration.

To finance the risk under the CSBFA guarantee, lenders are responsible for collecting and paying a registration fee of 2 percent of each loan made, plus an annual administration fee of 1.25 percent, calculated on the monthly loan balance.

In return, the federal government guarantees 85 percent of the lender's losses in the event of default.

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How to use this booklet*

There are a variety of ways to use this booklet.

For example, if you:

- have a new loan prospect, turn to page 6 and follow the flowcharts and checklists to screen and register a new loan.
- are considering changes to an outstanding loan, turn to page 18 for guidance on how to avoid loss of eligibility.
- are preparing a claim for loss, turn to page 22 to find tips on how to avoid common errors.
- do not have a current need, you may want to flip through the booklet to understand how it can help, then set it aside for future use.
- are familiar with the *Small Business Loans Act* (SBLA), which the CSBFA continues, you can simply review the list of changes contained on pages 4 and 5.

Note: This booklet is designed to answer most questions about the Act, but it is not the actual law. The law is contained in the Act and Regulations. The Lender Guidelines provide interpretations of the Act and Regulations and are updated on a regular basis.

Links to the CSBFA Guidelines

For situations that are unclear, use the references provided to obtain more information from the CSBFA Guidelines. Please see page 7 for an explanation of how the references appear. If you do not have a copy of the Guidelines, refer to your internal operations manual for the appropriate contact person, or visit our Web site at <http://strategis.ic.gc.ca/csbfa>

* Your institution may have its own guidelines on how you can use this program. Consult your internal operations manual or the appropriate individual for this information.

What's new in the CSBFA

This summary of key changes is intended for use by lenders familiar with the *Small Business Loans Act* (SBLA), which the CSBFA replaces.

CSBFA (new Act)	SBLA (old Act)
<p>Due diligence and care Expectations of CSBFA lenders are to:</p> <ul style="list-style-type: none"> • obtain satisfactory credit references • assess customer's ability to repay • apply similar procedures to those applied to non-CSBF loans. 	Not specifically addressed.
<p>Going concern A going concern is a small business that has operated within 60 days prior to acquisition.</p>	Not addressed.
<p>Eligible purposes and assets (Page 10) Only when buying property must 50 percent be required to operate the business. Subsequent improvements can only be to the operational area.</p>	The 50/50 rule applied to all premises loans, regardless of whether they were for purchase or improvement.
Non-refundable taxes and customs duties are included in eligible asset cost.	Not addressed.
<p>Appraisals are required when:</p> <ul style="list-style-type: none"> • asset purchase is not at arm's length • assets of a going concern are purchased • assets are purchased from a lender • services are provided not at arm's length. 	Only a non-arm's length asset purchase was addressed.
Expenditures or commitments made within 180 days of the loan approval date are eligible, as long as they were not financed by a term loan.	Expenditures or commitments made within 180 days of the loan date were eligible without restriction.
Decontamination can be financed in certain circumstances.	Not addressed.
<p>Maximum loan amount Related borrower is defined. (Page 13)</p>	Not addressed.
The CSBFA limits loans to related borrowers, including SBLA loans, to \$250 000 unless they are subject to the independent small business rule.	Not addressed.

Security	
Security-ranking requirements in various lending situations are set out.	Some situations not addressed.
Distinction is made between primary and additional security, making release and substitution rules clear.	Additional security not addressed.
Substitution and release of assets rules extended to cover more situations.	Some situations not addressed.
Guarantees may be substituted for other guarantees or security on business assets.	Guarantees could only be substituted for other guarantees.
Terms and documentation	
Loan document contents, but not the form, are specified.	A promissory note was required.
Interest rate is set when: <ul style="list-style-type: none"> • loan is made, or • when loan document is signed, if document is to accompany security document for registration. 	Interest rate was set when promissory note was signed.
Changes to outstanding loans – see also Security (above)	
Repayment terms may be altered at any time as long as changes do not compromise the ability to repay.	Changes were permitted only in case of actual or impending default.
Claims for loss	
Submission deadline is 36 months from the date specified in the demand for payment.	Deadline was 36 months from the default date.
An interim claim for loss can be made before realizing on personal guarantees and/or finalizing compromise settlements.	All realization was to be completed before a claim for loss was filed.
Interest on unpaid amounts is for: <ul style="list-style-type: none"> • 12 months at the loan rate, and • 12 months at one-half the loan rate. 	Interest on unpaid amounts was for: <ul style="list-style-type: none"> • 12 months at the loan rate, and • 24 months at one-half the loan rate.
Other	
Costs of preparing and registering security documents can be charged to the borrower.	Not addressed.
Annual administration fee of 1.25 percent is payable quarterly.	Annual fee was payable annually.
Specific remedies are set out for several examples of non-compliance.	List of remedies was much shorter and correction periods more restrictive.

