guidance of the public. Because the guidance in this notice covers not only virtually every NIH program but also essentially every federal research program in which DNA recombinant molecule techniques could be used, it has been determined to be not cost effective or in the public interest to attempt to list these programs. Such a list would likely require several additional pages. In addition, NIH could not be certain that every federal program would be included as many federal agencies, as well as private organizations, both national and international, have elected to follow the NIH Guidelines. In lieu of the individual program listing, NIH invites readers to direct questions to the information address above about whether individual programs listed in the *Catalog of Federal Domestic Assistance* are affected.

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federal register

Thursday
March 28, 1985

Part III

Administrative Committee of the Federal Register

1 CFR Part 1 et al.

Updating of Publication Procedures; Final Rule

ADMINISTRATIVE COMMITTEE OF THE FEDERAL REGISTER

1 CFR Parts 1, 2, 7, 8, 9, 10, 15, 18, 20 and 21

Updating of Publication Procedures

AGENCY: Administrative Committee of the Federal Register.

ACTION: Final rule.

SUMMARY: The Administrative Committee of the Federal Register (ACFR) is updating its regulations for the Federal Register system to clarify certain policies and to reflect current procedures. These amendments concern filing for public inspection, cross-referencing, authority citations, correction of errors, distribution of official copies, OMB control numbers and technical amendments. This action does not represent a change in policy or increase the burdens on agencies or the public.

EFFECTIVE DATE: April 29, 1985.

ADDRESS: Mail: Office of the Federal Register, National Archives and Records Service, Washington, DC 20408.

FOR FURTHER INFORMATION CONTACT: Martha Girard, (202) 523-5240.

or

Frances McDonald or James Burroughs, (202) 523-4534.

SUPPLEMENTARY INFORMATION: In the **Federal Register** of July 6, 1984 (49 FR 27910) the Administrative Committee of the Federal Register (ACFR) proposed to amend some of its regulations to reflect current procedures and to clarify certain policies. Most of the comments received were from Federal agencies. The ACFR has analyzed all the comments and based on them, has made a few changes to the regulations as proposed.

Filing for Constructive Notice

There has been confusion by agencies and by the public over the difference between the Office of the Federal Register (OFR) receiving a document for publication and filing a document for public inspection. This confusion appears to be over the term "filing" which is not defined in existing regulations on filing at 1 CFR 3.2. Therefore, the ACFR is amending its regulations to define the term "filing" and clarify its use by the OFR under the Federal Register Act (FRA).

The Federal Register Act (44 U.S.C. Chapter 15) requires that a copy of a document be placed on public inspection when it is filed (44 U.S.C. 1503), and states that filing constitutes constructive notice of the contents of the document filed (44 U.S.C. 1507). Thus, because the Federal Register Act directly links filing with the availability of the document for public inspection, a document is filed when it is made available for public inspection.

Before a document can be made available for public inspection it must be processed for publication so that the filed document accurately reflects what will be published in the **Federal Register.** Processing includes a review for compliance with publication requirements (1 CFR Chapters I and II), classification, assignment of a publication date, and editing.

The actual pre-filing processing time for a single document may vary depending on the document's length and its compliance with 1 CFR. Normally a document is published on the third working day after the day it is received by the OFR. A document is available for public inspection during OFR office hours at least on the working day before its publication in the **Federal Register.** The OFR does not release to the public information concerning a document before the document is filed.

Documents are on public inspection at the OFR during official office hours. These hours are 8:45 a.m. to 5:15 p.m. (1 CFR 2.3(d)).

If an agency wishes to provide immediate notice to the public of a document's contents, the agency may request immediate processing and filing for public inspection. This is known as emergency filing. A document may be filed on the same day it is received if there is sufficient time for the document to be both reviewed by the OFR staff and inspected by the public. The document remains on public inspection until it is published according to the normal schedule.

If a document arrives during office hours too late in the day to be filed that day, the agency may substantiate delivery by requesting OFR to stamp a copy of the document or provide a receipt stating the date and time the document was received by the OFR.

The purpose of adding the definition of "filing" to the regulations in 1 CFR is to clarify the usage of that term under the Federal Register Act. It does not change OFR procedures for normal filing, or for handling requests for immediate or emergency filing, expedited, or emergency publication as explained in §§ 17.3 and 17.4, or the withdrawal of documents after they have been filed for public inspection. One commentator sought further information about withdrawal procedures. A request for the withdrawal of a document on public inspection must be made by a timely letter signed by a duly authorized representative of the agency. The original document and the letter remain on public inspection (1 CFR 18.13).

Another commentator suggested that the OFR establish procedures for the issuance of verification receipts so that court ordered and legislative deadlines could be met. The OFR has such a procedure in place. An agency wishing a receipt merely needs to request such a receipt.

Cross-Referencing

The ACFR is responsible for publication of the Code of Federal Regulations (CFR) which is a special edition of the **Federal Register** (FR). The CFR consists of "complete codifications of the documents of *each* [emphasis added] agency of the Government having general applicability and legal effect, issued or promulgated by the agency . . ." (44 U.S.C. 1510(a)). In publishing the CFR, the ACFR is charged with ensuring its "practical usefulness and economical manufacture" (44 U.S.C. 1510(b)), as well as regulating the "manner and form" of the **Federal Register** (44 U.S.C. 1506(3)).

The OFR always has permitted cross-referencing in specific cases under the exceptions which are stated in this regulation. However, requests by agencies to cross-reference other agencies' regulations have multiplied in recent years as agencies seek to reduce regulations and save on printing costs paid to the Government Printing Office for material published in the **Federal Register** and the CFR, even though many of the requests are outside the scope of the recognized exceptions. Regulatory burdens on the public are not lessened by shifting them by cross-referencing from one agency's regulations to another. Moreover, cross-referencing casts legal shadows on the orderly giving of notice through the Federal Register system, which is the legislative intent of the Federal Register Act.

From a practical point of view, use of cross-references to replace regulatory text makes the Federal Register system difficult to use. The reader must look outside an agency's regulations to ascertain the nature of the entire regulatory scheme. In some instances an agency will cross-reference the regulations of another agency, but make piecemeal changes to the text of the cross-referenced regulations to fit its own needs. This imposes an additional burden on the reader who is required to look at two different versions of regulatory text and to determine, without further guidance, the combination of regulations which applies. If the referenced regulations also cross-reference a third agency's regulations, the reader must consult three different agencies' regulations, read them together and try to decide which version or combination of regulations is applicable to the user. The CFR could become a set of arrows pointing from agency to agency rather than self-contained, agency codifications of regulations. It was precisely because of the lack of a clear, uniform and workable system for providing proper legal notice that the Federal Register Act was passed.

Cross-referencing can create procedural problems for an agency. An untenable situation results when one agency adopts the rules of another agency by cross-referencing. The first agency surrenders to the second control over future amendments to the regulations. An agency could find itself, because the other agency changed its regulations, referencing regulations that are irrelevant or referencing regulations that cannot be enforced or which no longer exist.

The Administration Procedure Act (APA) requires that each agency "separately state and currently publish" in the **Federal Register** substantive rules of general applicability (5 U.S.C. 552(a)(1)(D)). The Federal Register Act directs the ACFR to regulate the "manner and form" of publication in the Federal Register system (44 U.S.C. 1506 (3)) and to publish the CFR in "separate books with a view to practical usefulness and economical manufacture" (44 U.S.C. 1510 (b)). One commentator indicated that the "practical usefulness" provision should be interpreted in a limited way to apply to mere printing and binding format. However, in reading the Federal Register Act and APA together, the ACFR holds, aside from the stated exceptions, that each agency must publish its own rules and not refer the reader to another agency's rules, and that the ACFR has the responsibility to ensure that this and other means "to keep the Code as current and readily useable as possible" (1 CFR 8.1(b)) are followed.

The ACFR received several comments about proposed § 21.21 prohibiting cross-referencing except in certain categories. Many commentators asked for a more detailed explanation of this section, particularly the use of exceptions. It has been rewritten to provide additional guidance. Most commentators accepted the basic reasoning behind this proposal, but were concerned about its effect on cross-references in their own regulations. The introductory text of § 21.21(c) states the general prohibition against cross-referencing and sets forth the criteria for exceptions. One commentator suggested that the issuing agency make the determination in certain circumstances on the propriety of a cross-reference. The ACFR has the statutory responsibility for maintaining the entire Code of Federal Regulations and preserving its practical usefulness. This governmentwide responsibility requires that the ACFR issue regulations which will ensure and facilitate access to the Government's rules. The OFR traditionally provides document drafting and reviewing services to agencies publishing in the Federal Register system. Through this existing consultative process, OFR staff will work with agencies to resolve borderline cases involving cross-referencing.

In the list of exceptions to the prohibition against cross-referencing, § 21.21(c) (1) and (3) are restatements of provisions in the proposed rule with the additions of the use of Executive orders and reorganization plans as legal authorities. The exception in paragraph (c)(1) recognizes that direction by statute, E.O., or reorganization plan to use the regulations of another agency in a rulemaking must be followed. Several commentators cited instances in which agencies' are legally mandated to cross-reference other agencies' regulations. This is recognized by the (c)(1) exception. The exception in paragraph (c)(3) provides for informational cross-referencing. An agency may wish to cite other agencies which regulate in the same field. For example an agency may properly state that "Compliance with this regulation may not necessarily mean compliance with the regulations of Department X found at XX CFR" or "these regulations are issued consistent with the regulations of agency X at XX CFR". These cross-references do not further regulate or burden the public.

The exception in paragraph (c)(2) may be considered part of paragraph (c)(1) but deserves separate mention because it is the most frequently used—and probably the most misunderstood—statutory cross-reference. Regulations promulgated by an agency with the sole legal authority to issue regulations may be referenced by another agency when authorized by statute or similar legal authority. This is permissible because the referencing agency has no legal authority to issue regulations, even duplicative ones, for that subject matter area. For example, the Environmental Protection Agency (EPA) has the legal authority to determine what level of a pollutant is hazardous to human health, but another agency enforces that finding in its own program. EPA sets noise limits but the Federal Railroad Administration enforces them in its area of responsibility. EPA determines radiation limits; the Nuclear Regulatory Commission uses them. The Food and Drug Administration (FDA) issues regulations concerning food and color additives. FDA has the sole authority in the Federal government to issue these regulations, but another agency may use these standards by way of cross-reference.

Exception (c)(4) in § 21.21 involves consensus standards or test methods which are used in many areas of regulations. Some agencies by regulation have issued standards or methods which replace or preempt the voluntary methods and have become mandatory. In cases such as this the nature of the government standard makes reprinting fully text unnecessary. The Department of Transportation has developed in its regulations many symbols of labels to ensure the safe handling and transportation of dangerous and hazardous materials. Other agencies in their own safety programs may reference a requirement to use a DOT label because it has become the accepted standard industry-wide.

The final exception, § 21.21(c)(5), simply recognizes that a subagency can reference regulations of its parent department.

One commentator suggested that when regulations are handled jointly by agencies cross-referencing should be allowed. If in the regulatory scheme one agency is responsible for one part of the program and another agency is responsible for another part of the program cross-referencing is permissible under exemption (c)(3). Where regulations are jointly issued and administered by agencies a separate chapter in the CFR is established for those joint regulations. Jointly issued regulations that are administered individually by each agency must be published in full text by each agency in its own chapter of the CFR.

When special situations occur in which agencies must publish joint regulations or the same regulations, the OFR has devised special formats and publication procedures to accommodate the agencies by permitting them to publish these documents jointly in the **Federal Register** although each agency must publish separately in the CFR. Examples include regulations issued under the Archaeological Resources Protection Act (49 FR 1015; January 6, 1984), and proposed regulations on enforcement of nondiscrimination on the basis of handicap in Federally conducted programs (49 FR 1449, January 11, 1984 and 49 FR 34132, August 28, 1984).

One commentator suggested that the ACFR consider the problem of the "blind cross-reference", that is, referencing material without giving the reader an idea of what the referenced material contains. The ACFR is not issuing a regulation on this point, but urges agencies to use the following as drafting guidance. Cross-referenced material should be introduced by a brief statement describing the matter referenced for the benefit of the reader.

Examples

Statements to be avoided:

(f) If a summary, rather than the total plan, is made available to the public, the summary must include information required under § 242.24(a) (1), (2) and (3); § 242.28.

Statements to be used:

(f) If the State provides to the public a summary of the proposed services plan, rather than the total plan, the summary must at least contain information on—

(1) The individuals to be served, as specified in § 242.24;

(2) The services to be provided, to whom, and where, as set forth in § 242.26(a) (1) and (4); and

(3) The funds that will be used for the program, as required by § 242.28.

This drafting technique will help to minimize the confusion caused by a permissible cross-reference and make agency regulations more understandable.

Some commentators asked if the prohibition on cross-references would require the agency to engage in full notice and comment rulemaking if the agency were to publish the material in full text. The ACFR does not believe additional notice and comment is necessary. Full text publication would not be a substantive change because the underlying regulation that was cross-referenced was subject to the initial notice and comment of the original rule. The regulatory effect of a regulation is not increased or lessened because it is given effect by a cross-reference.

This reasoning is consistent with the regulation in 1 CFR 5.1(c) where the ACFR states that it "does not intend to affect the validity of any document" by "prescribing headings, preambles, effective dates, authority citations and similar matters of form". When an agency has discretion to determine the content of a regulation, it may not cross-reference another agency's regulations in the CFR.

This formal expression of existing policy will not have significant impact onthe cost of publishing regulations for the affected agencies. The examples of cross-references given by the commentators all fall within the exceptions listed in the regulation. The ACFR does not plan any retroactive enforcement following publication of this regulation. The general prohibition against cross-referencing and the valid exceptions are not new. In practice they have been implicitly recognized and followed over the years, preventing many improper cross-references from being published. Now they are made explicit. In the future, agency regulation writers must consider this rule and the problem of cross-referencing exceptions when drafting new text.

Authority Citation

Each document classified as a rule or proposed rule in the **Federal Register** must contain a citation of the legal authority under which the agency issues the document (1 CFR 21.40). The ACFR is amending the requirements in 1 CFR for the form and placement of authority citations to conform to the guidance set forth in the OFR Document Drafting Handbook (DDH) 1980.

According to the new requirements an agency sets out the full text of the authority citation for each part affected by the document. If a document affects an entire part, the agency places the complete authority citation directly after the table of contents and before the regulatory text. If a document amends only certain sections within a CFR part, the agency presents the complete authority citation as the first item in the list of amendments to the part.

Examples

A. If the authority for issuing an amendment is the same as the authority listed for the whole CFR part, the agency simply restates the authority.

17 CFR Part 7 is amended as follows:

1. The authority citation for Part 7 continues to read as follows:

Authority: Sec. 5, Pub. L. 98-321, 82 Stat. 370 (34 U.S.C. 7).

2. In Part 7, § 7.10 is revised to read as follows:

(Continue with the new text of § 7.10)

B. If the authority for issuing an amendment changes the authority citation for the whole CFR part, the agency revises the authority citation in its entirety. The agency may specify the, particular authority under which certain sections are amended in the revised authority citation.

17 CFR Part 47 is amended as follows:

1. The authority citation for Part 47 is revised to read as follows:

Authority: Sec. 8, Pub. L. 98-328, 82 Stat. 470 (34 U.S.C. 21); §§ 47.10 and 47.11 also issued under sec. 11, Pub. L. 98-329, 82 Stat. 503 (34 U.S.C. 311).

2. In Part 47, Secs. 47.10 and 47.11 are revised to read as follows:

(Continue with the new text of §§ 47.10 and 47.11).

Two commentators felt that requiring an agency to present the complete authority citation for a part where there is no change in the authority citation is unnecessary, redundant, excessively costly and confusing to the reader.

Many of the authority citations presently in the CFR are redundant because agencies have not consolidated the Public Law, Statutes at Large, and U.S.C. citations. In the past, whenever an agency published an authority citation which was not in the exact form that appeared in the blanket authority, that new citation was added to the blanket authority with the result that the same authority was repeated a number of times. Besides being redundant, these authority citations are confusing to the public and can be costly in publication charges to the agencies.

Long-standing ACFR regulations reflecting the requirements in 5 U.S.C. 552 and 553 require that an issuing agency give an authority citation for each section in a rule or proposed rule document and that the agency be responsible for the authority citation.

Under the new regulations when an agency publishes the authority for a part each time the part is amended, the agency will be able to ensure that the citations are necessary and concise.

The ACFR also has decided to issue regulations requiring only the United States Code (U.S.C.) in authority citations. Agencies may use the U.S.C. citation whether or not that title has been enacted into positive law. The additional use of Public Law and U.S. Statutes at Large citations is now optional. This change conforms to the guidance found in "A Uniform System of Citation", 12th edition (the Blue Book).

Most of the comments received on this subject supported citing only the U.S.C. One commentator asked about instances in which the authority cited was not codified in the U.S.C. In those circumstances, the agency must cite the authority that exists.

The ACFR received one comment supporting the proposal to require that the authority citation appearing in the CFR be centralized at the part or subpart level of the regulations.

The authority citations at each section level cause a great amount of repetition. Centralizing the authority citations will be more helpful to the reader. Eliminating the repetition will result in fewer pages in the CFR, save agencies printing costs, and will be more helpful to the reader. If an agency wishes to specify the authority for a particular CFR section, this can be done within the centralized authority citation.

The ACFR will not require agencies to reach back and rewrite authority citations for regulations already in the CFR. This centralization of authority citations will take place as agencies amend their regulations. It will be most cost effective for agencies when amending their regulations to remove the authority citations at the section level and centralize the citations at the part or subpart level. This can be done with amendatory language such as:

1. The authority citation for Part X is revised to read as set forth below and the authority citations following all the sections in Part X are removed.

Correction of Errors

Although the correction of errors in printing is addressed in 1 CFR 18.15, the responsibility for identifying errors and procedures to correct them needs to be clarified. To ensure that proper legal notice is given the public, the ACFR believes that agencies share in the responsibility for the accuracy of the documents as printed. An agency is in the best position to identify errors found in its published documents; it should routinely and carefully review its own documents for accuracy after publication in the **Federal Register**. Some agencies have waited years to question the text of a rule that has been codified in the CFR.

If an error was submitted in the original document, the document should be corrected by the immediate filing and publication of a correction document. Complete responsibility for this type of error rests with the agency.

A significant OFR editing or GPO typographical error will be corrected by the OFR staff as soon as it is found by OFR staff or when the staff is informed by the agency of the error.

Three comments were received on this subject. Two requested a more flexible time limit for agencies to review their published documents in the **Federal Register**. The other comment asked for a definition in the regulation of what the OFR considered a significant OFR editing or GPO typographical error requiring a correction document. An agency should review its published documents as soon as possible after receiving the **Federal Register**. The commentator was concerned that because some agencies do not receive copies of the **Federal Register** until two or three days after publication, the agencies could not review their documents "immediately after publication". Ten days or two weeks was suggested as a reasonable time to discover and report errors. The ACFR did not intend that an agency be responsible for reviewing documents in the **Federal Register** before receipt of the issue in which they appear. The purpose of the proposed rule was to make clear that agencies share the responsibility for post publication review of the **Federal Register** and CFR. Timeliness was stressed to ensure prompt corrections for the benefit of the affected public and to prevent perpetuation of errors in the CFR. The ACFR believes that the need for promptness by the agencies in identifying errors will be understood without setting time limits in the rule.

The regulation explains that an OFR editing or GPO typographical error requiring a correction document is one which would tend to confuse or mislead the reader or would affect the text subject to codification. This is the type of error which is considered significant.

Another commentator suggested that the emphasis on this rule be changed to give agencies the right to insist on a correction notice, no matter how insignificant the error.

The commentator acknowledged that in his experience in dealing with OFR staff he had never had any problem with correction notices, but he was concerned that OFR staff might not recognize the significance of an error identified by an issuing agency.

The OFR, when informed in a timely manner of a significant clerical or typographical error, will issue a correction document. OFR staff and agencies often agree that certain errors are insignificant and no correction documents are required. In the rare circumstance when an agency and the OFR staff disagree about the source of an error, the Director of the OFR, who has possession of the original document, is in the best position to make the final judgment. Of course, an agency is always free to issue its own correction document.

Distribution of Official Copies

In the Federal Register Act the ACFR is given the authority to regulate the number of copies of **Federal Register** publications to be distributed without charge to members of the Government for official use (44 U.S.C. 1506).

The ACFR amends its regulations to formalize the long-standing policy of limiting to 300 the number of copies of the individual titles of the CFR sent to an executive agency without charge. Copies of the CFR may be requested in paper and microfiche. If an agency needs additional copies of the CFR, it should order them directly from GPO.

Only one comment was received concerning the distribution of official copies. That commentator suggested that issuing agencies be given unrestricted distribution of their CFR volumes at no charge. The reason the ACFR set a limit on the number of copies of the CFR which can be given to agencies free of charge is to keep the CFR page cost of publication to agencies as low as possible. To allow agencies an unlimited number of copies of the CFR without charge would increase the cost to the agencies for publication in the CFR.

The ACFR amends its regulations to change to 12 the number of copies of the United States Government Manual sent routinely to each Senator and each Member of the House of Representatives. Present regulations provide that two (2) copies of the United States Government Manual annually be sent and that an additional 10 be made available upon a written authorization to the Director of the Federal Register.

OMB Control Numbers

The ACFR is responsible for the manner and form of material appearing in the **Federal Register**. The OFR already has issued informal guidance on the style and format to be used by agencies for OMB Control Numbers in regulatory text. The ACFR is formalizing this guidance through regulations. Including these directions in the regulations will give uniformity to the way in which these OMB control numbers are displayed. This will promote orderly codification and aid the reader in finding the numbers.

Updating Regulations

Some of the regulations in 1 CFR are simply out of date. The ACFR therefore is deleting or changing these regulations.

In 1 CFR 15.2, the term "classified material" is deleted from the second sentence. Neither the ACFR nor the OFR have or receive classified material.

The OFR no longer offers the editorial services mentioned in 1 CFR 15.15–15.18. All lead type that was stored by GPO has been disposed of now that the CFR volumes have been converted to magnetic media as a full text data base. GPO offers agencies CFR data either on magnetic tapes or microfiche.

The ACFR makes a nomenclature change in 1 CFR Part 20. The correct title of the "United States Government Organization Manual" is "The United States Government Manual."

The regulations on headings are clarified and corrected to reflect the current style in the **Federal Register**. The material previously in §§ 21.16 and 21.17 is consolidated into § 21.16.

The ACFR is also adding an additional authority citation to Part 2 and Part 8 of 1 CFR. In Part 2, the authority for publishing the slip laws and Statutes at Large is 1 U.S.C. 112 and 113, and in Part 8 additional authority for publishing the CFR is 44 U.S.C. 1510.

A new cumulative "List of Sections Affected" has been published. Therefore, the ACFR is adding to 1 CFR 8.5(c) the "List of Sections Affected, 1964–1972", which lists all sections of the Code that have been affected by documents published during the period January 1, 1964-December 31, 1972.

The ACFR is revising Part 10—Presidential Papers to reflect current publication practices. This revision simplifies the existing regulations and explains that the basic text of the "Public Papers of the Presidents of the United States" is the annual compilation of the "Weekly Compilation of Presidential Documents."

The **Federal Register** and the CFR are available in both paper copies and microfiche. The ACFR is amending its regulations to reflect the fact that agencies may request the **Federal Register** and CFR in paper or microfiche.

These new regulations also reflect OFR's policy of requiring reimbursement from agencies for reproductions of original acts and documents filed with the OFR, unless funds are appropriated for this purpose.

The ACFR received comments suggesting that the regulations at §§ 18.4(a) and 19.1 (f) be amended to reflect the standard page size of $8\frac{1}{2} \times 11$. The paper size specification is being changed at § 18.4(a), but the specifications in § 19.1(f) for proposed Executive orders and Proclamations are from Executive Order No. 11030 and must remain as they appear currently in the regulations. Another comment suggested that the regulations should require documents to be typed double spaced. Double spacing a document for publication is required in § 18.4.

Another commentator pointed out that some of the regulations in 1 CFR are gender specific, and suggested that regulations in 1 CFR Chapter I be revised to remove gender specific terminology. As regulations are amended containing gender specific language, these regulations will be changed. However, the sections in the proposed rule which had gender specific terminology, 1 CFR 7.1(b), 8.8 (a) (4), and 10.2 (a) have been revised to eliminate any gender specification.

Executive Order 12291, Paperwork Reduction Act and Regulatory Flexibility Act

This is not a major rule as defined by Executive Order 12291. The rule will have no impact on small entities as described in the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). The rule does not contain any information collection or recordkeeping requirements as defined in the Paperwork Reduction Act of 1980.

List of Subjects in 1 CFR Parts 1, 2, 7, 8, 9, 10, 15, 18, 20, and 21.

Administrative practice and procedure, Government publications.

For the reasons set out in the preamble and under the authority given the Administrative Committee of the Federal Register, 1 CFR is amended as follows:

PART 1—DEFINITIONS

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

Authority: 44 U.S.C. 1506; sec. 6, E.O. 10530, 19 FR 2709; 3 CFR 1954–1958 Comp., p. 189.

2. Section 1.1 is amended by adding in alphabetical order a definition of "filing" to read as follows:

§ 1.1 Definitions.

* * * * *

"Filing" means making a document available for public inspection at the Office of the Federal Register during official business hours. A document is filed only after it has been received, processed and assigned a publication date according to the schedule in Pert 17 of this chapter.

* * * * *

PART 2—GENERAL INFORMATION

3. The authority citation for Part 2 is revised to read as follows:

Authority: 44 U.S.C. 1506; sec. 6, E.O. 10530, 19 FR 2709; 3 CFR 1954–1958 Comp., p. 189; 1 U.S.C. 112; 1 U.S.C. 113.

PART 7—DISTRIBUTION WITHIN FEDERAL GOVERNMENT

4. The authority citation for Part 7 continues to read as follows:

Authority: 44 U.S.C. 1506; sec. 6, E.O. 10530, 19 FR 2709; 3 CFR 1954–1958 Comp., p. 189.

