



Federal Register

**Wednesday,
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Part III

Small Business Administration

**13 CFR Part 120
Lender Oversight Program; Proposed Rule**

SMALL BUSINESS ADMINISTRATION**13 CFR Part 120****RIN 3245-AE14****Lender Oversight Program****AGENCY:** Small Business Administration (SBA).**ACTION:** Notice of Proposed Rulemaking.

SUMMARY: SBA is proposing a rule to incorporate SBA's risk-based lender oversight program into SBA regulations. Specifically, the proposed rule would establish the role and responsibilities of SBA's Office of Credit Risk Management within a new subpart of the business loan regulations. It would codify in SBA regulations SBA's process of risk-based oversight including: (i) Accounting and reporting requirements; (ii) off-site reviews/monitoring; (iii) on-site reviews and examinations; and (iv) capital adequacy requirements. The proposed rule would also list the types of, grounds for, and procedures governing SBA enforcement actions within consolidated enforcement regulations for all 7(a) Lenders, Certified Development Companies, Microloan Intermediaries, and Non-Lending Technical Assistance Providers. This rule is necessary to provide coordinated and effective oversight of financial institutions that originate and manage SBA guaranteed loans.

DATES: Comments must be received on or before December 31, 2007.**ADDRESSES:** You may submit comments, identified by [RIN number 3245-AE14] by any of the following methods:

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.
- *Mail:* Bryan Hooper, Director for Office of Credit Risk Management, U.S. Small Business Administration, 409 3rd Street, SW., 8th Floor, Washington, DC 20416.
- *Hand Delivery/Courier:* Bryan Hooper, Director for Office of Credit Risk Management, U.S. Small Business Administration, 409 3rd Street, SW., 8th Floor, Washington, DC 20416.

All comments will be posted on <http://www.Regulations.gov>. If you wish to include within your comment, confidential business information (CBI) as defined in the Privacy and Use Notice/User Notice at <http://www.Regulations.gov> and you do not want that information disclosed, you must submit the comment by either Mail or Hand Delivery and you must address the comment to the attention of Linda R.U.S.C.he, Supervisory Financial Analyst, Office of Credit Risk

Management. In the submission, you must highlight the information that you consider is CBI and explain why you believe this information should be held confidential. SBA will make a final determination, in its sole discretion, of whether the information is CBI and, therefore, will not be published or not.

FOR FURTHER INFORMATION CONTACT: Linda R.U.S.C.he, Supervisory Financial Analyst, at (816) 426.4860, or Bryan Hooper, Director, Office of Credit Risk Management, (202) 205.3049.

SUPPLEMENTARY INFORMATION:**I. Background***A. Statutory*

Section 7(a) of the Small Business Act (the Act), 15 U.S.C. 636, authorizes SBA to guarantee loans made by Lenders (7a Lenders) to eligible small businesses. Under Section 504 of the Small Business Investment Act, 15 U.S.C. 697a, SBA guarantees Certified Development Company (CDC) debentures. Section 7(m) of the Act authorizes SBA to make direct loans to Microloan Intermediaries, who use proceeds to make loans to very small businesses, and also authorizes SBA to make technical assistance grants to non-lending technical assistance providers (NTAPs). 15 U.S.C. 636(m). With this authority to offer government guarantees and related grants, Congress has also provided SBA with authority to support appropriate Lender, CDC, Microloan Intermediary, and NTAP supervision. 15 U.S.C. 650; 15 U.S.C. 634 note, citing Public Law 104-208, Division D, Title I, § 103(h); 15 U.S.C. 634(b)(14); 15 U.S.C. 634(b)(7); 15 U.S.C. 636(a)(31); 15 U.S.C. 687(f); 15 U.S.C. 696(3)(A); 15 U.S.C. 697(a)(2); 15 U.S.C. 697e(c)(8); and 15 U.S.C. 634(b)(6).

The provisions cited include both direct and indirect authority to supervise, regulate, and examine Small Business Lending Companies (SBLCs) and Non-Federally Regulated Lenders (NFRs). 15 U.S.C. 650; 15 U.S.C. 634(b)(14); 15 U.S.C. 636(a)(31); and 15 U.S.C. 634(b)(6) and (7). The cites also include both direct and indirect provisions that, together, authorize SBA oversight of and reviews of the SBA operations of other 7(a) Lenders (including national banks and other federally regulated financial institutions), CDCs, Microloan Intermediaries, and NTAPs. 15 U.S.C. 634 note, citing Public Law 104-208, Division D, Title I, § 103(h); 15 U.S.C. 634(b)(14); 15 U.S.C. 634(b)(6) and (7); 15 U.S.C. 636(a)(31); 15 U.S.C. § 687(f); 15 U.S.C. 696(3)(A); 15 U.S.C. 697(a)(2); and 15 U.S.C. 697e(c)(8).

B. History

Currently, there are over 5,000 7(a) Lenders and CDC s (together, SBA Lenders) authorized to make SBA-guaranteed loans and issue SBA-guaranteed debentures. These SBA Lenders hold approximately \$60 billion of 7(a) and 504 loans outstanding (in gross dollars). SBA has delegated increasingly more authority to its SBA Lenders such that the number of loans originated under delegated authority has grown from approximately 20% of SBA's loan volume in 1992 to over 75% of SBA's loan volume as of 2006. As SBA continues to place more responsibility and independence on its SBA Lenders, SBA must have the necessary controls to ensure that SBA Lenders' SBA operations are well-managed and avoid unnecessary losses. A comprehensive oversight process provides this control for the Agency.

Prior to 1999, SBA's risk management, lender monitoring, and lender oversight activities were conducted by SBA's Office of Financial Assistance (OFA) and SBA's District Offices, which were also responsible for developing and promoting the Agency's business loan programs. With the increase in lending authority given to SBA Lenders and lending volume, SBA needed a separate division to perform risk management and lender oversight.

Therefore, in 1999 SBA established the Office of Lender Oversight (OLO) for the primary purpose of ensuring the "consistent and appropriate supervision of SBA's lending partners." At the time it was initially established, OLO's major responsibilities were defined as: "evaluating existing oversight regulations, policies and procedures and promulgating new ones where appropriate; monitoring changes in the accounting, banking and financial industries, and recommending appropriate modification of SBA oversight policy; coordinating all headquarters and field office activities with respect to Lender reviews; [and] evaluating new programs and changes to existing programs to assess their risk potential * * *". The head of the office, the Associate Administrator for OLO, was to serve as a member of SBA's Risk Management Committee and a key member of the group developing and implementing the Agency's lender monitoring and oversight system.

Subsequent to its establishment, OLO assumed responsibility for conducting "safety and soundness" examinations of the SBLCs and compliance reviews for Preferred Lenders Program (PLP) Lenders. OLO then began developing a risk-based review process for all SBA

Lenders. OLO, in 2003, developed and implemented a Loan and Lender Monitoring System (L/LMS). In late 2004, Congress provided SBA specific supervision and enforcement authorities over SBLCs and NFRLs (together, SBA Supervised Lenders). In April 2005, SBA published Delegations of Authority that delineated the responsibilities of OLO and a new Lender Oversight Committee (LOC) consistent with new authorities. 70 FR 21262 (April 25, 2005). On May 5, 2007, SBA published a final rule governing 7(a) Lender review/examination fees. 72 FR 25189. On May 16, 2007 OLO published a final rule on SBA's Lender Risk Rating System. 72 FR 27611. Also, in May 2007, SBA reorganized and renamed the office to the Office of Credit Risk

Management (OCRM). Most recently, SBA has reviewed the Agency's current oversight regulations and is now proposing this rule to incorporate OCRM's new authorities and SBA's risk-based lender oversight program into SBA's regulations. A discussion of the proposed rule, consisting of an overview and key provisions, follows.

II. Proposal

A. Overview

The proposed rule would incorporate SBA's risk management/lender oversight program into SBA's business loan program regulations by: (i) Adding risk management definitions to Part 120 (13 CFR 120.10); (ii) incorporating risk management/lender oversight metrics

and tools into program participation criteria and requirements (13 CFR 120.410, 120.424, 120.433, 120.434, 120.451, 120.710, 120.812, 120.820, 120.826, 120.830, 120.839, and 120.841); (iii) updating provisions to include key OCRM Delegations of Authority (13 CFR 120.451, 120.461, 120.702, 120.710, and 120.845); and (iv) consolidating loan program oversight and enforcement regulations into subpart I, designated Risk-Based Lender Oversight. (See below chart on Regulations Relocated). Subpart I would cover the role and responsibilities of OCRM, the Risk Rating System, off-site reviews/monitoring, on-site reviews and examinations, and enforcement actions against SBA Lenders, Microloan Intermediaries, and NTAPs.

CHART OF REGULATIONS RELOCATED

| Current regulatory citation | Regulation subject matter | Proposed regulatory citation |
|-----------------------------|--|---|
| § 120.414 | SBA access to 7(a) Lender files | § 120.1010. |
| § 120.415 | 7(a) program—Suspension or revocation of eligibility to participate. | § 120.1400 (grounds). § 120.1500 (types of enforcement actions). § 120.1600 (enforcement procedures). |
| § 120.442 | Suspension or revocation of CLP status | § 120.1400 (grounds). § 120.1500 (types of enforcement actions). § 120.1600 (enforcement procedures). |
| § 120.454 | PLP performance review | § 120.1000(a) (Risk-Based Lender Oversight). § 120.1025 (off-site reviews/monitoring). § 120.1050 (on-site reviews and examinations). |
| § 120.455 | Suspensions or revocations of PLP status | § 120.1400 (grounds). § 120.1500 (types of enforcement actions). § 120.1600 (enforcement procedures). |
| § 120.470(b)(3) | Minimum SBLC capital requirement | § 120.471 (minimum capital requirement). § 120.472 (higher individual minimum capital requirement). § 120.473 (procedures for higher individual minimum capital requirement). |
| § 120.470(b)(4) | SBLC capital impairment | § 120.462(d). |
| § 120.470(b)(5) | SBLC issuance of securities | § 120.471(d). |
| § 120.470(b)(6) | SBLC voluntary capital reduction | § 120.471(c). |
| § 120.470(b)(7) | SBLC reserve for losses | § 120.463(e). |
| § 120.470(b)(8) | SBLC internal controls | § 120.460(b). |
| § 120.470(b)(9) | SBLC dual control | § 120.470(d). |
| § 120.470(b)(10) | SBLC fidelity insurance | § 120.470(e). |
| § 120.470(b)(11) | SBLC common control | § 120.470(f). |
| § 120.470(b)(12) | SBLC management | § 120.470(g). |
| § 120.470(b)(13) | SBLC borrowed funds | § 120.470(h). |
| § 120.471 | SBLC recordkeeping and retention requirements | § 120.461. |
| § 120.473 | SBLC change of control | § 120.475. |
| § 120.474 | SBLC prohibited financing | § 120.476. |
| § 120.475 | SBLC Audits | § 120.490. |
| § 120.476 | SBLC suspension and revocation | § 120.1400 (grounds). § 120.1500 (types of enforcement actions). § 120.1600 (enforcement procedures). |
| § 120.716 | Microloan Intermediary and NTAP suspension and revocation. | § 120.1425 (grounds). § 120.1540 (types of enforcement actions). § 120.1600 (enforcement procedures). |
| § 120.853 | CDC reviews | § 120.1000, § 120.1050. |
| § 120.854 | CDC grounds for taking enforcement action | § 120.1400 (grounds). |
| § 120.855 | CDC types of enforcement actions | § 120.1500 (types of enforcement actions). |
| § 120.856 | CDC enforcement procedures | § 120.1600 (enforcement procedures). |

Chart: This chart is intended to serve as a reference tool for locating regulatory provisions repositioned under the proposed rule. In some instances, the relocation involves simply moving text from one regulatory section to another. In other instances, SBA is proposing substantive changes with the move.

B. Key Provisions

The following is a discussion of key provisions of the proposed rule. They are as follows: (i) SBA Supervised Lender regulation; (ii) capital regulation; (iii) incorporation of a risk rating system; (iv) the addition of the CDC Single Audit Act provision; (v) the codification of the risk-based on-site review and examination program; and (vi) the coordination and development of enforcement policies and procedures. These key provisions are highlighted because they generally cover more than one regulation within the proposed rule. In addition, their discussion will provide a useful background for regulation review.

1. SBA Supervised Lender Regulation

Public Law 108–447, Division K, Title I (December 2004) effectively created a new category of SBA Lender—an SBA Supervised Lender. SBA Supervised Lenders consist of SBLCs and NFRLs. P.L. 108–447 generally treated these 7(a) Lenders the same for purposes of regulation, supervision, and enforcement. Accordingly, SBA has drafted a group of regulations applicable to SBA Supervised Lenders in general (§§ 120.460–120.465). The SBA Supervised Lender regulations would cover for example; internal controls, record retention, accounting and reporting, and capital adequacy. Many of these new regulations governing SBA Supervised Lenders, especially those related to capital, are similar to that of either the Federal Deposit Insurance Corporation; the Federal Reserve Board; the Office of the Comptroller of the Currency; the Office of Thrift Supervision; the National Credit Union Administration; or the Farm Credit Administration (each a Federal Financial Institution Regulator).

2. Capital Regulation

Essential to the success of a government guaranteed loan program is the financial strength of its lenders. Capital is a common metric for measuring financial strength. The proposed rule would incorporate capital more fully into the 7(a) program. Specifically, the proposed rule would explicitly make having sufficient permanent capital a requirement for 7(a) program participation (§ 120.410(a)). For 7(a) Lenders with a Federal Financial Institution Regulator, meeting capital requirements for an adequately capitalized financial institution would be considered sufficient permanent capital to support SBA lending activities. For SBA Supervised Lenders, adequate capital would mean meeting

its minimum capital requirement (For an SBLC—this would mean meeting SBA’s § 120.471 minimum or § 120.472 higher individual minimum capital requirement, as applicable. For an NFRL—this would mean meeting the minimum capital requirement set by its state of incorporation regulator). While the proposed rule does not revise the minimum capital requirement for all SBLCs, SBA is considering updating this requirement. SBA seeks comments as to the appropriate minimum capital requirement for SBLCs.

In addition to an SBLC minimum capital requirement, the proposed regulations would allow SBA to set a higher individual minimum capital requirement for an SBLC, where appropriate. (§ 120.472). SBA would set such a higher minimum capital requirement after consideration of certain risk-related factors described in proposed § 120.472 and pursuant to procedures contained in proposed § 120.473. The proposed rule would also require SBA Supervised Lenders to maintain a minimum capital adequacy plan (§ 120.462(b)), and to quarterly certify as to compliance with minimum capital requirements. (§ 120.462(c)). Capital impairment would be redefined under the proposed rule for SBA Supervised Lenders, as failing to meet its applicable minimum capital requirement. (§ 120.462(d)). Under the proposed rule, if an SBA Supervised Lender fails to meet its minimum capital requirement (*i.e.*, is capitally impaired), it must file with SBA a capital restoration plan (§ 120.462(e)) and then timely implement the approved plan. SBA could take enforcement action under the proposed enforcement regulations (§§ 120.1400–1600) against an SBA Supervised Lender that fails to submit a capital restoration plan that is acceptable to SBA or fails to implement, in any material respect, its capital restoration plan in a timely manner. The proposed capital regulations contain provisions similar to those maintained by some Federal Financial Institution Regulators.

3. Incorporation of a Risk Rating System

With the assistance of private industry leaders in predictive modeling and risk rating systems, SBA has developed an SBA Lender Risk Rating System. The proposed SBA Lender Risk Rating System was published for comment in the **Federal Register** at 71 FR 25624 (May 1, 2006). On May 16, 2007 OLO published the final rule on SBA’s Lender Risk Rating System. 72 FR 27611. The SBA Lender Risk Rating System is an internal tool for assessing the risk of each SBA Lender’s SBA loan

operations on a uniform basis within its program and for identifying those institutions whose SBA loan operations and portfolio require additional SBA monitoring or other action. Under the SBA Lender Risk Rating System, SBA assigns each SBA Lender a composite rating of one to five based on certain portfolio performance factors which may be overridden in some cases due to SBA Lender specific factors that may be indicative of a higher or lower level of risk. SBA would generally consider an SBA assigned Risk Rating (Risk Rating) of either one, two, or three on a scale of one to five to be an “Acceptable Risk Rating”. A “Less Than Acceptable Risk Rating” would be an SBA assigned Risk Rating of four or five. (§ 120.10 and § 120.1015). SBA may revise the scale for SBA Risk Ratings and related definitions as the program develops. Any such changes would be published in the **Federal Register** for notice and comment. SBA plans to develop a risk rating system for Microloan Intermediaries and NTAPs and will provide notice before implementation of this system.

SBA has incorporated the SBA Lender Risk Rating System into its on-site risk-based reviews and examinations as set forth in SOP 51–00 governing on-site SBA Lender reviews and examinations. The proposed rule would incorporate the SBA Lender Risk Rating System and its definitions into SBA’s loan program regulations. Risk Ratings would be considered in determining whether an SBA Lender (and, in the future, a Microloan Intermediary, or NTAP) has satisfactory SBA performance for purposes of continued participation in the 7(a), 504, Microloan, or NTAP programs (including the delegated authority programs) under proposed amendments to: §§ 120.410 (requirements for 7(a) Lenders); 120.424 (securitization requirements); 120.433 (sales and sales of participating interests); 120.434 (pledges of SBA loans); 120.451 (PLP Program); 120.812 (Extensions of CDC probationary periods and permanent CDC status); 120.820 (requirements for CDC certifications and operation); 120.839 (outside area of operation loan approval); and 120.841 (ALP status). SBA would also consider a Risk Rating before approving a Microloan Intermediary’s reduction in its loan loss reserve fund (LLRF) under proposed amendments to § 120.710. Under proposed § 120.1051, SBA would consider an SBA Lender’s, Intermediary’s, or NTAP’s Risk Rating in determining frequency of on-site reviews/examinations.

Under proposed rule § 120.1400(c)(9), a repeated Less Than Acceptable Risk Rating (particularly in conjunction with other grounds) may evidence increased financial risk to SBA to warrant consideration of taking formal enforcement action. A repeated Less Than Acceptable Risk Rating may also be evidence of an SBA Lender not performing underwriting, closing, disbursing, servicing, liquidation, or litigation in a commercially reasonable and prudent manner under proposed § 120.1400(c)(4). SBA expects to consider additional factors (e.g., on-site review/examination assessment, corrective actions implemented, and contribution toward SBA mission) before taking formal enforcement action on these Risk Rating grounds. Finally, a repeated Less Than Acceptable Risk Rating could be support for SBA not renewing program or delegated authorities.

The incorporation of the Risk Rating System into the regulations is consistent with SBA's movement away from considering only the lagging indicators of our portfolio benchmark performance measures and towards integration of more current and sophisticated performance measurement systems developed by private sector leaders.

4. Single Audit Act Provisions

The proposed rule incorporates Single Audit Act requirements into SBA's 504 program regulations. The Single Audit Act (31 U.S.C. 7501–7507) requires Non-Federal entities, such as non-profit CDCs, that expend a total of \$500,000 or more of federal awards (e.g. loan guarantees) in any fiscal year (including amounts outstanding), to have a single audit performed for such fiscal year. The audit must be conducted by an independent auditor in accordance with generally accepted government auditing standards. The Single Audit Act may also require, under certain circumstances, the Non-Federal entity to monitor the subrecipients' use of federal awards through site visits, limited scope audits, and other means. By including reference to the Single Audit Act in SBA regulations, SBA would not intend to extend coverage of the Single Audit Act to those CDCs for which the Single Audit Act does not apply. Therefore, for example, if a CDC does not meet the \$500,000 federal award minimum, then the Single Audit Act compliance requirement would not apply. However, SBA estimates that virtually all active CDCs are covered by the Single Audit Act. SBA also would intend to consider CDC compliance with the Single Audit Act, including any future amendments to it, as a requirement for participation

in the 504 program and, accordingly would monitor CDC compliance with Single Audit Act requirements.

5. Review and Examination Program

SBA has developed a coordinated risk-based SBA Lender review and examination program. SBA regulations need to reflect the updated coordinated risk-based review/examination approach. The proposed rule would remove current regulatory provisions governing on-site reviews and examinations within SBA's loan program regulations (§§ 120.414, 120.454, 120.470, 120.853) and consolidate them within subpart I on Risk-Based Lender Oversight. Under the proposed regulations, SBA Lenders could now look in one location for consistent regulatory guidance on on-site reviews and examinations. In addition, the proposed rule would extend such guidance beyond regulatory authorization for reviews and examinations. Specifically, the proposed rule would include provisions for off-site reviews and monitoring, on-site review and examination evaluative components, the frequency of on-site reviews and examinations, review and examination reports, and expected responses, including, as applicable, corrective actions and capital restoration plans. As to the proposed regulation's on-site reviews, if an SBA Lender is to be examined by a Federal Financial Institution Regulator in the same general timeframe, SBA would try to mutually coordinate the timing of the SBA operation review and the supervisor's examination to minimize any burden. Finally, the proposed rule also would include Microloan Intermediaries and NTAPs in the review regulations, and would harmonize the review process between for-profit 7(a) Lenders and non-profit CDCs, since SBA's partial guaranty of credit risk on individual loans for each program is similar.

6. Enforcement Policies and Procedures

SBA has consolidated within subpart I, the Agency's enforcement regulations for SBA Lenders, Microloan Intermediaries, and NTAPs. The consolidation would facilitate coordinated enforcement policies. It would allow all SBA Lenders, Microloan Intermediaries, and NTAPs to look in one place for such regulatory guidance. Finally, consolidation within subpart I should provide for greater consistency in taking formal enforcement actions.

SBA has modeled its proposed enforcement provisions after SBA's CDC enforcement regulations. Like the

current CDC enforcement regulations, subpart I's enforcement provisions would consist primarily of three main enforcement regulations. The first, proposed § 120.1400, would cover grounds for enforcement actions. The second, proposed § 120.1500, would list types of formal enforcement actions. The third, proposed § 120.1600, would set forth the procedures governing each type of formal enforcement action. Within each of these proposed regulations, the subsections are generally broken down into provisions that apply to all SBA Lenders; additional provisions that apply only to 7(a) Lenders; additional provisions that apply only to SBA Supervised Lenders; additional provisions that apply only to SBLCs; and additional provisions that apply only to CDCs.

Enforcement grounds and formal enforcement actions for Microloan Intermediaries and NTAPs would be contained in separate regulations within the enforcement series, as there was less overlap with these participants.

III. Section-by-Section Analysis

Section 120.10—Definitions. SBA proposes to add ten new definitions to this section primarily for purposes of risk management/lender oversight and enforcement. The new definitions would help to clarify categories of SBA Lenders and related parties referenced in the proposed regulations. Definitions would be added for 7(a) Lender, SBA Lender, Small Business Lending Company (SBLC), Non-Federally Regulated Lender (NFRL), SBA Supervised Lender, Other Regulated SBLC, Federal Financial Institutions Regulator, and Management Official. SBA would also add Risk Rating definitions that would describe an SBA Risk Rating and the key rating categories of Acceptable and Less Than Acceptable.

Section 120.410—Requirements for all participating Lenders. Under the proposed rule, the requirement in section 120.410(a) that a 7(a) Lender have the continuing ability to evaluate, process, close, disburse, service, liquidate, (and litigate) loans would be more specifically defined to include (but not be limited to) (i) holding sufficient permanent capital (For Lenders with Federal Financial Institution Regulators, that would entail being "adequately capitalized." For SBLCs, that would entail meeting its SBA minimum capital requirement. For NFRLs, that would entail meeting the minimum capital requirement of its state of incorporation) and (ii) having satisfactory SBA performance. SBA is more specifically defining the

continuing ability provision to include adequate capital and satisfactory SBA performance because sufficient capital and satisfactory performance sustain a 7(a) Lender's ability to evaluate, process, close, disburse, service, liquidate, and litigate loans.

In determining satisfactory SBA performance, SBA would consider a Lender's Risk Rating, among other factors. The other factors SBA anticipates considering may include on-site review/examination assessments, historical performance measures (like default rate, purchase rate and loss rate), loan volume to the extent that it impacts performance measures, other performance related measurements and information, and contribution toward SBA mission.