Making a CSBF Loan

The CSBF Loan screening and registration process is not complicated. Use the flowcharts on the following pages to guide your thinking.

Due diligence and care

Although the CSBFA is intended to make financing available to business that may not otherwise meet commercial lending requirements, lenders are expected to make and manage CSBF Loans with the same care and procedures they would use with any other loan.

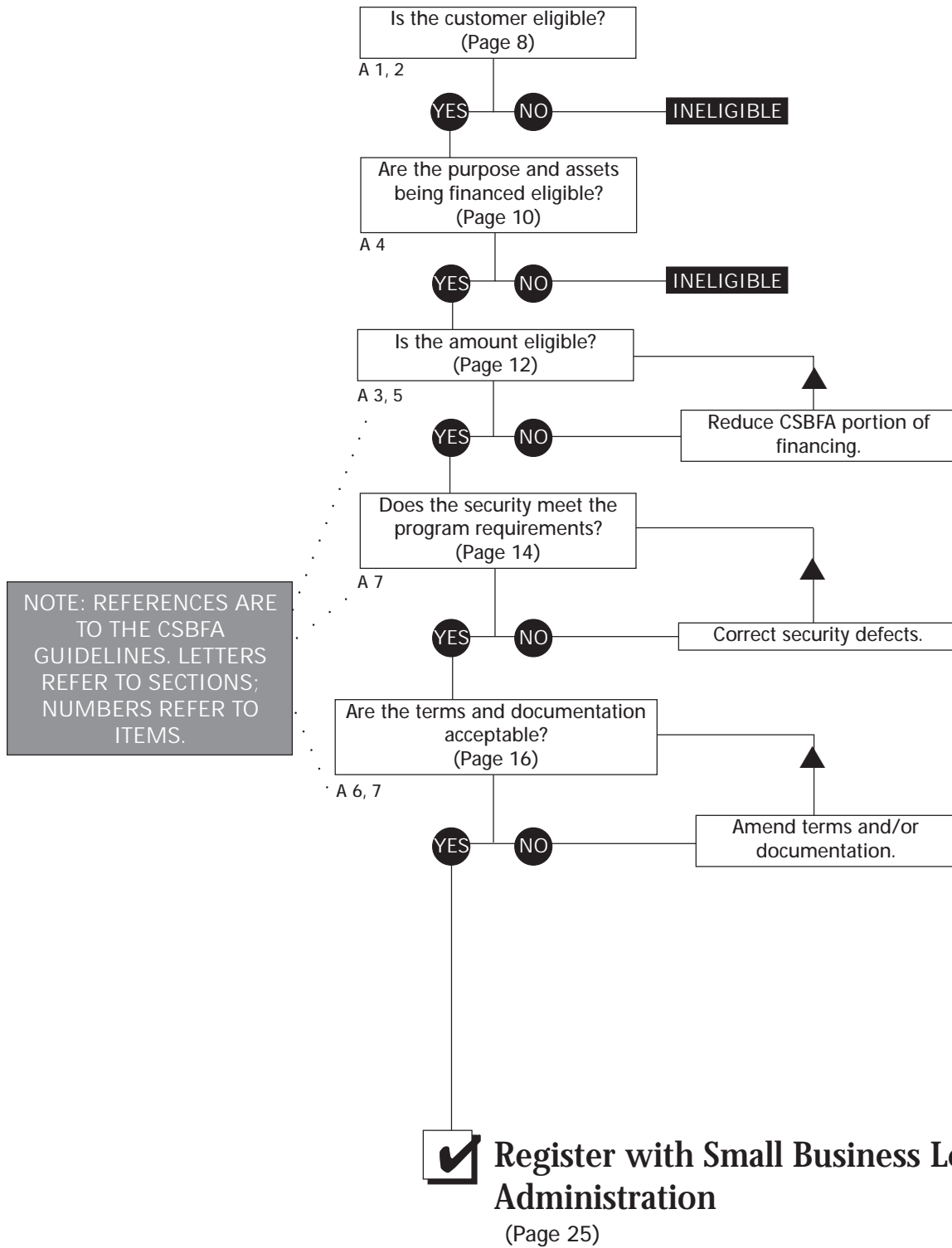
Before making the loan, lenders should:

- check the creditworthiness of the business
- obtain credit references on the key individuals
- assess the business's ability to service and repay the debt, taking into consideration all the other financial obligations of the borrower.

In managing the loan, lenders should:

- ensure their assessments are documented
- obtain documentation showing asset cost and payment
- register necessary security instruments
- ensure that changes to the terms and conditions of an outstanding loan do not diminish security or the ability to repay.

The process for making a CSBF Loan



Customer eligibility

The program is intended to assist Canadian small businesses.

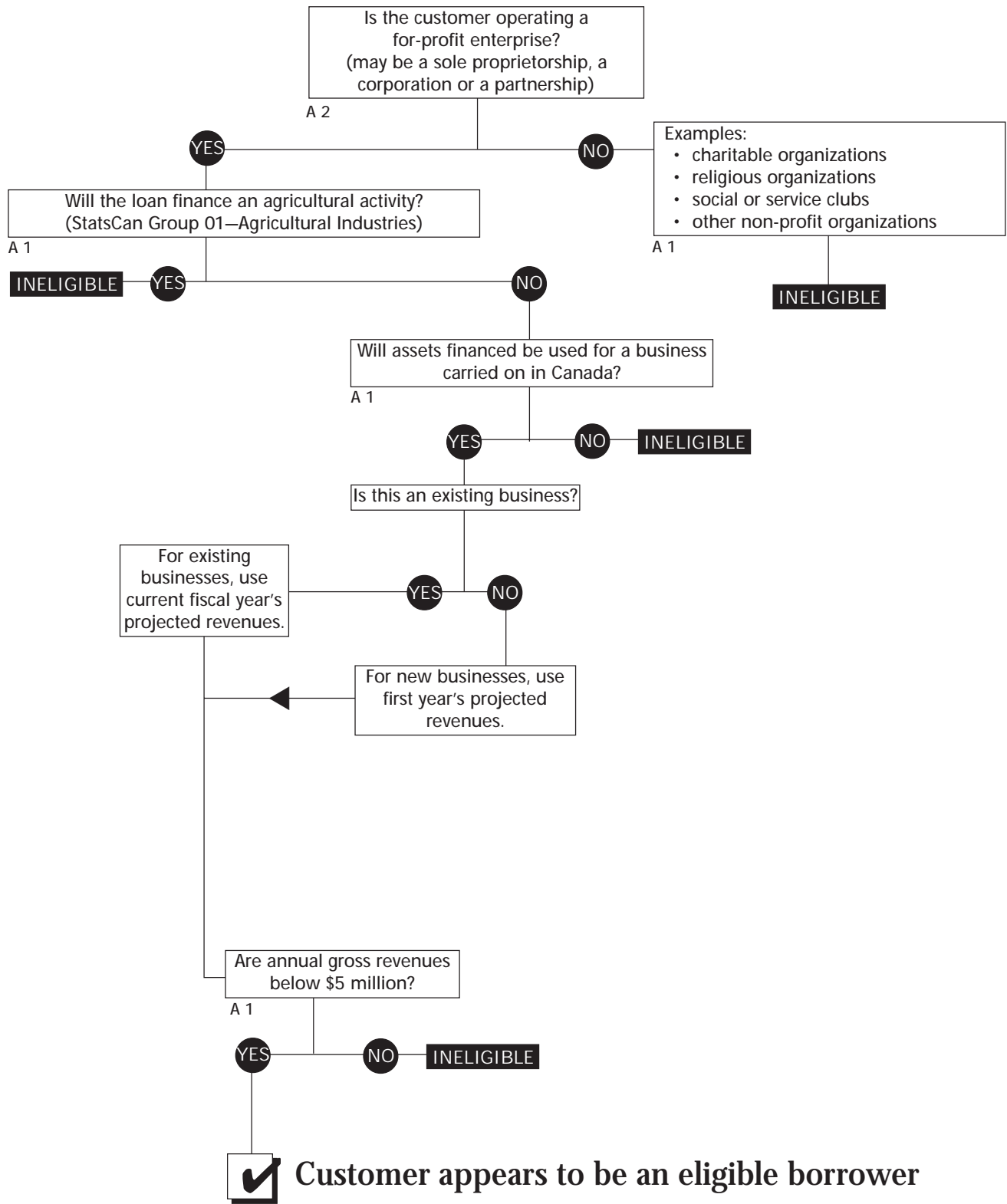
Virtually all small businesses are eligible to receive a loan under the CSBFA, but there are some restrictions.

