



# Federal Register

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**Thursday,  
December 11, 2008**

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**Part II**

## **Small Business Administration**

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

**SMALL BUSINESS ADMINISTRATION****13 CFR Part 120**

RIN 3245-AE14

**Lender Oversight Program****AGENCY:** Small Business Administration (SBA).**ACTION:** Interim Final Rule with request for comments.

**SUMMARY:** This interim final rule incorporates SBA's risk-based lender oversight program into SBA regulations. Specifically, the rule codifies in SBA regulations SBA's process of risk-based oversight including: Accounting and reporting requirements; off-site reviews/monitoring; on-site reviews and examinations; and capital adequacy requirements. It also codifies SBA Supervised Lender regulation and updates SBA's business loan program regulations to specify program standards. Finally, the rule lists the types of, grounds for, and procedures governing SBA enforcement actions against 7(a) Lenders, Certified Development Companies, Microloan Intermediaries, and Non-Lending Technical Assistance Providers within consolidated enforcement regulations. SBA previously published a Notice of Proposed Rulemaking (NPRM) addressing all of the topics and issues covered by this interim final rule. SBA has already allowed for public comment, reviewed the comments and made changes accordingly. SBA is publishing this rule interim final rather than proceeding to a final rule, however, in order to provide the public with an additional opportunity to comment and to allow for any necessary adjustments as the industry moves through the economic cycle.

**DATES:** *Effective Date:* January 12, 2009.

Comment Date: Comments must be received on or before March 11, 2009.

**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 Rusche, 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 discretion, of whether the information is CBI and, therefore, will be published or not.

**FOR FURTHER INFORMATION CONTACT:** Linda Rusche, Supervisory Financial Analyst, at (816) 426.4860 or [linda.rusche@sba.gov](mailto:linda.rusche@sba.gov), or Bryan Hooper, Director, Office of Credit Risk Management, at (202) 205.3049 or [bryan.hooper@sba.gov](mailto:bryan.hooper@sba.gov).

**SUPPLEMENTARY INFORMATION:****I. Background Information***SBA Mission and Lender Oversight*

In 1953, Congress established the Small Business Administration. The SBA's mission is to aid, counsel, and assist America's small businesses. Central to the mission is the intention that SBA assists America's small businesses' access to capital to start, continue operations and grow. SBA assists small businesses' access to credit through numerous finance programs, including but not limited to the section 7(a) guaranty loan program, the section 504 Certified Development Company debenture program, and SBA's Microloan Intermediary program authorized under 15 U.S.C. 636 and 15 U.S.C. 697a. In each of these programs Lenders/Intermediaries partner with SBA to provide America's small businesses with needed access to capital to support our nation's economy. In partnering, SBA delegates to many Lenders the authority to originate, service, and liquidate SBA guaranteed loans.

Today approximately 4,500 7(a) Lenders, Certified Development Companies (CDCs) and Intermediaries participate in SBA lending programs. These Lenders hold approximately \$67 billion in 7(a) and 504 loans outstanding. As the SBA portfolio grows and SBA places increasing responsibility on Lenders, SBA must have the necessary controls to ensure that SBA Lenders' SBA operations are well managed and to avoid undue losses. Such controls provide for the

long-term health of the business loan programs and sustain our ability to meet our statutory mission to assist small businesses in obtaining access to capital.

Central to the establishment of lender oversight controls are their incorporation in SBA rules and regulations. Therefore, on October 31, 2007, SBA published in the **Federal Register** SBA's Proposed Lender Oversight Program rule. (72 FR 61751) The proposed rule was comprehensive, covering 7(a) program, 504 program, and Microloan program monitoring and enforcement and also included updates to business loan program regulations consistent with the oversight program. On December 20, 2007, SBA published a notice extending the comment period for the proposed rule to February 29, 2008 allowing the public additional time to provide feedback. (72 FR 72264) Finally, in April 2008, SBA held public meetings on the proposed rule in eight cities nationwide to obtain a fuller understanding of the proposed rule comments. Those cities included: San Francisco, CA; Los Angeles, CA; Boston, MA; Philadelphia, PA; Atlanta, GA; Dallas, TX; Kansas City, MO; and Chicago, IL.

**II. Comments Received and Changes Made**

SBA received approximately 220 comments on the proposed regulations. One hundred and eighty-seven comments were from SBA Lenders, including approximately 100 comments from 7(a) Lenders, 80 comments from CDCs, six comments from SBA Supervised Lenders, and one comment from a Microloan Intermediary. SBA also received approximately 20 comments from non-Lenders, including five comments from trade organizations and several comments from legal and accounting professionals, consultants, and state government organizations. The remaining comments were anonymous.

Overall, both the written and oral comments were supportive of lender oversight. Commenters affirmed their support for lender oversight and recognized SBA's "substantial progress" in the audit and review process areas. Commenters agreed that many of the provisions of the proposed rule were indeed necessary. Comment discussions on individual regulations within the rule tended to be concentrated on certain specific topics (e.g., the Single Audit Act, specificity on what constitutes "satisfactory SBA performance", CDC annual report submissions, Risk Rating System implementation, and administrative appeals).

SBA appreciated the comments received and has incorporated many comment suggestions into this interim final rule. Among the provisions where SBA either adopted suggestions or made revisions are provisions on the Single Audit Act, criteria for satisfactory SBA performance, CDC annual report submissions, and Risk Rating System implementation. Comments pertaining to specific provisions are summarized below, along with any changes made to those provisions. Provisions not included in this analysis did not receive significant comments or, in most cases, received no comments; therefore they are adopted as proposed. A detailed discussion of the significant comments and changes made by section follows.

**Multiple sections—Agency Discretion.** The proposed rule included several references to SBA's "sole discretion" in Agency determinations. Approximately 130 commenters objected to this terminology. It is not uncommon for SBA to provide the public notice in its regulations as to those matters that involve some degree of Agency judgment. Some commenters were concerned that these references to "discretion" or "sole discretion" implied that the Agency could make determinations not subject to any form of review. That is simply not the case. While courts will often defer to an agency when it takes actions involving the use of agency discretion, such actions may not be arbitrary or capricious. Nevertheless, in finalizing these regulations, SBA deleted the reference to "sole" before discretion. SBA deleted the language because we do not believe that it imparted to the Agency any meaningful distinction than regular Agency discretion.

**Multiple sections—Satisfactory SBA Performance.** Approximately 125 commenters requested that SBA provide information on the factors it expects to consider in addition to the Risk Rating when evaluating satisfactory SBA performance. As stated in the preamble in the Notice of Proposed Rulemaking published October 31, 2007, 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. In response to the comments, SBA has incorporated these examples of other factors in the interim final rule.

These same commenters also requested that SBA provide the relative weight of the factors it will consider

when evaluating satisfactory SBA performance. SBA has considered these comments, but cannot publish the relative weights of the Risk Rating and any other factors it may consider in determining satisfactory SBA performance. Satisfactory SBA performance is not determined by using any arithmetic function. The weight attributed to any factor in evaluating a Lender's SBA performance may vary depending on the particular circumstances, and as a result may need to be determined on a case by case basis. However, SBA does plan to provide additional guidance in its Standard Operating Procedures (SOPs). In the public meetings, SBA requested comments regarding the consideration of contribution toward SBA mission in the determination of satisfactory SBA performance; however, no substantive comments were received. Similarly, the Agency requests comments in this interim final rule regarding how to best consider contribution toward SBA mission in the determination of SBA performance.