Subsection (a) would also be revised to specify the requirement that a 7(a) Lender have the ability to litigate loans. This is consistent with SBA's policy on 7(a) Lender litigation of SBA Loans.

In addition, the OCRM proposed rule would further define SBA's requirements to participate in the 7(a) program by adding the following 7(a) Lender requirements: (i) Good standing (as generally defined under § 120.420(f) and with a Lender's state banking regulator and/or Federal Financial Institution Regulator, as applicable); (ii) safe and sound condition; and (iii) use of commercially reasonable lending policies, procedures, and standards employed by prudent lenders. For SBA Supervised Lenders, safe and sound condition would be determined by SBA. For other 7(a) Lenders, SBA would look to a 7(a) Lender's Federal Financial Institution Regulator or state banking regulator, as applicable, to ensure safe and sound condition.

Finally, subsection (d) would be clarified to provide that a 7(a) Lender must be supervised and examined by either a Federal Financial Institution Regulator, a state banking regulator (satisfactory to SBA) or SBA. SBA is clarifying this provision to make clear that a 7(a) Lender participating in SBA's program must be supervised and examined by a banking regulator, satisfactory to SBA. The clarifications and revisions proposed for § 120.410 are intended to minimize losses in the 7(a) program.

Sections 120.420(f)—Participating lender financings, definition of "Good Standing"; 120.425(c)(2)—Reinstatement of securitizer PLP status; and 120.426—Actions SBA would take if SBA securitizer transfers tranche prior to holding period. SBA proposes to change the determining authority in these provisions from the Securitization Committee to the more recently

established Lender Oversight Committee (LOC). Proposed changes to § 120.420(f) would also specify the LOC's discretion in reviewing an SBA Lender's good-standing in certain circumstances involving investigations, indictments, convictions, and judgments, to be consistent with the LOC's discretion set forth in 120.420(f)(4). Finally, SBA proposes to add the words "In general" to its "good-standing" definition to underscore the discretionary nature of the "good-standing" determination.

Sections 120.424—What are the basic conditions a Lender must meet to securitize; 120.433—What are SBA's other requirements for sales and sales of participating interests; and 120.434—What are SBA's requirements for loan pledges? SBA is revising the requirements in these sections to more explicitly reference the "good standing" definition in § 120.420(f). SBA is also proposing to add the requirement that 7(a) Lenders have satisfactory SBA performance as determined by SBA and that Risk Ratings would be considered among other factors in determining satisfactory SBA performance. SBA expects to consider among the other factors, on-site review/examination assessments, historical performance measures like default rate, purchase rate and loss rate, other performance-related measures and information, and contribution toward SBA mission. This change would incorporate SBA's Risk Rating System within SBA's securitization and other conveyance regulations.

Section 120.435—Which loan pledges do not require notice to or consent by SBA? SBA proposes to update the cross-reference to "§ 120.434(e)" within this section consistent with proposed revisions to § 120.434.

Section 120.451—How does a Lender become a PLP Lender? SBA is proposing to amend § 120.451 to add satisfactory SBA performance to those items SBA would consider in approving PLP status. Subsection (e) on PLP recertification would also be amended to include SBA performance (including contribution to SBA mission), a Lender's Risk Rating, examination and review results, and other risk-related factors in the recertification decision. Section 120.451 would also be amended to provide that the recertification decision would be made by the appropriate Office of Capital Access official in accordance with Delegations of Authority. Also, SBA proposes to delete current subsections (c) and (f) to conform to existing Agency policy as published in Notice 5000-989 dated May 2, 2006 governing PLP territories. Finally, these additions incorporate lender oversight

and related performance metrics and OCRM's Delegations of Authority into PLP program participation determinations.

Section 120.460—What are SBA's additional requirements for SBA Supervised Lenders? SBA is proposing a new § 120.460 entitled "What are SBA's additional requirements for SBA Supervised Lenders?" In addition to complying with SBA's requirements for 7(a) Lenders, an SBA Supervised Lender would be required to meet additional requirements set forth in § 120.460 and the sections that follow. Under § 120.460, SBA would require an SBA Supervised Lender to adopt an internal control policy that would provide adequate direction for establishing effective control over and accountability for operations, programs, and resources. An SBA Supervised Lender that is required to maintain an adequate internal control program may be more likely to self-identify and self-correct operational deficiencies. Proposed § 120.460 is similar to a Federal Financial Institution Regulator internal control provision in Title 12 of the Code of Federal Regulations.

Section 120.461—What are SBA's additional requirements for filing SBA Supervised Lender reports with SBA and for record retention? This proposed regulation would require that SBA Supervised Lender specific reports be filed with the appropriate Office of Capital Access official in accordance with Delegations of Authority. This is consistent with current Delegations of Authority. This section would also extend the recordkeeping requirements for SBLCs to NFRLs. Record retention is required for SBA to be able to perform safety and soundness examinations or Lender reviews and to monitor that SBLC licensing requirements are maintained. Finally, this proposed section would newly specify certain time periods for retrieving certain documents (i.e., 1 day for documents that must be immediately retrievable and 15 days for originals of documents that are stored electronically). Consequently, an SBA Supervised Lender must be able to produce needed records when required, and within a reasonable period of time, as defined here.

Section 120.462—What are SBA's additional requirements on capital maintenance for SBA Supervised Lenders? A financial institution is expected to maintain capital commensurate with its existing and potential risk exposure and the ability of management to identify, measure, monitor, and control exposures. Given this, many SBA Supervised Lenders do,

and should be expected to, maintain capital levels above specified minimums. Therefore, SBA is proposing a new § 120.462 which would guide SBA Supervised Lenders to maintain their own capital adequacy goals and plans, typically at a level above SBA's minimum. The provision would also provide guidance as to factors an SBA Supervised Lender should consider in determining the total amount of capital needed to assure the SBA Supervised Lender's continued financial viability and to provide for any necessary growth.

Given the importance of maintaining adequate capital, the proposed rule would further require that all SBA Supervised Lenders, within 45 days of the end of each fiscal quarter, furnish SBA with a calculation of its compliance with its minimum regulatory capital requirement. Under proposed § 120.462(c), SBA would require the SBA Supervised Lender's chief financial officer to certify the calculation as correct.

Section 120.462 would extend to NFRLs SBA's requirement to timely notify SBA in writing of capital impairment. Under proposed § 120.462(d), SBA would redefine capital impairment as any failure by an SBA Supervised Lender to meet its minimum capital requirements. SBA is proposing this revision to provide SBA early notice of a Supervised Lender's deteriorating capital position below required minimums. Unless otherwise waived by SBA in writing, an SBA Supervised Lender would be prohibited from presenting any loans to SBA for guarantee until the capital impairment is cured.

Finally, the proposed rule would require an SBA Supervised Lender that fails to meet its minimum capital requirement to submit a capital restoration plan. Proposed subsection (e) would detail the plan content, how SBA would respond, amendments to the capital plan, and consequences of failure to: (i) Submit an acceptable plan within the required timeframe or (ii) implement in any material respect an approved capital restoration plan within the plan timeframe.

Section 120.463—Regulatory accounting. To facilitate accurate and reliable financial reporting, the proposed rule contains a new § 120.463 on regulatory accounting. The proposed regulation would require that an SBA Supervised Lender's (i) books and records be kept on an accrual basis in accordance with Generally Accepted Accounting Principles (GAAP) as supplemented by Regulatory Accounting Principles (RAP) and (ii)

financial statements be audited annually in accordance with generally accepted auditing standards by an independent certified public accountant experienced in auditing financial institutions.

Proposed subsection (d) would require an SBA Supervised Lender that discharges its auditor to notify SBA within ten days of discharge and provide SBA with the name, address, and telephone number of the discharged auditor. If the discharge involved a dispute over the financial statements, the SBA Supervised Lender would also have to provide additional information, including but not limited to, a detailed reason for the discharge and the effect of each party's position on the financial statements.

Proposed subsection (e) would extend the SBLC requirement for maintenance of an allowance for losses on loans to NFRLs. Under proposed § 120.463(e), an SBA Supervised Lender would be required to maintain documentation of its loan loss allowance calculations and analysis in sufficient detail to permit the SBA to review assumptions used and their application. SBA would also require, under subsection (e) that the unguaranteed portions of loans identified as uncollectible be charged off promptly. If the portion determined to be uncollectible by the SBA Supervised Lender would differ from that determined by its auditors or the SBA, the SBA Supervised Lender would be required to charge-off such amount as the SBA may direct. Each SBA Supervised Lender would also be required to classify loans as nonaccrual or formally restructured in accordance with stated guidelines. Under the proposed subsection, if one loan to a given borrower would be classified as nonaccrual or formally restructured, all loans to that borrower would be required to be so classified unless the SBA Supervised Lender could document that the loans have independent sources of repayment.

Finally, § 120.463, subsection (f), would require that SBA Supervised Lenders account for loan sales transactions and the valuation of loan servicing rights in accordance with GAAP. At the end of each quarter, assumptions used in the valuation would be reviewed by the SBA Supervised Lender for reasonableness in the existing environment. In evaluating the assumptions, the SBA Supervised Lender would be required to give particular attention to interest rate and repayment rate assumptions. Assumptions considered no longer reasonable would be required to be modified and reflected in the valuation and would have to be documented and

supported by a market analysis. Under subsection (f), SBA could require an SBA Supervised Lender to use industry averages for the valuation of servicing rights, in lieu of any other assumptions found unacceptable by SBA.

Section 120.464—Reports to SBA. Proposed § 120.464 would extend to NFRLs, SBA's current SBLC reporting requirements covering audited financial statements, administrative and legal proceedings, reports to stockholders, summaries of changes (in organization and financing), stock pledges, and other reports, as listed in current § 120.472.

Proposed § 120.464 would also clarify current reporting requirements by, for example, detailing required statements to accompany the Annual Report (audited financial statements); inserting filing time requirements where presently not stated (Stockholder Report and Report of Changes); detailing the form and format of financial reporting (e.g. for Annual Reports, Quarterly Condition Reports, and Reporting of Changes—to be in accord with GAAP, include footnotes, and utilize accrual accounting), and specifying that any legal or administrative proceedings must be included in other required reporting (e.g., Annual Report, Quarterly Condition Report, any Capital plan report, etc.) until such matter is resolved.

Proposed § 120.464 would also introduce two additional SBA Supervised Lender reports: (i) The Quarterly Condition Report and (ii) the Reports of Changes in Financial Condition. SBA Supervised Lenders would report quarterly financial status in Quarterly Condition Reports. The Quarterly Condition Report under proposed § 120.464 would contain quarterly financial statements that could be internally prepared and which would likely include the required certification of compliance with capital requirements under proposed § 120.462(c). Reports of Changes in Financial Condition would report material changes in an SBA Supervised Lender's financial condition (such as unanticipated reductions in asset values due to unanticipated events such as natural disasters or uninsured hazard loss). Generally, SBA would require the SBA Supervised Lender to file the Report of Changes in Financial Condition within 10 days of becoming aware of such a material financial change, except in cases of capital impairment which would be 30 days from the month-end in which the impairment occurred, in accordance with proposed § 120.462(d), as clearly specified in the Regulation language. These two financial reports would result in timelier financial reporting.

Subsection (c) would require that SBA Supervised Lenders certify each report of financial condition (e.g., the Quarterly Condition Report, the Changes in Financial Condition Report and the Annual Report) as having been prepared in accordance with applicable regulations and instructions and to be a true, accurate, and complete representation of the SBA Supervised Lender's financial condition and performance. Accurate financial reporting is essential to an institution's safety and soundness. Reliable financial reports are necessary for an SBA Supervised Lender to raise capital. They provide data to stockholders and potential investors on the company's financial position and results of operations. Such information is critical to effective market discipline. Accurate financial information also enables management to effectively manage the institution's risks and make sound business decisions. Further, the compilation and submission of accurate financial information on a regular basis in a consistent format allows SBA to perform more timely and effective risk-based supervision to support examination functions, off-site monitoring, assessments of an institution's capital adequacy and financial strength, and comparisons between SBA Supervised Lenders.

Finally, proposed § 120.464 would provide for a waiver provision for any reporting requirement for good cause. Good cause may include, but is not limited to, where an SBA Supervised Lender has a relatively small SBA loan portfolio, consistently-acceptable Risk Ratings, portfolio performance that exceeds SBA's portfolio or peer group averages, etc. This waiver would be determined by SBA, in its sole discretion. In making this determination based on portfolio size, SBA expects to consider the value of the report to SBA given the size of SBA Supervised Lender's SBA loan portfolio and relative to other SBA Supervised Lender's portfolios individually and in the aggregate and other risk related factors. Authority for such actions will be in accordance with SBA's Delegations of Authority.

Section 120.465—Civil penalty for late submission of required reports. Congress recognized the importance of reporting to effective oversight and legislated civil monetary penalties of up to \$5,000 per day for SBA Supervised Lenders that fail to meet reporting requirements (15 U.S.C. 650(j)). Proposed § 120.465 would codify in SBA regulations the statutory civil monetary penalties. The proposed regulation would provide that penalties

would automatically accrue from the report due date until the SBA Supervised Lender submits a complete report. If a submitted report is not complete, it would be deemed not filed for purposes of civil monetary penalty assessment. Under the proposed rule, if SBA discovers after the due date (e.g., during an examination) that the report was submitted only in part or was not filed, penalties would be assessed dating back to the original due date. Finally, proposed § 120.465 would provide procedures for requesting: (i) Due date extension and waiver of automatic penalty up to a new due date, (ii) reduction or exemption from the automatic penalty, and (iii) reconsideration of SBA decisions on extensions and reductions/exemptions and would include factors that would be considered in the SBA approval (e.g. determination of reasonable cause such as natural disaster or other conditions beyond the control of management, that failure was not due to willful neglect, demonstration of modified internal procedures to comply with reporting in the future, etc.). SBA seeks comments on the factors SBA would consider as discussed in the proposed rule.

Section 120.470—What is an SBLC? As part of the rewrite of the SBLC regulations, SBA is proposing to amend the title and certain content of current § 120.470. Under the proposed rule, the subject matter in several provisions of § 120.470 would be moved elsewhere in Part 120 (See Chart of Regulations Relocated in the Proposal section of the preamble) and some remaining provisions would be updated, reorganized, or expanded. Updates would include, for example: The addition of limited liability companies and limited partnerships as allowable business structures; an increase to \$2 million for required Fidelity Bond insurance; incorporation of new definitions of 7(a) Lender and Intermediary into subsection (a)(2) on lending requirements; a statement on SBA's policy on capitalization with borrowed funds. The Fidelity Bond increase would update the insurance requirements consistent with the current maximum loan amount that SBA can guarantee. SBA would expand guidance, in particular, on SBA's policy against capitalization with borrowed funds. Borrowed funds may result in a weaker capital position of the SBLC due to the potential for required repayment. SBA would also expand guidance in the proposed subsection on common control—providing terms and definitions, requirements for

divestitures, and a clearer statement on common control and presumptions.

Section 120.471, 120.472, 120.473, and 120.474—SBLC minimum capital requirements. SBA sets SBLC capital standards pursuant to 15 U.S.C. 650(a)(2) and 15 U.S.C. 634(b)(7) in conjunction with 15 U.S.C. 636. Proposed §§ 120.471 through 120.474 would govern SBLC minimum capital standards. Proposed § 120.471 would state SBA's baseline minimum capital standard for SBLCs. Under proposed § 120.471, the baseline would remain at the current level stated in § 120.470(b)(3). However, SBA is considering revising the baseline minimum capital standard and seeks comments on the appropriate minimum capital level.

Proposed § 120.471 would provide more detailed guidance on those items that SBA would include in calculating an SBLC's capital under the capital requirement. The capital calculation would generally consist of the following items: (i) Common stock; (ii) preferred stock that is non-cumulative as to dividends and does not have a maturity; (iii) additional paid-in-capital for stock in excess of the par value; (iv) retained earnings; and (v) for limited liability companies and limited partnerships, those capital contributions that are not subject to repayment at any specific time, are not subject to withdrawal and have no cumulative priority return. The inclusion of retained earnings and limitations on preferred stock in the proposed rule is consistent with Federal Financial Institution Regulator policies.

In some cases, SBA may determine that the baseline minimum capital formula may not be sufficient to support the risk associated with a particular SBLC's portfolio. Consequently, proposed § 120.472 would provide that SBA may require a higher individual minimum capital requirement for an SBLC. Proposed § 120.472 would provide examples of risk-related factors that SBA might consider in making that determination. An SBLC individual minimum capital requirement would be established pursuant to procedures set forth in proposed § 120.473 or through written agreement or a cease and desist proceeding as stated in proposed § 120.474. The proposed individual minimum capital requirement procedures are similar to those provided by some Federal Financial Institution Regulators.

Finally, the SBLC capital regulations would include a change in policy for approving issuances of securities (currently in § 120.470(b)(5) and proposed in § 120.471(d)). The proposed provisions would delete the last part of

current § 120.470(b)(5). This deletion would have the effect of making it a requirement for an SBLC to obtain prior written approval for issuances of common stock, including issuances for cash or direct obligations of or obligations fully guaranteed as to principal and interest by the United States government. This is consistent in general with SBA's policy of prior approval for other types of financings (e.g. warehouse lines, participations, and securitizations). For further information on proposed rule capital provisions see the Capital Regulation provision in the Proposal section of the preamble.

Section 120.475—Change of ownership or control. SBA proposes to relocate current § 120.473 governing change of ownership and control for SBLCs to § 120.475. In addition, the proposed rule would shift approval authority from the D/FA to the appropriate Office of Capital Access official in accordance with Delegations of Authority to reflect changes in internal agency procedure. Further, if a transfer of ownership or control is subject to approval of any State or Federal chartering, licensing, or other regulatory authority, copies of any documents filed with such authority would also have to be transmitted to the appropriate Office of Capital Access official in accordance with Delegations of Authority.

Section 120.630—Qualifications to be a Pool Assembler. SBA proposes to add an additional requirement applicable only to SBA Lenders. Specifically, SBA would require SBA Lenders seeking to become a Pool Assembler to have satisfactory SBA performance, as determined by SBA. SBA would consider an SBA Lender's Risk Rating, among other factors, in determining satisfactory SBA performance. The other factors that SBA anticipates considering may include on-site review/examination assessments, historical performance measures (e.g., default rate, purchase rate, and loss rate), loan volume to the extent that it impacts performance measures, and other performance related measurements and information. SBA considers these factors as relevant to the expected performance of a Pool Assembler. SBA is revising this regulation to incorporate SBA loan program performance for SBA Lenders/pool assemblers into pool assembler eligibility criteria.

Section 120.702—Limitations on where an Intermediary may operate? Current § 120.702 provides that Microloan Intermediaries may operate in only one state unless SBA determines that it would be in the best interests of

the small business community for it to operate across state lines. The proposed rule would shift approval authority for expansions from the D/FA to the appropriate Office of Capital Access official in accordance with Delegations of Authority to reflect changes in internal agency procedure.

Section 120.710(c) and (d)—Microloan Intermediary Loan Loss Reserve Fund (LLRF) approval authority. SBA proposes amending § 120.710(c) and (d) to shift approval authority for a reduction in the LLRF calculation from the D/FA to the appropriate Office of Capital Access official in accordance with Delegations of Authority. This revision would reflect changes in internal agency procedure.

Sections 120.710(e)(1), 120.812, 120.820, 120.839, and 120.841—Microloan Intermediary LLRF reduction and selected CDC authority criteria. SBA proposes amending §§ 120.710(e)(1) (Microloan Intermediary reduction of LLRF); 120.812 (Extension of CDC probationary periods and permanent CDC status); 120.820 (Requirements for CDC certification and operation); 120.839 (Outside area of operation loan approval); and 120.841 (ALP status), to incorporate that SBA would consider an Intermediary's or SBA Lender's performance (which will include its Risk Rating, among other factors) in making determinations under these regulations. SBA expects to consider in determining satisfactory SBA performance on-site review assessments; historical performance measures; loan volume to the extent that it impacts performance measures; other performance related measurements and information, and contribution toward SBA mission. Proposed § 120.841(c) (ALP status) would also add the requirement that an ALP CDC must have a risk-based review assessment of "acceptable" or "acceptable with corrective actions required" to be considered for ALP status.

Section 120.826—Basic requirements for operating a CDC. The proposed rule adds to § 120.826 internal control requirements similar to those proposed for SBA Supervised Lenders. Under the proposed rule, a CDC would be required to adopt an internal control policy to include maintenance of a loan review program, in conjunction with its SBA-guaranteed debenture financings. In addition, a CDC would have to have its financial statements annually audited by an independent certified public accountant since this would establish consistency in application of GAAP (a requirement) for CDC audits. Proposed § 120.826 would also incorporate the

Single Audit Act requirements into SBA's 504 program regulations.

Section 120.830—Reports a CDC must submit. SBA is proposing an amended § 120.830 to clarify the current annual report requirement by detailing the statements that must be included.

Section 120.845(b)—PCLP status. Section 120.845(b) would be revised to provide that final determinations under this section would be made by the appropriate Office of Capital Access official in accordance with Delegations of Authority. This proposed revision would reflect changes in internal agency procedure.

Section 120.853—Oversight and evaluation of CDCs. Section 120.853 currently covers both SBA reviews and Inspector General audits of CDCs. The proposed rule would move the CDC review portion of the regulation to subpart I—Lender Oversight (proposed §§ 120.1000 and 120.1050—On-site Reviews and Examinations). The proposed rule would retitle § 120.853 "Inspector General Audits of CDCs" consistent with the revised subject matter.

Section 120.956—Suspension or revocation of brokers and dealers. The proposed rule would revise § 120.956 to provide that the appropriate Office of Capital Access official in accordance with Delegations of Authority (rather than the D/FA) would be responsible for suspensions and revocations of broker/dealer participation in the Secondary Market. This is consistent with SBA's Delegations of Authority for oversight and enforcement responsibilities. In addition, the proposed rule deletes the last sentence on suspension of appeal rights.

Subpart I—Risk-Based Lender Oversight. SBA is significantly enhancing subpart I in Part 120 introduced on May 4, 2007 with SBA's published final rule on its Lender oversight fees. 72 FR 25194. The enhancements would consolidate SBA's supervision and enforcement authorities for SBA Lenders, Microloan Intermediaries and NTAPs. This consolidation would facilitate more coordinated and effective lender oversight.

Section 120.1000—Risk management/Lender oversight. SBA is proposing a new § 120.1000 entitled "Risk management/Lender oversight" that would describe lender oversight functions and the financial institutions supervised under the subpart.

Section 120.1005—Bureau of PCLP Oversight. In Public Law 108-232 (May 28, 2004), the "Premier Certified Lenders Program Improvement Act of 2004", Congress established two

alternative loss reserve pilot programs for certain Premier Certified Lenders (PCLP CDCs) loan loss reserve funds (LLRF). The public law also established the Bureau of PCLP Oversight in SBA to carry out such functions as the Administrator designates towards implementing the pilot programs. On May 26, 2006, SBA published a proposed rule governing the LLRF pilot programs. See, 71 FR 30323. Under the published proposed regulations, the Bureau of PCLP Oversight (Bureau) would approve the independent auditor that a pilot participant would engage to calculate its required LLRF. The Bureau would also review and make a determination as to a pilot participant's process for analyzing the risk of loss associated with the pilot participant's outstanding PCLP debentures (and the underlying loans) and the sufficiency of the LLRF. SBA anticipates publishing a final PCLP rule in the future.

Proposed § 120.1005 as contained in today's proposed lender oversight rule would include the Bureau of PCLP Oversight within subpart I, SBA's consolidated lender oversight regulations. Proposed § 120.1005 would provide that the Bureau monitor the capitalization of PCLP CDC pilot participants' LLRFs, and perform other related functions. SBA may expand Bureau functions in the future consistent with SBA's statutory authority.