To be eligible, a customer's business must:

- be for profit
- be non-agricultural
- carry on business primarily in Canada
- have annual gross revenues below \$5 million.

Note that a borrower must satisfy all of these conditions.

Is the customer eligible for a CSBF Loan?



Eligible purposes and assets

The Act is intended to help small businesses buy or improve tangible capital assets to be used in Canada for a new or existing business.

Working capital needs, such as inventory financing, are not eligible for loans under the Act.

Classes of CSBF Loans

Eligible assets fall into three classes:

- real property
- leasehold improvements
- equipment.

In addition, the 2 percent loan registration fee may be financed as part of a CSBF Loan.

Lenders may include more than one class of asset in a single loan registration. Note that each class carries certain security requirements, described later in this booklet.

Maximum loan amount

There are two criteria to consider in determining the maximum loan amount:

- outstanding aggregate CSBF Loans and SBLA Loans to a borrower and related borrowers cannot exceed \$250 000, and
- the loan amount cannot exceed 90 percent of the eligible cost of the financed assets.

The eligible cost of the asset can include related:

- installation charges (if invoiced and capitalized)
- freight and transportation charges
- non-refundable customs duties and taxes.

The eligible cost cannot include:

- any discounts, rebates or allowances
- the borrower's labour costs.

If the borrower is buying

- the assets of a going concern, or
- assets or services not at arm's length as defined in the *Income Tax Act* (Section E), or
- assets or services from the lender,

the eligible cost is the lower of the purchase price or an independent appraisal.

In the event of a claim for loss, the lender must supply the following documentation:

- proof of the eligible cost (e.g. invoice, purchase contract)
- the appraisal, if required, and
- proof of payment.

Securing a CSBF Loan

Security for loans is divided into two groups.

Primary security is mandatory.

- If the loan is used to finance real property or equipment, primary security will consist of a first charge on the assets being financed.
- If the loan is used to finance leasehold improvements or computer software, primary security can be on:
 - the assets financed, or
 - other business assets of the borrower (alternate security).

Additional security is optional. In addition to primary security, the lender may take:

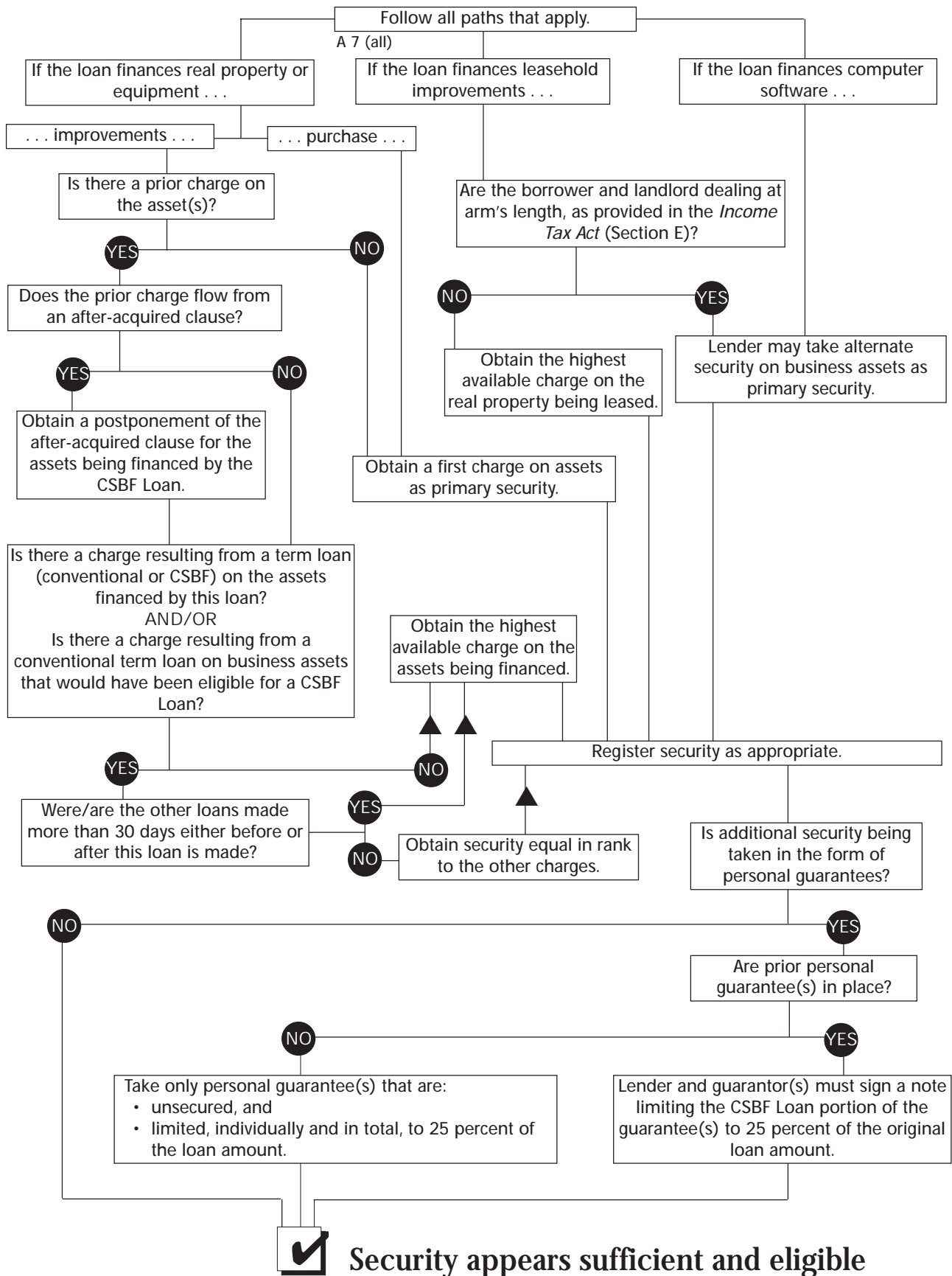
- security on any other business assets of the borrower
- any other secured or unsecured corporate guarantees, and
- one or more personal guarantees, provided they are:
 - unsecured, and
 - do not exceed, individually and in total, 25 percent of the original loan plus interest and costs.

To preserve eligibility in the event of a claim for loss, lenders must ensure that:

- the kind and priority of the security taken satisfies the Act and Regulations
- security is not released prematurely (see page 18), and
- personal guarantees do not exceed the 25-percent limit.

Note: Personal guarantees do not limit the liability of sole proprietors or unlimited partners in a partnership.

Is the security sufficient and eligible?



Terms and documentation

The Act specifies that each CSBF Loan must be:

- a term loan for a period not to exceed 10 years
- to finance assets needed for the operation of a Canadian business, and
- subject to a maximum interest rate.

Only fees specifically permitted by the Act may be charged to the borrower.

These include:

- the 2 percent registration fee
- the 1.25 percent annual administration fee
- reasonable fees for preparing and registering security documents.

The terms of the loan must be documented at the time the loan is made.

