

be made up prior to the end of the emergency program. Similarly, should the shortfall in funding by one or more parties require other parties to provide funding that exceeds their obligation in any given year, then those parties making excess payments in one year will have the latitude to reduce their payments in subsequent years in an amount that equals the amount of excess payment.

(b) To the extent that actual funding levels change, the difference (plus or minus) is to be applied to the calculation of cumulative funding as soon as practicable. In addition, if approved by APHIS in consultation with cooperators, any in-kind payment (*i.e.*, in the form of services, equipment, etc.) provided by a cooperator will be counted towards their funding obligation if the in-kind payment represents an expense that is not a normal program cost to the cooperator and directly affects emergency program objectives.

#### **§ 60.5 Activities not subject to cost sharing.**

The Federal Government will provide full funding and cost-sharing criteria will not apply to control and eradication activities that do not directly affect the targeted area, pest, or disease that is the focus of the emergency program. This would include, for example, national surveys and diagnostics; research not specific to the outbreak; public awareness not related to the outbreak; control and eradication programs in other countries; preclearance of passengers, cargo and means of conveyance; and port-of-entry inspection of passengers, cargo and means of conveyance.

#### **§ 60.6 Implementing agreements.**

The Secretary may, as a condition of providing the Federal funding pursuant to § 60.3, enter into agreements with cooperating entities. Such agreements will specify the particular responsibilities, including funding responsibilities, of the Federal Government and cooperators in conducting the emergency program.

Done in Washington, DC, this 1st day of July 2003.

**Bill Hawks,**

*Under Secretary for Marketing and Regulatory Programs.*

[FR Doc. 03-17042 Filed 7-7-03; 8:45 am]

**BILLING CODE 3410-34-P**

## **DEPARTMENT OF ENERGY**

### **10 CFR Chs. II, III, and X**

**RIN 1904-AA78**

#### **Semiannual Regulatory Agenda; Clarification**

**AGENCY:** Department of Energy.

**ACTION:** Semiannual Regulatory Agenda; clarification.

**SUMMARY:** The Department of Energy is clarifying its discussion of one of the items (Residential Furnaces, Boilers, and Mobile Home Furnaces) in the Semiannual Regulatory Agenda, 68 FR 30192, 30195 (May 27, 2003).

**DATES:** This correction is made as of July 8, 2003.

**FOR FURTHER INFORMATION CONTACT:** For information on Energy Efficiency Standards for Residential Furnaces, Boilers, and Mobile Home Furnaces contact: Mohammed Khan, Room 1J-018, Forrestal Building, 1000 Independence Avenue SW., Washington, DC 20585, *mohammed.khan@hq.doe.gov*, (202) 586-7892. For information on the Regulatory Agenda in general, please contact: Richard L. Farman, Room 6E-078, Forrestal Building, 1000 Independence Avenue SW., Washington, DC 20585, *richard.farman@hq.doe.gov*, (202) 586-8145.

**SUPPLEMENTARY INFORMATION:** In the fall of 2002, DOE designated the Energy Efficiency Standards for Residential Furnaces, Boilers, and Mobile Home Furnaces as high priority in *The FY2003 Priority Setting Summary Report and Actions Proposed*, which the Office of Building Technologies Program, U.S. Department of Energy, published on August 22, 2002.

In the Department of Energy's most recent Semiannual Regulatory Agenda notice, 68 FR 30195 (May 27, 2003), the Department inadvertently noted in its discussion of the Energy Efficiency Standards for Residential Furnaces, Boilers, and Mobile Home Furnaces that "the Department is reclassifying this action as low priority, pending further review."

The Department of Energy has not reclassified this action as a low priority and remains committed to getting public input before making decisions on the priorities for its rulemakings. As the Office of Building Technologies Program described in its 1996 Procedures for Consideration of New or Revised Energy Conservation Standards for Consumer Products (Process Rule), 61 FR 36974, 36976, 36982 (July 15,

1996), the program will prepare an analysis of pending or prospective rulemakings at least once a year. The program will invite the public to review and comment on the program's priority analysis prior to making any changes to its priority designation. As noted in the Semiannual Regulatory Agenda published May 27, 2003, the program will be seeking comments from stakeholders regarding the priority status of Residential Furnaces, Boilers, and Mobile Home Furnaces. In addition, the program will be seeking comments on its prioritization of all current rulemakings this summer. The program fully intends to follow the Process Rule and provide stakeholders with an opportunity to comment.

Issued in Washington, DC, on July 2, 2003.

**Douglas L. Faulkner,**

*Principal Deputy Assistant Secretary, Energy Efficiency and Renewable Energy.*

[FR Doc. 03-17196 Filed 7-7-03; 8:45 am]

**BILLING CODE 6450-01-P**

## **SMALL BUSINESS ADMINISTRATION**

### **13 CFR Part 120**

**RIN 3245-AE41**

#### **Development Company Loan (504) Program Changes**

**AGENCY:** U.S. Small Business Administration (SBA).

**ACTION:** Proposed rule.

**SUMMARY:** In response to an Advanced Notice of Proposed Rulemaking ("ANPRM") published by the U.S. Small Business Administration ("SBA" or "the Agency") on December 6, 2002, SBA solicited comments on the Certified Development Company ("CDC") Loan Program (the "CDC Program" or the "504 Program"). Based on the comments received and due to SBA's desire to improve 504 Program delivery to small businesses, SBA proposes to amend the regulations governing the 504 Program.

The most significant regulations that SBA proposes to change are those governing a CDC's area of operations; a CDC's organizational structure; the requirements for a new CDC or a CDC requesting to expand its territory; the "adequately served" standard; and whether a CDC may participate in other SBA loan programs. Also, to allow for greater delegation of authority to CDCs, the proposed rule includes expanded sections on the Accredited Lender Program ("ALP"), the Premier Certified Lender Program ("PCLP") and a simplification and clarification of the

enforcement provisions for CDCs. In addition, SBA proposes to increase the "job opportunity average" and to permit CDCs to approve more projects that do not meet the job creation criteria but do meet other statutory goals. The proposed amendments also clarify the regulations governing fees that a small business may and may not be charged.

**DATES:** Comments must be received on or before August 7, 2003.

**ADDRESSES:** Address written comments to James E. Rivera, Associate Administrator for Financial Assistance, U.S. Small Business Administration, 409 Third Street, SW., 8th Floor, Washington, DC 20416. You also may submit comments via e-mail to [proprule@sba.gov](mailto:proprule@sba.gov). You also may submit comments electronically to <http://www.regulations.gov>.

**FOR FURTHER INFORMATION CONTACT:** Gail H. Hepler, Chief, 504 Loan Policy Branch, (202) 205-7530.

**SUPPLEMENTARY INFORMATION:**

**Statutory Basis of the 504 Program**

The 504 Program, Title V of the Small Business Investment Act ("Act"), 15 U.S.C. 695, was established by Public Law 85-699 on August 21, 1958. A "development company" was defined as an enterprise formed for the purpose of furthering economic development of its community and environs, and with authority to promote and assist the growth and development of small business concerns in the areas covered by their operations. The law further stated that a local development company is a corporation chartered under any applicable State corporation law to operate in a specified area within a State and be composed of and controlled by persons residing or doing business in the locality. The program was amended in 1980 due to changing business conditions for small businesses. During the late 1970s and early 1980s, the prime interest rate and unemployment rate reached historically high levels. It was generally believed that long-term, fixed-rate money was not available at a reasonable cost to small businesses because of these high prevailing rates and that this was hindering job creation. Congress enacted section 503 of the Act in 1980. The 503 and 504 Programs were intended to provide long-term, fixed-rate financing to small businesses at favorable terms that were unavailable in the commercial marketplace. Congress specified in the Act that this program "foster economic development and create or preserve job opportunities in both urban and rural areas by providing long-term financing for small business concerns \* \* \*". The

statute authorizes SBA to guarantee debentures backing long-term, fixed-asset loans ("504 Loans") made by CDCs. It also authorizes SBA to pool the guarantees and sell interests in the pools to investors.

**Rulemaking History**

On December 6, 2002, SBA published the ANPRM to solicit comments on the 504 Program. SBA posed specific questions requesting comments on a wide range of topics including the overall 504 Program's effectiveness; CDC organizational structure; ways to increase the 504 Program's geographic coverage to ensure that all small businesses have access to long-term fixed-rate financing; 504 loan and debenture structure; CDC performance requirements; operational and logistical issues; economic development; and CDC participation in other SBA programs. SBA received more than 1,900 responses from lenders, borrowers, government and community organizations, and CDCs.

**Discussion of Comments Received in Response to ANPRM**

In response to the questions in the ANPRM as to whether the need for the 504 Program still exists, the overwhelming majority of commenters supported the continued need for the program. The comments included approximately 600 letters from banks and other lenders and 590 letters from 504 Program borrowers. A national lender explained as follows:

Nationally, we rely on the 504 Loan Program in many of our markets because conventional real estate financing offers numerous obstacles to small business financing including the following: loan-to-value of 75% or less—more cash out of pocket for the borrower, 20-30% down-payment requirements, shorter amortization periods, ineligibility of special purpose (use) properties, balloon payments, exposure to short-term interest rates, multiple loan and pricing covenants and financial reporting requirements. For our customers the 504 Loan Program continues to be the most viable alternative to conventional small business loan products.

Emphasizing program benefits from the perspective of the lender, a banker stated:

There are a number of unique benefits for our bank and our borrowers when we participate in the 504 loan program. It allows us to continue to serve the banking needs of our small business customers while mitigating a degree of risk that always accompanies small business lending \* \* \*. The 504 allows them to get a long-term, fixed rate financing through support from the government guaranty. With our bank in a first lien position with typically a 50% loan-to-

value ratio, our collateral risk is substantially reduced. The program also allows us to fund projects too large for our lending limit. There is also an active secondary market for 504 first mortgage loans. Most importantly, 504 enables us to meet customer credit needs and retain our business customer's primary banking relationship \* \* \*. The CDC's expertise and working relationship with the SBA means that we save valuable lender time and expense by the CDC handling the application paperwork required for a government loan. The CDC is truly the program expert and monitors the changing rules, regulations and procedures for the 504 loan program \* \* \*. Additionally, the 504 loan program has strengthened our small business community by allowing companies to grow and expand. We are heroes in the eyes of our small business borrowers and we like being able to keep our customers happy while maintaining our loan portfolio at a manageable risk level.

Another response from a bank added the following:

The program also allows us to fund projects too large for our lending limit. Additionally, we can limit our exposure to certain industries \* \* \*. There is also an active secondary market for 504 first mortgage loans, so we can meet our board's liquidity requirements and, in turn, make even more small business loans.

Addressing the question of compatibility of the 504 Program with the loan programs authorized by section 7(a) of the Small Business Act, 15 U.S.C. 632 *et seq.* ("7(a) Program"), a lender stated:

The 504 Program, along with the 7(a) program and a (state) working capital loan program, work to complement each other in our market. The 504 fits quite well in its market niche of providing long-term fixed-rate financing to larger companies for plant and major equipment purchases. It is appropriately targeted to reach those companies in their growth cycle to create jobs, expand the tax base, and improve their communities. Both the 7(a) and State programs target, for the most part, smaller credits to provide working capital and financing for smaller equipment purchases. The 7(a) program is also frequently used for real estate purchases where a variable rate loan is preferred, because of the lack of a prepayment penalty, or where job creation is not the purpose or the targeted outcome. Taken together, along with some specialized private sector programs, the needs of small businesses are, for the most part, being met in our market and filling a void in conventional lending.

Regarding the 504 program's contribution to the economic development of communities, a typical comment follows:

The 504 Program is critical in all economic cycles but of greatest significance in today's economy. The ability of a small business to buy needed equipment and real estate to grow while preserving capital to fund expansion and job growth is crucial in

today's economy. No other program provides these benefits to small businesses \* \* \* By virtue of its structure, providing a financing package that requires participation of a private sector lender, federal resources are leveraged. The program has always been available, regardless of economic cycle, and provides a high level of security to the participating private sector lender. This security is even more critical in a down economy and may mean the difference between financing with 504 or no financing available.

Other economic development benefits to the local communities from the CDC Program in addition to the long-term, fixed-rate financing are mentioned by many writers. One writer stated that:

To the extent that there are surplus reserves or revenues, they should be employed to accomplish our primary objective, the 504 Program, either through increased marketing in our existing area of operations or in a new, underserved market. Secondly, surpluses should be utilized for needed local economic development activities. We believe that was the intent, resulting in a separate CDC program and industry in the first place.

Another writer echoed the larger economic development goals of CDCs:

The 504 program has been the genesis for the creation of many other forms of local economic development and job creation. Unlike commercial lenders who distribute profits to shareholders, CDCs invariably invest, either directly or through affiliated companies, into their areas of operations. This was the basis for congressional creation of the 504 Program. 504 Program revenues have led to creation of new local revolving loan funds, economic development grant programs, job training programs, micro-loan programs, and many other small business assistance programs provided by CDCs. All of these programs are targeted at the intent of Congress: job creation in local communities.

There also was overwhelmingly negative response from banks, 504 borrowers, and CDCs to the questions about permitting a CDC to establish a 7(a) lender or permitting a 7(a) lender to establish a CDC. One writer explained that:

The Development Company Loan program \* \* \* was created by Congress to be an economic development tool, and measured the success by jobs. The 7(a) program was created by Congress to assist small businesses with capital not available from other resources, or the "lender of last resort." The 7(a) loan program may and probably does create jobs \* \* \*

but no economic development goal is required for a 7(a) loan to be approved. Another writer summarized his opposition as follows:

7a lenders, due to their for-profit structure, have significantly different goals and objectives that are often in conflict with the economic development goals of the non-

profit CDC industry. The independence of CDCs is critical to the maintenance of their unique economic and community development mission \* \* \*. The primary objective of the development company must be of benefit to the community as measured by increased employment, payroll, business volume, and corresponding factors rather than monetary profits to its shareholders \* \* \*. CDCs help to create a level playing field between large and small banks by providing expertise to small and rural banks that cannot afford in-house SBA lending departments.

Another writer adds that:

CDCs should build strength with adequate capital reserves just like any good business. We certainly expect it of our borrowers. To the extent that there are surplus reserves or revenues, they should be employed to accomplish our primary objective, the 504 Program, either through increased marketing in our existing area of operations or in a new, underserved market. Secondly, surpluses should be utilized for needed local economic development activities. We believe that was the intent, resulting in a separate CDC program and industry in the first place \* \* \*. Not only is the 7(a) program not economic development, a conflict could occur as a result of such an affiliation.

In summary, the comments supported the continuation of the 504 Program. The comments also suggested some policy changes to the 504 Program to permit increased access to capital for small businesses. The most frequently suggested changes dealt with the structure of CDCs, including their designated areas of operations. These suggestions included liberalizing the rules governing a CDC's membership requirements, changing the definition of a CDC's area of operations, and changing the definition of when a county is adequately served by existing CDCs. The comments also supported the distinct economic development aspect of the 504 Program by overwhelmingly opposing a CDC's investing in or being affiliated with a 7(a) lender.