Section 120.1010—SBA access to SBA Lender, Microloan Intermediary, and NTAP files. Proposed § 120.1010 governs SBA access to SBA Lender, Microloan Intermediary, and NTAP files. SBA is relocating its current file access regulation from § 120.414 and expanding this codification of authority to explicitly include CDCs, Microloan Intermediaries, and NTAPs. This provision is intended to facilitate lender oversight.

Section 120.1015—Risk Rating System. SBA is proposing a new § 120.1015 entitled "Risk Rating System." Under proposed § 120.1015, SBA could assign a Risk Rating to all SBA Lenders, Microloan Intermediaries, and NTAPs on a periodic basis (currently quarterly for SBA Lenders). This SBA Risk Rating process is detailed separately in final **Federal Register** notice at 72 FR 27320 (May 16, 2007). Risk Ratings range from one to five, with one indicating the least risk and five the most risk to SBA. OCRM would, from time to time, define the numeric definitions of acceptable and unacceptable levels of risk. For additional discussion of the Risk Rating System within this proposed rule, see the Proposal section of the preamble.

Section 120.1025—Off-site reviews/monitoring. SBA is proposing a new § 120.1025 entitled "Off-site reviews/monitoring". Under proposed § 120.1025, SBA may conduct off-site reviews/monitoring of all SBA Lenders, Microloan Intermediaries, and NTAPs, including SBA Lender self-assessments and other targeted off-site reviews as defined by SBA. Currently, SBA conducts off-site SBA Lender reviews on at least a quarterly basis using SBA's Loan and Lender Monitoring System (L/LMS). The L/LMS off-site review is SBA's primary method of monitoring all of SBA's 5000-plus SBA Lenders. For lower volume SBA Lenders, it may be the sole method of SBA review. L/LMS off-site reviews/monitoring are also used in conjunction with SBA Lender onsite reviews/exams and self-assessments (e.g. for purposes of planning and prioritization of exams/reviews/assessments and for evaluating performance).

Under proposed § 120.1025, SBA could require an SBA Lender, Microloan Intermediary, or NTAP to perform a self-assessment. This would be analogous to an AICPA Agreed Upon Procedures Engagement. For lower volume SBA Lenders, Microloan Intermediaries, and NTAPs, a self-assessment could consist of a self-evaluation as to SBA performance or compliance with certain SBA requirements. Generally, SBA would consider requiring a self-assessment to confirm corrective actions implemented or in lieu of a targeted or limited scope review. SBA expects to provide additional guidance on self-assessments in its SOPs.

Finally, SBA may also perform targeted off-site reviews and monitoring (e.g., performance comparison to SBA portfolio and peer averages, error rates in 1502 reporting, trend analysis, etc.). Off-site reviews/monitoring mechanisms like L/LMS, self-assessments, and other targeted off-site reviews are a timely and cost effective means of overseeing and monitoring the SBA performance and compliance of SBA Lenders, Microloan Intermediaries, and NTAPs.

Section 120.1050—On-site reviews and examinations. Proposed § 120.1050—"On-site reviews and examinations" would codify in one place within SBA regulations SBA's authority to conduct examinations of SBA Supervised Lenders and reviews of the SBA operations of SBA Lenders. The proposed section would also describe the examination and review components that SBA would likely evaluate. For SBA Supervised Lender safety and soundness examinations, SBA would examine capital adequacy;

asset quality; management quality; earnings; liquidity; compliance with laws, regulations, rules, SOPs, and SBA agreements; and such other risk related factors as SBA may identify from time to time. SBA's safety and soundness examinations are similar in scope to those conducted by the Federal Financial Institution Regulators. For SBA operational reviews, SBA would review the SBA portfolio performance; SBA operations management; credit administration; compliance with laws, regulations, rules, SOPs, and SBA agreements; and such other risk related factors as SBA identifies from time to time. These components have been identified by SBA as most useful in assessing lender performance and risk to the loan program. Section 120.1050 would also provide for SBA reviews of Microloan Intermediaries and NTAPs. Finally it would provide SBA with the flexibility to perform other reviews and examinations, as SBA determines necessary. These could include targeted or limited scope reviews/examinations (e.g., ad hoc reviews/examinations, additional monitoring activities, special performance assessments). Targeted and limited scope reviews/examinations would provide for a more efficient and less burdensome means of supervision of specific deficiencies.

Section 120.1051—Frequency of on-site Lender reviews and examinations. Proposed § 120.1051 provides that SBA would perform on-site reviews and examinations on a periodic basis. Currently, SBA plans on conducting such reviews and examinations on a 12 to 24 month cycle, depending on the risk characteristics of the SBA Lender, Microloan Intermediary, or NTAP. The proposed regulation would also list some risk-related factors that SBA would consider in determining review/examination frequency. They would include (but would not be limited to): (i) Off-site review/monitoring results (e.g. Risk Rating); (ii) SBA portfolio size; (iii) prior findings; (iv) responsiveness to correcting past deficiencies; and v) such other risk-related factors as determined by SBA.

Section 120.1055—Review and examination results. Under the proposed rule, SBA would provide SBA Lenders, Microloan Intermediaries, and NTAPs a copy of their report of examination or review (Report). The Report would contain findings, conclusions, corrective actions and/or recommendations. The proposed regulation requires each director of an SBA Supervised Lender and manager of the SBA Operations of SBA Lenders, Microloan Intermediaries, and NTAPs to review the Report. If such senior

management review the Report consistent with their responsibilities, it is more likely that the SBA Lender, Microloan Intermediary, and NTAP would commit to and make corrective actions. Proposed § 120.1055, would also provide procedures for responding in writing to SBA Reports along with the consequences of failure to submit or implement responses, corrective actions, and capital restoration plans.

Section 120.1060—Confidentiality of Reports, Risk Ratings, and related Confidential Information. Proposed § 120.1060 would provide that Reports and other SBA prepared review or examination related documents are the property of SBA. It would also provide that Reports, Risk Ratings and related Confidential Information (including SBA Lender portal information) would be privileged and confidential. The term “Confidential Information” is defined in the SBA Lender Information Portal, and by notice issued from time to time. Currently, it is defined as “all lender-related information contained in the Portal including ‘Lender Results’, except for the ‘Past 12 Month Actual Purchase Rate’ and the ‘Past 12 Month Actual Charge-Off Rate’.” Under the proposed rule, SBA Lenders, Microloan Intermediaries, and NTAPs would be required to restrict access to the Report, the Risk Rating, and the Confidential Information to certain “permitted parties” as defined in this proposed regulation and to those for whom access is required by applicable law or legal process. For example, if it is determined that such law or legal process requires disclosure to a Federal Financial Institution Regulator, then this proposed regulation would not preclude that access. SBA Lenders, Microloan Intermediaries and NTAPs would be prohibited from otherwise disclosing Report, Risk Rating, and Confidential Information in full or in part in any manner without SBA’s prior written permission. The confidentiality requirement is reflective of the principles underlying the bank examiners privilege—it provides for more open dialogue between regulators and financial institutions, intending to lead to more cooperative and expeditious identification and resolution of institution issues. For more discussion on the confidentiality and limitations on disclosure see SBA Lender Risk Rating System final notice, 72 FR 27611 (May 16, 2007).

Section 120.1400—Grounds for enforcement actions—SBA Lenders. The proposed rule would consolidate existing SBA enforcement authorities for SBA Lenders with new authorities, most of which are outlined in 15 U.S.C.

650 *et seq.* The SBA enforcement action provisions of the proposed rule would begin with a new § 120.1400 that would provide a listing of grounds that may trigger enforcement action. Proposed § 120.1400 lists first those grounds that, in general, could trigger enforcement actions, then those grounds that are specific to certain enforcement actions, most of which are specific to certain types of institutions (e.g., SBA Supervised Lenders).

Grounds for enforcement actions would not be limited to violations of the regulations as stated in proposed subsection (a). SBA is authorized to bring enforcement actions for breaches of terms and conditions in the SBA Form 750 Loan and Guaranty Agreement and all other agreements jointly executed by the SBA Lender and SBA.

The grounds, as proposed, are primarily derived from current regulations or directly from the Act. For example, the grounds would include: Failure to maintain eligibility requirements; failure to comply materially with any requirement imposed by statute, regulation, SOP, policy or procedural notice, or any agreement; making a material false statement; and not performing underwriting, closing, disbursing, servicing, liquidation, or litigation in a commercially reasonable and prudent manner with respect to the applicable loan program (e.g., 7(a) or 504). A repeated Less Than Acceptable Risk Rating would be included in enforcement action grounds indirectly through subsections (c)(4) and (c)(9). Subsection (c)(4) would provide that a repeated Less Than Acceptable Risk Rating or on-site review/examination assessment could be evidence to support a determination that the SBA Lender was not performing underwriting, closing, disbursing, servicing, liquidation, litigation or other actions in a commercially reasonable and prudent manner. Subsection (c)(9) would provide that SBA may take enforcement action if SBA determines there is increased financial risk (for example—if SBA Lender has a repeated Less Than Acceptable Risk Rating or if an officer, key employee, or loan agent involved with SBA loans for an SBA Lender is indicted for a felony or on fraud charges). SBA expects to consider additional factors (e.g., on-site review/examination assessment or corrective action implemented) before taking formal enforcement actions on Risk Rating grounds. For CDCs, in particular, the Risk Rating and review assessment would replace the indirect role of the

portfolio benchmarks under current § 120.854(a)(4).

Proposed paragraphs (11) and (12) would provide the grounds for immediate suspension of loan program activities for SBA Lenders except SBA Supervised Lenders, as well as the grounds for immediate suspension of delegated authorities for all SBA Lenders. The basis for such action would be a determination by SBA that one or more of the grounds in subsection (c) exist and, that immediate action is needed to prevent the risk of significant loss to SBA or to prevent significant impairment of the 7(a) or 504 programs.

Proposed subsections (d) and (e) would incorporate the statutory grounds for certain SBA Supervised Lender and SBLC enforcement actions under 15 U.S.C. 650 *et seq.* Among those are grounds specific to SBA Supervised Lenders (excluding Other Regulated SBLCs under proposed § § 120.1510 and 120.1511) for suspensions and revocations of SBA program authority. Subsection (f) would list additional grounds specific to CDCs and, for PCLP CDCs, includes failure to establish and maintain a LLRF in accordance with SBA regulations.

Section 120.1425—Grounds—Intermediaries participating in the Microloan program and NTAPs. Proposed § 120.1425 would incorporate grounds for enforcement actions against Microloan Intermediaries and NTAPs contained in current § 120.716 into subpart I. In addition, the proposed regulation would provide that a repeated Less Than Acceptable Risk Rating or an indictment for a felony or on fraud charges of an officer, key employee, or loan agent involved with SBA loans or the SBA program for a Microloan Intermediary or NTAP could be evidence of SBA’s increased financial or program risk, and as such, also serve as grounds for formal enforcement action. However, it would not automatically mean that SBA would take formal enforcement action under proposed § 120.1540. In addition, SBA expects to consider additional factors (e.g. on-site review/examination assessment or corrective actions implemented) before taking formal enforcement action.

Section 120.1500—Enforcement actions—SBA Lenders. SBA is proposing a new § 120.1500 entitled “Enforcement Actions—SBA Lenders” that lists the formal enforcement actions that SBA may take against an SBA Lender. These provisions generally would be listed in a graduated manner within each SBA Lender category. New to this formal list is (i) imposition of

portfolio guarantee dollar limit, (ii) suspension and/or revocation of Secondary Market activity; and (iii) the new statutory SBA Supervised Lender enforcement actions. SBA added the portfolio guarantee limit as a means of limiting SBA's risk exposure for a particular SBA Lender. SBA included suspension/revocation of a 7(a) Lender's authority to sell or purchase loans in the Secondary Market in its list of formal graduated actions also as a means of limiting an SBA Lender's risk exposure to SBA and the Secondary Market. The suspension and revocation of individual lending functions would facilitate SBA taking more targeted measures to address isolated but significant functional deficiencies.

The capital directive is within the SBLC enforcement actions. Under proposed subsection (d)(1), SBA may order a capital impaired SBLC (or SBLC operating in an imprudent manner) to meet its capital requirement, submit and adhere to a capital restoration plan, and obtain SBA approval before taking certain actions, as detailed.

Sections 120.1510 and 120.1511—Other Regulated SBLCs. Proposed §§ 120.1510 and 1511 would address the rare instance where an SBLC itself is directly examined by a Federal Financial Institution Regulator or State banking regulator. Under such circumstances, the "Other Regulated SBLC" would be exempt from the statutory enforcement provisions specific to SBA Supervised Lenders as granted in § 23 of the Act, 15 U.S.C. 650 [except those for SBLCs only in subsections (b) and (c)]. SBA, instead, would rely on a Federal Financial Institution Regulator's or state banking regulator's safety and soundness examination conducted directly on the SBLC and their follow-up to address safety and soundness issues.

To obtain the designation of Other Regulated SBLC, the SBLC would have to certify, under proposed § 120.1511, that it is directly examined and regulated by a Federal Financial Institution Regulator or state banking regulator. The elements of this certification are detailed in the Regulation. This certification would have to be submitted in writing within 60 days of the effective date of the final rule or within 60 days of the date the SBLC becomes directly examined and directly regulated by such regulator. The SBLC would have to identify the Federal Financial Institution or state banking regulator performing the examinations on it directly and provide information on the most recent safety and soundness examination. An Other

Regulated SBLC would also be required to notify SBA in writing each time such a safety and soundness examination of the SBLC itself took place and report the interaction, to the extent allowed by law.

Proposed § 120.1511(g) would provide that, in the event an SBLC fails to timely comply with the necessary certification and reporting requirements, then the § 120.1510 exemption would not apply and SBA would exercise its statutory authority to supervise the safety and soundness of the SBLC and may take the statutory SBA Supervised Lender enforcement actions, as necessary, to protect the financial interests of the 7(a) program.

While an Other Regulated SBLC would be expected to comply with SBLC requirements, as set forth for example in proposed §§ 120.470 (SBLC general licensing requirements), 120.471–474 (SBLC minimum capital requirements), 120.475 (SBLC change of control), 120.476 (SBLC prohibited financing), 120.460 (internal controls), 120.461 (document retention), 120.463 (regulatory accounting), 120.464 (reports), and 120.490 (IG audits), it would only be subject to SBA Lender risk-based reviews and enforcement provisions and not the statutory SBA Supervised Lender supervision and enforcement provisions, except those that are SBLC licensing specific (i.e., capital directive and civil action).

Section 120.1540—Enforcement actions—Intermediaries participating in the Microloan program and NTAPs. Proposed § 120.1540 would incorporate formal enforcement actions against Microloan Intermediaries and NTAPs set forth in current § 120.716 into subpart I.

Section 120.1600—General procedures for enforcement actions—SBA Lenders, Management Officials, Other Persons, Intermediaries, and NTAPs. Proposed § 120.1600 would largely adopt the enforcement procedures for CDCs currently contained in § 120.856 and extend them, in general, to all SBA Lenders, Microloan Intermediaries and NTAPs. Proposed procedures would include a notice of enforcement action; opportunity to object; notice of final Agency decisions; and a provision on appeals directly to federal district court. Additions/changes to the general provision include, but are not limited to, a provision to make clear that request for clarification of notice for additional time to respond must be received by the same deadline for objection; responses and such requests must be submitted to the appropriate Office of Capital Access official in accordance with Delegations

of Authority; and appeals of the final Agency decision would no longer be filed with SBA's OHA but would be filed in the appropriate Federal district court. Proposed § 120.1600 would also set forth procedures for certain SBA Supervised Lender, Management Official, or Other Person enforcement actions as prescribed by statute. This would include enforcement procedures specific to SBA Supervised Lenders (excluding Other Regulated SBLCs under proposed §§ 120.1510 and 120.1511) for suspensions and revocations of SBA program authority. The additional procedures in subsection "c" for SBLC capital directive would generally follow similar provisions of other Federal Financial Institution Regulators.

IV. Comments Request

Readers are encouraged to review closely each section of the proposed rule in conjunction with current regulations to fully comprehend the extent of the rule and its changes. SBA 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 12866, 12988, and 13132, the Regulatory Flexibility Act (5 U.S.C. 601–612), and the Paperwork Reduction Act (44 U.S.C., Ch. 35) Executive Order 12866: The Office of Management and Budget has determined that this rule constitutes a "significant regulatory action" under Executive Order 12866 thus requiring a Regulatory Impact Analysis, as set forth below.

A. Regulatory Objective of the Proposal

SBA is proposing a rule to incorporate SBA's risk-based lender oversight program into SBA regulations. Specifically, the proposed rule would establish the role and responsibilities of SBA's Office of Credit Risk Management within subpart I to 13 CFR Part 120. It would codify in 13 CFR SBA's process of risk-based oversight including: (i) Accounting and reporting requirements; (ii) off-site reviews/monitoring; (iii) on-site reviews and examinations; and (iv) capital adequacy requirements. The proposed rule would also list the types of, grounds for, and procedures governing SBA enforcement actions within consolidated enforcement regulations for all 7(a) Lenders, CDCs, Microloan Intermediaries, and NTAPs. This rule is necessary to provide coordinated and effective oversight of financial institutions that originate and manage SBA guaranteed loans.

These regulatory changes would improve SBA's oversight and management of the 7(a), 504, Microloan and NTAP programs. SBA believes that there are no viable alternatives to these changes that would produce similar positive results without imposing an additional burden on the SBA or the public.

B. Baseline Costs

1. Baseline Costs for 7(a) Lenders (Excluding SBA Supervised Lenders)

All 7(a) Lenders are currently required to be supervised and examined by a state or Federal regulatory authority, satisfactory to SBA. This is a cost already borne by these 7(a) Lenders. In addition, these 7(a) Lenders are subject to SBA's supervisory and enforcement provisions contained in the business programs portion of Part 120. The estimated annual baseline costs to the Federal government for 7(a) Lenders' oversight is provided for in the existing OCRM infrastructure.

2. Baseline Costs for SBLCs

Each SBLC is currently required to submit audited financial statements within three months after the close of each fiscal year and interim financial reporting when requested by SBA. SBA also currently requires that SBLCs submit a report on any legal or administrative proceeding, by or against the SBLC, or against an officer, director or employee of the SBLC for an alleged breach of official duty; copies of any report furnished to its stockholders; a summary of any changes in the SBLC's organization or financing; notice of capital impairment; and such other reports as SBA may require from time to time by written directive. The collection of the information and reports referenced here is largely already maintained by the SBLCs for operational and financing purposes. It is estimated that preparation and submission of this information takes about 80 hours annually for each SBLC. The hour burden is an SBA estimate based on inquiries made to selected SBLCs. The estimate of the total annual cost burden is based on an average annual outside audit fee of \$8,000 per respondent, plus an additional \$2,000 per respondent for staff involvement in the independent audit engagement and SBA reporting (approximately 15 hours of CFO time at a \$100 hourly rate plus 15 hours of administrative profession time at a \$30 hourly rate, rounded). This total cost burden is estimated at \$140,000 for 14 SBLCs. SBA has reduced this figure by \$20,000 to \$120,000 to adjust for reduced costs for smaller SBLCs. The

estimated annual cost to the Federal government for this information collection is approximately 8 hours of Financial Analyst time at \$55 per hour, or \$6,160 annually for all 14 SBLCs. Any additional estimated indirect annual cost to the Federal government for oversight of these SBLCs is provided for in the existing OCRM infrastructure.

3. Baseline Costs for NFRLs

No direct costs are currently incurred by NFRLs for SBA oversight and related functions discussed in this proposed rule. The estimated annual cost to the Federal government for oversight of these NFRLs is provided for in the existing OCRM infrastructure.

4. Baseline Costs for CDCs

Each CDC is currently required to submit to SBA an annual report within 180 days of the fiscal year end, including financial statements of the CDC and any affiliates or subsidiaries and such interim reports as SBA may require. The collection of the information and reports referenced here is largely already maintained by the CDCs for operational purposes. SBA has estimated that preparation and submission of this information takes approximately 28 hours annually for each CDC, at an average cost of \$30 per hour for staff compilation, which computes to a cost of \$840 per CDC, and a total of 7,560 hours for all CDCs. This total cost burden is \$226,800 (7,560 hours × \$30) for the approximately 270 CDCs. The estimated annual cost to the Federal government for this information collection is approximately 1 hour of financial analyst time per CDC or 270 hours total for all CDCs, at a cost of \$55 per hour. Estimated annual Federal cost burden therefore is estimated at \$14,850 (270 hours × \$55). The remaining estimated annual cost to the Federal government for oversight of CDCs is provided for in the existing OCRM infrastructure.

5. Baseline Costs for Microloan Intermediaries and NTAPs

Microloan Intermediaries and NTAPs currently incur no direct costs for oversight and related functions as discussed in this proposed rule. The estimated annual cost to the Federal government for oversight of these Microloan Intermediaries and NTAPs is currently provided for in the existing OFA infrastructure.

C. Potential Benefits and Costs of the Proposed Rule

1. Potential Benefits and Costs of the Proposed Rule to all SBA Lenders, Microloan Intermediaries and NTAPs

The proposed rule would benefit SBA Lenders, Microloan Intermediaries, and NTAPs by generally consolidating oversight authority and responsibility within one SBA office, OCRM. These institutions would also benefit from knowledge of established and further defined programmatic standards, enforcement grounds, ranges of enforcement actions and procedures for supervision and enforcement actions as set forth in the proposed rule. They may further benefit from performance feedback to the extent it can assist them in improving their SBA operations and minimizing losses.

While there are specific benefit and costs issues for specific categories of lenders as detailed below, all SBA Lenders, Microloan Intermediaries and NTAPs will incur some relatively minimal costs related to the proposed rule's incorporation of review/exam reporting (e.g., self-assessments and related reporting, corrective action plans). Self-assessments and review/exam reporting are a timely and cost effective means of overseeing and monitoring the SBA performance and compliance of SBA Lenders, Microloan Intermediaries and NTAPs.

2. Potential Benefits and Costs of the Proposed Rule to 7(a) Lenders (Other Than SBLCs and Other NFRLs)

No additional direct costs are projected to be incurred by 7(a) Lenders for oversight as contained in the proposed regulations. No additional reporting or direct costs are projected to be incurred by 7(a) Lenders with the rule's implementation.

3. Potential Benefits and Costs of the Proposed Rule to SBLCs

The proposed rule would provide for more developed internal control requirements and adoption of a formal capital plan. It would also require filing of (i) quarterly condition reports (including financial statements); (ii) reports of changes in financial condition; (iii) notice of change of auditor; (iv) capital restoration plans; and (v) Other Regulated SBLC Reports, with certifications as to accuracy or compliance (including capital compliance) as applicable. Because internal controls, formal capital plans, and quarterly financial statements are likely already maintained by the SBLCs for operational purposes, SBA estimates little or no additional cost for these new

requirements. It is estimated that preparation and submission of all the additional reports and the new recordkeeping would take approximately 3 hours annually of additional CFO time at a \$100 hourly cost, plus 3 hours annually of additional administrative professional time at a \$30 hourly cost. Therefore, the total additional cost burden would be \$5,460 ($\390×14) for 14 SBLCs.