The borrower and lender may agree to change the original terms of the loan during the life of the loan agreement. In this case, the lender should refer to page 18 of this booklet to ensure the loan remains eligible under the Act in the event of a claim for loss. Any change should be fully documented.

Terms and documentation checklist

- | | | |
|-------------------------------------|---------------------|---|
| <input checked="" type="checkbox"/> | Ten-year term: | The loan will be paid in full within 10 years, beginning from the date of the first scheduled payment. |
| <input checked="" type="checkbox"/> | Amortization: | If the loan has been amortized over a period of more than 10 years, a balloon payment has been scheduled before the end of the 10-year term. |
| <input checked="" type="checkbox"/> | Principal Payments: | Principal payments are scheduled at least annually, but do not have to be equal. Blended payments of interest and principal are acceptable. |
| <input checked="" type="checkbox"/> | Fixed Rate Loan: | If fixed, the interest rate will not exceed the lender's residential mortgage rate plus 3 percent. Use the mortgage rate for the equivalent term in effect at the date the loan is made or on the date the loan agreement is signed if it must be registered with the security document. |
| <input checked="" type="checkbox"/> | Floating Rate Loan: | If floating, the interest rate will not exceed the lender's prime lending rate on each day the loan is outstanding plus 3 percent. |
| <input checked="" type="checkbox"/> | Security: | Kind and priority of security is as specified in the Regulations. Appropriate security documents have been executed and registered. Fees charged for preparing and registering security instruments are no higher than those for a similar non-CSBF loan. |
| <input checked="" type="checkbox"/> | CSBFA Fees: | The 2 percent registration fee has been collected and remitted to Small Business Loans Administration within three months from the date of first disbursement. The annual administration fee of 1.25 percent is included in the interest rate. |
| <input checked="" type="checkbox"/> | Insurance: | If life and/or disability insurance is agreed upon and the premiums are expressed as a percent of the loan amount, these are shown separately from the interest rate. |
| <input checked="" type="checkbox"/> | Other Fees: | No other fees have been charged. |
| <input checked="" type="checkbox"/> | Documentation: | On or before the date the loan is made, the lender and borrower have signed a document that states: <ul style="list-style-type: none">• loan amount• rate of interest• repayment terms• frequency of principal payments• date of first principal payment. |

Changes to outstanding loans— retaining program eligibility

The intent of the Act is to give lenders and borrowers flexibility to respond to changing circumstances over the term of a CSBF Loan.

Changes need not be communicated to the Small Business Loans Administration provided:

- the reasoning and the changes themselves are documented, and
- the revised loan would pass the eligibility tests required for a new CSBF Loan.

When considering changes to outstanding loans, special care should be taken:

- to avoid exceeding the interest rate maximums
- to avoid extending the term beyond 10 years, and
- to ensure security remains adequate and eligible.

Checklist for changes to outstanding loans



Ten-year term:

Small Business Loans Administration must approve any change that extends the term of a loan beyond 10 years. Make the request in the last two years; include grounds and documentation.



Interest Rate:

If the interest rate is changed from fixed to floating or vice versa, ensure the new loan agreement specifically observes the prescribed rate ceiling.



Substituting
Primary Security:

Substitute assets only if:

- the nature of the security is the same (for example, a mortgage for a mortgage)
- the new assets are of equal or greater value, and
- security ranking on the new assets is the same or higher.



Substituting
Additional Security:

No restrictions on substitution.



Releasing
Primary Security:

Release primary security assets only if:

- the loan is in good standing, and
- the outstanding loan amount has been reduced by an amount equal to the original cost of the assets being released, or
- the assets are being sold to an arm's length party and all proceeds of the sale will be used to reduce the CSBF Loan, or
- the assets are being sold to a non arm's length party and the proceeds will reduce the loan by the higher of the sale price or an independent appraisal.



Releasing
Additional Security:

Release additional security only if:

- for assets, the loan is in good standing, and
- for a guarantee, the principal amount of the loan has been reduced by 50 percent.



REMEMBER:

Where other business assets have been taken as primary security for a leasehold improvement or computer software loan, be sure to observe the rules for substitution and release of primary security.

When substituting or adding personal guarantees, ensure that they are:

- unsecured, and
- specifically limited to 25 percent, individually and in total, of the original amount of the CSBF Loan.