5. 1 CFR Part 7 is amended by revising § 7.1 to read as follows:

§ 7.1 Official distribution.

Copies of the daily **Federal Register** in paper and microfiche copies as requested shall be distributed to the following without charge:

(a) *Senators and Representatives.* To each Senator and each Member of the House of Representatives not more than five copies of each daily issue.

(b) *Committees.* To each Committee of the Senate and the House of Representatives in the quantity needed for official use, upon written authorization of the Chairperson, or authorized delegate, to the Director of the Federal Register.

(c) *The Supreme Court.* The Supreme Court is entitled to the number of copies of each daily issue of the **Federal Register** that it needs for official use.

(d) *Other courts.* Each other constitutional or legislative court of the United States is entitled to the number of copies of each daily issue of the **Federal Register** that it needs for official use, based on a written authorization submitted to the Director of the Federal Register by the Director of the Administrative Office of the U.S. Courts specifying the number needed.

(e) *Executive Agencies.* Each Federal executive agency is entitled to the number of copies of each daily issue of the **Federal Register** that it needs for official use. The person in each agency concerned who is authorized under §§ 16.1 and 16.4 of this chapter to list the officers and employees of that agency who need the **Federal Register** for daily use shall send a written request to the Director of the Federal Register for placement of the names of those officers and employees on the mailing list.

§§ 7.2 and 7.3 [Removed]

6. 1 CFR Part 7 is amended by removing §§ 7.2 and 7.3.

PART 8—CODE OF FEDERAL REGULATIONS

7. The authority citation for Part 8 is revised to read as follows:

Authority: 44 U.S.C. 1506, 1510, sec. 6, E.O. 10530, 19 FR 2709; 3 CFR 1954–1958 Comp., p. 189.

8. 1 CFR Part 8 is amended by revising § 8.5(c) to read as follows:

§ 8.5 Ancillaries.

* * * * *

(c) *List of sections affected.* Following the text of each book or cumulative supplement, a numerical list of sections which are affected by documents published in the **Federal Register**. (Separate volumes, "List of Sections Affected, 1949–1963" and "List of Sections Affected, 1964–1972" list all sections of the Code which have been affected by documents published during the period January 1, 1949 to December 31, 1963 and January 1, 1964 to

December 31, 1972 respectively.) Listings shall refer to **Federal Register** pages and shall be designed to enable the user of the Code to assure the user of the precise text that was in effect on a given date in the period covered.

9. 1 CFR Part 8 is amended by revising § 8.8(a) introductory text and paragraph (a)(4) to read as follows:

§ 8.8 Official distribution.

(a) The Code of Federal Regulations, in paper or microfiche copies as requested, shall be distributed to the following, without charge:

* * * * *

(4) *Executive agencies.* To officials, libraries, and major organizational units of the executive agencies in the quantity needed for official use up to 300 copies of individual titles per agency, upon the written authorization of the authorizing officer or the alternate designated under § 16.1 of this chapter.

* * * * *

PART 9—UNITED STATES GOVERNMENT MANUAL

10. The authority citation for Part 9 continues to read as follows:

Authority: 44 U.S.C. 1506; sec. 6, E.O. 10530, 19 FR 2709; 3 CFR 1954–1958 Comp., p. 189.

§ 9.1 [Amended]

11. 1 CFR Part 9 is amended by removing in the Part heading and in § 9.1 the words "United States Government Organization Manual" and inserting in their place the words "United States Government Manual".

12. 1 CFR Part 9 is amended by revising § 9.3(a) introductory text and paragraph (a)(1) to read as follows:

§ 9.3 Distribution to Government agencies.

(a) The United States Government Manual shall be distributed to the following, in the quantities indicated, without charge:

(1) *Members of Congress.* Each Senator and each Member of the House of Representatives shall be furnished twelve copies.

* * * * *

13. 1 CFR Part 10 is amended by revising the entire part to read as follows:

PART 10—PRESIDENTIAL PAPERS

Subpart A—Weekly Publication

Sec.
10.1 Publication required.
10.2 Scope and sources.
10.3 Format, indexes, and ancillaries.
10.4 Distribution to Government agencies.

Subpart B—Annual Publication

10.10 Publication required.
10.11 Scope and sources.
10.12 Format, indexes, and ancillaries.
10.13 Coverage of prior years.
10.14 Distribution to Government agencies.

Authority: 44 U.S.C. 1506; sec. 6, E.O. 10530, 3 CFR 1954–1958 Comp., p. 189.

Subpart A—Weekly Publication

§ 10.1 Publication required.

The Director of the Federal Register shall publish a special edition of the **Federal Register** called the "Weekly Compilation of Presidential Documents".

§ 10.2 Scope and sources.

(a) The basic text of each publication consists of oral statements by the President or of writing subscribed by the President, and selected from transcripts or text issued by the Office of the White House Press Secretary, including—

(1) Communications to Congress;

(2) Public addresses and remarks;

(3) News conferences and interviews;

(4) Public messages and letters;

(5) Statements released on miscellaneous subjects; and

(6) Formal executive documents promulgated in accordance with law.

(b) In addition, each publication includes selections, either in full text or ancillary form, from the following groups of documents, when issued by the Press Office.

(1) Announcements of Presidential appointments and nominations;

(2) White House statements and announcements on miscellaneous subjects;

(3) Statements by the Press Secretary or Deputy Press Secretary;

(4) Statements and news conferences by senior administration officials; and

(5) Fact sheets.

§ 10.3 Format, indexes, and ancillaries.

(a) The "Weekly Compilation of Presidential Documents" is published in the binding and style that the Administrative Committee of the Federal Register considers suitable for public and official use.

(b) Each publication is appropriately indexed and contains ancillary information respecting Presidential activities and documents not printed in full text. In general, ancillary texts, notes, and tables are derived from official sources.

§ 10.4 Distribution to Government agencies.

(a) The "Weekly Compilation of Presidential Documents" is distributed regularly to Members of the Senate and the House of Representatives and to officials of the legislative, judicial, and executive branches of the Federal Government without charge in the quantities needed for official use. Requests for copies shall be made in writing by the authorizing officer to the Director of the Federal Register.

(b) Special needs for selected issues in substantial quantity are filled by the timely submission of a printing and binding requisition to the Government Printing Office on Standard Form 1.

Subpart B—Annual Publication

§ 10.10 Publication required.

The Director of the Federal Register shall publish annually a special edition of the **Federal Register** called the "Public Papers of the Presidents of the United States".

§ 10.11 Scope and sources.

The basic text of the Public Papers consists of the documents printed in the "Weekly Compilation of Presidential Documents".

§ 10.12 Format, indexes, and ancillaries.

(a) Each publication covers one calendar year, unless procedures require otherwise, and is divided into books according to the amount of material to be included. The publication is published in the binding and style that the Administrative Committee of the Federal Register considers suitable to the dignity of the Office of the President of the United States.

(b) Each publication is appropriately indexed and contains additional ancillary information and illustrative material respecting significant Presidential documents and activities.

§ 10.13 Coverage of prior years.

The Administrative Committee may authorize the publication of volumes of papers of the Presidents covering specified years before 1945 after consulting with the National Historical Publications and Records Commission.

§ 10.14 Distribution to Government agencies.

(a) The Public Papers are distributed to the following, in the quantities indicated, without charge:

(1) *Members of Congress.* Each Senator and each Member of the House of Representatives is entitled to one copy of each annual publication published during the Member's term in office, upon the Member's written request to the Director of the Federal Register.

(2) *Supreme Court.* The Supreme Court is entitled to 12 copies of each publication.

(3) *Executive agencies.* The head of each executive agency is entitled to one copy of each publication upon application to the Director of the Federal Register.

(b) Legislative, judicial, and executive agencies of the Federal Government may obtain copies of the publication, at cost, for official use, by the timely submission of a printing and binding requisition to the Government Printing Office on Standard Form 1.

(c) Each request for extra copies of the publication must be addressed to the Superintendent of Documents, to be paid for by the agency or official making the request.

PART 15—SERVICES TO FEDERAL AGENCIES

14. The authority citation for Part 15 continues to read as follows:

Authority: 44 U.S.C. 1506, sec. 6, E.O. 10530, 19 FR 2709; 3 CFR 1954–1958 Comp., p. 189.

15. 1 CFR Part 15 is amended by revising § 15.2 to read as follows:

§ 15.2 Information services.

The Director of the Federal Register shall provide for the answering of each appropriate inquiry presented in person, by telephone, or in writing. Each written communication and each matter involving the Administrative Committee shall be sent to the Director, Office of the Federal Register, National Archives and Records Service, Washington, DC 20408.

16. 1 CFR Part 15 is amended by revising § 15.4 to read as follows:

§ 15.4 Reproduction of certified copies of acts and documents.

The Director of the Federal Register shall furnish to requesting agencies, at cost, reproductions or certified copies of original acts and documents filed with that Office that are needed for official use unless funds are appropriated for that purpose.

Subpart C—[Removed]

17. 1 CFR Part 15 is amended by removing Subpart C (§§ 15.15, 15.16, 15.17, and 15.18).

PART 18—PREPARATION AND TRANSMITTAL OF DOCUMENTS GENERALLY

18. The authority citation for Part 18 continues to read as follows:

Authority: 44 U.S.C. 1506; sec. 6, E.O. 10530, 19 FR 2709; 3 CFR 1954–1958 Comp., p. 189.

§ 18.4 [Amended]

19. In § 18.5, paragraph (a) is amended by removing "8 by 10½ inches" and inserting in its place "8½ by 11 inches".

20. Part 18 is amended by revising § 18.15 to read as follows:

§ 18.15 Correction of errors in printing.

(a) Typographical or clerical errors made in the printing of the Federal Register shall be corrected by insertion of an appropriate notation or a reprinting in the Federal Register published without further agency documentation, if the Director of the Federal Register determines that—

(1) The error would tend to confuse or mislead the reader; or

(2) The error would affect text subject to codification.

(b) The issuing agency shall review published documents and notify the Office of the Federal Register of printing errors found in published documents.

(c) If the error was in the document as submitted by the agency, the issuing agency must prepare and submit for publication a correction document.

PART 20—HANDLING OF UNITED STATES GOVERNMENT MANUAL STATEMENTS

21. The authority citation for Part 20 continues to read as follows:

Authority: 44 U.S.C. 1506; sec. 6, E.O. 10530, 19 FR 2709; 3 CFR 1954–1958 Comp., p. 189.

§ 20.1 [Amended]

22. 1 CFR Part 20 is amended by removing in the Part heading and in § 20.1 the words "United States Government Organization Manual" and inserting in their place the words "United States Government Manual".

PART 21—PREPARATION OF DOCUMENTS SUBJECT TO CODIFICATION

23. The authority citation for Part 21 continues to read as follows:

Authority: 44 U.S.C. 1506; sec. 6, E.O. 10530, 19 FR 2709; 3 CFR 1954–1958 Comp., p. 189.

24. 1 CFR Part 21 is amended by revising § 21.16 to read as follows:

§ 21.16 Required document headings.

(a) Each rule and proposed rule document submitted to the Office of the Federal Register shall contain the following headings, when appropriate, on separate lines in the following order:

(1) Agency name;

(2) Subagency name;

(3) Numerical references to the CFR title and parts affected;

(4) Agency numbers of identifying symbol in brackets, if used;

(5) Brief subject heading describing the document.

(b) Each CFR section in the regulatory text of the document shall have a brief descriptive heading, preceding the text, on a separate line.

25. 1 CFR Part 21 is amended by revising the section heading and adding a new paragraph (c) to § 21.21 to read as follows:

§ 21.21 General requirements: References.

* * * * *

(c) Each agency shall publish its own regulations in full text. Cross-references to the regulations of another agency may not be used as a substitute for publication in full text, unless the Office of the Federal Register finds that the regulation meets any of the following exceptions:

(1) The reference is required by court order, statute, Executive order or reorganization plan.

(2) The reference is to regulations promulgated by an agency with the exclusive legal authority to regulate in a subject matter area, but the referencing agency needs to apply those regulations in its own programs.

(3) The reference is informational or improves clarity rather than being regulatory.

(4) The reference is to test methods or consensus standards produced by a Federal agency that have replaced or preempted private or voluntary test methods or consensus standards in a subject matter area.

(5) The reference is to the Department level from a subagency.

26. 1 CFR Part 21 is amended by adding an undesignated center heading and § 21.35 to Subpart A to read as follows:

OMB Control Numbers

§ 21.35 OMB control numbers.

To display OMB control numbers in agency regulations, those numbers shall be placed parenthetically at the end of the section or displayed in a table or codified section.

27. 1 CFR Part 21 is amended by revising § 21.40 to read as follows:

§ 21.40 General requirements: Authority citations.

Each section in a document subject to codification must include, or be covered by, a complete citation of the authority under which the section is issued, including—

(a) General or specific authority delegated by statute; and

(b) Executive delegations, if any, necessary to link the statutory authority to the issuing agency.

28. 1 CFR Part 21 is amended by revising § 21.43 to read as follows:

§ 21.43 Placing and amending authority citations.

(a) The requirements for placing authority citations vary with the type of amendment the agency is making in a document. The agency shall set out the full text of the authority citation for each Part affected by the document.

(1) If a document sets out an entire CFR part, the agency shall place the complete authority citation directly after the table of contents and before the regulatory text.

(2) If a document amends only certain sections within a CFR part, the agency shall present the complete authority citation to this part as the first item in the list of amendments.

(i) If the authority for issuing an amendment is the same as the authority listed for the whole CFR part, the agency shall simply restate the authority.

(ii) If the authority for issuing an amendment changes the authority citation for the whole CFR part, the agency shall revise the authority citation in its entirety. The agency may specify the particular authority under which certain sections are amended in the revised authority citation.

(b) The agency shall present a centralized authority citation. The authority citation shall appear at the end of the table of contents for a part or at the end of each subpart within a part. Citations of authority for particular sections may be specified within the centralized authority citation.

§ 21.44 [Removed]

29. 1 CFR Part 21 is amended by removing § 21.44.

30. 1 CFR 21.52 is amended by revising § 21.52 to read as follows:

§ 21.52 Statutory material.

(a) *United States Code.* All citations to statutory authority shall include a United States Code citation, where available. Citations to titles of the United States Code, whether or not enacted into positive law, shall be cited as follows without Public Law or U.S. Statutes at Large citation.

10 U.S.C. 501

(b) Citations to Public Laws and U.S. Statutes at Large are optional when the United States Code is cited.

(1) *Public Laws.* Citations to current public laws shall include reference to the volume and page of the U.S. Statutes at Large to which they have been assigned. For example:

Sec. 5 Pub. L. 89-670, 80 Stat. 935 (49 U.S.C. 1654)

(2) *U.S. Statutes at Large.* Citations to the U.S. Statutes at Large shall refer to section, page, and volume. The page number should refer to the page on which the section cited begins. For example:

Sec. 5 Pub. L. 89-670, 80 Stat. 935 (49 U.S.C. 1654); sec. 313, Pub. L. 85-726, 72 Stat. 752 (49 U.S.C. 1354)

Robert M. Warner,
Chairman.

Ralph E. Kennickell, Jr.,
Member.

Ralph W. Tarr,
Member.

Approved:

Edwin Meese, III,
Attorney General.

Ray Kline,
Acting Administrator of General Services.

[FR Doc. 85-7315 Filed 3-27-85; 8:45 am]

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federal register

Thursday
March 28, 1985

Part IV

Small Business Administration

13 CFR Parts 118, 119, 120, 122 and 130

Business Loans; Final Rule

SMALL BUSINESS ADMINISTRATION

13 CFR Parts 118, 119, 120, 122 and 130

[Rev. 7 for Part 120; Rev. 4 for Part 122]

Business Loans

AGENCY: Small Business Administration.

ACTION: Final rule.

SUMMARY: This final rule implements amendments to the Small Business Act by Pub. L. 97-35 (95 Stat. 357), codifies certain existing SBA loan policies, streamlines the organization of these regulations and clarifies certain existing rules and procedures.

EFFECTIVE DATE: March 28, 1985.

FOR FURTHER INFORMATION CONTACT: Everett Shell, Chief, Loan Processing Branch, Small Business Administration, 1441 L Street NW., Room 804, Washington, DC 20416, (202) 653-6470.

SUPPLEMENTARY INFORMATION:

Background

This final rule incorporates SBA basic loan policies, including borrower eligibility and participant eligibility in Part 120, Title 13 of the Code of Federal Regulations, and consolidates the rules and procedures governing specific loan programs into Part 122 of the same Title. Under this reorganization of the business loans regulations, it should no longer be difficult to isolate policies that apply to all loan programs from the policies that have limited applications.

When the President signed the Small Business Budget Reconciliation and Loan Consolidation/Inprovement Act of 1981 (Pub. L. 97-35), SBA's statutory authority for extending financial assistance was extensively revised. Section 7(e), 7(h), 7(i) and 7(l) of the Small Business Act (15 U.S.C. 631 et seq.)(Act) were all effectively repealed and section 7(a) was amended to incorporate the special purpose loan programs that are to be continued. The Trade Adjustment Loan Program [section 7(e)] and the Pool Loan [Group Corporation] Program [section 7(a)(5)] were discontinued. These final regulations represent an effort to reorganize the various parts of existent regulations referred to above into two more cohesive Parts (120 and 122) and to accommodate the changes in the Small Business Act which occurred as a result of Pub. L. 97-35. Since this final rule replaces former Parts 118 (Handicapped Assistance Loans), 119 (Economic Opportunity Loans) and 130 (Small Business Energy Loans), and amends Parts 120 (Loan Policy) and 122 (Business Loans), former Parts 118, 119 and 130 are hereby repealed.

Overview

Part 120 of these regulations sets forth the broad policies and principles SBA employs in deciding whether to grant or deny financial assistance to small businesses pursuant to section 7(a) of the Small Business Act. It also describes the steps SBA employs to administer such assistance once it has been made available to a small business, both with respect to the recipient and any lending institution with which SBA may participate in making the assistance, and the procedures which such a lending institution must follow in order to properly participate in the making of such assistance available.

Subpart A of new Part 120 is intended to set forth the policies that SBA follows in deciding to grant or deny financial assistance. Most of the regulations contained in this Subpart were formerly contained in Part 120 of 13 CFR. However, several of the sections of this Subpart reflect preexistent policies of the Agency which have not previously been stated in regulation form, and several others are a direct result of statutory change.

Section 120.1 sets forth several general provisions of a procedural nature which explain how SBA will interpret these reguations. Of particular note is § 120.1-3 which provides that financial assistance granted before the effective date of these final regulations will be governed by the regulations and contractual provisions then in effect. In addition, § 120.1-2 allows the Administrator of SBA to suspend or modify SBA rules, for a limited period of time in a specified area, so long as the reasons for such suspension or modification are clearly explained by a notice in the **Federal Register.**

Section 120.2 sets forth a number of definitions commonly used in these regulations most of which are self-explanatory. Section 120.3 describes the various forms of SBA financial assistance available to businesses under these regulations. These are statutorily prescribed forms of assistance and the same, or very similar regulations, have been in effect since the Agency's inception.

Section 120.101 specifies the criteria of eligibility for an applicant for SBA business financial assistance. In this regard, this section specifies that an applicant must be a small business as defined by SBA in its size regulations (13 CFR Part 121) and may be an agricultural enterprise. In addition, this section provides that it is permissible to extend assistance to small businesses owned or controlled by Indian Tribes (as defined in § 120.2-7 of this rule). This provision was in the previous regulations.

Subsection 120.101-2 of these regulations establishes the general principle that SBA will make financial assistance available to most types of small businesses. It also sets forth in sub-paragraphs (a)-(h) exceptions to this general rule and descriptions of the reasons for the exceptions and the circumstances under which they will be applied. In this regard, the only exception to the general rule which is different from those presently found in SBA's regulations involves loan packagers (§ 120.101-2(h)). This revision indicates that any small concern, 30 percent of the business of which is the preparation of applications for assistance from SBA, is ineligible for SBA business financial assistance. In addition, the following small business concerns are currently, and will continue to be, excluded from financial assistance under the circumstances specified in these regulations: (a) Charitable, religious or other nonprofit institutions; (b) concerns engaged in the creation, organization, expression, dissemination, propagation or distribution of ideas, values, thoughts, opinions or similar intellectual property, regardless of medium, form or content; (c) most concerns that derive any part of their annual gross receipts or whose principal owner(s) derive any part of their annual income from gambling activities; (d) concerns engaged in illegal activities; (e) concerns primarily engaged in the business of lending or investing or any otherwise eligible applicant where the purpose of the financial assistance is to finance investments that are neither related nor essential to the enterprise; (f) any concern where the proprietor, an holder of at least 20 percent of the stock, or a partner, officer or director is currently on parole or probation following conviction of a serious crime; and (g) any concern engaged in multilevel sales distribution plans of the "pyramid" type.

Section 120.102 of these final rules sets forth the general statutorily mandated principle that eligible recipients of SBA business financial assistance may utilize the assistance to finance construction, conversion or expansion; to purchase equipment, facilities, machinery, supplies or materials; for working capital; or, at the discretion of SBA, to refinance outstanding debt. The section then specifies several uses of SBA assistance which are impermissible. For the most part, these impermissible uses are stated in SBA's present regulations. However, § 120.102-2, which prohibits the use of assistance for revolving lines of credit other than those specifically permitted by the Small Business Act, is a new regulatory provision. In addition, the provisions of the final rule regarding conflicts of interest [§ 120.102-10(a)-(f)] reflect an attempt to clarify the general proscription against creation of a conflict of interest or appearance of such a conflict between SBA and an applicant or a participating lender, by setting forth examples of such prohibited conduct which have arisen in the course of program administration.

Section 120.103 of the regulations prescribes additional criteria which SBA employs in determining the eligibility of applicants for business assistance.

In general, under these regulations, an applicant must demonstrate need for the assistance which cannot be satisfied by private sources. This is a statutory requirement which has been previously expressed in SBA's regulations. In addition, the final rule provides that SBA must in each case determine and take such steps as are needed to assure that the applicant's credit is such that there is reasonable assurance of repayment of the assistance. Section 120.103-2(a)-(h) of the proposal sets forth the means by which this assurance will be attained. These means were previously contained in SBA regulations. Finally, § 120.103 also contains the administrative provisions under which reconsideration of declined applications will be made. These provisions were also contained in SBA's previous regulations.

Section 120.104 of the final regulations describes the types and amounts of fees which may be paid attendant to SBA business financial assistance, and circumstances under which they may be paid. In circumstances in which business financial assistance is made available by SBA in conjunction with a participating lender, the lender may be required to pay SBA a guaranty fee (§ 120.104-1). The regulations describe the amount, the terms of payment and the effect of payment of such fee. Such lenders are also permitted to charge SBA a servicing fee under certain circumstances [§ 120.104-2(a)] and the final regulations set forth those circumstances and the permissible amount of such fees. The final regulations further specify that no late payment or prepayment fees may be charged in connection with SBA assistance [§ 120.104-2(b)], and that enumerated commitment fees may be charged by participating lenders in connection with SBA's export line of credit program [§ 120.104-2(c)]. Finally, the final regulations provide the terms and conditions under which fees may be paid by applicants for assistance to third parties who represent or otherwise provide services to them in connection with their attempts to obtain SBA assistance [§ 120.104-2(d)-(f)]. All of these provisions were previously contained in SBA's regulations.

Subpart B of Part 120 of the final regulations contains the policies applicable to the administration of SBA business financial assistance. In most instances of financial assistance, other than loans made directly by SBA, the responsibilities for administration of the assistance lies with the lender. Pursuant to § 120.200-1, immediate participation loans which are closed by the lender will generally be serviced by the lender; immediate participation loans or direct loans closed by SBA will generally be administered by SBA. In addition, guaranteed loans will be serviced by the lender pursuant to § 120.200-2. The lender will receive all payments of principal and interest on the loan until SBA completes the purchase of its guaranteed share of the loan. The lender may, however, continue to service the loan after such purchase provided SBA gives written consent. Therefore, the major portion of this Subpart outlines the responsibilities of the lender to SBA and the borrower in the assistance and administration process. For example, § 120.201-1 specifies the instances in which SBA's prior consent is required to permit the lender to take a servicing action, and §§ 120.202-1 and 120.202-2 prescribe the circumstances under which SBA will purchase the guaranteed portion of a loan made by a participating lender. These provisions, for the most part, are reflections of SBA policy which have not previously appeared in regulations governing the program but rather have evolved as a matter of practice and administrative interpretation of relevant program documents.

Section 120.204 of the regulations describes the practices and procedures SBA will employ either to sell or convert an evidence of indebtedness or to liquidate collateral for business assistance when either step is necessary to collect an indebtedness. In general, SBA favors a policy of avoiding such steps in favor or pursuing any reasonable prospect of repayment. Paragraph 120.204-1(a) provides that liquidating the property securing a loan will not be resorted to if there is any reasonable prospect that the loan may be repaid within a reasonable time. Section 120.204-2 prescribes steps which may be taken when SBA determines repayment is not realistic. These steps were previously prescribed in SBA's regulations, and they are the normal practices any commercial lender would follow in realiling recovery on an indebtedness. Section 120.204-1(b)(1) authorizes SBA to sell any direct loan without the consent of the borrower. Direct loans may also be converted to guaranteed loans or to immediate participation loans (§ 120.204-1(b)(2)). Subparagraph 120.204-1(b)(3) authorizes the conversion of immediate participation loans to guaranteed loans or loans wholly owned by the participating financial institution without the borrower's consent. Section § 120.204-2 prescribes provisions for the foreclosure of collateral.

Paragraph 120.204-2(a) provides for the liquidation of the security when any one of seven specified conditions exists. Real and personal property, pledged as security for a loan which is in default, may also be sold in accordance with the provisions of the related security agreement [§ 120.204-2(b)].