#### **Overview of Proposed Changes to the 504 Regulations**

SBA believes the proposed regulatory changes will improve 504 Program delivery to small business customers by increasing customer choice of service; increase third party lender choice of CDCs; facilitate the formation of new CDCs; facilitate the expansion of existing CDCs; and increase the number of CDCs able to take advantage of special initiatives for rural areas. By allowing market-driven forces to determine availability of 504 Program service, small businesses will have greater opportunity to negotiate the best total financing package including fees, as well as receive increased service by CDCs. In addition, the 504 Program will

be more responsive to changes in market conditions.

To allow for greater delegation of authority to CDCs, this proposed rule includes expanded sections on the ALP and the PCLP. This proposed rule also simplifies and clarifies the enforcement provisions for CDCs. In addition, SBA proposes to amend the "job opportunity average," which will permit CDCs to approve more projects that do not meet the job creation criteria but do meet other statutory goals such as increasing manufacturers' productivity and competitiveness through re-tooling, robotics or modernization. Proposed amendments also clarify the regulations governing fees that a small business may and may not be charged. The regulations covered by the proposed rule are 13 CFR, subpart A, § 120.102 and § 120.140, and subpart H, §§ 120.800 through 120.984.

The 504 Program from 1986 to 2002 has created or retained more than 1.5 million jobs, averaging approximately \$13,600 of debenture per job. However, the 504 Program has not used all of its available budgetary authority for many years. The 504 Program's authorization level for fiscal year 2002, for example, was \$4.5 billion compared to the total approval level of \$2.5 billion.

SBA has decided to take steps to increase the availability of the long-term, fixed-rate financing offered by the 504 Program that is vital for our nation's small business community. This proposed rule begins this process by establishing the State in which a CDC is incorporated as the CDC's minimum area of operations. Currently, each CDC is assigned a specific, local area, typically several counties. Only one CDC per State is permitted to be a statewide CDC. In some cases, there are geographic areas that do not have CDC coverage. Although CDCs' areas of operations often overlap, SBA believes that establishing statewide areas of operations for all CDCs will increase the availability of 504 Program assistance to small businesses. SBA also believes that it is empowering the CDCs' boards to determine what is the optimal area of operations within the State for the CDC to market and service effectively.

Next, SBA is proposing to eliminate the "adequately served" standard. Currently, a county meets the standard of "adequately served" when the CDC that includes the county in its area of operations averages at least one 504 loan approval in that county per 100,000 population per year averaged over two years. In such cases, the county is unavailable both to an existing CDC applying to expand its operations to include that county, and to a new CDC

applying to include that county in its proposed area of operations. In addition, the regulations currently do not permit a new CDC, or a CDC applying to expand its area of operations, to apply for a particular county if that county has become part of another CDC's area of operations within the previous 24 months. Eliminating this standard will encourage new CDC applications and expansion applications from existing CDCs. SBA is proposing to allow the marketplace to determine the maximum number of CDCs that can co-exist within a State. With these changes SBA anticipates that small businesses, as well as lenders, will have greater choice in and access to capital.

To facilitate these changes, SBA is proposing to streamline a CDC's organizational structure by modifying the CDCs' general membership requirements. Currently, a CDC is required to have a general membership that covers the CDC's entire area of operations. In the proposed rule, SBA would no longer require that a CDC's membership cover the entire area of operations, but rather would require that the CDC's members each actively support economic development within all or some portion of the CDC's area of operations. The CDC's board of directors would make the decision on how widely disbursed the CDC's general membership needs to be to meet the objective of local economic development. SBA also is proposing to modify the regulations governing contracting for staff to facilitate a CDC's contracting for "back office" work with a contractor located outside of the CDC's area of operations. SBA believes that this will permit certain economies of scale by providing additional sources of expertise in 504 packaging, processing, servicing and liquidation.

For CDCs that apply to cross State lines as a multi-state CDC, the CDC also will be able to determine the maximum geographic coverage its general membership in the new State needs to be. Also for multi-state CDCs, SBA is proposing to relax the requirements for board representation from the new State by eliminating the current requirement that at least three of the CDC's board members must come from the new State. In addition, SBA is proposing to allow a CDC that currently has ALP or PCLP authority in its State of incorporation to use that authority in its expanded area. To ensure that only those CDCs with demonstrated strong underwriting are permitted to expand beyond their State of incorporation, SBA is clarifying the requirement that the expanding CDC must meet SBA's portfolio performance benchmarks. Taken together, SBA

believes that these changes in a CDC's area of operations, elimination of the concept of "adequately served," elimination of the requirement that a CDC's membership cover the entire area of operations, the clarification regarding contracting, and the changes in the expansion requirements for CDCs will result in the 504 Program becoming more relevant in today's dynamic financial services marketplace.

SBA agrees with the opinion of the majority of writers that the 504 Program should remain separate from the 7(a) Program. The proposed rule introduces a new regulation that prohibits a CDC from investing in or being affiliated with a 7(a) lender.

The concept of permitting a CDC to invest in a Small Business Investment Company ("SBIC") generally was supported by the commenters. Many writers viewed such an investment as economic development as long as the SBIC and the CDC were not affiliates. However, SBA's current regulations prohibit a CDC from owning an equity interest in a business that has received or is applying to receive SBA financing (§ 120.140). Since SBICs typically have an ownership interest in the businesses that they assist, a CDC that has invested in an SBIC also would have an ownership interest in the small business receiving financing from the SBIC and could potentially violate this regulation by providing financing directly to that small business. In addition, SBA's regulations state that a CDC must operate in its Area of Operations. SBA interprets this requirement to apply to all CDC activities that use funds generated from the 504 Program. In light of these concerns, at this time SBA proposes to prohibit a CDC from investing in an SBIC. The proposed rule would not require a CDC with an existing investment in an SBIC to liquidate such investment.

#### Section-by-Section Analysis

SBA proposes to add a definition of "SOP" to § 120.102, the definitions section applicable to the entire part 120.

SBA proposes to amend § 120.140 to delete references to Associate Development Companies ("ADC") (see discussion of § 120.850).

SBA proposed to change the headings for § 120.800 and § 120.801 to make their format consistent with the other section headings in subpart H.

SBA proposed some changes to the definitions in § 120.802. The definition of "Area of Operations" would be modified to add that the minimum area of operations for a CDC is the State in which the CDC is incorporated. This change would permit more access to

capital as well as choices for small businesses. In response to the ANPRM, several commentors suggested that a CDC's area of operations be SBA district-wide. However, SBA agrees with the reasoning of one commentor regarding the district-wide proposal:

(The district-wide proposal) presents two problems. First, it would not eliminate some current monopolies. \* \* \* Secondly, it produces something of a double standard. In some 41 states, all CDCs would be statewide by virtue of the fact that there is only one district office in each of those states. That leaves 9 states requiring special regulations and monitoring by the SBA. The statewide CDC proposal eliminates these problems and provides a single, national standard and is therefore preferable.

The definition of "Local Economic Area" would be revised slightly to make it consistent with the revised, statewide "Area of Operations" definition. In addition, the definition for "Associate Development Company" would be deleted. This change is discussed in the analysis of revisions proposed for § 120.850. Other regulations in subpart H of part 120 use the terms "Designated Attorney," "Lead SBA Office" and "Priority CDC." For clarification, this proposed rule would add definitions for those terms.

In § 120.810, application for certification as a CDC, SBA is proposing changes to the policies governing new CDC applications to reflect the change in the definition of a CDC's "Area of Operations" to a minimum of statewide. Additionally, it deletes the current restrictions that permit existing CDCs to exclude geographic areas from being considered for a new CDC. SBA is permitting the marketplace to determine the optimum number of CDCs that may be supported.

Because of these changes and in order to streamline the application process, SBA would delete § 120.811, public notice of CDC certification application, which requires public notice as well as direct notice to existing CDCs. SBA believes the application process, SBA oversight, and the marketplace will be enough to ensure that the process will lead to improved economic development. This proposed rule would add a clarification that an applicant CDC must demonstrate financial capability to meet the upfront costs of the program until the CDC's operations meet the breakeven point. This is to ensure that the CDC will be staffed sufficiently to meet the requirements of marketing, processing, closing, and servicing 504 Loans.

Section 120.812, probationary period for newly certified CDCs, proposes revisions that would clarify how SBA

will process a CDC's petition for permanent CDC status, and that the probationary period commences on the date of certification. Also SBA proposes to delete all references to ADCs in connection with the proposed elimination of the ADC program (see discussion of § 120.850).

In § 120.820, CDC non-profit status, SBA proposes to describe what SBA means by the term "good standing." While this is a term SBA has used over the years in administering the 504 Program, SBA has not fully defined it previously. Following discussions between SBA program officials and the CDC industry, SBA proposes several criteria that constitute good standing for the 504 Program. SBA intends to apply the term generally to all CDCs.

Section 120.821, CDC Area of Operations, would be revised to delete the limitation of one statewide CDC since all CDCs' areas of operations will be at least statewide (see discussion of definition of "Area of Operations" in § 120.802).

Section 120.822, CDC membership, would be revised to streamline CDC membership qualifications by deleting the requirement that a CDC's membership must be representative of its entire area of operations. Currently, a CDC must have representation from each of the four groups (*i.e.*, government organizations, financial institutions, community organizations, and businesses) for its entire area of operations. With this change, SBA still would require that each of the four groups be represented in the membership, but would no longer require that such members represent the entire area of operations. It will be up to the CDC's board to determine how broadly-based geographically the membership needs to be to meet the CDC's economic development objectives. The CDC's board may choose to have a membership that represents only a county, or some counties, while another CDC's board may choose to have a membership that represents the entire State.

In addition, SBA would clarify the intent of the regulation by adding that a CDC must not use its employees and staff to meet the membership requirements. The membership requirement is designed to be filled by local community leaders volunteering to assist in providing economic development in their communities through the formation of a CDC. The membership elects the CDC's board from among its members. The board, in turn, hires paid professional staff to operate the CDC on a daily basis. SBA also proposes to eliminate the

requirement that SBA pre-approve the CDC's members representing government organizations, and to add small business development companies ("SBDCs") and another type of community organization that may be a source of members for a CDC.

Section 120.824, professional management and staff, would be revised to delete the provision that describes the circumstances under which a rural CDC with insufficient loan volume may be managed by another CDC located in the same area of operations. This provision has not been used and appears to be unnecessary. In addition, the proposed change would clarify the requirements regarding CDC staff provided under contract including deleting the requirement that a contractor must live or do business in the CDC's area of operations. SBA believes that a CDC may wish to contract for certain services, such as "back office" staff support, with individuals or organizations that are outside of the CDC's area of operations.

Section 120.826, basic requirements for operating a CDC, would be slightly reworded for clarity. The responsibilities currently described in § 120.827(a) would be moved to this section because SBA considers them to be basic requirements for operating a CDC. In addition, SBA proposes to clarify that all CDCs must comply with all of the 504 Program requirements imposed by statute, regulation, SOP, policy and procedural notice, loan authorization, debenture, or any agreement between SBA and the CDC, some of which is currently in § 120.827(a).

Section 120.827, other services a CDC may provide to small businesses, would be revised to focus this section only on, and clarify what is meant by, "other services" that a CDC may provide to a small business, as well as describe the regulations to which the CDC will be subject if it does provide such other services.

Section 120.828, minimum level of 504 loan activity and restrictions on portfolio concentrations, would be reworded to clarify the minimum level of 504 loan activity a CDC must maintain. In addition, this section would cover the requirement concerning portfolio concentrations currently contained in § 120.827(a) and the heading to the section would be revised accordingly.

Section 120.829, job opportunity average a CDC must maintain, would modify the job opportunity average a CDC must maintain by changing it to an amount specified by SBA by means of a notice published in the **Federal**

**Register**. Currently, the average is preventing many CDCs from accepting 504 loan applications from small businesses for loans that would not create jobs but would meet other statutory 504 Program objectives, such as loans to increase business efficiency through technology. In addition, the present ratio has been in effect since 1990 and does not take into account the inflationary factors in the cost of land, real estate acquisition, construction, and machinery and equipment since that time. Finally, SBA is proposing to clarify that a new CDC is permitted two years from the date it is certified to meet the job portfolio requirement.

Section 120.830, reports a CDC must submit, would be revised to change the submission requirement for CDC annual reports from 90 days to 120 days after the end of the CDC's fiscal year to permit CDCs more time to provide financial statements with the required level of review. This proposed rule also clarifies the requirement by adding that the annual report must include financial statements of any affiliate or subsidiary of the CDC. In addition, it would add some clarifying language regarding the submission requirements for changes to directors or staff.

Section 120.835, application to expand an area of operations, would be revised. Most of the applications SBA receives are for expansions of a CDC's area of operations within its State of incorporation. The expansion request usually is for several counties in which there currently are one or more CDCs that include those counties in their areas of operations. Since the proposed rule gives all CDCs a minimum area of operations of the State in which they are incorporated, and since SBA is allowing the marketplace to determine the optimum number of CDCs, much of the current regulatory language is no longer required (refer to § 120.802 and § 120.810 for further discussion). SBA proposes that the only applications for expansion that it would consider would be when the CDC requests to expand beyond its State of incorporation. In this section, SBA also proposes to add the requirement that such applicants must be ALP-qualified. There are two reasons for this. The first is to limit expansions beyond State lines to only those CDCs who have met certain volume, closing, and portfolio quality standards. The second is to reflect the proposed change in the regulations governing multi-state expansions that would permit a CDC to use in the expanded area any unilateral authority it has already received in its State of incorporation (see discussion of proposed changes to § 120.837). To further streamline the application

process, SBA is proposing to delete the requirement that a multi-state CDC have at least three members from each State on its board. SBA believes that the general membership requirements (*see* § 120.822) and loan committee requirements (*see* § 120.823) for the State into which it is expanding are sufficient to demonstrate the CDC's commitment to local economic development in that State. Additionally, SBA is proposing to delete the requirement for public notice and for direct notice to all other CDCs in the proposed area of operations since SBA is permitting the marketplace to determine the optimum number of CDCs that can be supported.

Section 120.836, public notice, and opportunity for response, would be deleted. SBA believes that the requirement would not be needed for the same reasons discussed in § 120.811.

Section 120.837, SBA decision on application for a new CDC or for an existing CDC to expand an area of operations, proposes to streamline the process by changing the paragraph on a multi-state CDC to permit any unilateral authority that a CDC has in its State of incorporation to be carried over into the additional State in which it is approved to operate as a multi-state CDC and clarifying SBA's decision process.

Section 120.838, expiration of existing, temporary expansions, was a short-term regulation to manage the conversion of existing temporary expansions into permanent expansions by March 1, 1996. Because of the changes proposed to the rules covering areas of operation, SBA believes this section is no longer required and proposes its removal.

Section 120.839, case-by-case extensions, proposes to give a district office the authority to make a decision concerning whether SBA will allow a CDC to make a 504 Loan outside of its area of operations, and by adding as a new basis for such decision the situation in which a State may not have a CDC. (For example, currently Alaska has no CDC.) In addition, SBA is proposing to delete the exception that would require the Associate Administrator for Financial Assistance ("AA/FA") to approve because the exception has never been used and SBA's experience indicates that it is unnecessary.

In section 120.840, accredited lenders program, SBA proposes to substantially revise this section to describe the ALP, the benefits a CDC will receive through the ALP, how to apply for the ALP, and how SBA will process the application.