4. Potential Benefits and Costs of the Proposed Rule to NFRLs

The proposed rule would require each NFRL to submit an annual report, including audited financial statements within three months after the close of each fiscal year. The proposed rule would further require that all audited financial report filings be prepared in accordance with GAAP, and include an opinion from the independent accounting firm engaged in the audit. It would also require NFRLs to submit: (i) a report on any legal or administrative proceeding, by or against the NFRL, or against an officer, director or employee of the NFRL for an alleged breach of official duty; (ii) copies of any report/publications furnished to its stockholders; (iii) summaries of changes in the NFRL's organization or financial structure, personnel and eligibility; (iv) notice of capital impairment; (v) quarterly condition reports; (vi) changes in financial condition reports; (vii) recapitalization plans; and (viii) notice of changes in auditors and such other reports as SBA may require from time to time by written directive—with certifications as to accuracy and compliance (including capital compliance), as applicable. The proposed rule would also require adoption of a developed internal control policy, records maintenance, and adoption of a formal capital plan. Much of the collection of the information and reports referenced here, as well as the requirements for internal control, records retention and adoption of a formal capital plan are likely information already maintained by the NFRLs for operational, and in some instances financing, purposes. SBA estimates preparation and submission costs consistent with that of the baseline for the SBLCs, at 80 hours of external auditor time at \$100 hourly rate, plus an additional \$2,000 per NFRL for staff involvement in the independent audit engagement (approximately 15 hours of CFO time at a \$100 hourly rate plus 15 hours of administrative profession time at a \$30 hourly rate, rounded) for a total of \$10,000 per NFRL. SBA estimates additional reporting and recordkeeping requirements to the NFRLs (that which

would be new to SBLCs as well) at 3 hours of additional CFO time at a \$100 hourly rate plus 3 hours of additional administrative professional time at a \$30 hourly rate (\$390 per NFRL). Since there are no current baseline costs to NFRLs, the total additional cost burden for this proposed rule for the 58 NFRLs (as of May 2007) would potentially be \$602,620 ($\$10,390 \times 58$ NFRLs).

5. Potential Benefits and Costs of the Proposed Rule to CDCs

The proposed rule would require each CDC to submit an annual report, including audited financial statements within three months after the close of each fiscal year and interim financial reporting when requested by SBA. All audited financial report filings would be required to include an opinion from the independent accounting firm engaged in the audit. The proposed rule would also require enhanced internal control requirements. The collection of the information referenced here, including the annual audited financial statements, as well as the requirements for internal control would include information, policies and procedures likely already maintained by many of the CDCs for operational purposes. The hour burden is an SBA estimate based on inquiries made to selected CDCs. It is estimated that preparation and submission of this information would take approximately 40 (auditor) hours annually for each CDC, at an average cost of approximately \$4,000 (\$100 per hour for CPA-credentialed auditor) average outside audit fee, plus internal staff time of 4 hours at the administrative professional rate of \$30 per hour (\$120 per CDC). This is in lieu of existing Baseline Costs for CDCs outlined in paragraph 4 of Section B. Baseline Costs. The total cost would be \$1,112,400 ($\$4,120 \times 270$ CDCs). The total additional cost burden would be \$885,600 ($\$1,112,400 - \$226,800$ baseline) for the 270 CDCs for this proposed rule. We note, however, that this number may be dramatically reduced because many CDCs are already required to maintain audited financial statements and internal control programs under The Single Audit Act requirements.

6. Potential Benefits and Costs of the Proposed Rule to Microloan Intermediaries and NTAPs

No additional direct costs are projected to be incurred by Microloan Intermediaries and NTAPs for lender oversight and related functions in this proposed rule. No additional costs would be incurred by Intermediaries due to the implementation of this rule,

since general oversight, suspension or revocation already exists in § 120.716 and is replaced by consolidated oversight within subpart I, and no additional reporting is required by this proposed rule.

7. Potential Benefits and Costs for SBA and the Federal Government

Benefits to SBA include improved administration of the lender oversight process through general consolidation of oversight authority within OCRM. SBA would also benefit from having more timely and complete operations information, including financial information for SBA Supervised Lenders and CDCs. In addition, the Agency would benefit from further defined standards, enforcement grounds, ranges of enforcement actions and procedures for supervision and enforcement actions for all SBA Lenders, Microloan Intermediaries and NTAPs. Finally, the rules' additional requirements and lender oversight provisions would provide improved and more timely lender monitoring to ultimately further minimize the risks of losses in SBA's loan programs.

For 7(a) Lender specific sections, no additional reporting from these lenders is required by the proposed rule, and therefore no additional direct costs for assessment of any such reporting would be incurred by SBA for provisions related to oversight functions in this proposed rule.

For SBLCs, we estimate the proposed rule would require an additional 3 hours financial analyst time at a \$55 hourly rate to the Federal government for each SBLC or 42 hours overall (3×14 SBLCs) for an additional annual cost of \$2,310 to the Federal government.

For NFRLs, the estimated annual cost to the Federal government would be approximately 8 hours financial analyst time at a \$55 hourly rate. Therefore, estimated annual cost to the Federal government related to oversight of all 58 NFRLs in accordance with this proposed rule would be 688 hours for \$25,520.

For CDCs, the estimated cost to the Federal government would be for additional information collected approximated at 1 hour financial analyst time for each CDC at a \$55 hourly rate. The total additional cost would be \$14,850 ($1 \text{ hr} \times 270 \times \55). In lieu of existing baseline cost of \$14,850 (1 hr per CDC), the total cost would be \$29,700.

For Microloan Intermediaries and NTAPs, no additional direct costs to SBA would be incurred for the lender oversight functions and related provisions in this proposed rule.

Any additional indirect cost to the Federal government for oversight of the SBA Lenders, Microloan Intermediaries, and NTAPs under this proposed rule would be covered by the already-existing OCRM infra-structure.

8. Cost Basis

For purposes of this proposal, CPA and CFO salary rates used were based on information published by the American Institute of Certified Public Accountants (AICPA) for CPA-credentialed individuals (external auditor or internal CFO) estimated at \$100. The salary rates for administrative professionals were based on information published by the International Association of Administrative Professionals. Internal SBA financial analyst time was estimated at GS-14 step 5 level of \$99,203 plus 24.8% benefits allocation, or approximately \$55 per hour.

SBA is requesting comments from the public on any monetized, quantitative or qualitative costs of SBA Lenders, Microloan Intermediary, or NTAP compliance with this proposed rule. Please send comments to the SBA official referenced in the **ADDRESSES** section of the preamble.

D. Alternatives

SBA believes that this proposed rule is SBA's best available means for achieving its regulatory objective of incorporating coordinated risk-based supervision and enforcement into SBA regulations and implementing the provisions of Public Law 108-447 and SBA's Delegation of Authority for lender oversight. SBA is requesting comments from the public on any potentially effective and reasonably feasible alternative to this proposed rule as it applies to SBA Lenders, Microloan Intermediaries, and NTAPs and the costs and benefits of those alternatives.

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

Executive Order 12988: For the purposes of Executive Order 12988, Civil Justice Reform, SBA has determined that this proposed rule is crafted, to the extent practicable, in accordance with the standards set forth in §§ 3(a) and 3(b)(2), to minimize litigation, eliminate ambiguity, and reduce burden. The proposed regulations would provide for rights of appeal to SBA Lenders, Microloan Intermediaries, and NTAPs in the event they are aggrieved by an Agency decision, thereby limiting the possibility of litigation by these entities. This

proposed rule would not have retroactive or pre-emptive effect.

Regulatory Flexibility Act: This proposed rule directly affects all SBA Lenders, Microloan Intermediaries, and NTAPs. There are approximately 5,000 7(a) Lenders, 270 CDCs, 250 Microloan Intermediaries, and there were 11 NTAPs participating with SBA funding when NTAPs were last funded. SBA has determined that CDCs, Microloan Intermediaries, and the 14 SBLCs fall under the size standard for NAICS 522298. All other Nondepository Credit Intermediation. The size standard for NAICS 522298 is \$6.5 million or less in average annual receipts. There are approximately 58 NFRLs, most of which fall in NAICS 522298 (the rest fall into NAICS 522110, Commercial Banking). The remaining 7(a) Lenders fall under the size standard for NAICS 522110, Commercial Banking. The size standard for NAICS 522110 is assets of \$165 million or less. The NTAPs fall under the size standard for NAICS 541990, All Other Professional, Scientific and Technical Services. The size Standard for NAICS 541611 is \$6.5 million or less in average annual receipts.

SBA estimates that over 95 percent of the CDCs and Microloan Intermediaries do not exceed the applicable size standard and are, therefore, considered small entities by this definition. Approximately half of all of the 7(a) Lenders exceed the small business size standard set for NAICS 522110. Thus, SBA has determined that this proposed rule would have an impact on a substantial number of small entities. However, for the reasons explained following, SBA does not believe that the proposed rule will have a significant economic impact on those entities.

The proposed rule would contain several different sections. For clarity, SBA has analyzed the economic impact by section, as follows:

A. Proposed Reporting Requirements for SBA Supervised Lenders and CDCs: There are 14 Small Business Lending Companies (SBLCs) and approximately 58 NFRLs that are authorized to make 7(a) loans. The majority of the NFRLs are nondepository commercial Lenders. Most of the NFRLs are classified under NAICS 522298, which has a small business size standard of \$6.5 million or less in annual revenues. The remaining NFRLs are classified under NAICS 522110, Commercial Banking, which has a small business size standard of \$165 million or less in assets.

Current regulations require SBLCs to submit their audited financial statements to SBA within three months after the close of their fiscal year. Financial statement submission allows

SBA to perform a size determination on SBLCs with a reasonable degree of accuracy. Based on submitted financial statement, of the twelve active SBLCs, four exceed the small business size standard for NAICS 522298.

Presently, there is no requirement that NFRLs submit financial statements to SBA. Therefore, SBA does not have the information to determine current average annual receipts. To estimate the size of the NFRLs, SBA reviewed a sample of the financial statements that NFRLs had submitted to SBA when they first applied for authorization to make 7(a) loans. Based on a review of those financial statements, we estimate that two-thirds of the NFRLs are small. Based on the financial data in the NFRL applications and up-to-date financial data supplied by SBLCs to SBA, SBA believes that the proposed rule would impact a substantial number of these small entities, but not constitute a significant economic impact, as detailed below.

The proposed rule, which defines "SBA Supervised Lenders" as NFRLs and SBLCs, requires these Lenders to provide SBA with the following information: (1) Annual audited financial statements, (2) quarterly condition reports, (3) copies of any legal and administrative proceedings by or against the SBA Supervised Lender, (4) copies of any report furnished to its stockholders, (5) reports of changes in the SBA Supervised Lender's organization or financing, (6) reports of changes in the SBA Supervised Lender's financial condition, (7) notice of change in auditors, (8) notice of capital impairment, (9) capital restoration plans, (10) Other Regulated SBLC reports, (11) other reports (that SBA may require from time to time) and (12) certifications of compliance with capital requirement. Several of these are already required of SBLCs. The proposed rule would also provide for record retention requirements and recordkeeping of a capital adequacy plan.

As is mentioned above, SBLCs are already required to submit audited annual financial statements to SBA. It has been SBA's experience that SBLCs and NFRLs also prepare quarterly financial statements on a regular basis for their own internal management purposes, and SBA believes that most of the NFRLs also prepare audited annual financial statements for their internal management purposes. The proposed rule would require both NFRLs and SBLCs to provide the SBA with copies of their financial statements on a quarterly basis and would expand the requirement for annual audited

financial statements submitted to SBA to include NFRLs. Existing regulations also require SBLCs to maintain compliance with SBA capital requirements. The proposed rule would expand the number of firms subject to SBA's capital regulation by making NFRLs subject to certain capital regulations. The proposed rule would also require SBA Supervised Lenders to provide SBA with a quarterly certification that they are in compliance with the SBA capital requirement. A certificate of compliance with SBA capital regulations would normally be prepared by a financial institution's chief financial officer or someone from his staff under the proposed rule. SBA believes that it would take no more than one hour per quarter to prepare and certify. The certification could accompany quarterly condition reporting. In accordance with the American Institute of Public Accountants published surveys, the salary and benefits rate for a CPA-credentialed individual is estimated at \$100 per hour. This computes to an estimated annual cost of \$400 to cover the CFO's time. We estimate that the administrative staff work involved in preparing the submission materials would take no more than one hour for those quarters not covered by the Annual Report. According to a recent survey published by the International Association of Administrative Professionals, the salary estimate is \$30 per hour. This calculates to an annual expense of \$120 per year. The combined annual expense that SBA Supervised Lenders would incur in order to comply with this reporting would be on average \$520 (\$400 + \$120). SBA does not believe that an additional \$520 cost annually constitutes significant economic impact on any of these firms, which can routinely engage in financings in the million dollar range. Therefore, SBA certifies that this aspect of the proposed rule would not have a significant economic impact on a substantial number of small entities.

Current regulations require that SBLCs submit copies of the following to SBA: (1) Any legal and administrative proceedings by or against them, (2) any reports it furnishes to its stockholders, and (3) summaries of changes in the SBLCs organization and financing, (4) notice of capital impairment, and (5) such other report it is required by SBA to furnish on a specific matter. The proposed rule would extend to NFRLs these ad hoc reporting requirements. SBA believes this data is likely already collected and that similar documents are already prepared by the NFRLs. The

proposal only requires the NFRLs to submit the documents to SBA. Because these are documents that are likely already in the possession of the NFRLs, SBA does not believe that the NFRLs would incur any significant costs to comply with the proposal. SBA, therefore, certifies that this aspect of the proposed rule would not have a significant economic impact on a substantial number of small entities. However, SBA requests data from the public that would enable SBA to determine any additional costs as a result of the proposed rule to require reporting of these items.

The new reporting and recordkeeping requirements in the proposed rule for SBA Supervised Lenders that have not yet been discussed would occur on an ad hoc basis (e.g. change in financial condition). They generally would be triggered by exceptional circumstances. Thus given their ad hoc and exceptional nature, they would not likely have a significant economic impact on a substantial number of small entities.

The proposed rule would require all CDC financial statements that are filed with the CDC annual report submission to be audited. Currently, under OMB approved information collection number 3245-0074, SBA only requires CDCs with a 504 loan portfolio balance of \$20 million dollars or more to have the financial statements of be audited. (See SBA Form 1253.) For CDCs with a 504 loan portfolio balance of less than \$20 million dollars, the financial statements currently need only be reviewed by an independent CPA and be prepared in accordance with GAAP. SBA is extending the audit requirement to all CDCs to facilitate a better assessment of the performance and financial strength of all CDCs. In addition, this requirement is part of SBA's incorporation of Single Audit Act requirements into its regulations. SBA estimates that at least 70 of the 270 CDCs already maintain audited financial statements, SBA also estimates that the cost of auditing the financial statements beyond the current review requirement for the estimated remaining 200 is approximately \$4,000 per CDC (based upon an average additional 40 hours × \$100 per hour of auditor time). This \$4,000 annually is not an excessive cost for CDCs, all of which can routinely engage in financings in the million dollar range. Based on this, SBA certifies that the extension of this requirement would not likely have a significant economic impact on a substantial number of small entities.

B. Capital Adequacy: Only SBLCs are presently subject to the minimum capital requirements currently found in

13 CFR 120.470. The proposed rule would require SBLCs quarterly compliance with its minimum capital requirement. It would also require that NFRLs provide the SBA with a quarterly certification that they are in compliance with their state regulator's minimum capital requirement. In addition, the proposed rule would broaden the existing definition of capital, making it more consistent with that of other Federal Financial Institution Regulators, by allowing SBA Supervised Lenders to count retained earnings towards their regulatory capital requirement. SBA asserts that broadening the types of capital that are eligible towards the SBA capital requirements would have no adverse financial impact on small Lenders. In fact, allowing retained earnings to count toward an SBA Supervised Lender's regulatory capital would allow those SBLCs with significant retained earnings on their balance sheet to increase the size of their 7(a) portfolio without necessitating any additional injection of permanent capital. SBA, therefore, certifies that this aspect of the rule will not have a significant economic impact on a substantial number of small entities.

C. Enforcement Provisions: The proposed rule would list the types of, grounds for, and procedures governing SBA enforcement actions within consolidated enforcement regulations for all SBA Lenders, Microloan Intermediaries, and NTAPs. The general enforcement provisions for SBA Lenders, Microloan Intermediaries, and NTAPs follow, for the most part, the same format that was established for the CDC program. The enforcement provisions for SBA Supervised Lender specific and SBLC specific actions follow recent legislation codified at 15 U.S.C. 650 et. seq. Because SBA anticipates that enforcement actions would occur on an exception basis, SBA does not anticipate that these provisions would 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, therefore, certifies that the proposed rule would not have a significant impact on a substantial number of small entities.

D. Bureau of PCLP Oversight: SBA proposes to establish the Bureau of PCLP Oversight in accordance with statutory guidance to address undercapitalization in the LLRFs of Premier Certified Lenders (PCLP CDCs). Of the approximately 270 CDCs, less than 20 of them have PCLP authority. These are generally the larger CDCs, with portfolios which have a total outstanding portfolio balance of \$5.1

billion. SBA, therefore, certifies that the proposed rule Bureau of PCLP Oversight provision would not have a significant impact on a substantial number of small entities.

Paperwork Reduction Act: SBA has determined that this proposed rule would impose additional reporting and recordkeeping requirements under the Paperwork Reduction Act, 44 U.S.C. Chapter 35. Specifically, SBA would revise OMB approved information collection number 3245-0077 to include NFRLs in SBA's current reporting requirements for SBLCs. SBA would also revise 3245-0077 to add four reporting requirements for all SBA Supervised Lenders and one reporting requirement just for SBLCs. In addition, the proposed rule would also revise OMB approved information collection number 3245-0074 to extend to all CDCs a certain requirement in reporting that applied only to CDCs with 504 loan portfolio balances of \$20 million or more. Finally, the proposed rule would add a review/examination reporting requirement.

Under the proposed rule, NFRLs, like SBLCs, would have to file (i) Annual Reports (including audited financial statements); (ii) Reports of Administrative and Legal Proceedings; (iii) Stockholder Reports; (iv) Reports of Changes (in organization and financing); (v) notice of capital impairment; and (vi) other reports as required by SBA. The new reporting requirements would mean that both NFRLs and SBLCs would also have to file: (i) Quarterly Condition Reports (including certain certifications); (ii) Reports of Changes in Financial Condition (also including certain certifications); (iii) notice of a change in auditors; and (iv) Capital Restoration Plans, where applicable. In addition, SBLCs eligible to be exempt from the SBLC supervision and enforcement statutory provisions would have to report on direct examination activity and regulation by Federal Financial Institution Regulators or state banking regulators under proposed §§ 120.1510 and 1511. Also, under the proposed rule, all CDC (not just CDCs with a 504 loan portfolio of \$20 million dollars or more) would be required to have their annual financial statements that they submit to SBA, to be audited. Finally, the proposed rule would provide for self-assessments and corrective action plans, as applicable, for SBA Lenders, Microloan Intermediaries and NTAPs.

This proposed rule would also extend SBLC recordkeeping requirements to NFRLs in proposed § 120.461 and would add a new recordkeeping requirement for all SBA Supervised

Lenders. Specifically NFRLs, like SBLCs, would be required to retain a permanent record of certain substantiating documents for the financial statements and reports submitted to SBA. Such documents would include corporate charters and bylaws, applications for eligibility determination, capital stock certificates or stubs, general and subsidiary ledgers and journals, stock ledgers, stock transfer registers, and all minute books. The proposed rule would also require NFRLs, like SBLCs, to retain all documents and materials related to or supporting an SBA loan, such as applications for financing, participation and escrow accounts, and financing instruments, for a period of 6 years following final disposition of the loan. Many NFRLs may already retain much of this information for other purposes.

Under the proposed rule, the new recordkeeping requirement would apply to SBA Supervised Lenders. In particular, SBA Supervised Lenders would be required to maintain a capital adequacy plan. Under proposed § 120.462, the capital adequacy plan would detail Board of Director approved capital adequacy goals towards maintaining the financial institution's financial strength.

The titles, descriptions of respondents and the information collections are discussed below. In addition, SBA has provided an estimate of the annual reporting and recordkeeping burdens.

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 would 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 Bryan Hooper, Associate Administrator for Lender Oversight, Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

I. SBA Supervised Lender Reporting and Recordkeeping Requirements

The following authorities, description of respondents, statement of needs and purposes, and estimated hourly cost to respondents is applicable to the reports and recordkeeping to be included in revision to OMB approved information collection number 3245-0077 for SBA Supervised Lenders.

Authority: SBA is authorized pursuant to 15 U.S.C. 650(a) and 15 U.S.C. 634(b)(7) to collect this information associated with examining the safety and soundness of SBA Supervised Lenders.

Description of Respondents: The respondents for the below listed information collections would consist of all SBA Supervised Lenders. Currently there are approximately 100 (14 SBLCs and 58 NFRLs).

Statement of Needs and Purposes: The reports and recordkeeping requirements would facilitate safety and soundness examinations and appropriate supervision of SBA's licensed SBLCs and NFRLs. Annual and interim financial information would be analyzed by program management to timely assess SBA Supervised Lenders' financial strength, as well as compliance, with relevant program regulations (e.g., capital and SBLC licensing regulations). Other reporting requirements would update program management on the operational status of the SBA Supervised Lender and timely notify SBA of (i) changes in structure, personnel, auditors, and financial condition and (ii) potential financial exposure. Informed, SBA as supervisor and guarantor of 50 to 85% of an SBA Supervised Lender's portfolio, could intervene (where appropriate) to protect the interests of the United States.

Estimated Cost to Respondents: SBA estimates a cost of \$10,390 per SBA Supervised Lender (or approximately \$748,080 for all SBA Supervised Lenders; 14 SBLCs and 58 NFRLs) to comply with the below listed information collections. The \$10,390 per SBA Supervised Lender includes \$8,000 for the annual report audit (80 hours × \$100 per hour) plus \$2,390 for staff time to support the information collections (approximately 18 hours CFO time @ \$100 per hour and 18 hours staff time @ \$30 per hour). The hourly estimates are based on an informal survey of SBA Supervised Lenders. While a few of the information collections, like the annual and quarterly condition reports are required, most are ad hoc and occur on an exception basis. The hourly costs are derived from salary and benefit rate

surveys of the AICPA and International Association of Administrative Professionals. This \$628,080 increase from the current OMB approved collection is mainly attributable to the extension of the information collection to the 58 NFRLs, and SBA also believes that this number will be dramatically reduced to the extent that many or some of the NFRLs already maintain this information for other purposes.

Below is a listing of those reports and recordkeeping requirements that would be included in the revision to OMB approved information collection number 3245-0077.

A. Annual Audit Report [No SBA Form Number]

Summary: The Annual Audited Report would primarily consist of an SBA Supervised Lender's annual audited financial statements. The Annual Report would be due to SBA within three months after the SBA Supervised Lender's fiscal year end.

B. Legal and Administrative Proceedings [No SBA Form Number]

Summary: Under proposed § 120.464(a)(3), each SBA Supervised Lender would submit a report of any legal or administrative proceeding, by or against the SBA Supervised Lender, or against any officer, director or employee of the SBA Supervised Lender for an alleged breach of official duty.

C. Stockholder Report [No SBA Form Number]

Summary: Under proposed § 120.464(a)(4), all SBA Supervised Lenders would be required to submit to SBA copies of any report or publications concerning financial operations furnished to its stockholders.

D. Report of Changes [No SBA Form Number]

Summary: Under the proposed § 120.464(a)(5), all SBA Supervised Lenders would be required to submit a copy of any changes in the SBA Supervised Lender's organization or financing (e.g., change in type of organization, acquisition by or change of parent, change in primary financing entity, etc.).

E. Notice of Capital Impairment [No SBA Form Number]

Summary: Proposed § 120.462(d) would require all SBA Supervised Lenders to provide SBA prompt written notice of capital impairment.

F. Other Reports [No SBA Form Number]

Summary: Proposed rule § 120.464(a)(5) would require all SBA Supervised Lenders to submit such other reports as SBA may from time to time require by written directive.

G. Quarterly Condition Report and Certifications [No SBA Form Number]

Summary: Under proposed § 120.464(a)(2), all SBA Supervised Lenders would be required to submit a Quarterly Condition Report to SBA within 45 days following the end of each calendar quarter. The content of the Quarterly Condition Report would include the SBA Supervised Lender's interim financial statements, which may be internally prepared. SBA Supervised Lenders would be required to apply uniform definitions to categories of nonperforming loans and recovery amounts on liquidated loans within the reports. The Quarterly Condition Report would also contain a certification by the SBA Supervised Lender as to compliance with laws, completeness, and accuracy and may contain a certification as to capital requirement compliance.

H. Changes in Financial Condition Report [No SBA Form Number]

Summary: Proposed § 120.464(a)(6) would require SBA Supervised Lenders to file with SBA a report on any material change in financial condition within ten days after management becomes aware of the changes, except when reporting capital impairment under proposed § 120.462(d).