Subpart C of Part 120 prescribes the regulations governing the functions of banks and other lending institutions which participate with SBA in making, servicing and collecting business financial assistance. In this regard, SBA is authorized by statute to participate with banks and other lending institutions on an immediate or guaranteed basis in making such assistance (see § 120.300). A major portion of Subpart C describes the conditions under which a lender may (1) participate with SBA (§ 120.301-1 prescribes lender preferences), (2) sell or transfer the guaranteed portion of a loan (§ 120.301-2 and 120.301-3), (3) provide services to a borrower (§ 120.301-3), and (4) otherwise hold itself out as a participant to the public (§ 120.301-5). The remainder of the Subpart describes the qualifications an otherwise regulated lender must possess in order to be allowed to participate in the business financial assistance program with SBA (see § 120.301-6), and the terms on which Small Business Lending Companies (SBLC's), which are regulated only by SBA, may so participate. These qualifications and terms were previously stated in SBA's regulations and are restated without significant change in the final rule.

Subpart D prescribes the rules for the Preferred Lenders Program (PLP) which were published in final form in the **Federal Register** on December 31, 1984 (49 FR 50605). Section 120.400 sets forth the objective of this program to authorize certain lenders to undertake loan processing, servicing, collection and liquidation functions and responsibilities without obtaining prior SBA approval. Section 120.401 contains definitions of terms used in the subpart. Section 120.402 details how a lending institution becomes a perferred lender including factors which SBA shall consider in making this determination. Section 120.403-1 states that the amount of a PLP loan must exceed $100,000 and cannot exceed $500,000, and Section 120.403-2 prescribes that SBA's guarantee cannot exceed 75% of the loan. Section 120.403-3 sets forth the allocation procedure in providing credit to a PLP lender and Section 120.403-4 states that each PLP lender is responsible for all decisions relating to eligibility, creditworthiness, loan closing and legal compliance. Section 120.403-5 authorizes a Preferred Lender to charge fixed or variable interest rates and Section 120.403-6 discusses the fees which a Preferred Lender may impose. Section 120.403-7 authorizes SBA to have access to the lender's records and also requires the Preferred Lenders to be bound by the basic principles in Parts 120 and 122 relating to the granting and denying of loans. Section 120.404 deals with loan servicing and Section 120.405 with liquidation. Under Section 120.406 SBA reserves the right to suspend or revoke the eligibility of a Preferred Lender which has the right to appeal under Part 134 of this Title.

Subpart E is reserved and Subpart F, dealing with Central Registration for the Secondary Market, reflects the final rule published in the **Federal Register** on October 11, 1984 (49 FR 39837). On July 10, 1984, the Small Business Secondary Market Improvements Act of 1984 (Pub. L. 98-352, 98 Stat. 329) was enacted. It amended the Small Business Act with respect to the operation of the secondary market for SBA guaranteed loans. Subpart F reflects the procedural rules which were required to be published concerning central registration. Section 120.601 states that the statutory authority is Section 5(h) of the Small Business Act [(15 U.S.C. 634(h)] and Section 122.602 defines terms used in this Subpart.

Section 120.603 prescribes that SBA's fiscal and transfer agent (FTA) has the responsibility for registering (1) the guaranteed portions of loans sold in the secondary market and (2) the certificates to be issued representing interests in pools composed solely of the SBA guaranteed portions of loans. Section 120.604-2 details the information which the FTA shall obtain with respect to each sale in the secondary market. Section 120.605-1 provides that certificates issued by the FTA are freely transferable and it prescribes what information a seller must provide to the FTA with respect to each sale. Section 120.605-2 prescribes detailed procedures which must be used in order to replace any certificate which is lost, stolen, destroyed, mutilated or defaced.

Part 122 of these final regulations sets forth the rules governing the making of financial assistance available to small businesses pursuant to section 7(a) of the Small Business Act, 15 U.S.C. 636(a), *et seq*. Subpart A of this Part sets forth the general rules governing the terms and conditions upon which such assistance is made available, including such features as the maturities, amounts available, percentages of loan amounts SBA will guaranty, interest rates and collection policies relative to such assistance.

Subpart B of this Part describes the special features of certain loan programs which are provided for by statute such as financing residential or commercial construction or rehabilitation [Small Business Act section 7(a)(9)], subsidized loans to handicapped small business persons [section 7(a)(10)], loans to businesses located in areas of high unemployment or high proportions of low income individuals [section 7(a)(11)], loans to assist small businesses involved in energy related measures [section 7(a)(12)], loans for exporters [section 7(a)(14)], and loans to qualified employee trusts [section 7(a)(15)].

Sections 122.1-122.4 of the regulations set forth general procedural rules of applicability governing this Part. Section 122.5 describes the requirements of the SBA loan application for the various types of assistance indicated above. In general, SBA will require satisfactory evidence that lending institutions have refused to either make or participate in the making of a loan to a given small business before it will either participate with a lending institution or make the loan directly to a small business (see §§ 122.5 and 120.103). If a lending institution will make assistance available in participation with SBA, it will prepare and submit the application to SBA. For assistance made directly by SBA, the application is made by the small business (§ 122.5-3).

Section 122.6 describes the terms under which SBA assistance may be made available. Most of these requirements are provided for within the provisions of section 7(a) of the Small Business Act. In general, loans have 25 year maturities, with additional periods as may be required for that portion of a loan made for acquiring real property or constructing, converting or expanding business facilities (see § 122.6-1). SBA may also extend or renew a loan maturity up to ten years in order to aid in the orderly liquidation of the loan, or refinance a loan under prescribed conditions (see § 122.6-1). In addition, the regulations provide for the granting of grace periods and moratoria on payments under certain prescribed conditions (see §§ 122.6-2 and 3 and Part 131 [(Loan Moratorium Program) of this Title]).

As the regulations in § 122.7 indicate, SBA is statutorily permitted to make a direct loan in the amount of $350,000, but has administratively limited the available amount of a direct loan to $150,000 per borrower. In immediate participation loans, SBA is authorized a participation of 90 percent of the loan or $350,000 whichever is less. However, again by regulation SBA has limited its participation to 75 percent of the loan or $150,000, whichever is less. With respect to guaranteed loans, SBA's exposure cannot exceed $500,000 in any circumstance. The regulations also set forth statutorily prescribed percentages of SBA guaranty for certain sized loans [see § 122.7-3(a)-(c)].

Section 122.8 prescribes the interest rates which may be charged with respect to the various types of SBA loans. These, too, are statutorily prescribed [(see section 7(a)(4) of the Small Business Act)]. Of note is § 122.8-4 of the final regulations which prescribes SBA policy with respect to fluctuation of interest rates. Section 120.3(b)(2) of the former regulations, 13 CFR 120.3(b)(2), authorizes a participating lender to charge a fluctuating interest rate which could be changed no more frequently than quarterly after an initial rate period of at least one full quarter. Section 122.8-4, as stated herein, permits the fluctuation to commence on the first business day of the month following full disbursement with subsequent fluctuations no more frequently than monthly. The final regulation provides that the base rate is the low New York prime rate as printed in a national daily financial newspaper. This provision will clarify the uncertainty inherent in the previous regulation which referred only to the prime rate as published in the media. In addition, the regulation clarifies the amortization of the loan by allowing an interest spread of up to three percentage points. The previous regulation made no reference to such spread. The final regulation allows SBA to authorize unequal payments in order to amortize the loan. This is not in the present regulation but does reflect present policy and good lending practice.

Subpart B of Part 122 sets forth provisions for special purpose loans. These regulations contain provisions concerning small general contractors, organizations for the handicapped, low-income areas, energy conservation, exporters, qualified employee trusts, and loans to veterans.

Section 122.50 describes the policy and the availability of loans to small general contractors to finance residential or commercial construction. Such loan funds cannot be used primarily for the acquisition of land (i.e., not more than 20 percent of the loan proceeds can be used for the acquisition of land).

This section specifies eight conditions which must be met in order for these loans to be available (§ 122.50-2 to § 122.50-9). These conditions are: (1) The applicant must be a construction contractor with a demonstrated ability in profitable construction or rehabilitation projects of a comparable type and size; (2) the maturity of the loan cannot exceed 36 months beyond the estimated time to complete the construction or rehabilitation; (3) loan proceeds may only be used for construction or significant rehabilitation of structures for sale; (4) loan funds cannot be used to purchase vacant land or to operate or hold rental property for investment purposes; (5) the constructed or rehabilitated structure cannot be rented, pending sale, without SBA's written approval; (6) the sale of the property must be both a beneficial and a legal change of ownership in the title to the property; (7) SBA must have at least a second lien on the property as collateral; and (8) the application must include three additional letters (as described in § 122.50-9).

Section 122.51 details the authorized loans to assist organizations for the handicapped or to assist handicapped individuals in establishing, acquiring or operating a small business concern. Section 122.51-2 contains definitions of various terms used in this section. It defines the terms "HAL-1," "HAL-2," "organization for the handicapped," "handicapped individual," and "supportive services." HAL-1 applicants must submit evidence that the organization has the capability and experience to successfully perform the HAL-1 requirements [§ 122.51-4(b)]. In addition, pursuant to § 122.51-5(a), these applicants must submit copies of bylaws, incorporation papers, or other evidence that they meet the definition of HAL-1 organizations. This application must also show that private credit is not available and that funds from other government programs are not being duplicated by SBA. An applicant for an HAL-2 type loan must submit written information from a physician, psychiatrist or other qualified professional as to the permanent nature of the handicap and the limitations it places on the applicant]§ 122.51-5(b)]. Section 122.51-6 describes the uses to which the proceeds of both HAL-1 and HAL-2 loans may be put.

Section 122.52 authorizes loans to establish, preserve or strengthen small business concerns (1) located in areas with high proportions of unemployed or low-income individuals, or (2) owned by low-income individuals.

Section 122.53 describes the authorized loans to assist small business concerns to utilize energy measures designed to conserve the Nation's energy resources. Section 122.53-2 defines what the term "energy measures" encompasses, including: solar thermal energy equipment; photovoltaic cells; hydroelectric power equipment; and wind energy conversion equipment. Loan proceeds may be used to acquire vacant land necessary for the construction of a plant and any other equipment or materials which are required to effectively employ eligible energy measures (§ 122.53-3). Section 122.53-4 recognizes that because greater risk may be associated with these energy measures, the status of these loans need not be as sound as for other loans authorized under Subpart B.

Section 122.54 sets forth the provisions governing an authorized revolving line of credit for pre-export financing and for export purposes to enable small concerns to develop foreign markets. An applicant for an Export Revolving Line of Credit must have been in operation for 12 full months before filing an application in order to be eligible, but SBA may waive this requirement if the management of the applicant has sufficient export trade experience or other management ability (§ 122.54-2). The proceeds of such a loan may only be used to penetrate or develop a foreign market and to finance labor and materials for pre-export production (§ 122.54-3). This subsection then gives a few examples of what would constitute both eligible and ineligible uses of proceeds. These stated examples are by no means intended to be exclusive. Section 122.54-5 requires that only collateral that is located in the United States, its territories and possessions will be acceptable security for these loans. In addition, applications for these loans must contain a projected cash flow chart for the term of the loan and monthly progress reports (§ 122.54-6).

Section 122.55 describes the specifications for authorized guaranteed loans to qualified employee trusts. Such guaranteed loans are authorized to finance growth and to effect a change of ownership in business concerns that are small or that would be small after the purchase is accomplished (§ 122.55-1). Section 122.55-2 contains definitions of various terms used in this section. It defines the terms "employee," "employee organization," "employee trust," "employer concern," "ESOP," "qualified employee trust," and "qualifying employer securities." These definitions do not amend or modify the definitions in the Internal Revenue Code, and the regulations thereunder, or the Labor Department definitions. Section 122.55-3 clarifies the fact that the $500,000 statutory limit which SBA may guarantee applies to the *combined total* of all obligations of the qualified employee trust, the employer concern and all its other affiliates in the aggregate. The individual personal assets of the employee-owners cannot be considered in determining whether to guarantee a loan. However, SBA may consider business experience where certain employee-owners assume managerial responsibilities (§ 122.55-4(c)). Paragraph § 122.55-5(a) specifies eight requirements which must be met in order for a qualified employee trust to be eligible for an SBA loan guarantee, including the provision that the SBA guarantee loan can only be used for the purchase of qualifying employer securities. Pursuant to § 122.55-5(b), in order for a trust to be treated as a qualified employee trust for the purposes of an SBA loan guaranty, such trust must: (1) Be maintained by an employee organization which represents at least 51 percent of the employees of such concern; (2) be part of a plan which constitutes an employee benefit plan under the Labor Department regulations implementing ERISA, provided the plan contains certain specified requisites; and (3) enter into an agreement with SBA setting forth the eight requirement cited in paragraph (a) of § 122.55-5.

The veterans loan program is set forth in Sections 122.56—122.56-4. The specific statutory authority, as stated in Section 122.56-1 may be found in the Veterans Small Business Loan Act of 1981 (Pub. L. 97-35) and the Second Continuing Resolution of 1983 (Pub. L. 97-377). Section 122.56-2 states that it is a direct loan program. Section 122.56-3 sets forth the eligibility rules. Section 122.56-4 prescribes that the veteran status may be used only once.

Public Comments

SBA received three public comments concerning this rule as published in proposed form in the **Federal Register** on September 25, 1984 (49 FR 37614). Two of the three comments addressed the Handicapped Assistance Loan Program (HAL). One commenter suggested that the regulations include a statement of SBA's long standing policy that HAL-1 applicants are not subject to SBA size eligibility regulations (13 CFR Part 121). Another stated his belief that the proposed § 122.51-6 was overly restrictive as it required HAL-1 loan proceeds to be used primarily for direct labor and materials expenses. That commenter also objected to the proposed requirement that the eligibility of HAL-1 applicants be confirmed by "a state vocational rehabilitation agency," and the absence of a statement of the statutory requirement that reasonable doubts concerning a concerns ability to repay should be resolved in favor of the applicant. The third commenter objected to SBA's so-called "opinion molder rule" which precludes SBA loan assistance to small concerns engaged in the creation, organization, expression, dissemination, propagation or distribution of ideas, values, thoughts, opinions or similar intellectual property, regardless of medium, form or content.

SBA has reviewed and evaluated these comments as well as suggestions from other SBA employees and has modified the proposed regulations, where appropriate. SBA has added a sentence to § 122.51-2 clarifying that HAL-1 applicants are not subject to SBA size eligibility regulations. SBA has also modified section 122.51-6(a) to specify that proceeds may be used for legitimate business purposes similar to other SBA loans, except that funds may not be used for supportive services.

SBA notes that the language of the eligibility confirmation requirement: "recognition/approval by a state vocational rehabilitation agency" is followed by the qualifying phrase "or other evidence that it meets the definition of a HAL-1 organization." SBA believes this phrase expresses SBA's intent that recognition or approval by a state vocational rehabilitation agency not be the only type of acceptable eligibility confirmation. Nevertheless, in order to clarify this intent, § 122.51-5(a) has been modified to read ". . . recognition/approval by an appropriate State, local, or Federal rehabilitation agency or other evidence. . ." SBA did not modify the regulations as a result of the comment concerning an applicant's ability to repay. Section 122.51-4(a) clearly outlines this provision and we believe that reiteration in other parts of the regulation is unnecessary.

SBA's policy of excluding media-oriented businesses from loan assistance is longstanding and was not proposed in the September 25, 1984 **Federal Register** for purposes of substantive evaluation, but rather as part of an organizational revision. Therefore, SBA has no intent to alter this well-established policy at this time. SBA will consider the commenter's statements as part of a study evaluating all of the exceptions to SBA business loan eligibility.

The following changes have been made in the proposed rule in response to internal SBA suggestions.

Section 120.101-2(e) was rewritten to improve clarity. A phrase was added to subsection 120.101-2(f) prohibiting loans to firms that have principals who are incarcerated, on probation or parole. This prohibition is now extended to include ". . .other persons, including hired managers, who have or will have the authority to speak for and commit the borrower in the management of the business." The inclusion of this item is consistent with present practice. A sentence was added to § 120.103-2 in reference to SBA's credit evaluation as follows: "The Agency may obtain from credit reporting agencies the applicant's credit history and rating." This addition serves to codify the long standing practice of SBA to obtain commercial credit reports on loan applications.

Section 120.202-1 has been clarified to state the basic present rule that a lender may demand that SBA purchase the guaranteed percentage if borrower has defaulted in payment of any installment of principal or interest when due and if the default continues uncured for more than 60 days (or less if SBA agrees).

Section 120.202-5 and § 120.204-2(a)(7) describe circumstances where SBA is not bound to repurchase and when SBA may approve the liquidation of collateral. They have been expanded to include failure to disclose material facts, false statements, or material misrepresentations made to SBA during the life of the loan.

Section 120.302-1(d) has been modified to specify time frames that constitute "prompt notice". Section 120.303-2 has been modified to require audited financial statements instead of "financial reports.". Section 120.304 has been modified to change "Audit Division of SBA" to "Office of Inspector General, Audit Division". Proposed §§ 120.305 through 120.305-8 have been deleted because suspension of eligibility to participate with SBA is now addressed in 13 CFR 134, and the final § 120.305 is effectively a cross-reference to the procedures prescribed in Part 134.

Section 122.54-2 has been modified to permit exceptions to the general rule that applicants for an Export Revolving Line of Credit must have been in operation for twelve (12) full months before filing an application with SBA. This change was published as a final rule in the **Federal Register** (49 FR 32845) on a date that was too late to be incorporated into the proposed rule. In addition, some minor edits and cross references have been added to various subsections to promote the clarity of the narrative and to assist the user in locating related texts. This final rule also incorporates final regulations published since the publication of this proposal. The rules on the central registration for the secondary market published on October 11, 1984, (49 FR 39837), appears in place in subpart F of Part 120; the final rule on sale of the guaranteed portion published on November 2, 1984 (49 FR 44091), appears in Sections 120.301-2 and 120.301-3; and the final rule promulgating the Preferred Lenders Program published on December 31, 1984 (49 FR 50605), appears in place in Subpart D of Part 120.

Compliance With the Regulatory Flexibility Act, (5 U.S.C. 601 et seq.), Executive Order 12291 and the Paperwork Reduction Act, 44 U.S.C. Ch. 35

As indicated above, this final rule is primarily a reorganization of existing regulations and a revision of certain of the provisions to promulgate statutorily mandated changes in the operation of SBA's business financial assistance program. Taken as a whole, these final rules do constitute major rules for the purpose of E.O. 12291 and will have a significant economic impact on a substantial number of small businesses for the purpose of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq*. In this regard, the rules provide the general framework by which an annual program of approximately $3.5 billion is administered. Under this program, SBA annually approves approximately 25,000 small business applicants for business loan assistance.

1. Description of Potential Benefits

The benefits to be derived from this rulemaking are non-financial in nature. This rulemaking constitutes a procedural simplification of our present regulations which should assist all business loan applicants in understanding the program. It eliminates repetitious regulations, more clearly codifies existing policies, and updates the regulatory format governing the program to reflect statutory changes.

2. Potential Costs

These final regulations impose no costs in and of themselves, with one exception. Examination fees for existent non-bank lenders of which there are only 16, would be increased by doubling both the base fee and the additional fee calculation.

3. Net Benefits

Since no additional costs will be imposed on the vast majority of entities affected by this regulation, the net benefits of the rule will result from a simpler application and administration procedures for business loans and a clearer statement of SBA's policies regarding such loans.

4. Alternative Approaches

These final rules, as indicated above, constitute a necessary general reorganization and an incorporation of certain statutory requirements. In lieu of this reorganization, SBA could have left unchanged the regulation governing business loans or could have created a series of new parts each representing a separate loan program. SBA believes this reorganization is more logical, easier to follow and less cumbersome than either of the other alternatives.

5. Reporting or Recordkeeping Requirements

These final regulations do not duplicate or overlap any existent regulations. They impose no new application or recordkeeping requirements. Since there are no additional application or recordkeeping requirements imposed by this final regulation, this reorganization is not subject to the Paperwork Reduction Act, 44 U.S.C. Ch. 35.

However, inherent in this regulation are the requirements that applicants provide information and records to SBA to enable determination of eligibility and creditworthiness. Such requirements have been previously approved by the Office of Management and Budget and their appropriate approval numbers are cited in the text of the rule. Professional assistance in preparing such material may be required, i.e., accounting or bookkeeping assistance. Normally, however, applicants are capable of preparing the applications themselves. The statutory basis for these proposed rules are section 5(b)(7), 15 U.S.C. 634(b)(7) and section 7(a), 15 U.S.C. 636(a) of the Small Business Act, as amended.

The following table provides a cross reference to specific regulations as they appear in both the existing regulations and this final rule. Because of repetition in the existing regulations and because these final regulations represent a rearrangement of some sections, several previously existing citations may have the same citation as a reference or may have more than one citation in the final regulations as a reference. Those instances in which Pub. L. 97-35 appears as a reference indicates our authority was modified by the new law. Use of the word "out" appears as the indication that the existing regulation was dropped in this final rule.

118.1(a)	122.51-2(e)—122.51-6.
118.1(b)	122.51.
118.2 (a) and (b)	Out.
118.2(c)	120.101-1.
118.2(d)	120.2-1.
118.2(e)	122.51-2(c)—PL 97-35.
118.2(f)	122.51-2(d)—PL 97-35.
118.2(g)	122.51-2(a).
118.2(h)	122.51-2(b).
118.11(a) and (a)(1)	122.51-2(c)—122.51-5.
118.11(a)(2), (i), and (ii).	120.103-2.
118.11(a)(2) (iii) and (iv).	122.51-5.
118.11(b)	122.51-2(d)-122.4.
118.11(b)(1)	120.103-1.
118.11(c)	122.51-6.
118.11(d)	122.51-5(b).
118.21(a)	122.51-6.
118.21(b)	Out.
118.31(a) and (a)(1)	PL 97-35—122.7.
118.31(b)	122.51-3.
118.31(c)	PL 97-35—122.8.
118.31(d)	120.202-3.
118.31(e)	122.6-1—122.6-2.
118.41(a) and (a)(1)	120.3-4.
118.41(a)(2)	122.7-2—122.7-3.
118.41(a)(3)	120.104.
118.41(a)(4)	120.301-1.
118.51(a) and (a)(1)-(3).	120.103-2.
118.51(a)(4)	120.103-2.
118.51(a)(4)(i)	122.51-4(a).
118.51(a)(5)	120.103-2(c).
118.51(a)(5)(i)	122.51-4(c).
118.51(a)(5)(ii)	122.51-4(c).
118.51(a)(6)	120.103-2.
118.51(a)(6)(i)	122.51-4(b).
118.61	12.5—120.103-3.
118.71(a)	122.4.
118.71(b)	122.51-5(a).
119.1	PL 97-35—122.52.
119.2 (a) and (b)	122.52.
119.2(c)	Out—PL 97-35.
119.11	120.2.
119.21 (a), (b), and (b)(1).	122.52.
119.21(b)(2)	Out.
119.21 (c) and (d)	122.52—120.101-2(a).
119.21(e)	122.52.
119.21(f)	120.103-1.
119.31(a)	122.7.
119.31(b)	122.5—122.6 PL 97-35.
119.31(c)(1)	122.8-1.
119.31(c)(2)	122.8-2.
119.31(c)(3)	120.202-3.
119.31(d)	120.103-2(c).
119.41(a)	122.7-3—PL 97-35.
119.41(b)	122.7-2—PL 97-35.
119.51 (a) and (b)	120.103-2—122.52.
119.51(c)	120.103-2.
119.51(d)	120.103-2(b).
119.51(e)	Out—PL 97-35.
119.61	122.5-3.
119.71	122.4.
119.81	122.52.
119.91	Out—PL 97-35.
120.1(a)	120.1.
120.1(b)	120.2-5.
120.1(c)	120.2-6.
120.1(d)	120.2-2.
120.2(a)	120.103-1.
120.2(b) and (b)(1)	120.3-4.
102.2(b)(2)	122.7 -2 and -3.
120.2(b)(3)	120.301-1.
120.2(c)(1)	120.103-2.
120.2(c) (2) and (3)	120.102 -6 and -7.
120.2(c)(4)	120.101-1(b).
120.2(c)(5)	120.101-1(c).
120.2(d)(1)(i)	120.102-1.
120.2(d)(1)(ii)	120.102-3.
120.2(d)(1)(iii)	120.102-4.
120.2(d)(1)(iv)	120.102-11.
120.2(d)(2)	120.102-5.
120.2(d)(3)	120.101-2(a).
120.2(d)(4)	120.101-2(b).
120.2(d)(4)(i)	120.101-2(b).
120.2(d)(4)(ii)	120.101-2(b).
120.2(d)(4)(iii)	120.101-2(b).
120.2(d)(4)(iv)	120.101-2(b).
120.2(d)(4)(v)	120.101-2(b).
120.2(d)(4)(vi)	120.101-2(b).
120.2(d)(4)(vii)	120.101-2(b).
120.2(d)(5)	120.101-2(c).
120.2(d)(6)	120.102-8.
120.2(d)(7)	120.102-8—122.50.
120.2(d)(8)	120.102-9.
120.2(d)(9)	120.101-2(d).
120.2(d)(10)	120.101-2(e).
120.2(d)(11)	120.101-2(f).
120.2(d)(12)	120.101-2(g).
120.3(a)	122.6—122.6-1.
120.3(b)(1)	120.104.
120.3(b)(1)(i)	Out.
120.3(b)(1)(ii)	Out.
120.3(b)(1) (iii)-(iv)	120.104.
120.3(b)(2)(1) and (ii)	122.8—PL 97-35.
120.3(b)(iii)(A)	Out.
120.3(2)(iii)(B)	122.8-4.
120.3(b)(2)(iv)	122.8-3.
120.3(b)(2)(v)	120.202-3.
120.3(b)(2)(vi)	120.202-4.
120.3(b)(3)	120.104-2 (a) and (b).
120.3(b) (5) and (5)(i)	120.104-2 (d) and (e).
120.3(b)(5)(ii)	120.104-2 (d) and (f).
120.3(b)(6)	120.103-2(e).
120.4(a)	120.300.
120.4(a)(1)	120.301-5(a).
120.4(a)(2)	120.301-5(b).
120.4(a)(3)	120.301-5(c).
120.4(a)(4)	120.301-5(d).
120.4(b)	120.302.
120.4(b)(1)	120.302-1(a).
120.4(b)(2)	120.302-1.
120.4(c)(1)	120.300.
120.4(d)	120.305.
120.4(d)(1)	120.305-1.
120.4(d)(2)	120.305-2.