**Section 120.10—Definitions.** In the interim final rule, SBA has added a definition of "Lender Oversight Committee," made a technical change to the definition of "Less Than Acceptable Risk Rating" and has revised the definition for Non-Federally Regulated Lender to more closely conform to the definition in section 3(r) of the Small Business Act. (15 U.S.C. 632) SBA has also added a definition of "Person," which had previously been defined with reference to § 145.985 or its successor regulation. Section 145.985 was removed from Title 13 of the Code of Federal Regulations effective September 18, 2007, and now appears in the government-wide non-procurement debarment and suspension regulations at 2 CFR Parts 180 and 2700. Rather than reference a definition outside of 13 CFR, SBA determined to incorporate the definition of "Person" within § 120.10.

**Section 120.451—PLP Status Approvals.** The proposed rule provided that PLP status approvals and renewals would be made by the appropriate official in the Office of Capital Access in accordance with SBA's published Delegations of Authority. Some commenters requested that such approvals be made by the Director of Financial Assistance with input from the Director in the Office of Credit Risk Management and that the regulations include a specific statement to that effect. The foregoing is a matter of agency organization, procedure, and practice and as such it is appropriate for inclusion in the Agency's published Delegations of Authority. To include

such specificity in the regulations would unduly limit the Administrator's flexibility to manage internal agency procedures. Therefore, SBA is adopting § 120.451 as it was proposed.

**Sections 120.460–120.465—SBA Supervised Lender Regulation.** Approximately 70 commenters supported greater regulatory oversight for SBA Supervised Lenders in general. However, a few commenters requested that SBA reduce the reporting requirements in proposed § 120.464. SBA must have access to certain information to properly supervise SBA Supervised Lenders, and the reports required in this rule provide SBA with the needed information. SBA does understand the need to minimize Lender costs where appropriate. Consequently, the proposed rule provided for a waiver of certain reporting requirements for good cause. In addition, SBA will work to try to reduce the burden by coordinating with other bank regulators and by working with Lenders to accept electronic transmissions of the information to be collected. SBA thus specifically requests comments on how to further reduce such reporting requirements without sacrificing proper oversight.

**Section 120.463(b)—Regulatory accounting for SBA Supervised Lenders.** The interim final rule includes a technical correction in § 120.463(b). Specifically, SBA has clarified that SBA Supervised Lenders that are non-public companies must adhere to generally accepted auditing standards adopted by the American Institute of Certified Public Accountants (AICPA), and SBA Supervised Lenders that are public companies must adhere to the standards adopted by the Public Company Accounting Oversight Board (PCAOB). The PCAOB was established by the Sarbanes-Oxley Act of 2002.

**Section 120.472—Higher Individual Capital Requirement.** SBA received approximately 65 comments supporting the proposed capital requirements for Small Business Lending Companies (SBLCs). Section 120.472, based on current regulations of a Federal Financial Institution Regulator, contains six specific factors that SBA would consider in determining whether an SBA Supervised Lender should have a higher capital requirement. The commenters also suggested, however, that some of the factors that SBA listed in § 120.472 may be overly broad and vague. In particular, two factors were cited by commenters as broad or vague: management views of senior management, and other risk related factors. SBA does not agree. Examples of "management views of senior

management” and “other risk related factors” would include, for example, public announcements by management regarding the net equity value of the SBA Supervised Lender or the writedown of the value of the SBA Supervised Lender’s assets. SBA expects to provide further guidance on the factors in the SOPs.

Several commenters also suggested that the Lender Oversight Committee (LOC) rather than the Associate Administrator of Capital Access make the determination as to whether to require additional capital. The provision in proposed § 120.472 is consistent with statutory authority, which limits delegation of authority to issue a capital directive to the Associate Deputy Administrator level, retitled as the Associate Administrator level. Because it is consistent with the statute, SBA is adopting the provision as proposed.

**Section 120.826—CDC Basic Requirements.** SBA received a large number of comments on proposed § 120.826, which governs basic requirements for operating a CDC. As detailed below, comments focused mainly on subparts (b), (c), and (e): internal control requirements, annual audited financial statements, and Single Audit Act requirements.

**Section 120.826(b)—CDC Internal Control Policy.** Section 120.826(b) requires each CDC’s board of directors to adopt an internal control policy. The majority of commenters recognized the need for internal control requirements generally, but approximately 45 commenters requested that SBA consider the size and organizational structure of CDCs when reviewing compliance, particularly compliance with separation of duties requirements. Some commenters stated that SBA’s proposed internal control requirements were comparable to those of a commercial lending institution; they expressed concern that the requirements would be excessive given the generally smaller size of CDCs. In addition, several CDCs requested that SBA provide a sample internal control policy. SBA recognizes that CDCs vary in size and sophistication, and thus expects that CDCs’ levels of internal controls will vary accordingly. We believe that the proposed rule allows for such flexibility. Consequently, the provision will be adopted in this interim final rule as proposed. Nevertheless, SBA will work with representatives of the CDC industry to identify resources to assist CDCs in developing internal controls appropriate for their various sizes and structures.

**Section 120.826(c)—CDC Annual Report Submission.** In § 120.826(c), SBA

proposed requiring all CDCs to submit annual audited financial statements. Current SBA policy does not require audited financial statements from CDCs with 504 loan portfolios of less than \$20 million outstanding. Approximately 40 commenters suggested that the level of risk by CDCs with small portfolios did not justify the increase in costs associated with an annual audit. SBA has considered these comments and has decided to keep the audit requirement at the current level but retain the proposed rule’s requirement for the qualifications of the accountant as specified in § 120.826(d). Accordingly, the interim final rule has been revised to state that CDCs with portfolios of \$20 million or more in outstanding 504 loans submit audited annual financial statements, and that CDCs with portfolios of less than \$20 million submit annual financial statements reviewed by an independent CPA.

**Section 120.826(e)—Single Audit Act.** SBA received approximately 70 comments from CDCs concerning proposed § 120.826(e), which would have required not-for-profit CDCs to comply with the audit requirements contained in the Single Audit Act (31 U.S.C. 7501 *et seq.*) and OMB Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations.” Commenters were overwhelmingly opposed to this provision. Commenters argued that the Single Audit Act should not be applicable to CDCs given the unique nature of the program funding, that the audit would be duplicative of SBA’s on-site CDC reviews, and that the requirement would impose significant increases in annual audit costs. CDCs also anticipated difficulty in procuring auditors qualified to perform Single Audit Act audits, particularly for CDCs located in rural areas.