In new § 120.841, SBA proposes to establish more detailed qualifications

for the ALP. The standards will be consistent with section 507 of the Act and coordinate with eligibility requirements for CDC participation in the PCLP (*see* § 120.845 discussion below). These changes will make it easier for SBA to provide consistent and objective evaluation of a CDC application to participate in the ALP.

Section 120.845, premier certified lenders program, would be revised. The PCLP is now a permanent program pursuant to section 508 of the Act. SBA proposes to add considerably more detail to § 120.845 and move some of its revised and expanded provisions to new §§ 120.846–120.848. Since CDCs participating in the PCLP must be approved to participate under the ALP or be "ALP qualified," SBA proposes to add some of the PCLP requirements to § 120.841.

The PCLP is designed to take advantage of the proven loan processing and servicing skills of SBA's most proficient and most active CDCs. It is a relatively new program (started in 1994 as a pilot program) with a somewhat limited operating history. Because SBA transfers substantial additional authority to CDCs, the PCLP carries potentially significant risk to SBA and the 504 Program. Therefore, SBA intends to closely monitor and control its implementation and expansion. As a result, SBA will continue to work with the CDC industry to develop and publish enhanced operating policies and procedures as experience with the PCLP develops. While SBA intends to transfer as much authority and responsibility to PCLP CDCs as reasonably prudent, the extent of that delegation will continue to be refined over time. These refinements likely will address such issues as the type of 504 Loans eligible for the PCLP, the amount of prior SBA review applicable to each loan, program participation criteria, and other factors.

For example, while SBA believes that the PCLP may be most appropriately applied to routine 504 Loans and that particularly complex or problematic loans may need to be processed through standard 504 Program procedures, SBA will continue to study and analyze this issue and develop further guidance as appropriate. With respect to SBA's prior review of a 504 Loan at the loan approval stage, SBA is interested in limiting/minimizing its involvement in reviewing 504 Loans. While initially SBA expects to continue to review loan eligibility while delegating virtually all credit decisions to PCLP CDCs, SBA will consider expanding or reducing that authority as warranted by the results of the program.

Participation in the PCLP, pursuant to section 508(b) of the Act, is limited to those CDCs that are active in the 504 Program; are in good standing with SBA; have demonstrated the ability to properly analyze, close and service 504 Loans; and have been active as ALP CDCs. Section 508(b)(2)(A) of the Act allows SBA to waive the requirement for those non-ALP CDCs that meet the ALP participation criteria. However, rather than developing a waiver process, SBA proposes incorporating the ALP participation criteria into the PCLP participation criteria (*see* § 120.845(c)(1)).

Based on the guidance in the statute, and following extensive discussion with the CDC industry, SBA developed more specific factors to be used in evaluating a CDC's level of activity; ability to properly analyze, close, service and liquidate 504 Loans; and good standing. Each factor represents a major and essential CDC function, and each carries significant risk to SBA and the 504 Program. Because SBA delegates substantial authority and autonomy to PCLP CDCs, it considers each factor important, and a substantive deficiency in any one may preclude participation in the PCLP. SBA will use information from onsite compliance reviews, operational reviews and other program management and oversight activities, including the review of 504 loan applications to SBA, to make the determination regarding eligibility for PCLP status.

Congress, SBA and the CDC industry recognize that the success of the PCLP is highly dependent on the extent to which PCLP CDCs are familiar with SBA's credit and eligibility standards and its loan processing, closing, servicing and liquidation policies and procedures. These policies and procedures are highly complex and require processing a substantial volume of 504 Loans over an extended period of time to remain proficient. Also, SBA needs access to a significant number of a CDC's loans to evaluate its proficiency. SBA notes that the ALP requires that its participants must have processed at least 20 504 Loans in the most recent three years (*see* proposed § 120.841(b)). When considering the minimum 504 Loan volume requirement for participation in the PCLP, SBA considered the concern of smaller and rural CDCs that a high minimum 504 Loan volume requirement could exclude them from being a PCLP CDC. SBA discussed those concerns with the CDC industry and concluded that proficiency in 504 Loan policies and procedures can only be developed and maintained from regularly processing a significant

number of 504 Loans. In addition, one of the main purposes of the PCLP was to improve the efficiency and expedite the loan processing of higher volume CDCs, which were being disproportionately impacted by the longer turn-around time in SBA's district offices. Also, for low volume CDCs, any potential efficiency benefits from participating in the PCLP would more than likely be offset by the cost and effort required to develop and maintain the high level of 504 Loan proficiency required in a staff that rarely processes an SBA 504 Loan. (About half of all CDCs process less than six 504 Loan applications per year.) After considering these issues, SBA proposes to require that ALP and PCLP applicants must have received approval for at least twenty 504 Loans in the most recent three years and have a portfolio of at least 30 active 504 Loans. (SBA proposes to define an "active" 504 Loan as a loan that was approved and closed by the CDC and has a status of either current, delinquent, or in liquidation.)

To assist in determining the proficiency of a PCLP applicant to effectively process and administer 504 Loans, SBA proposes that SBA conducted oversight reviews of a PCLP applicant must have found the applicant to be at least generally in compliance with SBA's regulations, policies and procedures. In addition, SBA will need to assess the applicant's current proficiency, so these reviews must be relatively recent (within the past 12 months). While SBA has policy and procedural guidance in place generally requiring annual SBA oversight review, CDCs may occasionally request a postponement of those reviews. Applicants to the PCLP must recognize the need for current SBA review data and coordinate with their Lead SBA Office to ensure that the CDC is available and prepared for any required oversight reviews.

SBA has developed comprehensive management information systems to timely track and analyze the performance of a CDC's 504 Loan portfolio. As a result of an extensive examination and analysis of these performance data, SBA has determined that portfolio currency, delinquency, default, liquidation and loss rates are important measures of the quality of a CDC's portfolio and the effectiveness and diligence of its loan analysis, closing and servicing. Therefore, SBA has established benchmarks for each of these measures, which the large majority of CDCs regularly achieve. SBA proposes that PCLP applicants must meet SBA's established portfolio benchmarks.

SBA and the CDC industry recognize that the training and experience of the PCLP applicant's staff are critical determinants of the quality and effectiveness of its 504 Loan program administration as well as its diligence in applying SBA's 504 Loan credit and eligibility standards. As a result, the CDC industry has developed appropriate credit, packaging, loan closing and loan servicing training programs, which the staff of many CDCs attend. As a result, SBA proposes that the principal staff of PCLP applicants possess adequate 504 Loan training and experience.

Under the PCLP, SBA delegates authority and a certain level of autonomy to PCLP CDCs to process, close and service 504 Loans with only limited prior SBA review. As a result, SBA proposes that applicants to the PCLP must demonstrate a particularly thorough understanding of and an applied diligence to SBA's 504 Loan credit and eligibility standards and its 504 Loan processing, closing and servicing policies and procedures. A failure to consistently apply appropriate credit analyses and standards and loan processing, closing and servicing policies or procedures exposes SBA and the taxpayer to excessive risk of loss and negatively impacts the availability of SBA financing to the small business community. A CDC's failure to adequately apply SBA's 504 Loan eligibility standards could result in 504 Loan approvals to small businesses that are expressly prohibited by statute or regulation from receiving SBA loans.

Section 508(b)(2)(A) requires that PCLP CDCs be in good standing with SBA. SBA interprets that requirement to mean both in good standing with the State in which the CDC is incorporated (as discussed in § 120.820), and in compliance with the 504 Program requirements imposed by statute, regulation, SOP, policy and procedural notice, loan authorization, debenture, or any agreement between SBA and the CDC. Under the PCLP, due to the higher level of authority delegated to the PCLP CDCs and the potential risk to the Agency, SBA expects a significantly higher level of compliance with both of these requirements by PCLP CDCs, with only very rare deviation. SBA sees a similar distinction between non-PCLP CDCs generally meeting SBA's five established portfolio benchmarks versus virtually absolute compliance by PCLP CDCs with those benchmarks.

The Lead SBA Office would consider the CDC's initial application to the PCLP, and will forward the application package, including a recommendation regarding the applicant's qualifications,

to SBA's PCLP Processing Center, which then will forward the package with its recommendation to the AA/FA for final action. PCLP applicants are expected to coordinate with their Lead SBA Office early in their consideration of the PCLP to realistically assess its requirements and their prospects for admission. When officially applying for the PCLP, an applicant will need to provide certain essential information and documentation to assist SBA in ascertaining its qualifications, including a resolution from its Boards of Directors; resumes on key staff for 504 Loan processing, servicing, liquidation, and litigation; documentation of any required insurance; and information about the qualifications of its closing attorney. While SBA will generally confer PCLP status for a period of two years, under some conditions (such as borderline performance benchmarks, certain compliance review deficiencies, etc.) SBA may determine that a lesser period is appropriate.

Section 120.846, requirements for maintaining and renewing PCLP status, would be added. Pursuant to section 508(b)(3) of the Act, in order to retain its PCLP status, a PCLP CDC must continue to meet the eligibility requirements of the PCLP, as proposed in § 120.845. While level of activity is one of those criteria, section 508(i) of the Act requires that PCLP CDCs establish a goal of processing a minimum of 50 percent of their 504 Loan applications using PCLP procedures. SBA considered establishing a requirement that PCLP CDCs process at least 30 percent of their 504 Loans using PCLP procedures immediately after becoming a PCLP CDC and gradually increasing that requirement as the PCLP CDCs matures. However, following discussions with the CDC industry, SBA determined that immediately establishing such an absolute minimum could discourage participation in what is a developing program with a variety of relatively new concepts and procedures. Nevertheless, SBA recognizes that the legislation authorizing PCLP mandates that PCLP CDCs be active CDC lenders and establish a goal of processing a minimum of 50 percent of their 504 Loans using PCLP procedures. As a result, while SBA still expects PCLP CDCs to process a substantial proportion of their 504 Loans using PCLP procedures and strive to reach their 50 percent goal as mandated by statute, SBA will not immediately require an absolute minimum. Thus, as the PCLP matures, SBA intends to publish procedural guidance gradually

incorporating and increasing the minimum number and percent of 504 Loans that PCLP CDCs must process using PCLP procedures.

Due to the delegation of authority under the PCLP, and the associated risk of loss, SBA expects PCLP CDCs to develop, implement and actively monitor effective internal control systems and processes that will ensure continued conformance with the requirements of the PCLP. These systems should provide PCLP CDCs with early information on their performance. SBA also has developed management control systems to monitor individual PCLP CDCs, specifically the portfolio benchmark data and the management oversight reviews, and SBA provides this information to PCLP CDCs. With these internal and external control systems, SBA expects PCLP CDCs to constantly monitor their performance as a CDC and as a PCLP CDC and to be in a position to take appropriate and timely corrective action when necessary. Due to the risk inherent in the delegation of authority under the PCLP, SBA will move to timely suspend, terminate or decline to renew the PCLP status of PCLP CDCs that do not comply with the requirements of the PCLP. Significant problems with respect to liquidation and litigation activities by either a PCLP CDC or its contractor may, at SBA's option, also lead to suspension, termination, or the non-renewal of PCLP status. In egregious cases of a PCLP CDC's failure to comply with PCLP requirements, SBA also can issue an immediate suspension, under the proposed rule. In recommending a suspension or termination from the PCLP, SBA proposes to provide timely written notice to the PCLP CDC of its intention and the basis for the recommendation. The proposed regulations also delineate a PCLP CDC's appeal rights and reapplication time frames.

Section 120.847, requirements for the loan loss reserve fund, would be added. To mitigate some of the potential risk of delegating additional authority to PCLP CDCs, pursuant to section 508(c)(1) of the Act, PCLP CDCs must establish and make deposits to a Loan Loss Reserve Fund ("LLRF"). The LLRF is a restricted account established for the purpose of accumulating deposits and limiting withdrawals to those SBA specifically authorizes. The PCLP CDC may use the deposits to reimburse SBA for 10 percent of any loss sustained by SBA as a result of a default in the payment of principal or interest on a debenture issued by the PCLP CDC using PCLP procedures ("PCLP debenture").

Pursuant to section 508(c)(3) of the Act, the LLRF must be composed of: (1) Segregated deposit accounts at one or more federally insured depository institutions subject to a collateral assignment to SBA; (2) irrevocable letters of credit in favor of SBA; or (3) some combination of the above. Due to the characteristics and cost of letters of credit, and in consultation with the CDC industry, SBA has determined that letters of credit do not currently represent a feasible option for PCLP CDCs. Consequently, SBA is not addressing letters of credit in this proposed rule. However, SBA will continue to explore this option with the CDC industry, and will promulgate regulations addressing letters of credit to the extent this becomes a feasible option.

Pursuant to section 508(b)(2)(c) of the Act, PCLP CDCs must reimburse SBA for 10 percent of any loss SBA incurs in connection with a default on a PCLP debenture and the regulation proposes what is to be included in SBA's loss. The statute and proposed rule also require that the LLRF maintain a deposit equal to one percent of the original principal amount of each PCLP debenture.

The LLRF must be a deposit account with a federally insured depository institution selected by the PCLP CDC. Following discussions with the CDC industry, SBA is aware that alternative accounts and financial instruments may offer greater returns on the LLRF. However, the Act restricts LLRFs to federally insured depository institutions and that language as well as other applicable law greatly limit the investment alternatives. This proposed regulation elaborates on what constitutes a deposit account acceptable to SBA. Also, to simplify the administration of the LLRF, this proposed regulation would allow PCLP CDCs to pool loss reserves in a single segregated account. SBA generally does not anticipate that PCLP CDCs will incur significant fees in connection with their LLRFs, although PCLP CDCs will need to be mindful of breakage fees, should they place funds into certificates of deposit ("CDs"). This proposed regulation goes on to make clear that the PCLP CDC will be responsible for any fees, costs and expenses incurred in connection with the LLRF.

Pursuant to section 508(c)(3) of the Act, any LLRF established by a PCLP CDC must be subject to a collateral assignment in favor of, and in a format acceptable to, SBA. Accordingly, a PCLP CDC must give SBA a first priority perfected security interest in each LLRF. The PCLP CDC must grant the security

interest pursuant to a security agreement between the PCLP CDC and SBA, and the security interest must be subject to a control agreement between SBA, the PCLP CDC, and the applicable depository institution. The control agreement will include provisions requiring a depository institution to follow instructions from SBA regarding withdrawals without further consent from the PCLP CDC. The laws governing security interests in deposit accounts are complex, vary by jurisdiction and are undergoing change. Therefore, when establishing a LLRF, a PCLP CDC must coordinate with the Lead SBA Office to develop, execute and deliver the required documentation. SBA field counsel will have a model control agreement, which they may need to modify to meet local legal requirements. This proposed rule provides that the CDC must provide to the Lead SBA office a fully executed original copy of the security and control agreements which the Lead SBA Office will retain in its files. All associated documents must meet SBA requirements and occasional changes may be necessary. If a depository institution will not enter into or modify a control agreement or violates the terms of any such agreement, the PCLP CDC cannot maintain a LLRF with that institution.

Pursuant to section 508(c)(4) of the Act, PCLP CDCs are allowed to make required deposits to the LLRF associated with each loan in as many as three deposits, but specifies the minimum amount and timing of those deposits. This proposed rule sets forth the amount and timing of those deposits.

