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EIDL Consequences: Credit Impairment of Borrower Employees

COVID-19 Resource

Economic Injury Disaster Loans (EIDL) have long been a fixture of the Small Business Act to provide loans in the wake of disasters. The CARES Act expanded EIDL loans to cover the impacts from the current COVID-19 pandemic. Many of the CARES Act provisions regarding EIDL loans are beneficial — waiving the usual personal guaranty requirement for loans of less than $200,000, not requiring collateral for loans under $25,000, and only requiring a general blanket security for loans over that amount. For some inexplicable reason, however, the SBA is continuing its policy of impairing the credit of the individual completing the EIDL application. We believe such policy is as unjustified as it is perplexing.

EIDL Terms and Application Process

Loans under the EIDL program made through the CARES Act are generally fixed at 3.75 percent interest (2.75 percent for nonprofits) with a 30-year maturity, which, combined with the potential for no personal guaranty and flexible collateral requirements, make EIDL loans highly attractive to businesses and nonprofit organizations attempting to weather the extended economic interruption caused by COVID-19. A prospective EIDL borrower must complete a loan application available on the SBA's website. It is a straightforward process that the SBA streamlined in anticipation of the sizable demand for EIDL financing following the passage of the CARES Act. In many, but not all, cases the person completing the loan application is a mere employee, *i.e.* an agent, of the borrower.

Credit Inquiry upon Application

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As described in a June 26 letter signed by 15 members of Congress to the CEO of Experian, the person completing the EIDL application is subject to a "hard pull" of their credit report. This credit inquiry has the consequence of dropping such person's credit score by several points. Additionally, many individuals submitted EIDL applications multiple times, either out of concern that the first application was not effectively submitted or because they believed submitting multiple applications improved their chances of obtaining EIDL financing. In any case, each submission resulted in another "hard pull" of such individual's credit report, further damaging their credit score.

The EIDL application does contain language authorizing the SBA to obtain credit information from the "individual completing this application," but it is not immediately apparent why the credit quality of a mere agent of the borrower is relevant to the credit risk of the borrower itself. For example, assume the bookkeeper or controller of a small business applies for the loan on behalf of their employer. Given that the employee is not personally liable for repayment of their employer's debt, it is hard to imagine why the employee should be asked to pay the price of credit impairment for the benefit of their employer. Note, we are focusing on employees who complete the loan application, not the owner of the business that benefits from the EIDL funding.

Credit Reporting upon Default

Regrettably, this is not the end of the story. We have been advised by SBA representatives on multiple occasions that any default on the part of the EIDL borrower will be reported as a delinquency on the credit report of the person who completed the application on the borrower's behalf.

As discussed above, this could be a mere employee of the borrower who was instructed by their supervisor to apply for EIDL financing. In such case, the person would have very limited (if any) control over the borrower to ensure continued compliance with the EIDL loan documents and payment obligations thereunder. Given the 30-year maturities for EIDL loans, the individual completing the application will in many cases be years removed from any affiliation with the borrower when the default occurs.

We struggle to understand the SBA's rationale for a policy that penalizes the credit of a non-obligor in the event of a default by the borrower. This

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policy may make sense in the context of an owner of the borrower or a guarantor of the borrower's obligations who completes the EIDL application. However, we submit that it does not make sense in the context of a mere agent completing the application on behalf of the borrower.

In contrast to the modest credit impairment that results upon submission of the EIDL application — which we find arbitrary but at least fully disclosed in the EIDL application — the reported delinquency upon default does not appear to be authorized or disclosed anywhere in the EIDL loan application or final loan documentation. Despite our requests, SBA representatives have been unwilling or unable to explain or justify this policy. It is possible that it is motivated in part by the collection requirements set forth in 31 U.S.C. § 3711(g), which include reporting delinquencies to credit reporting bureaus. Even if this is the case, reporting a delinquency on a non-obligor's credit strikes us as both coercive and ineffective, where the non-obligor has no ability to control the borrower. We are hopeful that it is only a matter of time before the SBA corrects this policy — or is forced to do so by a court.

Relatedly, query whether this will result in the borrower's liability to an employee for asking such agent to apply for the EIDL financing and incur the credit impairment, both upon submitting the application and in the event of a subsequent borrower default.

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