SBA consulted with OMB throughout the comment period concerning the applicability of the Single Audit Act to CDCs. OMB is responsible for providing interpretations of Single Audit Act policy requirements (stated in OMB Circular A-133), and assistance to Federal agencies to ensure uniform, effective, and efficient implementation of the Single Audit Act. In light of the more than 25 year successful history of the CDC program, the unique nature of the program funding and the CDCs’ administrative and financial role in it, and the comprehensive oversight SBA currently performs on CDCs for program compliance and results, OMB and SBA have determined that the Single Audit Act does not apply to the CDC program. SBA’s current oversight includes: Annual CDC financial reporting,

quarterly off-site monitoring of all CDCs’ portfolio performance and risk, more detailed on-site reviews of all larger CDCs and certain smaller CDCs identified as high-risk, corrective action plans for SBA findings from on-site reviews, and regular program reviews on CDC status and program compliance. This determination applies only to SBA’s CDC program; CDCs that participate in other Federal programs may still be subject to the Single Audit Act as a result of their activities in those programs. Because the Single Audit Act does not apply to SBA’s CDC program, proposed § 120.826(e) is deleted in the interim final rule.

**Section 120.830—CDC Annual Report Deadline.** SBA received approximately 75 comments regarding proposed § 120.830(a), which would have required each CDC to submit its annual report to SBA within 90 days after the end of the CDC’s fiscal year. Commenters were unanimously opposed to this proposed provision, and recommended that SBA keep the current report submission deadline of 180 days. Some commenters stated that accelerating the report submission deadline would create a financial hardship, particularly for smaller rural CDCs with limited access to auditors. Other commenters noted that some CDCs have a lengthy and complex audit process because they are part of larger organizations, such as councils of governments. Numerous CDCs stated that their fiscal year ends in September, which is a very busy time for CPA firms. Finally, many commenters noted that SBA had a 90 day reporting deadline prior to 2003, when the deadline was extended to 180 days in order to permit CDCs more time to provide financial statements with the required level of review. SBA has considered these comments, and has decided not to adopt proposed § 120.830(a); the CDC annual report submission deadline will remain unchanged at 180 days. In addition, § 120.830(a) has been revised to reflect the different reporting requirements for audited and reviewed financial statements.

**Section 120.1005—Bureau of PCLP Oversight.** Section 120.1005, which establishes the Bureau of PCLP Oversight, received a large amount of support from commenters. SBA received approximately 50 comments in favor of the proposed provision. In addition, approximately 55 commenters suggested that the Bureau of PCLP Oversight conduct random audits of loans submitted by PCLP CDCs to ensure compliance with SBA policies and regulations, particularly environmental and appraisal report documentation

requirements. SBA has reviewed these comments and is considering conducting audits of PCLP CDC loans through the Bureau of PCLP Oversight or otherwise. Section 120.1005 is adopted as proposed.

**Section 120.1015—Risk Rating System.** SBA received approximately 170 comments on proposed § 120.1015, which incorporates SBA's Risk Rating System into the loan program regulations. Commenters questioned the incorporation of the Risk Rating System into SBA's regulations at this time, citing concerns regarding the effectiveness and appropriateness of using this sophisticated tool developed by private sector leaders to evaluate business loan portfolios. Many commenters also noted that the Risk Rating System has not yet been through an entire economic cycle. In addition, approximately 100 commenters requested that SBA obtain third-party validation of the Risk Rating System.

These commenters also objected to incorporation of the Risk Rating System into certain specific provisions of the proposed regulations. Multiple proposed provisions contained the requirement that a Lender have or maintain "satisfactory SBA performance," which SBA proposed to determine by considering the Lender's Risk Rating, among other factors. Specifically, SBA proposed to incorporate "satisfactory SBA performance," and thus the Risk Rating, in the following proposed provisions: § 120.410(a), Requirements for all participating Lenders; § 120.424(b), What are the basic conditions a Lender must meet to securitize?; § 120.433(b), What are the SBA's other requirements for sales and sales of participating interests?; § 120.434(c), What are SBA's requirements for loan pledges?; § 120.451(b)(3), How does a Lender become a PLP Lender?; § 120.630(a)(5), Qualifications to be a Pool Assembler; § 120.710(e)(1), What must an Intermediary demonstrate to get a reduction in Loan Loss Reserve Fund?; § 120.812(c), Probationary period for newly certified CDCs; § 120.820(c), CDC non-profit status and good standing; § 120.839, Case-by-case application to make a 504 loan outside of a CDC's Area of Operations; and § 120.841(c), Qualifications for the ALP.

SBA has considered these comments. We believe, however, that the Risk Rating System is a reasonable internal tool for assessing portfolio risk, because it incorporates past, present, and future predictive performance to rate Lenders' relative risk to SBA and provides SBA with a comprehensive risk management tool previously unavailable to the

Agency. The Risk Rating System was developed with the assistance of Dun & Bradstreet and Fair Isaac, private industry leaders in predictive modeling and risk rating systems. These companies have performed annual validation testing at both the loan and Lender level since 2004. In addition to the validation testing, SBA has provided to Lenders and trade groups data demonstrating the correlation between the Risk Ratings and portfolio risk factors in various presentations given between May and September, 2008. We note that SBA may amend the Risk Rating System from time to time. Any such amendments will be published in the **Federal Register**. We also note that a Lender's Risk Rating will be used in combination with other factors when evaluating satisfactory SBA performance and that SBA does not expect that the Risk Rating would be the sole basis for taking enforcement action. The relevant provisions of this interim final rule have been revised to reflect this expectation. Conversely, a good Risk Rating does not preclude SBA from taking actions based on other factors or grounds. Therefore, SBA is adopting § 120.1015 as proposed.

**Section 120.1050—On-Site Review/Exam Responses.** SBA received seven comments on § 120.1050, which describes SBA's on-site examinations of SBA Supervised Lenders and on-site reviews of the SBA operations of SBA Lenders. Two commenters stated that SBA on-site reviews are duplicative of the safety and soundness reviews already conducted by Federal regulators. One of these commenters stated that its Federal financial regulator examines the Lender's SBA portfolio for safety and soundness, although the regulator does not look at compliance with SBA program regulations and policies. SBA has considered these comments, but believes that its on-site reviews and examinations are a critical component of Lender oversight, and are necessary to ensure the continued integrity of SBA's lending programs. SBA notes that other Federal credit guaranty agencies perform similar reviews of their lenders and the management of the agencies' guaranteed loan portfolios. Furthermore, to SBA's knowledge, the Federal financial regulators do not perform an equivalent review of SBA loan portfolios during safety and soundness reviews. SBA will, however, continue to make efforts to coordinate its oversight with other bank regulators. If SBA is able to leverage the efforts of Federal bank regulators in the future, it could lead to a more streamlined review by SBA. Therefore

§ 120.1050 remains unchanged from the proposed regulation.

**Section 120.1060—Confidentiality of Reports, Risk Ratings and Related Confidential Information.** SBA received approximately 50 comments on § 120.1060, SBA's confidentiality provision for Risk Ratings, review and examination reports, and other related confidential information. Although all of the commenters supported confidentiality requirements generally, some commenters thought that the requirements in proposed § 120.1060 were too restrictive. These commenters recommended modifying § 120.1060 to allow Lenders to share "general information" on their review and examination results with other Lenders and trade organizations in order to develop industry best practices. SBA has considered these comments and recognizes the commenters' desire to develop best practices. SBA believes, however, that allowing Lenders to share "general" review and examination report information is too indefinite a standard, and would increase the risk that confidential information would be disclosed to the public. Alternatively, SBA will seek to share best practices with trade organizations and Lenders using aggregate information obtained from Lender review and examination reports. Therefore, § 120.1060 is adopted as proposed.