120.4(d)(3)	120.305-3.
120.4(d)(4)	120.305-4.
120.4(d)(5)	120.305-5.
120.4(d)(6)	120.305-6.
120.4(d)(7)	120.305-7.
120.4(d)(8)	120.305-8.
120.5(a)(1)	120.102-10.
120.5(a)(2)	120.301-3.
120.5(a)(2)(i)	120.103-2 (d) and (e).
120.5(a)(2)(ii)	Out.
120.5(a)(3)	120.301-2—120.301-3.
120.5(a)(4)	120.301-4.
120.5(b)	120.302.
120.5(b)(1)	120.302-2(d).
120.5(b)(2)	120.302-1(c).
120.5(b)(3)	120.302-1(e).
120.5(b)(4)	120.302-1(f).
120.5(b)(5)	120.302-1(g).
120.5(b)(6)	120.302-1(h).
120.5(b)(7)	120.302-1(i).
120.5(b)(8)	120.302-1(j), (k), and (l).
120.5(b)(9)	120.302-1(m).
120.5(b)(10)	Out.
120.5(b)(11)	120.302-1 (n).
120.5(b)(12)	120.302-1 (o).
120.5(b)(13)	120.302-1 (p).
120.5(b)(14)	120.302-1 (q).
120.6(a)	120.303-1.
120.6(b)	120.303-2.
120.6(c)	120.303-3.
120.6(d)(1)	120.303-4.
120.6(d)(2)	120.303-5.
120.6(d)(3)	120.303-6.
120.7	120.304.
122.1	122.1.
122.2(a)	120-1—120.103-1.
122.2(b)	120.103-1.
122.2(c)	120.103-2.
122.2(d)	120.103.
122.2(d)(1)	Out.
122.2(d)(2)	Out.
122.2(d)(3)	Out.
122.2(e)	122.4.
122.2(f)	120.2-3—120.2-6.
122.3	122.4.
122.4	Out.
122.5 (a) and (b)	122.7—PL 97-35.
122.6	Out.
122.7	120.3-2—122.7-2.
122.8	120.3-1.
122.9	Out PL 97-35.
122.10(a) (1)-(4)	Out.
122.10(a)(5)	120.202-1.
122.10(a)(6)	120.202-2—120.202-5.
122.10(b)(1) (i)-(iii)	Out.
122.10(b)(1)(iv)	120.202-5(e).
122.10(b) (2) and (3)	Out.
122.11	Out.
122.12	Out.
122.13	120.102.
122.14	122.6-1.
122.15	122.5.
122.15-1-3	120.103-3.
122.16(a)-(d)	120.103-2.
122.16 (d)(1), (e), (f), and (g).	120.103-2.
122.17	122.6-1.
122.18	120.104-2(e).
122.19	122.5-5.
122.20(a)	120.200-1.
122.20(b)	120.200-2.
122.20(c)(1)	Out.
122.20(c)(2)	120.201.
122.20(d)	Out.
122.21	120.203.
122.22 (a)-(d)	120.204.
122.23(a)	120.204-1.
122.23(b) (1)-(7)	120.204-2.
122.24 (a)-(d)	122.204-2.
122.25 (a)-(c)	120.204-2.
122.100	120.400.
122.101	120.401.
122.102	120.402-1.
122.103	120.402-2.
122.104	120.403-1.
122.105	120.403-2.
122.106	120.403-3.
122.107	120.403-4.
122.108	120.403-5.
122.109	120.403-6.
122.110	120.403-7.
122.111	120.404.
122.112	120.405.
122.113	120.406.
122.302	122.55-2.
122.303	122.55-1.
122.304	122.66-1—122.55-3.
122.305(a)	122.55-5.
122.305(b)	122.55-4(a).
122.305(c)	122.55-4(b).
122.305(d)	122.55-4(c).
122.305(e)	122.55-4(c).
122.305(f)	122.55-5.
122.306(a)	122.55-5(a).
122.306(b)	122.55-5(b).
122.307	122.55-1(b).
122.308(a)	122.55-4(c).
122.308(b)	122.55-4(b).
122.308(c)	122.55-4(b).
122.308(d)	122.55-4(b).
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List of Subjects

13 CFR Part 120

Loan programs/business, Small businesses.

13 CFR Part 122

Handicapped, Employee benefit plans, Loan programs/business, Small businesses, Trusts and trustees, Energy, Grant programs/energy, Loan programs/energy, Solar energy.

Accordingly, pursuant to the authority in Section 5(b)(6) of the Small Business Act (15 U.S.C. 631 et seq) Parts 118, 119, and 130, Chapter 1 Title 13 of the Code of Federal Regulations are repealed and Parts 120 and 122 are revised to read as follows:

PART 120—BUSINESS LOAN POLICY

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120.1-2 Pilot programs.
120.1-3 Savings clause.
120.2 Definitions.
120.2-1 Act.
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120.2-3 Financial assistance.
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Authority: Sec. 5(b)(6), 7(a) and 7(h) of the Small Business Act, as amended, 15 U.S.C. 634(b)(6) and 636 (a) and (h).

§ 120.1 General.

§ 120.1-1 Scope.

This Part sets forth the broad policies and principles that the Small Business Administration (SBA) follows in deciding to grant or deny Financial Assistance under the authority of section 7(a) of the Small Business Act, 15 U.S.C. 636(a), administering and servicing loans, and overseeing the operations of all loan participants. This Part does not apply to financial assistance provided under the Development Company loan program unless specifically referenced by Part 108 of this Title. Frequently firms seeking a loan do not need financial assistance but are in need of management or financial counseling. SBA will, in these cases, provide such assistance through its various counseling programs.

§ 120.1-2 Pilot programs.

(a) In order to explore new directions or improved delivery of SBA services to small concerns, the Administrator of SBA may from time to time publish a notice in the **Federal Register** that certain rules will be suspended or modified for a limited period of time in a specified area.

(b) Such notice in the **Federal Register** shall clearly explain the reasons or grounds for the suspension or modification of SBA rules and comply with all applicable statutes and regulations.

§ 120.1-3 Savings clause.

Financial Assistance granted before March 26, 1985, shall be governed by the related contractual terms and the regulations then in effect. Nothing herein shall bar SBA enforcement action with respect to such Financial Assistance granted pursuant to contractual terms no longer in use or prior regulations no longer in effect. If any section or part of a section of these regulations shall be adjudged invalid, only that part shall be invalid, and the other parts shall not be affected thereby.

§ 120.1-4 Captions.

Captions are inserted as required by the **Federal Register** for convenience only and are not part of the substance of these regulations. Defined terms are capitalized hereafter.

§ 120.2 Definitions.

The following terms have the same meaning wherever they are used in this Part dealing with loan programs or Financial Assistance.

§ 120.2-1 Act.

Act means the Small Business Act, as amended, 15 U.S.C. 631 *et seq.*

§ 120.2-2 Associate.

Associate means an associate of the Lender. This includes any of the following persons who have, or had, an interest in the applicant during the period six months before the date of the application or at any time thereafter while the loan is outstanding:

(a) An officer or director of the Lender; and employee authorized to approve loans on the Lender's behalf; a holder directly or indirectly of 10 percent or more of the value of the Lender's stock, debt instruments or other securities; or a close relative or partner of any such person.

(b) Any person, business or other entity that, directly or indirectly, controls, is controlled by or is under common control with the Lender, or a close relative or partner of such person.

(c) Any enterprise in which 10 percent or more of the value of the stock or ownership interest, debt instruments and other securities are owned or controlled by one or more persons or entities acting in concert and named in paragraphs (a) and (b) of this definition (except a Small Business Investment Company licensed by SBA), or when any such person or entity is an officer, director or partner.

(d) A "close relative" as used in paragraphs (a) and (b) of this definition only, means ancestor, lineal descendant, brother or sister or the lineal descendant of either, spouse, father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law or sister-in-law who is a member of the person's household.

§ 120.2-3 Financial assistance.

Financial Assistance means any SBA loan, whether made directly by SBA or as an immediate participation or guarantee loan made in cooperation with a Financial Institution.

§ 120.2-4 Financial institution.

Financial Institution means banks, or other concerns whose regular course of business entails the making of commercial and industrial loans. The terms participating lender, participant, non-bank lender, small business lending company, bank or lender refer to Financial Institutions that are eligible to participate with SBA and have executed participation agreements.

§ 120.2-5 Lending institution or lender.

(See definition of Financial Institution, § 120.2-4.)

§ 120.2-6 Participant and participating lender.

(See definition of Financial Institution, § 120.2-4.)

§ 120.2-7 Qualified Indian tribe.

Qualified Indian Tribe means an Indian tribe, as defined in section 4(a) of the Indian Self-Determination and Education Assistance Act (25 U.S.C. 4506), which owns and controls 100 percent of a small business concern.

§ 120.2-8 Small Business Lending Company (SBLC).

(See definition for Financial Institution, § 120.2-4.)

§ 120.3 Types of loans.

§ 120.3-1 Direct loans.

These loans are made by SBA without a Financial Institution's participation.

§ 120.3-2 Immediate Participation (IP) loans.

These are loans where either SBA or a Financial Institution agree to purchase from the other, immediately upon disbursement, an agreed percentage of each disbursement.

§ 120.3-3 Guaranty (GP) loans.

These loans, which are referred to as "deferred participations" in the Act, are loans made by a Lender to a small business under a guaranty agreement between the Lender and SBA. The agreement may be an individual agreement that pertains to one specific loan only or a blanket agreement that pertains to all such loans submitted by the Lender and approved by SBA. The Lender advances the total funds for the loan and SBA agrees to purchase, upon demand by the Lender and subject to specific conditions, an agreed portion of the outstanding balance.

§ 120.3-4 Priority of loan type.

Every applicant for a direct loan, immediate participation or guaranty loan must show that the loan is not available without SBA assistance. In addition, an applicant for a direct loan must show that neither an immediate participation nor a guaranty loan is available; an applicant for an immediate participation must show that a guaranty loan is not available.

(Approved by the Office of Management and Budget under control number 3245-0016)

Subpart A—Loan Making Policy

§ 120.100 General.

This subpart outlines the general loans policies covering eligibility, basic loan principles, interest rates, fees and other matters that apply to all SBA Financial Assistance.

§ 120.101 Eligibility of applicant.

§ 120.101-1 Applicant business concern.

(a) *Size.* To receive Financial Assistance from SBA the business applicant must qualify as a small business as defined in Part 121 (Size Standards) of this Chapter.

(b) *Loans to Agricultural Enterprises.* Small concerns engaged in farming and related businesses will be assisted by SBA in accordance with the Memorandum of Understanding signed by the SBA and the United States Department of Agriculture, Farmers Home Administration (FmHA), which appears as Appendix A to this part.

(c) *Loans to Indian Tribes.* Eligibility of small business concerns under section 7(a) of the Act shall not be adversely affected because any such concern is owned or controlled by an Indian Tribe as defined herein (see § 120.2-7).

§ 120.101-2 Type of business.

Most small concerns are eligible for Financial Assistance. The following types of businesses are, however, not eligible for SBA assistance except where otherwise stated in this section (§ 120.101-2).

(a) *Charitable, Religious or Other Non-profit Institutions.* Eleemosynary (charitable) institutions, other non-profit enterprises, government-owned corporations, consumer and marketing cooperatives, churches and organizations promoting religious objectives. An otherwise eligible small concern owned in whole or in part by a private non-profit organization is eligible, as is such a concern when owned and controlled by a qualified Indian Tribe. Sheltered workshops for the handicapped are eligible under a special program, see § 122.51. Producer cooperatives, including farm cooperatives, are eligible if "small" under Part 121 of this Title, and if they are totally owned by otherwise eligible small concerns that share a common need, the cooperative is for the exclusive use of the members and the cooperative provides raw materials, equipment, inventories, supplies or the benefits of research and development or the facilities for such purposes. For qualified employee trusts, see § 122.56.

(b) *Media and Similar Concerns.* Concerns engaged in the creation, origination, expression, dissemination, propagation or distribution of ideas, values, thoughts, opinions or similar intellectual property, regardless of medium, form or content. Financial Assistance to such applications is barred in order to avoid Government interference, or the appearance of such interference, with the constitutionally protected freedoms of speech and press.

(1) Such concerns include:

(i) *Publishing.* Concerns that are publishers, including so-called "vanity" publishers, and producers, importers, exporters or distributors of communications, including newspapers, magazines, books, greeting cards, sheet music, pictures, posters, film, tape, live broadcasts, recordings or reproductions of sight, sound or musical programs or products, motion picture theaters or theatrical productions, and transportation concerns limited to the distribution or delivery of such products.

(ii) *Book Distributors.* Concerns that are book distributors, that specialize in selling products (books, newspapers, etc.) that promote or advocate ideas, including ideological, political, artistic or philosophical viewpoints. This does not prohibit assistance for a general merchandise store that is also selling books, newspapers, magazines, records, etc. or a general (as distinguished from a specialized) book or music, record, or videotape store.

(iii) *Schools.* Concerns operating schools that teach academic subjects. Nursery and pregrade schools are eligible if they are not primarily (50% or more of the time) engaged in teaching academic subjects, and vocational, technical or other nonacademic schools that do not also teach academic subjects are eligible. English taught in a vocational school may be considered a nonacademic subject if the instruction focuses on grammar, spelling, vocabulary, syntax or communications.

(2) Financial Assistance may, however, be extended to:

(i) *Printing.* A concern solely engaged in commercial or job printing, if there is no common ownership or other affiliation with another concern that is ineligible under this section [§ 120.101-2(b)], and the printer has no direct financial interest in the commercial success of the material produced.

(ii) *Advertisements and Technical Material.* A concern that produces advertisements and promotional material for a client's goods and services or technical or instructional material relating to a client's goods and services.

(iii) *Shoppers' Newspapers.* A concern that publishes shoppers' newspapers or circulars consisting of advertising material only, without editorial, narrative or filler material.

(iv) *Reproduction of Material.* A concern that provides motion picture, videotape, sound recording or theatrical technical production facilities, or the technical reproduction of motion picture, videotape or sound recordings without editorial or artistic participation, provided that the applicant concern has no direct interest in the commercial success of the material produced and that there is no common ownership or other affiliation between the applicant and the concern interested in the success of the material being produced.

(v) *Broadcasting and Cable TV.* A concern operating a commercial broadcasting (radio or television) station or a cable TV system under the regulatory jurisdiction of the Federal Communications Commission (FCC) or a cable TV franchise granted in conformity with FCC standards. Concerns engaged in predominantly religious or political programming are not eligible.

(c) *Gambling.* Concerns that derive any part of their annual gross receipts, including rental income, or whose principal owner(s) derive any part of their annual income from gambling activities: *Provided, however,* That an otherwise eligible concern shall not become ineligible if it obtains less than one-third of its annual gross income (either before the loan application or during the life of the loan) from (1) commissions from the sale of official State lottery tickets under a State license or (2) from gambling activities in those States where such activities are legal and supervised by the State.

(d) *Illegal Activities.* Concerns that are engaged in an illegal activity or are engaged in the production, servicing, or distribution by sale or otherwise of products or services used in connection with an illegal activity. This includes, but is not limited to, the production, servicing, distribution of paraphernalia, products or services that are used or intended to be used primarily or exclusively in connection with the unlawful use of drugs or controlled substances.

(e) *Lending or Investment, "Alter Ego".* Concerns primarily engaged in the business of lending or investing. Applicants that are otherwise eligible become ineligible where the purpose of the Financial Assistance is to finance investments that are neither related nor essential to the enterprise: *Provided, however,* That a small concern (holding company) owning and leasing or proposing to own and lease real or personal property to an otherwise eligible small concern (operating company) shall be eligible if all the following conditions are met:

(1) The holding company must be a small business organized and operated for profit as an individual proprietorship, parternship or corporation.

(2) It must be in the business of owning and leasing real or personal property to the operating company.

(3) It must propose to use loan proceeds for purposes that would be eligible uses for the operating company.

(4) It must use the loan proceeds solely to acquire or improve real or personal properly (including eligibile refinancing) for the exclusive use of such operating company.

(5) It must have ownership interest(s) completely identical with and in the same proportion as the ownership interest(s) in the operating company and agree in writing that such identity of ownership shall remain unchanged until the loan is paid in full or unless SBA gives written approval for an earlier change.

(6) It must pledge the lease between it and the operating company having a remaining term at least equal to the term of the loan and a lien on the property itself as collateral for the loan.

(7) The operating company must be either a guarator or coborrower on the loan and the owner(s) of the operating company must guarantee the loan.

(f) *Parole or Probation.* Any concern if the proprietor, or a holder of 20 or more precent of the stock, or a partner, officer, director, or other persons, including hired managers, who have or will have the authority to speak for and commit the borrower in the management of the business, in currently incarcerated, on parole or on probation either pursuant to a pre-trial diversion or following conviction of a serious offense. The concern remains ineligible if the probation or parole is lifted solely because it is an impediment to obtaining a loan.

(g) *Multilevel Sales Distribution Plan.* Generally, any concern engaged in multilevel sales distribution plans of the "pyramid" type.

(h) *Loan Packager.* Any small business concern, where a substantial part (30% or more of its annual business volume) is the preparation of applications seeking Financial Assistance from the SBA. This is not intended to preclude Financial Assistance to an otherwise eligible small concern that regularly provides accounting or legal services to the public.

§ 120.102 Limitations on loan purposes.

Small manufacturers, wholesalers, retailers, service concerns and other firms may borrow to finance construction, conversion or expansion; to purchase equipment, facilities, machinery, supplies or materials; to obtain working capital; or, at the discretion of SBA, to refinance outstanding notes payable. for additional special rules applicable to refinancing loans, see § 122.7-3(c). Financial Assistance shall not be granted if the direct or indirect purpose or result of granting the loan would be to:

§ 120.102-1 Refinance unsecured loans.

Pay off inadequately secured creditor(s) who could suffer a loss if the debt is not refinanced, and SBA would probably sustain all or part of the same loss, or if SBA determined that the loan will not benefit the small concern: *Provided, however,* That (subject to intervening adverse change) SBA may reimburse a lender's interim advance from loan proceeds if made in compliance with a loan authorization previously issued by SBA. SBA shall not decline to guarantee a loan solely because such loan will refinance existing indebtedness of a small concern.

§ 120.102-2 Revolving credit.

Except as permitted under § 122.54, create a revolving line of credit, such as "floor plan" financing.

§ 120.102-3 Pay obligation of owners.

Provides funds for payments, distributions or loans to owners, partners or shareholders of the applicant, exclusive of ordinary compensation for services rendered, and excluding the proceeds of loans to change ownership of the business as described in § 120.102-6 below.

§ 120.102-4 Refund debt to SBIC

Refund a debt owed to a Small Business Investment Company (SBIC) (see Part 107 of this chapter). However, applications may be accepted from business applicants financed by an SBIC if SBA's collateral position will be superior to that of the SBIC.

(a) *Participation with an SBIC.* SBA shall not participate on either an immediate or guaranty basis with an

SBIC (§§ 120-2 and 120-3). However, this does not limit the granting of a loan to an applicant which has or will have a loan or equity capital from an SBIC if SBA's collateral position is superior to that of the SBIC.

(b) *Loans to Firms Owned or Controlled by SBIC.* A loan may be made to a firm which is otherwise eligible but temporarily owned or controlled by an SBIC in compliance with the regulations in Part 107 of this chapter.

§ 120.102-5 **Speculation.**

Provide or free funds for speculation in any kind of real or personal property, whether tangible or intangible. Examples of speculations include "wildcatting" in oil and dealing in commodity futures.

§ 120.102-6 **Change in ownership.**

To effect a change in the ownership of the applicant unless the change (a) will promote the sound development or preserve the existence of a small concern or (b) will contribute to a well-balanced national economy by facilitating ownership of small concerns by person(s) whose participation in the free enterprise system has been prevented or hampered because of economic, physical or social disadvantages or because of disadvantages in residential or business location.

Note.—It is not intended that the Agency permit an individual(s) to borrow funds to purchase an interest in a business (except as permitted under § 122.55).

§ 120.102-7 **Recreational or amusement enterprises.**

Finance the construction, acquisition, conversion or operation of recreational or amusement enterprises unless (a) they are open to the general public and (b) they are properly licensed by the appropriate State or local authority. The character and reputation of the applicant will be given special consideration.

§ 120.102-8 **Investment in property.**

Finance the acquisition, construction, improvement or operation of personal or real property that is, or is to be, held for sale or investment (rental income) and is not be used in connection with the applicant's otherwise eligible small business. (See § 122.50 of this chapter for an exception.)

§ 120.102-9 **Monopoly.**

Have the effect of encouraging a monpoly or be inconsistent with the accepted standards of the American system of free enterprise.

§ 120.102-10 **Conflict of interest.**

Create, or appear to create, a conflict of interest. Without the prior written approval of the responsible district office, SBA shall not participate in or guarantee a loan to a business where the lender or an Associate has, or acquires while the loan is outstanding, an interest in any form which constitutes a conflict of interest, or the appearance thereof, with respect to the loan or the small concern. A field office reviewing a request for approval must determine whether a conflict of interest exists or appears to exist because of preferential treatment or the loss of independent, impartial and objective judgment. It must determine what corrective action, if any, will eliminate the actual or apparent conflict of interest and allow immediate processing of the loan application. The field office determination shall be based on such factors as the nature of the relationship between the Lender and its Associate, the significance of an Associate's influence on the actions or decisions of the Lender, the nature of the relationship with a close relative (e.g. would it tend to prejudice an objective decision) and such other factor(s) as may, directly or indirectly, contribute to or negate a conflict of interest. The following are examples (not an all inclusive listing) of where SBA shall not participate in or guarantee a loan:

(a) *Non-disclosure.* When the Lender's application to SBA does not contain a full disclosure statement, including negative statements to the best of its knowledge, from the Lender and from the small concern, relative to all relationships discussed in § 120.2-2 and an undertaking that no such relationship shall knowingly be created as long as the loan is outstanding. For an exception relating to the handicapped see § 122.51-5(a).

(b) *Purchase from Lender.* When the proceeds will directly or indirectly finance the purchase of real estate, personal property or services (including insurance) from the Lender, its Associate, or the designee of either, SBA may permit such on a case by case basis by making a written determination that the purchase is in the best interest of the applicant and will not impair the Lender's objective judgment in any decisions with respect to the making, servicing or liquidation of the loans. The applicant shall not contract with the Lender or an Associate for goods or services without written approval by SBA.

(c) *Reduced Exposure.* When the proceeds will reduce the exposure of the Participant unless SBA makes a written determination that it is in the best interest of the applicant and meets the requirements of § 122.7-3(c) of this chapter.

(d) *Repay Associate.* To repay or refinance a debt due an Associate unless SBA makes a written determination that the documentation in the file supports the repayment or refinancing. The evidence shall show that the terms of the existing debt are causing the applicant undue hardship, that refinancing the debt will relieve the hardship and the relief from the hardship is not available through extension or modification of the original debt or through refinancing with private lending sources.

(e) *Forward Commitment.* Where the Lender has issued a real estate forward commitment to a builder/developer with respect to a project of such builder/developer and the applicant for Financial Assistant proposes to use the proceeds to acquire space in such project.

(f) *Reinvestment in Lender.* When the applicant or its principals invest funds in the Participant Lender: *Provided, however,* That if the enabling authority of a Participant (such as a Production Credit Association) requires such investment, Participant may make a "side loan" not guaranteed by SBA and subordinated to SBA's Financial Assistance except that lender may hold a first lien on the securities representing such investment, and *Provided, further,* That the interest rate applicable to such side loan does not exceed SBA's maximum for guaranteed loans and the maturity is no shorter than that of SBA's Financial Assistance.

§ 120.102-11 **Replacement of funds.**

Replace funds already used for the purposes described in § 120.102.

§ 120.103 **Lending criteria.**

§ 120.103-1 **Evidence of needs.**

Applications for Financial Assistance shall be considered only when the desired credit is not otherwise available on reasonable terms from non-Federal sources. To establish that the credit is otherwise available, SBA shall:

(a) *Proof of Refusal.* (1) Direct or immediate participation loans: Require written proof of refusal from (i) the applicant's bank of account or, if the amount of the loan exceeds that bank's legal or normal lending limit, from a correspondent bank with a legal or normal lending limit that is adequate to cover the loan, and (ii) from a second Financial Institution in cities with a population exceeding 200,000. The proof of refusal must be dated and signed and include the amount and terms requested and the reason for denial;

(2) *Guaranty Loans.* The certification a Lender makes in its application for a guaranty by SBA will generally be accepted as sufficient documentation in lieu of a letter(s) of decline.

(b) *Funds Otherwise Available.* Determine from financial statements or other financial information provided whether it appears that the funds are available (1) from a private or public sale of securities issued by the applicant, (2) by disposal at a fair price of assets not necessary to the applicant's operation or growth, (3) through utilization, without undue hardship, of the resources of the owners, partners, management or principal shareholders. SBA may obtain the applicant's credit history from credit reporting agencies as part of the credit evaluation.

(Approved by the Office of Management and Budget under control numbers 3245-0016 and 3245-0196)

§ 120.103-2 Credit evaluation.

In evaluating a loan application, SBA attaches importance to many factors including the character and reputation of the applicant and its principals, experience and depth of management, the inherent soundness of the business enterprise, the past earnings record and future prospects, the long-range possibilities of successful operation, and whether the granting of Financial Assistance has a sound business purpose. SBA may obtain from credit reporting agencies the applicant's credit history and rating.

(a) *Repayment.* The Act specifies that ". . . all loans shall be of such sound value or so secured as to reasonably assure repayment . . ." Therefore no Financial Assistance shall be extended unless there is reasonable assurance that the loan can be paid from the earnings of the business.

