AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

§ 105.403 Designated Agency Ethics Officials.

The Designated Agency Ethics Official and Alternates administer the program for Financial Disclosure Statements under 5 CFR 2634.201, receive and evaluate these statements, and provide advice and counsel regarding matters relating to the Ethics in Government Act of 1978 and its implementing regulations. The duties and responsibilities of the Designated Agency Ethics Official and Alternates are set forth in more detail in 5 CFR 2638.203, which is promulgated and amended by the Office of Government Ethics.

[62 FR 2399, Jan. 26, 1996, as amended at 62 FR 48477, Sept. 16, 1997]

PART 107—SMALL BUSINESS INVESTMENT COMPANIES

Subpart A—Introduction to Part 107

Sec.
107.20 Legal basis and applicability of this part 107.
107.30 Amendments to Act and regulations.
107.40 How to read this part 107.

Subpart B—Definition of Terms Used in Part 107

107.50 Definition of terms.

Subpart C—Qualifying for an SBIC License

ORGANIZING AN SBIC

107.100 Organizing a Section 301(c) Licensee.
107.110 Organizing a Section 301(d) Licensee.
107.115 1940 Act and 1980 Act Companies.
107.120 Special rules for a Section 301(d) Licensee owned by another Licensee.
107.130 Requirement for qualified management.
107.140 SBA approval of initial Management Expenses.
107.150 Management and ownership diversity requirement.
107.160 Special rules for Licensees formed as limited partnerships.

CAPITALIZING AN SBIC

107.200 Adequate capital for Licensees.
107.210 Minimum capital requirements for Licensees.
107.220 Special minimum capital requirements for Licensees issuing Leverage.
107.230 Permitted sources of Private Capital for Licensees.
107.240 Limitations on including non-cash capital contributions in Private Capital.
107.250 Exclusion of stock options issued by Licensee from Management Expenses.

APPLYING FOR AN SBIC LICENSE

107.300 License application form and fee.

Subpart D—Changes in Ownership, Control, or Structure of Licensee; Transfer of License

CHANGES IN CONTROL OR OWNERSHIP OF LICENSEE

107.400 Changes in ownership of 10 percent or more of Licensee but no change of Control.
107.410 Changes in Control of Licensee (through change in ownership or otherwise).
107.420 Prohibition on exercise of ownership or Control rights in Licensee before SBA approval.
107.430 Notification to SBA of transactions that may change ownership or Control.
107.440 Standards governing prior SBA approval for a proposed transfer of Control.
107.450 Notification to SBA of pledge of Licensee's shares.

RESTRICTIONS ON COMMON CONTROL OR OWNERSHIP OF TWO OR MORE LICENSEES

107.460 Restrictions on Common Control or ownership of two (or more) Licensees.

CHANGE IN STRUCTURE OF LICENSEE

107.470 SBA approval of merger, consolidation, or reorganization of Licensee.

TRANSFER OF LICENSE

107.475 Transfer of license.

Subpart E—Managing the Operations of a Licensee

GENERAL REQUIREMENTS

107.500 Lawful operations under the Act.
107.501 Identification as a Licensee.
107.502 Representations to the public.
107.503 Licensee's adoption of an approved Valuation Policy.
107.504 Computer capability requirements of Licensee.
107.505 Facsimile requirement.
107.506 Safeguarding Licensee's assets/Internal controls.
107.507 Violations based on false filings and nonperformance of agreements with SBA.
107.508 Accessible office.
107.509 Employment of SBA officials.

MANAGEMENT AND COMPENSATION

107.510 SBA approval of Licensee's Investment Adviser/Manager.
107.520 Management Expenses of a Licensee.

CASH MANAGEMENT BY A LICENSEE

107.530 Restrictions on investments of idle funds by leveraged Licensees.

BORROWING BY LICENSEES FROM NON-SBA SOURCES

107.550 Prior approval of secured third-party debt of leveraged Licensees.
107.560 Subordination of SBA's creditor position.
107.570 Restrictions on third-party debt of issuers of Participating Securities.

VOLUNTARY DECREASE IN LICENSEE'S REGULATORY CAPITAL

107.585 Voluntary decrease in Licensee's Regulatory Capital.

REQUIREMENT TO CONDUCT ACTIVE INVESTMENT OPERATIONS

107.590 Licensee's requirement to maintain active operations.

Subpart F—Recordkeeping, Reporting, and Examination Requirements for Licensees

RECORDKEEPING REQUIREMENTS FOR LICENSEES

107.600 General requirement for Licensee to maintain and preserve records.
107.610 Required certifications for Loans and Investments.
107.620 Requirements to obtain information from Portfolio Concerns.

REPORTING REQUIREMENTS FOR LICENSEES

107.630 Requirement for Licensees to file financial statements with SBA (Form 468).
107.640 Requirement to file Portfolio Financing Reports (SBA Form 1031).
107.650 Requirement to report portfolio valuations to SBA.
107.660 Other items required to be filed by Licensee with SBA.
107.670 Application for exemption from civil penalty for late filing of reports.
107.680 Reporting changes in Licensee not subject to prior SBA approval.

EXAMINATIONS OF LICENSEES BY SBA FOR REGULATORY COMPLIANCE

107.690 Examinations.
107.691 Responsibilities of Licensee during examination.
107.692 Examination fees.

Subpart G—Financing of Small Businesses by Licensees

DETERMINING THE ELIGIBILITY OF A SMALL BUSINESS FOR SBIC FINANCING

107.700 Compliance with size standards in part 121 of this chapter as a condition of Assistance.
107.710 Requirement to Finance Smaller Enterprises.
107.720 Small Businesses that may be ineligible for Financing.
107.730 Financings which constitute conflicts of interest.
107.740 Portfolio diversification (''overline'' limitation).
107.750 Conditions for financing a change of ownership of a Small Business.
107.760 How a change in size or activity of a Portfolio Concern affects the Licensee and the Portfolio Concern.

STRUCTURING LICENSEE'S FINANCING OF ELIGIBLE SMALL BUSINESSES: TYPES OF FINANCING

107.800 Financings in the form of Equity Securities.
107.810 Financings in the form of Loans.
107.815 Financings in the form of Debt Securities.
107.820 Financings in the form of guarantees.
107.825 Purchasing Securities from an underwriter or other third party.

STRUCTURING LICENSEE'S FINANCING OF AN ELIGIBLE SMALL BUSINESS: TERMS AND CONDITIONS OF FINANCING

107.830 Minimum duration/term of financing.
107.835 Exceptions to minimum duration/term of Financing.
107.840 Maximum term of Financing.
107.845 Maximum rate of amortization on Loans and Debt Securities.
107.850 Restrictions on redemption of Equity Securities.
107.855 Interest rate ceiling and limitations on fees charged to Small Businesses (''Cost of Money'').
107.860 Financing fees and expense reimbursements a Licensee may receive from a Small Business.
107.865 Restrictions on Control of a Small Business by a Licensee.
107.880 Assets acquired in liquidation of Portfolio securities.

LIMITATIONS ON DISPOSITION OF ASSETS

107.885 Disposition of assets to Licensee's Associates or to competitors of Portfolio Concern.

MANAGEMENT SERVICES AND FEES

107.900 Management fees for services provided to a Small Business by Licensee or its Associate.

Subpart H—Non-leveraged Licensees-Exceptions to Regulations

107.1000 Licensees without Leverage—exceptions to the regulations.

Subpart I—SBA Financial Assistance for Licensees (Leverage)

GENERAL INFORMATION ABOUT OBTAINING LEVERAGE

107.1100 Types of Leverage available.
107.1110 How to apply for Leverage.
107.1120 General eligibility requirements for Leverage.
107.1130 Leverage fees payable by Licensee.
107.1140 Licensee's acceptance of SBA remedies under §§ 107.1800 through 107.1820.

MAXIMUM AMOUNT OF LEVERAGE FOR WHICH A LICENSEE IS ELIGIBLE

107.1150 Maximum amount of Leverage for a Section 301(c) Licensee.
107.1160 Maximum amount of Leverage for a Section 301(d) Licensee.
107.1170 Maximum amount of Participating Securities for any Licensee.

CONDITIONAL COMMITMENTS BY SBA TO RESERVE LEVERAGE FOR A LICENSEE

107.1200 SBA's Leverage commitment to a Licensee—application procedure, amount, and term.
107.1210 Commitment fees payable by Licensee.
107.1220 Requirement for Licensee to file quarterly financial statements.
107.1230 Draw-downs by Licensee under SBA's Leverage commitment.
107.1240 Funding of Licensee's draw request through sale to short-term investor.

EXCHANGE OF OUTSTANDING DEBENTURES FOR PARTICIPATING OR PREFERRED SECURITIES—SECTION 301(d) LICENSEES

107.1350 Exchange by Section 301(d) Licensee of Debentures for Preferred or Participating Securities.

PREFERRED SECURITIES LEVERAGE—SECTION 301(d) LICENSEES

107.1400 Stock dividends or partnership distributions on 4 percent Preferred Securities.
107.1410 Requirement to redeem 4 percent Preferred Securities.
107.1420 Articles requirements for 4 percent Preferred Securities issuers.
107.1430 Redeeming 4 percent Preferred Securities with proceeds of non-subsidized Debentures.
107.1440 Three percent preferred stock issued before November 21, 1989.
107.1450 Optional redemption of Preferred Securities.

PARTICIPATING SECURITIES LEVERAGE

107.1500 General description of Participating Securities.
107.1505 Liquidity requirements for Licensees issuing Participating Securities.
107.1510 How a Licensee computes Earmarked Profit (Loss).
107.1520 How a Licensee computes and allocates Prioritized Payments to SBA.
107.1530 How a Licensee computes SBA's Profit Participation.
107.1540 Distributions by Licensee—Prioritized Payments and Adjustments.
107.1550 Distributions by Licensee—permitted ''tax Distributions'' to private investors and SBA.
107.1560 Distributions by Licensee—required Distributions to private investors and SBA.
107.1570 Distributions by Licensee—optional Distribution to private investors and SBA.
107.1580 Special rules for In-Kind Distributions by Licensees.
107.1590 Special rules for companies licensed on or before March 31, 1993.

FUNDING LEVERAGE BY USE OF SBA-GUARANTEED TRUST CERTIFICATES (''TCS'')

107.1600 SBA authority to issue and guarantee Trust Certificates.
107.1610 Effect of prepayment or early redemption of Leverage on a Trust Certificate.
107.1620 Functions of agents, including Central Registration Agent, Selling Agent and Fiscal Agent.
107.1630 SBA regulation of Brokers and Dealers and disclosure to purchasers of Leverage or Trust Certificates.
107.1640 SBA access to records of the CRA, Brokers, Dealers and Pool or Trust assemblers.

MISCELLANEOUS

107.1700 Transfer by SBA of its interest in Licensee's Leverage security.
107.1710 SBA authority to collect or compromise its claims.

Subpart J—Licensee's Noncompliance With Terms of Leverage

107.1800 Licensee's agreement to terms and conditions in §§ 107.1810 and 107.1820.
107.1810 Events of default and SBA's remedies for Licensee's noncompliance with terms of Debentures.
107.1820 Conditions affecting issuers of Preferred Securities and/or Participating Securities.

COMPUTATION OF LICENSEE'S CAPITAL IMPAIRMENT

107.1830 Licensee's Capital Impairment—definition and general requirements.
107.1840 Computation of Licensee's Capital Impairment Percentage.
107.1850 Exceptions to Capital Impairment provisions for Licensees with outstanding Participating Securities.

Subpart K—Ending Operations as a Licensee

107.1900 Surrender of license.

Subpart L—Miscellaneous

107.1910 Non-waiver of SBA's rights or terms of Leverage security.
107.1920 Licensee's application for exemption from a regulation in this part 107.
107.1930 Effect of changes in this part 107 on transactions previously consummated.

AUTHORITY: 15 U.S.C. 662 (12).

SOURCE: 61 FR 3189, Jan. 31, 1996, unless otherwise noted.

EDITORIAL NOTE: At 63 FR 5865, Feb. 5, 1998, the authority citation for Part 107 was revised.

Subpart A—Introduction to Part 107

§ 107.20 Legal basis and applicability of this part 107.

(a) The regulations in this part implement Title III of the Small Business Investment Act of 1958, as amended. All Licensees must comply with all applicable regulations, accounting guidelines and valuation guidelines for Licensees.

(b) Provisions of this part which are not mandated by the Act shall not supersede existing State law. A party claiming that a conflict exists shall submit an opinion of independent counsel, citing authorities, for SBA's resolution of the issues involved.

§ 107.30 Amendments to Act and regulations.

A Licensee shall be subject to all existing and future provisions of the Act and parts 107 and 112 of title 13 of the Code of Federal Regulations.

§ 107.40 How to read this part 107.

(a) *Center Headings.* All references in this part to SBA forms, and instructions for their preparation, are to the current issue of such forms. Center headings are descriptive and are used for convenience only. They have no regulatory effect.

(b) *Capitalizing defined terms.* Terms defined in § 107.50 are capitalized in this part 107.

(c) The pronoun ''you'' as used in this part 107 means a Licensee or license applicant, as appropriate, unless otherwise noted.

Subpart B—Definition of Terms Used in Part 107

§ 107.50 Definition of terms.

Accumulated Prioritized Payments has the meaning set forth in § 107.1520.

Act means the Small Business Investment Act of 1958, as amended.

Adjustments has the meaning set forth in § 107.1520.

Affiliate or *Affiliates* has the meaning set forth in § 121.103 of this chapter.

Articles mean articles of incorporation or charter for a Corporate Licensee and the partnership agreement or certificate for a Partnership Licensee.

Assistance or *Assisted* means Financing of or management services rendered to a Small Business by a Licensee pursuant to the Act and these regulations.

Associate of a Licensee means any of the following:

(1)(i) An officer, director, employee or agent of a Corporate Licensee;

(ii) A Control Person, employee or agent of a Partnership Licensee;

(iii) An Investment Adviser/Manager of any Licensee, including any Person who contracts with a Control Person of a Partnership Licensee to be the Investment Adviser/Manager of such Licensee; or

(iv) Any Person regularly serving a Licensee on retainer in the capacity of attorney at law.

(2) Any Person who owns or controls, or who has entered into an agreement to own or control, directly or indirectly, at least 10 percent of any class of stock of a Corporate Licensee or a limited partner's interest of at least 10 percent of the partnership capital of a Partnership Licensee. However, a limited partner in a Partnership Licensee is not considered an Associate if such Person is an entity Institutional Investor whose investment in the Partnership, including commitments, represents no more than 33 percent of the partnership capital of the Licensee and no more than five percent of such Person's net worth.

(3) Any officer, director, partner (other than a limited partner), manager, agent, or employee of any Associate described in paragraph (1) or (2) of this definition.

(4) Any Person that directly or indirectly Controls, or is Controlled by, or is under Common Control with, a Licensee.

(5) Any Person that directly or indirectly Controls, or is Controlled by, or is under Common Control with, any Person described in paragraphs (1) and (2) of this definition.

(6) Any Close Relative of any Person described in paragraphs (1),(2), (4), and (5) of this definition.

(7) Any Secondary Relative of any Person described in paragraphs (1), (2), (4), and (5) of this definition.

(8) Any concern in which—

(i) Any Person described in paragraphs (1) through (6) of this definition is an officer; or

(ii) Any such Person(s) singly or collectively Control or own, directly or indirectly, an equity interest of at least 10 percent (excluding interests that such Person(s) own indirectly through ownership interests in the Licensee).

(9) Any concern in which any Person(s) described in paragraph (7) of this definition singly or collectively own (including beneficial ownership) a majority equity interest, or otherwise have Control. As used in this paragraph (9), ''collectively'' means together with any Person(s) described in paragraphs (1) though (7) of this definition.

(10) For the purposes of this definition, if any Associate relationship described in paragraphs (1) through (7) of this definition exists at any time within six months before or after the date that a Licensee provides Financing, then that Associate relationship is considered to exist on the date of the Financing.

(11) If any Licensee has any ownership interest in another Licensee, the two Licensees are Associates of each other.

Capital Impairment has the meaning set forth in § 107.1830(c).

Central Registration Agent or *CRA* means one or more agents appointed by SBA for the purpose of issuing TCs and performing the functions enumerated in § 107.1620 and performing similar functions for Debentures and Participating Securities funded outside the pooling process.

Close Relative of an individual means:

(1) A current or former spouse;

(2) A father, mother, guardian, brother, sister, son, daughter; or

(3) A father-in-law, mother-in-law, brother-in-law, sister-in-law, son-in-law, or daughter-in-law.

Combined Capital means the sum of Regulatory Capital and outstanding Leverage.

Commitment means a written agreement between you and an eligible Small Business that obligates you to provide Financing (except a guarantee) to that Small Business in a fixed or determinable sum, by a fixed or determinable future date. In this context the term ''agreement'' means that there has been agreement on the principal economic terms of the Financing. You may include in the agreement reasonable conditions precedent to your obligation to fund the commitment but these conditions must be outside your control.

Common Control means a condition where two or more Licensees either through ownership, management, contract, or otherwise, are under the Control of one group or Person. Two or more Licensees are presumed to be under Common Control if they are Affiliates of each other by reason of common ownership or common officers, directors, or general partners; or if they are managed or their investments are significantly directed either by a common independent investment advisor or managerial contractor, or by two or more such advisors or contractors that are Affiliates of each other. This presumption may be rebutted by evidence satisfactory to SBA.

Control means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a Licensee or other concern, whether through the ownership of voting securities, by contract, or otherwise.

Control Person means any Person that controls a Licensee, either directly or through an intervening entity. A Control Person includes:

(1) A general partner of a Partnership Licensee;

(2) Any Person serving as the general partner, officer, director, or manager

(in the case of a limited liability company) of any entity that controls a Licensee, either directly or through an intervening entity;

(3) Any Person that—

(i) Controls or owns, directly or through an intervening entity, at least 10 percent of a Partnership Licensee or any entity described in paragraphs (1) or (2) of this definition; and

(ii) Participates in the investment decisions of the general partner of such Partnership Licensee;

(4) Any Person that controls or owns, directly or through an intervening entity, at least 50 percent of a Partnership Licensee or any entity described in paragraphs (1) or (2) of this definition.

Corporate Licensee. See definition of Licensee in this section.

Cost of Money has the meaning set forth in § 107.855.

Debenture Rate means the interest rate, as published from time to time in the FEDERAL REGISTER by SBA, for ten year debentures issued by Licensees and funded through public sales of certificates bearing SBA's guarantee. User or guarantee fees, if any, paid by a Licensee are not considered in determining the Debenture Rate.

Debentures means debt obligations issued by Licensees pursuant to section 303(a) of the Act and held or guaranteed by SBA.

Debt Securities has the meaning set forth in § 107.815.

Disadvantaged Business means a Small Business that is at least 50 percent owned, and controlled and managed, on a day to day basis, by a person or persons whose participation in the free enterprise system is hampered because of social or economic disadvantages.

Distribution means any transfer of cash or non-cash assets to SBA, its agent or Trustee, or to partners in a Partnership Licensee, or to shareholders in a Corporate Licensee. Capitalization of Retained Earnings Available for Distribution constitutes a Distribution to the Licensee's non-SBA partners or shareholders.