**Section 120.1400—Grounds for Enforcement Actions—SBA Lenders.** SBA received comments on several provisions of proposed § 120.1400, which details the grounds for enforcement actions against SBA Lenders; these comments are detailed below.

**Section 120.1400(a)—Grounds for enforcement actions—Agreement.** Some commenters objected to 120.1400(a) because it references Form 750, the SBA Loan Guaranty Agreement. These commenters argued that the Agreement is out of date and, therefore, should not be referenced. SBA disagrees with the comment that the form should not be referenced. The Form 750 contains the Lender's agreement to participate in SBA programs in accordance with program rules and regulations, and every 7(a) Lender has executed a Form 750.

**Section 120.1400(b)—Grounds for enforcement actions—Scope.** Approximately 85 commenters requested that § 120.1400(b), which defines the scope of the regulation, be clarified. In response to the comments, SBA has revised subsection (b) for clarity.

**Section 120.1400(c)—Grounds for enforcement actions—Grounds in**

*General.* Subsection (c) lists twelve enforcement grounds that generally apply to all SBA Lenders. Some commenters were concerned that the enforcement grounds did not provide a degree of certainty regarding which enforcement grounds would trigger particular enforcement actions. SBA believes that enforcement actions will depend upon the particular facts and circumstances of individual cases; therefore SBA cannot be constrained to a one size fits all approach to application of enforcement actions. However, SBA does plan on providing additional enforcement action guidance through SBA's SOPs.

SBA also received approximately 90 comments on § 120.1400(c)(4), which describes failure to lend in a commercially reasonable and prudent manner, evidence of which may include, but is not limited to, the SBA Lender having a repeated Less Than Acceptable Risk Rating or an on-site review/examination assessment which is Less Than Acceptable. Commenters requested that SBA specify how many low Risk Ratings a Lender could be assigned before it would be subject to an enforcement action. Commenters also stated that an enforcement action should not be taken based solely on a single Less Than Acceptable on-site review/examination assessment. SBA has considered these comments. The Less Than Acceptable Risk Ratings or on-site review/examination assessments reflect the particular facts and circumstances of individual cases. Sometimes the risk can be addressed solely through Lender corrective actions; sometimes other action must be taken. SBA must have the flexibility to take actions appropriate to the particular risk evidenced by Less Than Acceptable Risk Ratings and/or on-site review/assessments. Therefore, SBA is reluctant to set a specific number of low risk ratings or Less Than Acceptable on-site assessments to trigger enforcement action. However, as noted above, SBA does not anticipate using the Risk Rating System as the sole basis for taking enforcement actions against SBA Lenders, and has modified § 120.1400(c)(4) accordingly.

These same commenters also opposed the use of "repeated Less Than Acceptable Risk Ratings" as a possible enforcement ground in § 120.1400(c)(9). SBA has considered these comments, and § 120.1400(c)(9) has also been modified to conform to the change in § 120.1400(c)(4).

Finally, SBA received approximately 90 comments on proposed § 120.1400(c)(6), which gives SBA authority to take possible enforcement

action if it determines that a Lender is "engaging in a pattern of uncooperative behavior" or taking an action that is "detrimental to an SBA program, that undermines management or administration of a program, or that is not consistent with standards of good conduct." This language was based on current language in the CDC regulations. Commenters stated that this provision is overly broad, and requested that SBA give examples of the types of behavior that might trigger an enforcement action under this provision. One commenter also requested that, prior to taking enforcement action against a Lender, SBA provide notice to the Lender explaining why the Lender's actions were uncooperative, detrimental to the program, undermined SBA's management of the program, or were not consistent with standards of good conduct prior to enforcement. In response, SBA is providing examples of the types of behavior that may trigger this provision. Those behaviors include, but are not limited to, refusal to implement actions to correct material weaknesses found in on-site reviews/assessments, and failure to carry out an approved plan to correct material weaknesses identified in an on-site review/assessment before a new on-site review/assessment is conducted. As for the additional notice, SBA has added language to the interim final rule providing such notice prior to enforcement.

*Section 120.1400(d)(5)—Grounds for enforcement actions—Grounds required for certain enforcement actions against SBA Supervised Lenders (except Other Regulated SBLCs) or, as applicable, Other Persons—For transfer of loan portfolio.* SBA has made a clarification to § 120.1400(d)(5)(i) consistent with statutory authority. 15 U.S.C. 650(i). Specifically, we revised the "and" in subparagraph "i" to read as an "or".

*Section 120.1425(c)(2)—Grounds for enforcement actions—Intermediaries participating in the Microloan Program and NTAPs—Grounds in general.* Section 120.1425(c)(2)(viii) has been modified to conform with the changes in § 120.1400(c)(4) and (9) and reflect that SBA does not anticipate using the Risk Rating System as the sole basis for taking enforcement actions against Intermediaries or NTAPs.

*Section 120.1500(a)(1)—Portfolio Guaranty Dollar Limit.* SBA received several comments requesting clarification of § 120.1500(a)(1), SBA's proposed portfolio guaranty dollar limit enforcement action. The commenters requested that SBA clarify whether the guaranty limit applies to the total dollars of SBA loans or debentures

guaranteed for an SBA Lender, or whether it restricts the maximum dollar amount on individual loans or debentures a Lender may make. SBA intended § 120.1500(a)(1) to apply only to the total dollars of SBA loans or debentures guaranteed for an SBA Lender. SBA is adopting § 120.1500(a)(1) as proposed.

*Section 120.1500(a)(3)—Continuing Guaranty.* Approximately 80 commenters supported § 120.1500(a)(3), which provides that the suspension or revocation of a Lender from an SBA program will not invalidate a guaranty previously provided by SBA. These commenters further recommended that this provision be moved to the introductory paragraph to § 120.1500, so as to apply to all enforcement actions, not just non-immediate suspensions or revocation. SBA has considered these comments, and agrees that the provisions should apply to all enforcement actions. We have therefore moved the provision to the beginning of the text, and clarified that an enforcement action, by itself, would not invalidate a guaranty previously provided by SBA.

*Section 120.1500(b)—Secondary Market Suspension.* SBA received approximately 90 comments opposing secondary market suspension as an available enforcement action. As stated in the proposed rule preamble, SBA is including this enforcement provision as a means of limiting an SBA Lender's risk exposure to SBA and the Secondary Market. Commenters contended that many Lenders are reliant on access to the Secondary Market in order to continue their 7(a) lending activities, and that such a suspension or revocation "is tantamount to a program suspension or termination." Many commenters also questioned the need for SBA to provide additional protection to the Secondary Market, because "purchasers in the Secondary Market conduct extensive due diligence." Finally, numerous commenters questioned SBA's need to protect itself from an SBA Lender's risk exposure, noting that the Agency has "very little risk of loss" because Lenders are ultimately responsible for their loans if SBA determines the need to repair or deny liability.