Due to its management control and oversight responsibilities, SBA must ensure that LLRFs (1) are properly established, (2) contain the required reserve amounts and (3) are appropriately administered and controlled. Periodic reporting by PCLP CDCs to SBA on the amount of funds maintained in LLRFs is critical to ensuring that LLRFs are properly established and maintained. However, while LLRFs must contain deposits equal to one percent of each PCLP debenture, the deposits associated with each PCLP debenture may be made in as many as three installments. Also, during the normal course of a PCLP CDC's operations, LLRFs will be subject to a variety of other deposits and withdrawals (e.g., withdrawals associated with loans paid in full and defaults). As a result, reporting and reconciling LLRFs might become quite complex. SBA is concerned with the potential burden such reporting could represent to PCLP CDCs. SBA continues to work with the CDC industry to



develop and test efficient and effective reporting procedures, and will publish appropriate procedural guidance as those procedures are finalized.

SBA proposes to allow PCLP CDCs to withdraw any funds from the LLRFs that exceed required minimums, at SBA's discretion. The proposed § 120.847(g) provides that requests for withdrawals must be forwarded to the Lead SBA Office, which will check the balances to ensure the required minimums are maintained and authorize withdrawals as appropriate.

Proposed § 120.847(h) would provide that when a PCLP CDC has submitted a liquidation wrap-up report to SBA, or SBA otherwise has determined that all reasonable collection efforts have been exhausted, the Lead SBA Office will calculate the SBA's loss and notify the PCLP CDC of the amount of any reimbursement obligation and provide appropriate supporting documentation. The proposed rule sets forth procedures so that PCLP CDCs may appeal any problems or disagreements regarding the calculation of SBA's loss.

Proposed § 120.847(i) would require PCLP CDCs to reimburse SBA for 10 percent of any loss and states that the reimbursement may come from the LLRF or from other funds provided by the PCLP CDC. There could also be instances where a PCLP CDC would not have sufficient funds in its LLRF to reimburse SBA for 10 percent of SBA's loss, and the regulation proposes to provide the PCLP CDC a reasonable period of time after SBA demand to reimburse the Agency.

Pursuant to section 508(c)(5), the proposed regulations would also require that should a PCLP CDC's LLRF drop below the required minimum, the PCLP CDC must replenish the LLRF within 30 days of the time that it realizes this deficiency or of a notice from SBA that the LLRF is deficient. Thus, if a depository institution offsets from any LLRFs maintained with the institution any amounts owing by the PCLP CDC to it, the PCLP CDC must replenish the LLRF to the full amount then required within 30 days.

Section 120.848, requirements of PCLP loan processing, closing, servicing, liquidating and litigating, would be added. SBA believes that the PCLP can be most prudently implemented and expanded if SBA focuses, at least initially, on expediting the processing of routine CDC loan applications under the PCLP and handling complex or problematic eligibility issues using standard 504 Loan procedures. However, SBA will continue to study and analyze this issue

and develop further guidance as the PCLP progresses.

Pursuant to § 508(e) of the Act, PCLP CDCs are permitted to approve, authorize, and close 504 Loans, subject to standards established by SBA. Proposed § 120.848 provides additional guidance and notes that all 504 Program requirements apply to 504 Loans processed by PCLP CDCs. PCLP CDCs are specifically authorized to determine a 504 Loan applicant's credit-worthiness and are permitted to establish the terms and conditions under which the loan will be made. The PCLP CDC also will be authorized to take other processing actions as may be delegated by SBA to PCLP CDCs. However, because SBA's management control and oversight responsibilities require a systematic review of a PCLP CDC's 504 loan processing proficiency, SBA must periodically review the processing actions of PCLP CDCs to ensure the PCLP CDC is using appropriate and reasonable procedures. PCLP CDCs are thus expected to retain in their loan files copies of all documents associated with their processing actions. SBA may occasionally review these documents on site or request that they be forwarded to SBA for review. If SBA identifies significant problems or deviations from SBA's 504 Program requirements, SBA will take appropriate corrective action, including possible removal from the PCLP.

The proposed rule also would require the authorized PCLP CDC official to sign all required documents and forward them to SBA's designated loan processing center for assignment of a loan number, subject to the availability of funds.

The PCLP CDC then would be expected to take appropriate action to close the loan and to prepare the closing documents for the corresponding debenture its closing counsel must issue an opinion stating the legal sufficiency of all closing documents, that all documentation has been obtained to comply with the loan terms and conditions established by the PCLP CDC and that the loan closing complies with all legal requirements and all 504 Program requirements for the PCLP. These actions are complex and will require the opinion of a qualified loan closing counsel. SBA counsel will close the PCLP debenture.

Pursuant to section 508(e) of the Act, SBA may delegate to PCLP CDCs responsibility for servicing 504 Loans, subject to terms and conditions as established by SBA. To enhance the efficiency of the PCLP, SBA intends to delegate most routine servicing actions to PCLP CDCs. However, SBA retains

management oversight responsibility for the effectiveness of the PCLP. Therefore, SBA will continue to monitor the quality and effectiveness of PCLP CDC servicing activities through onsite reviews and other evaluation activities. As a result, should significant problems develop, or when it substantially benefits SBA or the PCLP CDC, SBA may elect to handle some or all servicing actions associated with a particular 504 Loan or a particular PCLP CDC portfolio. However, SBA anticipates such actions to be rare and unusual. In delegating servicing authority to PCLP CDCs, SBA proposes that PCLP CDCs must use prudent and commercially reasonable standards and practices, as well as comply with all 504 Program requirements.

SBA is proposing to delete §§ 120.850–120.852, concerning ADCs, and to eliminate the ADC designation. First, SBA is seeking to eliminate redundancy in the regulations. One aspect of the ADC program was that it established requirements for organizations to qualify to contract with CDCs for 504-related services. However, § 120.824 permits CDCs to contract for 504-related services and governs such contracts. Second, these regulations established one of the grounds (not meeting the minimum required level of 504 Loan approval activity) for removing a CDC from the 504 Program. In the proposed rule, all grounds for taking enforcement action against a CDC would be combined under one regulation, § 120.854.

Section 120.855, CDC ethical requirements, would be redesignated as § 120.851, and reworded to clarify its meaning and to remove the reference to ADCs (see § 120.850 discussion).

Proposed new § 120.852 would prohibit a CDC from investing in or being affiliated with a 7(a) lender or an SBIC, which SBA believes will help to avoid apparent conflicts of interest and serve the economic development mission of the CDC. The proposed rule would not require a CDC with an existing investment in an SBIC to liquidate such investment. As part of the ANPRM, SBA asked the question whether SBA should permit a CDC to establish a 7(a) lender or permit a 7(a) lender to establish a CDC. The overwhelming response was that two programs should remain separate.

Proposed new § 120.853 is identical to existing § 120.973 except that it would eliminate references to ADCs.

Proposed new § 120.854, grounds for taking enforcement action against a CDC, § 120.855, types of enforcement actions, and § 120.856, enforcement procedures, would consolidate existing

§ 120.852 and §§ 120.982–120.984 and would clarify the grounds required for SBA enforcement actions against CDCs as well as SBA's and CDCs' rights and responsibilities in such actions. Section 120.981, voluntary transfer and surrender of CDC certification, would be redesignated as § 120.857 to move it under the new heading.

Section 120.861, job creation or retention, is revised (see discussion of proposed revisions to § 120.829 for a description of the changes to the job requirement criteria). The change in the criteria will be published in a **Federal Register** notice from time to time.

Section 120.862, other economic development objective, includes two technical changes. The first is the Agency-wide replacement of "SIC" codes with "NAICS" codes when identifying the types of small businesses eligible to receive SBA assistance. The second is to correct the cross-reference to the regulation that describes a minority for purposes of the public policy goal of assisting minority-owned businesses. The proposed changes also reflect the statutory changes to section 501(d) of the Act, which added women-owned and veteran-owned businesses to the public policy goals.

Section 120.870, leasing project property, would eliminate references to 504 project property being leased by the CDC to the borrower.

Section 120.880, basic eligibility requirements, proposes simplifying changes by replacing the actual size standards with a cross-reference to the size standard regulation. As the size standard regulations change, so will this regulation without requiring it to be rewritten.

Section 120.882, eligible project costs for 504 loans, proposes clarifying eligible costs that may be included in 504 project costs.

Section 120.883, eligible administrative costs for 504 loans, proposes changes clarifying eligible administrative costs that may be paid from the proceeds of the 504 Loan and debenture.

Section 120.892 would be revised to require a 504 loan borrower to provide to the CDC current financial statements within 120 days of 504 loan closing, instead of within 90 days.

SBA proposes to change the headings of §§ 120.900 and 120.910 to make their form consistent with the other section headings in subpart H.

Section 120.911, land contributions, proposes to make a technical correction to the regulation by deleting the reference to CDCs. CDCs do not contribute land for a 504 loan.

Section 120.913, limitations on any SBIC contributions, proposes changes to clarify the heading, and to add a cross-reference and clarify the section.

Section 120.923, policies on subordination, proposes changing the section heading and consolidating existing §§ 120.923 and 120.924.

Section 120.925, preferences, proposes adding a cross-reference to another SBA regulation governing preferences.

Section 120.926, referral fee, proposes modifying the language by adding "reasonable" in describing the referral fee that a CDC may charge a third party lender. The proposed changes also emphasize that neither the lender nor the CDC can charge this fee to the borrower.

Section 120.930, amount, proposes eliminating the requirement that SBA must approve 504 loans between \$25,000 and \$50,000 on an exception basis. SBA does not believe that it ever has declined such a request.

Section 120.931, 504 lending limits, proposes increasing the dollar amounts to reflect the changes to section 502(2) of the Act that became effective December 21, 2000.

Section 120.933, maturity, proposes creating flexibility in debenture maturities. This will permit SBA to consider other maturities besides 10 and 20 years at some future date.

Section 120.934, collateral, proposes clarifying the paragraph by rearranging and re-wording the sentences.

Section 120.935, deposit, proposes changing the heading.

SBA proposes to delete section 120.936, subordination to CDC. SBA believes that this regulation is a holdover from the former 501 and 502 programs. SBA knows of no instance when a CDC has requested a subordination on its 504 Loans.

Section 120.960, responsibility for closing, proposes clarifying language that describes the circumstances under which SBA can decline to close a debenture or cancel its guarantee of the debenture prior to sale.

Section 120.970, servicing of 504 loans and debentures, proposes clarifying language regarding a CDC's responsibility in servicing a 504 loan.

Section 120.971, allowable fees paid by borrower, proposes clarifying language regarding the loan closing fees that a CDC may charge.

Section 120.972, third party lender participation fee and CDC fee, proposes revising the heading, deleting the language "from the Third Party Lender" from paragraph (a), and slightly clarifying paragraph (b). SBA accepts the third party lender participation fee

from the third party lender, the 504 borrower, or the CDC.

SBA proposes to remove §§ 120.980–120.984.

### Specific Comments Requested

SBA is considering reordering the entire subpart H, and SBA invites comments specifically responding to this proposal. SBA is considering whether renumbering the regulations within subpart H would better highlight the purposes of the 504 Program and the requirements pertaining to 504 Loans. SBA is considering reordering the sections into the following topic areas in the following new order:

Purpose  
How a 504 project is financed  
Definitions  
Project economic development goals  
Loan-making policies specific to 504 loans  
Leasing policies specific to 504 loans  
Interim financing  
Permanent financing  
Borrower's contribution  
Third party loans 504 loans and debentures  
Fees  
504 loan and debenture closings  
Servicing  
Debenture sales and service agents  
CDC requirements  
Accredited lenders program (ALP)  
Premier certified lenders program (PCLP)  
Other CDC requirements  
SBA oversight of CDCs  
CDC transfer, suspension, and revocation  
Enforceability of 501, 502, and 503 loan and other laws

SBA would be interested in comments concerning whether renumbering the sections using this scheme would enhance the organization of the Subpart enough to outweigh any confusion it might create in the CDC industry and among borrowers, borrower counsel, and CDC counsel. SBA also would be interested in any other re-ordering proposals commenters may have.

SBA also generally invites comment on all aspects of this proposed rule, including the underlying policies. SBA may rely on its own expertise in promulgating the final rule. Submitted comments will be available to any person or entity upon request.

### Compliance With Executive Orders 13132, 12988, and 12866, the Regulatory Flexibility Act (5 U.S.C. 601–612), and the Paperwork Reduction Act (44 U.S.C., Ch. 35)

*Executive Order 13132:* For the purposes of Executive Order 13132, SBA determined that this proposed rule has no federalism implications warranting preparation of a federalism assessment.

*Executive Order 12866:* The Office of Management and Budget (OMB) has

determined that this proposed rule constitutes a significant regulatory action under Executive Order 12866. SBA believes there is a need for this regulatory action for the reasons stated in the preamble to this proposed rule. SBA believes the proposed regulatory changes will improve 504 Program delivery to small business customers by increasing customer choice of service; increase third party lender choice of CDCs; facilitate the formation of new CDCs; facilitate the expansion of existing CDCs; and increase the number of CDCs able to take advantage of special initiatives for rural areas. By allowing market-driven forces to determine availability of 504 Program service, small business will have greater opportunity to negotiate the best total financing package, including fees, as well as receive increased service by CDCs. In addition, the 504 Program will be more responsive to changes in market conditions. SBA believes that there are no viable alternatives to these changes that would produce similar positive results without imposing an additional burden on SBA or the public. However, SBA requests comment from members of the public who believe there are viable alternatives that would achieve the same objectives with no greater burden.

In FY2002, OMB developed the Program Assessment Rating Tool (PART) to establish a systematic, consistent process for rating the performance of programs across the federal government. The 504 Program was evaluated under the PART criteria in FY2002. The PART review revealed that SBA needs to increase the availability of CDCs within the 504 Program to improve customer access to loans. Additionally, increasing the availability of CDCs will enable borrowers to determine which of SBA's loan programs best meet their needs. SBA expects that this proposed rule will address this recommendation of OMB.

SBA does not have sufficient data to establish a baseline in order to measure the costs and benefits of this proposed rule on the affected public. However, SBA has data on the cost to SBA of the 504 Program. In FY2002, the cost of the 504 Program to SBA was approximately \$15 million. The majority of the cost of the Program, 82% or \$12.6 million, was for the cost of the field office staff support that reviewed and approved loan applications and conducted marketing and outreach to generate new loans. The cost of the 504 Program to SBA also includes the cost of reviewing and analyzing CDC requests to expand their areas of operations by SBA's field office and Headquarters staff. SBA

would expect this cost to decline substantially as a result of this proposed rule because it permits all CDCs to operate at least throughout their State of incorporation. Other data on the program can be found at [www.sba.gov](http://www.sba.gov). SBA requests data from the public that would enable SBA to determine existing regulatory costs of the program to the public and changed costs and benefits as a result of the proposed rule.

*Regulatory Flexibility Act:* This proposed rule directly affects all CDCs, of which there are approximately 270. SBA has determined that CDCs fall under the size standard for NAICS 522298, All Other Nondepository Credit Intermediation. The size standard is \$6 million in average annual receipts. SBA estimates that at least 95 percent of the CDCs do not exceed this size standard and are therefore considered small entities by this definition. Thus, SBA has determined that this proposed rule will have an impact on a substantial number of small entities. However, SBA has determined that such impact will not be significant.

The effect of the proposed rule will be to "level the playing field" by allowing CDCs more flexibility to choose the optimal area of operations within their State of incorporation. Currently, each CDC has a specific area of operations that is approved by SBA. The typical area of operations is several counties within the CDC's State of incorporation. If a CDC wishes to apply to expand into neighboring counties, it can only do so if those counties are available.