(b) *Sound Finances.* The applicant shall have enough equity invested or to invest so that, if SBA Financial Assistance is approved, it can operate on a sound financial basis.

(c) *Collateral.* Adequate collateral is required to reasonably protect the interest of the Government. The amount of collateral needed, considered along with other credit factors, is determined on a case-by-case basis. Proprietors, partners, officers, directors, and owners of 20 percent or more of the business shall generally be required to guarantee payment of the loan and, in SBA's discretion, to pledge personal assets to secure the guarantee. Inadequate collateral will not normally be used as the sole reason for decline unless the applicant refuses to pledge whatever worthwhile collateral is available.

(d) *Special Reports.* SBA may require professional appraisals of the applicant's assets, an engineering survey or feasibility study of the applicant's operation, earnings, management, competitive position or other such factors. The need will be determined by a review of the application and, when needed, the applicant is generally required to purchase the service and submit the report to SBA.

(e) *Insurance Coverage.* A small business is generally required to purchase and maintain hazard insurance and flood insurance (see Part 116 of this chapter). In some instances, life insurance on the principal(s) may also be required. The borrower must select the agent and carrier from whom the insurance is purchased and, generally, any new or additional insurance required should be reducing term insurance with an original face amount no greater than the amount of the loan. Any variation in the type of life insurance shall be authorized by SBA in writing. Any fee or commission for insurance purchased from the Lender or an Associate must be reported as a fee paid to the Lender. The purchase of insurance from the Lender or an Associate may not be required as a condition to accepting, processing, or approving a loan.

(f) *Compliance with Other Parts.* All Financial Assistance under this part shall require compliance with Parts 112, 113, 116 and 117 of this chapter. With respect to any Financial Assistance of SBA, Part 112 prohibits discrimination on the grounds of race, color, or national origin. Part 113 prohibits discrimination based on race, color, religion, sex, material status, handicap or national origin with respect to all recipients of SBA Financial Assistance. Part 116 prescribes policies of general application set forth in several subparts. Subpart A sets forth SBA policies and criteria for giving special consideration to veterans and their survivors or dependents. Subpart B prescribes rules on the prohibition of SBA Financial Assistance for acquisition or construction in special flood hazard areas when persons eligible for flood insurance have not obtained it. Subpart C prohibits recipients of SBA Financial Assistance from using lead-based paint as described therein. Subpart D prescribes policies and procedures dealing with floodplain management and wetlands protection. When promulgated, Part 117 will cover the prohibition of discrimination based on age.

(g) *Tax Requirements.* If any portion of the loan proceeds will be used for paying wages of additional employees, the applicant shall be current on all payroll taxes, both Federal and State. It shall have a depository plan in operation for payment of future employee withholding taxes.

(h) *Bonding Requirements.* On all construction loans, a 100 percent payment and performance bond and builders risks/workman's compensation insurance must be supplied unless waived by SBA.

(Approved by the Office of Management and Budget under control numbers 3245-0016 and 3245-0191)

§ 120.103-3 Reconsideration of decline.

Any applicant that is declined for size may appeal the decision only in accordance with Part 121 of this Chapter. Otherwise, any applicant whose request (including request for a modification of an existing loan condition) has been declined shall have the right to present new or additional information to overcome the reason(s) for decline and request a reconsideration.

(a) *File Within 6 Months.* Applicant shall submit a written request for reconsideration to the office that processed and declined the application within six months of the date of the initial decline. After six months a new application is required. A request for reconsideration of a guaranty loan application must be submitted by the lender.

(b) *Additional Information.* The written request for reconsideration must contain all significant new or additional information which is expected to overcome the reason(s) for decline. Reconsideration requests without new information will not be accepted.

(c) *Reasons for Decline.* Decline of an application for one reason(s) does not waive the Agency's right to decline a request for reconsideration for another reason(s).

(d) *Appeal of Declined Reconsiderations.* An applicant whose request was declined on reconsideration shall have the right to request reconsideration at the next higher office. Such written requests for further reconsideration must be submitted to the office that processed the loan within 30 days of the last decline action, and shall specifically request reconsideration at the next higher office and shall contain the written justification for requesting a reversal of the decline action.

(e) *Finality of Review.* The decision of the regional office is final: *Provided,* *however*, That the Regional Administrator may refer a case to the Associate Administrator for Finance and Investment (AA/F&I), or the AA/F&I may request that a file be forwarded to the Central Office because of special circumstances. The term "special circumstances" refers to a policy reconsideration or reevaluation of an existing policy by the Agency, conflicting policy interpretations between two regional offices, alleged improper act by SBA personnel or other such considerations.

(Approved by the Office of Management and Budget under control number 3245-0189)

§ 120.104 Fees.

§ 120.104-1 Guaranty fees.

The Financial Institution shall pay a guaranty fee to SBA for each loan. Acceptance of the guaranty fee by SBA shall not waive any right of SBA arising from the Lender's negligence, misconduct or violation of any provision of these regulations, the guaranty agreement or the loan authorization.

(a) *Amount*. SBA shall charge a guaranty fee on loans with maturities in excess of twelve months, equal to one percent (1%) of the guaranteed portion of the loan. For loans with a maturity of twelve (12) months or less, the guaranty fee shall be one-quarter (1/4) of one percent of the guaranteed portion of the loan. (See section 122.6-1 of this Chapter with respect to loan maturities.)

(b) *When Payable*. The Lender shall pay the guaranty fee on a loan with a maturity not in excess of 12 months at the time the Lender submits the application for guaranty. The Lender shall pay the guaranty fee on a loan with a maturity in excess of 12 months within 90 calendar days of the date of SBA's approval as stated in the loan authorization. Like fees shall be paid for increases in the loan amount. If the guaranty fee is not paid by the Lender within this time period, SBA will send the Lender a written notice (bill) requesting payment. The guaranty shall be subject to termination if SBA does not receive the fee within the time period stated in the notice.

(c) *Who Pays*. The Participating Lender is responsible for paying the guaranty fee to SBA. For guaranty loans having a maturity of 12 months or less, the lender (having paid the fee to SBA) may charge borrower for the guaranty fee upon approval of the loan by SBA. For guaranty loans with maturities exceeding 12 months, a Lender (having paid the guaranty fee to SBA and made the first disbursement on the loan) may charge the borrower for the guaranty fee. The borrower may use loan proceeds to pay the fee.

(d) *Reinstatement of Guaranty*. SBA may, at its sole discretion, reinstate a guaranty that was cancelled for failure to pay the guaranty fee, where SBA determines that such Lender's failure was not intentional and not part of a recurring pattern. SBA will not reinstate a guaranty if the fee is unpaid at the time the borrower defaults and if such default continues uncured for sixty days or if SBA determines that there has been a substantial adverse change in the borrower's condition.

(e) *Refunds*. (1) SBA shall refund the guaranty fee submitted with the application for loans with a maturity of 12 months or less, when an application is withdrawn prior to approval by SBA, or declined by SBA, or when SBA substantially changes the Lender's loan terms and then approves the loan. When SBA's modified terms are unacceptable, the Lender must request refund in writing within 30 calendar days of such approval.

(2) SBA shall refund the guaranty fee for a loan with a maturity exceeding 12 months only when the Lender has not made any disbursement on the guaranteed loan and requests the refund and cancellation of the guaranty in writing.

(Approved by the Office of Management and Budget under control numbers 3245-0016 and 3245-0191)

§120.104-2 Service and commitment fees.

(a) *Service Fees*—(1) *Regular Service*. The Lender may charge SBA a service fee for servicing immediate participation loans or guaranty loans where SBA has purchased its guaranty portion but has not assumed responsibility for servicing the loan. The Lender may also charge a service fee to a third party where the guaranty portion has been transferred by the Lender to a third party. The Lender shall deduct such fee only from interest collected for the account of SBA or a third party and only so long as the Lender is servicing the loan. The fee shall not be added to any amount the borrower is obligated to pay under the loan. Fees on guaranty loans after SBA purchase are determined by the initial percent of SBA guarantee. Where SBA's share of an immediate participation or guaranteed loan is seventy-five (75) percent or less, the service fee shall be three-eighths (⅜) of one (1) percent per annum on the unpaid principal balance of SBA's share of the loan. Where SBA's share of any immediate participation or guaranteed loan is in excess of seventy-five (75) percent, the service fee shall be one-fourth (¼) of one (1) percent per annum of the unpaid principal balance of SBA's share of the loan. The fee a Lender receives for servicing a loan for the benefit of a third party is negotiated between the two parties and is not subject to the limitations set forth above.

(2) *Loan Extension*. An additional service fee not exceeding one (1) percent of the outstanding amount of the principal may be paid by the borrower to the Lender in consideration for extending the term or refinancing the indebtedness where the extension results in a term that exceeds ten years.

(3) *Extraordinary Service*. Subject to prior written SBA approval, if a loan will have extraordinary servicing needs, a Lender may charge the applicant a service fee not to exceed two (2) percent per annum on the outstanding balance of such loan, or in the case of construction loans, two (2) percent of the amount approved. If the extraordinary services are required only for part of the loan, or for part of the collateral for a loan, such service fee shall be applied only to that part of the loan, or for the part secured by such collateral. In no event may such service fee represent additional interest or profit on the loan. The fee charged shall be commensurate with the extra service provided and shall be requested by the Lender and justified in writing prior to approval of the loan.

(b) *No Late Payment or Prepayment Fees*. Fees for handling late payments and fees or penalties for partial or full prepayment of the loan shall not be charged in connection with any SBA loans.

(c) *Commitment Fee for Export Revolving Line of Credit (ERLC) Loans*. After SBA approves a loan under the ERLC program a Lender may charge the borrower a commitment fee of one-quarter (¼) of one (1) percent (or $200 minimum) of the loan. (See Section 122.54-4 of this Title relating to Export Revolving Lines of Credit.)

(d) *Fees for Representatives*. Except as herein provided, no applicant for SBA Financial Assistance shall be required to pay the Lender, an Associate of the Lender or any party designated by either, any fees or charges, for any goods or services, including insurance as a condition of the Lender's participation in an SBA loan. See also Parts 103 and 104 of this title, especially §103.13-5.

(e) *Fees for Other Services*. Payment of bonus, or brokerage fees or commissions for the purpose of, or in connection with, obtaining financial assistance through SBA is prohibited. A Lender or Associate may charge an applicant reasonable fees on an hourly basis for necessary services actually performed at the request and for the primary benefit of the applicant. Nothing contained herein shall be deemed to authorize any Lender to impose upon an applicant fees or charges (including origination or packaging fees), any part of which defrays the Lender's overhead cost; for example, payments for services of counsel, accountants, financial analysts, etc., who are salaried employees of the Lender or its Associate. An opinion on the validity of the loan or its compliance with SBA requirements serves the interest of the Lender and is part of its overhead cost. If the Lender needs additional appraisals, abstracts of title or other record searches for the processing or as a condition of the disbursement of a loan, the Lender or an Associate (with the consent of the applicant in either case) may prepare such documentation for a reasonable fee. Legible copies of any such documents shall be made available to the applicant, together with any supporting workpapers that the applicant may request. If the same law firm represents both Lender and applicant, with the applicant's consent and pursuant to applicable bar and court rules, such law firm may charge applicant reasonable fees for the services rendered to and for the benefit of the applicant. SBA has no national standard as to what is reasonable. The SBA district offices determine what fee is reasonable on a case by case basis. A Lender may be reimbursed by the borrower for any reasonable out-of-pocket expenses incurred for filing or recordation necessary to perfect a security interest in the assets of the borrower, including title insurance. A Lender shall not require that borrower pay points, and add-on interest may not be used. A Lender may receive the fees authorized under this paragraph, and no others, whether or not the requested loan is made.

(f) *Report on Fees.* The applicant shall certify the names of all attorneys, accountants or other representatives, including the Participating Lender or its Associates, engaged by the applicant for a fee in connection with the Financial Assistance being requested, as well as the amount paid. SBA Form 159 (Compensation Agreement) shall be used therefor.

(Approved by the Office of Management and Budget under control number 3245-0201)

§ 120.105 Other legal requirements.

SBA loans are also subject to the provisions and requirements of other legislation such as the Freedom of Information, Privacy, Right to Financial Privacy, Paperwork Reduction, Flood Disaster Protection, Lead-Based Paint Poisoning Prevention, Equal Credit Opportunity, Occupational Safety and Health, Consumer Credit Protection Acts, Civil Rights Legislation and various Executive Orders. Therefore, SBA may request data, agreements, or acknowledgements to support or document compliance with, and respond to reporting requirements of, these statutes in addition to the data required to make an informed credit decision. (See Parts 112, 113, 116 and 117 of this chapter.)

Subpart B—Loan Administration

§ 120.200 General.

This subpart outlines the general loan administration policies applicable to SBA Financial Assistance.

§ 120.200-1 Servicing direct or immediate participation loans.

Immediate participation loans which are closed by the Lender shall be serviced by the Lender, and immediate participation loans or direct loans closed by SBA shall be administered by SBA. However, SBA reserves the right to transfer the servicing of an immediate participation loan from the Lender to SBA and, with mutual agreement, from SBA to the Lender.

§ 120.200-2 Servicing guaranteed loans.

Guaranteed loans shall be serviced by the Lender. The Lender shall hold the note, instruments of hypothecation, and all other agreements, documents, and instruments required in connection with such loans. The Lender shall receive all payments of principal and interest on the loan until such time as SBA may complete the purchase of its guaranteed share of the loan, i.e., when SBA perfects the paperwork necessary to process disbursement and SBA's purchase of its share of a guaranteed loan is complete. The Lender shall thereupon assign the note and the other loan instruments to SBA and loan servicing shall become the responsibility of SBA. With SBA's written consent the Lender may continue to service the loan after purchase. In such case, the Lender shall execute a certificate of interest evidencing SBA's percentage of the loan and shall continue to service the loan and be the holder of the note and the other instruments, until SBA makes a written request for the transfer of loan servicing to SBA; the Lender shall thereupon assign and deliver to SBA all loan instruments immediately after receipt of such a transfer request from SBA.

(Approved by the Office of Management and Budget under control number 3245-0191)

§ 120.201 Servicing requirements.

§ 120.201-1 Prior consent required.

The holder of the note shall not, without the prior written consent of the other participant:

(a) *Alteration.* Make or consent to any substantial alteration in the terms or conditions of any loan instrument. For the purpose of this paragraph, "substantial" includes, but is not limited to, increases in principal amount or interest rate or any action that benefits or confers a preference on the holder;

(b) *Release of Collateral.* Make or consent to releases of collateral having a cumulative value, as reasonably determined by the holder of the note, which is more than 20 percent of the original loan amount;

(c) *Accelerate Maturity.* Accelerate the maturity of the note;

(d) *Sue.* Sue upon any loan instrument;

(e) *Waive Claim.* Waive any claim against any borrower, guarantor, obligor or standby creditor arising out of any loan instrument;

(f) *Increase Amount of Prior Lien.* Increase the amount of any prior lien held by the Lender on property securing an SBA guaranteed loan.

§ 120.202 SBA purchase of guaranteed loans.

§ 120.202-1 SBA purchases determination.

SBA shall have the right at any time to purchase its guaranteed percentage of a loan if SBA shall determine that such purchase is in the best interest of the Government. If the borrower has defaulted in payment of any installment of principal or interest when due and if the default continues uncured for more than 60 calendar days (or less if SBA agrees), Lender may demand in writing that SBA purchase the guaranteed percentage of the loan.

§ 120.202-2 No waiver.

Purchase by SBA of its guaranteed share shall not waive any right of SBA arising from Lender's negligence, misconduct or violation of these regulations, the guaranty agreement or the loan instruments.

§ 120.202-3 Rate of interest to borrower.

When SBA purchases its share of a loan, the rate of interest payable by the borrower on the SBA share shall be the same as the rate of interest provided in the note. On loans with a fluctuating interest rate, the interest paid to SBA shall be the rate in effect at the time of default where a default has occurred, or the rate in effect at the time of purchase where no default has occurred.

§ 120.202-4 Accrued interest to holder.

When SBA purchases its guaranteed share, its payment to the holder of accrued interest to the date of purchase shall be at the rate of interest provided in the note. On those loans with a fluctuating interest rate, the SBA's payment of accrued interest shall be at that rate in effect at the time of default when a default has occurred, or at the rate in effect at the time of purchase where no default has occurred.

§ 120.202-5 When SBA does not purchase.

SBA shall be released from obligation to purchase its share of the guaranteed loan unless the Lender has substantially complied with all of the provisions of these regulations, the Guaranty Agreement and the Loan Authorization, and has not failed to disclose material facts, and has made no material misrepresentations to SBA with respect to the loan; or upon the happening of any one or more of the following events:

(a) *Defective Closing.* Failure of the Lender to close and disburse the loan substantially in accordance with the terms and requirements of the loan instruments (including the loan authorization), or to service the loan in a prudent manner, either of which may result in a substantial loss on the loan;

(b) *Full Payment.* Payment in full of the amount due on the note;

(c) *Request to Terminate.* Receipt by SBA of written request from the Lender to terminate the guarantee; or

(d) *Non-Payment of Guaranty Fee.* Failure of the Lender to pay the guaranty fee as required by § 120.104-1(c).

(e) *Late Demand.* Failure of the Lender to demand purchase of an unpaid guaranteed portion or to request an extension of maturity within one year after the maturity of the note: *Provided, however,* That if SBA denies the request to extend the loan, the Lender shall have 6 months from the date of such denial to demand that SBA purchase the guaranteed portion of the loan.

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§ 120.203 Collection policy.

It is the policy of SBA to insist upon prompt payments, and upon compliance with all conditions of the note, mortgage and loan agreement. Any request for relief should be directed to the Participating Lender or the SBA field office, whichever is servicing the loan. In order to aid and assist borrowers in the discharge of their finanical obligations, it is the policy of SBA to advise and counsel with borrowers in all aspects of their business, with a view to the development of a healthy, growing concern.

§ 120.204 Liquidation of loans and security.

§ 120.204-1 Liquidation policy.

(a) *Assist and Protect Business.* It is the policy of SBA to aid, counsel, assist and protect small concerns to which loans have been made. Ordinarily, the liquidation of the property securing a loan will not be resorted to if there appears to be any reasonable prospect that the loan may be repaid by the borrower or a guarantor (other than SBA) within a reasonable period.

(b) *Sale and Conversion of Loans*—(1) *Sale of Direct Loan.* SBA is authorized to effect the sale of any direct loan upon payment of the full amount of the borrower's obligation. The consent of the borrower is not required.

(2) *Conversion of Direct Loans.* Direct loans may be converted to guaranteed loans or to immediate participation loans.

(3) *Conversion of Immediate Participation Loans.* An immediate participation loan may be converted to a guaranteed loan or a loan wholly owned by the Participating Institution without the borrower's approval upon payment of the unpaid amount of SBA's participation in such loan, together with accrued interest due thereon and any advances that may have been made by SBA.

§ 120.204-2 Foreclosure of collateral.

(a) *Liquidation of Collateral.* Liquidation of the security may be approved when any one of the following conditions exists:

(1) The borrower is in default in the payment of one or more installments due under a note or has defaulted in the performance of conditions contained in the note, loan agreement, other instrument, or a security instrument, and the failure to cure, or to attempt to cure, such default is due to (i) lack of diligence; (ii) lack of managerial ability which the borrower has failed to correct; (iii) other circumstances within the borrower's control; or (iv) the inability of the borrower to remedy the default;

(2) Foreclosure of other creditor's rights proceedings have been instituted which may jeopardize the interests of the Government;

(3) A borrower has filed a voluntary petition or an involuntary petition has been filed against the borrower pursuant to any of the provisions of the Bankruptcy Code, as amended;

(4) A receiver has been appointed or other judicial action is taken for the purpose of liquidating the borrower's assets.

(5) The borrower has made an assignment for the benefit of creditors;

(6) The borrower is in default and has discontinued or abandoned the business or has not submitted an acceptable plan of payment;

(7) The borrower has failed to disclose in the loan application or during the life of the loan any fact deemed by SBA to be material; or a misrepresentation by, on behalf of, or for the benefit of, the borrower has been made to SBA.

(b) *Disposal of Collateral.* Real and personal property, including contracts and claims, pledged as security for a loan which is in default may be sold in accordance with the provisions of the related security instrument.

(1) *Competitive Bids or Negotiated Sale.* SBA or the Participating Lender generally shall offer acquired collateral for public sale.
Such sales, unless otherwise authorized, will be ordinarily effected through competitive bids at an auction sale or a sealed bid sale. Where property cannot be sold advantageously at auction or sealed bid sale, a negotiated sale of the property may be authorized. The right, title and interest of SBA in property sold will, unless otherwise authorized, be conveyed by an appropriate bill of sale or deed, without representation or warranty.

(2) *Lease of Acquired Property.* SBA does not favor renting or leasing acquired property or the granting of options to purchase. In those instances where the property cannot be sold advantageously and it appears to be in the interest of the Government to lease the property, proposals for a lease will be considered. Any such proposals shall provide for termination by SBA upon the giving of reasonable notice when a favorable offer to purchase is received.

(c) *Recoveries and Security Interests Shared.* All payments or recoveries on a loan as well as all reasonable expenses (including advances for the care, preservation, and maintenance of collateral securing the loan) incurred by SBA or the Participating Lender, and any security interest or guaranty (excluding SBA's guaranty) which the Participating Lender or SBA may hold or receive in connection with a loan shall be shared ratably by SBA and such Lender in accordance with their respective interests in the loan.

(d) *Guarantors.* Guarantors of Financial Assistance, other than SBA, shall have no rights of contribution against SBA on a SBA guaranteed loan. SBA shall not be deemed to be a coguarantor with any other guarantors.

Subpart C—Loan Participants

§ 120.300 Policy.

SBA is authorized to make in its discretion participation loans in cooperation with banks and other Financial Institutions, excluding Small Business Investment Companies licensed by SBA, through agreements to participate on an immediate or deferred (guaranty) basis. Such agreements do not obligate SBA to participate in any particular loan or loans that a Lender may submit. The existence of a participation agreement does not limit SBA's right to determine from time to time, as a matter of general policy or with respect to particular loans, the ratio between its share of a loan and the Lender's share, or SBA's right to withhold, at its sole discretion, approval of a proposed transfer of the guaranteed portion of any loan.

§ 120.301 Operation of all loan participants.

§ 120.301-1 Preferences.

No agreement to participate under the Small Business Act shall establish any preferences in favor of the Participant. "Preferences" as used in this regulation include, but are not limited to, (a) any arrangement giving a Participating Lender a preferred position over the SBA position as regards repayment, collateral or guarantees in connection with the loan, (b) any requirement that the borrower accept a separate or companion loan which results in a preferred position for the Participant or (c) any requirement that a borrower purchase a certificate of deposit or maintain a compensating balance which is not under the unrestricted control of the borrower. For loans made in participation with offices of the Production Credit Association see § 120.102-10(f).

§ 120.301-2 Sale or transfer of guaranteed position.

In addition to assignments of an SBA guaranteed loan as provided in SBA Form 750 and 750B (Loan Guaranty Agreements), a Lender may transfer the entire guaranteed portion using, after February 15, 1985, only SBA Form 1086, Secondary Participation Guaranty and Certification Agreement in which the Lender and SBA agree to the repurchase of the guaranteed portion as provided in such agreement: *Provided*, That prior to the execution thereof:

(a) *Documents*. The duly executed note and settlement sheet(s) underlying the transaction, and such other documents as SBA may expressly require have been submitted by the Lender to SBA;

(b) *Fees Approved*. All fees, including fees to agents (as defined in § 103.13-2 of this chapter) paid or to be paid by the borrower in connection with the loan have been approved by SBA;

(c) *Full Disbursement*. The full amount of the loan, as authorized, has been disbursed by the Lender to the borrower;

(d) *Guaranty Fees Paid*. All guaranty fees have been paid in full; and

(e) *Terms*. The terms of sale do not obligate the Lender or SBA to repurchase under any circumstances other than those provided for in the said secondary participation agreement.

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§ 120.301-3 Centralized registration of guaranty transfers.

When the initial sale by Lender was transacted on SBA Form 1084, the next succeeding transfer, after February 15, 1985, by holder must utilize SBA Form 1085, Request for Certification of SBA Form 1084. All transfers of a guaranteed portion after February 15, 1985, must be centrally registered with SBA's fiscal and transfer agent (FTA) and all financial transactions relative to the guaranteed portion must flow through the FTA. Updating the central registry to reflect subsequent transfers will be accomplished through the use of informaion contained on the Certificate evidencing the transfer. Execution of the secondary participation agreement by SBA shall not relieve any Lender of the obligation of compliance with all legal requirements relating to the sale or other transfer of securities, including (but not limited to) the statutes administered by the Securities and Exchange Commission and "Blue Sky" laws.

(Approved by the Office of Management and Budget under control number 3245-0195)

§ 120.301-4 Services to borrowers.

Subject to § 120.102-10, Lenders, their Associates or the designee of either may provide services to and contract for goods with any small concern only after full disbursement of the loan to the small concern or to an account not controlled by the lender, its Associate, or designee of either. Where lender or any Associate or the designee of either provides services permitted under Subpart A of this part, such srvices shall be furnished on a time basis pursuant to a written contract approved by the board of directors, partners, or proprietor of the small concern. Records of time spent and charges made for such services shall be maintained for examination by SBA. Charges made shall not exceed those charged by established professional consultants providing similar services.

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§ 120.301-5 Advertisement of relationship with SBA.

A Lender may make reference in its advertising to its participation with SBA by the use of phrases such as "a participant with SBA in loans to small business" or "solely engaged in participation with SBA in loans to small business": *Provided, however*, That no such advertising shall state or imply that such Lender, or any of its borrowers, will enjoy preferential treatment from SBA; or be false or misleading in any other respect; and *Provided, further*, That such advertising shall not make use of SBA's seal or any facsimile thereof.

§ 120.301-6 Requirements for all participants.