SBA has considered these comments, and recognizes that suspension or revocation of authority to sell or purchase loans or certificates in the Secondary Market could have very serious implications for certain 7(a) Lenders. Nonetheless, SBA has a responsibility to protect the integrity of the Secondary Market, whose operation is contingent upon SBA's full faith and

credit guaranty. SBA must also mitigate the risk to the Agency. SBA disagrees with the contention that the Agency has little risk of loss due to the Lender's responsibility to SBA in the case of a repair or denial of liability. If SBA has previously honored its guaranty to a holder in the Secondary Market, SBA is subject to risk that it will not be able to recoup funds from the SBA Lender, particularly if the SBA Lender is insolvent. Furthermore, for some SBA Lenders, Secondary Market Suspension may be preferable as an alternative to suspension or revocation of the SBA Lender's authority to participate in the SBA program. Therefore, § 120.1500(b) is adopted in the interim final rule as proposed.

**Section 120.1600 (a)(3)—Enforcement Procedures—SBA Timeframes.** Approximately 90 commenters requested that SBA give a definitive time period for rendering a decision in enforcement actions in order to allow the affected Lender to plan its SBA operations with some degree of certainty. The majority of these commenters recommended that SBA adopt a 60-day response time. Commenters also requested that SBA adopt an Agency response deadline of 30 days instead of the 90-day deadline proposed by SBA on immediate suspensions.

SBA recognizes the need for SBA Lenders, Intermediaries, and NTAPs (non-lending technical assistance providers) to plan their future SBA operations with certainty. SBA also recognizes the need for the Agency to provide an expeditious response, particularly when an immediate suspension has been put into effect. But

SBA must balance this against the time needed to make the appropriate decision. SBA will make every effort to issue final enforcement decisions as quickly as possible and has decided to adopt a 30-day deadline (unless SBA provides notice that it requires additional time) for the final decision in the case of an immediate suspension and a 90-day deadline (unless SBA provides notice that it requires additional time) for final decisions for all other enforcement actions. We note that consideration of additional information (e.g., information provided by the Lender subsequent to objection) may extend the deadline accordingly.

**Section 120.1600(a)(5)—Enforcement Procedures—Administrative Appeals Process for SBA Lenders, Intermediaries, and NTAPs.** In general, proposed § 120.1600(a)(5) provided SBA Lenders, Intermediaries, and NTAPs streamlined enforcement appeal rights direct to Federal district court rather than requiring that Lenders first go through SBA's administrative appeals process. Many commenters requested that SBA incorporate an administrative appeals process within SBA's enforcement procedures framework citing cost concerns.

SBA has considered these comments and considered the possibility of incorporating an administrative appeals process for enforcement decisions, including to the Office of Hearings and Appeals (OHA). However, SBA has concluded that a direct appeal to Federal district court will, on balance, be a more efficient and cost-effective process for Lenders to utilize. For example, Lenders would be able to seek immediate injunctive relief from the

Federal district courts, whereas OHA does not have the authority to issue injunctive relief. The Lender could lose valuable time and incur greater expense if it had to pursue its appeal through OHA before it could seek injunctive relief from the Federal courts. In reaching its conclusion, SBA has also considered the fact that SBA's enforcement decision will have been based on multiple levels of administrative review, including in most cases the independent Lender Oversight Committee. In addition, the extensive due process provisions of Section 1600 include notice and an opportunity to object.

**Section 120.1600(b)—Enforcement Procedures—Administrative Appeals Process for SBA Supervised Lenders, Management Officials and Other Persons.** SBA has made technical changes to § 120.1600(b)(1)(i) and (b)(3)(i) to clarify that administrative hearings under these subparagraphs, which are specifically required by the Small Business Act, will be conducted by SBA's Office of Hearings and Appeals in accordance with 15 U.S.C. 650 and applicable sections of Part 134 of SBA regulations.

**III. Chart of Regulations Relocated**

Some of the regulations promulgated in this interim final rule were relocated from other sections within Part 120. 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. See below chart of regulations relocated.

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).

CHART OF REGULATIONS RELOCATED—Continued

Current regulatory citation	Regulation subject matter	Proposed regulatory citation
§ 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).

**IV. Justification for Interim Final Rule**

SBA finds that good cause exists to publish this rule as an interim final rule. As discussed above, SBA previously published a Notice of Proposed Rulemaking (NPRM) addressing all of the topics and issues covered by this interim final rule. SBA has already allowed for public comment, reviewed the comments and made changes accordingly. SBA has determined that the changes made in this rule are a logical outgrowth of the proposed rule and the comments received on the proposed rule. Procedurally, SBA could therefore issue a final rule; however, SBA is publishing this rule interim final rather than proceeding to a final rule in order to provide the public with an additional opportunity to comment.

SBA has a statutory obligation to implement a Lender Oversight Program and it is critically important during the current financial crisis that a proper oversight program is in place. Any delay in promulgation could be prejudicial to the integrity of the program and could potentially result in additional losses to the American taxpayers. SBA is requesting additional public comments in order to further shape the program. Publishing this rule as interim final allows for any needed adjustments as the industry moves through the economic cycle.

SBA invites comments from all interested members of the public. These comments must be received on or before the close of the comment period noted in the **DATES** section of this interim final rule. SBA may then consider these comments in making any necessary revisions to these regulations.

*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*

This rule incorporates SBA’s risk-based lender oversight program into SBA regulations. Specifically, the rule codifies 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 rule also consolidates and lists the types of, grounds for, and procedures governing SBA enforcement actions within Subpart I. This rule is a necessary first step to provide coordinated and effective oversight of financial institutions that originate and manage SBA guaranteed loans.

These regulatory changes will 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, excluding SBA Supervised 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.

During the comment period, one comment was received questioning whether the Baseline Costs for SBLCs were estimated too low. However, no information was provided regarding which specific component(s) of the estimate were of concern. SBA considers the information it received directly from selected SBLCs during development of the rule to be most applicable; therefore, the SBLC baseline costs estimate remains unchanged from the proposed rule.

### 3. Baseline Costs for NFRLs

No direct costs are currently incurred by NFRLs for SBA oversight and related functions discussed in this 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 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. Benefits and Costs of the Rule

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

The rule benefits SBA Lenders, Microloan Intermediaries, and NTAPs by generally consolidating oversight authority and responsibility within one SBA office, OCRM. These institutions 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 rule. They further benefit from performance feedback to the extent it assists them in improving their SBA operations and minimizing losses.

While there are specific benefit and cost 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 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. Benefits and Costs of the Rule to 7(a) Lenders (Other Than SBLCs and NFRLs)

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

SBA received approximately 90 comments requesting that SBA include

cost estimates of appealing proposed enforcement actions to a Federal district court rather than SBA's Office of Hearings and Appeals (OHA). The Agency does not currently have data that would enable it to provide a reasonably accurate estimate of Lenders' costs for appealing such actions through the judicial process. SBA is also unable to extrapolate from data on the costs of appealing to OHA because although that process is currently available, the process has been used rather infrequently and any such extrapolation would be unreliable. SBA is willing to consider comments from Lenders that would enable the agency to obtain the relevant costs data.

SBA also received one request for estimates of the costs that could be incurred in connection with possible enforcement actions included in § 120.1500 of the interim final rule. SBA is unable to estimate the cost of appealing or responding to potential enforcement actions SBA might take, because the type of enforcement action and steps necessary to correct a deficiency will vary based on the specific deficiency and characteristics and situation of the particular Lender. SBA is willing to consider comments from Lenders that would enable the agency to obtain the relevant costs data.