Currently, a county is available to a new CDC or a CDC requesting to expand its area of operations if the CDC(s) that include that county in its area of operations is not meeting a threshold of one 504 approval per year per 100,000 population averaged over two years. If the existing CDC is meeting this threshold of activity, both an applicant wishing to become a CDC and a CDC wishing to expand its area of operations is barred from including that county in their request. The proposed rule levels the playing field by eliminating this threshold and by permitting all CDCs to operate anywhere in their State of incorporation. SBA believes that some CDCs will choose to continue to operate in those counties they presently operate in while others will choose to expand their market area into neighboring counties or throughout the State. It has been SBA's experience with CDCs that are permitted to compete with other CDCs in the same market area, that the market of eligible 504 Loan projects itself expands, resulting in a benefit for the affected CDCs as well as a benefit to small business borrowers.

This proposed rule will also permit new CDCs the opportunity to market in areas that may produce more 504 loans sooner. This in turn will permit the new CDC to reach a breakeven point sooner in its operations and continue to meet the required 504 activity of two 504 approvals per year. Currently it is estimated that it takes a CDC at least two years at a cost of \$200,000 or more to reach the 504 activity level where the 504 fee income covers the CDC's expenses. SBA believes that smaller, rural CDCs will derive a similar benefit by having a greater opportunity to meet the required 504 loan activity level. Since 1993, SBA has had to revoke certifications from more than 100 CDCs and transfer their 504 loan portfolios and fees to other, active CDCs due to their failure to meet the required 504 activity level of two 504 loan approvals per year averaged over two years. Most of these CDCs have been located in rural areas where there are a limited number of potential 504 Loan projects. This proposed rule will enable those small, rural CDCs the opportunity to expand their market area by doing projects in more populous areas, resulting in their more easily meeting the 504 loan activity level. At the same time those CDCs that currently have exclusive areas that include populous urban areas resulting in substantial 504 loan activity may seek to expand their market areas into the less lucrative rural areas. The expected result is that future 504 borrowers will benefit from an increase in choice among CDCs.

In addition, SBA expects the impact of the proposed rule will be a reduction in the overall paperwork burden for CDCs since CDCs will no longer have to apply to SBA to expand their area of operations within their State of incorporation. SBA received and approved approximately 11 expansion requests during 2002. All were for CDCs requesting expansions into neighboring counties within the CDC's State of incorporation. The burden hours for a new CDC or a CDC wishing to expand to complete an application is estimated to be 10 hours. None of the applications for an expansion would have been necessary under the proposed rule. In addition, applicants requesting to become CDCs also will be permitted to establish their optimal area of operations within their State of incorporation without being excluded from areas that currently have one or more CDCs. SBA receives one or two applications to become a CDC per year. The burden hours for an application will be reduced by approximately one hour due to the changes in the general

membership requirements that will allow an applicant more flexibility in meeting this requirement. SBA asserts that the economic impact of the reduction in paperwork, if any, will be minimal to small entities.

Finally, it has been SBA's experience that the more CDCs that market the 504 program in a particular area, the higher the 504 Loan volume in that area. SBA believes that this is due to the additional marketing initiatives by the CDCs which creates an increased awareness of the 504 Program among the local lending community and improves their willingness to participate because they have a choice. SBA also believes having multiple CDCs in the area improves the service provided by the CDCs, which also makes the 504 Program more useful to the commercial banking community. As more and more bankers successfully use the program, they discuss it and provide information about it to other bankers which increases the impact of the marketing efforts of the CDCs. A similar phenomenon occurred in the banking industry. Over the years, bankers participating in SBA's 7(a) program have always been willing to come to bankers' meetings to describe their activity with other bankers. They do this because they recognize that as more people are aware of the program, the size of the market will increase. They may not have as high a percentage of the market but will have a smaller percentage of a bigger market resulting in more overall loan activity for the lender.

Accordingly, SBA hereby determines that this rule will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601-612. SBA invites comment from members of the public who believe there will be a significant economic impact on a substantial number of small entities.

*Paperwork Reduction Act:* SBA has determined that this proposed rule imposes additional reporting or recordkeeping requirements under the Paperwork Reduction Act, 44 U.S.C. chapter 35. This collection of information relates to two different reporting requirements: (1) The PCLP application and (2) the PCLP Loan Loss Reserve Fund reporting requirements. We include below an estimate of the time necessary to review the instructions, search data, fill in the forms, and gather, maintain and report the required data.

SBA invites comments on: (1) Whether the proposed collection of information is necessary for the proper

performance of SBA's functions, including whether the information will have a practical utility; (2) the accuracy of SBA's estimate of the burden of the proposed collections of information, including the validity of the methodology and assumptions used; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques, when appropriate, and other forms of information technology.

Please send comments by the closing date for comment for this proposed rule to David Rostker, Office of Management and Budget, Office of Information and Regulatory Affairs, 725 17th Street, NW., Washington, DC 20503 and to LeAnn Oliver, Deputy Associate Administrator for Financial Assistance, Office of Financial Assistance, Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

#### A. Application

*Title:* CDC Checklist for Submitting PCLP Guarantee Requests (Part A); Supplemental Information for PCLP Processing (Part B); Eligibility Information Required for PCLP Submissions (Part C); How to Apply for a PCLP Number from SBA (instructions); and Instructions for "Supplemental Information for PCLP Processing" (No SBA form no. yet) (An application for OMB clearance is being submitted under separate cover.)

*Summary:* The PCLP application form is designed for PCLP CDCs. Under PCLP, the CDC is delegated the authority to (1) determine whether the proposed borrower poses an acceptable credit risk and (2) limiting SBA's determination of eligibility to a checklist filled in by the CDC. The other forms that make a complete PCLP application package are data collection forms to enable SBA to enter descriptive information about the borrower into SBA's database, and two pages of "Application for Section 504 Loan," SBA Form 1244 (OMB Approval No. 3245-0071) that include information about the borrower as well as the signature page regarding CDC Agreements and Certifications.

*Need and Purpose:* Under standard SBA 504 Loan processing, SBA extensively analyzes the financing proposal and supporting documentation such as personal and business financial statements, cash flow projections and documentation to support an eligibility determination. These activities are designed to control and limit the risk associated with the 504 Program and

SBA's guaranty, but they do require significant SBA resources. The time between submission of the 504 application to SBA and SBA making a decision to approve or deny the application can be several days to several weeks. If the loan defaults, SBA assumes 100 percent of the cost associated with the purchase of the debenture as well as costs associated with collection and liquidation activities. Under the PCLP, the CDC makes the credit decision regarding the application and submits an abbreviated eligibility checklist for SBA's review to determine eligibility. The time between submission of an application by the PCLP CDC and SBA making a decision is generally an hour or less. In exchange for this quick turn-around time by SBA, the PCLP CDC assumes 10 percent of any loss to SBA on any loan processed under the PCLP.

*Description of Respondents:* CDCs that qualify as PCLP CDCs. There are approximately 270 CDCs. Of those, 26 CDCs are PCLP CDCs. The number of PCLP CDCs has remained relatively static for several years. In FY 2002, 14 percent of the number of loans and 15 percent of the approved dollars were processed PCLP. For fiscal year 2003, year-to-date (through May 9, 2003), the percentage has dropped to 12 percent in the number of loans and 12 percent of the approved dollars.

SBA estimates the burden of this collection of information as follows: A PCLP CDC will complete these forms for each PCLP loan it processes. SBA estimates that the time needed to complete this collection is 45 minutes. SBA estimates that the cost to complete this collection will be approximately \$20 per hour due to the clerical nature of most of the completion. Total estimated aggregated burden per annum is estimated to be approximately 700 hours per annum costing an aggregated \$14,000 per year.

#### B. LTRF Compliance Information

*Title:* LTRF Compliance Information (No SBA Form Number)

*Summary:* The LTRF compliance information will document the PCLP CDC's meeting of the LTRF deposit requirements.

*Need and Purpose:* Proposed § 120.847(f) of SBA regulations states that each PCLP CDC must periodically report to SBA the amounts in its LTRF in a form that will readily facilitate reconciliation of the amounts maintained in its LTRF with the amounts required. This will require the PCLP CDC to keep track of the face amount of each PCLP debenture and then determine and record the amount

that must be contributed into its LLRF. Pursuant to the proposed regulations (§ 120.847(e)) the PCLP CDC has several deadlines related to when those contributions relating to each PCLP debenture must be made. There are three relevant deadlines for each PCLP debenture. The PCLP CDC must also keep track of its contributions to the LLRF.

*Description of Respondents:* There are approximately 270 CDCs. Of those, there are approximately 26 PCLP CDCs, or less than 10 percent of all CDCs.

SBA estimates the burden of this collection of information as follows: one hour per PCLP debenture. PCLP debenture volume will vary significantly among participants. We expect that few PCLP CDCs will issue more than 50 PCLP debentures annually. That would mean an aggregate burden of no more than 50 hours per year. SBA estimates that the added cost would be minimal, because existing PCLP CDC support staff and ordinary bank records will cover the labor costs. At an estimate of \$10 per hour, the reporting requirements would not likely exceed \$500 per year for any PCLP CDC.

*Executive Order 12988:* For purposes of Executive Order 12988, SBA determines that this proposed rule is drafted, to the extent practicable, to accord with the standards set forth in paragraph 3 of that Order.

#### List of Subjects in 13 CFR Part 120

Loan Programs—business, Reporting and recordkeeping requirements, Small business.

For the reasons set forth in the preamble, SBA proposes to amend 13 CFR part 120 as follows:

#### PART 120—BUSINESS LOANS

1. The authority citation for part 120 continues to read as follows:

**Authority:** 15 U.S.C. 634(b)(6), 636(a) and (h), 696(3) and 697(a)(2).

2. Amend § 120.10 by adding a definition of “SOP” to read as follows:

##### § 120.10 Definitions.

\* \* \* \* \*

*SOPs* are SBA Standard Operating Procedures, as issued and revised by SBA from time to time.

#### Subpart A—Policies Applying to All Business Loans

2. Revise the first sentence of the introductory text of § 120.140 to read as follows:

##### § 120.140 What ethical requirements apply to participants?

Lenders, Intermediaries, and CDCs (in this section, collectively referred to as “Participants”), must act ethically and exhibit good character. \* \* \*

#### Subpart H—Development Company Loan Program (504)

3. Revise the heading of § 120.800 to read as follows:

##### § 120.800 The purpose of the 504 program.

4. Revise the heading of § 120.801 to read as follows:

##### § 120.801 How a 504 Project is financed.

5. Amend § 120.802 by removing the definition of “Associate Development Company”; revising the definition of “Area of Operations”; adding definitions of “Designated Attorney”, “Lead SBA Office”, “Priority CDC”, and revising the first sentence of the definition of “Local Economic Area”, to read as follows:

##### § 120.802 Definitions.

\* \* \* \* \*

*Area of Operations* is the geographic area where SBA has approved a CDC’s request to provide 504 program services to small businesses on a permanent basis. The minimum Area of Operations is the State in which the CDC is incorporated.

\* \* \* \* \*

*Designated Attorney* is the CDC closing attorney that SBA has approved to close loans under an expedited closing process for a Priority CDC.

\* \* \* \* \*

*Lead SBA Office* is the SBA District Office designated by SBA as the primary liaison between SBA and a CDC and with responsibility for managing SBA’s relationship with that CDC.

\* \* \* \* \*

*Local Economic Area* is an area, as determined by SBA, that is in a State other than the State in which an existing CDC (or an applicant applying to become a CDC) is incorporated, is contiguous to the CDC’s existing Area of Operations (or the applicant’s proposed Area of Operations) of its State of incorporation, and is a part of a local trade area that is contiguous to the CDC’s Area of Operations (or applicant’s proposed Area of Operations) of its State of incorporation. \* \* \*

*Priority CDC* is a CDC certified to participate on a permanent basis in the 504 program (see § 120.812) that SBA has approved to participate in an expedited 504 loan and Debenture closing process.

\* \* \* \* \*

6. Revise § 120.810 to read as follows:

##### § 120.810 Applications for certification as a CDC.

(a) An applicant for certification as a CDC must apply to the SBA District Office serving the jurisdiction in which the applicant has or proposes to locate its headquarters (see § 101.103 of this chapter).

(b) The applicant must apply for an Area of Operations. The applicant’s proposed Area of Operations must include the entire State in which the applicant is incorporated, and may include Local Economic Areas. An applicant may not apply to cover an area as a Multi-State CDC.

(c) The applicant must demonstrate that it satisfies the CDC certification and operational requirements in §§ 120.820, and § 120.822 through 120.824. The applicant also must include an operating budget, approved by the applicant’s Board of Directors, which demonstrates the required financial ability (as described in § 120.825), and a plan to meet CDC operational requirements (without specializing in a particular industry) in § 120.821, and §§ 120.826 through 120.830.

(d) The District Office will forward the application and its recommendation to the AA/FA, who will make the final decision. SBA will notify the CDC in writing of its decision, and, if the petition is declined, the reasons for the decision. The procedures of §§ 120.855 through 120.857 do not apply to the denial of an application.

##### § 120.811 [Removed]

7. Remove § 120.811.

8. Revise § 120.812 to read as follows:

##### § 120.812 Probationary period for newly certified CDCs.

(a) Newly certified CDCs will be on probation for a period of two years from the date of certification, at the end of which the CDC must petition the Lead SBA Office for:

- (1) Permanent CDC status; or
- (2) A single, one-year extension of probation.

(b) SBA will consider the failure to file a petition before the end of the probationary period as a withdrawal from the 504 program. If the CDC elects withdrawal, SBA will direct the CDC to transfer all funded and/or approved loans to another CDC, SBA, or another servicer approved by SBA.

(c) The Lead SBA Office will send the petition and its recommendation to the AA/FA, who will make the final decision. SBA will determine permanent CDC status or an extension of probation, in part, based upon the

CDC's compliance with the certification and operational requirements in §§ 120.820 through 120.830.

(d) SBA will notify the CDC in writing of its decision, and, if the petition is declined, the reasons for the decision. The procedures of §§ 120.855 through 120.857 do not apply to a denial of a petition for permanent CDC status.

9. Revise § 120.820 to read as follows:

**§ 120.820 CDC non-profit status and good standing.**

A CDC must be a non-profit corporation, except that for-profit CDCs certified by SBA prior to January 1, 1987 may retain their certifications. An SBIC may not become a CDC. A CDC must be in good standing based upon the following criteria:

(a) In good standing in the State in which the CDC is incorporated and any other State in which the CDC conducts business.

(b) In compliance with all laws, including taxation requirements, in the State in which the CDC is incorporated and any other State in which the CDC conducts business.

10. Revise § 120.821 to read as follows:

**§ 120.821 CDC Area of Operations.**

A CDC must operate only within its designated Area of Operations approved by SBA except as provided in § 120.839.

11. Revise § 120.822 to read as follows:

**§ 120.822 CDC membership.**

(a) *CDC Membership.* A CDC must have at least 25 members (or stockholders for for-profit CDCs approved prior to January 1, 1987). The CDC membership must meet annually. No person or entity can own or control more than 10 percent of the CDC's voting membership (or stock). No employee or staff of the CDC can qualify as a member of the CDC for the purpose of meeting the membership requirements. The CDC membership must include representatives from all the groups listed in paragraph (b) of this section.