A participating Financial Institution must meet all of the following requirements:

(a) *Capability*. Have a continuing capability to evaluate, process, close, disburse, and service loans authorized to be made by SBA to small business concerns. Such capability will be deemed to exist when the Financial Institution's operations are at all times conducted by persons possessing the above listed capability. The Financial Institution shall hold itself out to the public as engaged in the making of such loans, and shall maintain a reasonably accessible office in its own name, have a listed telephone number, and be open to the public during regular business hours.

(b) *Good Character and Reputation*. Have continuing good character and reputation. A Lending Institution will be deemed to possess good character and reputation if the holders, direct or indirect, of ten (10) percent or more of its voting power, and all members of its management (including managers and other key employees, officers and directors) possess good character and reputation. Good character and reputation shall be deemed absent if any of the above mentioned is or are currently incarcerated, on parole or probation, or has or have been indicted for, formally charged with or convicted of a felony, or suffered an adverse final civil judgment in any case involving a breach of trust or the violation of a law or regulation protecting the integrity of business transactions.

(c) *Financing Subsidiaries*. Not be engaged (or planning to engage) primarily in financing the operations of an affiliate as defined in Part 121 of this chapter.

(d) *Supervision and Examination.* Be a Financial Institution subject to continuing supervision and examination by a State or Federal chartering, licensing, or similar regulatory authority as SBA may deem satisfactory, such as a State or National Bank, or a State or Federal Savings and Loan Association.

§ 120.302 Loan participants regulated by SBA.

§ 120.302-1 Small business lending companies.

Prior to January 4, 1982, SBA regulations provided that any Lending Institution which was not subject to continuing supervision and examination by State or Federal regulatory authority could be approved as a Participating Lender subject to certain conditions. Such a Lender was referred to as a "Subsection (b) Lender" and is presently known as a "Small Business Lending Company" or "SBLC". Effective January 4, 1982, SBA does not accept applications for SBLC status but existing SBLC's continue to participate with SBA and be subject to supervision and examination by SBA. In addition to the requirements set forth in § 120.301-6 (a) through (c), an SBLC shall:

(a) *Business Purposes.* Be a corporation (profit or non-profit) engaged solely in the making of loans under Section 7(a) [except Section 7(a)(13)] of the Act in participation with SBA.

(b) *Subject to SBA Supervision.* Maintain a written agreement with SBA whereby it will be subject to supervision and examination by SBA and will conduct its business operations in accordance with all applicable SBA regulations.

(c) *Capital Structure.* Have unencumbered paid-in capital and paid-in surplus of at least $500,000 or ten percent of the aggregate of its share of all outstanding loans, whichever shall be more.

(d) *Capital Impairment.* Maintain at all times an unimpaired capital. Impairment shall be deemed to exist when the retained earnings deficit exceeds fifty percent of combined paid-in capital and paid-in-surplus, excluding treasury stock. SBA shall be given prompt written notice of any capital impairment within 30 calendar days of the month-end financial report that first reflects the impairment. Until the said impairment is cured, a Lender shall not present any loans to SBA for guaranty.

(e) *Issuance of Securities.* Without prior written SBA approval, not issue any securities including stock options and debt securities, except stock dividends and common stock issued for cash or direct obligations of, or obligations fully guaranteed as to principal and interest by, the United States.

(f) *Voluntary Capital Reduction.* Without prior written SBA approval, not voluntarily reduce its capital, or purchase and hold more than two (2) percent of any class or combination of classes of its stock.

(g) *Reserves for Losses.* Maintain a reserve in the amount of anticipated losses on loans and receivables.

(h) *Maintenance of Records.* Maintain accurate and current financial records, including books of account. All financial records, minutes of meetings of stockholders, directors, executive committees, or other officials, and all documents and supporting materials relating to the said Lender's transactions shall be maintained at its principal business office, *Provided, however,* That securities held by a custodian pursuant to a written agreement shall be exempt from this requirement.

(i) *Preservation of Records.* Preserve, for the periods hereinafter specified and in a manner that permits the immediate location thereof, such documents which are the basis for financial statements required by section 120.303 (and of the accompanying independent public accountant's opinion), and shall:

(1) Preserve permanently—

(i) All general and subsidiary ledgers (or other records) reflecting asset, liability, capital stock and surplus, income, and expense accounts;

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

(iii) 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.

(2) Preserve for at least six years following final disposition of the related loan—

—All applications for financing;
—Lending, participation, and escrow agreements;
—Financing instruments;
—All other documents and supporting material relating to such loans, including correspondence.

Records and other documents referred to in this paragraph (i) may be preserved by reproduction: *Provided, however,* That said Lender shall cause a duplicate to be made on a current basis and stored separately from the original for the time required, and shall maintain at all times facilities for the projection and reproduction of the records.

(j) *Internal Control.* Adopt a plan designed to safeguard its funds and other assets, to assure the reliability of its personnel, and the accuracy of its financial data.

(k) *Dual Control.* Maintain dual control over disbursement of funds and withdrawal of securities. Disbursements shall be made only by means of checks or wire transfers authorized by signatures of two or more officers covered by the said Lender's fidelity bond, except that checks in an amount of $1,000 or less may be signed by one bonded officer. Two or more bonded officers, or one bonded officer and a bonded employee, shall be required to open safe deposit boxes or withdraw securities from safekeeping. The SBLC shall furnish to each depository bank, custodian, or entity providing safe deposit boxes, a certified copy of the resolution implementing the foregoing control procedures.

(l) *Fidelity Insurance.* 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 $25,000 executed by a surety holding a certificate of authority from the Secretary of the Treasury pursuant to 6 U.S.C. 6-13.

(m) *Change of Ownership or Control.* Report any proposed change of ownership or control to SBA. Any change of ownership or control is prohibited without prior written approval of SBA. Lender shall file request for approval of any such change with the Associate Administrator for Finance and Investment, SBA, Washington, D.C. 20416. Pending such approval, Lender shall neither register the proposed new owners on its transfer books, nor permit them to participate in any manner in the conduct of the Lender's affairs. Change of ownership or control shall include:

(1) Any transfer of ten percent or more of any class of the SBLC's stock, and any agreement providing for such transfer;

(2) Any transfer that could result in the beneficial ownership by any person or group of persons acting in concert of ten (10) percent or more of any class of its stock, and any agreement providing for such transfer;

(3) Any merger, consolidation, or reorganization; or

(4) Any other transaction or agreement that in fact transfers control (as defined in § 121.3-2(a) of this chapter). If transfer of ownership or control is subject to the approval of any

State or Federal chartering, licensing, or similar regulatory authority, copies of any documents filed with such authority shall, at the same time, be transmitted to the SBA District Office serving the area in which the Lender's principal office is located.

(n) *Common Control.* Not control, be controlled by or under common control with, another SBLC. Without prior written SBA approval, Lender shall not have any officer, director, or holder of ten (10) percent or more of its voting securities who is an officer, director or holder of ten percent or more of the voting securities either of another SBLC or of any entity which directly or indirectly controls or is under common control with another SBLC.

(o) *Management Services.* Employ a manager only with SBA approval. An SBLC may employ a manager or adviser or may contract for managerial or advisory services, subject to prior written approval of SBA and subject to the supervision of the board of directors. The contract shall specify the services to be rendered to the SBLC and to its applicants or borrowers.

(p) *Prohibited Financing.* Not make a loan to a small business concern which has received financing (or commitment therefore) from a small business investment company licensed by SBA which is an "Associate" of such SBLC, as defined by § 120.2–2.

(q) *Borrowed Funds.* Without SBA's prior written approval be capitalized with borrowed funds. Shareholders owning ten (10) percent or more of any class of its stock shall not use borrowed funds in purchasing such stock unless the net worth of such shareholders is at least twice the amount borrowed or unless such shareholders receives SBA's prior written approval of a lesser ratio.

(Approved by the Office of Management and Budget under control number 3245–0077)

§ 120.303 Reports to SBA by small business lending companies.

§ 120.303–1 General.

All reports required to be filed hereunder shall be transmitted to the Associate Administrator for Finance and Investment, SBA, Washington, D.C. 20416.

§ 120.303–2 Financial reports to SBA.

Within three months after the close of each fiscal year, every Small Business Lending Company shall submit an audited financial statement prepared by an independent public accountant who is approved by SBA. When requested by SBA, interim financial reports shall also be submitted.

(Approved by the Office of Management and Budget under control number 3245–0077)

§ 120.303–3 Litigation reports.

When a Small Business Lending Company becomes a party to litigation or other legal or administrative proceedings, including any action commenced by it, or by a security holder thereof in a personal or derivative capacity, against an officer, director, or employee of the SBLC for alleged breach of official duty, it shall within ten (10) days thereof file a report with SBA describing the proceedings, identity of and the SBLC's relationship to other parties involved and upon request, submit copies of the pleadings and other documents specified by SBA. Where such proceedings have been terminated by settlement or final judgment, the company shall within ten (10) days advise SBA of the terms thereof. The requirements of this paragraph are in addition to the requirements of SBA's Form 750 and 750B (Loan Guaranty Agreement).

(Approved by the Office of Management and Budget under control number 3245–0077)

§ 120.303–4 Reports to stockholders.

At the time any report is furnished to its stockholders (including any prospectus, letter, or other publication concerning the financial operations of said Lender or any of its borrowers) it shall file three copies of such report with SBA.

§ 120.303–5 Reports of changes.

A Small Business Lending Company shall, within thirty (30) calendar days of the event in question, notify SBA in writing (using an SBA Form, where appropriate) of:

(a) *Name or Address.* Any change in its name, address or telephone number;

(b) *Charter or Bylaws.* Any change in its charter or bylaws, or if its officers or directors (to be accompanied by a statement of personal history SBA, Form 912);

(c) *Capitalization.* Any changes in capitalization not otherwise required by § 120.303–1(f) to be reported to SBA; or

(d) *Continued Eligibility.* Any changes in the circumstances affecting the validity of representations on the basis of which SBA determined that the Lender was an eligible participant.

(e) *Pledge of Stock.* Whenever ten (10) percent or more of the stock is pledged by any person (or group of persons acting in concert) as collateral for indebtedness, and such pledge does not involve any transfer for which prior written approval of SBA is required under § 120.302–1(m), written notice of the terms of such transaction shall be furnished to SBA by the pledgor within thirty (30) calendar days following the date of the transaction.

(Approved by the Office of Management and Budget under control number 3245–0077)

§ 120.303–6 Miscellaneous reports.

Each Small Business Lending Company shall file with SBA such other reports as SBA may require from time to time by written directive.

(Approved by the Office of Management and Budget under control number 3245–0077)

§ 120.304 Audits of small business lending companies.

Each Small Business Lending Company is subject to periodic audits by SBA's Office of the Inspector General, Audit Division, and the cost of such audits shall be assessed against it, except for the first audit. SBA may waive audits in the case of a company whose operations have been suspended, or which is in receivership. As a general rule, SBA will not assess audit fees for special audits to obtain specific information. The fees structure for audits is based on the company's assets as of the date of the latest audited financial statement submitted to SBA before the audit. The rate table is as follows:

Total assets	Total fee	
	Base fee	Additional fee
$500,000 or less	$800	None.
$500,001 to $1,000,000	800	0.12 pct over $500,000.
$1,000,001 to $3,000,000.	1,400	0.030 pct over $1,000,000.
$3,000,001 to $5,000,000.	2,000	0.016 pct over $3,000,000.
Over $5,000,000	2,320	0.006 pct over $5,000,000.

For example, an SBLC with total assets of $2,000,000 would pay an audit fee of $1700 ($1400+0.030 percent of $1,000,000). SBA may assess an additional fee of $250 per day required to complete an audit that is delayed or prolonged beyond twenty days if, in the judgment of SBA, such delay or prolongation is caused by the SBLC's failure to keep or maintain its books or records in the manner prescribed herein or by failure to cooperate in such audit.

(Approved by the Office of Management and Budget under control number 3245–0077)

§120.305 Suspension and revocation of eligibility to participate.

SBA reserves the right to revoke the eligibility of any Lender to participate with SBA or to suspend temporarily the eligibility of any Lender to participate with SBA, as a result of any violation of SBA regulations, any breach of any agreement with SBA, or any change of circumstance resulting in the Lender's inability to meet the operational requirements set forth herein: *Provided, however,* That such suspension or revocation shall not invalidate any guaranty previously entered into by SBA. Proceedings for such purposes will be conducted in accordance with the provisions of Part 134 of this title. The Assistant Administrator of the Office of Hearings and Appeals or an Administrative Law Judge of such office shall be the reviewing official for purposes of § 134.34 of this chapter.

Subpart D—Preferred Lenders Program

§ 120.400 Objective of preferred lenders program.

The intent of Congress as expressed in 15 U.S.C. 634(b)(7) and of the regulations in this Subpart is to authorize designated Lending Institutions, hereinafter called Preferred Lenders, to undertake loan processing, servicing, collection and liquidation functions and responsibilities with respect to SBA guaranteed loans without obtaining prior SBA approval ("the Program"). Each Preferred Lender has the right to consult with and obtain guidance at any time from SBA with respect to any loan in the Program.

§ 120.401 Definitions as used in this subpart.

(a) "Act" means the Small Business Act, 15 U.S.C. 631 et seq.

(b) "Administrator" means the Administrator of SBA.

(c) "Preferred Lender" means a small business lending company or a Lending Institution which is subject to continuing supervision and examination by a State or Federal chartering, licensing, or similar regulatory authority satisfactory to SBA, which has met the eligibility requirements prescribed in this Subpart, and which has executed with SBA the Program participation agreement.

(d) "Program" or "PLP" means the Preferred Lenders Program.

(e) "SBA" means the Small Business Administration.

(f) "State" includes the District of Columbia, the Commonwealth of Puerto Rico, the Trust Territory of the Pacific Islands, and the Territories and possessions of the United States.

§ 120.402 Eligibility of preferred lender.

§ 120.402-1 Procedure.

An SBA branch or district office serving the area where the principal office of the Lending Institution is located shall initiate the process designating Lender as a Preferred Lender. It shall make any such recommendation of designation to its supervisory SBA Regional Office which together with its recommendation, shall submit the documentation to the Associate Administrator for Finance and Investment (or designee) for decision. The determination of such Associate Administrator shall be final on whether a lending institution shall be a Preferred Lender.

§ 120.402-2 Factors which SBA shall consider in determining eligibility.

In making the determination of whether a Lending Institution shall be a Preferred Lender, SBA shall consider, but is not limited to, the following factors:

(a) The Lending Institution must have been an active participant in the SBA Certified Lenders Program for at least the twelve consecutive months immediately prior to the SBA field office's initial recommendation.

(b) The Lending Institution must have demonstrated that it has the consistant ability to develop complete and well analyzed loan packages. This factor can be demonstrated by the lack of any negative comments in the file by SBA loan officers familiar with Lender, the inclusion of only a minimal amount of adverse load officer comment in relation to the volume of loans processed by this Lender, or the inclusion of favorable comments by SBA loan officers. If the Lender is a Small Business Lending Company subject to supervision and examination by SBA, this factor may be met by minimal adverse comments by SBA examiners in their reports.

(c) The Lending Institution must have demonstrated a satisfactory history of participation with SBA, which can be shown, among other ways, by a repurchase rate acceptable to SBA.

(d) The Lending Institution, before it can operate as a Preferred Lender, must execute SBA Form 1347, "Supplemental Loan Guaranty Agreement."

(Approved by the Office of Management and Budget under control number 3245-0190)

§ 120.403 Characteristics of PLP loans.

§ 120.403-1 Amount of PLP loan and of maximum guaranteed portion.

The amount of a loan under this program must exceed $100,000 and the amount of the guaranteed portion shall not exceed the statutory ceiling of $500,000.

§ 120.403-2 Maximum percentage of PLP loan to be guaranteed.

SBA shall not guarantee more than 75% of any loan approved under this program.

§ 120.403-3 Credit allocation.

SBA shall provide each Preferred Lender with a periodic allocation of credit which shall be its maximum authority to make program loans for the period designated in such allocation. The Preferred Lender's allocation of credit authority shall be increased only by written permission of SBA and shall not be restored automatically by payments received on SBA loans. Loans made in excess of the allocation do not qualify under this program but may be submitted for guaranty to SBA using regular (non-PLP) procedures.

§ 120.403-4 Loan processing.

Each Preferred Lender shall be responsible for all decisions relating to eligibility (including but not limited to size), creditworthiness, loan closing and compliance with all legal requirements of law or SBA regulations as they apply to non-PLP loans. Evidence of a PLP loan shall be on SBA Form 4-I (Lender's Application for Guaranty or Participation) stating the guaranteed percentage and signed by two authorized representatives of the Preferred Lender and submitted to SBA immediately after approval.

(Approved by the Office of Management and Budget under control number 3245-0016)

§ 120.403-5 Interest rates.

A Preferred Lender has the option of applying, on a loan to loan basis, a fixed or variable rate of interest.

(a) *Fixed Interest Rate.* If the Preferred Lender uses a fixed rate of interest in this program, such rate shall not exceed the maximum rate authorized by the State laws applicable to the particular loan.

(b) *Variable rate loans.* If the Preferred Lender uses a variable interest rate, the base rate shall be either of the rates defined in Section 122.8-4, and the rate may fluctuate no more frequently than the first business day of each month starting with the month following initial disbursement. If the Preferred Lender is a member of the Federal Reserve System, it may use its own prime rate, and the interest rate may fluctuate on daily basis starting no sooner than the first business day of the month following initial disbursement. The maximum allowable interest rate shall be governed by local laws applicable to the particular loan.

§ 120.403-6 Fees.

(a) *Servicing Fee on Loan Sold in Secondary Market.* If the Preferred Lender sells the guaranteed portion of a loan made under the program within six months following full disbursement, such transfer shall be at a price which will not result in a differential greater than three percentage points (three hundred basis points) between the interest rate paid by the borrower and the interest rate received by the purchaser-investor.

(b) *Fees in General.* SBA regulations in this Part relating to any fees which may be charged to a borrower shall apply to any loan made under this program. This includes, by way of example and without limitation, the rules relating to borrower's fees for services including the payment of legal, brokerage or bonus fees.

§ 120.403-7 Limitations on preferred lender's authority; prohibition on reducing lender's exposure; SBA access.

(a) Every Preferred Lender, in making loans under this program, shall be bound by the basic principles governing the granting and denial of applications for Financial Assistance as contained in Parts 120 and 122 of this chapter which may be changed from time to time. This includes the description contained therein of business concerns which are not eligible for SBA Financial Assistance.

(b) A Preferred Lender shall not use the PLP procedure to reduce its existing credit exposure for any borrower.

(c) Every Preferred Lender shall allow SBA authorized representatives, during normal business hours, to have access to its files to review, inspect and copy all records and documents relating to SBA borrowers.

(Approved by the Office of Management and Budget under control number 3245-0190)

§ 120.404 Loan servicing.

§ 120.404-1 Standard.

Each Preferred Lender shall service its SBA guaranteed loan portfolio using generally accepted commercial banking standards of loan servicing employed by prudent lenders, and shall not use lower standards for such loans compared to others, if any.

§ 120.404-2 Servicing actions.

Notwithstanding §120.201-1, a Preferred Lender may take any servicing action it deems necessary for any loan approved under the Preferred Lenders Program: *Provided,* That the action does not confer a preference on the Lender.

§ 120.404-3 Limitation.

A PLP lender shall not accept a compromise settlement.

§ 120.405 Loan liquidation.

§ 120.405-1 Scope.

Each Preferred Lender shall liquidate any loan which it has made under PLP procedures unless SBA advises the lender in writing that SBA will liquidate such loan. The Preferred Lender has authority to make the decision required by § 120.204 with respect to any loan made under this program.

§ 120.405-2 Standard and requirements.

A Preferred Lender shall submit a liquidation plan to SBA. Such plan should generally describe the course of action and provide cost estimates. SBA may require the Lender to make such changes to the liquidation plan as SBA determines are necessary. Any liquidation by a Preferred Lender must be executed and completed in a commercially reasonable manner.

§ 120.405-3 Final accounting report.

Upon completion of a liquidation under this program, the Preferred Lender shall transmit to SBA a certified accounting of receipts and disbursements.

(Approved by the Office of Management and Budget under control number 3245-0190)

§ 120.405-4 Post audit.

SBA reserves the right to conduct a post liquidation audit of any liquidation of a PLP loan by a Preferred Lender.

(Approved by the Office of Management and Budget under control number 3245-0190)

§ 120.406 Suspension or revocation of preferred lender status.

SBA reserves the right to suspend or revoke the eligibility of a Preferred Lender by providing written notice at least 10 business days prior to the effective date of the suspension or revocation. Reasons for such revocation or suspension include a repurchase rate unacceptable to SBA, violations of applicable statutes, regulations or SBA policy and procedures as published from time to time, and contained in SBA Form 1347, see § 120.402-2(d) above. Procedures for appealing these decisions are found in Part 134 of this chapter.

Subpart E—[Reserved]

Subpart F—Central Registration for Secondary Market

§ 120.601 Statutory provisions.

The statutory authority for this Subpart F is section 5(h) of the Small Business Act [15 U.S.C. 634(h)], as amended by Pub. L. 98-352, approved July 9, 1984.

§ 120.602 Definitions.

(a) *Act* means the Small Business Act, 15 U.S.C. 631, *et seq.*

(b) *Certificate* means the document:

(1) Representing a beneficial fractional interest in a pool consisting of the SBA guaranteed portions of loans or

(2) Representing the guaranteed portion of an SBA loan which is not sold into a pool.

(c) *FTA* means the SBA's fiscal and transfer agent.

(d) *Secondary Market* means the process by which the SBA guaranteed portions of loans made by lending institutions are purchased and sold.

§ 120.603 Fiscal and transfer agent.

The FTA, as authorized by law, is SBA's agent in carrying out the central registration of (a) the SBA guaranteed portions of loans sold in the secondary market and (b) certificates representing fractional interests in pools composed solely of the SBA guaranteed portions of loans. The FTA also has the responsibility for issuing, on behalf of SBA, the certificates representing such interests.

§ 120.604 Registration.

§ 120.604-1 Applicability of registration function.

The rules and requirements in this subpart relating to registration shall apply to:

(a) Every Guaranteed portion of a loan sold in the secondary market commencing with the initial sale by the lender which made the loan; and

(b) Every certificate representing a fractional or undivided interest in a pool approved by the SBA and composed solely of the SBA guaranteed portions of loans.

§ 120.604-2 Central registration.

The FTA shall register each guaranteed portion and each pool certificate sold pursuant to section 5 (f) and (g) of the Act. Such registration shall include, with respect to each sale the following:

(a) Identity of the lender which made the loan and which sold the loan;

(b) Interest rate paid by the borrower to the lender, and whether the rate is fixed or variable;

(c) Lender's servicing fee;

(d) Identity of the purchaser;

(e) Price paid by the purchaser;

(f) Interest rate paid on the guaranteed portion or the certificate, as applicable;

(g) Fees which the FTA is charging for these registration duties and for the issuance of certificates to facilitate pooling; and

(h) Such other information as SBA shall determine.

This information shall be available from the FTA upon request of the purchaser of a guaranteed portion or of a certificate.

(Approved by the Office of Management and Budget under control number 3245-0185)

§ 120.605 Certificates.

§ 120.605-1 Transferability.

Certificates issued by the FTA shall be freely transferable. Transfers shall be carried out pursuant to and in accordance with Article 8 of the Uniform Commercial Code of the State of New York. A form of assignment on the back of each certificate shall be used to transfer the certificate, unless the parties choose to use another form acceptable to FTA. The FTA may refuse to issue a certificate until the documents of transfer are correct and complete. Each certificate presented to the FTA for transfer must be accompanied by a letter of transmittal which shall include the following information: pool number, if applicable; certificate number; exact spelling of name in which new certificate is to be issued; complete address and tax identification number of the new holder; name and telephone number of person handling the transfer; complete instructions for the delivery of the new certificate. Together with such letter there shall be sent the appropriate fee which may be charged by the FTA.

§ 120.605-2 Claim on account of loss, theft, destruction, mutilation or defacement of certificate.

(a) *General.* To obtain a replacement certificate on account of loss, theft, destruction, mutilation or defacement of a certificate, the holder must provide the FTA with complete identification of the certificate and the pertinent facts relating to the situation reported. In addition, the holder must file a bond of indemnity in such form and with such surety, sureties or security as may be required by the FTA to protect the interest of SBA and the FTA. Copies of the form of bond are available from the FTA. The FTA may charge a fee for each replacement certificate.

(1) *Loss or Theft.* Report of the loss or theft of a certificate must be made promptly to the FTA in the form of an affidavit of loss. Copies of the form of affidavit are available from the FTA. The report shall include:

(i) The name and address of the registered owner. If the report is made by any other person or entity, the capacity in which he/she or it represents the owner must be reported;

(ii) The identification of the certificate by pool number, if applicable; certificate number; original principal amount, and the exact form in which the certificate was registered and a full description of any assignment, endorsement or any other writing therein;

(iii) A statement of the circumstances surrounding the theft or loss.

Upon receiving notification of loss or theft, the FTA will stop transfer of the certificate for up to 60 days to allow the registered holder to obtain the required bond of indemnity and any other documentation. The FTA will extend the stop for up to an additional 60 days if subsequently requested.

(b) *Destruction, Mutilation or Defacement.* If a certificate is destroyed, or becomes so mutilated or defaced as to impair its value to owner, a report as outlined in subsection (a)(1) of this section shall be made to the FTA. All available portions of the mutilated or defaced certificates also must be submitted. The FTA then will arrange for the preparation of a replacement certificate.

Subpart G—Pooling of SBA Guaranteed Portions [Reserved]

Subpart H—Individual SBA Guaranteed Portions Sold in the Secondary Market [Reserved]

Appendix A—Memorandum of Understanding Between the Small Business Administration and the United States Department of Agriculture, Farmers Home Administration

Preamble

Pub. L. 94-305, which amended the Small Business Act, authorized the Small Business Administration (SBA) to assist small businesses engaged in farming and related activities under its existing programs. The legislation did not create any new SBA loan programs but merely included the agricultural industries among the industries eligible for SBA assistance. Neither did the legislation diminish, in any way, the responsibility of the Farmers Home Administration (FmHA) to meet the financial and other needs of farmers.