Claim for loss procedure

A claim for loss is made after the following have occurred:

- default by the borrower
- notice of default and demand for repayment
- expiration of the time specified in the notice of default, and
- efforts by the lender to realize on the assets and guarantees taken to secure the loan.

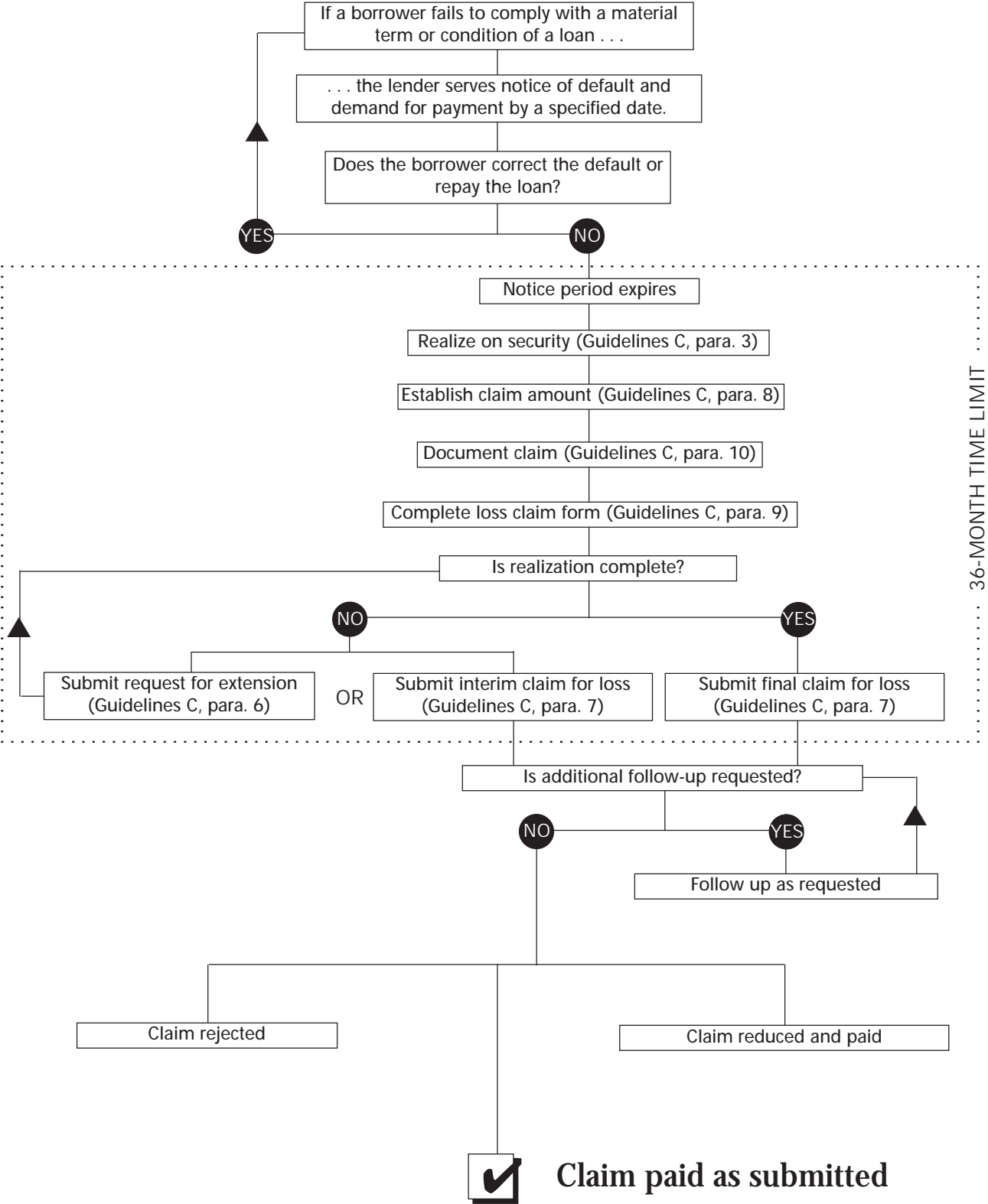
There are two types of claim for loss:

- a final claim for loss means the lender has realized on all the security, guarantees and personal liability of sole proprietors or general partners.
- an interim claim for loss means the lender has realized on the primary security, but has not fully implemented a compromise or realized on the additional security, guarantees or personal liability of sole proprietors or general partners.