Earmarked Assets has the meaning set forth in § 107.1510(b). (See also § 107.1590.)

Earmarked Profit (Loss) has the meaning set forth in § 107.1510.

Earned Prioritized Payments has the meaning set forth in § 107.1520.

Equity Capital Investments means investments in a Small Business in the form of common or preferred stock, limited partnership interests, options, warrants, or similar equity instruments, including subordinated debt with equity features if such debt provides only for interest payments contingent upon and limited to the extent of earnings. Equity Capital Investments must not require amortization. Equity Capital Investments may be guaranteed; however, neither Equity Capital Investments nor such guarantee may be collateralized or otherwise secured. Investments classified as Debt Securities (see §§ 107.800 and 107.815) are not precluded from qualifying as Equity Capital Investments.

Equity Securities has the meaning set forth in § 107.800.

Financing or *Financed* means outstanding financial assistance provided to a Small Business by a Licensee, whether through:

(1) Loans;

(2) Debt Securities;

(3) Equity Securities;

(4) Guarantees; or

(5) Purchases of securities of a Small Business through or from an underwriter (see § 107.825).

Guaranty Agreement means the contract entered into by SBA which is a guarantee backed by the full faith and credit of the United States Government as to timely payment of principal and interest on Debentures or the Redemption Price of and Prioritized Payments on Participating Securities and SBA's rights in connection with such guarantee.

Includible Non-Cash Gains means those non-cash gains (as reported on SBA Form 468) that are realized in the form of Publicly Traded and Marketable securities or investment grade debt instruments. For purposes of this definition, investment grade debt instruments means those instruments that are rated ''BBB'' or ''Baa'', or better, by Standard & Poor's Corporation or Moody's Investors Service, respectively. Non-rated debt may be considered to be investment grade if Licensee

obtains a written opinion from an investment banking firm acceptable to SBA stating that the non-rated debt instrument is equivalent in risk to the issuer's investment grade debt.

Institutional Investor means:

(1) *Entities.* Any of the following entities if the entity has a net worth (exclusive of unfunded commitments from investors) of at least $1 million, or such higher amount as is specified in paragraph (1) of this definition. (See also § 107.230(b)(4) for limitations on the amount of an Institutional Investor's commitment that may be included in Private Capital.)

(i) A State or National bank, trust company, savings bank, or savings and loan association.

(ii) An insurance company.

(iii) A 1940 Act Investment Company or Business Development Company (each as defined in the Investment Company Act of 1940, as amended (15 U.S.C. 8a–1 *et seq.*).

(iv) A holding company of any entity described in paragraph (1)(i), (ii) or (iii) of this definition.

(v) An employee benefit or pension plan established for the benefit of employees of the Federal government, any State or political subdivision of a State, or any agency or instrumentality of such government unit.

(vi) An employee benefit or pension plan (as defined in the Employee Retirement Income Security Act of 1974, as amended (Pub. L. 93–406, 88 Stat. 829), excluding plans established under section 401(k) of the Internal Revenue Code of 1986 (26 U.S.C. 401(k)), as amended).

(vii) A trust, foundation or endowment exempt from Federal income taxation under the Internal Revenue Code of 1986, as amended.

(viii) A corporation, partnership or other entity with a net worth (exclusive of unfunded commitments from investors) of more than $10 million.

(ix) A State, a political subdivision of a State, or an agency or instrumentality of a State or its political subdivision.

(x) An entity whose primary purpose is to manage and invest non-Federal funds on behalf of at least three Institutional Investors described in paragraphs (1)(i) through (1)(ix) of this definition, each of whom must have at least a 10 percent ownership interest in the entity.

(xi) Any other entity that SBA determines to be an Institutional Investor.

(2) *Individuals.* (i) Any of the following individuals if he/she is also a permanent resident of the United States:

(A) An individual who is an Accredited Investor (as defined in the Securities Act of 1933, as amended (15 U.S.C. 77a–77aa)) and whose commitment to the Licensee is backed by a letter of credit from a State or National bank acceptable to SBA.

(B) An individual whose personal net worth is at least $2 million and at least ten times the amount of his or her commitment to the Licensee. The individual's personal net worth must not include the value of any equity in his or her most valuable residence.

(C) An individual whose personal net worth (determined in accordance with paragraph (2)(i)(B) of this definition) is at least $10 million.

(ii) Any individual who is not a permanent resident of the United States but who otherwise satisfies paragraph (2)(i) of this definition *provided* such individual has irrevocably appointed an agent within the United States for the service of process.

Investment Adviser/Manager means any Person who furnishes advice or assistance with respect to operations of a Licensee under a written contract executed in accordance with the provisions of § 107.510.

Lending Institution means a concern that is operating under regulations of a state or Federal licensing, supervising, or examining body, or whose shares are publicly traded and listed on a recognized stock exchange or NASDAQ and which has assets in excess of $500 million; and which, in either case, holds itself out to the public as engaged in the making of commercial and industrial loans and whose lending operations are not for the purpose of financing its own or an Associates's sales or business operations.

Leverage means financial assistance provided to a Licensee by SBA, either through the purchase or guaranty of a Licensee's Debentures or Participating Securities, or the purchase of a Licensee's Preferred Securities, and any other

SBA financial assistance evidenced by a security of the Licensee.

Leverageable Capital means Regulatory Capital, excluding unfunded commitments and Qualified Non-private Funds whose source is Federal funds.

Licensee means either a corporation (Corporate Licensee), or a limited partnership organized pursuant to § 107.160 (Partnership Licensee), to which a license has been granted pursuant to the Act. For certain purposes, the Entity General Partner of a Partnership Licensee is treated as if it were a Licensee (see § 107.160(b)(2)).

Loan has the meaning set forth in § 107.810.

Loans and Investments means Portfolio Securities, Assets Acquired in Liquidation of Portfolio Securities, Operating Concerns Acquired, and Notes and Other Securities Received, as set forth in the Statement of Financial Position of SBA Form 468.

Management Expenses has the meaning set forth in § 107.520.

1940 Act Company means a Licensee which is registered under the Investment Company Act of 1940.

1980 Act Company means a Licensee which is registered under the Small Business Investment Incentive Act of 1980.

Original Issue Price means the price paid by the purchaser for securities at the time of issuance.

Participating Securities means preferred stock, preferred limited partnership interests, or similar instruments issued by Licensees, including debentures having interest payable only to the extent of earnings, all of which are subject to the terms set forth in §§ 107.1500 through 107.1590 and section 303(g) of the Act.

Partnership Licensee. See definition of Licensee in this section.

Payment Date means, for a Participating Securities issuer, each February 1, May 1, August 1, and November 1 during the term of a Participating Security.

Person means a natural person or legal entity.

Pool means an aggregation of SBA guaranteed Debentures or SBA guaranteed Participating Securities approved by SBA.

Portfolio means the securities representing a Licensee's total outstanding Financing of Small Businesses. It does not include idle funds or assets acquired in liquidation of Portfolio securities.

Portfolio Concern means a Small Business Assisted by a Licensee.

Preferred Securities means nonvoting preferred stock issued to SBA by a for-profit Section 301(d) Corporate Licensee, or securities having similar characteristics issued by a Section 301(d) Licensee organized as a nonprofit corporation, or nonvoting preferred limited partnership interests issued by a Section 301(d) Partnership Licensee.

Prioritized Payments has the meaning set forth in § 107.1520.

Private Capital has the meaning set forth in § 107.230.

Profit Participation has the meaning set forth in § 107.1500(c)(3).

Publicly Traded and Marketable means securities that are salable without restriction or that are salable within 12 months pursuant to Rule 144 (17 CFR 230.144) of the Securities Act of 1933, as amended, by the holder thereof (or in the case of an In-kind Distribution by the distributee thereof), and are of a class which is traded on a regulated stock exchange, or is listed in the Automated Quotation System of the National Association of Securities Dealers (NASDAQ), or has, at a minimum, at least two market makers as defined in the relevant sections of the Securities Exchange Act of 1934, as amended (15 U.S.C. 77b *et seq.*), and in all cases the quantity of which can be sold over a reasonable period of time without having an adverse impact upon the price of the stock.

Qualified Non-private Funds has the meaning set forth in § 107.230.

Redemption Price means the amount required to be paid by the issuer, or successor to the issuer, of Preferred or Participating Securities to repurchase such securities from the holder. The Redemption Price shall be the Original Issue Price less any prepayments or prior redemptions.

Regulatory Capital means:

(1) *General.* Regulatory Capital means Private Capital, excluding non-cash assets contributed to a Licensee or a license applicant, and non-cash assets

purchased by a license applicant, unless such assets have been converted to cash or have been approved by SBA for inclusion in Regulatory Capital. For purposes of this definition, sales of contributed non-cash assets with recourse or borrowing against such assets shall not constitute a conversion to cash.

(2) *Exclusion of questionable commitments.* An investor's commitment to a Licensee is excluded from Regulatory Capital if SBA determines that the collectibility of the commitment is questionable.

Retained Earnings Available for Distribution means Undistributed Net Realized Earnings less any Unrealized Depreciation on Loans and Investments (as reported on SBA Form 468), and represents the amount that a Licensee may distribute to investors (including SBA) as a profit Distribution, or transfer to Private Capital.

SBA means the Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

Secondary Relative of an individual means:

(1) A grandparent, grandchild, or any other ancestor or lineal descendent who is not a Close Relative;

(2) An uncle, aunt, nephew, niece, or first cousin; or

(3) A spouse of any person described in paragraph (1) or (2) of this definition.

Section 301(c) Licensee has the meaning set forth in § 107.100.

Section 301(d) Licensee has the meaning set forth in § 107.110.

Short-term Financing means Financing for a term of less than five years in accordance with the regulations.

SIC Manual means the latest issue of the Standard Industrial Classification Manual, prepared by the Office of Management and Budget, and available from the U.S. Government Printing Office, Superintendent of Documents, P.O. Box 371954, Pittsburgh, Pa., 15250–7954.

Small Business means a small business concern as defined in section 103(5) of the Act (including its Affiliates), which for purposes of size eligibility, meets the applicable criteria set forth in part 121 of this chapter.

Smaller Enterprise has the meaning set forth in § 107.710.

Start-up Financing means an Equity Capital Investment in a Small Business that—

(1) Has not had sales exceeding $3,000,000 or positive cash flow from operations in any of its last three full fiscal years; and

(2) Was not formed to acquire any existing business, unless the acquired business satisfies paragraphs (1) and (2) of this definition.

Temporary Debt has the meaning set forth in § 107.570.

Trust means the legal entity created for the purpose of holding guaranteed Debentures or Participating Securities and the guaranty agreement related thereto, receiving, holding and making any related payments, and accounting for such payments.

Trust Certificate Rate means a fixed rate determined at the time Participating Securities are issued by the Secretary of the Treasury taking into consideration the current average market yield on outstanding marketable obligations of the United States with maturities comparable to the maturities of the Trust Certificates being guaranteed by SBA, adjusted to the nearest one-eighth of one percent.

Trust Certificates (TCs) means certificates issued by SBA, its agent or Trustee and representing ownership of all or a fractional part of a Trust or Pool of Debentures or Participating Securities.

Trustee means the trustee or trustees of a Trust.

Undistributed Net Realized Earnings means Undistributed Realized Earnings less Non-cash Gains/Income, each as reported on SBA Form 468.

Unrealized Appreciation means the amount by which a Licensee's valuation of each of its Loans and Investments, as determined by its Board of Directors or General Partner(s) in accordance with Licensee's valuation policies, exceeds the cost basis thereof.

Unrealized Depreciation means the amount by which a Licensee's valuation of each of its Loans and Investments, as determined by its Board of Directors or General Partner(s) in accordance with Licensee's valuation policies, is below the cost basis thereof.

Unrealized Gain (Loss) on Securities Held means the sum of the Unrealized

Appreciation and Unrealized Depreciation on all of a Licensee's Loans and Investments, less estimated future income tax expense or estimated realizable future income tax benefit, as appropriate.

Venture Capital Financing has the meaning set forth in § 107.1160.

Wind-up Plan has the meaning set forth in § 107.590.

[61 FR 3189, Jan. 31, 1996; 61 FR 41496, Aug. 9, 1996, as amended at 62 FR 11759, Mar. 13, 1997]

Subpart C—Qualifying for an SBIC License

ORGANIZING AN SBIC

§ 107.100 Organizing a Section 301(c) Licensee.

Section 301(c) Licensee means a company licensed under section 301(c) of the Act. It may be organized as a for-profit corporation or as a limited partnership created in accordance with the special rules of § 107.160.

§ 107.110 Organizing a Section 301(d) Licensee.

Section 301(d) Licensee means a company licensed under section 301(d) of the Act that may provide Assistance only to Disadvantaged Businesses. A Section 301(d) Licensee may be organized as a for-profit corporation, a nonprofit corporation, or as a limited partnership created in accordance with the special rules of § 107.160.

§ 107.115 1940 Act and 1980 Act Companies.

A 1940 Act or 1980 Act Company is eligible to apply for an SBIC license, and an existing Licensee is eligible to apply for SBA's approval to convert to a 1940 Act or 1980 Act Company. In either case, the 1940 Act or 1980 Act Company may elect to be taxed as a regulated investment company under section 851 of the Internal Revenue Code of 1986, as amended (26 U.S.C. 851). However, a Licensee making such election may make Distributions only as permitted under the applicable sections of this part (see the definition of Retained Earnings Available for Distribution, § 107.585, and §§ 107.1540 through 107.1580).

§ 107.120 Special rules for a Section 301(d) Licensee owned by another Licensee.

A Section 301(d) Licensee may be licensed to operate as the subsidiary of one or more Licensees (participant Licensee), with or without non-Licensee participation, subject to the following:

(a) *Application.* In reviewing the license application, SBA will consider what effect, if any, a capital contribution to the proposed Section 301(d) Licensee will have on the participant Licensee.

(b) *Participant Licensees.* Each participant Licensee must propose to own at least twenty percent of the voting securities of the proposed Section 301(d)Licensee.

(c) *Capital contribution.* A subsidiary Section 301(d) Licensee must receive capital contributions in cash, in an amount at least equal to the minimum capital requirement under § 107.210. Capital contributed by a participant Licensee in excess of the required minimum may be in the form of securities of a Disadvantaged Business, valued at the lower of cost or fair value. A participant Licensee must treat its entire capital contribution to the subsidiary as a reduction of its Leveragable Capital. The participant Licensee's remaining Leverageable Capital must be sufficient to support its outstanding Leverage.

(d) *No transfer of Leverage.* A participant Licensee may not transfer its Leverage to a subsidiary Section 301(d) Licensee.

§ 107.130 Requirement for qualified management.

When applying for a license, you must show, to the satisfaction of SBA, that your current or proposed management is qualified and has the knowledge, experience, and capability necessary for investing in the types of businesses contemplated by the Act, these regulations and your business plan. You must designate at least one individual as the official responsible for contact with SBA.

§ 107.140 SBA approval of initial Management Expenses.

If you plan to obtain Leverage, you must have your Management Expenses

approved by SBA at the time of licensing. (See § 107.520 for the definition of Management Expenses.)

§ 107.150 Management and ownership diversity requirement.

You must have diversity between management and ownership in order to be licensed, unless you do not plan to obtain Leverage. To establish diversity, you must meet the requirements in paragraphs (a) and (b) of this section unless SBA approves otherwise.

(a) *Requirement one.* You must satisfy either paragraph (a)(1) or paragraph (a)(2) of this section.

(1) You must have at least three shareholders or limited partners, or at least one acceptable Institutional Investor, in either case with an aggregate ownership interest equal to at least 30 percent of your Regulatory Capital. Such investors must not be your Associates (except for their status as your shareholders or limited partners) or Affiliates of any of your Associates. For purposes of this paragraph (a)(1), the following Institutional Investors are acceptable:

(i) Entities regulated by state or Federal authorities satisfactory to SBA;

(ii) Public or private employee pension funds;

(iii) Trusts, foundations, or endowments which are exempt from Federal income taxation; or

(iv) Other Institutional Investors satisfactory to SBA.

(2) Your common stock or limited partnership interests are publicly traded.

(b) *Requirement two.* Your shareholders or limited partners may not delegate their voting rights to any other Person without prior SBA approval. This restriction does not apply to:

(1) Publicly traded Licensees.

(2) Proxies given to vote at single specified meetings.

(3) Delegations of voting rights by your investors to their investment advisors, provided such advisors are not your Associates (except for their status as your shareholder or partner).

(c) *Diversity based on Licensee's parent company.* If you do not have diversity as defined in paragraphs (a) and (b) of this section, SBA in its sole discretion may accept diversity achieved on the same basis through your parent company as a substitute. As used in this paragraph (c), ''parent company'' means an entity that directly or indirectly has an interest of more than 50 percent of your Regulatory Capital.

(d) *Requirement to maintain diversity after licensing.* If you were required to have diversity between management and ownership at the time you were licensed, you must maintain such diversity while you have outstanding Leverage or Earmarked Assets, unless SBA approves otherwise. If, at any time, you no longer satisfy the diversity criteria in paragraph (a) or (b) of this section, you must:

(1) Notify SBA within 10 days; and

(2) Re-establish diversity within six months.

(e) *Exception to diversity rule.* This § 107.150 does not apply if you are not licensed to issue participating securities and:

(1) You received your license before November 28, 1995; or

(2) SBA received your license application before November 28, 1995 and, as of such date, you had raised the funds needed to begin operations as contemplated in your business plan.

§ 107.160 Special rules for Licensees formed as limited partnerships.

A limited partnership organized under State law solely for the purpose of performing the functions and conducting the activities contemplated under the Act may apply for a license under section 301(c) or section 301 (d) of the Act (''Partnership Licensee'').

(a) *Number of Licensee's General Partners.* If you are a Partnership Licensee, you must have as your general partner(s) at least two individuals, or at least one corporation, partnership, or limited liability company (LLC), or any combination of individuals, corporations, partnerships, or LLCs.

(b) *Entity General Partner of Licensee.* A general partner which is a corporation, limited liability company or partnership (an ''Entity General Partner'') shall be organized under state law solely for the purpose of serving as the general partner of one or more Licensees.

(1) SBA must approve any person who will serve as an officer, director, manager, or general partner of the Entity

General Partner. This provision must be stated in an Entity General Partner's Certificate of Incorporation, member agreement, Limited Partnership Agreement or other similar governing instrument which must, in each case, accompany the license application.

(2) An Entity General Partner is subject to the same examination and reporting requirements as a Licensee under section 310(b) of the Act. The restrictions and obligations imposed upon a Licensee by §§ 107.1800 through 107.1820, and 107.30, 107.410 through 107.450, 107.470, 107.475, 107.500, 107.510, 107.585, 107.600, 107.680, 107.690 through 107.692, 107.865, and 107.1910 apply also to an Entity General Partner of a Licensee.

(3) The general partner(s) of your Entity General Partner(s) will be considered your general partner.

(4) If your Entity General Partner is a limited partnership, its limited partners may be considered your Control Person(s) if they meet the definition for Control Person in § 107.50.

(5) If your Entity General Partner is a limited partnership, it is subject to paragraph (a) of this section.