The joint memorandum reaffirms the mutual desire of SBA and FmHA to cooperate in the use of their respective loan making authorities to complement the activities of each other and, to the extent possible, to improve and expand the delivery of financial assistance to the agricultural production segment of the country; all with the least possible degree of overlapping, confusing or duplicating activities.

1. The FmHA administers its financial assistance programs through its State, District and County offices.

The SBA administers its financial assistance programs through its Regional, District and Branch offices.

FmHA State Directors and SBA District Directors will exchange addresses of their offices and identify the geographical areas served by each. This information will be available in all field offices of both agencies so applicants can be referred to the appropriate offices. These same officials will make arrangements to inform the personnel within their jurisdictions of the other agency's current loan making and servicing policy so the referral advice given to potential applicants will be as accurate as possible.

2. FmHA and SBA will establish a liaison at both the State Director/District Director level and the National level and periodically coordinate their activities to: (a) Exchange detailed information concerning loan programs; (b) define areas of cooperation between the two agencies; (c) assure that their programs are servicing the intended recipients; (d) establish new methods to serve the public more expeditiously; and (e) achieve maximum utilization of their respective resources.

The SBA and the FmHA agree that the interests of agricultural industries will be best served and that each agency will achieve better utilization of available resources through the following operating guidelines:

3. Potential applicants may contact either agency for an interview but may file an application with only one agency at a time. However, SBA will encourage those potential applicants that have been or are borrowing through the FmHA to continue their relationship with that agency.

4. Potential applicants meeting FmHA eligibility requirements will, at the time of initial interview, be advised by SBA to contact the appropriate FmHA County Office for assistance.

FmHA personnel will, at the time of initial interview, refer potential applicants who are not eligible for FmHA assistance, (such as corporations, partnerships or aliens, applying for certain loans) to SBA if they appear to be eligible for SBA assistance.

5. Potential applicants are not to be referred back and forth between FmHA and SBA. Representatives of each agency must be reasonably certain that the applicant and proposed use of proceeds may be eligible for assistance from the other agency before a referral is made.

6. Neither agency will refuse a loan request from an applicant who prefers to file with that agency.

7. Agricultural applicants filing for financial assistance from either agency will give written permission for FmHA and SBA to exchange whatever prior or current loan application and loan experience information including appraisals, either may have in its files.

8. Applicants who are denied FmHA assistance for any reason, including lack of FmHA funding, may contact SBA for assistance.

9. Applicants filing for financial assistance from either agency must use the forms and procedure of the agency being requested to provide the assistance. An applicant who is denied assistance by either agency must use a new application to file with the other in

accordance with that agency's forms and procedures.

10. Applicants should not have to apply to two Federal agencies to borrow funds for a single purpose. Therefore, if either FmHA or SBA can make the entire loan, the applicant should not be referred to the other agency for part of the funds needed. If either FmHA or SBA cannot make the entire loan, the applicant should be referred to the other agency. Joint funding with shared collateral between the agencies is not encouraged and should be used only as a last resort.

Description of Lending Policies

11. The FmHA makes guaranteed loans and insured loans. Guaranteed loans are loans where the lending institution advances the entire funds from its account and the FmHA guarantees repayment of a certain percentage of principal and interest. Insured loans are those made from one of FmHA's insurance funds.

The SBA makes guaranteed, immediate participation and direct loans. The Guaranteed loans are those where the lending institution advances the entire loan and the SBA agrees to purchase a percentage of the outstanding balance at time of default. Immediate participation loans are those where SBA disburses a percentage of the loan and the lender disburses the remainder from its account. Direct loans are made with SBA funds alone.

FmHA Loan Programs for Farmers

12. Operating Loans.

a. Eligibility.

Be a citizen of the United States.

Be unable to obtain credit elsewhere (Exclusive of SBA.)

Be the operator of a family farm.

Note.—A "family farm" is defined as "one that will produce agricultural commodities for sale in sufficient quantities so that it is recognized as a farm rather than a rural residence; one that will provide substantial income by itself and which together with an other dependable income will enable the family to pay necessary family and other operating expenses, including maintenance of essential chattel and real property and pay debts; and one for which the operator and his immediate family provide the management and are actively engaged in the operation by providing a major amount of the farm and any non-farm enterprise labor. A reasonable amount of hired labor may be used during seasonal peakload periods."

b. Loan Purposes.

Finance livestock, machinery and operating expenses.

Refinance debts.

Finance non-farm enterprises.

c. Terms.

Up to seven years with five year renewal.

Interest rate based on the cost of Treasury borrowings.

d. Loan Limit—$50,000.

13. Farm Ownership Loans.

a. Eligibility.

Be a citizen of the United States.

Be unable to obtain the credit from other sources (exclusive of SBA.)

b. Loan Purpose.

Buy land.

Construct and repair farm buildings.

Develop land and pollution control measures.

Develop farm irrigation facilities and domestic water supply.

Refinance debt.

Finance non-farm enterprise.

c. Terms.

Up to 40 years.

Five (5) percent interest rate.

d. Loan Limits.

$100,000.

Maximum debt on security with other credit is $225,000.

14. Soil and Water Loans.

a. Eligibility.

Be unable to obtain the credit elsewhere (exclusive of SBA).

Be a farm tenant, owner, partnership or corporation engaged in farming.

b. Loan Purposes.

Develop land and pollution control practices.

Water development.

Purposes related to soil and water conservation.

c. Terms.

Up to 40 years.

Five (5) percent interest.

d. Loan Limits.

$100,000.

Maximum debt on security with other credit is $225,000.

15. Recreation Loans.

a. Eligibility.

Be a citizen of the United States.

Be unable to obtain the credit elsewhere (exclusive of SBA).

Be an individual engaged in farming when the loan is applied for.

b. Loan Purposes.

Convert all or part of the farm to outdoor recreation enterprises.

Acquire land and easement for recreational uses.

Refinance debts.

c. Terms.

Up to 40 years.

Five (5) percent interest rate.

d. Loan Limits.

$100,000.

Maximum debt on security with other credit is $225,000.

16. Rural Housing.

a. Eligibility.

Be a U.S. Citizen or permanent resident.

Be unable to obtain credit elsewhere (exclusive of SBA).

Be a farmowner without decent, safe and sanitary housing for his own use or the use of tenants, sharecroppers, farm laborers or farm manager.

b. Loan Purpose.

Buy, build or repair dwellings of modest size, design and cost.

c. Terms.

Up to 33 years.

Interest rate established periodically based on housing money market rate.

d. Loan Limits.

The cost of providing modest, decent, safe and sanitary housing.

17. Business and Industry Loans.

a. Eligibility.

If an individual, a U.S. Citizen.

A cooperative, corporation, partnership, trust, Indian tribe, or other legal entity.

b. Loan Purposes.

Pollution control measures.

c. Terms.

Up to 30 years.

Interest rate is negotiated between lender and applicant.

c. Loan Limits.

No statutory dollar limit; determined by cost of project and credit factors.

18. Grazing Association Loans.

a. Eligibility.

Be a nonprofit association.

Be unable to obtain credit elsewhere (exclusive of SBA).

Provide seasonal grazing for association members.

b. Loan Purposes.

Acquire land for grazing.

Develop land for grazing.

Pollution control measure incidental to other authorized purposes.

c. Terms.

Up to 40 years.

Five (5) percent interest rate.

d. Loan Limits.

No statutory or regulatory dollar limit determined by value of security.

19. Irrigation, drainage and soil and water association loans.

a. Eligibility.

Be an association composed primarily of farmers and other rural residents.

Be unable to obtain credit elsewhere (exclusive of SBA).

Provide a facility to serve farmers and other rural residents within the service area.

b. Loan Purpose.

Install or improve drainage facilities.

Install, repair or enlarge irrigation facilities.

Install or improve soil conservation and water control facilities including pollution abatement.

Special-purpose machinery and equipment.

c. Terms.

Up to 40 years.

Five (5) percent interest rate.

d. Loan Limits.

No statutory or regulatory dollar limit determined by value of security.

Note.—In addition to the eligibility requirements for specific programs listed above, the following eligibility requirements must be met by all FmHA borrowers:

Have the experience to carry out the proposed operation to be financed.

Have the ambition to carry out the proposed operations.

Have the management ability to carry out the obligations required in connection with the loan.

SBA Loan Programs for Agricultural Enterprises

In addition to the specific eligibility factors listed under the following SBA programs, a borrower must be of good character, be an eligible small business under SBA rules and regulations (13 CFR Parts 121 and 122), be organized for profit, and be able to evidence reasonable assurance of ability to repay the loan from the profits of the business. Can be proprietorship, partnership or corporate business organization, and need not be a citizen of the U.S.A.

20. Regular Business Loans—7(a).

a. Eligibility.
Be eligible under SBA rules and regulations (13 CFR Part 120).
Be unable to obtain the credit from non-Federal sources through utilization of personal resources or otherwise.
b. Loan Purpose.
Purchase of land and buildings and land improvements (fencing, irrigation systems, etc.) including pollution control facilities essential to the small business.
Construction, renovation or improvement (including water systems) of (i) farm building other than residential buildings (ii) residential building essential to the business if not available from other Federal Sources.
Purchase of farm machinery and equipment (appliances and other household contents used for residential purposes are not eligible).
Operating expenses directly related to the farming operation excluding personal or family living expenses.
Refinancing of debt directly related to the farming operation, but excluding personal or family debt.
c. Terms.
The interest rate on direct and SBA share of immediate participation loans is based on a legislative formula.
The lender's interest rate on immediate participation and guaranty participation loans is established by the lending institution, within SBA policy, but cannot exceed SBA's maximum which is periodically published in the **Federal Register**.
Maturity of the loans will generally not exceed one year for annual seed, feed, fertilizer and other annual needs, 7 years for the portion of the loan used for working capital, 10 years for that portion of the loan use for livestock and/or farm machinery and equipment, and 20 years for that portion of the loan used for acquisition or construction of real estate. However, all borrowers are expected to repay the loan as soon as possible and these maximum maturities are not automatically available in every case.
SBA loans are generally repaid in even monthly payments of principal and interest. However, quarterly, semiannual, annual or seasonal payments can be arranged when necessary.
d. Loan Limits.
Direct loans have an administrative limit of $150,000.
Immediate participation loans have an administrative limit of $150,000, SBA share. (Both the direct and immediate participation administrative limits can be waived in exceptional situations by SBA's Regional Directors.)
Guaranty participation loans have a limit of $350,000, SBA share, except that in exceptional situations the SBA share can be increased to $500,000.
The limits on a borrower's total indebtedness to SBA on all outstanding loans is (i) the aggregate of direct and the SBA share of immediate participation loans cannot exceed $350,000 and (ii) the aggregate of direct and the SBA share of immediate participation and guaranty participation loans cannot exceed $500,000 at any one time.
21. Economic Opportunity Loans.
a. Eligibility.
Must be economically or socially disadvantaged.
Meet the eligibility requirements set forth in SBA rules and regulations (13 CFR Parts 119 and 120).
b. Loan Purposes.
Can be used for the same purpose as Regular Business Loans.
c. Terms.
Interest on direct and SBA share of immediate participation loans is subject to a legislative formula, and is subject to change quarterly.
The lender's interest on immediate and guaranty participation is the same as for regular business loans.
Maturities of these loans are generally restricted to 10 years for working capital other than annual operating expenses and farm machinery and equipment and to the legislative limit of 15 years for real estate purposes. However, no borrower will receive a longer maturity than is necessary for the loan to be repaid from the business income.
d. Loan Limits.
These loans cannot exceed $100,000 SBA share, whether direct, immediate participation or guaranty.
22. Water Pollution Control Loans.
a. Eligibility.
Meet eligibility requirements set forth in SBA rules and regulations (13 CFR Parts 120 and 123).
Must have a statement from EPA of the necessity and adequacy.
Must show evidence of substantial economic injury.
b. Loan Purposes.
Only to make modifications and changes necessary to meet the Federal standards established under the Federal Water Pollution Control Act or State standards established in compliance with the Federal Water Pollution Control Act.
c. Terms.
Interest rate same as for Regular Business Loans.
Maturity not to exceed 30 years.
d. Loan Limits.
No dollar limit.
23. Other Substantial Economic Injury Programs.
The SBA has loan authority to aid small businesses that suffer substantial economic injury as a result of a Federal action or Federally directed action, such as Occupational Health and Safety regulations, Air Pollution Control regulations or being displaced by a Federally financed construction project. These programs are more completely described in 13 CFR Part 123.

Administrative Guidelines

24. The services of FmHA and SBA to lenders and applicants are, by mutual agreement, those that each agency would provide any eligible applicant in the normal course of business and there will be no reimbursement by either agency to the other for such services.
25. The National Office of FmHA and the Central Office of SBA will cooperate with each other in counseling their field offices and in resolving problems in specific cases.
26. This Memorandum of Understanding in no way alters or supersedes the existing Memorandums between the two agencies covering their disaster (emergency) loan authority and FmHA's Business and Industrial Loan Program.
27. This Agreement may be amended at any time by written agreement of both parties.
28. This agreement shall take effect upon the date of execution thereof.

Mitchell P. Kobelinski,
Administrator, SBA.
Dated: September 2, 1976.

Frank B. Elliott,
Administrator, FmHA.
Dated: September 20, 1976.

PART 122—BUSINESS LOANS

Subpart A—General Provisions

Sec.

Subpart B—Special Purpose Loans

Authority: Sec. 5(b) (6) and 7(a) of the Small Business Act, as amended, 15 U.S.C. 634(b)(16) and 636(a).

§ 122.1 Statutory provisions.

The authority for these loans is contained in Section 7(a) of the Small Business Act, as amended, 15 U.S.C. 636(a). See also 15 U.S.C. 636 (Note).

§ 122.2 Captions.

Captions are inserted as required by the **Federal Register** for convenience only and are not part of the substance of these regulations.

§ 122.3 Savings clause.

§ 122.3-1 Prior rules.

Financial assistance granted before (the date of publication of this rule) shall be governed by the related contractual terms and the regulations then in effect. Nothing herein shall bar SBA enforcement action with respect to such financial assistance granted pursuant to contractual terms no longer in use and prior regulations no longer in effect.

§ 122.3-2 Effect of invalidity.

If any section or part of a section of these regulations should be adjudged invalid, only that part shall be invalid, and the other parts shall not be affected thereby.

§ 122.4 Applicability of other parts.

The Loan Policy and definitions of Part 120 of this chapter apply to the loans authorized in this part. Also applicable are Parts 112, 113, 116 and 117. With respect to any financial assistance of SBA, Part 112 prohibits discrimination on the grounds of race, color, or national origin. Part 113 prohibits discrimination based on race, color, religion, sex, marital status, handicap or national origin with respect to all recipients of SBA financial assistance.

Part 116 prescribes policies of general application set forth in several subparts. Subpart A sets forth SBA policies and criteria for giving special consideration to veterans and their survivors or dependents. Subpart B prescribes rules on the prohibition of SBA financial assistance for acquisition or construction in special flood hazard areas when persons eligible for flood insurance have not obtained it. Subpart C prohibits recipients of SBA financial assistance from using lead-based paint as described therein. Subpart D prescribes policies and procedures dealing with floodplain management and wetlands protection. Part 117 covers the prohibition of discrimination based on age.

§ 122.5 Application.

§ 122.5-1 Other financing.

Except as otherwise specified, before applying for SBA financial assistance, an applicant shall endeavor to obtain financing from other non-Federal sources, including (but not limited to) other resources of its owners, and private lending sources.

If an institution is unable or unwilling to make the loan, the applicant must then determine if the Lender would make the loan in participation with SBA as a guaranty or an immediate participation loan. (If a Lending Institution will make a loan in participation with SBA, the Lender, not the applicant, shall contact SBA.) SBA shall require satisfactory evidence concerning the Lending Institution(s) refusing to make, or to participate in, the loan. See § 120.3-4 and 120.103-1 of this chapter.

§ 122.5-2 Contents of application.

An applicant for SBA financial assistance in any form shall furnish [1] a history of the business, the nature of the business, the amount and purpose(s) of the loan, the collateral offered for the loan, and current financial statements, together with financial statements (or tax returns if appropriate) for the past three years. Annual financial statements shall be required from borrower thereafter, but SBA may also require more frequent reports. In addition, personal financial statements may be required, as applicable, from a proprietor, general partners, officers, directors, guarantors and holders of twenty percent or more of the equity of the applicant. Finanical statements from non-stockholder directors or officers may be waived by SBA.

(Approved by the Office of Management and Budget under control numbers 3245-0016 and 3245-0196)

§ 122.5-3 Direct assistance.

Subject to availability of funds, an applicant unable to obtain a loan or loan participation from a private lender (See § 120.3-4 of this chapter) may apply to SBA for a direct loan on a form provided by SBA. Such application shall be made to the SBA office serving the location of the proposed or existing business, but counseling may be obtained from any SBA office. (See § 101.3-1 of this chapter for the addresses of all SBA offices.)

(Approved by the Office of Management and Budget under control number 3245-0016)

§ 122.5-4 Approval or decline.

Applicants will be given notice of approval or decline by either the Lender (for a participation/guaranty loan) or by SBA (for a direct loan). The decline notification will include the reason(s) for the decline.

§ 122.5-5 Loan authorization.

If SBA approves a loan request, a loan authorization is issued. The authorization states the terms and conditions on which SBA is willing to make, participate in or guarantee a loan but it is not a contract to loan money.

(Approved by the Office of Management and Budget under control number 3245-0201)

§ 122.6 Loan terms.

§ 122.6-1 Maturities.

(a) Except as otherwise specified, a loan, including extensions and renewals, may be made for a period not to exceed twenty-five years, except that such portion of a loan made for the purpose of acquiring real property or constructing, converting or expanding facilities may have a maturity of twenty-five years plus such additional period as may be required to complete such construction, conversion or expansion.

(b) The maximum maturity shall not be available for every loan. The maturity of each loan will be the shortest feasible term commensurate with the repayment ability of the borrower and shall not exceed ten years, except when the loan finances real estate or the construction or the acquisition of equipment with a useful life exceeding ten years. Amortization will generally require equal monthly payments of principal and interest but may be adjusted to accommodate the cash flow of the borrower. See § 122.8-4(g) of this part. In addition, SBA may extend the maturity of a loan before October 1, 1985 pursuant to section 1902 of Pub. L. 97-35, approved August 13, 1981, conditioned in the case of a participation upon the concurrence of the participant, the holder in due course (if any) and the borrower, or refinance such loan with an extension of its term. The aggregate term of such extended or refinanced loan shall not exceed the maximum maturity permitted by this paragraph and shall be repaid in equal installments of principal and interest. SBA may also extend the maturity of or renew a loan pursuant to Section 7(c)(1) of the Act (including any loan transferred to SBA pursuant to Reorganization Plans No. 2 of 1954 and No. 1 of 1957) for additional periods not to exceed ten years beyond their original maturity, limited to such periods of time as appear necessary to avoid forced liquidation of loans. Extensions are granted under the preceding sentence only when it appears that no other course will result in a greater or earlier recovery of the indebtedness.

§ 122.6-2 Grace periods.

SBA may defer initial payments for a grace period, and use such other methods as it deems necessary and appropriate to assure the successful establishment and operation of the borrower.

§ 122.6-3 Moratorium.

SBA may suspend or undertake borrower's obligations to pay principal and interest in certain circumstances and on certain conditions. See Part 131 of this title.

§ 122.7 Loan amounts.

Limits on loan amounts apply to the combined aggregate amount of all loans to a given borrower under this Part, including such borrower's affiliates, as defined in § 121.3(a) of this title.

§ 122.7-1 Direct loans.

The statutory limit for direct loans is $350,000. SBA has established an administrative limit of $150,000. Regional Administrators may authorize, in writing, the acceptance of an application that exceeds the administrative but not the statutory limit.

§ 122.7-2 Immediate participation.

The statutory limit on SBA's portion of an immediate participation loan is the lesser of 90 percent of the loan, or $350,000. The administrative limit, however, is the lesser of 75% of the loan, or $150,000. Regional Administrators may allow exceptions to the administrative dollar limit, up to $350,000. District directors may make exceptions to the percentage limit if the participant's legal lending limit precludes a 25 percent exposure. In such cases the Lender will be required to participate up to its legal lending limit, but in no event less than 10 percent.

§ 122.7-3 Guaranty loans.

SBA's exposure on guaranty loans shall not exceed $500,000 in any circumstance. The percentage of the SBA guaranty shall not exceed the following:

(a) *Guaranty of loans not to exceed $100,000.* SBA shall guarantee at least 90 percent of a loan so long as the total amount outstanding (including the loan under consideration) does not exceed $100,000, except as permitted under paragraph (c) below.

(b) *Guaranty of loans in excess of $100,000.* SBA shall guarantee no more than 90 percent and not less than 70 percent of loans in excess of $100,000 so long as the total amount approved and outstanding does not increase SBA's exposure beyond $500,000, subject to paragraph (c) below. Decisios to guarantee such loans in amounts between 70 percent and 90 percent shall be made on a case-by-case basis. The percentage guaranteed shall not influence loan approvals. A Lender's request for less than a 70 percent participation by SBA shall not be approved unless a lesser percentage is necessary due to the statutory $500,000 ceiling on SBA exposure.

(c) *Refinancing.* SBA shall guarantee no more than 80 percent of that portion of a loan used to refinance a debt owed to a bank or other lending institution. Therefore the blended guaranty percentage of the total loan will reflect the respective percentages of guaranty for the refinancing and the remaining portion of the loan. Until October 1, 1985, SBA shall not refuse to guarantee a loan solely because such loan will be used to refinance all or any part of the outstanding indebtedness of a small concern unless:

(1) The creditor is likely to suffer a loss if the loan is not refinanced and SBA is likely to sustain part or all of any loss which would have otherwise been sustained by the creditor, or

(2) SBA determines that refinancing the debt will not benefit the small concern.

§ 122.8 Interest rate.

§ 122.8-1 Direct loans.

The rate of interest on direct loans and SBA's share of immediate participation loans is determined by a statutory formula based on the cost of money to the Federal government. No later than the 10th day of each calendar quarter (Jan. 10, April 10, July 10, and Oct. 10) SBA shall publish such rate in the **Federal Register** for such quarter. (The rate in effect at any time is available from the local SBA offices.)

§ 122.8-2 Immediate participation.

The maximum rate a Participating Lender shall charge on its share of an immediate participation loan shall be the lesser of (a) the rate permitted under the applicable usury statute, or (b) one percent less than the maximum rate permitted by SBA policy for a guaranteed loan of the same maturity, published from time to time in the **Federal Register** and available from local SBA offices.

§ 122.8-3 Guaranty loans.

A Participating Lender may establish an interest rate that is legal and reasonable. SBA publishes from time to time in the **Federal Register** the maximum rate permitted. Such rate information is available from local SBA offices.

§ 122.8-4 Variable (fluctuating) rate.

A Participating Lender may utilize a fluctuating rate of interest. SBA's maximum allowable rates apply only to the initial rate as of the date the loan application was received by SBA. SBA's approval of the use of a variable interest rate shall be subject to the following conditions:

(a) *Frequency.* The fluctuation may occur no more frequently than monthly, except for the first fluctuation, which may occur on the first business day of the month following initial disbursement.

(b) *Commencement of fluctuation.* Fluctuation periods may commence on the first business day of the month following initial disbursement.

(c) *Basis for fluctuation.* The note rate must rise and fall on the same basis. Where a participant establishes a floor and ceiling for the fluctuating rate, the difference between the initial rate and the ceiling rate may be no greater than the difference between the initial rate and the floor rate.

(d) *Base rate.* The base rate shall be the low New York prime rate in effect on the first business day of the month, as printed in a national financial newspaper published each business day, or the SBA Optional peg rate which SBA publishes quarterly in the **Federal Register.**

(e) *Maturities under 7 years.* For loans with maturities under seven years, the maximum interest rate shall not exceed two and one-quarter (2¼) percentage points over the base rate.

(f) *Maturities of 7 years or more.* For loans with maturities of seven or more years, the maximum interest rate shall not exceed two and three-quarters (2¾) percentage points over the base rate.

(g) *Amortization.* Amortization shall require equal monthly payments combining principal and interest, and may be computed on the basis of an interest rate higher than the interest rate prevailing at the date of the note to insure that future payments will be sufficient in the event of a rise in the base rate. With SBA prior approval, unequal payments or fixed payments of principal plus interest may be agreed upon on a case-by-case basis.

(h) *Pilot Project.* Pursuant to § 120.1-2 of this chapter, for a period of one year from April 27, 1984, and only for the States of New Jersey, New York, the Commonwealth of Puerto Rico (Region II); Iowa, Kansas, Missouri, Nebraska (Region VII); and Arizona, California, Hawaii, Nevada (Region IX), the maximum initial interest rate on a fluctuating rate loan shall be the State legal rate applicable to such loan. Thereafter, the rate may fluctuate and the loan be amortized as set forth in this section: *Provided,* That the reference to percentage point limits is not applicable. If the guaranteed portion of a loan made pursuant to this subparagraph is transferred as provided in § 120.301-2 of this part to a third party within six months following full disbursement, such transfer shall be at a price which will not result in a differential greater than three percentage points (three hundred basis points) between the interest rate paid by the borrower and the coupon rate received by the investor.

Subpart B—Special Purpose Loans

§ 122.50 Small general contractors.

§ 122.50-1 Policy.