#### 3. Benefits and Costs of the Rule to SBLCs

The rule provides for more developed internal control requirements and adoption of a formal capital plan. It requires 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, there is little or no additional cost for these new requirements. Preparation and submission of all the additional reports and the new recordkeeping takes 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 is \$5,460 (\$390 × 14) for 14 SBLCs.

#### 4. Benefits and Costs of the Rule to NFRLs

The rule requires each NFRL to submit an annual report, including

audited financial statements within three months after the close of each fiscal year. The rule further requires that all audited financial report filings are prepared in accordance with Generally Accepted Accounting Principles (GAAP), and include an opinion from the independent accounting firm engaged in the audit. It also requires 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 rule requires 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 information likely already maintained by the NFRLs for operational, and in some instances financing, purposes. Preparation and submission costs are 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. Additional reporting and recordkeeping requirements to the NFRLs (that which would be new to SBLCs as well) are 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 rule for the 58 NFRLs is \$602,620 (\$10,390 × 58 NFRLs).

#### 5. Benefits and Costs of the Rule to CDCs

Approximately 70 commenters requested that SBA include an estimate for the cost of CDCs' compliance with the Single Audit Act requirements. SBA

and OMB have determined that the Single Audit Act does not apply to SBA's 504 program; therefore, cost estimates of Single Audit Act compliance are unnecessary.

SBA also received several comments from CDCs requesting estimates of the costs of implementing the internal control requirements contained in § 120.826(b). Because most CDCs likely already maintain internal controls for operational purposes, and because the interim final rule allows for flexibility in the internal control structure of CDCs with varying size and sophistication, SBA estimates little or no additional cost for the requirements.

SBA did not adopt the proposed 90-day annual report filing deadline or the proposed requirement that all CDCs obtain audited financial statements in the interim final rule; therefore, the rule does not implement any significant changes to CDC operations or management. Thus, there are no additional costs of the rule and no substantive alteration of Baseline Costs for CDCs outlined in paragraph 4 of section B.

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

No additional direct costs are incurred by Microloan Intermediaries and NTAPs for lender oversight and related functions in this rule, because no additional reporting is required. Furthermore, general oversight, suspension and revocation already existed in former § 120.716 and remains the same when relocated within subpart I, and no additional reporting is required by this rule.

#### 7. 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 also benefits from having more timely and complete operations information, including financial information for SBA Supervised Lenders. In addition, the Agency benefits from further consolidated standards, enforcement grounds, ranges of enforcement actions and procedures for supervision and enforcement actions for many SBA Lenders, Microloan Intermediaries and NTAPs. Finally, the rule's additional requirements and lender oversight provisions 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 rule, and therefore no

additional direct costs for assessment of any such reporting are incurred by SBA for provisions related to oversight functions in this proposed rule.

For SBLCs, the rule requires 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 rule requires an additional 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 rule is 464 hours for \$25,520.

For CDCs, baseline costs remain unchanged for the Federal government. Baseline costs remain \$14,850 (1 hr per CDC).

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

Any additional indirect costs to the Federal government for oversight of the SBA Lenders, Microloan Intermediaries, and NTAPs under this rule are covered by the already-existing OCRM infrastructure.

#### 8. Cost Basis

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

#### D. Alternatives

SBA believes that this 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 believes that there are no other potentially effective and reasonably feasible alternatives to this rule as it applies to SBA Lenders, Microloan Intermediaries, and NTAPs.

*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 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. This rule does not have retroactive or pre-emptive effect.

*Regulatory Flexibility Act:* This rule directly affects all SBA Lenders, Microloan Intermediaries, and NTAPs. There are approximately 4,500 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 \$7 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 \$175 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 541990 is \$7 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 rule will have an impact on a substantial number of small entities. However, for the reasons explained following, SBA does not believe that the rule will have a significant economic impact on those entities.

The rule contains 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 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 \$7 million or less in annual revenues. The remaining NFRLs are classified under NAICS 522110, Commercial Banking, which

has a small business size standard of \$175 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 statements, 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 rule impacts a substantial number of these small entities, but does not constitute a significant economic impact, as detailed below.

The 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 rule also provides 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 rule requires both NFRLs and SBLCs to provide the SBA with copies of their financial statements on a quarterly basis and expands 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 rule expands the number of firms subject to SBA's capital regulation by making NFRLs subject to certain capital regulations. The rule also requires 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 or her staff under the 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. SBA has estimated 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 is 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 rule does 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, (3) summaries of changes in the SBLCs organization and financing, (4) notice of capital impairment, and (5) such other reports it is required by SBA to furnish on a specific matter. The rule extends 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 rule 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 rule. SBA, therefore, certifies that this aspect of the rule does not have a significant economic impact on a substantial number of small entities.

The new reporting and recordkeeping requirements in the rule for SBA Supervised Lenders that have not yet been discussed 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 do not have a significant economic impact on a substantial number of small entities.

The rule does not require any new financial or other reporting from CDCs. SBA certifies that this aspect of the rule does not 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 rule requires quarterly compliance by SBLCs with their respective minimum capital requirements. It also requires 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 rule broadens 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 has no adverse financial impact on small Lenders. In fact, allowing retained earnings to count toward an SBA Supervised Lender's regulatory capital allows 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 does not have a significant economic impact on a substantial number of small entities.

**C. Enforcement Provisions:** The rule consolidates and lists the types of, grounds for, and procedures governing SBA enforcement actions within

consolidated enforcement regulations for all SBA Lenders, Microloan Intermediaries, and NTAPs. The enforcement provisions specific to 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 will 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 rule does not have a significant impact on a substantial number of small entities.

**D. Bureau of PCLP Oversight:** The Bureau of PCLP Oversight has been established in accordance with statutory guidance to address the LLRFs of Premier Certified Lenders (PCLP CDCs). Of the approximately 270 CDCs, approximately 25 of them have PCLP authority. These are generally the larger CDCs, with portfolios which have a total outstanding portfolio balance of \$7.9 billion. SBA, therefore, certifies that the rule's Bureau of PCLP Oversight provision does not have a significant impact on a substantial number of small entities.

**Paperwork Reduction Act:** SBA has determined that this rule imposes additional reporting and recordkeeping requirements under the Paperwork Reduction Act, 44 U.S.C. Chapter 35. Specifically, SBA is revising OMB approved information collection number 3245–0077 to include NFRLs in SBA's current reporting requirements for SBLCs. SBA is also revising 3245–0077 to add four reporting requirements for all SBA Supervised Lenders and one reporting requirement just for SBLCs. Finally, the rule adds a review/examination reporting requirement.

SBA received several comments from the public on the information collections added by this rule, including several on the costs of complying with the new or expanded reporting requirements. SBA's responses to these comments are discussed in detail in the comment section of the preamble, and in the Executive Order 12866 regulatory impact analysis section. As a result of comments received, SBA has modified the proposed reporting requirements. Specifically, SBA will not require all CDCs to submit annual audited financial statements; rather, this requirement will continue to apply to only those CDCs with a loan portfolio balance of \$20 million or more. All other proposed collections of information are adopted as proposed and have been submitted to OMB for final review and approval. The

titles, authority, descriptions of respondents, descriptions of each information collection, needs and purposes for the collections, and the estimated annual cost and hour burdens imposed on Lenders as a result of these collections are outlined below.