(c) *Other requirements for Partnership Licensees.* If you are a Partnership Licensee:

(1) You must have a minimum duration of ten years or two years following the maturity of your last-maturing Leverage security, whichever is longer. After 10 years, if all Leverage has been repaid or redeemed and all amounts due SBA, its agent, or Trustee have been paid, the Partnership Licensee may be terminated by a vote of your partners. (For purposes of this provision SBA is not considered a partner.);

(2) None of your general partner(s) may be removed or replaced by your limited partners without prior written approval of SBA;

(3) Any transferee of, or successor in interest to, your general partner shall have only the rights and liabilities of a limited partner pending SBA's written approval of such transfer or succession; and

(4) You must incorporate all the provisions in this paragraph (c) in your Limited Partnership Agreement.

(d) *Obligations of a Control Person.* All Control Persons are bound by the disciplinary provisions of sections 313 and 314 of the Act and by the conflict-of-interest rules under section 312 of the Act. The term Licensee, as used in §§ 107.30, 107.460, and 107.680 includes all of the Licensee's Control Persons. The term Licensee as used in § 107.670 includes only the Licensee's general partner(s). The conditions specified in §§ 107.1800 through 107.1820 and § 107.1910 apply to all general partners.

(e) *Liability of general partner for partnership debts to SBA.* Subject to section 314 of the Act, your general partner is not liable solely by reason of its status as a general partner for repayment of any Leverage or debts you owe to SBA unless SBA, in the exercise of reasonable investment prudence, and with regard to your financial soundness, determines otherwise prior to the purchase or guaranty of your Leverage.

(f) *Reorganization of Licensee.* A corporate Licensee wishing to reorganize as a Partnership Licensee, or a Partnership Licensee wishing to reorganize as a Corporate Licensee, may apply to SBA for approval under § 107.470.

(g) *Special Leverage requirement.* Before your first issuance of Leverage, you must furnish SBA with evidence that you qualify as a partnership for tax purposes, either by a ruling from the Internal Revenue Service, or by an opinion of counsel.

CAPITALIZING AN SBIC

§ 107.200 Adequate capital for Licensees.

You must meet the requirements of this § 107.200 to qualify for a license, to continue as a Licensee, and to receive Leverage.

(a) You must have enough Regulatory Capital to provide reasonable assurance that:

(1) You will operate soundly and profitably over the long term; and

(2) You will be able to operate actively in accordance with your Articles and within the context of your business plan, as approved by SBA.

(b) In SBA's sole discretion, you must be economically viable, taking into consideration actual and anticipated income and losses on your Loans

and Investments, and the experience and qualifications of your owners and managers.

§ 107.210 Minimum capital requirements for Licensees.

(a) *Minimum capital for Section 301(c) Licensees—general rule.* A Section 301(c) Licensee or applicant must have Regulatory Capital (excluding commitments from your investors) of at least $2,500,000.

(b) *Minimum capital for Section 301(d) Licensees—general rule.* A Section 301(d) Licensee or applicant must have Regulatory Capital (excluding commitments from your investors) of at least $1,500,000.

(c) *Exception to general rule—grandfather clause.* The minimum capital requirements in paragraphs (a) and (b) of this section do not apply if you were licensed before October 2, 1990, or if SBA had your license application on file before October 2, 1990 and granted you a license on the basis of such application. If you qualify for this exception, you must have at least the minimum Private Capital required by the regulations in effect on October 1, 1990.

(d) *Additional capital requirements for Licensees seeking Leverage.* If you are a license applicant who intends to seek Leverage, see § 107.220.

§ 107.220 Special minimum capital requirements for Licensees issuing Leverage.

(a) *Participating Securities.* You must have Regulatory Capital of at least $10,000,000 in order to apply for Participating Securities, unless you demonstrate to SBA's satisfaction that you can be financially viable over the long term with a lower amount. You are not permitted under any circumstances to apply for Participating Securities if your Regulatory Capital is less than $5,000,000.

(b) *Debentures.* If you are licensed after January 31, 1996, you must have Regulatory Capital of at least $5,000,000 in order to apply for Debentures, unless you demonstrate to SBA's satisfaction that you can be financially viable over the long term with a lower amount.

(c) *Companies licensed before October 2, 1990.* If § 107.210(c) applies to you and your Regulatory Capital (excluding commitments from investors) is below $2,500,000 (for a Section 301(c) Licensee) or $1,500,000 (for a Section 301(d) Licensee):

(1) You are eligible for Leverage (other than refinancing) only if you can demonstrate to SBA's satisfaction that you have been profitable for three out of your last four fiscal years before applying for Leverage and, on the average, have been profitable for all such fiscal years.

(2) Even if you do not satisfy paragraph (c)(1) of this section, you may apply for Leverage needed to refinance any Debenture outstanding on October 2, 1990, one time only, for a term to be determined by SBA.

§ 107.230 Permitted sources of Private Capital for Licensees.

Private Capital means the contributed capital of a Licensee, plus unfunded binding commitments by Institutional Investors (including commitments evidenced by a promissory note) to contribute capital to a Licensee.

(a) *Contributed capital.* For purposes of this section, contributed capital means the paid-in capital and paid-in surplus of a Corporate Licensee, or the partners' contributed capital of a Partnership Licensee, in either case subject to the limitations in paragraph (b) of this section.

(b) *Exclusions from Private Capital.* Private Capital does not include:

(1) Funds borrowed by a Licensee from any source.

(2) Funds obtained through the issuance of Leverage.

(3) Funds obtained directly or indirectly from any Federal, State, or local government, or any government agency or instrumentality, except for funds invested by a public pension fund and ''Qualified Non-private Funds'' as defined in paragraph (d) of this section.

(4) Any portion of a commitment from an Institutional Investor with a net worth of less than $10 million that exceeds 10 percent of such Institutional Investor's net worth and is not backed by a letter of credit from a State or National bank acceptable to SBA.

(c) *Non-cash capital contributions.* Capital contributions in a form other than cash are subject to the limitations in § 107.240.

(d) *Qualified Non-private Funds.* Private Capital includes ''Qualified Non-private Funds'' as defined in this paragraph (d); however, investors of Qualified Non-private Funds must not control, directly or indirectly, a Licensee's management, or its board of directors or general partner(s). Qualified Non-private Funds are:

(1) Funds directly or indirectly invested in any Licensee on or before August 16, 1982 by any Federal agency except SBA, under a statute explicitly mandating the inclusion of such funds in ''Private Capital'';

(2) Funds directly or indirectly invested in any Licensee by any Federal agency under a statute that is enacted after September 4, 1992, explicitly mandating the inclusion of such funds in ''Private Capital'';

(3) Funds invested in any Licensee or license applicant by one or more State or local government entities (including any guarantee extended by such entities) in an aggregate amount that does not exceed 33 percent of Regulatory Capital; and

(4) Funds invested in any Section 301(d) Licensee or such license applicant from the following sources:

(i) A State financing agency, or similar agency or instrumentality, if the funds invested are derived from such agency's net income and not from appropriated State or local funds; and

(ii) Grants made by a state or local government agency or instrumentality into a nonprofit corporation or institution exercising discretionary authority with respect to such funds, if SBA determines that such funds have taken on a private character and the nonprofit corporation or institution is not a mere conduit.

(e) You may not accept any capital contribution made with funds borrowed by a Person seeking to own an equity interest (whether direct or indirect, beneficial or of record) of at least 10 percent of your Private Capital. This exclusion does not apply if:

(1) Such Person's net worth is at least twice the amount borrowed; or

(2) SBA gives its prior written approval of the capital contribution.

§ 107.240 Limitations on including non-cash capital contributions in Private Capital.

Non-cash capital contributions to a Licensee or license applicant are included in Private Capital only if they fall into one of the following categories:

(a) Direct obligations of, or obligations guaranteed as to principal and interest by, the United States.

(b) Services rendered or to be rendered to you, priced at no more than their fair market value.

(c) Tangible assets used in your operations, priced at no more than their fair market value.

(d) Shares in a Disadvantaged Business received by a subsidiary Section 301(d) Licensee from its parent Licensee, valued at the lower of cost or fair value.

(e) Other non-cash assets approved by SBA.

§ 107.250 Exclusion of stock options issued by Licensee from Management Expenses.

Stock options issued by any Licensee, including a 1940 or 1980 Act Company, are not considered compensation and therefore do not count as part of a Licensee's Management Expenses.

APPLYING FOR AN SBIC LICENSE

§ 107.300 License application form and fee.

The license application must be submitted on SBA Form 415 together with a processing fee computed as follows:

(a) All license applicants will pay a base fee of $10,000.

(b) All applicants who will be Partnership Licensees will pay an additional $5,000 fee, for a total of $15,000.

(c) All applicants who will be issuing Participating Securities will pay an additional $5,000 fee, for a total of $15,000, or a total fee of $20,000 if they also intend to be Partnership Licensees.

Subpart D—Changes in Ownership, Control, or Structure of Licensee; Transfer of License

CHANGES IN CONTROL OR OWNERSHIP OF LICENSEE

§107.400 Changes in ownership of 10 percent or more of Licensee but no change of Control.

(a) *Prior approval requirements.* You must obtain SBA's prior written approval for any proposed transfer or issuance of ownership interests that results in the ownership (beneficial or of record) by any Person, or group of Persons acting in concert, of at least 10 percent of any class of your stock or partnership capital.

(b) *Fee.* A processing fee of $200 must accompany each such request for approval of a change of ownership.

§107.410 Changes in Control of Licensee (through change in ownership or otherwise).

(a) *Prior approval requirements.* You must obtain SBA's prior written approval for any proposed transaction or event that results in Control by any Person(s) not previously approved by SBA.

(b) *Fee.* A processing fee of $10,000 must accompany any application for approval of one or more transactions or events that will result in a transfer of Control.

§107.420 Prohibition on exercise of ownership or Control rights in Licensee before SBA approval.

Without prior written SBA approval, no change of ownership or Control may take effect and no officer, director, employee or other Person acting on your behalf shall:

(a) Register on your books any transfer of ownership interest to the proposed new owner(s);

(b) Permit the proposed new owner(s) to exercise voting rights with respect to such ownership interest (including directly or indirectly procuring or voting any proxy, consent or authorization as to such voting rights at any shareholders' or partnership meeting);

(c) Permit the proposed new owner(s) to participate in any manner in the conduct of your affairs (including exercising control over your books, records, funds or other assets; participating directly or indirectly in any disposition thereof; or serving as an officer, director, partner, employee or agent); or

(d) Allow ownership or Control to pass to another Person.

§107.430 Notification to SBA of transactions that may change ownership or Control.

You must promptly notify SBA as soon as you have knowledge of transactions or events that may result in a transfer of Control or ownership of at least 10 percent of your capital. If there is any doubt as to whether a particular transaction or event will result in such a change, report the facts to SBA.

§107.440 Standards governing prior SBA approval for a proposed transfer of Control.

SBA approval is contingent upon full disclosure of the real parties in interest, the source of funds for the new owners' interest, and other data requested by SBA. As a condition of approving a proposed transfer of control, SBA may:

(a) Require an increase in your Regulatory Capital;

(b) Require the new owners or the transferee's Control Person(s) to assume, in writing, personal liability for your Leverage, effective only in the event of their direct or indirect participation in any transfer of Control not approved by SBA; or

(c) Require compliance with any other conditions set by SBA.

§107.450 Notification to SBA of pledge of Licensee's shares.

(a) You must notify SBA in writing, within 30 calendar days, of the terms of any transaction in which:

(1) Any Person, or group of Persons acting in concert, pledges shares of your stock (or equivalent ownership interests) as collateral for indebtedness; and

(2) The shares pledged are at least 10 percent of your Regulatory Capital.

(b) If the transaction creates a change of ownership or Control, you must comply with §107.400 or §107.410, as appropriate.

RESTRICTIONS ON COMMON CONTROL OR OWNERSHIP OF TWO OR MORE LICENSEES

§ 107.460 Restrictions on Common Control or ownership of two (or more) Licensees.

(a) *General rule.* Without SBA's prior written approval, you must not have an officer, director, manager, Control Person, or owner (with a direct or indirect ownership interest of at least 10 percent) who is also:

(1) An officer, director, manager, Control Person, or owner (with a direct or indirect ownership interest of at least 10 percent) of another Licensee; or

(2) An officer or director of any Person that directly or indirectly controls, or is controlled by, or is under Common Control with, another Licensee.

(b) *Exceptions to general rule.* This § 107.460 does not apply to:

(1) Common officers, directors, managers, or owners of a Section 301(c) Licensee and its Section 301(d) subsidiary; or

(2) Common officers, directors, managers, Control Persons, or owners of two (or more) Licensees which have no Leverage.

CHANGE IN STRUCTURE OF LICENSEE

§ 107.470 SBA approval of merger, consolidation, or reorganization of Licensee.

(a) *Prior approval requirements.* You may not merge, consolidate, change form of organization (corporation or partnership) or reorganize without SBA's prior written approval. Any such merger or consolidation will be subject to § 107.440.

(b) *Fee.* A processing fee of $5,000 must accompany any application for approval of a change in your form of organization (from corporation to partnership or partnership to corporation).

TRANSFER OF LICENSE

§ 107.475 Transfer of license.

You may not transfer your license in any manner without SBA's prior written approval.

Subpart E—Managing the Operations of a Licensee

GENERAL REQUIREMENTS

§ 107.500 Lawful operations under the Act.

You must engage only in the activities contemplated by the Act and in no other activities.

§ 107.501 Identification as a Licensee.

You must display your SBIC license in a prominent location. You must also have a listed telephone number. Before collecting an application fee or extending Financing to a Small Business, you must obtain a written statement from the concern acknowledging its awareness that you are ''a Federal licensee under the Small Business Investment Act of 1958, as amended.''

§ 107.502 Representations to the public.

You may not represent or imply to anyone that the SBA, the U.S. Government or any of its agencies or officers has approved any ownership interests you have issued or obligations you have incurred. Be certain to include a statement to this effect in any solicitation to investors. Example: You may not represent or imply that ''SBA stands behind the Licensee'' or that ''Your capital is safe because SBA's experts review proposed investments to make sure they are safe for the Licensee.''

§ 107.503 Licensee's adoption of an approved Valuation Policy.

(a) *SBA approval.* You must have a written valuation policy for use in determining the value of your Loans and Investments. You must include this policy as part of your initial application to SBA.

(b) *Adopting SBA's valuation guidelines/automatic approval.* If you adopt the exact wording of the Model Valuation Policy, ''Valuation Guidelines for SBICs'', and make absolutely no additions or changes, then SBA will automatically accept your Valuation Policy. With SBA's prior written approval, you may adopt a policy that differs from the model.

(c) *Licensee's adoption of policy.* Your board of directors or general partners will be solely responsible for adopting your Valuation Policy and for using it to prepare valuations of your Loans and Investments for submission to SBA. If SBA reasonably believes that your valuations, individually or in the aggregate, are materially misstated, it reserves the right to require you to engage, at your expense, an independent third party, acceptable to SBA, to substantiate the valuations.

(d) *Frequency of valuations.* (1) If you have outstanding Leverage or Earmarked Assets, you must value your Loans and Investments at the end of the second quarter of your fiscal year, and at the end of your fiscal year.

(2) Otherwise, you must value your Loans and Investments only at your fiscal year end.

(3) On a case-by-case basis, SBA may require you to perform valuations more frequently.

(4) You must report material adverse changes in valuations at least quarterly, within thirty days following the close of the quarter.

(e) *Review of valuations by independent public accountant.* Your independent public accountant must review only valuations performed as of the end of your fiscal year. The accountant's responsibility includes reviewing your valuation procedures and the implementation of such procedures, including adequacy of documentation. The accountant also has reporting responsibilities concerning the results of this review.

§ 107.504 Computer capability requirements of Licensee.

You must have a personal computer with a modem, and be able to use this equipment to prepare reports (using SBA-provided software) and transmit them by modem to SBA.

§ 107.505 Facsimile requirement.

You must be able to receive fax messages 24 hours per day at your primary office.

§ 107.506 Safeguarding Licensee's assets/Internal controls.

You must adopt a plan to safeguard your assets and monitor the reliability of your financial data, personnel, Portfolio, funds and equipment. You must provide your bank and custodian with a certified copy of your resolution or other formal document describing your control procedures.

§ 107.507 Violations based on false filings and nonperformance of agreements with SBA.

The following shall constitute a violation of this part:

(a) *Nonperformance.* Nonperformance of any of the requirements of any Debenture, Participating Security or Preferred Security, or of any written agreement with SBA.

(b) *False statement.* In any document submitted to SBA:

(1) Any false statement knowingly made; or

(2) Any misrepresentation of a material fact; or

(3) Any failure to state a material fact. A material fact is any fact which is necessary to make a statement not misleading in light of the circumstances under which the statement was made.

§ 107.508 Accessible office.

You must maintain an office that is convenient to the public and is open for business during normal working hours.

§ 107.509 Employment of SBA officials.

Without SBA's prior written approval, for a period of two years after the date of your most recent issuance of Leverage (or the receipt of any SBA Assistance as defined in part 105 of this chapter), you are not permitted to employ, offer employment to, or retain for professional services, any person who:

(a) Served as an officer, attorney, agent, or employee of SBA on or within one year before such date; and

(b) As such, occupied a position or engaged in activities which, in SBA's determination, involved discretion with respect to the granting of Assistance under the Act.

Management and Compensation

§ 107.510 SBA approval of Licensee's Investment Adviser/Manager.

You may employ an Investment Adviser/Manager who will be subject to

the supervision of your board of directors or general partner. If you have Leverage or plan to seek Leverage, you must obtain SBA's prior written approval of the management contract. SBA's approval of an Investment Adviser/Manager for one Licensee does not indicate approval of that manager for any other Licensee.

(a) *Management contract.* The contract must:

(1) Specify the services the Investment Adviser/Manager will render to you and to the Small Businesses in your Portfolio; and

(2) Indicate the basis for computing Management Expenses.

(b) *Material change to approved management contract.* If there is a material change, both you and SBA must approve such change in advance. If you are uncertain if the change is material, submit the proposed revision to SBA.

§ 107.520 Management Expenses of a Licensee.

SBA must approve any increases in your Management Expenses if you have outstanding Leverage or Earmarked Assets.

(a) *Definition of Management Expenses.* Management Expenses include:

(1) Salaries;

(2) Office expenses;

(3) Travel;

(4) Business development;

(5) Office and equipment rental;

(6) Bookkeeping; and

(7) Expenses related to developing, investigating and monitoring investments.

(b) Management Expenses do not include services provided by specialized outside consultants, outside lawyers and independent public accountants, if they perform services not generally performed by a venture capital company.

(c) If your Management Expenses have not already been approved by SBA, you must submit such expenses for approval with your SBA Form 468 for your first fiscal year ending after January 31, 1996.

CASH MANAGEMENT BY A LICENSEE

§ 107.530 Restrictions on investments of idle funds by leveraged Licensees.

(a) *Applicability of this section.* This § 107.530 applies if you have outstanding Leverage or if you have applied for Leverage.

(b) *Permitted investments of idle funds.* Funds not invested in Small Businesses must be maintained in:

(1) Direct obligations of, or obligations guaranteed as to principal and interest by, the United States, which mature within 15 months from the date of the investment; or

(2) Repurchase agreements with federally insured institutions, with a maturity of seven days or less. The securities underlying the repurchase agreements must be direct obligations of, or obligations guaranteed as to principal and interest by, the United States. The securities must be maintained in a custodial account at a federally insured institution; or

(3) Certificates of deposit with a maturity of one year or less, issued by a federally insured institution; or

(4) A deposit account in a federally insured institution, subject to a withdrawal restriction of one year or less; or

(5) A checking account in a federally insured institution; or

(6) A reasonable petty cash fund.