A claim for loss or a request for an extension to the loss submission deadline must be submitted within 36 months of expiration of the period specified in a notice of default.

Since most loans are repaid without recourse to the claim for loss process, the claims procedure is not covered in detail in this learning guide. Please refer to the relevant CSBFA Guidelines sections (noted opposite) for instructions on establishing and documenting losses.

Typical claim for loss procedure



Common causes of claims reductions and declines

Only a small percentage of loans registered under the Act result in claims for loss. Of these, most are paid without adjustment.

Where a lender has not adhered to the requirements of the Act, however, the Small Business Loans Administration has no alternative but to reduce or decline the lender's claim.

The purpose of this section is to list common causes of claims reductions and declines and to suggest remedies. The list is in three sections:

- non-correctable errors, which make a loan ineligible for any claim.
- correctable errors, which may be corrected to retain program eligibility. To catch these errors, some lenders routinely review each CSBF Loan file within a year of registration.
- claims processing errors, which delay claims payments. During the delay, lenders:
 - do not have use of the funds being claimed
 - continue to pay the 1.25 percent annual fee
 - risk expiry of the interest reimbursement period.

Many causes of claims reductions and declines stem from fundamental mistakes made long before the loan goes into default. To lessen the chance that a future claim will be reduced or declined, refer to this list when

- considering a new loan, or
- making changes to an outstanding loan.

Causes of claims reductions and declines and suggested remedies

Causes

Suggested remedies

Non-correctable errors

Errors that make a loan ineligible for any claim:

- ineligible borrower (see page 8)
- borrower has annual gross revenues of more than \$5 million (see page 8)
- ineligible purpose (see page 10)
- total loans exceed \$250 000 maximum (see page 12)
- independent appraisal required but not done (see page 12)
- all assets were purchased more than 180 days before loan approval date (see page 13).

De-register and manage as a conventional loan.

Claim or extension not submitted in time frame (see page 21).

No remedy.

Correctable errors

No evidence of asset purchase or payment.

See page 12. This fault occurs most often with property and leasehold improvement loans. Some lenders reduce this risk by advancing funds against receipts and later convert the documented file to a CSBF Loan.

Some assets were purchased more than 180 days before loan approval date (see page 13).

De-register ineligible portion of the CSBF Loan.

Loan exceeds prescribed percentage of asset cost.

See page 13 and Guidelines C, para. 5.

Personal guarantees exceed maximum.

See page 15 and Guidelines C, para. 5.

Ineligible fee charged.

See page 17 and Guidelines C, para. 5.

Security not taken or defective.

Correct defects (see page 15).

Loan terms and/or documentation faulty.

See page 17 and Guidelines C, para. 5.

Common errors include:

Ensure that:

- payments not scheduled at least annually
- loan term exceeds 10 years
- interest exceeds maximum rate.

- demand loan form of promissory note is not used
- insurance costs are not shown as part of the loan interest rate
- when changing the term of a fixed rate loan, the interest rate reflects the mortgage rate for the new term.

Causes (continued)	Suggested remedies (continued)
Processing errors Payment reversal after five days.	CSBF Loan payments reversed by the lender after five working days must be credited to the loan, reducing the amount claimed correspondingly.
Additional realization proceeds.	Ensure all assets held as security and all guarantees are accounted for in the realization documentation.
Sharing of realization proceeds.	See Guidelines C, para. 4 for requirements.
Realization costs claimed twice.	Calculation error. Costs that have been deducted from the realization proceeds cannot also be added to the amount claimed.
Ineligible or unsupported realization costs.	See Guidelines C, para. 3, C, para. 9 and C, para. 10.
Claim loss documentation incomplete.	See Guidelines C, para. 9 and C, para. 10.

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Page 1 of registration instructions here

Page 2 of registration instructions here