### **I. SBA Supervised Lender Reporting and Recordkeeping Requirements**

OMB approved information collection number 3245–0077, Reports to SBA: Provisions of 13 CFR 120, is revised to include these additional reporting and recordkeeping requirements 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 consist of all SBA Supervised Lenders. Currently there are approximately 75 such Lenders—(14 SBLCs and 58 NFRLs).

**Statement of Needs and Purposes:** The reports and recordkeeping requirements facilitate safety and soundness examinations and appropriate supervision of SBA's licensed SBLCs and NFRLs. Annual and interim financial information is 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 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, can intervene (where appropriate) to protect the interests of the United States.

**Estimated Cost to Respondents:** SBA estimated a cost of \$10,340 per SBA Supervised Lender (or approximately \$744,480 for all SBA Supervised Lenders) to comply with the below listed information collections. The \$10,340 per SBA Supervised Lender includes \$8,000 for the annual report audit (80 hours × \$100 per hour) plus \$2,340 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 \$624,480 increase from the current OMB approved collection is mainly attributable to the extension of the information collection to the 58 NFRLs; 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.

### **Description of Reporting and Recordkeeping Requirements**

#### *A. Annual Audit Report [No SBA Form Number]*

*Summary:* The Annual Audited Report primarily consists of an SBA Supervised Lender's annual audited financial statements. The Annual Report is 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 submits 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 § 120.464(a)(4), all SBA Supervised Lenders are required to submit to SBA copies of any report or publications concerning financial operations furnished to their stockholders.

#### *D. Report of Changes [No SBA Form Number]*

*Summary:* Under § 120.464(a)(5), all SBA Supervised Lenders are 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:* Section 120.462(d) requires all SBA Supervised Lenders to provide SBA prompt written notice of capital impairment.

#### *F. Other Reports [No SBA Form Number]*

*Summary:* Section 120.464(a)(7) requires 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 § 120.464(a)(2), all SBA Supervised Lenders are 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 includes the SBA Supervised Lender's interim financial statements, which may be internally prepared. SBA Supervised Lenders are required to apply uniform definitions to categories of nonperforming loans and recovery amounts on liquidated loans within the reports. The Quarterly Condition Report also contains a certification by the SBA Supervised Lender as to compliance with laws, completeness, and accuracy and may contain the certification as to capital requirement compliance.

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

*Summary:* Section 120.464(a)(6) requires 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:* Section 120.463(d) requires SBA Supervised Lenders to notify SBA in writing if they discharge or change auditors.

#### *J. Capital Restoration Plan [No SBA Form Number]*

*Summary:* Section 120.462(e) requires 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:* Sections 120.1510 and 120.1511 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 also requires 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:* Section 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:* Section 120.462 requires SBA Supervised Lenders' Board of Directors to determine capital adequacy goals and to establish, adopt, and maintain a capital plan.

### **II. SBA Lender, Microloan Intermediary, and NTAP Reporting Requirements**

These are new reporting and recordkeeping requirements.

#### *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 are SBA Lenders, Microloan Intermediaries, and NTAPS.

*Need and Purpose:* Section 120.1025 of this rule provides that "SBA may conduct off-site reviews and monitoring \* \* \* including SBA Lenders', Intermediaries', or NTAPS' self-assessments." Generally, SBA will 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.

*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.

#### *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 consist of SBA Lenders, Microloan Intermediaries, and NTAPs that receive an onsite review or examination assessment of Acceptable With Corrective Actions Required or Less Than Acceptable, or as otherwise required by SBA.

*Need and Purpose:* Section 120.1055 provides that SBA Lenders, Microloan Intermediaries, and NTAPs must submit proposed corrective action plans, if requested. The reports facilitate corrective action to address SBA Lender, Microloan Intermediary, or NTAP deficiencies identified generally during reviews and examinations.

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

Loan programs—business, Small businesses.

■ For the reasons set forth above, SBA amends 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 Institution Regulator”, “Lender Oversight Committee”, “Less Than Acceptable Risk Rating”, “Management Official”, “Non-Federally Regulated Lender”, “Other Regulated SBLC”, “Person”, “Risk Rating”, “SBA Lender”, “SBA Supervised Lender”, and “Small Business Lending Company” in alphabetical order, and removing the definition for “Lender” and adding in its place a definition of “Lender or 7(a) 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.

*Lender Oversight Committee* is a committee within SBA, with responsibilities as outlined in Delegations of Authority, as published in the **Federal Register**.

*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 a higher 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 regulated 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.

*Person* is any individual, corporation, partnership, association, unit of government, or legal entity, however organized.

*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 a Small Business Lending Company or 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 discretion. The 7(a) Lender’s Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and information (such as contribution toward SBA mission);

(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 discretion) and, as applicable, with an SBA Lender’s state regulator and 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 discretion;

(b) Have satisfactory SBA performance, as determined by SBA in its discretion. The Lender’s Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and

information (such as contribution toward SBA mission);

\* \* \* \* \*

**§ 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’s 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 discretion;

(b) The Lender has satisfactory SBA performance, as determined by SBA in its discretion. The Lender’s Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and information (such as contribution toward SBA mission); 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 discretion;

(c) The Lender has satisfactory SBA performance, as determined by SBA in its discretion. The Lender’s Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other

performance related measurements and information (such as contribution toward SBA mission);

\* \* \* \* \*

■ 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 discretion. The Lender’s Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and information (such as contribution toward SBA mission).

\* \* \* \* \*

(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 the 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 are 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.* (1) 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:

- (i) Management capability;
- (ii) Quality of operating policies, procedures, and internal controls;
- (iii) Quality and quantity of earnings;
- (iv) Asset quality and the adequacy of the allowance for loan losses within the loan portfolio;
- (v) Sufficiency of liquidity; and
- (vi) Any other risk-oriented activities or conditions that warrant additional capital (e.g., portfolio growth rate).

(2) 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 SBLCs 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 SBLCs 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 accordance with Delegations of Authority in writing, an SBA Supervised Lender may not present any loans to SBA for guaranty 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 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 discretion within the required timeframe, or fails to implement, in any material respect as determined by SBA in its 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) for non-public companies and by the Public Company Accounting Oversight Board (PCAOB) for public companies. 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 certified 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 an 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 this part 120;
- (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 this part 120, 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 principals, 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 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. The 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 the SBA Supervised Lender did not submit a required report by the due date.

(e) *Extensions of submission due dates.* (1) An 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 discretion. SBA will consider the following factors in determining willful neglect:

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

(ii) If SBA provided the SBA Supervised Lender notice of the failure to file and the 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 the 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 the 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 the SBA Supervised Lender has demonstrated to SBA's satisfaction that it has modified its internal procedures to comply with reporting requirements in the future; and

(iii) Whether the 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, the 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's original request. SBA will not consider untimely requests. The 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, the 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.* Civil penalties under this section 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 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 paragraph (f) of this section, 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 § 120.10 of this chapter). 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 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 the individual minimum capital requirement for the SBLC, the date when the individual minimum must be achieved, and/or 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.

■ 32. 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.