(c) *Deposit of funds in excess of the insured amount.* (1) You are permitted to deposit funds in a federally insured institution in excess of the institution's insured amount, but only if the institution is ''well capitalized'' in accordance with the definition set forth in regulations of the Federal Deposit Insurance Corporation, as amended (12 CFR 325.103).

(2) Exception: You may make a temporary deposit (not to exceed 30 days) in excess of the insured amount, in a transfer account established to facilitate the receipt and disbursement of funds or to hold funds necessary to honor Commitments issued.

(d) *Deposit of funds in Associate institution.* A deposit in, or a repurchase

agreement with, a federally insured institution that is your Associate is not considered a Financing of such Associate under §107.730, provided the terms of such deposit or repurchase agreement are no less favorable than those available to the general public.

BORROWING BY LICENSEES FROM NON-SBA SOURCES

§107.550 Prior approval of secured third-party debt of leveraged Licensees.

(a) *Definition.* In this §107.550, ''secured third-party debt'' means any non-SBA debt secured by any of your assets, including secured guarantees and other contingent obligations that you voluntarily assume, secured lines of credit, and secured Temporary Debt of a Licensee with outstanding Participating Securities.

(b) *General rule.* If you have outstanding Leverage, you must get SBA's written approval before you incur any secured third-party debt or refinance any debt with secured third-party debt, including any renewal of a secured line of credit, increase in the maximum amount available under a secured line of credit, or expansion of the scope of a security interest or lien. For purposes of this paragraph (b), ''expansion of the scope of a security interest or lien'' does not include the substitution of one asset or group of assets for another, provided the asset values (as reported on your most recent annual Form 468) are comparable.

(c) *Additional rule for secured lines of credit in existence on April 8, 1994.* If you have outstanding Leverage and you have a secured line of credit that was created on or before April 8, 1994, you must receive SBA's written approval of the line before you increase the amounts outstanding thereunder.

(d) *Conditions for SBA approval.* As a condition of granting its approval under this §107.550, SBA may impose such restrictions or limitations as it deems appropriate, taking into account your historical performance, current financial position, proposed terms of the secured debt and amount of aggregate debt you will have outstanding (including Leverage). SBA will not favorably consider any requests for approval which include a blanket lien on all your assets, or a security interest in your investor commitments in excess of 125 percent of the proposed borrowing.

(e) *Thirty day approval.* Unless SBA notifies you otherwise within 30 days after it receives your request, you may consider your request automatically approved if:

(1) You are in regulatory compliance;

(2) The security interest in your assets is limited to either those assets being acquired with the borrowed funds or an asset coverage ratio of no more than 2:1;

(3) Your Leverage does not exceed 150 percent of your Leverageable Capital; and

(4) Your request is for approval of a secured line of credit that would not cause your total outstanding borrowings (not including Leverage) to exceed 50 percent of your Leverageable Capital.

§107.560 Subordination of SBA's creditor position.

(a) *Debentures purchased or guaranteed on or before July 1, 1991.* Under the terms of any Debenture purchased or guaranteed by SBA on or before July 1, 1991, SBA's unsecured claims against you, as a Debenture-holder or as subrogee, are subordinated in favor of all your other creditors, except to the extent that such claims may be subject to equitable subordination in SBA's favor.

(b) *Debentures purchased or guaranteed after July 1, 1991, including refinancings of Debentures previously purchased or guaranteed.* (1) Under the terms of any Debenture purchased or guaranteed by SBA after July 1, 1991, SBA's unsecured claims against you, as a Debenture-holder or as subrogee, are subordinated only in favor of non-Associate lenders; and, to the extent that your indebtedness to such lenders exceeds the lesser of $10,000,000 or 200 percent of your Regulatory Capital (determined as of the date your Debentures were purchased or guaranteed), SBA's unsecured claims enjoy parity with those of other unsecured creditors, except with respect to indebtedness created on or before July 1, 1991.

(2) In order to induce others to lend you money after your Debenture has

been purchased or guaranteed, SBA may agree in writing on a case-by-case basis to subordinate its unsecured claims, on such terms as it may determine, in favor of one or more of your Associates, or in favor of other lenders in excess of the amounts mentioned in paragraph (b)(1) of this section.

(3) SBA reserves the authority to refuse to subordinate its claims if it determines, at the time you request your Debenture be purchased or guaranteed, that the exercise of reasonable investment prudence and your financial condition warrant such refusal.

§ 107.570 Restrictions on third-party debt of issuers of Participating Securities.

(a) *General.* Temporary Debt is the only debt (other than Leverage) that you are permitted to incur if you have applied to issue Participating Securities or if you have outstanding Participating Securities. For additional rules governing secured Temporary Debt, see § 107.550.

(b) *Definition of Temporary Debt.* Temporary Debt means your short-term borrowings if:

(1) Such borrowings are for the purpose of maintaining your operating liquidity or providing funds for a particular Financing of a Small Business;

(2) The funds are borrowed from a regulated financial institution or a regulated credit company (or, if approved by SBA on a case-by-case basis, from non-regulated lenders including shareholders or partners);

(3) Your total outstanding borrowings (not including Leverage) do not exceed 50 percent of your Leverageable Capital; and

(4) All such borrowings are fully paid off for at least 30 consecutive days during your fiscal year so that you have no outstanding third-party debt for 30 days.

VOLUNTARY DECREASE IN LICENSEE'S REGULATORY CAPITAL

§ 107.585 Voluntary decrease in Licensee's Regulatory Capital.

You must obtain SBA's prior written approval to reduce your Regulatory Capital by more than two percent in any fiscal year, unless otherwise permitted under §§ 107.1560 and 107.1570. At all times, you must retain sufficient Regulatory Capital to meet the minimum capital requirements in the Act and § 107.210, and sufficient Leverageable Capital to avoid having excess Leverage in violation of section 303 of the Act and §§ 107.1150 through 107.1170.

REQUIREMENT TO CONDUCT ACTIVE INVESTMENT OPERATIONS

§ 107.590 Licensee's requirement to maintain active operations.

(a) *Activity test.* You must conduct active operations, as determined under this § 107.590, as a condition of your license. You will be considered active if:

(1) During the eighteen months preceding your most recent fiscal year end, you made Financings totaling at least 20 percent of your Regulatory Capital; or

(2) Your idle funds did not exceed 20 percent of your total assets (at cost) at your most recent fiscal year end.

(b) *Permitted exceptions to activity requirements.* You are considered active if your failure to meet the requirements in paragraph (a) of this section is the result of one or more of the following factors:

(1) Your excess idle funds are the result of the receipt, within the previous nine months, of realized gains, repayments, additional capital contributions, or Leverage.

(2) It is necessary for you to maintain excess idle funds to conduct your operations because:

(i) Your unfunded commitments from investors are no more than 20 percent of your Regulatory Capital; and

(ii) You cannot receive additional Leverage, solely because SBA has insufficient funds available.

(3) You have not made sufficient Financings because of a lack of available funds, evidenced by Loans and Investments (at cost) equal to at least 90 percent of your Combined Capital as of your most recent fiscal year end.

(4) You have not made sufficient Financings solely because SBA has restricted your ability to make investments.

(c) *Applicability of activity requirements.* The activity requirements in paragraph (a) of this section do not apply if you have filed a ''Wind-up

Plan'' approved by SBA. ''Wind-up Plan'' means a plan that you prepare when you decide that you will no longer make any Financings other than follow-on investments, and that you update annually when you file your SBA Form 468. The plan must contain your best estimates of the following:

(1) The remaining number of years you expect to operate.

(2) For each of your Loans and Investments, the expected liquidation date and anticipated proceeds.

(3) The timing of your repayment of obligations to SBA.

(4) The timing and amount of any planned reductions in your Management Expenses.

(d) *Phase-in of activity requirements.* (1) *General rule.* You must meet the activity requirements in this §107.590 as of the end of your first full fiscal year beginning after January 31, 1996. Until then, you will be considered active if you meet the activity requirements in effect on January 30, 1996.

(2) *Rule for new Licensees.* If you received your license after January 31, 1996, or if you received your license less than eighteen months before the fiscal year end determined under paragraph (d)(1) of this section, you must meet the activity requirements in this §107.590 as of the end of your second full fiscal year beginning after the date you received your license.

Subpart F—Recordkeeping, Reporting, and Examination Requirements for Licensees

RECORDKEEPING REQUIREMENTS FOR LICENSEES

§107.600 General requirement for Licensee to maintain and preserve records.

(a) *Maintaining your accounting records.* You must establish and maintain your accounting records using SBA's standard chart of accounts for Licensees, unless SBA approves otherwise.

(b) *Location of records.* You must keep the following records at your principal place of business or, in the case of paragraph (b)(3) of this section, at the branch office that is primarily responsible for the transaction:

(1) All your accounting and other financial records;

(2) All minutes of meetings of directors, stockholders, executive committees, partners, or other officials; and

(3) All documents and supporting materials related to your business transactions, except for any items held by a custodian under a written agreement between you and a Portfolio Concern or non-SBA lender, or any securities held in a safe deposit box, or by a licensed securities broker in an amount not exceeding the broker's per-account insurance coverage.

(c) *Preservation of records.* You must retain all the records that are the basis for your financial reports. Such records must be preserved for the periods specified in this paragraph (c), and must remain accessible for the first two years of the preservation period.

(1) You must preserve for at least 15 years or, in the case of a Partnership Licensee, at least two years beyond the date of liquidation:

(i) All your accounting ledgers and journals, and any other records of assets, asset valuations, liabilities, equity, income, and expenses.

(ii) Your Articles, bylaws, minute books, and license application.

(iii) All documents evidencing ownership of the Licensee including ownership ledgers, and ownership transfer registers.

(2) You must preserve for at least six years all supporting documentation (such as vouchers, bank statements, or canceled checks) for the records listed in paragraph (b)(1) of this section.

(3) After final disposition of any item in your Portfolio, you must preserve for at least six years:

(i) Financing applications and Financing instruments.

(ii) All loan, participation, and escrow agreements.

(iii) Size status declarations (SBA Form 480) and Financing Eligibility Statements (SBA Form 1941).

(iv) Any capital stock certificates and warrants of the Portfolio Concern that you did not surrender or exercise.

(v) All other documents and supporting material relating to the Portfolio Concern, including correspondence.

(4) You may substitute a microfilm or computer-scanned or generated copy for the original of any record covered by this paragraph (c).

§ 107.610 Required certifications for Loans and Investments.

For each of your Loans and Investments, you must have the documents listed in this section. You must keep these documents in your files and make them available to SBA upon request.

(a) SBA Form 480, the Size Status Declaration, executed both by you and by the concern you are financing. By executing this document, both parties certify that the concern is a Small Business. For securities purchased from an underwriter in a public offering, you may substitute a prospectus showing that the concern is a Small Business.

(b) SBA Form 652, a certification by the concern you are financing that it will not illegally discriminate (see part 112 of this chapter).

(c) SBA Form 1941 (for Section 301(d) Licensees only), executed both by you and by the concern you are financing. By executing this document, both parties certify that the concern is a Disadvantaged Business.

(d) A certification by the concern you are financing of the intended use of the proceeds. For securities purchased from an underwriter in a public offering, you may substitute a prospectus indicating the intended use of proceeds.

§ 107.620 Requirements to obtain information from Portfolio Concerns.

All the information required by this section is subject to the requirements of § 107.600 and must be in English.

(a) *Information for initial Financing decision.* Before extending any Financing, you must require the applicant to submit such financial statements, plans of operation (including intended use of financing proceeds), cash flow analyses and projections as are necessary to support your investment decision. The information submitted must be consistent with the size and type of the business and the amount of the proposed Financing.

(b) *Updated financial information.* (1) The terms of each Financing must require the Portfolio Concern to provide, at least annually, sufficient financial information to enable you to perform the following required procedures:

(i) Evaluate the financial condition of the Portfolio Concern for the purpose of valuing your investment;

(ii) Determine the continued eligibility of the Portfolio Concern; and

(iii) Verify the use of Financing proceeds.

(2) The information submitted to you must be certified by the president, chief executive officer, treasurer, chief financial officer, general partner, or proprietor of the Portfolio Concern.

(3) For financial and valuation purposes, you may accept a complete copy of the Federal income tax return filed by the Portfolio Concern (or its proprietor) in lieu of financial statements, but only if appropriate for the size and type of the business involved.

(4) The requirements in this paragraph (b) do not apply when you acquire securities from an underwriter in a public offering (see § 107.825). In that case, you must keep copies of all reports furnished by the Portfolio Concern to the holders of its securities.

(c) *Information required for examination purposes.* You must obtain any information requested by SBA's examiners for the purpose of verifying the certifications made by a Portfolio Concern under § 107.610. In this regard, your Financing documents must contain provisions requiring the Portfolio Concern to give you and/or SBA's examiners access to its books and records for such purpose.

Reporting Requirements for Licensees

§ 107.630 Requirement for Licensees to file financial statements with SBA (Form 468).

(a) *Annual filing of Form 468.* For each fiscal year, you must submit to SBA financial statements and supplementary information prepared on SBA Form 468. You must file Form 468 on or before the last day of the third month following the end of your fiscal year, except for the information required under paragraph (e) of this section, which must be filed on or before the last day of the fifth month following the end of your fiscal year.

(1) *Audit of Form 468.* The annual Form 468 must be audited by an independent public accountant acceptable to SBA.

(2) *Insurance requirement for public accountant.* Unless SBA approves otherwise, your independent public accountant must carry at least $1,000,000 of Errors and Omissions insurance, or be self-insured and have a net worth of at least $1,000,000.

(b) *Interim filings of Form 468.* When requested by SBA, you must file interim reports on Form 468. SBA may require you to file the entire form or only certain statements and schedules. You must file such reports on or before the last day of the month following the end of the reporting period. If you have an outstanding Leverage commitment from SBA, see the filing requirements in § 107.1220.

(c) *Standards for preparation of Form 468.* You must prepare SBA Form 468 in accordance with SBA's Accounting Standards and Financial Reporting Requirements for Small Business Investment Companies.

(d) *Where to file Form 468.* Submit all filings of Form 468 to the Investment Division of SBA.

(e) *Reporting of economic impact information on Form 468.* Your annual filing of SBA Form 468 must include an assessment of the economic impact of each Financing, specifying the full-time equivalent jobs created or retained, and the impact of the Financing on the revenues and profits of the business and on taxes paid by the business and its employees.

§ 107.640 Requirement to file Portfolio Financing Reports (SBA Form 1031).

For each Financing of a Small Business (excluding guarantees), you must submit a Portfolio Financing Report on SBA Form 1031 within 30 days of the closing date.

§ 107.650 Requirement to report portfolio valuations to SBA.

You must determine the value of your Loans and Investments in accordance with § 107.503. You must report such valuations to SBA within 90 days of the end of the fiscal year in the case of annual valuations, and within 30 days following the close of other reporting periods. You must report material adverse changes in valuations at least quarterly, within thirty days following the close of the quarter.

§ 107.660 Other items required to be filed by Licensee with SBA.

(a) *Reports to owners.* You must give SBA a copy of any report you furnish to your investors, including any prospectus, letter, or other publication concerning your financial operations or those of any Portfolio Concern.

(b) *Documents filed with SEC.* You must give SBA a copy of any report, application or document you file with the Securities and Exchange Commission.

(c) *Litigation reports.* When you become a party to litigation or other proceedings, you must give SBA a report within 30 days that describes the proceedings and identifies the other parties involved and your relationship to them.

(1) The proceedings covered by this paragraph (c) include any action by you, or by your security holder(s) in a personal or derivative capacity, against an officer, director, Investment Adviser or other Associate of yours for alleged breach of official duty.

(2) SBA may require you to submit copies of the pleadings and other documents SBA may specify.

(3) Where proceedings have been terminated by settlement or final judgment, you must promptly advise SBA of the terms.

(4) This paragraph (c) does not apply to collection actions or proceedings to enforce your ordinary creditors' rights.

(d) *Other reports.* You must file any other reports that SBA may require by written directive.

§ 107.670 Application for exemption from civil penalty for late filing of reports.

(a) If it is impracticable to submit any required report within the time allowed, you may apply for an extension. The request for an extension must:

(1) Be filed before the reporting deadline;

(2) Certify to an extraordinary occurrence, not within your control, that

makes timely filing of the report impracticable; and

(3) Be accompanied by written evidence of such occurrence, where appropriate.

(b) Upon receipt of your request, SBA may exempt you from the civil penalty provision of section 315(a) of the Act, in such manner and under such conditions as SBA determines.

§ 107.680 Reporting changes in Licensee not subject to prior SBA approval.

(a) *Changes to be reported for post approval.* (1) This section applies to any changes in your Articles, ownership, capitalization, management, operating area, or investment policies that do not require SBA's prior approval. You must report such changes to SBA within 30 days for post approval. A processing fee of $200 must accompany each request for post approval of new officers, directors, or Control Persons.

(2) *Exception for non-leveraged Licensees.* If you do not have outstanding Leverage or Earmarked Assets, you are not required to obtain post approval of new directors or new officers other than your chief operating officer; however, you must notify SBA of the new directors or officers within 30 days.

(b) *Approval by SBA.* You may consider any change submitted under this section § 107.680 to be approved unless SBA notifies you to the contrary within 90 days after receiving it. SBA's approval is contingent upon your full disclosure of all relevant facts and is subject to any conditions SBA may prescribe.

Examinations of Licensees by SBA for Regulatory Compliance

§ 107.690 Examinations.

SBA will examine all Licensees for the purpose of evaluating regulatory compliance.

§ 107.691 Responsibilities of Licensee during examination.

You must make all books, records and other pertinent documents and materials available for the examination, including any information required by the examiner under § 107.620(c). In addition, the agreement between you and the independent public accountant performing your audit must provide that any information in the accountant's working papers be made available to SBA upon request.

§ 107.692 Examination fees.

(a) *General.* SBA will assess fees for examinations in accordance with this § 107.692. Unless SBA determines otherwise on a case by case basis, SBA will not assess fees for special examinations to obtain specific information.

(b) *Base fee.* A base fee will be assessed based on your total assets (at cost) as of the date of your latest certified financial statement or a more recent interim statement requested by and submitted to SBA in connection with the examination. The base fee table is as follows:

Total assets of licensee	Base fee	Plus, percent of assets
$0 to $1,500,000	$3,500	+0%
$1,500,001 to $5,000,000	3,700	+.065% of the amount over $1,500,000
$5,000,001 to $10,000,000	6,000	+.02% of the amount over $5,000,000
$10,000,001 to $15,000,000	7,000	+.01% of the amount over $10,000,000
$15,000,001 to $25,000,000	7,700	+.015% of the amount over $15,000,000
$25,000,001 to $50,000,000	9,200	+.015% of the amount over $25,000,000
$50,000,001 to $60,000,000	13,000	+.01% of the amount over $50,000,000
$60,000,001 and above	14,000	+0%

(c) *Adjustments to base fee.* Your base fee, as determined by the table in paragraph (b) of this section, will be adjusted (increased or decreased) based on the following criteria:

(1) If you have no outstanding regulatory violations at the time of the commencement of the examination and SBA did not identify any violations as a result of the most recent prior examination, you will receive a 15% discount on your base fee;

(2) If you were fully responsive to the letter of notification of examination (that is, you provided all requested documents and information within the

time period stipulated in the notification letter in a complete and accurate manner, and you prepared and had available all information requested by the examiner for on-site review), you will receive a 10% discount on your base fee;

(3) If you are organized as a partnership or limited liability company, you will pay an additional charge equal to 5% of your base fee;

(4) If you are a Licensee authorized to issue Participating Securities, you will pay an additional charge equal to 10% of your base fee; and

(5) If you maintain your records/files in multiple locations (as permitted under §107.600(b)), you will pay an additional charge equal to 10% of your base fee.