(b) *Membership groups.* Members must be responsible for actively supporting economic development in the Area of Operations and must be from one of the following groups:

- (1) Government organizations responsible for economic development in the Area of Operations;
- (2) Financial institutions that provide commercial long term fixed asset financing in the Area of Operations;
- (3) Community organizations dedicated to economic development in the Area of Operations such as

chambers of commerce, foundations, trade associations, colleges, universities, or small business development centers (as defined in section 21(a)(1) of the Act, 15 U.S.C. 648(a)(1)); and

(4) Businesses in the Area of Operations.

(c) A CDC that is incorporated in one State and is operating as a Multi-State CDC in another State must meet the membership requirements for each State.

12. Amend § 120.824 by revising the second sentence in the introductory text and paragraph (a) to read as follows:

**§ 120.824 Professional management and staff.**

\* \* \* CDCs may obtain, under written contract, management, marketing, packaging, processing, closing, servicing or liquidation services provided by qualified individuals and entities under the following circumstances:

(a) The CDC must have at least one salaried professional employee that is employed directly (not a contractor or an Associate of a contractor) full-time to manage the CDC. The CDC manager must be hired by the CDC's board of directors and subject to termination only by the board. A CDC may petition SBA to waive the requirement of the manager being employed directly if another non-profit entity that has the economic development of the CDC's Area of Operations as one of its principal activities will contribute the management of the CDC. The management contributed by the other entity also may work on and operate that entity's economic development programs, but must be available to small businesses interested in the 504 program and to 504 loan borrowers during regular business hours.

\* \* \* \* \*  
13. Revise § 120.826 to read as follows:

**§ 120.826 Basic requirements for operating a CDC.**

A CDC must operate in accordance with all 504 program requirements imposed by statute, regulation, SOPs, SBA policy and procedural notices, loan authorizations, Debentures, and agreements between the CDC and SBA. In its Area of Operations, a CDC must market the 504 program, package and process 504 loan applications, close and service 504 loans, and if authorized by SBA, liquidate and litigate 504 loans. It must supply to SBA current and accurate information about all certification and operational requirements, and maintain the records and submit the reports required by SBA.

14. Revise § 120.827 to read as follows:

**§ 120.827 Other services a CDC may provide to small businesses.**

A CDC may provide a small business with assistance unrelated to the 504 loan program as long as the CDC does not make such assistance a condition of the CDC accepting from that small business an application for a 504 loan. An example of other services a CDC may provide is assisting a small business in applying for a 7(a) loan (as described in § 120.2). A CDC is subject to part 103 of this chapter when providing such assistance.

15. Revise § 120.828 to read as follows:

**§ 120.828 Minimum level of 504 loan activity and restrictions on portfolio concentrations.**

(a) A CDC is required to receive SBA approval of at least four 504 loan approvals during two consecutive fiscal years.

(b) A CDC's 504 loan portfolio must be diversified by business sector.

16. Amend § 120.829 by revising paragraph (a) to read as follows:

**§ 120.829 Job Opportunity average a CDC must maintain.**

(a) A CDC's portfolio must maintain a minimum average of one Job Opportunity per an amount of 504 loan funding that will be specified by SBA from time to time in a **Federal Register** notice. Such Job Opportunity average remains in effect until changed by subsequent **Federal Register** publication. A CDC is permitted two years from its certification date to meet this average.

\* \* \* \* \*

17. Revise paragraphs (a) and (b) of, and add a new paragraph (g) to, § 120.830 to read as follows:

**§ 120.830 Reports a CDC must submit.**

\* \* \* \* \*

(a) An annual report within 120 days after the end of the CDC's fiscal year (to include financial statements of the CDC and any affiliates or subsidiaries of the CDC), and such interim reports as SBA may require;

(b) For each new associate and staff, a Statement of Personal History (for use by non-bank lenders and CDCs) and other information required by SBA;

\* \* \* \* \*

(g) Other reports as required by SBA.

18. Revise § 120.835 to read as follows:

**§ 120.835 Application to expand an Area of Operations.**

(a) *General.* A CDC that has been certified to participate in the 504 program may apply to expand its Area of Operations if it meets all requirements to be an Accredited Lender Program (ALP) CDC, as set forth in § 120.840(c), and demonstrates that it can competently fulfill its 504 program responsibilities in the proposed area.

(b) *Local Economic Area Expansion.* A CDC seeking to expand its Area of Operations into a Local Economic Area must apply in writing to the Lead SBA Office.

(c) *Multi-State CDC Expansion.* A CDC seeking to become a Multi-State CDC must apply to the SBA District Office that services the area within each State where the CDC intends to locate its principal office for that State. A CDC may apply to be a Multi-State CDC only if:

(1) The State the CDC seeks to expand into is contiguous to the State of the CDC's incorporation;

(2) The CDC demonstrates that its membership meets the requirements in § 120.822 separately for its State of incorporation and for each additional State in which it seeks to operate as a Multi-State CDC; and

(3) The CDC has a loan committee meeting the requirements of § 120.823.

**§ 120.836 [Removed]**

19. Remove § 120.836.

20. Amend § 120.837 by revising paragraph (b) and adding a new paragraph (c) to read as follows:

**§ 120.837 SBA decision on application to become a Multi-State CDC.**

\* \* \* \* \*

(b) SBA will notify the CDC of its decision in writing, and if the application is denied for some, or all, of the requested states, the reasons for its decision. The procedures set forth in §§ 120.855 through 120.857 will not apply to the denial of a Multi-State application.

(c) If a CDC is approved to operate as a Multi-State CDC, the CDC's ALP, PCLP, or Priority CDC authority will carry over into every additional State in which it is approved to operate as a Multi-State CDC.

**§ 120.838 [Removed]**

21. Remove § 120.838.

22. Revise § 120.839 to read as follows:

**§ 120.839 Case-by-case application to make a 504 loan outside of a CDC's Area of Operations.**

A CDC may apply to make a 504 loan for a Project outside its Area of

Operations to the District Office serving the area in which the Project will be located. The applicant CDC must demonstrate that it can adequately fulfill its 504 program responsibilities for the 504 loan. The District Office may approve the application if:

(a) The applicant CDC has previously assisted the business to obtain a 504 loan; or

(b) The existing CDC or CDCs serving the area agree to permit the applicant CDC to make the 504 loan; or

(c) There is no CDC within the Area of Operations.

23. Revise § 120.840 to read as follows:

**§ 120.840 Accredited Lenders Program (ALP).**

(a) *General.* Under the ALP program, SBA designates qualified CDCs as ALP CDCs, gives them increased authority to process, close, and service 504 loans, and provides expedited processing of loan approval and servicing actions.

(b) *Application.* A CDC must apply for ALP status to the Lead SBA Office. The Lead SBA Office will send its recommendation and the application to the AA/FA for final decision.

(c) *Eligibility.* In order for a CDC to be eligible to receive ALP status, its application must show that it meets the criteria set forth in § 120.841.

(d) *Additional application requirements.* The CDC's application must include the following:

(1) Certified copy of the CDC's Board of Directors' resolution authorizing the application for ALP status.

(2) Summary of the experience of each of the CDC's loan processing, closing, and servicing staff members with significant authority.

(3) Name, address, and summary of experience of Designated Attorney.

(4) Documentation of any SBA required insurance.

(5) Any other documentation required by SBA.

(e) *Term of ALP designation.* SBA generally will designate a CDC as an ALP CDC for a two-year period. SBA may renew the designation for an additional two-year period if the CDC continues to meet the ALP program eligibility requirements. The procedures of §§ 120.855 through 120.857 do not apply to the non-renewal of ALP status.

(f) *SBA approval or decline decision.* SBA will notify the CDC in writing of an approval or decline of either an ALP application or of an ALP renewal. If the SBA approves the CDC's application, the ALP CDC may exercise its ALP authority in its entire Area of Operations. If an application or renewal is declined, SBA will notify the CDC of the reasons for the decision.

24. Add a new § 120.841 to read as follows:

**§ 120.841 Qualifications for the ALP.**

An applicant for ALP status must show that it meets the following criteria:

(a) *CDC staff experience.* Key staff must have at least two years of experience processing and servicing 504 loans prior to the date of the application.

(b) *Number of 504 loans approved and size of portfolio.* SBA must have approved at least 20 504 loan applications by the CDC in the most recent three years, and the CDC must have a portfolio of at least 30 active 504 loans. (An "active" 504 loan is a loan that was approved and closed by the CDC and has a status of either current, delinquent, or in liquidation.)

(c) *Current reviews in compliance.* SBA-conducted oversight reviews must be current (within past 12 months) for applicants for ALP status, and these reviews must have found the CDC to be in compliance with 504 program requirements imposed by statute, regulation, SOPs, policy and procedural notices, loan authorizations, Debentures, and agreements between the CDC and SBA.

(d) *Adequate performance on SBA portfolio benchmarks.* SBA's CDC portfolio benchmarks are important measures of the quality of a CDC's portfolio and the effectiveness of its loan analysis, closing and servicing. At the time of the CDC's application for ALP status the CDC's portfolio must meet SBA's established portfolio benchmarks.

(e) *Staff experience.* The CDC's principal loan officers must have three full years of 504 loan processing, closing and servicing experience or two years experience plus satisfactory completion of the CDC industry's approved credit, packaging, loan closing and loan servicing training programs.

(f) *Record of compliance with 504 program requirements.* The CDC must have a record of conforming to SBA's policies and procedures and of satisfactorily underwriting, closing and servicing 504 loans, including:

(1) Submission of satisfactory 504 loan analyses and applications, and all required, and properly completed, loan documents.

(2) Careful and thorough analysis and screening of all 504 loan applications for conformance with SBA credit and eligibility standards.

(3) Proper and diligent completion of required 504 loan closing documents and compliance with SBA 504 loan closing policies and procedures.

(4) Compliance with SBA loan servicing policies and procedures.

(5) Compliance with the certification and operational requirements as set forth in §§ 120.820–120.830.

(6) Submission of timely, complete and acceptable annual reports.

(7) Compliance with CDC ethical requirements (*see* § 120.851).

(g) *Priority CDC*. The CDC must be a Priority CDC with a Designated Attorney and SBA required insurance.

(h) *Record of Cooperation*. The CDC must have a record of effective communication and a cooperative relationship with all SBA offices including district offices and SBA's loan processing and servicing centers.

25. Revise § 120.845 and add new §§ 120.846–120.848 to read as follows:

**§ 120.845 Premier Certified Lenders Program (PCLP).**

(a) *General*. Under the PCLP, SBA designates qualified CDCs as PCLP CDCs and delegates to them increased authority to process, close, service, and liquidate 504 loans. SBA also may give PCLP CDCs increased authority to litigate 504 loans.

(b) *Application*. A CDC must apply for PCLP status to the Lead SBA Office. The Lead SBA Office will send its written recommendation and the application to SBA's PCLP Loan Processing Center, which will review these materials and forward them with a recommendation to the AA/FA for final decision.

(c) *Eligibility*. In order for a CDC to be eligible to receive PCLP status, its application must show that it meets the following criteria:

(1) The CDC must be an ALP CDC in compliance with 504 program requirements imposed by statute, regulation, SOP, policy and procedural notices, Debentures, loan authorizations, and any agreement between SBA and the CDC or meet the criteria to be an ALP CDC set forth in § 120.841(a)–(h).

(2) The CDC can adequately comply with SBA liquidation and litigation requirements.

(d) *Additional application requirements*. The application must include the following:

(1) Certified copy of the CDC's Board of Directors' resolution authorizing the application for PCLP status.

(2) Summary of the experience of each of the CDC's loan processing, closing, servicing and liquidation staff members with significant authority.

(3) Name, address and summary of experience of Designated Attorney.

(4) Documentation of any SBA required insurance.

(5) Any other documentation required by SBA.

(e) *Term of designation*. If approved, SBA generally will confer PCLP status for a period of two years. However, if SBA deems it appropriate, it may confer PCLP status for a period of less than two years.

(f) *Area of Operations for PCLP CDCs*. If the SBA approves the CDC's application, the PCLP CDC may exercise its PCLP authority in its entire Area of Operations.

(g) *SBA approval or decline decision*. SBA will notify the CDC in writing of an approval or decline of a PCLP application. If an application is declined, SBA will notify the CDC of the reasons for the decision.

**§ 120.846 Requirements for maintaining and renewing PCLP status.**

(a) To maintain its status as a PCLP CDC, a CDC must continue to:

(1) Meet the PCLP eligibility requirements in § 120.845 .

(2) Timely conform with all requirements and deadlines set forth in SBA's regulations and policy and procedural guidance concerning properly establishing, funding and reporting a PCLP Loan Loss Reserve Fund (LLRF).

(3) Substantially comply with all 504 program requirements imposed by statute, regulation, SOPs, policy and procedural notices, loan authorizations, Debentures, and agreements between the CDC and SBA.

(4) Remain an active CDC.

(5) In accordance with statutory requirements set forth in 508(i) of Title V, 15 U.S.C. 697e(i), establish a goal of processing at least 50 percent of its 504 loans using PCLP procedures.

(b) SBA will notify the PCLP CDC in writing of a renewal or non-renewal of PCLP status. If PCLP status is not renewed, SBA will notify the CDC of the reasons for the decision. The procedures of §§ 120.855 through 120.857 do not apply to the non-renewal of PCLP status.

**§ 120.847 Requirements for the Loan Loss Reserve Fund (LLRF).**

(a) *General*. PCLP CDCs must establish and maintain a LLRF (or multiple accounts which together constitute one LLRF) which complies with paragraphs (b) through (g) of this section. A PCLP CDC must use the LLRF to reimburse the SBA for 10 percent of any loss sustained by SBA as a result of a default in the payment of principal or interest on a Debenture it issued under the PCLP ("PCLP Debenture"). A CDC that is participating in the PCLP as of January 1, 2004, and a CDC that has participated in the PCLP in the past but which does not have PCLP status as of

that date, must establish a LLRF within 30 days of that date to cover potential losses for all 504 loans made in connection with PCLP Debentures that remain outstanding as of that date. A CDC that receives PCLP status after that date must establish and maintain a LLRF prior to closing any 504 loans processed under its PCLP status. The LLRF is the accumulation of deposits that a PCLP CDC must establish and maintain for each PCLP Debenture that it issues. PCLP CDCs must coordinate with their Lead SBA Office to ensure that the LLRF is properly established, that all necessary documentation is executed and delivered by all parties in a timely fashion, and that all required deposits are made.

(b) *PCLP CDC Exposure and LLRF deposit requirements*. A PCLP CDC's "Exposure" is defined as its reimbursement obligation to SBA with respect to default in the payment of any PCLP Debenture. The amount of a PCLP CDC's Exposure is 10 percent of any loss (including attorney's fees; litigation costs; and care of collateral, appraisal and other liquidation costs and expenses) sustained by SBA as a result of a default in the payment of principal or interest on a PCLP Debenture. For each PCLP Debenture a PCLP CDC issues, it must establish and maintain an LLRF equal to one percent of the original principal amount (the face amount) of the PCLP Debenture. The amount the PCLP CDC must maintain in the LLRF for each PCLP Debenture remains the same even as the principal balance of the PCLP Debenture is paid down over time.