■ 33. 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 discretion. The Lender's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and information (such as contribution toward SBA mission).

\* \* \* \* \*

■ 34. 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.

\* \* \* \* \*

■ 35. 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 discretion. The Intermediary's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and information (such as contribution toward SBA mission); and

\* \* \* \* \*

**§ 120.716 [Removed]**

■ 36. Remove § 120.716.

■ 37. Amend § 120.812 to add three new sentences 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 discretion. The CDC's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and information (such as contribution toward SBA mission).

\* \* \* \* \*

■ 38. 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 discretion. The CDC's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and information (such as contribution toward SBA mission).

■ 39. Revise § 120.826 to read 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/Reviewed Financial Statements.* Each CDC with a 504 loan portfolio balance of \$20 million or more (as calculated by SBA) 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 GAAP. For CDCs with a 504 portfolio balance of less than \$20 million (as calculated by SBA), the CDC's annual financial statements submitted to SBA must be reviewed by an independent CPA in accordance with GAAP.

(d) *Auditor qualifications.* The audit or review 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.

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

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

\* \* \* \* \*

(a) An annual report within one hundred-eighty days after the end of the CDC's fiscal year (to include audited or reviewed financial statements of the CDC, as applicable, 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.

(1) The audited financial statements must, at a minimum, include the following:

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

(2) The reviewed financial statements must, at a minimum, include the following:

- (i) Balance sheet;
- (ii) Statement of income (or receipts) and expense;
- (iii) Statement of source and application of funds;
- (iv) Such footnotes as are necessary to an understanding of the financial statements; and
- (v) The accountant's review report.

\* \* \* \* \*

■ 41. Amend § 120.839 to add three 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 discretion. The CDC's Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and information (such as contribution toward SBA mission). \* \* \*

\* \* \* \* \*

■ 42. 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 discretion. The CDC’s Risk Rating, among other factors, will be considered in determining satisfactory SBA performance. Other factors may include, but are not limited to, 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, and other performance related measurements and information (such as contribution toward SBA mission);

\* \* \* \* \*

■ 43. 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.

\* \* \* \* \*

■ 44. Remove the undesignated center heading before § 120.853.

■ 45. 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.**

\* \* \* \* \*

■ 46. Remove the undesignated center heading before § 120.854.

**§ 120.854 [Removed]**

■ 47. Remove § 120.854.

**§ 120.855 [Removed]**

■ 48. Remove § 120.855.

**§ 120.856 [Removed]**

■ 49. Remove § 120.856.

■ 50. 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.

■ 51. 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**

**§ 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; and
- (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 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 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, the SBA Lender, Intermediary, or NTAP must detail: The steps it will take to correct the finding(s); the time within which each step will be taken; the timeframe for accomplishing the entire corrective action plan; and the person(s) or department at the SBA Lender, Intermediary, or NTAP charged with carrying out the corrective action 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 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 discretion, then SBA may take enforcement action under § 120.1500 through § 120.1540. 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 through § 120.1540.

#### **§ 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 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. Each 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 from and against any and all claims, demands, suits, actions, and liabilities to any degree based upon or resulting from any unauthorized use or disclosure of the Report, Risk Rating, or Confidential Information. Information Provider contact information is available from the Office of Capital Access.

■ 52. 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 Types of enforcement actions—SBA Lenders.
- 120.1510 Other Regulated SBLCs.
- 120.1511 Certification and other reporting and notification requirements for Other Regulated SBLCs.
- 120.1540 Types of 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. Paragraphs (c) through (e) of this section list the grounds that trigger enforcement actions against each

type of SBA Lender. In general, the grounds listed in paragraph (c) apply to all SBA Lenders. However, certain enforcement actions against SBA Supervised Lenders require the existence of certain grounds, as set forth in paragraphs (d) and (e). In addition, paragraph (f) of this section lists two additional grounds for taking enforcement action against CDCs that do not apply to other SBA Lenders.

(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, 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 Less Than Acceptable Risk Rating (generally in conjunction with other evidence) or an on-site review/examination assessment which is Less Than Acceptable;

(5) Failure within the 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. Prior to issuing a notice of a proposed enforcement action or immediate suspension under § 120.1500 based upon this paragraph, SBA must send prior written notice to the SBA Lender explaining why the SBA Lender's actions were uncooperative,

detrimental to the program, undermined SBA's management of the program, or were not consistent with standards of good conduct. The prior notice must also state that the SBA Lender's actions could give rise to a specified enforcement action, and provide the SBA Lender with a reasonable time to cure the deficiency before any further action is taken;

(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 (generally in conjunction with other indicators of increased financial risk) 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; and

(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; or

(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 (generally in conjunction with other indicators of increased risk) 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 Types of enforcement actions—SBA Lenders.**

Upon a determination that the grounds set forth in § 120.1400 exist, SBA may undertake, in SBA's 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. SBA's decision to take an enforcement action will not, by itself, invalidate a guaranty previously provided by SBA.

(a) *Enforcement actions for all SBA Lenders.* (1) *Imposition of portfolio guaranty dollar limit.* SBA may limit the maximum dollar amount that SBA will guarantee 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.

(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 2 CFR Parts 180 and 2700, SBA may take any necessary action to debar a Person,

as defined in § 120.10, including but not 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 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 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 Types of 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 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, 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 discretion why it does not understand the reasons given by SBA in its notice of the action, the Agency will provide clarification. 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 such clarification is not necessary. SBA, in its 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 the response timeframe given by the notice. If such requests are submitted to the Agency, SBA may, in its 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 in writing to the appropriate Office of Capital Access official in accordance with Delegations of Authority or other official identified in the notice and received by SBA within the 30 day timeframe or the response timeframe given by the notice.

(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 decision within 90 days of either receiving the objection or from when additional information is provided under paragraph (a)(2)(v) or (a)(3)(iii) of this section, whichever is later, unless SBA provides notice that it requires additional time.

(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 30 days of receiving the objection advising whether SBA is continuing with the immediate suspension, unless SBA provides notice that it requires additional time. If the SBA Lender, Intermediary, or NTAP submits additional information to SBA (under paragraph (a)(2)(v) or (a)(3)(iii) of this section) after submitting its objection but before SBA issues its final decision, SBA must issue its final decision within 30 days of receiving such information, unless SBA provides notice that it requires additional time.

(iii) Prior to issuing a notice of decision, SBA in its 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 discretion, to consider an untimely objection, it must issue a notice of final decision pursuant to this paragraph (a)(3).

(4) *SBA's notice of final agency decision where no filed objection 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 an immediate suspension of the SBA Lender, Intermediary, or NTAP will continue. 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.* An SBA Lender, Intermediary, or 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, 15 U.S.C. 650, and applicable sections of part 134 of this chapter. The Administrative Law Judge will issue a recommended decision based on the record.

(ii) *Witnesses.* The party calling witnesses will pay the witness 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 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. The hearing will be conducted in accordance with 5 U.S.C. 554–557, 15 U.S.C. 650 and applicable sections of part 134 of this chapter. 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 in case of consent which will be effective at the time specified in the order or 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 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 directive, 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.* (i) 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:

(A) 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;

(B) With the consent of the SBLC; or

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

(ii) 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.

**Sandy K. Baruah,**

*Acting Administrator.*

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