The Act authorizes loans to contractors to finance residential or commercial construction or rehabilitation provided that loan funds are not used primarily for the acquisition of land. The terms "construction" and "rehabilitation" as used in this section apply only to work done on-site, construction and rehabilitation of the structure, above or underground utility connections and landscaping. Not more than five (5) percent of the loan proceeds can be used for community improvements that benefit more than the structure financed with the SBA loan. Examples include streets, curbs, open spaces and similar improvements. These loans can be used for individual structures only: *Provided, however,* That an SBA loan may be used for more than one individual structure if each structure is separately identified, the loan proceeds for each structure are identified separately, and the amount that must be paid on the loan to effect transfer of clear title on each structure as sold is shown. Such loans are not prohibited by § 120.102-8 of this title. These loans may be available under the following conditions:

§ 122.50-2 Demonstrated ability.

The applicant shall be a construction contractor or homebuilder with a demonstrated managerial and technical ability in profitable construction or rehabilitation projects of a comparable type and size. Joint ventures or other organizations that have no history or are organized only for a specified project are not eligible. A portion of the work may be subcontracted, but on subcontracts in excess of $25,000 a one-hundred percent payment and performance bond may be required.

(Approved by the Office of Management and Budget under control number 3245-0077)

§ 122.50-3 Maturity.

The maturity of the loan shall not exceed thirty-six months plus the estimated time to complete the construction or rehabilitation.

§ 122.50-4 Purpose of loan.

Loan proceeds shall be used solely for the direct expense of acquisition, immediate construction and/or prompt significant rehabilitation of residential or commercial structures for sale. For this purpose "significant" rehabilitation means rehabilitation costing more than one-third (⅓) of the purchase price or fair market value at time of loan application. Not more than twenty (20) percent of the loan proceeds shall be used for the acquisition of land.

(Approved by the Office of Management and Budget under control number 3245-0077)

§ 122.50-5 Investment property prohibited.

Loan funds shall not be used to purchase vacant land for possible future construction or to operate or hold rental property pending future rehabilitation. Loan funds shall not replace or free applicant's funds for these purposes.

§ 122.50-6 Rental.

The constructed or rehabilitated structures shall not be rented, in whole or in part, pending sale, without SBA's prior written approval.

§ 122.50-7 Sale of entire property.

Loan proceeds shall not be used as a construction loan to be repaid with permanent financial if the applicant or its affiliate retains title. The sale of the property must be both a beneficial and a legal change or ownership in the title to the property.

§ 122.50-8 SBA's Lien.

SBA shall have not less than a second lien on the property as collateral. All prior liens shall permit the release of individual parcels upon payment of a predetermined amount (so the buyer of each parcel can get a clear title) and the sum of all liens, including SBA's shall not exceed eighty (80) percent of the fair market value of the completed structure.

§ 122.50-9 Application.

The application shall include three letters in addition to the regular requirements of § 122.5-2. (A Participating Lender may provide the necessary written assurance instead of three such separate letters). The three letters are (a) from a mortgage lender doing business in the project area advising whether permanent mortgage money is normally available to qualified purchasers of comparable real estate at the project location; (b) from an independent, licensed real estate broker with at least three years experience in the project area advising whether a market exists for the proposed structure and whether the property's monetary and architectural values are compatible with other structures in the neighborhood; (c) from an independent licensed architect, appraiser or engineer who shall agree to make all construction inspections and certifications needed to support interim disbursements. (Inspection fees may be paid from loan proceeds.)

§ 122.51 Handicapped.

§ 122.51-1 Policy.

The Act authorizes loans to assist a public or private organization for the handicapped or to assist a handicapped individual in establishing, acquiring or operating a small concern.

§ 122.51-2 Definitions.

(a) *HAL-1* is the designation of a loan to a nonprofit public or private organization for the employment of the handicapped. HAL-1 applicants are not subject to Part 121 of this title.

(b) *HAL-2* is the designation of a loan to a handicapped individual or a small business which is wholly owned by a handicapped individual(s). Such loans shall comply with the requirements of Parts 120 and 121 of this title, and direct loans are subject to the availability of funds.

(c) *Organization for the Handicapped* means one which:

(1) Is organized under the laws of the United States or any State, the net income of which does not inure in whole or in part to the benefit of any shareholder or other individual, and which is operated in the interest of handicapped individuals;

(2) Complies with all occupational health and safety standards prescribed by the Secretary of Labor; and,

(3) Employs in the production of commodities and the provision of services during any fiscal year in which it received financial assistance under this subsection, handicapped individuals for not less than 75 per centum of the man-hours required for the production or provision of the commodities or services.

(d) *Handicapped individual* means a person who has a physical, mental or emotional impairment, defect, ailment, disease or disability of a permanent nature which in any way limits the selection of any type of employment for which the person would otherwise be qualified or qualifiable. For HAL-2 purposes a partnership or corporation must be 100 percent owned by handicapped individuals.

(e) *Supportive services* refers to expenses incurred by HAL-1 organizations to subsidize wages of low producers, health and rehabilitation services, management, training, education and housing of handicapped workers and other such uses.

§ 122.51-3 Interest rate.

Direct loans and SBA's share of immediate participation loans are subject to an administrative limit of $150,000 and shall bear interest at a rate of three (3) percent. There is no separate interest rate on guaranty loans. See § 122.8-3 of this part.

§ 122.51-4 Repayment ability.

(a) *Reasonable doubt.* In the application of § 120.103-2 of this chapter to loans under this § 122.51, reasonable doubt shall be resolved in favor of the applicant.

(b) *Capability and experience.* HAL-1 applicants must submit evidence that the organization has the capability and experience to perform successfully, but evidence of repayment ability from the earnings of the organization is not necessary provided other sources of repayment are reasonably established.

(c) *Collateral*—(i) *Assignment of proceeds.* Loans to finance Federal Government contracts may require an assignment of the proceeds of the contracts.

(ii) *Personal guarantees.* Personal guarantees of the officers and directors of a HAL-1 organization shall not be required but may be accepted if offered.

(Approved by the Office of Management and Budget under control number 3245-0016)

§ 122.51-5 Application.

(a) *Contents of HAL-1 application.* A HAL-1 applicant shall submit copies of bylaws, incorporation papers, Internal Revenue Service certification of tax-exempt status, recognition/approval by an appropriate State, local or Federal rehabilitation agency or other evidence that it meets the definition of a HAL-1 organization, including the percentage of man-hours performed by handicapped persons. The applicant shall also show that private credit is not available and that funds from other Government programs are not being duplicated by SBA and that contributions from foundations, State fund raising activities (including tax assessements) and other traditional funding will not be diminished as a result of an SBA loan. Notwithstanding § 120.102-10 of this chapter, a HAL-1 organization shall not be considered to be an associate of the lender solely because one or more of the organization's officers or directors are also officers, directors or holders of 10 or more percent of the stock of the lender: *Provided, however,* That such person shall have no part in the lender's decision to participate in the loan.

(b) *Contents of HAL-2 application.* A HAL-2 applicant shall submit written information from a physician, psychiatrist or other qualified professional as to the permanent nature of the handicap and the limitations it places on the applicant.

(Approved by the Office of Management and Budget under control number 3245-0016)

§ 122.51-6 Use of proceeds.

(a) *HAL-1.* HAL-1 loan proceeds may be used for purposes consistent with §§ 120.101 and 120.102 of this chapter, except that loan funds cannot be used for supportive services, see Section § 122.51-2(e). Further, the use of SBA funds to purchase or construct facilities is prohibited when construction grants and mortgage assistance are available from another Federal source.

(b) *HAL-2.* HAL-2 funds may be used to effect a change of ownership without regard to § 120.102-6 of this chapter.

§ 122.52 Low-income areas.

The Act authorizes loans to small concerns with particular emphasis on the establishment, preservation and strengthening of small concerns located in urban and rural areas with high proportions of unemployed (as designated by the Department of Labor) or low-income individuals or owned by low-income individuals (income is not adequate to satisfy basic family needs). Partnerships and corporations must be over 50 percent owned by low-income individuals to qualify under the low-income criteria. Program requirements and credit standards outlined in other sections of this regulation will not be relaxed to accommodate loan applicants qualifying under this Section.

§ 122.53 Energy conservation.

§ 122.53-1 Policy.

The Act authorizes loans to assist a small concern to design architecturally or to engineer, manufacture, distribute, market, install or service energy measures designed to conserve the Nation's energy resources. See Table 1 for eligible energy measures.

§ 122.53-2 Energy measures defined.

Energy measures include:

(a) Solar thermal energy equipment which is either of the active type based on mechanically forced energy transfer or of the passive type based on convective, conductive or radiant energy transfer or some combination of these types;

(b) Photovoltaic cells and related equipment;

(c) A product or service the primary purpose of which is conservation of energy through devices or techniques which increase the energy efficiency of existing equipment, methods of operation or systems which use fossil fuels, and which is on the Energy Conservation Measures list of the Secretary of Energy (see Table 1) or which the Administrator determines to be consistent with the intent of this subsection;

(d) Equipment the primary purpose of which is the production of energy from wood, biological waste, grain or other biomass source of energy;

(e) Equipment the primary purpose of which is industrial cogeneration of energy, district heating or production of energy from industrial waste;

(f) Hydroelectric power equipment;

(g) Wind energy conversion equipment; and

(h) Engineering, architectural, consulting or other professional services which are necessary or appropriate to aid citizens in using any of the measures described in paragraphs (a) through (g) of this section.

§ 122.53-3 Use of proceeds.

Loan proceeds may be used to acquire vacant land immediately necessary for the construction of a plant and for buildings, machinery, equipment, furniture, fixtures, facilities, supplies or materials for eligible energy measures. Working capital loans shall be made only to the extent it is demonstrated to SBA's satisfaction that the proceeds will be used for entry into or expansion in the area defined above as energy measures. The applicant may be a new business or an existing business that is expanding. Loan funds shall not be used primarily for research and development:

Provided, however, That up to 30 percent of the loan proceeds may be used for further development of a product or service already on the market or where the remaining development of a product or service may be completed under a business plan that provides reasonable assurance of repayment.

§ 122.53-4 Repayment ability.

Recognizing that greater risk may be associated with these energy measures, the status of these loans need not be as sound as for other loans authorized under this part. In order to determine "sound value", SBA will consider such factors as quality of the product or service, technical qualifications of the applicant's management and employees, sales projections and the applicant's financial status.

§ 122.54 Loans for exporters.

§ 122.54-1 Policy.

The Act authorizes a revolving line of credit for export purposes to enable small concerns to develop foreign markets and for pre-export financing. No such credit shall be extended for a period or periods exceeding eighteen months.

§ 122.54-2 Eligibility.

An applicant for an Export Revolving Line of Credit (ERLC) loan, in addition to meeting the eligibility criteria applicable to all section 7(a) loans, shall have been in operation for at least 12 full months prior to filing an application. This 12-months requirement may be waived by the appropriate SBA regional office if the management of the applicant has sufficient export trade experience or other management ability to warrant an exception to the general rule. Waivers can be made only by regional office officials who have delegated authority to approve ERLC loans.

§ 122.54-3 Use of proceeds.

Proceeds of an ERLC loan can be used only to penetrate or develop a foreign market and to finance labor and materials for pre-export production. Professional export marketing advice or services, foreign business travel or participation in trade shows are examples of eligible expenses to develop or penetrate a foreign market. The cost of acquiring or renting office or commercial space in a foreign country, equipping such an office, or wages for a staff in such an office are examples of ineligible uses of proceeds.

§ 122.54-4 Fees.

In addition to other allowable fees [see Section 120.104-2 of this Chapter], the participant in an ERLC loan may charge the borrower a commitment fee equal to one-fourth (¼) of one (1) percent of the loan or $200, whichever is greater. This fee shall not be charged until the SBA has approved the lender's request for guaranty.

§ 122.54-5 Collateral.

Only collateral that is located in the United States, its territories and possessions shall be acceptable security for these loans.

§ 122.54-6 Additional loan conditions.

(a) *Cash flow projection.* All ERLC loan applications shall include a projected cash flow chart for the term of the loan that supports the need for the funds and that evidences repayment ability. The projection must cover the applicant's total operation and clearly identifies the use(s) of the loan proceeds and source(s) or repayment.

(b) *Monthly progress reports.* The ERLC borrowers must submit monthly progress reports to the Lender and explain discrepancies between the projected cash flow and the progress report.

(Approved by the Office of Management and Budget under contract number 3245-0196)

§ 122.55 Qualified employee trust.

§ 122.55-1 Policy.

The Act authorizes guaranty loans to:

(a) *Finance growth.* A qualified or other employee trust which may be treated as a qualified employee trust (see § 122.55-5 below), that represents at least 51 percent of the employees and that is maintained by a continuing small concern which is seeking to finance its corporate growth through the use of a loan from the trust; or

(b) *Change of ownership.* A qualified or other employee trust representing at least 51 percent of the employees, to purchase at least 51 percent of the voting control of a business operated for profit which is (1) a small concern or (2) a business which is other than small and controlled by another person or entity if, after the purchase is accomplished, such business would be a small concern. Such purchase shall be deemed completed when at least 51 percent of the total voting stock of the employer concern is registered in the name of the qualifying employee trust. In these cases the trustee must certify, without limitation, that

(i) Subsequent to such purchase, the small business will be a corporation which

(A) Is a small concern pursuant to Part 121 of this chapter, and

(B) Is not under the effective control (as defined in Part 121 of this title), directly or indirectly, of the seller(s), and

(ii) Not later than the date the guaranteed loan is repaid (or as soon thereafter as is consistent with the requirements of the Internal Revenue Code) at least 51 percent of the total voting stock of the small concern shall be allocated to the accounts of at least 51 percent of the employees entitled to share in such allocations.

(iii) There will be annual reviews by the plan participants or by the trustee of the role in management of employees entitled to share in the allocations in the management of such concern,

(iv) There will be adequate management to assure management expertise and continuity, and

(v) The trustee shall report annually to the lender with respect to the requirements of this section.

§ 122.55-2 Definitions.

The following definitions do not amend or modify the definitions of the Internal Revenue Code (26 U.S.C. 4975(e)(8)), or the Treasury or Labor Department definitions in their respective regulations. As used in this subpart:

Employee means, in the case of a loan not involving a change of majority ownership of the employer concern's voting stock, every person who has been on the payroll of the employer concern as a permanent, full-time employee in any capacity for at least 30 days prior to the date SBA receives the application for a loan guarantee. In case of a loan guarantee to an employee trust to effect a change of the majority ownership (at least 51 percent) of the employer concern, employee means every person on the payroll of such concern as a permanent, full-time employee in any capacity at the time such majority ownership is acquired. (Any person who is employed for 1,000 or more hours over 12 consecutive months is considered a full-time, permanent employee).

Employee organization means an entity representing at least 51 percent of the employees of the employer concern and which maintains a trust treated as an employee trust.

Employee trust means a qualified employee trust or a trust (described in § 122.55-5(b)) maintained by an employee organization.

Employer concern means the present, or prospective, corporate business concern with respect to which an employee trust is receiving an SBA loan guarantee and which qualifies (or will qualify) as small under Part 121 of this chapter.

ESOP means an employee stock ownership plan as defined in the Internal Revenue Code (26 U.S.C. 4975(e)(8)).

Qualified employee trust means, with respect to a small business concern, a trust which forms a part of an ESOP (or a part of an employee benefit plan that is treated as an ESOP for SBA loan guarantee purposes):

(a) Which is maintained by such concern,

(b) Which represents at least 51 percent of the employees;

(c) Which provides that each plan participant is entitled to direct the plan how to vote the qualifying employer securities which are or will be (as the SBA guarantee loan is repaid and encumbrances are removed) allocated to the account of such participant with respect to corporate matters which by law, charter or by-laws must be decided by a majority vote of outstanding qualifying employer securities voted; and

(d) Which the Internal Revenue Service has qualified in writing or which has been exempted in writing from appropriate Labor Department regulations governing Employee Benefit Plans under ERISA.

Qualifying employer securities means, for SBA purposes, and employer security which is (a) stock or otherwise an equity security or (b) a bond, debenture, note, certificate or other evidence of indebtedness which is described in the ESOP provisions of the Internal Revenue Code. Warrants and options are excluded.

§ 122.55-3 Amount of loan.

The $500,000 statutory limit which SBA may guarantee applies to the combined total of all obligations of the qualified employee trust, the employer concern and all its other affiliates in the aggregate.

§ 122.55-4 Exceptions to other SBA regulations.

(a) *Guaranty loan only.* SBA's assistance is available only as a loan guaranty.

(b) *Repayment ability.* In determining whether a reasonable assurance of repayment exists,

(1) SBA shall consider the earnings history and projected future earnings of the employer concern together with its ability to make the necessary payments to the trust. The trustee must document in the application that funds generated from the employee trust will enable the small business concern to overcome present competitive difficulties, if any, which may have an adverse impact on the small concern's prospects of success, including (without limitation) plant obsolescence or the need for regulatory compliance.

(2) SBA shall not consider the personal assets of the employee-owners who are members of the employee organization. However, SBA must have evidence that financial assistance is not otherwise available by utilizing the personal resources and credit of the principals of the employer concern who are not participating in the employee organization, the resources and credit of the employer concern or the sale of those employer assets that are not assential to the operation of the business or its healthy growth.

(c) *Experience or assets of employees.* The individual personal assets of the employee-owners shall not be used as criteria in determining whether to guarantee a loan: *Provided, however,* That SBA may consider business experience, where certain employee-owners assume managerial responsibilities. The small concern must maintain an adequate managerial capacity which may be derived from contracts with employee-owners, or with others. An employee trust relying on the expertise of other than employee-owners shall endeavor to train employee-owners for managerial responsibilities in order to accelerate the assumption of such responsibilities by employee-owners no later than the date the guaranteed loan is repaid.

(Approved by the Office of Management and Budget under control number 3245-0016)

§ 122.55-5 Eligibility.

(a) *Qualified employee trust.* A qualified employee trust shall be eligible for an SBA loan guarantee to assist an employer concern if the trustee of the trust enters into an agreement with SBA which is binding on both the trust and the small concern and which provides that:

(1) The SBA guaranteed loan shall be used solely for the purchase of qualifying employer securities;

(2) The employer concern agrees to use funds received from the employee trust solely for the business purposes for which the loan was guaranteed;

(3) The employer concern agrees to provide the funds necessary for the trust to repay the loan principal plus interest;

(4) The property of the employer concern shall be available as security for repayment of the loan;

(5) All unencumbered qualifying employer securities acquired by the trust using SBA guarantee loan funds shall be allocated to the accounts of the plan participants who are entitled to share in the allocation;

(6) Each plan participant has a nonforfeitable (vested) right, not later than the date such loan is repaid, to all such allocated qualifying employer securities which are acquired with SBA guaranty loan funds;

(7) The employer concern agrees that an employee organization owning less than 51 percent of the voting control will have a 90 day "right of first refusal" to acquire the business before the business is relocated, sold, liquidated or loses its identity as an independently owned and operated small concern by any means other than court action; and

(8) The employer concern has placed no maximum or minimum limits on the percentage of voting stock that the employee organization is allowed to purchase and control.

(b) *Trust equivalent to a qualified employee trust.* A trust may be treated as a qualified employee trust for the purposes of an SBA loan guaranty if:

(1) Such trust is maintained by an employee organization which represents at least 51 percent of the employees of such concern;

(2) The trust is part of a plan which constitutes an employee benefit plan under the Labor Department regulations implementing ERISA and has a written Labor Department exemption from certain prohibited loan transactions. The plan must provide for the following:

(i) Be designed to invest primarily in qualifying employer securities;

(ii) Stipulate that each plan participant is entitled to direct the trustee in the manner of voting all qualifying employer securities acquired with SBA loan guarantee funds that have been allocated or, as the SBA loan is repaid, will be allocated to the participants' accounts, on all corporate matters which, by law, charter or by-laws, must be decided by a majority vote of the qualifying employer securities voted;

(iii) Provides that each participant who is entitled to distribution from the plan has a right, with respect to qualifying employer securities not readily tradable on an established market, to require that the employer concerned repurchase such securities under either a fair valuation formula, appraisal requirement or other method, any of which the Internal Revenue Service or the Labor Department have accepted in writing;

(iv) Provides procedures for including future employees in the plan; and

(3) The trust, with respect to an SBA loan guaranty, enters into an agreement with SBA setting forth the provisions

outlined in paragraph (a) of this § 122.55-5.

§ 122.56 **Veterans loan program.**

§ 122.56-1 **Policy.**

The statutory authorities for these loans appear in Pub. L. 97-377 (96 Stat. 1871), Pub. L. 97-72 (95 Stat. 1055), and Section 7(a) of the Act.

§ 122.56-2 **Direct loans.**

Only SBA direct financial assistance is available to eligible veterans under this program. Private sector financing and SBA guaranteed loans must be unavailable before a direct loan can be considered.

§ 122.56-3 **Eligibility.**

(a) *Eligible veterans.* Veterans eligible for this program include the following:

(1) Vietnam-era veterans who served for a period of more than 180 days, any part of which was between August 5, 1964, and May 7, 1975, and were discharged other than dishonorably.

(2) Disabled veterans of any era with a minimum compensable disability of 30%, or a veteran of any era who was discharged for disability.

(b) *Ownership percentage.* The small business concern must be owned (a minimum of 51%) by one or more eligible veterans.

(c) *Management requirements.* Management and daily operations of the business must be directed by one or more of the veteran owners of the applicant whose veteran status was used to qualify for the loan.

§ 122.56-4 **Single loan benefit.**

The veteran status of an individual may only be used once to qualify for an SBA loan. After having received an SBA loan with eligibility based on veteran status, second or refunding loans can be considered only under the regular business loan program or based on the ownership by other eligible veterans (51% minimum ownership by persons of unused eligibility). Individuals who formerly received SBA loans with eligibility based on veteran status have used their loan benefit and may not be considered for the veterans loan program.

Table 1—Eligible Energy Measures

Subject to the requirements and limitations set forth in Title 10, Code of Federal Regulations, Chapter II, § 450.32 (1984), an energy conservation measure shall be—

(a) Ceiling insulation in a residential or commercial building which is a material which is installed on the surface of the ceiling facing the building interior or between the heated top level living area and the unheated attic space and which resists heat flow through the ceiling;

(b) Wall insulation in a residential or commercial building or industrial plant, which is a material which is installed on the surface facing the building interior or in the cavity of an exterior wall and which functions to resist heat flow through the wall;

(c) Floor insulation in a residential or commercial building, which is a material which resists heat flow through the floor between the first level heated space and the unheated space beneath it, including a basement or crawl space;

(d) Insulation for hot bare pipes in a residential or commercial building or industrial plant, which is a material which resists heat flow from the pipes to the surrounding space;

(e)(1) Caulks and sealants in a residential or commercial building or industrial plant, which are nonrigid materials placed in joints of buildings to prevent the passage of heat, air and moisture;

(2) Weatherstripping in a residential or commercial building or industrial plant, which consists of narrow strips of flexible material placed over or in movable joints of windows and doors to reduce the passage of air and moisture;

(f) Roof insulation in a commercial building or industrial plant which is insulation placed on the surface of the roof facing the building interior or between a roof deck and its water repellent roof surface;

(g) Clock thermostat in a residential building, which is a temperature control device for interior spaces incorporating more than one temperature control point and a clock for switching from one control point to another;

(h) Exterior insulation for a hot water heater in a residential or commercial building or industrial plant, which is a material placed around the tank which resists the heat flow from the hot water heater to its surrounding space;

(i) Insulation for forced air ducts in a residential or commercial building or industrial plant, which is a material which resists heat flow from the duct to its surrounding space;

(j) Storm window in a residential or commercial building which is an extra window, normally installed to the exterior, but which may be installed to the interior, of the primary or ordinary window, to increase resistance to heat flow and to decrease air infiltration;

(k) Efficient lighting fixture or lamp in a residential or commercial building or industrial plant, which is one which—

(1) Replaces an incandescent fixture or lamp with a type of lighting system including fluorescent, mercury vapor, metal halide, and high pressure sodium or ellipsoidal reflector lamps; or

(2) Replaces a mercury vapor fixture or lamp with a high pressure sodium lighting system.

(l) Mixing valve for a hot water supply line in a residential or commercial building or industrial plant, which is a type of valve mounted in the hot water supply line, close to the water heater, which mixes cold water with hot, reducing the temperature of the water in the hot water distribution system;

(m) Flow restrictor for hot water lines in a residential or commercial building or industrial plant, which is a device that limits the rate of flow of hot water from shower heads and faucets;

(n) Burner for oil fired heating equipment in a residential building, which is a device which atomizes the fuel oil, mixes it with air and ignites the fuel-air mixture, and is an integral part of an oil fired furnace or boiler, including the combustion chamber;

(o) Individual meters to replace a master meter for gas, electricity and hot water in a commercial building, which are meters that measure the consumption of gas, electricity or centrally distributed hot water for individual users, instead of the total consumption which is measured by a master meter;

(p)(1) New oil burner in a commercial building or industrial plant, which is a device that meters, atomizes, ignites and mixes the oil with air for the combustion process of boiler; or

(2) New boiler controls in a commercial building or industrial plant, which are devices that sense the need for reducing or increasing the firing rate and change the combustion air and oil flow rate accordingly;

(q) Controls for lighting in a residential or commercial building or industrial plant which are manual or automatic cut off switches for lighting systems that allow cut off of all lighting or a portion of the lighting systems when lighting is not required;

(r) Automatic HVAC control system in a commercial building or industrial plant, which is a device which adjusts the supply of heating or cooling to meet space conditioning requirements;

(s) High efficiency electric motor or motor controls in a commercial building or industrial plant, which replace an existing motor or motor controls, resulting in not less than a specified increase in efficiency at a specified level of use, as determined by DOE; and

(t) Whole house ventilation fan in a residential building, which is a fan which removes air from the inside of a residential building to the outside.

(u) Air source heat pump, which is a system which is part of the central heating system and which has the capability of extracting heat from a body of air and transferring this heat to a body of liquid or to another body of air for space conditioning purposes;

(v) Water source heat pump, which is a system which is part of the central heating system and which has the capability of extracting heat from a body of water and transferring this heat to another body of liquid or to a body of air for space conditioning purposes.

(Catalog of Federal Domestic Assistance Programs No. 59.012, Small Business Loans)

Dated: March 7, 1985.

James C. Sanders,

Administrator.

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