(d) *Fee discounts and additions table.* The following table summarizes the discounts and additions noted in paragraph (c) of this section:

Examination fee discounts	Amount of discount—% of base examination fee	Examination fee additions	Amount of Addition—% of base examination fee
No prior violations	15	Partnership or limited liability company	5
Responsiveness	10	Participating Security Licensee	10
		Records/files at multiple locations	10

(e) *Delay fee.* If, in the judgement of SBA, the time required to complete your examination is delayed due to your lack of cooperation or the condition of your records, SBA may assess an additional fee of up to $500 per day.

[62 FR 23338, Apr. 30, 1997]

Subpart G—Financing of Small Businesses by Licensees

DETERMINING THE ELIGIBILITY OF A SMALL BUSINESS FOR SBIC FINANCING

§107.700 Compliance with size standards in Part 121 of this chapter as a condition of Assistance.

You are permitted to provide financial assistance and management services only to a Small Business. To determine whether an applicant is a Small Business, you may use either the financial size standards in §121.301(c)(1) of this chapter or the industry standard covering the industry in which the applicant is primarily engaged, as set forth in §121.301(c)(2) of this chapter.

§107.710 Requirement to Finance Smaller Enterprises.

Your Portfolio must include Financings to Smaller Enterprises.

(a) *Definition of Smaller Enterprise.* A Smaller Enterprise means any small business concern that:

(1) Together with its Affiliates has a net worth of not more than $6.0 million and average net income after Federal income taxes (excluding any carry-over losses) for the preceding two years no greater than $2.0 million; or

(2) Both together with its Affiliates, and by itself, meets the size standard of §121.201 of this chapter at the time of Financing for the industry in which it is then primarily engaged.

(b) Phase 1 of Smaller Enterprise Financing requirement. At the close of your first complete fiscal year beginning on or after April 25, 1994, at least 10 percent of the total dollar amount of the Financings you extended since April 25, 1994, must have been in Smaller Enterprises.

(c) Phase 2 of Smaller Enterprise Financing requirement. At the close of each of your next fiscal years, at least 20 percent of the total dollar amount of the Financings you extended since April 25, 1994, must have been invested in Smaller Enterprises.

(d) Financing a change of ownership which results in the creation of a Smaller Enterprises. The Financing of a change of ownership under §107.750 which results in the creation of a Smaller Enterprise qualifies as a Smaller Enterprise Financing.

(e) Non-compliance with this section. If you have not reached the required percentage of Smaller Enterprise

Financings at the end of any fiscal year, then you must be in compliance by the end of the following fiscal year.

[62 FR 11760, Mar. 13, 1997]

§ 107.720 Small Businesses that may be ineligible for Financing.

(a) *Relenders or reinvestors.* You are not permitted to finance any business that is a relender or reinvestor.

(1) *Definition.* Relenders or reinvestors are businesses whose primary business activity involves, directly or indirectly, providing funds to others, purchasing debt obligations, factoring, or long-term leasing of equipment with no provision for maintenance or repair.

(2) *Exception.* You may provide Venture Capital Financing to Disadvantaged Businesses that are relenders or reinvestors (except banks or savings and loans not insured by agencies of the federal government, and agricultural credit companies). Without SBA's prior written approval, total Financings under this paragraph (a)(2) that are outstanding as of the close of your fiscal year must not exceed your Regulatory Capital.

(b) *Passive Businesses.* You are not permitted to finance a passive business.

(1) *Definition.* A business is passive if:

(i) It is not engaged in a regular and continuous business operation (for purposes of this paragraph (b), the mere receipt of payments such as dividends, rents, lease payments, or royalties is not considered a regular and continuous business operation); or

(ii) Its employees are not carrying on the majority of day to day operations, and the company does not provide effective control and supervision, on a day to day basis, over persons employed under contract; or

(iii) It passes through substantially all of the proceeds of the Financing to another entity.

(2) *Exception.* You may finance a passive business if, for all Financings extended, it passes substantially all the proceeds through to the same eligible Small Business that is not passive.

(c) *Real Estate Businesses.* (1) You are not permitted to finance any business classified under Major Group 65 (Real Estate) or Industry No. 1532 (Operative Builders) of the SIC Manual, with the following exceptions:

(i) Title Abstract companies (Industry No. 6541); and

(ii) Companies listed under Industry No. 6531 (for example, real estate agents, brokers, escrow agents, managers and multiple listing services) that derive at least 80 percent of their revenue from non-Affiliate sources.

(2) You are not permitted to finance a business, regardless of SIC classification, if the Financing is to be used to acquire realty or to discharge an obligation relating to the prior acquisition of realty, unless the Small Business:

(i) Is acquiring an existing property and will use at least 51 percent of the usable square footage for an eligible business purpose; or

(ii) Is building or renovating a building and will use at least 67 percent of the usable square footage for an eligible business purpose.

(d) *Project Financing.* You are not permitted to finance a business if:

(1) The assets of the business are to be reduced or consumed, generally without replacement, as the life of the business progresses, and the nature of the business requires that a stream of cash payments be made to the business's financing sources, on a basis associated with the continuing sale of assets. Examples include real estate development projects and oil and gas wells; or

(2) The primary purpose of the Financing is to fund production of a single item or defined limited number of items, generally over a defined production period, and such production will constitute the majority of the activities of the Small Business. Examples include motion pictures and electric generating plants.

(e) *Farm land purchases.* You are not permitted to finance the acquisition of farm land. Farm land means land which is or is intended to be used for agricultural or forestry purposes, such as the production of food, fiber, or wood, or is so taxed or zoned.

(f) *Public interest.* You are not permitted to finance any business if the proceeds are to be used for purposes contrary to the public interest, including but not limited to activities which

are in violation of law, or inconsistent with free competitive enterprise.

(g) *Foreign investment*—(1) *General rule.* You are not permitted to finance a business if:

(i) The funds will be used substantially for a foreign operation; or

(ii) At the time of the Financing or within one year thereafter, more than 49 percent of the employees or tangible assets of the Small Business are located outside the United States (unless you can show, to SBA's satisfaction, that the Financing was used for a specific domestic purpose).

(2) *Exception.* This paragraph (g) does not prohibit a Financing used to acquire foreign materials and equipment or foreign property rights for use or sale in the United States.

(h) *Associated supplier.* You are not permitted to finance a business that purchases, or will purchase, goods or services from a supplier who is your Associate, except under the following conditions:

(1) The amount of goods and services purchased (or to be purchased) from your Associate with the proceeds of the Financing, or with funds released as a result of the Financing, is less than 50 percent of the total amount of the Financing (75 percent for a Section 301(d) Licensee);

(2) The price of such goods and services is no higher than that charged other customers of your Associate; and

(3) The Small Business purchases no capital goods from your Associate.

(i) *Financing Licensees.* You are not permitted to provide funds, directly or indirectly, that the Small Business will use:

(1) To purchase stock in or provide capital to a Licensee; or

(2) To repay an indebtedness incurred for the purpose of investing in a Licensee.

§ 107.730 Financings which constitute conflicts of interest.

(a) *General rule.* You must not self-deal to the prejudice of a Small Business, the Licensee, its shareholders or partners, or SBA. Unless you obtain a prior written exemption from SBA for special instances in which a Financing may further the purposes of the Act despite presenting a conflict of interest, you must not directly or indirectly:

(1) Provide Financing to any of your Associates.

(2) Provide Financing to an Associate of another Licensee if one of your Associates has received or will receive any direct or indirect Financing or a Commitment from that Licensee or a third Licensee (including Financing or Commitments received under any understanding, agreement, or cross dealing, reciprocal or circular arrangement).

(3) Borrow money from:

(i) A Small Business Financed by you;

(ii) An officer, director, or owner of at least a 10 percent equity interest in such business; or

(iii) A Close Relative of any such officer, director, or equity owner.

(4) Provide Financing to a Small Business to discharge an obligation to your Associate or free other funds to pay such obligation. This paragraph (a)(4) does not apply if the obligation is to an Associate Lending Institution and is a line of credit or other obligation incurred in the normal course of business.

(5) Provide Financing to a Small Business for the purpose of purchasing property from your Associate, except as permitted under § 107.720(h).

(b) *Rules applicable to Associates.* Without SBA' s prior written approval, your Associates must not, directly or indirectly:

(1) Borrow money from any Person described in paragraph (a)(3) of this section.

(2) Receive from a Small Business any compensation in connection with Assistance you provide (except as permitted under §§ 107.825(c) and 107.900), or anything of value for procuring, attempting to procure, or influencing your action with respect to such Assistance.

(c) *Applicability of other laws.* You are also bound by any restrictions in Federal or State laws governing conflicts of interest and fiduciary obligations.

(d) *Financings with Associates*—(1) *Financings with Associates requiring prior approval.* Without SBA's prior written approval, you may not Finance any business in which your Associate has either a voting equity interest, or

total equity interests (including potential interests), of at least five percent.

(2) *Other Financings with Associates.* If you and an Associate provide Financing to the same Small Business, either at the same time or at different times, you must be able to demonstrate to SBA's satisfaction that the terms and conditions are (or were) fair and equitable to you, taking into account any differences in the timing of each party's financing transactions.

(3) *Exceptions to paragraphs (d)(1) and (d)(2) of this section.* A Financing that falls into one of the following categories is exempt from the prior approval requirement in paragraph (d)(1) of this section or is presumed to be fair and equitable to you for the purposes of paragraph (d)(2) of this section, as appropriate:

(i) Your Associate is a Lending Institution that is providing financing under a credit facility in order to meet the operational needs of the Small Business, and the terms of such financing are usual and customary.

(ii) Your Associate invests in the Small Business on the same terms and conditions and at the same time as you.

(iii) Both you and your Associate are leveraged Licensees, and both have outstanding Participating Securities or neither has outstanding Participating Securities.

(iv) Both you and your Associate are non-leveraged Licensees.

(e) *Use of Associates to manage Portfolio Concerns.* To protect your investment, you may designate an Associate to serve as an officer, director, or other participant in the management of a Small Business. You must identify any such Associate in your records available for SBA's review under § 107.600. Without SBA's prior written approval, the Associate must not:

(1) Have any other direct or indirect financial interest in the Portfolio Concern that exceeds, or has the potential to exceed, 5 percent of the Portfolio Concern's equity.

(2) Have served for more than 30 days as an officer, director or other participant in the management of the Portfolio Concern before you provided Financing.

(3) Receive any income or anything of value from the Portfolio Concern unless it is for your benefit, with the exception of director's fees, expenses, and distributions based upon the Associate's ownership interest in the Concern.

(f) *1940 and 1980 Act Companies: SEC exemptions.* If you are a 1940 or 1980 Act Company and you receive an exemption from the Securities and Exchange Commission for a transaction described in this § 107.730, you need not obtain SBA's approval of the transaction. However, you must promptly notify SBA of the transaction and satisfy the public notice requirements in paragraph (g) of this section.

(g) *Public notice.* Before SBA grants an exemption under this § 107.730, you must publish notice of the transaction in a newspaper of general circulation in the locality most directly affected by the transaction, and furnish a certified copy to SBA within 10 days of publication. SBA will publish a similar notice in the FEDERAL REGISTER.

§ 107.740 Portfolio diversification ("overline" limitation).

(a) *General rule.* This § 107.740 applies if you have outstanding Leverage or want to be eligible for Leverage. Without SBA's prior written approval, your aggregate outstanding Financings and Commitments to a Small Business (including its Affiliates) must not exceed:

(1) 20 percent of Regulatory Capital for a Section 301(c) Licensee; or

(2) 30 percent of Regulatory Capital for a Section 301(d)Licensee.

(b) *Outstanding Financings.* For the purposes of paragraph (a) of this section, you must measure each outstanding Financing at its current cost plus any amount of the Financing that was previously written off.

(c) *Adjustment to Regulatory Capital.* For the purposes of paragraph (a) of this section, you may compute a higher maximum permitted investment in a Small Business (an ''increased limit'') by adding ''net unrealized gains'' on Publicly Traded and Marketable securities to your Regulatory Capital, subject to the following conditions:

(1) ''Net unrealized gains'' on Publicly Traded and Marketable securities means unrealized gains on Publicly

Traded and Marketable securities minus unrealized losses on *all* Loans and Investments.

(2) You must value your Publicly Traded and Marketable securities in accordance with your SBA-approved valuation policy.

(3) You must have positive Retained Earnings Available for Distribution at the time you compute an increased limit under this paragraph (c).

(4) At the time you first compute an increased limit, and as of the first business day of each calendar quarter that the increased limit is in effect, you must keep copies in your files of the NASDAQ listings (or the Wall Street Journal) or written quotations from the market makers quoting the Publicly Traded and Marketable securities which support the adjustment.

(5) If your net unrealized gains on Publicly Traded and Marketable securities are more than 30 percent below their original level on the first business day of any calendar quarter, and remain so for the next 30 days, you agree to do one of the following to remain in compliance with the terms of your Leverage:

(i) By the first day of the next calendar quarter, increase your Regulatory Capital sufficiently to restore support for the increased limit; or

(ii) Lower the increased limit to reflect the decrease in net unrealized gains on Publicly Traded and Marketable securities, and reduce any Financings that exceed the lower limit.

Example to paragraph (c) of this section. Your Regulatory Capital is $2,500,000 and your overline limit is $500,000 (20 percent of $2,500,000). On January 15, 1995, you document net unrealized gains on Publicly Traded and Marketable securities of $200,000 and compute an increased limit of $540,000 (20 percent of $2,700,000). You now make an investment of $540,000 in a Small Business. Nothing changes until the first business day of April, 1996, when you document net unrealized gains on Publicly Traded and Marketable securities of only $120,000, a reduction of more than 30 percent. Your net unrealized gains remain at this level for the next 30 days. Your increased limit is now only $524,000 (20 percent of $2,620,000). By July 1, 1996, you must either increase Regulatory Capital by $80,000 to restore your increased limit to $540,000, or reduce your portfolio investment from $540,000 to $524,000.

§ 107.750 Conditions for financing a change of ownership of a Small Business.

You may finance a change of ownership of a Small Business only under the conditions set forth in this section.

(a) The Financing must:

(1) Promote the sound development or preserve the existence of the Small Business;

(2) Help create a Small Business as a result of a corporate divestiture; or

(3) Facilitate ownership in a Disadvantaged Business.

(b) The Resulting Concern (as defined in paragraph (c) of this section) must:

(1) Be a Small Business under § 107.700;

(2) Have 500 or fewer full-time equivalent employees; or meet one of the appropriate debt/equity ratio tests:

(i) If you have outstanding Leverage, the Resulting Concern's ratio of debt to equity must be no more than 5 to 1; or

(ii) If you have no outstanding Leverage, the Resulting Concern's ratio of debt to equity must be no more than 8 to 1.

(c) *Definitions.* (1) The ''Resulting Concern'' is determined by viewing the business as though the change of ownership had already occurred, giving effect to all contemplated financing, mergers, and acquisitions.

(2) For purposes of this section, ''debt'' means long-term debt, including contingent liabilities, but excluding accounts payable, operating leases, letters of credit, subordinated notes payable to the seller, any other liabilities approved for exclusion by SBA and short-term working capital loans (so long as the loans carry a zero balance for 30 consecutive days during the concern's fiscal year).

(3) For purposes of this section, ''equity'' means common and preferred stock (corporation), contributed capital (partnership), or membership interests (limited liability company).

§ 107.760 How a change in size or activity of a Portfolio Concern affects the Licensee and the Portfolio Concern.

(a) *Effect on Licensee of a change in size of a Portfolio Concern.* If a Portfolio Concern no longer qualifies as a Small

Business you may keep your investment in the concern and:

(1) Subject to the overline limitations of § 107.740, you may provide additional Financing to the concern up to the time it makes a public offering of its securities.

(2) Even after the concern makes a public offering, you may exercise any stock options, warrants, or other rights to purchase Equity Securities which you acquired before the public offering, or fund Commitments you made before the public offering.

(b) *Effect of a change in business activity occurring within one year of Licensee's initial Financing*—(1) *Retention of Investment.* Unless you receive SBA's written approval, you may not keep your investment in a Portfolio Concern, small or otherwise, which becomes ineligible by reason of a change in its business activity within one year of your initial investment.

(2) *Request for SBA's approval to retain investment.* If you request that SBA approve the retention of your investment, your request must include sufficient evidence to demonstrate that the change in business activity was caused by an unforeseen change in circumstances and was not contemplated at the time the Financing was made.

(3) *Additional Financing.* If SBA approves your request to retain an investment under paragraph (b)(2) of this section, you may provide additional Financing to the Portfolio Concern to the extent necessary to protect against the loss of the amount of your original investment, subject to the overline limitations of § 107.740.

(c) *Effect of a change in business activity occurring more than one year after the initial Financing.* If a Portfolio Concern becomes ineligible because of a change in business activity more than one year after your initial Financing you may:

(1) Retain your investment; and

(2) Provide additional Financing to the Portfolio Concern to the extent necessary to protect against the loss of the amount of your original investment, subject to the overline limitations of § 107.740.

STRUCTURING LICENSEE'S FINANCING OF ELIGIBLE SMALL BUSINESSES: TYPES OF FINANCING

§ 107.800 Financings in the form of Equity Securities.

(a) You may purchase the Equity Securities of a Small Business. You may not, inadvertently or otherwise:

(1) Become a general partner in any unincorporated business; or

(2) Become jointly or severally liable for any obligations of an unincorporated business.

(b) *Definition.* Equity Securities means stock of any class in a corporation, stock options, warrants, limited partnership interests in a limited partnership, membership interests in a limited liability company, or joint venture interests. If the Financing agreement contains debt-type acceleration provisions or includes redemption provisions other than those permitted under § 107.850, the security will be considered a Debt Security for purposes of § 107.855.

§ 107.810 Financings in the form of Loans.

You may make Loans to Small Businesses. A Loan means a transaction evidenced by a debt instrument with no provision for you to acquire Equity Securities.

§ 107.815 Financings in the form of Debt Securities.

You may purchase Debt Securities from Small Businesses.

(a) *Definition.* Debt Securities are instruments evidencing a loan with an option or any other right to acquire Equity Securities in a Small Business or its Affiliates, or a loan which by its terms is convertible into an equity position. Consideration must be paid for all options that you acquire.