I. Notice of Change in Auditor [No SBA Form Number]

Summary: Proposed § 120.463(d) would require SBA Supervised Lenders to notify SBA in writing if it discharged or changed auditors.

J. Capital Restoration Plan [No SBA Form Number]

Summary: Proposed § 120.462(e) would require an SBA Supervised Lender to file a written capital restoration plan with SBA generally within 45 days of the date the SBA Supervised Lender receives or is deemed to have received notice that it has not met its minimum capital requirement.

K. Other Regulated SBLC Report [No SBA Form Number]

Summary: Proposed §§ 120.1510 and 120.1511 would require an SBLC that is directly examined by a Federal Financial Institution Regulator or State banking regulator to certify to SBA in

writing the extent to which its lending activities are subject to such regulation. It would also require such an Other Regulated SBLC to report to SBA on its interactions with its Federal Financial Institution Regulator or State banking regulator to the extent allowed by law.

L. Records Retention, In General

Summary: Proposed § 120.461(b) and (c) require SBA Supervised Lenders to maintain and preserve certain records with immediate availability of specific documents (e.g. general and subsidiary ledgers, general journals, bylaws, stock transfer ledgers). The provision provides for electronic preservation, if the original is available for retrieval within a reasonable period.

M. Capital Adequacy Plan

Summary: Proposed § 120.462 would require SBA Supervised Lenders' Board of Directors to determine capital adequacy goals and to establish, adopt, and maintain a capital plan.

II. CDC Reporting Requirements

The following corresponds to the revisions to OMB approved information collection number 3245-0074, CDC Annual Report Guide.

Authority: SBA is authorized to collect this information under 15 U.S.C. 687(f).

Description of Respondents: The respondents would consist of all CDCs. Currently, there are approximately 270.

Estimated Cost to Respondents: SBA estimates a cost of \$4,120 per CDC (or approximately \$1,112,400 for all CDCs) to comply with the information collection as revised. The \$4,120 cost per CDC includes \$4,000 for the elevated audit requirement (40 hours × \$100 per hour for auditors) plus an additional \$120 for staff time (4 hours CDC staff time @ \$30 per hour) working with the auditors. The hourly costs are derived from a salary and benefit rate survey of the International Association of Administrative Professionals. This \$885,600 increase in total cost to all CDCs would be attributable to the cost of requiring audited financial statements. However, SBA believes the cost is likely much less, since many of these CDCs likely already maintain audited financial statements.

Summary: Proposed § 120.826 would be revised to require that each CDC have financial statements audited annually by an independent CPA. This change would extend to all CDCs the requirement that financial statements be audited currently only required for CDCs with a 504 loan portfolio balance of \$20 million dollars or more.

Need and Purpose: Collection of annual audited financial statements is critical to allowing SBA to assess accurately CDCs' financial strength and for the purpose of lender oversight.

III. SBA Lender, Microloan Intermediary, and NTAP Reporting Requirements

The following authorities, description of respondents, statement of needs and purposes and estimated hourly cost to respondents are applicable to the review/examination reporting requirements for SBA Lenders, Microloan Intermediaries, and NTAPs.

A. Self-Assessment

Authority: SBA is authorized to collect self-assessment information under 15 U.S.C. 634(b)(7) and 15 U.S.C. 650.

Description of Respondents: The respondents would consist of SBA Lenders, Microloan Intermediaries, and NTAPS.

Estimated Cost to Respondents: SBA estimates a cost of \$430 per SBA Lender, Microloan Intermediary, or NTAP or \$8,600 for all those required during a year to submit a self-assessment certification or self-assessment report. SBA estimates requiring 20 self-assessments a year. This cost would consist of \$30 for administrative staff to prepare the self-assessment certification or report (one hour × \$30 hour) and \$400 for CFO composition time (four hours × \$100 per hour). The hourly estimates are based on an informal survey of SBA Lenders by OCRM financial analysts.

Summary: Proposed Section 120.1025 would provide that "SBA may conduct off-site reviews and monitoring * * * including SBA Lenders', Intermediaries', or NTAPs' self-assessments."

Need and Purpose: Generally, SBA would consider requiring a self-assessment to confirm corrective actions implemented or in lieu of targeted or limited scope reviews. Self-assessments are a cost effective means of overseeing and monitoring the SBA performance and compliance of SBA Lenders, Microloan Intermediaries, and NTAPs.

B. Corrective Action Plan

Authority: SBA is authorized to collect this information under 15 U.S.C. 634(b)(7) and 15 U.S.C. 650.

Description of Respondents: The respondents would consist of SBA Lenders, Microloan Intermediaries, and NTAPs that receive an onsite review or examination assessment of acceptable with corrective action or less than

acceptable, or as otherwise required by SBA.

Estimated Cost to Respondents: SBA estimates a cost of \$430 per SBA Lender, Microloan Intermediary, or NTAP or \$64,500 for all those required during a year to submit a corrective action plan. SBA estimates requiring 150 corrective actions a year. This number may be dramatically reduced as SBA Lenders, Microloan Intermediaries, and NTAPs improve SBA program operations. The cost would consist of \$30 for administrative staff to prepare the corrective action plan (one hour × \$30 per hour) and \$400 for CFO composition time (four hours × \$100 per hour). The hourly estimates are based on an informal survey of SBA Lenders by OCRM financial analysts.

Summary: Proposed Section 120.1055 would provide that SBA Lenders, Microloan Intermediaries, and NTAPs must submit proposed corrective action plans, if requested.

Need and Purpose: The reports would facilitate corrective action to address SBA Lender, Microloan Intermediary, or NTAP deficiencies identified generally during reviews and examinations.

Proposal

List of Subjects in 13 CFR Part 120

Loan Programs—business, Small businesses.

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

PART 120—BUSINESS LOANS

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

Authority: 15 U.S.C. 634(b)(6), (b)(7), (b)(14), (h), and note, 636(a), (h) and (m), 650, 687(f), 696(3), and 697(a) and (e).

2. Amend § 120.10 by adding new definitions "Acceptable Risk Rating", "Federal Financial Institutions Regulator", "Less Than Acceptable Risk Rating", "Management Official", "Non-Federally Regulated Lender", "Other Regulated SBLC", "Risk Rating", "SBA Lender", "SBA Supervised Lender", and "Small Business Lending Company", and revising the definition for "Lender" to read as follows:

§ 120.10 Definitions.

* * * * *

Acceptable Risk Rating is an SBA-assigned Risk Rating, currently defined by SBA as "1", "2" or "3" on a scale of 1 to 5, which represents an acceptable level of risk as determined by SBA, and which may be revised by SBA from time

to time as published in the **Federal Register** through notice and comment.

* * * * *

Federal Financial Institution Regulator is the federal banking regulator of a 7(a) Lender and may include the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration, and the Farm Credit Administration.

* * * * *

Lender or 7(a) Lender is an institution that has executed a participation agreement with SBA under the guaranteed loan program.

Less Than Acceptable Risk Rating is an SBA-assigned Risk Rating, currently defined by SBA as "4" or "5" on a scale of 1 to 5, which represents an unacceptable level of risk as determined by SBA, and which may be revised by SBA from time to time as published in the **Federal Register** through notice and comment.

* * * * *

Management Official is an officer, director, general partner, manager, employee participating in management, agent or other participant in the management of the affairs of the SBA Supervised Lender's activities under the 7(a) program.

Non-Federally Regulated Lender (NFRL) is a business concern that is authorized by the SBA to make loans under section 7(a) and is subject to regulation by a state but whose lending activities are not subject to regulation by a Federal Financial Institution Regulator.

* * * * *

Other Regulated SBLC is a Small Business Lending Company whose SBA operations receive regular safety and soundness examinations by a state banking regulator or a Federal Financial Institution Regulator, and which meets the requirements set forth in § 120.1511.

* * * * *

Risk Rating is an SBA internal composite rating assigned to individual SBA Lenders, Intermediaries, or NTAPs that reflects the risk associated with the SBA Lender's or Intermediary's portfolio of SBA loans or with the NTAP. Risk Ratings currently range from one to five, with one representing the least risk and five representing the most risk, and may be revised by SBA from time to time as published in the **Federal Register** through notice and comment.

* * * * *

SBA Lender is a 7(a) Lender or a CDC. This term includes SBA Supervised Lenders.

SBA Supervised Lender is a 7(a) Lender that is either (1) a Small Business Lending Company or (2) a NFRL.

* * * * *

Small Business Lending Company (SBLC) is a nondepository lending institution that is SBA licensed and is authorized by SBA to only make loans pursuant to section 7(a) of the Small Business Act and loans to Intermediaries in SBA's Microloan program. SBA has imposed a moratorium on licensing new SBLCs since January 1982.

* * * * *

3. Amend § 120.410 by revising paragraphs (a), (d) and (e) and adding a new paragraph (f) to read as follows:

§ 120.410 Requirements for all participating Lenders.

* * * * *

(a) Have a continuing ability to evaluate, process, close, disburse, service, liquidate and litigate small business loans including, but not limited to:

(1) Holding sufficient permanent capital to support SBA lending activities (for SBA Lenders with a Federal Financial Institution Regulator, meeting capital requirements for an adequately capitalized financial institution is considered sufficient permanent capital to support SBA lending activities; for SBLCs, meeting its SBA minimum capital requirement; and for NFRLs meeting its state minimum capital requirement); and

(2) Maintaining satisfactory SBA performance, as determined by SBA in its sole discretion. The 7(a) Lender's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance;

* * * * *

(d) Be supervised and examined by either:

(1) A Federal Financial Institution Regulator,

(2) A state banking regulator satisfactory to SBA, or

(3) SBA;

(e) Be in good standing with SBA as defined in § 120.420(f) (and determined by SBA in its sole discretion) and, as applicable, with an SBA Lender's state regulator or Federal Financial Institution Regulator; and

(f) Operate in a safe and sound condition using commercially reasonable lending policies, procedures, and standards employed by prudent Lenders.

4. Remove the undesignated center heading immediately preceding § 120.414.

§ 120.414 [Removed]

5. Remove § 120.414

§ 120.415 [Removed]

6. Remove § 120.415.

7. In § 120.420, revise paragraph (f) introductory text and paragraphs (f)(3) and (4) to read as follows:

§ 120.420 Definitions.

* * * * *

(f) Good Standing—In general, a Lender is in "good standing" with SBA if it:

(3) Is not under investigation or indictment for, or has not been convicted of, or had a judgment entered against it for felony or fraud, or charges relating to a breach of trust or violation of a law or regulation protecting the integrity of business transactions or relationships, unless the Lender Oversight Committee has determined that good-standing exists despite the existence of such factors.

(4) Does not have any officer or employee who has been under investigation or indictment for, or has been convicted of or had a judgment entered against him for, a felony or fraud, or charges relating to a breach of trust or violation of a law or regulation protecting the integrity of business transactions or relationships, unless the Lender Oversight Committee has determined that good standing exists despite the existence of such person.

* * * * *

8. Amend § 120.424 by revising paragraph (a), redesignating paragraphs (b), (c), (d), and (e) as (c), (d), (e), and (f), and adding new paragraph (b) to read as follows:

§ 120.424 What are the basic conditions a Lender must meet to securitize?

* * * * *

(a) Be in good standing with SBA as defined in § 120.420(f) of this chapter and determined by SBA in its sole discretion;

(b) Have satisfactory SBA performance as determined by SBA, in its sole discretion. The Lender's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance;

* * * * *

§ 120.425 [Amended]

9. Amend § 120.425(c)(2) by removing "SBA Securitization Committee" and add in its place "Lender Oversight Committee" in the fourth sentence.

§ 120.426 [Amended]

10. Amend § 120.426 by removing "SBA Securitization Committee" and add in its place "Lender Oversight Committee" in the second sentence.

11. Amend § 120.433 by revising paragraph (a), redesignating paragraph (b) as (c), and adding a new paragraph (b) to read as follows:

§ 120.433 What are the SBA's other requirements for sales and sales of participating interests?

* * * * *

(a) The Lender must be in good standing with SBA as defined in § 120.420(f) and determined by SBA in its sole discretion;

(b) The Lender has satisfactory SBA performance, as determined by SBA in its sole discretion. The Lender's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance; and

* * * * *

12. Amend § 120.434 by revising paragraph (b), redesignating paragraphs (c), (d), (e), (f), and (g) as (d), (e), (f), (g), and (h), and adding a new paragraph (c) to read as follows:

§ 120.434 What are SBA's requirements for loan pledges?

* * * * *

(b) The Lender must be in good standing with SBA as defined in § 120.420(f) and determined by SBA in its sole discretion;

(c) The Lender has satisfactory SBA performance, as determined by SBA, in its sole discretion. The Lender's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance;

* * * * *

13. Revise § 120.435 introductory text to read as follows:

§ 120.435 Which loan pledges do not require notice to or consent by SBA?

Notwithstanding the provisions of § 120.434(e), 7(a) loans may be pledged for the following purposes without notice to or consent by SBA:

* * * * *

§ 120.442 [Removed]

14. Remove § 120.442

15. Amend § 120.451 by revising the last sentence in paragraph (a), revising paragraph (b)(3), removing paragraph (c), redesignating paragraph (d) as (c), redesignating paragraph (e) as (d) and revising its last sentence, and adding a new paragraph (e) to read as follows:

§ 120.451 How does a Lender become a PLP Lender?

(a) * * * The SBA field office will forward its recommendation to an SBA

centralized loan processing center which will submit its recommendation and supporting documentation to the appropriate Office of Capital Access official in accordance with Delegations of Authority for final decision.

(b) * * *

(3) Has satisfactory SBA performance, as determined by SBA in its sole discretion. The Lender's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance.

(c) * * *

(d) * * * The recertification decision is made by the appropriate Office of Capital Access official in accordance with Delegations of Authority and is final.

(e) When a PLP lender's Supplemental Guaranty Agreement expires, SBA may recertify the Lender as a PLP Lender for an additional term not to exceed two years. Prior to recertification, SBA will review a PLP Lender's loans, policies, procedures, SBA performance, Risk Rating, review or examination results, and other risk related information as determined by SBA.

* * * * *

§ 120.454 [Removed]

16. Remove § 120.454

§ 120.455 [Removed]

17. Remove § 120.455

18. Add new undesignated center heading before § 120.460 to read as follows:

SBA Supervised Lenders

19. Add new § 120.460 to read as follows:

§ 120.460 What are SBA's additional requirements for SBA Supervised Lenders?

(a) In general. In addition to complying with SBA's requirements for SBA Lenders, an SBA Supervised Lender must meet the additional requirements set forth in this regulation and the SBA Supervised Lender regulations that follow.

(b) Operations and internal controls. Each SBA Supervised Lender's board of directors (or management, if the SBA Supervised Lender is a division of another company and does not have its own board of directors) must adopt an internal control policy which provides adequate direction to the institution in establishing effective control over and accountability for operations, programs, and resources. The internal control policy must, at a minimum:

(1) Direct management to assign responsibility for the internal control function (covering financial, credit,

credit review, collateral, and administrative matters) to an officer or officers of the SBA Supervised Lender;

(2) Adopt and set forth procedures for maintenance and periodic review of the internal control function; and

(3) Direct the operation of a program to review and assess the SBA Supervised Lender's assets. The asset review program policies must specify the following:

(i) Loan, loan-related asset, and appraisal review standards, including standards for scope of selection for review (of any such loan, loan-related asset or appraisal) and standards for work papers and supporting documentation;

(ii) Asset quality classification standards consistent with the standardized classification systems used by the Federal Financial Institution Regulators;

(iii) Specific internal control requirements for SBA Supervised Lender's major asset categories (cash and investment securities), lending, and the issuance of debt;

(iv) Specific internal control requirements for the SBA Supervised Lender's oversight of Lender Service Providers; and

(v) Standards for training to implement the asset review program.

20. Add new § 120.461 to read as follows:

§ 120.461 What are SBA's additional requirements for SBA Supervised Lenders concerning records?

(a) *Report filing.* All SBA Supervised Lender-specific reports (including all SBLC-only reports) must be filed with the appropriate Office of Capital Access official in accordance with Delegations of Authority.

(b) *Maintenance of records.* An SBA Supervised Lender must maintain at its principal business office accurate and current financial records, including books of accounts, minutes of stockholder, directors, and executive committee meetings, and all documents and supporting materials relating to the SBA Supervised Lender's transactions. However, securities held by a custodian pursuant to a written agreement must be exempt from this requirement.

(c) *Permanent preservation of records.* An SBA Supervised Lender must permanently preserve in a manner permitting immediate (one business day) retrieval the following documentation for the financial statements and other reports required by § 120.464 (and the accompanying certified public accountant's opinion):

(1) All general and subsidiary ledgers (or other records) reflecting asset,

liability, capital stock and additional paid-in capital, income, and expense accounts;

(2) All general and special journals (or other records forming the basis for entries in such ledgers); and

(3) The corporate charter, bylaws, application for determination of eligibility to participate with SBA, and all minutes books, capital stock certificates or stubs, stock ledgers, and stock transfer registers.

(d) *Other preservation of records.* An SBA Supervised Lender must preserve for at least 6 years following final disposition of each individual SBA loan:

(1) All applications for financing;

(2) Lending, participation, and escrow agreements;

(3) Financing instruments; and

(4) All other documents and supporting material relating to such loans, including correspondence.

(e) *Electronic preservation.* Records and other documents referred to in this section may be preserved electronically if the original is available for retrieval within 15 working days.

21. Add new § 120.462 to read as follows:

§ 120.462 What are SBA's additional requirements on capital maintenance for SBA Supervised Lenders?

(a) *Capital adequacy.* The board of directors (or management, if the SBA Supervised Lender is a division of another company and does not have its own board of directors) of each SBA Supervised Lender must determine capital adequacy goals; that is, the total amount of capital needed to assure the SBA Supervised Lender's continued financial viability and provide for any necessary growth. The minimum standards set in § 120.471 for SBLCs and those established by state regulators for NFRLs are not to be adopted as the ideal capital level for a given SBA Supervised Lender. Rather, the minimum standards are to serve as minimum levels of capital that each SBA Supervised Lender must maintain to protect against the credit risk and other general risks inherent in its operation.

(b) *Capital plan.* The board of directors of each SBA Supervised Lender must establish, adopt, and maintain a formal written capital plan. The plan must include any interim capital targets that are necessary to achieve the SBA Supervised Lender's capital adequacy goals as well as the minimum capital standards. The plan must address any projected dividend goals, equity retirements, or any other anticipated action that may decrease the SBA Supervised Lender's capital. The

plan must set forth the circumstances in which capital retirements (e.g., dividends, distributions of capital or purchase of treasury stock) can occur. In addition to factors described above that must be considered in meeting the minimum standards, the board of directors must also address the following factors in developing the SBA Supervised Lender's capital adequacy plan:

- (1) Management capability;
- (2) Quality of operating policies, procedures, and internal controls;
- (3) Quality and quantity of earnings;
- (4) Asset quality and the adequacy of the allowance for loan losses within the loan portfolio;
- (5) Sufficiency of liquidity; and
- (6) Any other risk-oriented activities or conditions that warrant additional capital (e.g., portfolio growth rate).

An SBA Supervised Lender must keep its capital plan current, updating it at least annually or more often as operating conditions may warrant.

(c) *Certification of compliance.* Within 45 days of the end of each fiscal quarter, each SBA Supervised Lender must furnish the SBA with a calculation of capital and certification of compliance with its minimum capital requirement as set forth in §§ 120.471, 120.472, or 120.474, as applicable, for SBLs and as established by state regulators for NFRLs. The SBA Supervised Lender's chief financial officer must certify the calculation to be correct. The quarterly calculation and certification of compliance may be included in the SBA Supervised Lender's Quarterly Condition Report.

(d) *Capital impairment.* An SBA Supervised Lender must meet its minimum regulatory capital requirement and avoid capital impairment. Capital impairment exists if an SBA Supervised Lender fails to meet its minimum regulatory capital requirement under §§ 120.471, 120.472, and 120.474 for SBLs or as established by state regulators for NFRLs. An SBA Supervised Lender must provide the appropriate Office of Capital Access official in accordance with Delegations of Authority written notice of any failure to meet its minimum capital requirement within 30 calendar days of the month-end in which the impairment occurred. Unless otherwise waived by the appropriate Office of Capital Access official in writing, an SBA Supervised Lender may not present any loans to SBA for guarantee until the impairment is cured. SBA may waive the presentment prohibition for good cause as determined by SBA in its discretion. In the case of differences in

calculating capital or capital requirements between the SBA Supervised Lender and SBA, SBA's calculations will prevail until differences between the two calculations are resolved.

(e) *Capital restoration plan*—(1) *Filing requirement.* An SBA Supervised Lender must file a written capital restoration plan with SBA within 45 days of the date that the SBA Supervised Lender provides notice to SBA under paragraph (d) of this section above or receives notice from SBA (whichever is earlier) that the SBA Supervised Lender has not met its minimum capital requirement, unless SBA notifies the SBA Supervised Lender in writing that the plan is to be filed within a different time period.

(2) *Plan content.* An SBA Supervised Lender must detail the steps it will take to meet its minimum capital requirement; the time within which each step will be taken; the timeframe for accomplishing the entire capital restoration; and the person or department at the SBA Supervised Lender charged with carrying out the capital restoration plan.

(3) *SBA response.* SBA will provide written notice of whether the capital restoration plan is approved or not or whether SBA will seek additional information. If the capital restoration plan is not approved by SBA, the SBA Supervised Lender will submit a revised capital restoration plan within the timeframe specified by SBA.

(4) *Amendment of capital restoration plan.* An SBA Supervised Lender that has submitted an approved capital restoration plan may, after prior written notice to and approval by SBA, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the SBA Supervised Lender must implement the capital restoration plan as approved prior to the proposed amendment.

(5) *Failure.* If an SBA Supervised Lender fails to submit a capital restoration plan that is acceptable to SBA within its sole discretion within the required timeframe, or fails to implement, in any material respect as determined by SBA in its sole discretion, its SBA approved capital restoration plan within the plan timeframe, SBA may undertake enforcement actions under § 120.1500.

22. Add new § 120.463 to read as follows:

§ 120.463 Regulatory accounting—What are SBA's regulatory accounting requirements for SBA Supervised Lenders?

(a) *Books and records.* The books and records of an SBA Supervised Lender must be kept on an accrual basis in accordance with Generally Accepted Accounting Principles (GAAP) as promulgated by the Financial Accounting Standards Board (FASB), supplemented by Regulatory Accounting Principles (RAP) as identified by SBA in Policy, Procedural or Information Notices, from time to time.

(b) *Annual audit.* Each SBA Supervised Lender must have its financial statements audited annually by a certified public accountant experienced in auditing financial institutions. The audit must be performed in accordance with generally accepted auditing standards as adopted by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA). Annually, the auditor must issue an audit report with an opinion as to the fairness of the SBA Supervised Lender's financial statements and their compliance with GAAP.

(c) *Auditor qualifications.* The audit shall be conducted by an independent public accountant who:

(1) Is registered or licensed to practice as a certified public accountant, and is in good standing, under the laws of the state or other political subdivision of the United States in which the SBA Supervised Lender's principal office is located;

(2) Agrees in the engagement letter with the SBA Supervised Lender to provide the SBA with access to and copies of any work papers, policies, and procedures relating to the services performed;

(3) (i) Is in compliance with the AICPA Code of Professional Conduct; and

(ii) Meets the independence requirements and interpretations of the Securities and Exchange Commission and its staff;

(4) Has received a peer review or is enrolled in a peer review program, that meets AICPA guidelines; and

(5) Is otherwise acceptable to SBA.

(d) *Change of auditor.* If an SBA Supervised Lender discharges or changes its auditor, it must notify SBA in writing within ten days of the occurrence. Such notification must provide:

(1) The name, address, and telephone number of the discharged auditor; and

(2) If the discharge/change involved a dispute over the financial statements, a reasonably detailed statement of all the

reasons for the discharge or change. This statement must set out the issue in dispute, the position of the auditor, the position of the SBA Supervised Lender, and the effect of each position on the balance sheet and income statement of the SBA Supervised Lender.