(c) *Establishing a LLRF*. The LLRF must be a deposit account (or accounts) with a federally insured depository institution selected by the PCLP CDC. A "deposit account" is a demand, time, savings, or passbook account, including a certificate of deposit (CD) which is either uncertificated or, if certificated, non-transferable. A "deposit account" is not an investment account and must not contain securities or other investment properties. A deposit account may contain only cash and CDs credited to that account. A PCLP CDC may pool its deposits for multiple PCLP Debentures in a single account in one institution. The LLRF must be segregated from the PCLP CDC's other operating accounts. The PCLP CDC is responsible for all fees, costs and expenses incurred in connection with establishing, managing and maintaining the LLRF, including fees associated with transferring funds or early withdrawal of CDs, and related income tax expenses.

(d) *Creating and perfecting a security interest in a LLRF*. A PCLP CDC must



give SBA a first priority, perfected security interest in the LLRF to secure the PCLP CDC's obligation to reimburse SBA for the PCLP CDC's Exposure under all of its outstanding PCLP Debentures. (If a PCLP CDC's LLRF is comprised of multiple deposit accounts, it must give SBA this security interest with respect to each such account.) The PCLP CDC must grant to SBA the security interest in the LLRF pursuant to a security agreement between the PCLP CDC and SBA, and a control agreement between the PCLP CDC, SBA, and the applicable depository institution. The control agreement must include provisions requiring the depository institution to follow SBA instructions regarding withdrawal from the account without a requirement for obtaining further consent from the PCLP CDC, and must restrict the PCLP CDC's ability to make withdrawals from the account without SBA consent. When establishing the LLRF, a PCLP CDC must coordinate with its Lead SBA Office to execute and deliver the required documentation. The PCLP CDC must provide to the Lead SBA Office a fully executed original of the security and control agreements. All documents must be satisfactory to SBA in both form and substance.

(e) *Schedule for contributions to a LLRF.* The PCLP CDC must contribute to the LLRF the required deposits for each PCLP Debenture in accordance with the following schedule:

(1) At least 50 percent of the required deposits to the LLRF on or about the date that it issues the PCLP Debenture.

(2) At least an additional 25 percent of the required deposits to the LLRF no later than one year after it issues the PCLP Debenture.

(3) Any remainder of the required deposits to the LLRF no later than two years after it issues the PCLP Debenture.

(f) *LLRF reporting requirements.* Each PCLP CDC must periodically report to SBA the amount in the LLRF in a form that will readily facilitate reconciliation of the amount maintained in the LLRF with the amount required to meet a PCLP CDC's Exposure for its entire portfolio of PCLP Debentures.

(g) *Withdrawal of excess funds.* Interest and other funds in the LLRF that exceed the required minimums as set forth in paragraph (b) of this section, within the time frames set forth in paragraph (e) of this section, accrue to the benefit of the PCLP CDC. PCLP CDCs are authorized to withdraw excess funds, including interest, from the LLRF if such funds exceed the required minimums set forth in paragraph (b) of this section. The PCLP CDC must forward requests for withdrawals to the

Lead SBA Office, which will verify the existence and amount of excess funds and notify the financial institution to transfer the excess funds to the PCLP CDC.

(h) *Determining SBA loss.* When a PCLP CDC has concluded the liquidation of a defaulted 504 loan made with the proceeds of a PCLP Debenture and has submitted a liquidation wrap-up report to SBA, or when SBA otherwise determines that the PCLP CDC has exhausted all reasonable collection efforts with respect to that 504 loan, SBA will determine the amount of the loss to SBA. SBA will notify the PCLP CDC of the amount of its reimbursement obligation to SBA (if any) and will explain how SBA calculated the loss.

(1) If the PCLP CDC agrees with SBA's calculations of the loss, it must reimburse SBA for ten percent of the amount of that loss no later than 30 days after SBA's notification to the PCLP CDC of the CDC's reimbursement obligation.

(2) If the PCLP CDC disputes SBA's calculations, it must reimburse SBA for ten percent of any loss amount that is not in dispute no later than 30 days after SBA's notification to the PCLP CDC of the CDC's reimbursement obligation. No later than 30 days after SBA's notification, the PCLP CDC may submit to the AA/FA or his or her delegate a written appeal of any disagreement regarding the calculation of SBA's loss. The PCLP CDC must include with that appeal an explanation of its reasons for the disagreement. Upon the AA/FA's final decision as to the disputed amount of the loss, the PCLP CDC must promptly reimburse SBA for ten percent of that amount.

(i) *Reimbursing SBA for loss.* A PCLP CDC may use funds in the LLRF or other funds to reimburse SBA for the PCLP CDC's Exposure on a defaulted PCLP Debenture. If a PCLP CDC does not satisfy the entire reimbursement obligation within 30 days after SBA's notification to the PCLP CDC's of its reimbursement obligation, SBA may cause funds in the LLRF to be transferred to SBA in order to cover the PCLP CDC's Exposure, unless the PCLP CDC has filed an appeal under paragraph (h)(2) of this section. If the PCLP CDC has filed such an appeal, SBA may cause such a transfer of funds to SBA 30 days after the AA/FA's or his or her delegate's decision. If the LLRF does not contain sufficient funds to reimburse SBA for any unpaid Exposure with respect to any PCLP Debenture, the PCLP CDC must pay SBA the difference within 30 days after demand for payment by SBA.

(j) *Insufficient funding of LLRF.* A PCLP CDC must diligently monitor the LLRF to ensure that it contains sufficient funds to cover its Exposure for its entire portfolio of PCLP Debentures. If, at any time, the LLRF does not contain sufficient funds, the PCLP CDC must, within 30 days of the earlier of the date it becomes aware of this deficiency or the date it receives notification from SBA of this deficiency, make additional contributions to the LLRF to make up this difference.

**§ 120.848 Requirements for 504 loan processing, closing, servicing, liquidating, and litigating by PCLP CDCs.**

(a) *General.* In processing, closing, servicing, liquidating and litigating 504 loans under the PCLP ("PCLP Loans"), the PCLP CDC must comply with 504 program requirements imposed by statute, regulation, SOPs, policy and procedural notices, loan authorizations, Debentures, and agreements between the CDC and SBA and in accordance with prudent and commercially reasonable lending standards.

(b) *Documentation of decision making.* For each PCLP Loan, the PCLP CDC must document in its files the basis for its decisions with respect to loan processing, closing, servicing, liquidating, and litigating.

(c) *Processing requirements.* SBA expects PCLP CDCs to handle most 504 loan processing situations, although SBA may require that the PCLP CDC process 504 loans involving complex or problematic eligibility issues through the Lead SBA Office using standard 504 loan processing procedures. The PCLP CDC is responsible for properly determining borrower creditworthiness and establishing the terms and conditions under which the PCLP Loan will be made. The PCLP CDC also is responsible for properly undertaking such other processing actions as SBA may delegate to the PCLP CDC.

(d) *Submission of loan documents.* A PCLP CDC must notify SBA of its approval of a 504 loan by submitting to SBA's PCLP Loan Processing Center all documentation required by SBA, including SBA's PCLP eligibility checklist, signed by an authorized representative of the PCLP CDC. The PCLP Loan Processing Center will review these documents to determine whether the PCLP CDC has identified any problems with the PCLP Loan approval, and whether SBA funds are available for the PCLP Loan. If appropriate, the PCLP Processing Center will notify the PCLP CDC of the loan number assigned to the loan.

(e) *Loan and Debenture closing.* After receiving notification from SBA PCLP

Loan Processing Center, the PCLP CDC is responsible for properly undertaking all actions necessary to close the PCLP Loan and Debenture in accordance with the expedited loan closing procedures applicable to a Priority CDC and with § 120.960.

(f) *Servicing, liquidation and litigation responsibilities.* The PCLP CDC generally must service, liquidate and litigate its entire portfolio of PCLP Loans, although SBA may in certain circumstances elect to handle such duties with respect to a particular PCLP Loan or Loans.

(g) *Making a 504 loan previously considered by another CDC.* A PCLP CDC also may utilize its PCLP status to process a 504 loan application from an applicant whose application was declined or rejected by another CDC operating in that same Area of Operations, if the applicant is located within that area and as long as SBA has not previously declined that applicant's 504 loan application. This may include the processing of a 504 loan application from an applicant that has withdrawn its application from another CDC.

26. Revise § 120.850 to read as follows:

**§ 120.850 Expiration of Associate Development Company designation.**

The designation of Associate Development Company (ADC) will cease to exist on January 1, 2004. After that date, former ADCs may continue to contract with CDCs as Lender Service Providers (see part 103 of this chapter) or to perform other services.

27. Add new undesignated center heading before § 120.851 to read as follows:

**Other CDC Requirements**

28. Revise § 120.851 to read as follows:

**§ 120.851 CDC ethical requirements.**

CDCs and their Associates must act ethically and exhibit good character. They must meet all of the ethical requirements of § 120.140. In addition, they are subject to the following:

(a) Any benefit flowing to a CDC's Associate or his or her employer from activities as an Associate must be merely incidental (this requirement does not prevent an Associate or an Associate's employer from providing interim financing as described in § 120.890 or Third Party Loans as described in § 120.920, as long as such activity does not violate § 120.140); and

(b) A CDC's Associate may not be an officer, director, or manager of more than one CDC.

29. Revise § 120.852 to read as follows:

**§ 120.852 Restrictions regarding CDC participation in the Small Business Investment Company (SBIC) program and the 7(a) loan program.**

(a) *7(a) loan program.* A CDC must not invest in or be an Affiliate of a Lender participating in the 7(a) loan program described in § 120.2(a). (For a definition of Affiliation, refer to § 121.103 of this chapter.)

(b) *SBIC program.* A CDC must not directly or indirectly invest in a Licensee (as defined in § 107.50 of this Title) licensed by SBA under the SBIC program authorized in Part A of Title III of the Small Business Investment Act, 15 U.S.C. 681 *et seq.*

30. Add a new undesignated center heading immediately preceding new § 120.853 to read as follows:

**SBA Oversight**

31. Redesignate § 120.973 as § 120.853 and revise redesignated § 120.853 to read as follows:

**§ 120.853 Oversight and evaluation of CDCs.**

SBA may conduct an operational review of a CDC. The SBA Office of Inspector General may also conduct, supervise or coordinate audits pursuant to the Inspector General Act. The CDC must cooperate and make its staff, records, and facilities available.

32. Add a new undesignated center heading immediately preceding new § 120.854 to read as follows:

**SBA Enforcement Actions**

**§ 120.855 [Removed]**

33. Remove § 120.855.

33a. Add §§ 120.854–120.856 to read as follows:

**§ 120.854 Grounds for taking enforcement action against a CDC.**

The AA/FA or his or her authorized delegate may undertake one or more of the enforcement actions set forth in § 120.855 with respect to a CDC, based upon a determination that one or more of the following grounds exist:

(a) The CDC has failed to receive SBA approval for at least four 504 loans during two consecutive fiscal years;

(b) The CDC has failed to comply materially with any requirement imposed by statute, regulation, SOP, policy and procedural notice, any agreement the CDC has executed with SBA, or the terms of a Debenture or loan authorization.

(c) The CDC has made a material false statement or has failed to disclose a material fact to SBA:

(1) With respect to a 504 loan;

(2) In applying to SBA for authority to participate in the 504 program or for any

change in the CDC's participation in the 504 program; or

(3) In any report or other disclosure of information that SBA requires.

(d) The CDC is not performing underwriting, closing, servicing, liquidation, litigation, or other actions with respect to 504 loans in a commercially reasonable or prudent manner. Supporting evidence may include but is not limited to failure to meet one or more of the portfolio benchmarks.

(e) The CDC fails to correct an underwriting, closing, servicing, liquidation, litigation, or reporting deficiency, or fails to take other corrective action, after receiving notice from SBA of a deficiency or the need to take corrective action, within the time period specified in SBA's notice of deficiency.

(f) The CDC has engaged in a pattern of uncooperative behavior or taken an action that SBA determines is deleterious to the 504 program, that undermines SBA's management and administration of the 504 program, or that is not consistent with standards of good conduct.

**§ 120.855 Types of enforcement actions.**

(a) *Enforcement.* Upon a determination that one or more of the grounds set forth in § 120.854 exist, the AA/FA or his or her authorized delegate may undertake, in SBA's sole discretion, one or more of the following enforcement actions:

(1) Suspend or terminate the CDC's authority to participate in the 504 program or to participate as an ALP CDC or PCLP CDC, or in any pilot or program within the 504 program established by SBA. Any such suspension will be for a term determined by SBA in its sole discretion.

(2) Suspend or terminate the CDC's authority to perform underwriting, closing, servicing, liquidation, or litigation on one or more 504 loans or to perform any other function in connection with the 504 program. Any such suspension will be for a term determined by SBA in its sole discretion.

(3) Require the CDC to transfer some or all of its existing 504 loan portfolio and/or some or all of its pending 504 loan applications, to SBA, another CDC, or any other entity designated by SBA. Any such transfer may be on a temporary or permanent basis, in SBA's sole discretion.

(4) Instruct the CSA to withhold payment of servicing, late and/or other fee(s) to the CDC and, if SBA has experienced financial loss as a result of the CDC's failure to comply with any

SBA requirement or of the CDC's imprudent or commercially unreasonable action, direct the CSA to submit all or some of such payments to SBA to compensate for any such loss.

(b) *Immediate suspension.* If SBA determines that one or more grounds set forth in § 120.854 exist and further determines that immediate action is necessary to prevent the risk of significant loss to SBA or to prevent significant impairment of the integrity of the 504 program, the AA/FA may issue a written notice of immediate suspension to a CDC, suspending all or certain activities of a CDC pertaining to the 504 program, and such suspension will be effective as of the date of the notice. Any such suspension will be for a term determined by SBA in its sole discretion. SBA may combine a notice of immediate suspension with any enforcement action set forth in paragraph (a) of this section.

#### § 120.856 Enforcement procedures.

(a) *SBA's notice to CDC of enforcement action.* Prior to undertaking an enforcement action set forth in § 120.855(a), the AA/FA or his or her authorized delegate must issue a written notice to the affected CDC identifying the proposed enforcement action, setting forth the reasons for the proposed action and, if a suspension also is proposed, stating the term of the proposed suspension.

(b) *SBA's notice to CDC of immediate suspension.* If the AA/FA or his or her authorized delegate undertakes an immediate suspension pursuant to § 120.855(b), he or she must issue a written notice to the affected CDC identifying the scope and term of the suspension, and setting forth the reasons for the proposed action.

(c) *CDC's opportunity to object.* A CDC that desires to contest a proposed enforcement action or an immediate suspension must file, within 30 calendar days of the notice or within some other term established by SBA in its notice, a written objection with the AA/FA or other SBA official identified in the notice. The objection must set forth in detail all grounds known to the CDC to contest the proposed action or immediate suspension and all mitigating factors, and must include documentation that the CDC believes is most supportive of its objection. A CDC must exhaust this administrative remedy in order to preserve its objection to a proposed enforcement action or an immediate suspension.