(b) *Restriction on options obtained by Licensee's management and employees.* If you have outstanding Leverage or plan to obtain Leverage, your employees, officers, directors or general partners, or the general partners of the management company that is providing services to you or to your general partner, may obtain options in a Financed Small Business only if:

(1) They participate in the Financing on a pari passu basis with you; or

(2) SBA gives its prior written approval; or

(3) The options received are compensation for service as a member of the board of directors of the Small Business, and such compensation does not exceed that paid to other outside directors. In the absence of such directors, fees must be reasonable when compared with amounts paid to outside directors of similar companies.

§ 107.820 Financings in the form of guarantees.

At the request of a Small Business or where necessary to protect your existing investment, you may guarantee the monetary obligation of a Small Business to any non-Associate creditor.

(a) You may not issue a guaranty if:

(1) You would become subject to State regulation as an insurance, guaranty or surety business;

(2) The amount of the guaranty plus any direct Financings to the Small Business exceed the overline limitations of § 107.740, except that a pledge of the Equity Securities of the issuer or a subordination of your lien or creditor position does not count toward your overline; or

(3) The total financing cost to the Small Business exceeds the cost of money limits of § 107.855.

(b) *Pledge of Licensee's assets as guaranty.* For purposes of this section, a guaranty with recourse only to specific asset(s) you have pledged is equal to the fair market value of such asset(s) or the amount of the debt guaranteed, whichever is less.

§ 107.825 Purchasing securities from an underwriter or other third party.

(a) *Securities purchased through or from an underwriter.* You may purchase the securities of a Small Business through or from an underwriter if:

(1) You purchase such securities within 90 days of the date the public offering is first made;

(2) Your purchase price is no more than the original public offering price; and

(3) The amount paid by you for the securities (less ordinary and reasonable underwriting charges and commissions) has been, or will be, paid to the Small Business, and the underwriter certifies in writing that this requirement has been met.

(b) *Recordkeeping requirements.* If you have outstanding Leverage or plan to obtain Leverage, you must keep records available for SBA's inspection which show the relevant details of the transaction, including, but not limited to, date, price, commissions, and the underwriter's certifications required under paragraph (c) of this section.

(c) *Underwriter's requirements.* If you have outstanding Leverage or plan to obtain Leverage, the underwriter must certify whether it is your Associate. You may pay reasonable and customary commissions and expenses to an Associate underwriter for the portion of an offering that you purchase, provided it is no more than 25 percent of the total offering. If you buy more than 25 percent of the offering, the amount you pay to the Associate underwriter must not exceed the total of the application and closing fees and reimbursable expenses permitted by § 107.860.

(d) *Securities purchased from another Licensee or from SBA.* You may purchase from, or exchange with, another Licensee, Portfolio securities (or any interest therein). Such purchase or exchange may only be made on a non-recourse basis. You may not have more than one-third of your total assets(valued at cost) invested in such securities. If you have previously sold Portfolio Securities (or any interest therein) on a recourse basis, you shall include the amount for which you may be contingently liable in your overline computation.

(e) *Purchases of securities from other non-issuers.* You may purchase securities of a Small Business from a non-issuer not previously described in this § 107.825 if:

(1) Such acquisition is a reasonably necessary part of the overall sound Financing of the Small Business under the Act; or

(2) The securities are acquired to finance a change of ownership under § 107.750.

STRUCTURING LICENSEE'S FINANCING OF AN ELIGIBLE SMALL BUSINESS: TERMS AND CONDITIONS OF FINANCING

§ 107.830 Minimum duration/term of financing.

(a) *General rule for Section 301(c) Licensees.* If you are a Section 301(c) Licensee, the duration/term of all your Financings must be for a minimum period of five years. *Exception:* You may finance a Disadvantaged Business for a minimum term of four years.

(b) *General rule for Section 301(d) Licensees.* The duration/term of your Financings may be for a minimum period of four years.

(c) *Restrictions on mandatory redemption of Equity Securities.* If you have acquired Equity Securities, options or warrants on terms that include redemption by the Small Business, you must not require redemption by the Small Business within the first five years of your acquisition except as permitted in § 107.850.

(d) *Special rules for Loans and Debt Securities.* (1) *Term.* The minimum term for Loans and Debt Securities starts with the first disbursement of the Financing.

(2) *Prepayment before five years.* You must permit voluntary prepayment of Loans and Debt Securities by the Small Business at any time during the initial five year term. You must obtain SBA's prior written approval of any restrictions on the ability of the Small Business to prepay other than the imposition of a reasonable prepayment penalty under paragraph (d)(3) of this section.

(3) *Prepayment penalties.* You may charge a reasonable prepayment penalty which must be agreed upon at the time of the Financing. If SBA determines that a prepayment penalty is unreasonable, you must refund the entire penalty to the Small Business. A prepayment penalty equal to 5 percent of the outstanding balance during the first year of any Financing, declining by one percentage point per year through the fifth year, is considered reasonable.

§ 107.835 Exceptions to minimum duration/term of Financing.

You may make a Short-term Financing for a term less than five years if the Financing is:

(a) An interim financing (for a period not to exceed one year) in contemplation of long-term Financing. The contemplated long-term Financing must be in an amount at least equal to the short-term Financing, and must be made by you alone or in participation with other investors; or

(b) For protection of your prior investment(s); or

(c) For the purpose of Financing a change of ownership under § 107.750. The total amount of such Financings may not exceed 20 percent of your Loans and Investments (at cost) at the end of any fiscal year; or

(d) For the purpose of aiding a Small Business in performing a contract awarded under a Federal, State, or local government set-aside program for ''minority'' or ''disadvantaged'' contractors.

§ 107.840 Maximum term of Financing.

The maximum term of any Loan or Debt Security Financing must be no longer than 20 years.

§ 107.845 Maximum rate of amortization on Loans and Debt Securities.

The principal of any Loan (or the loan portion of a Debt Security) with a term of five years or less cannot be amortized faster than straight line. If the term is greater than five years, the principal cannot be amortized faster than straight line for the first five years.

§ 107.850 Restrictions on redemption of Equity Securities.

(a) A Portfolio Concern cannot be required to redeem Equity Securities earlier than five years from the date of the first closing unless:

(1) The concern makes a public offering, or has a change of management or control, or files for protection under the provisions of the Bankruptcy Code, or materially breaches your Financing agreement; or

(2) You make a follow-on investment, in which case the new securities may be redeemed in less than five years, but no earlier than the redemption date associated with your earliest Financing of the concern.

(b) The redemption price must be either:

(1) A fixed amount that is no higher than the price you paid for the securities; or

(2) An amount that cannot be fixed or determined before the time of redemption. In this case, the redemption price must be based on:

(i) A reasonable formula that reflects the performance of the concern (such as one based on earnings or book value); or

(ii) The fair market value of the concern at the time of redemption, as determined by a professional appraisal performed under an agreement acceptable to both parties.

(c) Any method for determining the redemption price must be agreed upon no later than the date of the first (or only) closing of the Financing.

§ 107.855 Interest rate ceiling and limitations on fees charged to Small Businesses ("Cost of Money").

''Cost of Money'' means the interest and other consideration that you receive from a Small Business. Subject to lower ceilings prescribed by local law, the Cost of Money to the Small Business must not exceed the ceiling determined under this section.

(a) *Financings to which the Cost of Money rules apply.* This section applies to all Loans and Debt Securities. As required by § 107.800(b), you must include as Debt Securities any equity interests with redemption provisions that do not meet the restrictions in § 107.850.

(b) *When to determine the Cost of Money ceiling for a Financing.* You may determine your Cost of Money ceiling for a particular Financing as of the date you issue a Commitment or as of the date of the first closing of the Financing. Once determined, the Cost of Money ceiling remains fixed for the duration of the Financing.

(c) *How to determine the Cost of Money ceiling for a Financing.* At a minimum, you may use a Cost of Money ceiling of 19 percent for a Loan and 14 percent for a Debt Security. To determine whether you may charge more, do the following:

(1) Choose a base rate for your Cost of Money computation. The base rate may be either the Debenture Rate currently in effect or your own ''Cost of Capital'' as determined under paragraph (d) of this section.

(2) For a Loan, add 11 percentage points to the base rate; for a Debt Security, add 6 percentage points. In either case, round the sum down to the nearest eighth of one percent.

(3) If the result is more than 19 percent (for a Loan) or 14 percent (for a Debt Security), you may use it as your Cost of Money ceiling.

(4) If two or more Licensees participate in the same Financing of a Small Business, the base rate used in this paragraph (c) is the highest of the following:

(i) The current Debenture rate;

(ii) The Cost of Capital of the lead Licensee; or

(iii) The weighted average of the Cost of Capital for all Licensees participating in the Financing.

(d) *How to determine your Cost of Capital.* ''Cost of Capital'' is an optional computation of the weighted average interest rate you pay on your ''qualified borrowings''. ''Qualified borrowings'' means your Debentures together with your borrowings at or below the usual interest rate charged by banks in your locality on the date your loan was made.

(1) For any fiscal year, you may compute your Cost of Capital:

(i) As of the first day of your fiscal year, to remain in effect for the entire year; or

(ii) As of the first day of every fiscal quarter during the fiscal year, to remain in effect for the duration of the quarter.

(2) For each qualified borrowing outstanding at your last fiscal year or fiscal quarter end, multiply the ending principal balance (net of related unamortized fees) by the number of days during the past four fiscal quarters that the borrowing was outstanding, and divide the result by 365.

(3) Add together the amounts computed for all borrowings under paragraph (d)(2) of this section. The result is your weighted average borrowings.

(4) For all qualified borrowings outstanding at your last fiscal year or fiscal quarter end, determine the aggregate interest expense for the past four fiscal quarters (excluding amortization of loan fees).

(5) Divide the interest expense from paragraph (d)(4) of this section by the weighted average borrowings from paragraph (d)(3) of this section, and multiply by 100. The result is your Cost of Capital, which you may use to compute a Cost of Money ceiling under paragraph (c) of this section.

(e) *SBA review of Cost of Capital computation.* You must keep your Cost of Capital computations in a separate file available for SBA's review.

(1) A computation that is kept in such a file and is audited by your independent public accountant is considered correct unless SBA demonstrates otherwise.

(2) If a computation is not kept in such a file or is unaudited, you must prove its accuracy to SBA's satisfaction.

(f) *Charges included in the Cost of Money.* The Cost of Money includes all interest, points, discounts, fees, royalties, profit participation, and any other consideration you receive from a Small Business, except for the specific exclusions in paragraph (g) of this section. For equity interests subject to the Cost of Money rules (see paragraph (a) of this section), you must include:

(1) The portion of the fixed redemption price that exceeds your original cost.

(2) Any amount of a redemption that is paid out of accounts other than the Small Business's capital accounts (capital, paid-in surplus, or retained earnings of a corporation; or partners' capital of a partnership).

(g) *Charges excluded from the Cost of Money.* You may exclude from the Cost of Money:

(1) Closing fees, application fees, and expense reimbursements, each as permitted under § 107.860.

(2) Reasonable prepayment penalties permitted under § 107.830(d)(3).

(3) Out-of-pocket conveyance and/or recordation fees and taxes.

(4) Reasonable closing costs.

(5) Fees for management services as permitted under § 107.900.

(6) Reasonable and necessary out-of-pocket expenses you incur to monitor the Financing.

(7) Board of director fees not in excess of those paid to other outside directors, if your board representation meets the requirements of § 107.730(e).

(8) A reasonable fee for arranging financing for a Small Business from a source that is neither a Licensee nor an Associate of yours. The Small Business must agree in writing to pay such a fee before you arrange the financing.

(9) A one-time ''bonus'' that satisfies the requirements in paragraph (i) of this section.

(10) The difference between the contractual interest rate of the Financing and a default rate of interest permitted as follows:

(i) If a Small Business is in default, you may charge a default rate of interest as much as 7 percentage points higher than the contractual rate until the default is cured.

(ii) For this purpose, ''default'' means either failure to pay an amount when due or failure to provide information required under the Financing documents.

(h) *How to evaluate compliance with the Cost of Money ceiling.* You must determine whether a Financing is within the Cost of Money ceiling based on its discounted cash flows, as follows:

(1) Beginning with the date of the first disbursement (''period zero''), identify your cash inflows and cash outflows for each period of the Financing. The appropriate period to use (such as years, quarters, or months) depends on how you have structured the disbursements and payments.

(2) Discount the cash flows back to the first disbursement date using the Cost of Money ceiling from paragraph (d) of this section as the discount rate.

(3) If the result is zero or less, the Financing is within the Cost of Money ceiling; if it is greater than zero, the Financing exceeds the Cost of Money ceiling.

(i) *''Bonus'' paid by a Small Business.* You may provide Financing to a Small Business that includes both a loan and a one-time ''bonus'' determined at the end of the loan term. For Cost of Money purposes, you must treat such a Financing as a Debt Security. You may

exclude a bonus from the Cost of Money only if it is:

(1) Computed on or after the date that the Financing is repaid in full or was originally due to be repaid in full, whichever is earlier;

(2) Not fixed or determinable before the computation date; and

(3) Fully contingent upon factor(s) that reflect the performance of the Small Business. The period for which such performance is measured must not extend beyond the Small Business's fiscal year end immediately following repayment of the Financing. You must demonstrate to SBA's satisfaction that the factor(s) used are appropriate indicators of performance. Examples of generally acceptable factors include net income and operating cash flow; examples of generally unacceptable factors include gross revenues or gross margin.

§107.860 Financing fees and expense reimbursements a Licensee may receive from a Small Business.

You may collect Financing fees and receive expense reimbursements from a Small Business only as permitted under this §107.860.

(a) *Application fee.* You may collect a nonrefundable application fee from a Small Business to review its Financing application. The application fee may be collected at the same time as the closing fee under paragraph (c) or (d) of this section, or earlier. The fee must be:

(1) No more than 1 percent of the amount of Financing requested (or, if two or more Licensees participate in the Financing, their combined application fees are no more than 1 percent of the total Financing requested); and

(2) Agreed to in writing by the Financing applicant.

(b) *SBA review of application fees.* For any fiscal year, if the number of application fees you collect is more than twice the number of Financings closed, SBA in its sole discretion may determine that you are engaged in activities not contemplated by the Act, in violation of §107.500.

(c) *Closing fee—Loans.* You may charge a closing fee on a Loan if:

(1) The fee is no more than 2 percent of the Financing amount (or, if two or more Licensees participate in the Financing, their combined closing fees are no more than 2 percent of the total Financing amount); and

(2) You charge the fee no earlier than the date of the first disbursement.

(d) *Closing fee—Debt or Equity Financings.* You may charge a Closing Fee on a Debt Security or Equity Security Financing if:

(1) The fee is no more than 4 percent of the Financing amount (or, if two or more Licensees participate in the Financing, their combined closing fees are no more than 4 percent of the total Financing amount); and

(2) You charge the fee no earlier than the date of the first disbursement.

(e) *Limitation on dual fees.* If another Licensee or an Associate of yours collects a transaction fee under §107.900(e) in connection with your Financing of a Small Business, the sum of the transaction fee and your application and closing fees cannot exceed the maximum application and closing fees permitted under this §107.860.

(f) *Expense reimbursements.* You may charge a Small Business for the reasonable out-of-pocket expenses, other than Management Expenses, that you incur to process its Financing application. If SBA determines that any of your reimbursed expenses are unreasonable or are Management Expenses, SBA will require you to include such amounts in the Cost of Money or refund them to the Small Business.

(g) *Breakup fee.* If a Small Business accepts your Commitment and then fails to close the Financing because it has accepted funds from another source, you may charge a ''breakup fee'' equal to the closing fee that you would have been permitted to charge under paragraph (c) or (d) of this section.

[61 FR 3189, Jan. 31, 1996; 61 FR 41496, Aug. 9, 1996]

§107.865 Restrictions on Control of a Small Business by a Licensee.

(a) *General.* You must not operate a business enterprise or function as a holding company exercising Control over a business enterprise. Neither you, nor you and your Associates, nor you and other Licensee(s) (in the latter two

cases, the ''Investor Group'') may, except as set forth in this section, assume Control over a Small Business through management agreements, voting trusts, majority representation on the board of directors, or otherwise.

(b) *Presumption of Control.* Control over a Small Business will be presumed to exist whenever you or the Investor Group own or control, directly or indirectly:

(1) At least 50 percent of the outstanding voting securities, if there are fewer than 50 shareholders; or

(2) More than 25 percent of the outstanding voting securities, if there are 50 or more shareholders; or

(3) A block of at least 20 percent of the outstanding voting securities, if there are 50 or more shareholders and no other party holds a larger block.

(c) *Rebuttals to presumption of Control.* A presumption of Control under paragraph (b) of this section is rebutted if:

(1) The management of the Small Business owns at least a 25 percent interest in the voting securities of the business; and

(2) The management of the Small Business can elect at least 40 percent (rounded down) of the board members of a corporation, general partners of a limited partnership, or managers of a limited liability company, as appropriate, and the Investor Group can elect no more than 40 percent (rounded up). The balance of such officials may be elected through mutual agreement by management and the Investor Group.

(d) *Temporary Control permitted.* You may acquire temporary Control:

(1) Where reasonably necessary for the protection of your investment;

(2) If there has been a material breach of the Financing agreement by the Small Business;

(3) If there has been a substantial change in the Small Business's operations or products during the past 2 years, or such a change is the intended result of the Financing, and the Investor Group's Financing constitutes the Small Business's major source of capital; or

(4) In the case of a Start-up Financing, if you or the Investor Group constitute the Small Business's major source of capital.

(e) *Control certification.* If you take temporary Control of a Small Business under paragraph (d) of this section, you must file a Control certification with SBA within 30 days. The certification must state:

(1) The date on which you took Control;

(2) The basis for taking Control; and

(3) Your agreement to relinquish Control within five years (although you may, under extraordinary circumstances, request SBA's approval of an extension beyond five years).

(f) *Control acquired through enforcement actions.* If you retain or acquire Control through enforcement action, you must notify SBA immediately and submit a Control certification within 30 days.

(g) *Additional Financing for businesses under Licensee's Control.* If you assume Control of a Small Business, you may later provide additional Financing, without an exemption under § 107.730(a)(1).

§ 107.880 Assets acquired in liquidation of Portfolio securities.

You may acquire assets in full or partial liquidation of a Small Business's obligation to you under the conditions permitted by this § 107.880. The assets may be acquired from the Small Business, a guarantor of its obligation, or another party.

(a) *Timely disposition of assets.* You must dispose of assets acquired in liquidation of a Portfolio security within a reasonable period of time.

(b) *Permitted expenditures to preserve assets.* (1) You may incur reasonably necessary expenditures to maintain and preserve assets acquired.

(2) You may incur reasonably necessary expenditures for improvements to render such assets saleable.

(3) You may make payments of mortgage principal and interest (including amounts in arrears when you acquired the asset), pay taxes when due, and pay for necessary insurance coverage.

(c) *SBA approval of expenditures.* This paragraph (c) applies if you have outstanding Leverage or are applying for Leverage. Any application for SBA approval under this paragraph must specify all expenses estimated to be

necessary pending disposal of the assets. Without SBA's prior written approval:

(1) Your total expenditures under paragraphs (b)(1) and (b)(2) of this section plus your total Financing(s) to the Small Business must not exceed your overline limit under §107.740; and

(2) Your total expenditures under paragraph (b) of this section plus your total Financing(s) to the Small Business must not exceed 35 percent of your Regulatory Capital.