(e) *Specific accounting requirements.*

(1) Each SBA Supervised Lender must maintain an allowance for losses on loans and other assets that is sufficient to absorb all probable and estimated losses that may reasonably be expected based on the SBA Supervised Lender's historical performance and reasonably-anticipated events. Each SBA Supervised Lender must maintain documentation of its loan loss allowance calculations and analysis in sufficient detail to permit the SBA to understand the assumptions used and the application of those assumptions to the assets of the SBA Supervised Lender.

(2) The unguaranteed portions of loans determined to be uncollectible must be charged-off promptly. If the portion determined to be uncollectible by the SBA Supervised Lender is different from the amount determined by its auditors or the SBA, the SBA Supervised Lender must charge-off such amount as the SBA may direct.

(3) Each SBA Supervised Lender must classify loans as:

(i) "Nonaccrual", if any portion of the principal or interest is determined to be uncollectible and

(ii) "Formally restructured," if the loan meets the "troubled debt restructuring" definition set forth in FASB Statement of Financial Accounting Standards No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings.

(4) When one loan to a borrower is classified as nonaccrual or formally restructured, all loans to that borrower must be so classified unless the SBA Supervised Lender can document that the loans have independent sources of repayment.

(f) *Valuing loan servicing rights and residual interests.* Each SBA Supervised Lender must account for loan sales transactions and the valuation of loan servicing rights in accordance with GAAP. At the end of each quarter, the SBA Supervised Lender must review for reasonableness the existing environmental assumptions used in the valuation. Particular attention must be given to interest rate and repayment rate assumptions. Assumptions considered no longer reasonable must be modified and modifications must be reflected in the valuation and must be documented and supported by a market analysis. Work papers reflecting the analysis of

assumptions and any resulting adjustment in the valuation must be maintained for SBA review in accordance with § 120.461. SBA may require a SBA Supervised Lender to use industry averages for the valuation of servicing rights.

23. Add new § 120.464 to read as follows:

§ 120.464 Reports to SBA.

(a) An SBA Supervised Lender must submit the following to SBA:

(1) *Annual Report.* Within three months after the close of each fiscal year, each SBA Supervised Lender must submit to SBA two copies of an annual report including audited financial statements as prepared by a certified public accountant in accordance with § 120.463. Specifically, the annual report must, at a minimum, include the following:

- (i) Audited balance sheet;
- (ii) Audited statement of income and expense;
- (iii) Audited reconciliation of capital accounts;
- (iv) Audited source and application of funds;
- (v) Such footnotes as are necessary to an understanding of the report;
- (vi) Auditor's letter to management on internal control weaknesses; and
- (vii) The auditor's report.

(2) *Quarterly Condition Reports.* By the 45th calendar day following the end of each calendar quarter, each SBA Supervised Lender must submit a Quarterly Condition Report in a form and content as the SBA may prescribe from time to time. At a minimum, the Quarterly Condition Report must include the SBA Supervised Lender's quarterly financial statements, which may be internally prepared. The SBA Supervised Lender must apply uniform definitions to categories of nonperforming loans and include recovery amounts on liquidated loans. SBA may, on a case-by-case basis, depending on an SBA Supervised Lender's size and the quality of its assets, adjust the requirements for content and frequency of filing Quarterly Condition Reports.

(3) *Legal and Administrative Proceeding Report.* Each SBA Supervised Lender must report any legal or administrative proceeding by or against the SBA Supervised Lender, or against any officer, director or employee of the SBA Supervised Lender for an alleged breach of official duty, within ten business days after initiating or learning of the proceeding, and also must notify the SBA of the terms of any settlement or final judgment. The SBA Supervised Lender must include such

information in any reporting required under other provisions of SBA regulations.

(4) *Stockholder Reports.* Each SBA Supervised Lender must submit to SBA a copy of any report furnished to its stockholders in any manner, within 30 calendar days after submission to stockholders, including any prospectus, letter, or other document, concerning the financial operations or condition of the SBA Supervised Lender.

(5) *Reports of Changes.* Each SBA Supervised Lender must submit to SBA a summary of any changes in the SBA Supervised Lender's organization or financing (within 30 calendar days of the change), such as:

(i) Any change in its name, address or telephone number;

(ii) Any change in its charter, bylaws, or its officers or directors (to be accompanied by a statement of personal history on the form approved by SBA);

(iii) Any change in capitalization, including such types of change as are identified in these regulations;

(iv) Any changes affecting an SBA Supervised Lender's eligibility to continue to participate as an SBA Supervised Lender; and

(v) Notice of any pledge of stock (within 30 calendar days of the transaction) if 10 percent or more of the stock is pledged by any person (or group of persons acting in concert) as collateral for indebtedness.

(6) *Report of Changes in Financial Condition.* In addition to other reports required under these regulations, each SBA Supervised Lender must submit a report to SBA on any material change in financial condition. The SBA Supervised Lender must submit such report promptly but no later than ten days after its management becomes aware of such change (except as provided for in § 120.462(d)). Failure to promptly notify SBA concerning a material change in financial condition may lead to enforcement action.

(7) *Other Reports.* Each SBA Supervised Lender must submit such other reports as SBA from time to time may in writing require.

(b) *Preparing financial reports for filing.* Each SBA Supervised Lender must prepare financial reports:

(1) In accordance with all applicable laws, regulations, procedures, standards, and such instructions and specifications and in such form and media format as may be prescribed by SBA from time to time;

(2) On an accrual basis, in accordance with GAAP principles and such other accounting requirements, standards, and procedures as may be prescribed by the SBA from time to time;

(3) that contain all applicable footnotes in accordance with GAAP principles, one of which includes a brief analysis of how the SBA Supervised Lender complies with SBA's capital regulations, as applicable; and

(4) in such manner as to facilitate the reconciliation of these reports with the books and records of the SBA Supervised Lender.

(c) *Responsibility for assuring the accuracy of filed financial reports.* Each financial report filed with SBA must be certified as having been prepared in accordance with all applicable regulations, SOPs, notices, and instructions and to be a true, accurate, and complete representation of the financial condition and financial performance of the SBA Supervised Lender to which it applies. The reports must be certified by the officer of the reporting SBA Supervised Lender named for that purpose by action of the institution's board of directors. If the institution's board of directors has not acted to name an officer to certify the correctness of its reports of financial condition and financial performance, then the reports must be certified by the president or chief executive officer of the reporting SBA Supervised Lender.

(d) *Waiver.* The appropriate Office of Capital Access official in accordance with Delegations of Authority may in his/her sole discretion waive any § 120.464 reporting requirement for SBA Supervised Lenders for good cause (including, but not limited to, where an SBA Supervised Lender has a relatively small SBA loan portfolio), as determined by SBA. SBA Supervised Lenders must request the waiver in writing and include all supporting reasons and documentation. The waiver decision of the appropriate Office of Capital Access official in accordance with Delegations of Authority is final.

24. Add new § 120.465 to read as follows:

§ 120.465 Civil penalty for late submission of required reports.

(a) *Obligation to submit required reports by applicable due dates.* SBA Supervised Lenders must submit complete reports by the due dates described in the regulations or as directed in writing by SBA. SBA considers any report that an SBA Supervised Lender sends to SBA by the applicable due date but that is submitted only in part, to have not been submitted by the applicable due date. SBA also considers any report that is postmarked by the due date to be submitted by the due date.

(b) *Amount of civil penalty.* For each day past the due date for such report,

the SBA Supervised Lender must pay to SBA a civil penalty of not more than \$5,000 per day per report. Such civil penalty continues to accrue until and including the date upon which SBA Supervised Lender submits the complete report. In determining the amount of the civil penalty to be assessed, SBA may consider the financial resources and good faith of the SBA Supervised Lender, the gravity of the violation, the history of previous violations and any such other matters as justice may require.

(c) *Notification of amount of civil penalty.* SBA will notify the SBA Supervised Lender in writing of the amount of civil penalties imposed either upon receiving the required complete report or at such other time as SBA determines. SBA Supervised Lender must pay this amount to SBA within 30 days of the date of SBA's written demand.

(d) *Identification during examination.* SBA may also impose on an SBA Supervised Lender a civil penalty as described in this section if SBA discovers, during an examination pursuant to subpart I of this Part 120 or otherwise, that SBA Supervised Lender did not submit a required report by the due date.

(e) *Extensions of submission due dates.* (1) SBA Supervised Lender may request in writing to SBA that SBA extend its report due date. The request must reference the report and its due date, state the reasonable cause for extension, and assert how much additional time is needed in order to submit a complete report. SBA will advise SBA Supervised Lender in writing as to whether it approved or denied the extension request. If SBA determines that there is reasonable cause to grant an extension and it is not due to willful neglect, SBA will establish a new due date. Such determination as to willful neglect and reasonable cause is in SBA's sole discretion. SBA will consider the following factors in determining willful neglect:

(i) Whether SBA Supervised Lender failed to file required reports for more than two reporting periods and

(ii) If SBA provided SBA Supervised Lender notice of the failure to file and SBA Supervised Lender failed to respond or failed to provide a reasonable explanation for the filing failure in its response.

(2) If SBA disapproves the extension, the due date remains the same. The civil penalty accrues regardless of whether SBA Supervised Lender files an extension request. If SBA approves the extension, SBA will waive the civil

penalty that has accrued so far for that particular report. However, a new civil penalty will accrue if SBA Supervised Lender does not submit a complete report by the new due date established by SBA.

(f) *Requests for reduction or exemption.* (1) An SBA Supervised Lender may request a reduction or exemption from the civil penalty in writing to SBA. The request must reference the required report, its due date and the amount sought for reduction, and state in detail the reasons for the reduction. SBA will consider the following factors:

(i) Whether there is reasonable cause for failure to file timely and it was not due to willful neglect;

(ii) Whether SBA Supervised Lender has demonstrated to SBA's satisfaction that it has modified its internal procedures to comply with reporting requirements in the future; or

(iii) Whether SBA Supervised Lender has demonstrated to SBA's satisfaction, based on financial information fully disclosed together with its request, that it would have difficulty paying the civil penalty assessed.

(2) SBA must also determine that a reduction or exemption is not inconsistent with the public interest or the protection of SBA.

(3) SBA may in writing approve the exemption, reduce the civil penalty, or deny the exemption.

(4) If SBA grants the reduction request or denies the reduction or exemption, SBA Supervised Lender must pay the amount owed within 30 days of the letter date. Civil penalties will accrue while the request is pending.

(g) *Reconsideration of decisions.* An SBA Supervised Lender may request in writing to the Associate Administrator for Capital Access (AA/CA) to reconsider its request for extension, reduction, or exemption. The reconsideration request must be received by SBA within 30 days of the date of the letter denying the SBA Supervised Lender of any such request. SBA will not consider untimely requests. SBA Supervised Lender must include any additional information or documentation to support its reconsideration request. SBA will issue a written decision on the reconsideration request. The decision is a final agency decision. If on reconsideration, a civil penalty remains due, SBA Supervised Lender must pay to SBA the civil penalty within 30 days of the written decision or as otherwise directed. Civil penalties will continue to accrue while the reconsideration request is pending.

(h) *Other enforcement actions.* SBA may seek additional remedies for failure to timely file reports as authorized by law.

(i) *Exception for affiliate of SBLC.* Such civil penalties do not apply to any affiliate of an SBLC that procures at least 10% of its annual purchasing requirements from small manufacturers.

25. Revise § 120.470 to read as follows:

§ 120.470 What are SBA's additional requirements for SBLCs?

In addition to complying with SBA's requirements for SBA Lenders and SBA Supervised Lenders, an SBLC must meet the requirements contained in this regulation and the SBLC regulations that follow.

(a) *Lending.* An SBLC may only make:

(1) Loans under section 7(a) (except section 7(a)(13) of the Act in participation with SBA); and/or

(2) SBA guaranteed loans to Intermediaries (see subpart G of this part). Such loans are subject to the same conditions as guaranteed loans made to Intermediaries by 7(a) Lenders.

(b) *Business structure.* An SBLC must be a corporation (profit or non-profit) or a limited liability company or limited partnership.

(c) *Written agreement.* An SBLC must sign a written agreement with SBA.

(d) *Dual control.* An SBLC must maintain dual control over disbursement of funds and withdrawal of securities.

(1) An SBLC may disburse funds only by checks or wire transfers authorized by signatures of two or more officers covered by the SBLC's fidelity bond, except that checks in an amount of \$1,000 or less may be signed by one bonded officer, provided that such action is permitted under the SBLC's fidelity bond.

(2) There must be two or more bonded officers, or one bonded officer and a bonded employee to open safe deposit boxes or withdraw securities from safekeeping. The SBLC must furnish to each depository bank, custodian, or entity providing safe deposit boxes a certified copy of the resolution implementing control procedures.

(e) *Fidelity insurance.* An SBLC must maintain a Brokers Blanket Bond, Standard Form 14, or Finance Companies Blanket Bond, Standard Form 15, or such other form of coverage as SBA may approve, in a minimum amount of \$2,000,000 executed by a surety holding a certificate of authority from the Secretary of the Treasury pursuant to 31 U.S.C. 9304-9308.

(f) *Common control.* (1) An SBLC must not control, be controlled by, or be

under common control with another SBLC.

(2) In the case of a purchase of an SBLC by an organization that already owns an SBLC, the purchasing entity will have six months to submit a plan to SBA for the divestiture of one of the SBLCs. All divestiture plans must be approved by SBA and SBA may withhold approval in its sole discretion. Divestiture of the SBLC must occur within one year of purchase date.

(3) Without prior written SBA approval, an Associate of one SBLC must not be an Associate of another SBLC or of any entity which directly or indirectly controls, or is under common control with, another SBLC.

(4) For purposes of this regulation, common control means a condition where two or more SBLCs, either through ownership, management, contract, or otherwise, are under the Control of one group or Person (as defined in § 145.985 of this chapter or successor regulation). Two or more SBLCs are presumed to be under common control if they are Affiliates of each other by reason of common ownership or common officers, directors, or general partners.

(5) "Affiliate" has the meaning set forth in § 121.103 of this chapter.

(6) "Control" means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an SBLC or other concern, whether through the ownership of voting securities, by contract, or otherwise. The common control presumption may be rebutted by evidence satisfactory to SBA.

(g) *Management.* An SBLC must employ full time professional management.

(h) *Borrowed funds.* In general, an SBLC may not be capitalized with borrowed funds. Shareholders owning 10 percent or more of any class of its stock must not use personally-borrowed funds to purchase the stock unless the net worth of the shareholder is at least twice the amount borrowed or unless the shareholder receives SBA's prior written approval for a lower ratio.

26. Revise § 120.471 to read as follows:

§ 120.471 What are the minimum capital requirements for SBLCs?

(a) *Minimum capital requirements.* Each SBLC must maintain, at a minimum, unencumbered paid-in capital and paid-in surplus of at least \$1,000,000, or ten percent of the aggregate of its share of all outstanding loans, whichever is more.

(b) *Composition of capital.* For purposes of complying with paragraph

(a) of this section, capital consists only of one or more of the following:

(1) Common stock;

(2) Preferred stock that is noncumulative as to dividends and does not have a maturity date;

(3) Additional paid-in capital representing amounts paid for stock in excess of the par value;

(4) Retained earnings of the business; and/or

(5) For limited liability companies and limited partnerships, capital contributions must not be subject to repayment at any specific time, must not be subject to withdrawal and must have no cumulative priority return.

(c) *Voluntary capital reduction.*

Without prior written SBA approval, an SBLC must not voluntarily reduce its capital, or repurchase and hold more than 2 percent of any class or combination of classes of its stock.

(d) *Issuance of securities.* Without prior written SBA approval, an SBLC must not issue any securities (including stock options and debt securities) except stock dividends.

27. Revise § 120.472 to read as follows:

§ 120.472 Higher individual minimum capital requirement.

The Associate Administrator for Capital Access (AA/CA) may require, under § 120.473(d), an SBLC to maintain a higher level of capital, if the AA/CA determines, in his/her sole discretion, that the SBLC's level of capital is potentially inadequate to protect the SBA from loss due to the financial failure of the SBLC. The factors to be considered in the determination will vary in each case and may include, for example:

(a) Specific conditions or circumstances pertaining to the SBLC;

(b) Exigency of those circumstances or potential problems;

(c) Overall condition, management strength, and future prospects of the SBLC and, if applicable, its parent or affiliates;

(d) The SBLC's liquidity and existing capital level, and the performance of its SBA loan portfolio;

(e) The management views of the SBLC's directors and senior management; and

(f) Other risk-related factors, as determined by SBA.

§ 120.476 [Removed]

28. Remove § 120.476.

§§ 120.473, 120.474, and 120.475
[Redesignated as §§ 120.475, 120.476, and 120.490]

29. Redesignate §§ 120.473, 120.474, and 120.475 as §§ 120.475, 120.476, and 120.490, respectively.

30. In newly redesignated § 120.475, revise the second sentence of paragraph (a) introductory text and revise paragraph (b) to read as follows:

§ 120.475 Change of ownership or control.

(a) * * * An SBLC must request approval of any such change from the appropriate Office of Capital Access official in accordance with Delegations of Authority.* * *

(b) If transfer of ownership or control is subject to the approval of any State or Federal chartering, licensing, or other regulatory authority, copies of any documents filed with such authority must, at the same time, be transmitted to the appropriate Office of Capital Access official in accordance with Delegations of Authority.

31. Add new § 120.473 to read as follows:

§ 120.473 Procedures for determining individual minimum capital requirement.

(a) *Notice.* When SBA determines that an individual minimum capital requirement above that set forth in this subpart or other legal authority is necessary or appropriate for a particular SBLC, SBA will notify the SBLC in writing of the proposed individual minimum capital requirement, the date by which it should be reached and will provide an explanation of why the requirement proposed is considered necessary or appropriate.

(b) *SBLC response.* The SBLC may respond to the notice. The response should include any matters which the SBLC would have SBA consider in deciding whether individual minimum capital requirements should be established for the SBLC, what those capital requirements should be, and, if applicable, when they should be achieved. The response must be in writing and delivered to the AA/CA within 30 days after the date on which the SBLC received the notice. SBA may shorten the time for response when, in the opinion of SBA, the condition of the SBLC so warrants, provided that the SBLC is informed promptly of the new time period, or the SBLC consents to the shortening of its response time. In its discretion, SBA may extend the time period for good cause.

(c) *Failure to respond.* An SBLC that does not respond within 30 days or such other time period as may be specified by SBA will have waived any objections to the proposed minimum capital

requirement and the deadline for its achievement. Failure to respond will also constitute consent to the individual minimum capital requirement.

(d) *Decision.* After the close of the SBLC's response period, the AA/CA will decide, based on a review of SBA reasons for proposing the individual minimum capital requirement, the SBLC's response, and other information concerning the SBLC, whether the individual minimum capital requirement should be established for the SBLC and, if so, the requirement and the date it will become effective. The SBLC will be notified of the decision in writing. The notice will include an explanation of the decision; except for a decision not to establish an individual minimum capital requirement for the SBLC.

(e) *Submission of plan.* The decision may require the SBLC to develop and submit to SBA, within a time period specified, an acceptable plan to reach the individual minimum capital requirement by the date required.

(f) *Change in circumstances.* If, after SBA's decision in paragraph (d) of this section, there is a change in the circumstances affecting the SBLC's capital adequacy or its ability to reach the required individual minimum capital requirement by the specified date, either the SBLC or the AA/CA may propose to the other a change in (i) the individual minimum capital requirement for the SBLC, (ii) the date when the individual minimum must be achieved, and/or (iii) the SBLC's plan (if applicable). The AA/CA may decline to consider proposals that are not based on a significant change in circumstances or are repetitive or frivolous. Pending a decision by the AA/CA on reconsideration, SBA's original decision and any plan required under that decision will continue in full force and effect.

31. Add new § 120.474 to read as follows:

§ 120.474 Relation to other actions.

In lieu of, or in addition to, the procedures in this subpart, the individual minimum capital requirement for an SBLC may be established or revised through a written agreement or cease and desist proceedings under Subpart I of this Part.

32. Amend § 120.630 by adding paragraph (a)(5) to read as follows:

§ 120.630 Qualifications to be a Pool Assembler.

(a) * * *

(5) For any pool assembler that is an SBA Lender, that the SBA Lender has satisfactory SBA performance, as

determined by SBA in its sole discretion. The Lender's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance.

* * * * *

33. Revise § 120.702(b) to read as follows:

§ 120.702 Are there limitations on who can be an Intermediary or on where an Intermediary may operate?

* * * * *

(b) *Limitation to one state.* An Intermediary may not operate in more than one state unless the appropriate Office of Capital Access official in accordance with Delegations of Authority determines that it would be in the best interests of the small business community for it to operate across state lines.

34. Amend § 120.710 by revising paragraphs (c), (d), the introductory text of paragraph (e) and paragraph (e)(1) to read as follows:

§ 120.710 What is the Loan Loss Reserve Fund?

* * * * *

(c) *SBA review of Loan Loss Reserve Fund.* After an Intermediary has been in the Microloan program for five years, it may request SBA's appropriate Office of Capital Access official in accordance with Delegations of Authority to reduce the percentage of its Portfolio which it must maintain in its LLRF to an amount equal to the actual average loan loss rate during the preceding five-year period. Upon receipt of such request, he/she will review the Intermediary's annual loss rate for the most recent five-year period preceding the request.

(d) *Reduction of Loan Loss Reserve Fund.* The appropriate Office of Capital Access official in accordance with Delegations of Authority has the authority to reduce the percentage of an Intermediary's Portfolio that it must maintain in its LLRF to an amount equal to the actual average loan loss rate during the preceding five-year period. The appropriate Office of Capital Access official in accordance with Delegations of Authority cannot reduce the LLRF to less than ten percent of the Portfolio.

(e) *What must an Intermediary demonstrate to get a reduction in Loan Loss Reserve Fund?* To receive a reduction in its LLRF, an Intermediary must:

(1) Have satisfactory SBA performance, as determined by SBA in its sole discretion. The Intermediary's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance; and

* * * * *

§ 120.716 [Removed]

35. Remove § 120.716.

36. Amend § 120.812 to add a new sentence at the end of paragraph (c) to read as follows:

§ 120.812 Probationary period for newly certified CDCs.

* * * * *

(c) * * * To be considered for permanent CDC status or an extension of probation, the CDC must have satisfactory SBA performance, as determined by SBA in its sole discretion. The CDC's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance.

* * * * *

37. Amend § 120.820 to add a new paragraph (c) to read as follows:

§ 120.820 CDC non-profit status and good standing.

* * * * *

(c) Must have satisfactory SBA performance, as determined by SBA in its sole discretion. The CDC's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance.

38. Revise § 120.826 as follows:

§ 120.826 Basic requirements for operating a CDC.

A CDC must operate in accordance with the following requirements:

(a) *In general.* CDCs must meet all 504 Loan Program Requirements. 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 all reports required by SBA.

(b) *Operations and internal controls.* Each CDC's board of directors must adopt an internal control policy which provides adequate direction to the institution for effective control over and accountability for operations, programs, and resources. The board adopted internal control policy must, at a minimum:

(1) Direct management to assign the responsibility for the internal control function (covering financial, credit, credit review, collateral, and administrative matters) to an officer or officers of the CDC;

(2) Adopt and set forth procedures for maintenance and periodic review of the internal control function;

(3) Direct the operation of a program to review and assess the CDC's 504-

related loans. For the 504 review program, the internal control policies must specify the following:

(i) Loan, loan-related collateral, and appraisal review standards, including standards for scope of selection (for review of any such loan, loan-related collateral or appraisal) and standards for work papers and supporting documentation;

(ii) Loan quality classification standards consistent with the standardized classification systems used by the Federal Financial Institution Regulators;

(iii) Specific control requirements for the CDC's oversight of Lender Service Providers; and

(iv) Standards for training to implement the loan review program; and

(4) Address other control requirements as may be established by SBA.