(d) *SBA's decision on CDC's objection to proposed action.* If the affected CDC files a timely written objection to a proposed enforcement action or

immediate suspension, the AA/FA or his or her authorized delegate must issue a notice of decision to the affected CDC advising whether SBA is undertaking the proposed enforcement action or continuing the immediate suspension. If SBA is undertaking the enforcement action or continuing the immediate suspension, the notice of decision must set forth the grounds for the decision. SBA will issue a notice of decision whenever it deems appropriate. Prior to issuing a notice of decision, SBA in its sole discretion can request additional information from the affected CDC or other parties and conduct any other investigation it deems appropriate. If SBA determines, in its sole discretion, to consider an untimely objection, it must issue a notice of decision pursuant to this paragraph (d).

(e) *SBA's notice of final agency decision.* If SBA chooses not to consider an untimely objection or if the affected CDC fails to file a written objection to a proposed enforcement action or an immediate suspension, and if SBA continues to believe that such proposed enforcement action or immediate suspension is appropriate, the AA/FA or his or her authorized delegate must issue a notice of decision to the affected CDC that SBA is undertaking one or more of the proposed enforcement actions against the CDC or that SBA will continue to pursue an immediate suspension of the CDC. Such a notice of decision need not state any grounds for the action other than to reference the CDC's failure to file a timely objection, and represents the final agency decision. If the affected CDC fails to file a written objection to an immediate suspension, SBA need not issue any further notice to the CDC.

(f) *Appeal to OHA.* A CDC may appeal from an SBA notice of decision issued pursuant to paragraphs (d) and/or (e) of this section, to the SBA Office of Hearings and Appeals (OHA). The rules and procedures set forth in part 134 of this chapter will govern such appeals. OHA must limit its review to a determination of whether SBA's decision was arbitrary, capricious or contrary to law, or without procedure required by law, in accordance with the legal precedent established under 5 U.S.C. 706(2)(A) or 5 U.S.C. 706(2)(D). OHA must limit its review to the record that the AA/FA or his or her authorized delegate, and any other SBA officials directly involved with the decision, considered in making the final decision. OHA must not consider any argument, fact or other information presented by the affected CDC, unless the CDC previously submitted that information

to SBA in or with the affected CDC's objection or in response to a request for information from SBA. A decision by OHA is the final agency decision.

#### § 120.857 Voluntary transfer and surrender of CDC certification. [Redesignated from § 120.981]

33b. Redesignate § 120.981 as § 120.857.

34. Revise § 120.861 to read as follows:

#### § 120.861 Job creation or retention.

A Project must create or retain one Job Opportunity per an amount of 504 loan funding that will be specified by SBA from time to time in a **Federal Register** notice. Such Job Opportunity average remains in effect until changed by subsequent **Federal Register** publication.

35. Amend § 120.862 as follows:

a. By revising the parenthetical at the end of paragraph (a)(4);

b. By revising paragraph (b)(2);

c. By redesignating paragraphs (b)(3) through (b)(7) as (b)(5) through (b)(9);

d. By adding new paragraphs (b)(3) and (b)(4); and

e. By revising redesignated paragraph (b)(5). The revisions and additions read as follows:

#### § 120.862 Other economic development objectives.

\* \* \* \* \*

(a) \* \* \*

(4) \* \* \* (North American Industry Classification System (NAICS), Sectors 31–33); or

\* \* \* \* \*

(b) \* \* \*

(2) Expansion of exports;

(3) Expansion of small businesses owned and controlled by women as defined in section 29(a)(3) of the Act, 15 U.S.C. 656(a)(3);

(4) Expansion of small businesses owned and controlled by veterans (especially service-disabled veterans) as defined in section 3(q) of the Act, 15 U.S.C. 632(q);

(5) Expansion of minority enterprise development (*see* § 124.103(b) of this chapter for minority groups who qualify for this description);

\* \* \* \* \*

36. Amend § 120.870 as follows:

a. By removing paragraph (b);

b. By redesignating paragraph (c) as paragraph (b); and

c. By revising paragraph (a) to read as follows:

#### § 120.870 Leasing Project Property.

(a) A Borrower may use the proceeds of a 504 loan to acquire, construct, or modify buildings and improvements,

and/or to purchase and install machinery and equipment located on land leased to the Borrower by an unrelated lessor if:

\* \* \* \* \*

37. Revise the heading of § 120.871 to read as follows:

**§ 120.871 Leasing part of Project Property to another business.**

38. Amend § 120.880 by revising paragraph (b) to read as follows:

**§ 120.880 Basic eligibility requirements.**

\* \* \* \* \*

(b) Together with its Affiliates, meet one of the size standards set forth in § 121.301(b) of this chapter.

39. Revise paragraph (c) of § 120.882 to read as follows:

**§ 120.882 Eligible Project costs for 504 loans.**

\* \* \* \* \*

(c) Professional fees directly attributable and essential to the Project, such as title insurance, opinion of title, architectural and engineering costs, appraisals, environmental studies, hazard and flood insurance, recording fees, and legal fees related to zoning, permits, or platting (see § 120.971(a)(2) for limitations on legal fees associated with 504 loan and Debenture closing); and

\* \* \* \* \*

40. Revise paragraph (d) of § 120.883 to read as follows:

**§ 120.883 Eligible administrative costs for 504 loans.**

\* \* \* \* \*

(d) Borrower's out-of-pocket costs associated with 504 loan and Debenture closing other than legal fees (for example, certifications and the copying costs associated with them, overnight delivery, postage, and messenger services) but not to include fees and costs described in § 120.882(c);

\* \* \* \* \*

41. Amend § 120.892(b) by revising the phrase "90 days" to read "120 days".

42. Revise the heading of § 120.900 to read as follows:

**§ 120.900 Sources of permanent financing.**

43. Revise the heading of § 120.910 to read as follows:

**§ 120.910 Borrower contributions.**

44. Revise § 120.911 to read as follows:

**§ 120.911 Land contributions.**

The Borrower's contribution may be land (including buildings, structures and other site improvements which will

be part of the Project Property) previously acquired by the Borrower.

45. Revise § 120.913 to read as follows:

**§ 120.913 Limitations on any contributions by a Licensee.**

Subject to part 107 of this chapter, a Licensee may provide financing for all or part of the Borrower's contribution to the Project. SBA will consider Licensee funds to be derived from Federal sources if the Licensee has Leverage (as defined in § 107.50 of this chapter). If the Licensee does not have Leverage, SBA will consider the investment to be from private funds. Licensee financing must be subordinated to the 504 loan and must not be repaid at a faster rate than the Debenture. (Refer to § 120.930(a) for additional limitations.)

46. Amend § 120.923 by revising the heading and redesignating § 120.924 as paragraph (c) of § 120.923 to read as follows:

**§ 120.923 Policies on subordination.**

\* \* \* \* \*

47. Revise § 120.925 by adding a parenthetical at the end to read as follows:

**§ 120.925 Preference.**

\* \* \* (See § 120.10 for a definition of Preference.)

48. Revise § 120.926 to read as follows:

**§ 120.926 Referral fee.**

The CDC can receive a reasonable referral fee from the Third Party Lender if the CDC secured the Third Party Lender for the Borrower under a written contract between the CDC and the Third Party Lender. Both the CDC and the Third Party Lender are prohibited from charging this fee to the Borrower. If a CDC charges a referral fee, the CDC will be construed as a Referral Agent under part 103 of this chapter.

49. Revise paragraph (b) of § 120.930 to read as follows:

**§ 120.930 Amount.**

\* \* \* \* \*

(b) A 504 loan must not be less than \$25,000.

\* \* \* \* \*

50. Revise § 120.931 to read as follows:

**§ 120.931 504 lending limits.**

The outstanding balance of all SBA financial assistance to a Borrower and its affiliates under the 504 program covered by this part must not exceed \$1,000,000 (or \$1,300,000 if one or more of the public policy goals enumerated in § 120.862(b) applies to the Project).

51. Revise § 120.933 to read as follows:

**§ 120.933 Maturity.**

From time to time, SBA will publish in the **Federal Register** the available maturities for a 504 loan and the Debenture that funds it. Such available maturities remain in effect until changed by subsequent **Federal Register** publication.

52. Revise § 120.934 to read as follows:

**§ 120.934 Collateral.**

The CDC usually takes a second lien position on the Project Property to secure the 504 loan. Sometimes additional collateral is required. (In rare circumstances, SBA may permit other collateral substituted for Project Property.) All collateral must be insured against such hazards and risks as SBA may require, with provisions for notice to SBA and the CDC in the event of impending lapse of coverage.

53. Revise the heading of § 120.935 to read as follows:

**§ 120.935 Deposit from the Borrower that a CDC may require.**

**§ 120.936 [Removed]**

54. Remove § 120.936.

55. Revise § 120.960 to read as follows:

**§ 120.960 Responsibility for closing.**

(a) The CDC is responsible for the 504 loan closing.

(b) The Debenture closing is the joint responsibility of the CDC and SBA.

(c) SBA may, within its sole discretion, decline to close the Debenture; direct the transfer of the 504 loan to another CDC; or cancel its guarantee of the Debenture, prior to sale, if any of the following occur:

(1) The CDC has failed to comply with any requirement imposed by statute, regulation, SOP, policy and procedural notice, any agreement the CDC has executed with SBA, or the terms of a Debenture or loan authorization.

(2) The CDC has failed to make or close the 504 loan or prepare the Debenture closing in a prudent or commercially reasonable manner.

(3) The CDC's improper action or inaction places SBA at risk.

(4) The CDC has failed to use required SBA forms or electronic versions of those forms.

(5) The CDC, Third Party Lender or Borrower has failed to timely disclose to SBA a material fact regarding the Project or 504 loan.

(6) The CDC, Third Party Lender or Borrower has misrepresented a material fact to SBA regarding the Project or 504 loan.

(7) SBA determines that there has been a material adverse change, such as deterioration in the Borrower's financial condition, since the 504 loan was approved, or that approving the closing of the Debenture will put SBA at unacceptable financial risk.

56. Revise the undesignated center heading immediately preceding § 120.970 to read as follows:

#### Servicing

57. Revise § 120.970 to read as follows:

#### § 120.970 Servicing of 504 loans and Debentures.

(a) In servicing 504 loans, CDCs must comply with 504 program requirements imposed by statute, regulation, SOPs, policy and procedural notices, loan authorizations, Debentures, and agreements between the CDC and SBA, and in accordance with prudent and commercially reasonable lending standards.

(b) The CDC is responsible for routine servicing including receipt and review of the Borrower's or Operating Company's financial statements on an annual or more frequent basis and monitoring the status of the Borrower and 504 loan collateral.

(c) The CDC is responsible for assuring that the Borrower makes all required insurance premium payments, pays all taxes when due, and files renewals and extension of security interests on collateral for the 504 loan, as required.

(d) The CDC must timely respond to Borrower requests for loan modifications.

(e) For any 504 loan that is more than three months past due, the CDC must promptly request that SBA purchase the Debenture unless the 504 loan has an SBA-approved deferment or is in compliance with an SBA-approved plan to allow the Borrower to catch up on delinquent loan payments.

(f) The CDC must cooperate with SBA to cure defaults and initiate workouts.

(g) SBA may negotiate agreements with CDCs to liquidate 504 loans.

58. Add a new undesignated center heading immediately preceding § 120.971 to read as follows:

#### Fees

59. Revise paragraphs (a) introductory text, and (a)(2) of § 120.971 to read as follows:

#### § 120.971 Allowable fees paid by Borrower.

(a) *CDC fees.* The fees a CDC may charge the Borrower in connection with

a 504 loan and Debenture are limited to the following:

\* \* \* \* \*

(2) *Closing fee.* The CDC may charge a reasonable closing fee sufficient to reimburse it for the expenses of its in-house or outside legal counsel, and other miscellaneous closing costs (CDC Closing Fee). Some closing costs may be funded out of the Debenture proceeds (see § 120.883 for limitations);

\* \* \* \* \*

60. Revise § 120.972 to read as follows:

#### § 120.972 Third Party Lender participation fee and CDC fee.

(a) *Participation fee.* For loans approved by SBA after September 30, 1996, SBA must collect a one-time fee equal to 50 basis points on the Third Party Lender's participation in a Project when the Third Party Lender occupies a senior credit position to SBA in the Project.

(b) *CDC fee.* For loans approved by SBA after September 30, 1996, SBA must collect an annual fee from the CDC equal to 0.125 percent of the outstanding principal balance of the Debenture. The fee must be paid from the servicing fees collected by the CDC and cannot be paid from any additional fees imposed on the Borrower.

61. Remove the undesignated center heading immediately preceding § 120.980 and §§ 120.980, 120.982 through 120.984.

Dated: June 27, 2003.

**Hector V. Barreto,**

*Administrator.*

[FR Doc. 03-16862 Filed 7-7-03; 8:45 am]

**BILLING CODE 8025-01-U**

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## DEPARTMENT OF TRANSPORTATION

### Federal Aviation Administration

#### 14 CFR Part 39

[Docket No. 2001-NE-21-AD]

RIN 2120-AA64

#### Airworthiness Directives; General Electric Company CF34-3A1, -3B, and -3B1 Turbofan Engines

**AGENCY:** Federal Aviation Administration, DOT.

**ACTION:** Notice of proposed rulemaking (NPRM).

**SUMMARY:** The Federal Aviation Administration (FAA) proposes to revise an existing airworthiness directive (AD) applicable to General Electric Company (GE) CF34-3A1, -3B,

and -3B1 turbofan engines with scavenge screens part numbers (P/Ns) 4047T95P01 and 5054T86G02 installed in the B-sump oil scavenge system. That AD currently requires initial and repetitive visual inspections and cleaning of the B-sump scavenge screens until a screenless fitting is installed. This proposal requires the same initial and repetitive visual inspections and cleaning of the B-sump scavenge screens until a screenless fitting is installed. This proposal also corrects a typographical error, and introduces a less restrictive terminating action schedule. This proposal is prompted by the need to correct a typographical error and by the need to introduce a less restrictive terminating action schedule. The actions specified by the proposed AD are intended to prevent B-sump scavenge screen blockage due to coking which could result in ignition of B-sump oil in the secondary air system, fan drive shaft separation, and uncontained engine failure.

**DATES:** Comments must be received by September 8, 2003.

**ADDRESSES:** Submit comments in triplicate to the Federal Aviation Administration (FAA), New England Region, Office of the Regional Counsel, Attention: Rules Docket No. 2001-NE-21-AD, 12 New England Executive Park, Burlington, MA 01803-5299. Comments may be inspected at this location, by appointment, between 8 a.m. and 4:30 p.m., Monday through Friday, except Federal holidays. Comments may also be sent via the Internet using the following address: "9-ane-adcomment@faa.gov." Comments sent via the Internet must contain the docket number in the subject line.

The service information referenced in the proposed rule may be obtained from GE Aircraft Engines, 1000 Western Avenue, Lynn, MA 01910; Attention: CF34 Product Support Engineering, Mail Zone: 34017; telephone (781) 594-6323; fax (781) 594-0600. This information may be examined, by appointment, at the FAA, New England Region, Office of the Regional Counsel, 12 New England Executive Park, Burlington, MA.

**FOR FURTHER INFORMATION CONTACT:** Barbara Caufield, Aerospace Engineer, Engine Certification Office, FAA, Engine and Propeller Directorate, 12 New England Executive Park, Burlington, MA 01803-5299; telephone (781) 238-7146; fax (781) 238-7199.

#### SUPPLEMENTARY INFORMATION:

#### Comments Invited

Interested persons are invited to participate in the making of the