LIMITATIONS ON DISPOSITION OF ASSETS

§107.885 Disposition of assets to Licensee's Associates or to competitors of Portfolio Concern.

(a) *Sale of assets to Associate.* Except with SBA's prior written approval, you are not permitted to dispose of assets (including assets acquired in liquidation) to any Associate if you have outstanding Leverage or Earmarked Assets. As a prerequisite to such approval, you must demonstrate that the proposed terms of disposal are at least as favorable to you as the terms obtainable elsewhere.

(b) *Sale of assets to competitor of Small Business.* Except with the prior written approval of the Portfolio Concern (if it is not under your Control) or of SBA, you are not permitted to dispose of Portfolio securities to a competitor of such concern. If SBA's prior approval is not required, you must promptly notify SBA of any such disposal.

MANAGEMENT SERVICES AND FEES

§107.900 Management fees for services provided to a Small Business by Licensee or its Associate.

This §107.900 applies to management services that you or your Associate provide to a Small Business during the term of a Financing or prior to Financing. It does not apply to management services that you or your Associate provide to a Small Business that you do not finance. Fees permitted under this section are not included in the Cost of Money (see §107.855).

(a) *Permitted management fees.* You or your Associate may provide management services to a Small Business financed by you if:

(1) You or your Associate have entered into a written contract with the Small Business;

(2) The fees charged are for services actually performed;

(3) Services are provided on an hourly fee, project fee, or other reasonable basis; and

(4) You can demonstrate to SBA, upon request, that the rate does not exceed the prevailing rate charged for comparable services by other organizations in the geographic area of the Small Business.

(b) *Fees for service as a board member.* You or your Associate may receive fees in the form of cash, warrants, or other payments, for services provided as members of the board of directors of a Small Businesses Financed by you. The fees must not exceed those paid to other outside board members. In the absence of such board members, fees must be reasonable when compared with amounts paid to outside directors of similar companies.

(c) *SBA approval required.* You must obtain SBA's prior written approval of any management contract that does not satisfy paragraphs (a) or (b) of this section.

(d) *Recordkeeping requirements.* You must keep a record of hours spent and amounts charged to the Small Business, including expenses charged.

(e) *Transaction fees.* (1) You may charge reasonable transaction fees for work you or your Associate perform to prepare a client for a public offering, private offering, or sale of all or part of the business, and for assisting with the transaction. Compensation may be in the form of cash, notes, stock, and/or options.

(2) Your Associate may charge market rate investment banking fees to a Small Business on that portion of a Financing that you do not provide.

Subpart H—Non-leveraged Licensees—Exceptions to Regulations

§107.1000 Licensees without Leverage—exceptions to the regulations.

The regulatory exceptions in this section apply to Licensees with no outstanding Leverage or Earmarked Assets.

(a) You are exempt from the following provisions (but you must come into compliance with them to become eligible for Leverage):

(1) The overline limitation in § 107.740.

(2) The restrictions in § 107.530 on investments of idle funds, provided you do not engage in activities not contemplated by the Act.

(3) The restrictions in § 107.550 on third-party debt.

(4) The restrictions in § 107.880 on expenses incurred to maintain or improve assets acquired in liquidation of Portfolio securities.

(5) The recordkeeping requirements and fee limitations in § 107.825 (b) and (c), respectively, for securities purchased through or from an underwriter.

(b) You are exempt from the requirements to obtain SBA's prior approval for:

(1) A decrease in your Regulatory Capital of more than two percent under § 107.585 (but not below the minimum required under the Act or these regulations). You must report the reduction to SBA within 30 days.

(2) Disposition of any asset to your Associate under § 107.885.

(3) A contract to employ an Investment Adviser/Manager under § 107.510. However, you must notify SBA of the Management Expenses to be incurred under such contract, or of any subsequent material changes in such Management Expenses, within 30 days of execution. In order to become eligible for Leverage, you must have the contract approved by SBA.

(4) Your initial Management Expenses under § 107.140 and increases in your Management Expenses under § 107.520. However, you must have your Management Expenses approved by SBA in order to become eligible for Leverage.

(5) Options obtained from a Small Business by your management or employees under § 107.815(b).

(c) You are exempt from the requirement in § 107.680 to obtain SBA's post approval of new directors and new officers, other than your chief operating officer. However, you must notify SBA of the new directors or officers within 30 days, and you must have all directors and officers approved by SBA in order to become eligible for Leverage.

Subpart I—SBA Financial Assistance for Licensees (Leverage)

GENERAL INFORMATION ABOUT OBTAINING LEVERAGE

§ 107.1100 Types of Leverage available.

(a) *Types of Leverage available for Section 301(c) Licensees.* If you are a Section 301(c) Licensee, you may apply for Leverage from SBA in one or both of the following forms:

(1) The purchase or guarantee of your Debentures.

(2) The purchase or guarantee of your Participating Securities.

(b) *Types of Leverage available for Section 301(d) Licensees.* If you are a Section 301(d) Licensee, you may apply for Leverage from SBA in one or more of the following forms:

(1) The purchase or guarantee of your Debentures.

(2) The purchase or guarantee of your Participating Securities.

(3) The purchase of your Preferred Securities.

(c) *Subsidized and non-subsidized Debentures available to Licensees.* If you are a Section 301(d) Licensee, you may issue both subsidized and non-subsidized Debentures. If you are a Section 301(c) Licensee, you may issue only non-subsidized Debentures.

(1) *Non-subsidized Debentures.* SBA may purchase or guarantee non-subsidized Debentures under section 303(b) of the Act. You pay interest on a non-subsidized Debenture at the rate stated on its face.

(2) *Subsidized Debentures.* SBA may purchase or guarantee subsidized Debentures under section 303(c) of the Act. On a guaranteed Debenture, during the first 5 years of the term, you pay an interest rate that is 300 basis points below the rate stated on the face of the Debenture. On a Debenture that SBA purchases, you pay a reduced interest rate determined under section 317 of the Act.

§107.1110 How to apply for Leverage.

(a) *Application forms.* Select the appropriate form from the following table:

Type of Leverage you are applying for:	Application form:
Debentures (any type)	SBA Form 1022.
4% Preferred Securities	SBA Form 1022A.
Participating Securities	SBA Form 1022B.

(b) *Where to send your application.* Send all Leverage applications to SBA, Investment Division, 409 Third Street, SW., Washington, DC 20416.

§107.1120 General eligibility requirements for Leverage.

To be eligible for Leverage, you must:

(a) Demonstrate a need for Leverage, evidenced by your investment activity and a lack of sufficient funds for investment. For your first issuance of Leverage, if you have invested at least 50 percent of your Leverageable Capital, you are presumed to lack sufficient funds for investment.

(b) Have adequate Private Capital to satisfy the requirements for financial viability under §107.200.

(c) Meet the minimum capital requirements of §107.210 or §107.220, as appropriate.

(d) Show, to the satisfaction of SBA, that your management is qualified and has the knowledge, experience, and capability necessary for investing in the types of businesses contemplated by the Act, the regulations in this part and your business plan.

(e) Be in compliance with the regulations in this part.

(f) If required by SBA, have your Control Person(s) assume, in writing, personal responsibility for your Leverage, effective only if such Control Person(s) participate (directly or indirectly) in a transfer of Control not approved by SBA.

§107.1130 Leverage fees payable by Licensee.

(a) *User fee for Debentures and Participating Securities.* You must pay a user fee to SBA for each issuance of a Debenture or Participating Security. The fee is 2 percent of the face amount of the Leverage issued.

(b) *Payment of user fee.* If you issue a Debenture or Participating Security:

(1) To repay or redeem existing Leverage, you must pay the user fee before SBA will guarantee or purchase the new Debenture or Participating Security.

(2) That is not used to repay or redeem existing Leverage, SBA will deduct the user fee from the proceeds remitted to you, unless you prepaid the fee under §107.1210.

(c) *Refundability.* The user fee is not refundable under any circumstances.

(d) *Other Leverage fees.* SBA may establish a fee structure for services performed by the CRA. SBA will not collect any fee for its guarantee of TCs.

§107.1140 Licensee's acceptance of SBA remedies under §§107.1800 through 107.1820.

If you issue Leverage after April 25, 1994, you automatically agree to the terms and conditions in §§107.1800 through 107.1820 as they exist at the time of issuance. The effect of these terms and conditions is the same as if they were fully incorporated in the terms of your Leverage.

Maximum Amount of Leverage for Which a Licensee Is Eligible

§107.1150 Maximum amount of Leverage for a Section 301(c) Licensee.

(a) *Maximum amount of Leverage.* If you are a Section 301(c) Licensee, use the following table to determine the maximum amount of Leverage you may have outstanding at any time:

If your Leverageable Capital is:	Then your maximum Leverage is:
Not over $15,000,000	300% of Leverageable Capital.
Over $15,000,000 but not over $30,000,000.	$45,000,000 + [200% of [Leverageable Capital—$15,000,000)].
Over $30,000,000 but not over $45,000,000.	$75,000,000 + [100% of [(Leverageable Capital—$30,000,000)].
Over $45,000,000	$90,000,000.

(b) *Exceptions to maximum Leverage provisions*—(1) *Licensees under Common Control.* Two or more Licensees under Common Control may have aggregate outstanding Leverage over $90,000,000 only if SBA gives them permission to do so. SBA may grant such permission on a case-by-case basis only. SBA may

impose any terms and conditions SBA considers appropriate to minimize its risk of loss in the event of default.

(2) *Licensees with excess Leverage issued before March 31, 1993.* If you had outstanding Debentures on March 31, 1993 that exceeded 300 percent of your Leverageable Capital:

(i) You do not have to prepay the excess amount.

(ii) You may apply for an additional Debenture guarantee or Participating Security guarantee if you use the proceeds solely to pay the amount due at maturity on a Debenture issued before March 31, 1993. The new Debenture or Participating Security must mature on or before September 30, 2002.

(iii) You must maintain at least 65 percent of your ''Total Funds Available for Investment'' in ''Venture Capital Financings'' (as defined in § 107.1160(e) and (f), respectively) until your outstanding Debentures no longer exceed 300 percent of your Leverageable Capital.

(3) *Maximum amount of Participating Securities.* See § 107.1170.

§ 107.1160 Maximum amount of Leverage for a Section 301(d) Licensee.

(a) *Maximum amount of subsidized Leverage.* (1) ''Subsidized Leverage'' means Debentures with a reduced interest rate and Preferred Securities. If you are a Section 301(d) Licensee:

(i) The maximum amount of subsidized Leverage you may have outstanding at any time is the lesser of 400 percent of your Leverageable Capital, or $35,000,000. The same limit applies to a group of Section 301(d) Licensees under Common Control.

(ii) The maximum amount of Preferred Securities you may have outstanding at any time is 200 percent of your Leverageable Capital.

(2) Certain types and amounts of subsidized Leverage have special eligibility requirements (see paragraphs (c) and (d) of this section).

(b) *Maximum amount of total Leverage.* Use § 107.1150 (a) and (b)(1) to determine your maximum amount of Leverage as if you were a Section 301(c) Licensee. If the result is more than your maximum subsidized Leverage, then this is your maximum total (subsidized plus nonsubsidized) Leverage. Otherwise, your maximum total Leverage is the same as your maximum subsidized Leverage. For Participating Securities, see § 107.1170.

(c) *Special eligibility requirements for fourth tier of Leverage.* A ''fourth tier of Leverage'' is any amount of outstanding Leverage in excess of 300 percent of your Leverageable Capital.

(1) To qualify for a fourth tier of Leverage, you must have invested (or have Commitments to invest) at least 30 percent of your ''Total Funds Available for Investment'' in ''Venture Capital Financings'' (see the definitions in paragraphs (e) and (f) of this section).

(2) While you have a fourth tier of Leverage, you must maintain Venture Capital Financings (at cost) that equal at least 30 percent of your Total Funds Available for Investment.

(d) *Special eligibility requirements for second tier of Preferred Securities.* A ''second tier of Preferred Securities'' is any amount of outstanding Preferred Securities in excess of 100 percent of your Leverageable Capital.

(1) To qualify for a second tier of Preferred Securities:

(i) If your license was issued after October 13, 1971, you must have at least $500,000 of Leverageable Capital.

(ii) You must have invested (or have Commitments to invest) at least the same dollar amount in Venture Capital Financings.

(2) While you have a second tier of Preferred Securities, you must maintain at least the same dollar amount of Venture Capital Financings (at cost).

(e) *Definition of ''Total Funds Available for Investment''.* Total Funds Available for Investment means the result obtained from the following formula:

$$T = .90 \times (CA + LI)$$

Where:

T = Total funds available for investment

CA = Total current assets

LI = Total Loans and Investment at cost (as reported on SBA Form 468), net of current maturities

(f) *Definition of ''Venture Capital Financing''.* Venture Capital Financing means an investment represented by common or preferred stock, a limited partnership interest, or a similar ownership interest; or by an unsecured

debt instrument that is subordinated by its terms to all other borrowings of the issuer.

(1) A debt secured by any agreement with a third party is not a Venture Capital Financing, whether or not you have a security interest in any asset of the third party or have recourse against the third party.

(2) A Financing that originally qualified as a Venture Capital Financing will continue to qualify (at its original cost), even if you later must report it on SBA Form 468 under either Assets Acquired in Liquidation of Portfolio Securities or Operating Concerns Acquired.

§107.1170 Maximum amount of Participating Securities for any Licensee.

The maximum amount of Participating Securities you may have outstanding at any time is 200 percent of your Leverageable Capital. If you are a Section 301(d) Licensee, the maximum combined amount of Participating Securities and Preferred Securities you may have outstanding at any time is 200 percent of your Leverageable Capital.

CONDITIONAL COMMITMENTS BY SBA TO RESERVE LEVERAGE FOR A LICENSEE

§107.1200 SBA's Leverage commitment to a Licensee—application procedure, amount, and term.

(a) *General.* Under the provisions in §§107.1200 through 107.1240, you may apply for SBA's conditional commitment to reserve a specific amount and type of Leverage for your future use. You may then apply to draw down Leverage against the commitment.

(b) *Applying for a Leverage commitment.* SBA will notify you when it is accepting requests for Leverage commitments. Upon receipt of your request, SBA will send you a complete application package.

(c) *Limitations on the amount of a Leverage commitment.* The amount of any Leverage commitment must be at least $500,000. It must not exceed 100 percent of your Regulatory Capital or your remaining Leverage eligibility, whichever is less.

(d) *Term of Leverage commitment.* SBA's Leverage commitment will automatically lapse at 5:00 P.M. Eastern Time on August 1 of the next full Federal fiscal year following issuance of the commitment.

§107.1210 Commitment fees payable by Licensee.

(a) *Commitment fees.* As a condition of SBA's Leverage commitment, and before you may draw any Leverage, you must pay SBA a non-refundable fee of:

(1) 3 percent of the face amount of the Debentures or Participating Securities reserved under the commitment; or

(2) 1 percent of the issue price of Preferred Securities reserved under the commitment.

(b) *Credit for user fee.* The 3 percent commitment fee paid by issuers of Debentures or Participating Securities under paragraph (a)(1) of this section includes the 2 percent user fee required under §107.1130. If you pay the commitment fee, you do not have to pay the user fee separately.

(c) *Automatic cancellation of commitment.* Unless you pay the full amount of the commitment fee by 5:00 P.M. Eastern Time on the 30th calendar day following the issuance of SBA's Leverage commitment, the commitment will be automatically canceled.

§107.1220 Requirement for Licensee to file quarterly financial statements.

As long as any part of SBA's Leverage commitment is outstanding, you must give SBA a Financial Statement on SBA Form 468 (Short Form) as of the close of each quarter of your fiscal year (other than your fourth fiscal quarter, which is covered by your annual filing of Form 468 under §107.630(a)). You must file this form within 30 days after the close of the quarter, or with any request for a draw that you make within such 30-day period. You will not be eligible for a draw if you are not in compliance with this §107.1220.

§107.1230 Draw-downs by Licensee under SBA's Leverage commitment.

(a) *Licensee's authorization of SBA to purchase or guarantee securities.* By submitting a request for a draw against SBA's Leverage commitment, you:

(1) Authorize SBA to purchase your Preferred Security; or

(2) Authorize SBA, or any agent or trustee SBA designates, to guaranty your Debenture or Participating Security and to sell it with SBA's guarantee.

(b) *Limitations on amount of draw.* For Debentures or Participating Securities, any draw against SBA's Leverage commitment must be at least $500,000; amounts above $500,000 must be in multiples of $100,000. You may issue Preferred Securities in any amount.

(c) *Effect of regulatory violations on Licensee's eligibility for draws*—(1) *General rule.* You are eligible to make a draw against SBA's Leverage commitment only if you are in compliance with all applicable provisions of the Act and SBA regulations (i.e., no unresolved statutory or regulatory violations).

(2) *Exception to general rule.* If you are not in compliance, you may still be eligible for draws if:

(i) SBA determines that your outstanding violations are of non-substantive provisions of the Act or regulations and that you have not repeatedly violated any non-substantive provisions; or

(ii) You have agreed with SBA on a course of action to resolve your violations and such agreement does not prevent you from issuing Leverage.

(d) *Procedures for funding draws.* You may request a draw at any time during the term of the commitment. With each request, submit the following documentation:

(1) If your request is submitted within 30 days following the close of your fiscal quarter, a Financial Statement on SBA Form 468 (Short Form) prepared as of the close of that fiscal quarter; otherwise, a statement certifying that there has been no material adverse change in your financial condition since your last filing of SBA Form 468 (Long or Short Form).

(2) A statement certifying that to the best of your knowledge and belief, you are in compliance with all provisions of the Act and SBA regulations (i.e., no unresolved regulatory or statutory violations), or a statement listing any specific violations you are aware of. Either statement must be executed by one of the following:

(i) An officer of the Licensee;

(ii) An officer of a corporate general partner of the Licensee; or

(iii) An individual who is authorized to act as or for a general partner of the Licensee.

(3) A statement that the proceeds are needed to fund one or more particular Small Businesses. If required by SBA, the statement must include the name and address of each Small Business, and the amount and anticipated closing date of each proposed Financing.

(e) *Reporting requirements after drawing funds.* (1) Within 30 calendar days after the actual closing date of each Financing funded with the proceeds of your draw, you must file an SBA Form 1031 confirming the closing of the transaction.

(2) If SBA required you to provide information concerning a specific planned Financing under paragraph (d)(3) of this section, and such Financing has not closed within 60 calendar days after the anticipated closing date, you must give SBA a written explanation of the failure to close.

(3) If you do not comply with this paragraph (e), you will not be eligible for additional draws. SBA may also determine that you are not in compliance with the terms of your Leverage under §§ 107.1810 or 107.1820.

§ 107.1240 Funding of Licensee's draw request through sale to short-term investor.

(a) *Licensee's authorization of SBA to arrange sale of securities to short-term investor.* By submitting a request for a draw of Debenture or Participating Security Leverage, you authorize SBA, or any agent or trustee SBA designates, to enter into any agreements (and to bind you to such agreements) necessary to accomplish:

(1) The sale of your Debenture or Participating Security to a short-term investor;

(2) The purchase of your security from the short-term investor, either by you or on your behalf; and

(3) The pooling of your security with other securities with the same maturity date.