(c) *Annual Audited Financial Statements.* Each CDC must have its financial statements audited annually by a certified public accountant that is independent and experienced in auditing financial institutions. The audit must be performed in accordance with generally accepted auditing standards as adopted by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA). The auditor must be independent, as defined by the AICPA, of the CDC. Annually, the auditor must issue an opinion as to the fairness of the CDC's financial statements and their compliance with GAAS.

(d) *Auditor qualifications.* The audit must be conducted by an independent certified public accountant who:

(1) Is registered or licensed to practice as a public accountant, and is in good standing, under the laws of the state or other political subdivision of the United States in which the CDC's principal office is located;

(2) Agrees in the engagement letter with the CDC to provide the SBA with access to and copies of any work papers, policies, and procedures relating to the services performed;

(3)(i) Is in compliance with the AICPA Code of Professional Conduct; and

(ii) Meets the independence requirements and interpretations of the Securities and Exchange Commission and its staff;

(4) Has received a peer review or is enrolled in a peer review program that meets AICPA guidelines; and

(5) Is otherwise acceptable to SBA.

(e) *Single Audit Act requirements for not-for-profit CDCs.* Not-for-profit CDCs that are subject to the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-

7507) (the Single Audit Act) must comply with the audit requirements contained in the Single Audit Act and revised OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. To the extent that any of such audit requirements conflict with SBA's regulations, the Single Audit Act and OMB Circular A-133 requirements control.

39. Amend § 120.830 to revise paragraph (a) to read as follows:

§ 120.830 Reports a CDC must submit.

* * * * *

(a) An annual report within three months after the end of the CDC's fiscal year (to include audited financial statements of the CDC and any affiliates or subsidiaries of the CDC prepared in accordance with § 120.826(c) and (d)), and such interim reports as SBA may require. The financial statements must, at a minimum, include the following:

- (1) Audited balance sheet;
- (2) Audited statement of income (or receipts) and expense;
- (3) Audited statement of source and application of funds;
- (4) Such footnotes as are necessary to an understanding of the report;
- (5) Auditor's letter to management on internal control weaknesses; and
- (6) The auditor's report.

* * * * *

40. Amend § 120.839 to add two new sentences after the second sentence in the introductory text to read as follows:

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

* * * In addition, the CDC must have satisfactory SBA performance, as determined by SBA in its sole discretion. The CDC's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. * * *

* * * * *

41. Revise § 120.841(c) to read as follows:

§ 120.841 Qualifications for the ALP.

* * * * *

(c) *CDC reviews.* CDC reviews conducted by SBA must be current (within the last 24 months, if applicable) for applicants for ALP status. The CDC must have received a review assessment of either "acceptable" or "acceptable with corrective actions required". In addition, the CDC must have satisfactory SBA performance, as determined by SBA in its sole discretion. The CDC's Risk Rating, among other factors, will be considered

in determining satisfactory SBA performance.

* * * * *

42. Revise § 120.845(b) to read as follows:

§ 120.845 Premier Certified Lenders Program (PCLP).

* * * * *

(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. The PCLP Loan Processing Center will review these materials and forward them to the appropriate Office of Capital Access official in accordance with Delegations of Authority for final determination.

* * * * *

43. Remove the undesignated center heading before § 120.853.

44. Revise the heading for § 120.853 to read as set forth below and remove the first sentence of the section.

§ 120.853 Inspector General audits of CDCs.

45. Remove the undesignated center heading before § 120.854.

§ 120.854 [Removed]

46. Remove § 120.854.

§ 120.855 [Removed]

47. Remove § 120.855.

§ 120.856 [Removed]

48. Remove § 120.856.

49. Revise § 120.956 to read as follows:

§ 120.956 Suspension or revocation of brokers and dealers.

The appropriate Office of Capital Access official in accordance with Delegations of Authority may suspend or revoke the privilege of any broker or dealer to participate in the sale or marketing of Debentures and Certificates for actions or conduct bearing negatively on the broker's fitness to participate in the securities market. SBA must give the broker or dealer written notice, stating the reasons, at least 10 business days prior to the effective date of the suspension or revocation. A broker or dealer may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of this official will remain in effect pending resolution of the appeal.

50. Revise the heading to subpart I and add an undesignated center heading and §§ 120.1000, 120.1005, 120.1010, 120.1015, 120.1025, 120.1050, 120.1051, 120.1055, and 120.1060 to read as follows:

Subpart I—Risk-Based Lender Oversight Supervision

Sec.

120.1000 Risk-Based Lender Oversight.

120.1005 Bureau of PCLP Oversight.

120.1010 SBA access to SBA Lender, Intermediary, and NTAP files.

120.1015 Risk Rating System.

120.1025 Off-site reviews and monitoring.

120.1050 On-site reviews and examinations.

120.1051 Frequency of on-site reviews and examinations.

120.1055 Review and examination results.

120.1060 Confidentiality of Reports, Risk Ratings, and related Confidential Information.

Subpart I—Risk-Based Lender Oversight Supervision

Supervision

§ 120.1000 Risk-Based Lender Oversight.

(a) *Risk-Based Lender Oversight.* SBA supervises, examines, and regulates, and enforces laws against, SBA Supervised Lenders and the SBA operations of SBA Lenders, Intermediaries, and NTAPs.

(b) *Scope.* Most rules and standards set forth in this subpart apply to SBA Lenders as well as Intermediaries and NTAPs. However, SBA has separate regulations for enforcement grounds and enforcement actions for Intermediaries and NTAPs at § 120.1425 and § 120.1540.

§ 120.1005 Bureau of PCLP Oversight.

SBA's Bureau of PCLP Oversight within OCRM, monitors the capitalization of PCLP CDC pilot participants' LLRFs and performs other related functions.

§ 120.1010 SBA access to SBA Lender, Intermediary, and NTAP files.

An SBA Lender, Intermediary, and NTAP must allow SBA's authorized representatives, including representatives authorized by the SBA Inspector General, during normal business hours, access to its files to review, inspect, and copy all records and documents, relating to SBA guaranteed loans or as requested for SBA oversight.

§ 120.1015 Risk Rating System.

(a) *Risk Rating.* SBA may assign a Risk Rating to all SBA Lenders, Intermediaries, and NTAPs on a periodic basis. Risk Ratings are based on certain risk-related portfolio performance factors as set forth in notices or SBA's SOPs and as published from time to time.

(b) *Rating categories.* Risk Ratings fall into one of two broad categories: Acceptable Risk Ratings or Less Than Acceptable Risk Ratings.

§ 120.1025 Off-site reviews and monitoring.

SBA may conduct off-site reviews and monitoring of SBA Lenders, Intermediaries, and NTAPs, including SBA Lenders', Intermediaries' or NTAPs' self-assessments.

§ 120.1050 On-site reviews and examinations.

(a) *On-site reviews.* SBA may conduct on-site reviews of the SBA loan operations of SBA Lenders. The on-site review may include, but is not limited to, an evaluation of the following:

- (1) Portfolio performance;
- (2) SBA operations management;
- (3) Credit administration; and
- (4) Compliance with Loan Program Requirements.

(b) *On-site examinations.* SBA may conduct safety and soundness examinations of SBA Supervised Lenders, except SBA will not conduct safety and soundness examinations of Other Regulated SBLCs under §§ 120.1510 and 1511. The on-site safety and soundness examination may include, but is not limited to, an evaluation of:

- (1) Capital adequacy;
- (2) Asset quality (including credit administration and allowance for loan losses);
- (3) Management quality (including internal controls, loan portfolio management, and asset/liability management);
- (4) Earnings;
- (5) Liquidity;
- (6) Compliance with Loan Program Requirements

(c) *On-site reviews/examinations of Intermediaries and NTAPs.* SBA may perform on-site reviews or examinations of Intermediaries and NTAPs.

(d) *Other on-site reviews or examinations.* SBA may perform other on-site reviews/examinations as needed as determined by SBA in its sole discretion.

§ 120.1051 Frequency of on-site reviews and examinations.

SBA may conduct on-site reviews and examinations of SBA Lenders, Intermediaries, and NTAPs on a periodic basis. SBA may consider, but is not limited to, the following factors in determining frequency:

- (a) Off-site review/monitoring results, including an SBA Lender's, Intermediary's or NTAP's Risk Rating;
- (b) SBA loan portfolio size;
- (c) Previous review or examination findings;
- (d) Responsiveness in correcting deficiencies noted in prior reviews or examinations; and

(e) Such other risk-related information as SBA, in its sole discretion, determines to be appropriate.

§ 120.1055 Review and examination results.

(a) *Written Reports.* SBA will provide an SBA Lender, Intermediary, and NTAP a copy of SBA's written report prepared as a result of the SBA Lender review or examination ("Report"). The Report may contain findings, conclusions, corrective actions and recommendations. Each director (or manager, in the absence of a Board of Directors) of the SBA Lender, Intermediary, and NTAP, in keeping with his or her responsibilities, must become fully informed regarding the contents of the Report.

(b) *Response to review and examination Reports.* SBA Lenders, Intermediaries, and NTAPs must respond to Report findings and corrective actions, if any, in writing to SBA and, if requested, submit proposed corrective actions and/or a capital restoration plan. An SBA Lender, Intermediary, or NTAP must respond within 30 days from the Report date unless SBA notifies the SBA Lender, Intermediary, or NTAP in writing that the response, proposed corrective actions or capital restoration plan is to be filed within a different time period. The SBA Lender, Intermediary, or NTAP response must address each finding and corrective action. In proposing a corrective action or capital restoration plan, SBA Lender, Intermediary, or NTAP must detail: The steps it will take to correct the finding deficiency; the time within which each step will be taken; the timeframe for accomplishing the entire corrective action; and the person(s) or department at the SBA Lender, Intermediary, or NTAP charged with carrying out the corrective actions or capital restoration plan, as applicable.

(c) *SBA response.* SBA will provide written notice of whether the response and, if applicable, any corrective action or capital restoration plan, is approved, or whether SBA will seek additional information or require other action.

(d) *Failure to respond or to submit or implement an acceptable plan.* If an SBA Lender, Intermediary, or NTAP fails to respond in writing to SBA, respond timely to SBA, or provide a response acceptable to SBA within SBA's sole discretion, or respond to all findings and required corrective actions in a Report, then SBA may take enforcement action under Subpart I. If an SBA Lender, Intermediary, or NTAP that is requested to submit a corrective action plan or capital restoration plan to

SBA fails to do so in writing; fails to submit timely such plan to SBA; or fails to submit a plan acceptable to SBA within SBA's sole discretion, then SBA may take enforcement action under § 120.1500 *et. seq.* If an SBA Lender, Intermediary, or NTAP fails to implement in any material respect a corrective action or capital restoration plan within the required timeframe, then SBA may undertake enforcement action under § 120.1500 *et. seq.*

§ 120.1060 Confidentiality of Reports, Risk Ratings and related Confidential Information.

(a) *In general.* Reports and other SBA prepared review or examination related documents are the property of SBA and are loaned to an SBA Lender, Intermediary, or NTAP for its confidential use only. The Reports, Risk Ratings, and related Confidential Information are privileged and confidential as more fully explained in paragraph (b) of this section. The Report, Risk Rating, and Confidential Information must not be relied upon for any purpose other than SBA's Lender oversight and SBA's portfolio management purposes. An SBA Lender, Intermediary, or NTAP must not make any representations concerning the Report (including its findings, conclusions, and recommendations), the Risk Rating, or the Confidential Information. For purposes of this regulation, Report means the review or examination report and related documents. For purposes of this regulation, Confidential Information is defined in the SBA Lender information portal and by notice issued from time to time. Access to the lender information portal may be obtained by contacting the OCRM.

(b) *Disclosure prohibition.* Each SBA Lender, Intermediary, and NTAP is prohibited from disclosing its Report, Risk Rating, and Confidential Information, in full or in part, in any manner, without SBA's prior written permission. An SBA Lender, Intermediary, and NTAP may use the Report, Risk Rating, and Confidential Information for confidential use within its own immediate corporate organization. SBA Lenders, Intermediaries, and NTAPs must restrict access to their Report, Risk Rating and Confidential Information to those of its officers and employees who have a legitimate need to know such information for the purpose of assisting them in improving the SBA Lender's, Intermediary's, or NTAP's SBA program operations in conjunction with SBA's Lender Oversight Program and SBA's portfolio management (for purposes of

this regulation, each referred to as a "permitted party"), and to those for whom SBA has approved access by prior written consent, and to those for whom access is required by applicable law or legal process. If such law or process requires SBA Lender, Intermediary, or NTAP to disclose the Report, Risk Rating, or Confidential Information to any person other than a permitted party, SBA Lender, Intermediary, or NTAP will promptly notify SBA and SBA's Information Provider in writing so that SBA and the Information Provider have, within their sole discretion, the opportunity to seek appropriate relief such as an injunction or protective order prior to disclosure. For purposes of this regulation, "Information Provider" means any contractor that provides SBA with the Risk Rating. SBA Lender, Intermediary, and NTAP must ensure that each permitted party is aware of these regulatory requirements and must ensure that each such permitted party abides by them. Any disclosure of the Report, Risk Rating, or Confidential Information other than as permitted by this regulation may result in appropriate action as authorized by law. An SBA Lender, Intermediary, and NTAP will indemnify and hold harmless SBA of the Risk Rating or Confidential Information from and against any and all claims, demands, suits, actions, and liabilities to any degree based upon or resulting from the unauthorized use or disclosure of the Report, Risk Rating, or Confidential Information. Information Provider contact information is available from the Office of Capital Access.

51. In subpart I, add an undesignated center heading and §§ 120.1400, 120.1425, 120.1500, 120.1510, 120.1511, 120.1540, and 120.1600 to read as follows:

Subpart I—Risk-Based Lender Oversight

* * * * *

Enforcement Actions

| Sec. | |
|----------|--|
| 120.1400 | Grounds for enforcement actions—SBA Lenders. |
| 120.1425 | Grounds for enforcement actions—Intermediaries participating in the Microloan Program and NTAPs. |
| 120.1500 | Enforcement actions—SBA Lenders. |
| 120.1510 | Other Regulated SBLCs. |
| 120.1511 | Certification and other reporting and notification requirements for Other Regulated SBLCs. |
| 120.1540 | Enforcement actions—Intermediaries participating in the Microloan Program and NTAPs. |

120.1600 General procedures for enforcement actions against SBA Lenders, SBA Supervised Lenders, Other Regulated SBLCs, Management Officials, Other Persons, Intermediaries, and NTAPs.

Enforcement Actions

§ 120.1400 Grounds for enforcement actions—SBA Lenders.

(a) *Agreement.* By making SBA 7(a) guaranteed loans or 504 loans, SBA Lenders automatically agree to the terms, conditions, and remedies in Loan Program Requirements, as promulgated or issued from time to time and as if fully set forth in the SBA Form 750, Loan Guaranty Agreement or other applicable participation, guaranty, or supplemental agreement.

(b) *Scope.* SBA may undertake one or more of the enforcement actions listed in § 120.1500 or as otherwise authorized by law, if SBA determines that the grounds applicable to the enforcement action exist. In general, the grounds listed in paragraph (c) of this section may trigger enforcement actions against any SBA Lender. However, certain enforcement actions against SBA Supervised Lenders, as set forth in paragraphs (d) and (e) of this section, require the existence of certain grounds, and paragraph (f) of this section lists two additional grounds for taking enforcement action against CDCs. Below is a listing of the grounds that trigger enforcement actions against each type of SBA Lender.

(c) *Grounds in general.* Except as provided in paragraphs (d) and (e) of this section, the grounds that may trigger an enforcement action against any SBA Lender (regardless of its Risk Rating) include:

(1) Failure to maintain eligibility requirements for specific SBA programs and delegated authorities, including but not limited to: 7(a), PLP, SBAExpress, Community Express, 504, ALP, PCLP, the alternative loss reserve pilot program and any pilot loan program;

(2) Failure to comply materially with any requirement imposed by Loan Program Requirements;

(3) Making a material false statement or failure to disclose a material fact to SBA (A material fact is any fact which is necessary to make a statement not misleading in light of the circumstances under which the statement was made.);

(4) Not performing underwriting, closing, disbursing, servicing, liquidation, litigation or other actions in a commercially reasonable and prudent manner for 7(a) or 504 loans, respectively, as applicable. Evidence of such performance or actions may include, but is not limited to, the SBA

Lender having a repeated Risk Rating or an on-site review/examination assessment which is Less Than Acceptable;

(5) Failure within time period specified to correct an underwriting, closing, disbursing, servicing, liquidation, litigation, or reporting deficiency, or failure in any material respect to take other corrective action, after receiving notice from SBA of a deficiency and the need to take corrective action;

(6) Engaging in a pattern of uncooperative behavior or taking an action that SBA determines is detrimental to an SBA program, that undermines management or administration of a program, or that is not consistent with standards of good conduct;

(7) Repeated failure to correct continuing deficiencies;

(8) Unauthorized disclosure of Reports, Risk Rating, or Confidential Information;

(9) Any other reason that SBA determines may increase SBA's financial risk (for example, repeated Less Than Acceptable Risk Ratings or indictment on felony or fraud charges of an officer, key employee, or loan agent involved with SBA loans for the SBA Lender);

(10) As otherwise authorized by law; or

(11) For immediate suspension of all SBA Lenders from delegated authorities—upon a determination by SBA that one or more of the grounds in paragraph (c) or paragraph (f) of this section, as applicable, exist and, that immediate action is needed to prevent significant impairment of the integrity of the 7(a) or 504 loan program.

(12) For immediate suspension of all SBA Lenders except SBA Supervised Lenders from the authority to participate in the SBA loan program, including the authority to make, service, liquidate, or litigate 7(a) or 504 loans—upon a determination by SBA that one or more of the grounds in paragraph (c) or paragraph (f) of this section, as applicable, exist and, that immediate action is needed to prevent significant impairment of the integrity of the 7(a) or 504 loan program.

(d) *Grounds required for certain enforcement actions against SBA Supervised Lenders (except Other Regulated SBLCs) or as applicable, Other Persons.* For purposes of Subpart I, Other Person means a Management Official, attorney, accountant, appraiser, Lender Service Provider or other individual involved in the SBA Supervised Lender's operations. For the below listed SBA Supervised Lender

enforcement actions, the grounds that are required to take the enforcement action are:

(1) *For SBA program suspensions and revocations—*

(i) False statements knowingly made in any required written submission to SBA; or

(ii) An omission of a material fact from any written submission required by SBA; or

(iii) A willful or repeated violation of the Small Business Act (the Act) or SBA regulations; or

(iv) A willful or repeated violation of any condition imposed by SBA with respect to any application, request, or agreement with SBA; or

(v) A violation of any cease and desist order of SBA.

(2) *For SBA program immediate suspension—*SBA may suspend an SBA Supervised Lender, effective immediately, if in addition to meeting the grounds set forth in paragraph (d)(1) of this section, the Administrator (or the Deputy Administrator, only if the Administrator is unavailable to take such action) finds extraordinary circumstances and takes such action in order to protect the financial or legal position of the United States.

(3) *For cease and desist orders—*

(i) A violation of the Act or SBA regulations, or

(ii) Where an SBA Supervised Lender or Other Person engages in or is about to engage in any acts or practices that will violate the Act or SBA's regulations.

(4) *For an emergency cease and desist order—*

(i) Where grounds for cease and desist order are met,

(ii) The Administrator (or the Deputy Administrator, only if the Administrator is unavailable to take such action) finds extraordinary circumstances, and

(iii) In order to protect the financial or legal position of the United States.

(5) *For transfer of Loan portfolio—*

(i) Where a court has appointed a receiver and

(ii) The SBA Supervised Lender is either not in compliance with capital requirements or is insolvent. An SBA Supervised Lender is insolvent within the meaning of this provision when all of its capital, surplus, and undivided profits are absorbed in funding losses and the remaining assets are not sufficient to pay and discharge its contracts, debts, and other obligations as they come due.

(6) *For transfer of servicing activity—*

(i) Where grounds for transfer of Loan portfolio are met or

(ii) Where the SBA Supervised Lender is otherwise operating in an unsafe and unsound condition.

(7) *For order to remove Management Official*—where, in the opinion of the Administrator or his/her delegatee, the Management Official—

(i) Willfully and knowingly committed a substantial violation of the Act, SBA regulation, a final cease and desist order, or any agreement by the Management Official or the SBA Supervised Lender under the Act or SBA regulations, or

(ii) Willfully and knowingly committed a substantial breach of a fiduciary duty of that person as a Management Official and the violation or breach of fiduciary duty is one involving personal dishonesty on the part of such Management Official, or

(iii) The Management Official is convicted of a felony involving dishonesty or breach of trust and the conviction is no longer subject to further judicial review (excludes writ of habeas corpus).

(8) *For order to suspend or prohibit participation of Management Official (interim measure pending removal)*—where SBA is undertaking enforcement action of removal of a Management Official.

(9) *For order to suspend or prohibit participation of Management Official due to criminal charges*—where the Management Official is charged in any information, indictment or complaint authorized by a United States attorney with a felony involving dishonesty or breach of trust.

(e) *Grounds required for certain enforcement actions against SBLCs and Other Regulated SBLCs.*

(1) *Capital directive.* If the AA/CA determines that an SBLC is capitally impaired or is otherwise being operated in an imprudent manner, the AA/CA may, in addition to any other action authorized by law, issue a directive to the SBLC to increase capital consistent with § 120.1500(d)(1).

(2) *Civil action for termination.* If an SBLC violates the Act or SBA regulations, SBA may institute a civil action to terminate SBLC rights, privileges, and the franchise under § 120.1500(d)(2).

(f) *Additional grounds specific to CDCs.* In addition to the grounds set forth in paragraphs (b) and (c) of this section, SBA may take enforcement action against a CDC for:

(1) Failure to receive SBA approval for at least four 504 loans during the last two consecutive fiscal years, or

(2) For PCLP CDCs, failure to establish or maintain a LLRF as required by the PCLP.

§ 120.1425 Grounds for enforcement actions—Intermediaries participating in the Microloan Program and NTAPs.

(a) *Agreement.* By participating in the SBA Microloan or NTAP program, Intermediaries and NTAPs automatically agree to the terms, conditions, and remedies in this Part 120 as if fully set forth in their participation agreement and all other agreements jointly executed by the Intermediary or NTAP and SBA.

(b) *Scope.* SBA may undertake one or more of the enforcement actions listed in § 120.1540, or as otherwise authorized by law, if SBA determines that any of the grounds listed in paragraphs (c) through (e) of this section exist.

(c) *Grounds in general.* For any Intermediary or NTAP, grounds that may trigger enforcement action against the Intermediary or NTAP (regardless of its Risk Rating) include:

(1) Violation of any laws, regulations, or policies of the program; or

(2) Failure to meet any one of the following performance standards:

(i) Coverage of the service territory assigned by SBA, including honoring SBA's determined boundaries of neighboring intermediaries and NTAPs;

(ii) Fulfill reporting requirements;

(iii) Manage program funds and matching funds in a satisfactory and financially sound manner;

(iv) Communicate and file reports within six months after beginning participation in program;

(v) Maintain a currency rate of 85% or more for the Intermediary's SBA Microloan portfolio (that is, loans that are no more than 30 days late in scheduled payments);

(vi) Maintain a default rate in the Intermediary's Microloan portfolio of 15% or less of the cumulative dollars loaned under the program;

(vii) Maintain a staff trained in Microloan program issues and requirements; or

(viii) Any other reason that SBA determines may increase SBA's financial or program risk (for example, repeated Less Than Acceptable Risk Ratings or indictment on felony or fraud charges of an officer, key employee, or loan agent involved with SBA programs for the Intermediary or NTAP).

(d) *Additional grounds specific to Intermediaries.* In addition to the grounds set forth in paragraph (c) of this section, SBA may take enforcement action against an Intermediary for:

(1) Failure to satisfactorily provide in-house technical assistance to Microloan clients and prospective Microloan clients; or

(2) Failure to close and fund a minimum of four Microloans annually.

(e) *Additional grounds specific to NTAPs.* In addition to grounds set forth in paragraph (c) of this section, SBA may take enforcement action against an NTAP for failure to show that, for every 30 clients for which the NTAP provided technical assistance, at least one client received a loan from the private sector.

§ 120.1500 Enforcement actions—SBA Lenders.

Upon a determination that the grounds set forth in § 120.1400 exist, SBA may undertake, in SBA's sole discretion, one or more of the following enforcement actions for each of the types of SBA Lenders listed. SBA will take such action in accordance with procedures set forth in § 120.1600. If enforcement action is taken under this section and the SBA Lender fails to implement required corrective action in any material respect within the required timeframe in response to the enforcement action, SBA may take further enforcement action, as authorized by law.

(a) *Enforcement actions for all SBA Lenders—(1) Imposition of portfolio guarantee dollar limit.* SBA may limit the maximum dollar amount that SBA will guaranty on the SBA Lender's SBA loans or debentures.

(2) *Suspension or revocation of delegated authority.* SBA may suspend or revoke an SBA Lender's delegated authority (including, but not limited to PLP, SBA Express, or PCLP delegated authorities).

(3) *Suspension or revocation from SBA program.* SBA may suspend or revoke an SBA Lender's authority to participate in the SBA loan program, including the authority to make, service, liquidate, or litigate 7(a) or 504 loans. Section 120.1400(d)(1) sets forth the grounds for SBA program suspension or revocation of an SBA Supervised Lender (except Other Regulated SBLCs). The grounds for SBA program suspension or revocation for all other SBA Lenders are set forth in § 120.1400(c) and, as applicable, paragraph (f) of § 120.1400. A suspension or revocation will not invalidate a guaranty previously provided by SBA.

(4) *Immediate suspension.* SBA may suspend, effective immediately, an SBA Lender's delegated authority or authority to participate in the SBA loan program, or the authority to make, service, liquidate, or litigate 7(a) or 504 loans. Section 120.1400(d)(2) sets forth the grounds for SBA program immediate suspension of an SBA Supervised Lender (except Other Regulated SBLCs). The grounds for SBA program immediate suspension for all other SBA Lenders and the grounds for immediate

suspension of delegated authority for all SBA Lenders are set forth in § 120.1400(c)(11) and § 120.1400(c)(12).

(5) *Debarment.* In accordance with Part 145 or successor regulation of this Chapter, SBA may take any necessary action to debar a person, as defined in Part 145, including but not be limited to an officer, a director, a general partner, a manager, an employee, an agent or other participant in the affairs of an SBA Lender's SBA operations.

(6) *Other actions available under law.* SBA may take all other enforcement actions against SBA Lenders available under law.

(b) *Enforcement actions specific to 7(a) Lenders.* In addition to those enforcement actions applicable to all SBA Lenders, SBA may suspend or revoke a 7(a) Lender's authority to sell or purchase loans or certificates in the Secondary Market.

(c) *Enforcement actions specific to SBA Supervised Lenders and Other Persons (except Other Regulated SBLCs).* In addition to those enforcement actions listed in paragraphs (a) and (b) of this section, SBA may take any one or more of the following enforcement actions specific to SBA Supervised Lenders and as applicable, Other Persons:

(1) *Cease and desist order.* SBA may issue a cease and desist order against the SBA Supervised Lender or Other Person. The Cease and Desist order may either require the SBA Supervised Lender or the Other Person to take a specific action, or to refrain from a specific action. The Cease and Desist Order may be issued as effective immediately (or as a proposal for Order). SBA may include in the cease and desist order the suspension of authority to lend.

(2) *Remove Management Official.* SBA may issue an order to remove a Management Official from office. SBA may suspend a Management Official from office or prohibit a Management Official from participating in management of the SBA Supervised Lender or in reviewing, approving, closing, servicing, liquidating or litigating any 7(a) loan, or any other activities of the SBA Supervised Lender while the removal proceeding is pending in order to protect an SBA Supervised Lender or the interests of SBA or the United States.

(3) *Initiate request for appointment of receiver.* The SBA may make application to a district court to take exclusive jurisdiction of an SBA Supervised Lender and appoint a trustee or receiver to hold or administer or liquidate the SBA Supervised Lender's assets under direction of the court. The

receiver may take possession of the portfolio of 7(a) loans and sell such loans to a third party, and/or take possession of servicing activities of 7(a) loans and sell such servicing rights to a third party.

(4) *Civil monetary penalties for report filing failure.* SBA may seek civil penalties, in accordance with § 120.465, of not more than \$5,000 a day against an SBA Supervised Lender that fails to file any regular or special report by its due date as specified by regulation or SBA written directive.

(d) *Enforcement actions specific to SBLCs.* In addition to those supervisory actions listed in paragraphs (a), (b), and (c) of this section, SBA may take the following enforcement actions specific to SBLCs.

(1) *Capital directive.* The AA/CA may issue a capital directive upon a determination that the grounds in § 120.1400(e)(1) exist. A directive may order the SBLC to:

(i) Achieve its minimum capital requirement applicable to it by a specified date;

(ii) Adhere to a previously submitted capital restoration plan (provided under § 120.462 or § 120.1055) to achieve the applicable capital requirement;

(iii) Submit and adhere to a capital restoration plan acceptable to SBA describing the means and time schedule by which the SBLC will achieve the applicable capital requirement (The SBLC must provide its capital restoration plan within 30 days from the date of the SBA order unless SBA notifies the SBLC that the plan is to be filed within a different time period. SBA may perform an on-site examination (generally within 90 days after the restoration plan is submitted) to verify the implementation of the plan and verify that the SBLC meets minimum capital requirements.);

(iv) Refrain from taking certain actions without obtaining SBA's prior written approval (Such actions may include but are not limited to: Paying any dividend; retiring any equity; maintaining a rate of growth that causes further deterioration in the capital percentage; securitizing any unguaranteed portion of its 7(a) loans; or selling participations in any of its 7(a) loans); or

(v) Undertake a combination of any of these or similar actions.

(2) *Civil action for termination.* SBA may institute a civil action to terminate the rights, privileges, and franchises of an SBLC.

(e) *Enforcement actions specific to CDCs.* In addition to those enforcement actions listed in paragraph (a) of this section, SBA may take any one or more

of the following enforcement actions specific to CDCs:

(1) Require the CDC to transfer part or all of its existing 504 loan portfolio and/or part 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; or

(2) Instruct the Central Servicing Agent to withhold payment of servicing, late and/or other fee(s) to the CDC.

§ 120.1510 Other Regulated SBLCs.

Other Regulated SBLCs are exempt from §§ 120.465, 120.1050(b), 120.1400(d), 120.1500(c), and 120.1600(b). This exemption is not intended to preclude SBA from seeking any other remedy authorized by law or equity.

§ 120.1511 Certification and other reporting and notification requirements for Other Regulated SBLCs.

(a) *Certification.* An SBLC seeking Other Regulated SBLC status must certify to SBA in writing that its lending activities are subject to regulation by a Federal Financial Institution Regulator or state banking regulator. This certification must be executed by the chair of the board of directors of the SBLC and submitted to SBA either:

(1) Within 60 calendar days of the effective date of this section or

(2) If the SBLC becomes subject to regulation by a Federal Financial Institution Regulator or state banking regulator after the effective date of this section for any reason (e.g. license transfers), within 60 days of the date that the SBLC becomes directly examined and directly regulated by such regulator.

(b) *Contents of Certification.* This certification must include:

(1) The identity of the Federal Financial Institution Regulator or state banking regulator that regulates the lending activities of the SBLC;

(2) A statement that the Federal Financial Institution Regulator or state banking regulator identified in paragraph (b)(1) of this section regularly conducts safety and soundness examinations on the SBLC itself and not only on the SBLC's parent company or affiliate, if any; and

(3) The date of the most recent safety and soundness examination conducted on the SBLC by the Federal Financial Institution Regulator or state banking regulator. To qualify as an Other Regulated SBLC, the SBLC must have received this examination within the past 3 years of the date of certification.

(c) *Notification of examination.* An Other Regulated SBLC must notify SBA

in writing each time a Federal Financial Institution Regulator or state banking regulator conducts a safety and soundness examination, and this notification must be submitted to SBA within 30 calendar days of the SBLC receiving the results of the examination. To retain its status as an Other Regulated SBLC, the Other Regulated SBLC must receive such examination, and provide the written notification to SBA, at least once every two years following initial certification.

(d) *Report.* An Other Regulated SBLC must report in writing to SBA on its interactions with other Federal Financial Institution Regulators or state banking regulator (e.g., the results of the safety and soundness examinations and any order issued against the Other Regulated SBLC), to the extent allowed by law.

(e) *Notification of change in status.* If, for any reason, an Other Regulated SBLC becomes no longer subject to regulation by a Federal Financial Institution Regulator or state banking regulator, the Other Regulated SBLC must immediately notify SBA in writing, and the exemption provided in § 120.1510 will immediately no longer apply.

(f) *Extension of timeframes.* SBA may in its sole discretion extend any timeframe imposed on the SBLC under this section if the SBLC can show good cause for any delay in meeting the time requirement. The SBLC may appeal this decision to the AA/CA.

(g) *Failure to satisfy requirements.* In the event that an SBLC fails to satisfy the requirements set forth in paragraphs (a), (b), and (c) of this section, then the exemption provided in § 120.1510 will not apply to the SBLC.

§ 120.1540 Enforcement actions—Intermediaries participating in the Microloan Program and NTAPs.

Upon a determination that any ground set out in § 120.1425 exists, the SBA may take in its sole discretion, one or more of the following enforcement actions against an Intermediary or NTAP:

(a) Suspension or pre-revocation sanctions which may include, but are not limited to:

(1) Accelerated reporting requirements;

(2) Accelerated loan repayment requirements for outstanding program debt to SBA, as applicable;

(3) Imposition of a temporary lending moratorium, as applicable; or

(4) Imposition of a temporary training moratorium.

(b) Revocation of authority to participate in the Microloan program which will include:

(1) Removal from the program;

(2) Liquidation of Intermediary's Microloan Revolving Fund and Loan Loss Reserve Fund accounts by SBA, and application of the liquidated funds to any outstanding balance owed to SBA;

(3) Payment of outstanding debt to SBA by the Intermediary;

(4) Forfeiture or repayment of any unused grant funds by the Intermediary or NTAP;

(5) Debarment of the organization from receipt of federal funds until loan and grant repayments are met; or

(6) Taking such other actions available under law.

§ 120.1600 General procedures for enforcement actions against SBA Lenders, SBA Supervised Lenders, Other Regulated SBLCs, Management Officials, Other Persons, Intermediaries, and NTAPs.

(a) *In general.* Except as otherwise set forth for the enforcement actions listed in paragraphs (b) and (c) of this section, SBA will follow the procedures listed below.

(1) *SBA's notice of enforcement action.* (i) When undertaking an immediate suspension under § 120.1500(a)(4), or prior to undertaking an enforcement action set forth in § 120.1500(a), (b), and (e) and § 120.1540, SBA will issue a written notice to the affected SBA Lender, Intermediary, or NTAP identifying the proposed enforcement action or notifying it of an immediate suspension. The notice will set forth in reasonable detail the underlying facts and reasons for the proposed action or immediate suspension. If the notice is for a proposed or immediate suspension, SBA will also state the scope and term of the proposed or immediate suspension.

(ii) If a proposed enforcement action or immediate suspension is based upon information obtained from a third party other than the SBA Lender, Intermediary, and NTAP or SBA, SBA's notice of proposed action or immediate suspension will provide copies of documentation received from such third party, or the name of the third party in case of oral information, unless SBA determines that there are compelling reasons not to provide such information. If compelling reasons exist, SBA will provide a summary of the information it received to the SBA Lender, Intermediary, or NTAP.

(2) *SBA Lender, Intermediary, or NTAP's opportunity to object.* (i) An SBA Lender, Intermediary, or NTAP that desires to contest a proposed enforcement action or an immediate suspension must file, within 30

calendar days of its receipt of the notice or within some other term established by SBA in its notice, a written objection with the appropriate Office of Capital Access official in accordance with Delegations of Authority or other SBA official identified in the notice. Notice will be presumed to have been received within five days of the date of the notice unless the SBA Lender, Intermediary, or NTAP can provide compelling evidence to the contrary.

(ii) The objection must set forth in detail all grounds known to the SBA Lender, Intermediary, or NTAP to contest the proposed action or immediate suspension and all mitigating factors, and must include documentation that the SBA Lender, Intermediary, or NTAP believes is most supportive of its objection. An SBA Lender, Intermediary, or NTAP must exhaust this administrative remedy in order to preserve its objection to a proposed enforcement action or an immediate suspension.

(iii) If an SBA Lender, Intermediary, or NTAP can show legitimate reasons as determined by SBA in SBA's sole discretion why it does not understand the reasons given by SBA in its notice of the action, the SBA Lender, Intermediary, or NTAP may request and receive clarification from the Agency. SBA will provide the requested clarification in writing to the SBA Lender, Intermediary, or NTAP or notify the SBA Lender, Intermediary, or NTAP in writing that SBA has determined that SBA Lender's reasons as presented were not legitimate and that such clarification is not necessary. SBA, in its sole discretion, will further advise in writing whether the SBA Lender, Intermediary, or NTAP may have additional time to present its objection to the notice. Requests for clarification must be made to the appropriate Office of Capital Access official in accordance with Delegations of Authority in writing and received by SBA within the 30-day timeframe or the timeframe given by the notice for response.

(iv) An SBA Lender, Intermediary, or NTAP may request additional time to respond to SBA's notice if it can show that there are compelling reasons why it is not able to respond within the 30-day timeframe or timeframe given by the notice for response. If such requests are submitted to the Agency, SBA may, in its sole discretion, provide the SBA Lender, Intermediary, or NTAP with additional time to respond to the notice of proposed action or immediate suspension. Requests for additional time to respond must be made to the appropriate Office of Capital Access official in accordance with Delegations

of Authority or other official identified in the notice in writing and received by SBA within the 30-day timeframe or the timeframe given by the notice for response.

(v) Prior to the issuance of a final decision by SBA, if an SBA Lender, Intermediary, or NTAP can show that there is newly discovered material evidence which, despite the SBA Lender, Intermediary, or NTAP's exercise of due diligence, could not have been discovered within the timeframe given by SBA to respond to a notice, or that there are compelling reasons beyond the SBA Lender, Intermediary, or NTAP's control as to why it was not able to present a material fact or argument to SBA, and that the SBA Lender, Intermediary, or NTAP has been prejudiced by not being able to present such information, the SBA Lender, Intermediary, or NTAP may submit such information to SBA and request that the Agency consider such information in its final decision.

(3) *SBA's notice of final agency decision where SBA Lender, Intermediary, or NTAP filed objection to the proposed action or immediate suspension.* (i) If the affected SBA Lender, Intermediary, or NTAP files a timely written objection to a proposed enforcement action other than an immediate suspension in accordance with this section, SBA must issue a written notice of final decision to the affected SBA Lender, Intermediary, or NTAP advising whether SBA is undertaking the proposed enforcement action and setting forth the grounds for the decision. SBA will issue such a notice of final decision whenever it deems appropriate.

(ii) If the affected SBA Lender, Intermediary, or NTAP files a timely written objection to a notice of immediate suspension, SBA must issue a written notice of final decision to the affected SBA Lender, Intermediary, or NTAP within 90 days of receiving the SBA Lender, Intermediary, or NTAP's objection advising whether SBA is continuing with the immediate suspension. If the SBA Lender, Intermediary, or NTAP submits additional information to SBA (under paragraph (a)(2)(v) of this section) after submitting its objection but before SBA issues its final decision, SBA must issue its final decision within 90 days of receiving such information.

(iii) Prior to issuing a notice of decision, SBA in its sole discretion can request additional information from the affected SBA Lender, Intermediary, NTAP 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 final decision pursuant to this paragraph.

(4) *SBA's notice of final agency decision where no objection filed or untimely objection not considered.* If SBA chooses not to consider an untimely objection or if the affected SBA Lender, Intermediary, or NTAP 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, SBA must issue a written notice of final decision to the affected SBA Lender, Intermediary, or NTAP that SBA is undertaking one or more of the proposed enforcement actions against the SBA Lender, Intermediary, or NTAP or that SBA will continue to pursue an immediate suspension of the SBA Lender, Intermediary, or NTAP. Such a notice of final decision need not state any grounds for the action other than to reference the SBA Lender, Intermediary, or NTAP's failure to file a timely objection, and represents the final agency decision.

(5) *Appeals.* SBA Lender, Intermediary, and NTAP may appeal the final agency decision only in the appropriate federal district court.

(b) *Procedures for certain enforcement actions against SBA Supervised Lenders (except Other Regulated SBLCs) and, where applicable, Management Officials and Other Persons—*(1) *Suspension and revocation actions and cease and desist orders.* If SBA seeks to suspend or revoke loan program authority (including the authority to make, service, liquidate, or litigate SBA loans), or issue a cease and desist order to an SBA Supervised Lender or, as applicable, Other Person, SBA will follow the procedures below in lieu of those in paragraph (a) of this section.

(i) *Show cause order and hearing.* The Administrator will serve upon the SBA Supervised Lender or Other Person an order to show cause why an order suspending or revoking the authority or why a cease and desist order should not be issued. The show cause order will contain a statement of the matters of fact and law asserted by SBA, as well as the legal authority and jurisdiction under which an administrative hearing will be held, and will set forth the place and time of the administrative hearing. The hearing will be conducted by an administrative law judge in accordance with 5 U.S.C. 554–557.

(ii) *Witnesses.* The party calling witnesses will pay the witnesses the same fees and mileage paid witnesses for their appearance in U.S. courts.

(iii) *Administrator finding and order issuance.* If after the administrative hearing, or the SBA Supervised Lender's or Other Person's waiver of the administrative hearing, the Administrator determines that the order should be issued, the Administrator will issue an order to suspend or revoke authority or a cease and desist order, as applicable. The order will include a statement of findings, the grounds and reasons, and will specify the order's effective date. SBA will serve the order on the SBA Supervised Lender or Other Person. The Administrator may delegate the power to issue a cease and desist order or to suspend or revoke loan program authority only if the Administrator is unavailable and only to the Deputy Administrator.

(iv) *Judicial review.* The order issuance constitutes a final agency action. The SBA Supervised Lender or Other Person will have 20 days from the order issuance date to file an appeal in the appropriate federal district court.

(2) *Immediate suspension or immediate cease and desist order.* If SBA undertakes an immediate suspension of authority to participate in the 7(a) loan program or immediate cease and desist order against an SBA Supervised Lender or, as applicable, Other Person, SBA will within two business days follow the procedures set forth in paragraph (b)(1) of this section.

(3) *Removal of Management Official.* If SBA undertakes the removal of a Management Official of an SBA Supervised Lender, SBA will follow the procedures below in lieu of those in paragraph (a) of this section.

(i) *Notice and hearing.* SBA will serve upon the Management Official and the SBA Supervised Lender written notice of intention to remove that includes a statement of the facts constituting the grounds and the date, time, and place for an administrative hearing. The administrative hearing will be held between 30 and 60 days from the date notice is served, unless an earlier or later date is set at the request of the Management Official for good cause shown or at the request of the Attorney General. Failure of the Management Official to appear at the administrative hearing will constitute consent to the removal order. SBA will serve on the SBA Supervised Lender a copy of each notice that is served on a Management Official,

(ii) *Suspension from office or prohibition in participation, pending removal.* The suspension or prohibition will take effect upon service of intention to remove the Management Official or such subsequent time as the Administrator or his/her delegate deems

appropriate and serves notice. It will remain in effect pending the completion of the administrative proceedings to remove and until such time as either SBA dismisses the charges in the removal notice or, if an order to remove or prohibit participation is issued, until the effective date of an order to remove or prohibit. In the case of suspension or prohibition following criminal charges, it may remain in effect until the information, indictment, or complaint is finally disposed of, or until the suspension is terminated by SBA or by order of a district court. A Management Official may appeal to the appropriate federal district court for a stay of the suspension or prohibition pending completion of the administrative hearing not later than 10 days from the suspension or prohibition's effective date.

(iii) *Decision.* SBA may issue the order of removal if the Management Official consents or is convicted of the criminal charges and the judgment is not subject to further judicial review (not including writ of habeas corpus), or if upon a record of a hearing, SBA finds that any of the notice grounds have been established. After the hearing, in the latter case, and within 30 days after SBA has notified the parties that the case has been submitted for final decision, SBA will render a decision (which includes findings of fact upon which the decision is predicated) and issue and serve an order upon each party to the proceeding. The decision will constitute final agency action.

(iv) *Effective date and judicial review.* The removal order will take effect 30 days after date of service upon the SBA Supervised Lender and the Management Official except i) in case of consent which will be effective at the time specified in the order or ii) in case of removal for conviction on criminal charges the order will be effective upon removal order service on the SBA Supervised Lender and the Management Official. The order will remain effective and enforceable, except to the extent it is stayed, modified, terminated, or set aside by the Administrator or a reviewing court. The adversely affected party will have 20 days from the order issuance date to seek judicial review in the appropriate federal district court.

(4) *Receiverships, transfer of assets and servicing activities.* If SBA undertakes the appointment of a receiver for, or the transfer of assets or servicing rights of, an SBA Supervised Lender, SBA will follow the applicable procedures in 15 U.S.C. 650.

(5) *Civil penalties for report filing failure.* If SBA seeks to impose civil penalties against an SBA Supervised Lender for failure to file a report in accordance with SBA regulations or written directives, SBA will follow the procedures set forth for enforcement actions in § 120.465.

(c) *Additional procedures for certain enforcement actions against SBLCs. Capital directive—(1) Notice of intent to issue capital directive.* SBA will notify an SBLC in writing of its intention to issue a directive. The notice will state:

(i) Reasons for issuance of the directive and

(ii) The proposed contents of the directive.

(2) *Response to notice.* An SBLC may respond to the notice by stating why a capital directive should not be issued and/or by proposing alternative contents for the capital directive or seeking other appropriate relief. The response must include any information, mitigating circumstances, documentation, or other relevant evidence that supports its position. The response may include a plan for achieving the minimum capital requirement applicable to the SBLC. The response must be in writing and delivered to the SBA within 30 days after the date on which the SBLC received the notice. In its discretion, SBA may extend the time period for good cause. SBA may shorten the 30-day time period:

(i) When, in the opinion of SBA, the condition of the SBLC so requires, provided that the SBLC will be informed promptly of the new time period;

(ii) With the consent of the SBLC; or

(iii) When the SBLC already has advised SBA that it cannot or will not achieve its applicable minimum capital requirement.

Failure to respond within 30 days or such other time period as may be specified by SBA will constitute a waiver of any objections to the proposed capital directive.

(3) *Decision.* After the closing date of the SBLC's response period, or receipt of the SBLC's response, if earlier, SBA may seek additional information or clarification of the response. Thereafter, SBA will determine whether or not to issue a capital directive, and if one is to be issued, whether it should be as originally proposed or in modified form.

(4) *Issuance of a capital directive.* (i) A capital directive will be served by delivery to the SBLC. It will include, or be accompanied by, a statement of reasons for its issuance.

(ii) A capital directive is effective immediately upon its receipt by the SBLC, or upon such later date as may be specified therein, and will remain effective and enforceable until it is stayed, modified, or terminated by SBA.

(5) *Reconsideration based on change in circumstances.* Upon a change in circumstances, an SBLC may request SBA to reconsider the terms of its capital directive or may propose changes in the plan to achieve the SBLC's applicable minimum capital requirement. SBA also may take such action on its own initiative. SBA may decline to consider requests or proposals that are not based on a significant change in circumstances or are repetitive or frivolous. Pending a decision on reconsideration, the capital directive and plan will continue in full force and effect.

(6) *Relation to other administrative actions.* A capital directive may be issued in addition to, or in lieu of, any other action authorized by law, including cease and desist proceedings. SBA also may, in its discretion, take any action authorized by law, in lieu of a capital directive, in response to an SBLC's failure to achieve or maintain the applicable minimum capital requirement.

(7) *Appeals.* The capital directive constitutes a final agency action. An SBLC may appeal the final agency decision only in the appropriate federal district court.

Dated: October 18, 2007.

Steven C. Preston,
Administrator.

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