(b) *Sale of Debentures to a short-term investor.* If SBA sells your Debenture to a short-term investor:

(1) The sale will be at a discount based on an interest rate determined under section 303(b) of the Act (without any interest rate subsidy), as if the maturity date of the Debenture were the next scheduled date for the sale of Debenture Trust Certificates.

(2) If the actual sale of Trust Certificates takes place after the scheduled date, you must pay the short-term investor daily interest on the Debenture, at the same rate, from the scheduled sale date to the actual sale date. This additional interest is due on the actual sale date. Failure to pay the interest constitutes noncompliance with the terms of your Leverage (see §§107.1810 and 107.1820).

(c) *Sale of Participating Securities to a short-term investor.* If SBA sells your Participating Security to a short-term investor:

(1) The sale price will be the face amount.

(2) At the closing of the next scheduled sale of Participating Security Trust Certificates, you (or SBA, as guarantor) must pay the short-term investor Earned Prioritized Payments at a rate determined under section 303(b) of the Act, as if the maturity date of the Participating Security were the next scheduled date for the sale of Trust Certificates.

(d) *Licensee's right to repurchase its securities before pooling.* You may repurchase your securities from the short-term investor before they are pooled. To do so, you must:

(1) Give SBA written notice at least 10 days before the cut-off date for the pool in which your security is to be included; and

(2) Pay the face amount of the Debenture, or the face amount of the Participating Security plus Earned Prioritized Payments, to the short-term investor.

EXCHANGE OF OUTSTANDING DEBENTURES FOR PARTICIPATING OR PREFERRED SECURITIES—SECTION 301(D) LICENSEES

§107.1350 Exchange by Section 301(d) Licensee of Debentures for Preferred or Participating Securities.

(a) *Conditions for exchange of Debentures.* A Section 301(d) Licensee may, in SBA's discretion, retire an eligible Debenture through the issuance of Preferred or Participating Securities. To do so, you must:

(1) Pay all unpaid accrued interest on the Debenture, plus any applicable prepayment penalties, fees, and other charges.

(2) Comply with all conditions that apply to the issuance of Preferred or Participating Securities.

(b) *Debentures not eligible for exchange.* You may not retire a Debenture by issuing Preferred or Participating Securities if SBA guaranteed or purchased it on the basis of funds not included in your Leverageable Capital. You must repay such a Debenture at its maturity date, unless SBA extends it. SBA has discretion to extend the maturity to a date not more than 15 years from the date of issuance if SBA believes the extension is necessary for orderly liquidation of the indebtedness.

PREFERRED SECURITIES LEVERAGE—SECTION 301(D) LICENSEES

§107.1400 Stock dividends or partnership distributions on 4 percent Preferred Securities.

Preferred Securities that SBA purchases from a Section 301(d) Licensee may be in the form of either preferred stock issued at par value or a preferred limited partnership interest issued at face value. When you issue Preferred Securities, you agree to pay SBA a dividend or partnership distribution of 4 percent per year, from the date you issue Preferred Securities to the date you repay them, both inclusive. The dividend or partnership distribution is:

(a) Computed on the par value of the outstanding stock or the face value of the outstanding limited partnership interest.

(b) Cumulative. This means that if you do not pay the entire dividend or partnership distribution for a given fiscal year, the unpaid balance accumulates as a distribution in arrears. You do not have to pay interest on distributions in arrears.

(c) Preferred. This means that you must pay SBA in full (including distributions in arrears) before setting aside or paying any amount to any other equity holder.

(d) Payable at the discretion of your Board of Directors or General Partner(s), except that all distributions in

arrears must be paid in full when you redeem the Preferred Securities.

§ 107.1410 Requirement to redeem 4 percent Preferred Securities.

You must redeem 4 percent Preferred Securities not later than 15 years from the date of issuance. At the redemption date, you must pay to SBA:

(a) The par value (of preferred stock) or face value (of a preferred limited partnership interest); plus

(b) Any unpaid dividends or partnership distributions accrued to the redemption date.

§ 107.1420 Articles requirements for 4 percent Preferred Securities issuers.

You may issue 4 percent Preferred Securities only if your Articles contain all the provisions in §§ 107.1400 and 107.1410.

§ 107.1430 Redeeming 4 percent Preferred Securities with proceeds of non-subsidized Debentures.

If SBA approves, a Section 301(d) Licensee may use the proceeds of a Debenture to redeem Preferred Securities at their mandatory redemption date, including any accrued unpaid dividends or partnership distributions. For this purpose, you may issue only a non-subsidized Debenture (see § 107.1100(c)).

§ 107.1440 Three percent preferred stock issued before November 21, 1989.

Before November 21, 1989, Preferred Securities were available only in the form of preferred stock and had a preferred and cumulative dividend of 3 percent. If you have such preferred stock outstanding, you must follow § 107.1400 (except for § 107.1400(d)), substituting ''3 percent'' for ''4 percent'' throughout.) Dividends on 3 percent preferred stock are payable at the discretion of your Board of Directors or General Partner(s), except that all dividends in arrears must be paid in full before any non-SBA investor receives any distribution. Upon your liquidation, SBA is entitled to payment of all dividends in arrears even if you have no Retained Earnings Available for Distribution at such time.

§ 107.1450 Optional redemption of Preferred Securities.

(a) *Redemption at par or face value.* A Section 301(d) Licensee may redeem Preferred Securities at any time, provided you give SBA at least 30 days written notice. You may redeem all or only part of your Preferred Securities, but the par value or face value of the securities being redeemed must be at least $50,000. At the redemption date, you must pay to SBA:

(1) The par value (of preferred stock) or face value (of a preferred limited partnership interest); plus

(2) Any unpaid dividends or partnership distributions accrued to the redemption date.

(b) *Repurchase of 3 percent preferred stock for less than par value.* If you issued 3 percent preferred stock to SBA, you may ask SBA to sell it back to you at a price less than its par value. The terms and conditions of any such transaction will be as set forth in the Notice published in the FEDERAL REGISTER on April 1, 1994 (Copies of this notice are available from SBA, 409 3rd Street, SW., Washington, DC, 20416). SBA has sole discretion to:

(1) Approve or disapprove the sale.

(2) Determine the sale price after considering any factors SBA considers appropriate.

(3) Determine the form of payment SBA will accept. SBA is not authorized to accept the proceeds of a subsidized Debenture as payment.

PARTICIPATING SECURITIES LEVERAGE

§ 107.1500 General description of Participating Securities.

(a) *Types of Participating Securities.* Participating Securities are redeemable, preferred, equity-type securities. SBA may purchase or guarantee Participating Securities issued by Licensees in the form of limited partnership interests, preferred stock, or debentures with interest payable only to the extent of earnings. The structure, terms and conditions of Participating Securities are set forth in detail in §§ 107.1500 through 107.1590.

(b) *Special eligibility requirements for Participating Securities.* In addition to the general eligibility requirements for Leverage under § 107.1120, Participating

Securities issuers must also comply with special rules on:

(1) Minimum capital (see §107.220).

(2) Liquidity (see §107.1505).

(3) Non-SBA borrowing (see §107.570).

(4) Making Equity Capital Investments in Small Businesses, as follows:

(i) *General rule.* If you issue Participating Securities, you must invest an amount equal to the Original Issue Price of such securities solely in Equity Capital Investments.

(ii) *Continuing requirement to maintain Equity Capital Investments.* Unless SBA permits otherwise, once you have met the initial investment requirement of this paragraph (b)(4), you must maintain Equity Capital Investments with an original cost equal to or greater than the outstanding balance of Participating Securities in your portfolio, measured as of the end of each fiscal year.

(c) *Special features of Participating Securities—Prioritized Payments, Adjustments, and Profit Participation.* When you issue Participating Securities, you agree to make the following payments:

(1) *Prioritized Payments.* Depending upon the type of Participating Security you issue, Prioritized Payments may be preferred partnership distributions, preferred dividends, or interest. Your obligation to pay Prioritized Payments is contingent upon your profits as determined under §107.1520.

(2) *Adjustments to Prioritized Payments.* If you have unpaid Prioritized Payments, you must compute Adjustments, which are additional contingent obligations determined under §107.1520. The conditions for paying Adjustments are the same as for Prioritized Payments.

(3) *SBA Profit Participation.* Profit Participation is an amount payable to SBA under §107.1530 in consideration for SBA's guarantee of your Participating Securities.

(d) *Distributions by Licensees issuing Participating Securities.* Sections 107.1540 through 107.1580 govern both required and optional Distributions by Participating Securities issuers. Distributions include both profit distributions and returns of capital, paid either to SBA or to your non-SBA investors.

(e) *Mandatory redemption of Participating Securities.* You must redeem Participating Securities at the redemption date, which is the same as the maturity date of the Trust Certificates for the Trust containing such securities. The redemption date can never be later than 15 years after the issue date. You must pay the Redemption Price plus any unpaid Earned Prioritized Payments and any earned Adjustments due under §107.1520.

(f) *Priority of Participating Securities in liquidation of Licensee.* In the event of your liquidation, the following are senior in priority, for all purposes, to all other equity interests you have issued at any time:

(1) The Redemption Price of Participating Securities;

(2) Any Prioritized Payments and earned Adjustments; and

(3) Any Profit Participation allocated to SBA under §107.1530.

§107.1505 Liquidity requirements for Licensees issuing Participating Securities.

If you have outstanding Participating Securities, you must maintain sufficient liquidity to avoid a condition of Liquidity Impairment. Such a condition will constitute noncompliance with the terms of your Leverage under §107.1820(e).

(a) *Definition of Liquidity Impairment.* A condition of Liquidity Impairment exists when your Liquidity Ratio, as determined in paragraph (b) of this section, is less than 1.20. You are responsible for calculating whether you have a condition of Liquidity Impairment as of the close of your fiscal year, at the time of application for Leverage, or at such time as you contemplate making any Distribution.

(b) *Computation of Liquidity Ratio.* Your Liquidity Ratio equals your Total Current Funds Available (A) divided by your Total Current Funds Required (B), as determined in the following table:

CALCULATION OF LIQUIDITY RATIO

Financial account	Amount reported on SBA Form 468	Weight	Weighted amount
Cash and invested idle funds		× 1.00	
Commitments from investors		× 1.00	
Current maturities		× 0.50	
Other current assets		× 1.00	
Publicly Traded and Marketable Securities		× 0.65	
Anticipated operating revenue for next 12 months	(1)	× 1.00	
Total Current Funds Available			A
Current liabilities		× 1.00	
Commitments to Small Businesses		× 0.75	
Anticipated operating expense for next 12 months	(1)	× 1.00	
Anticipated interest expense for next 12 months	(1)	× 1.00	
Contingent liabilities (guarantees)		× 0.25	
Total Current Funds Required			B

[1] As determined by Licensee's management under its business plan.

§ 107.1510 How a Licensee computes Earmarked Profit (Loss).

Computing your Earmarked Profit (Loss) is the first step in determining your obligations to pay Prioritized Payments and Adjustments under § 107.1520 and Profit Participation under § 107.1530.

(a) *Requirement to compute your Earmarked Profit (Loss).* While you have Participating Securities outstanding or have Earmarked Assets (as defined in paragraph (b) of this section), you must compute your Earmarked Profit (Loss) for:

(1) Each full fiscal year.

(2) Any interim period (consisting of one or more fiscal quarters) for which you want to make a Distribution.

(b) *How to determine your Earmarked Assets.* ''Earmarked Assets'' means all the Loans and Investments that you have when you issue Participating Securities or that you acquire while you have Participating Securities outstanding, and any non-cash assets that you receive in exchange for such Loans and Investments.

(1) An Earmarked Asset remains earmarked until you dispose of it, even if you no longer have any outstanding Participating Securities.

(2) Investments you make after redeeming all your Participating Securities are not Earmarked Assets. However, if you issue new Participating Securities, all of your Loans and Investments again become Earmarked Assets.

(3) If you were licensed before March 31, 1993, you may be permitted to exclude Loans and Investments held at that date from Earmarked Assets under § 107.1590.

(c) *How to compute your Earmarked Asset Ratio.* You must determine your Earmarked Asset Ratio each time you compute Earmarked Profit (Loss). If all your Loans and Investments are Earmarked Assets, your Earmarked Asset Ratio equals 100 percent. Otherwise, compute your Earmarked Asset Ratio using the following formula:

$$EAR = [(EA + P) / (LI + P)] \times 100$$

where:

EAR = Earmarked Asset Ratio

EA = Weighted average Earmarked Assets (at cost) for the fiscal year or interim period

P = Weighted average uninvested proceeds of Participating Securities for the fiscal year or interim period

LI = Weighted average Loans and Investments (at cost) for the fiscal year or interim period

(d) *How to compute your Earmarked Profit (Loss) if Earmarked Asset Ratio is 100 percent.* (1) (i) If your Earmarked Asset Ratio from paragraph (b) of this section is 100 percent, use the following formula to compute your Earmarked Profit (Loss):

$$EP = NI + IK + EME$$

where:

EP = Earmarked Profit (Loss)

NI = Net Income (Loss), as reported on SBA Form 468 except as otherwise provided in this paragraph (d)(1)

IK = Unrealized Appreciation (Depreciation) on Earmarked Assets that you are distributing as an In-Kind Distribution under §107.1580

EME = Excess Management Expenses

(ii) For the purpose of determining Net Income (Loss), user fees and commitment fees paid to SBA and partnership syndication costs that you incur must be capitalized and amortized on a straight-line basis over five years.

(2) ''Excess Management Expenses'' are those that exceed the following limit:

(i) For a full fiscal year, the limit is the lower of:

(A) 2.5 percent of your weighted average Combined Capital for the year, plus $125,000 if Combined Capital is below $20,000,000; or

(B) Your Management Expenses approved by SBA.

(ii) For less than a full fiscal year, you must prorate the annual amounts in paragraph (d)(2)(i) of this section to determine the limit.

(e) *How to compute your Earmarked Profit (Loss) if Earmarked Asset Ratio is less than 100 percent.* If your Earmarked Asset Ratio is less than 100 percent, compute your Earmarked Profit (Loss) as follows:

(1) Do the Earmarked Profit (Loss) computation in paragraph (d) of this section.

(2) Subtract your net realized gain (loss) (as reported on SBA Form 468) on Loans and Investments that are not Earmarked Assets.

(3) Separate the result from paragraph (e)(2) of this section into:

(i) Net realized gain (loss) (as reported on SBA Form 468) on Earmarked Assets (''EGL''); and

(ii) The remainder (''R'').

(4) Your Earmarked Profit (Loss) equals:

EGL + (R × Earmarked Asset Ratio)

(f) *How to compute your cumulative Earmarked Profit (Loss).* Sum your Earmarked Profit (Loss) for all fiscal years and for any interim period following the end of your last fiscal year. The total is your cumulative Earmarked Profit (Loss), which you must use in the Prioritized Payment computations under §107.1520.

§107.1520 How a Licensee computes and allocates Prioritized Payments to SBA.

This section tells you how to compute Prioritized Payments and Adjustments and determine the amounts you must pay. To distribute Prioritized Payments, see §107.1540.

(a) *How to compute Prioritized Payments and Adjustments.* (1) *Prioritized Payments.* For a full fiscal year, the Prioritized Payment on an outstanding Participating Security equals the Redemption Price times the Trust Certificate Rate. For a shorter period (one or more fiscal quarters), you must prorate the annual Prioritized Payment.

(2) *Adjustments.* Compute Adjustments using paragraph (f) of this section.

(b) *Licensee's obligation to pay Prioritized Payments and Adjustments.* You are obligated to pay Prioritized Payments and Adjustments only if you have profit as determined under paragraph (d) of this section.

(1) Prioritized Payments that you must pay (or have already paid) because you have sufficient profit are ''Earned Prioritized Payments''.

(2) Prioritized Payments that are not payable because you lack sufficient profit are ''Accumulated Prioritized Payments''. Treat all Prioritized Payment as ''Accumulated'' until they become ''Earned'' under this section.

(3) Adjustments are computed under paragraph (f) of this section and are ''earned'' according to the same criteria applied to Prioritized Payments.

(c) *How to keep track of Prioritized Payments.* You must establish three accounts to record your Accumulated and Earned Prioritized Payments.

(1) *Accumulation Account.* The Accumulation Account is a memorandum account. Its balance represents your Accumulated Prioritized Payments and unearned Adjustments.

(2) *Distribution Account.* The Distribution Account is a liability account. Its balance represents your unpaid Earned Prioritized Payments and earned Adjustments.

(3) *Earned Payments Account.* The Earned Payments Account is a memorandum account. Each time you add to the Distribution Account balance, add

the same amount to the Earned Payments Account. Its balance represents your total (paid and unpaid) Earned Prioritized Payments and earned Adjustments.

(d) *How to determine your profit for Prioritized Payment purposes.* As of the end of each fiscal year and any interim period (one or more fiscal quarters) for which you want to make a Distribution:

(1) Bring the Accumulation Account up to date by adding to it all Prioritized Payments through the end of the fiscal period.

(2) Determine your cumulative Earmarked Profit (Loss) under § 107.1510(e) and subtract your Earned Payments Account balance from it. The result (if greater than zero) is your profit for the purposes of this section; if zero or less, you have no profit.

(3) If you have a profit, continue with paragraph (e) of this section. Otherwise, continue with paragraph (f) of this section.

(e) *Allocating Prioritized Payments to the Distribution Account.* (1) If you have a profit under paragraph (d) of this section, determine the lesser of:

(i) Your profit; or

(ii) The balance in your Accumulation Account.

(2) Subtract the result in paragraph (e)(1) of this section from the Accumulation Account and add it to the Distribution Account.

(f) *How to compute Adjustments.* You must compute your Adjustments as of the end of each fiscal year.

(1) *Adjustments based on Accumulation Account balance.* If you have any balance in your Accumulation Account, determine your average Accumulation Account balance for the fiscal year and multiply it by the average of the Trust Certificate Rates for all the Participating Securities poolings during such year.

(2) *Adjustments based on Distribution Account balance.* If you have any balance in your Distribution Account after giving effect to any Distribution that will be made on the first or second Payment Date following your fiscal year end, do the computations in paragraph (f)(1) of this section, substituting ''Distribution Account'' for ''Accumulation Account''.

(3) Add the amounts computed in this paragraph (f) to your Accumulation Account balance.

(g) *Licensee's obligation to pay Prioritized Payments after redeeming Participating Securities.* This paragraph (g) applies if you have redeemed all your Participating Securities, but you still hold Earmarked Assets and still have a balance in your Accumulation Account.

(1) You must continue to perform all the procedures in this § 107.1520 as of the end of each fiscal quarter. You must distribute any Earned Prioritized Payments and earned Adjustments in accordance with § 107.1540.

(2) After you dispose of all your Earmarked Assets and make any required Distributions in accordance with § 107.1540, your obligation to pay any remaining Accumulated Prioritized Payments and unearned Adjustments will be extinguished.

§ 107.1530 How a Licensee computes SBA's Profit Participation.

This section tells you how to compute SBA's Profit Participation. Profit Participation is included in the Distributions you make to SBA under §§ 107.1550 and 107.1560.

(a) *How to compute Profit Participation.* Profit Participation equals your ''Base'' times your ''Profit Participation Rate'' (if the Base is zero or less, you do not owe SBA Profit Participation). Compute the Base using paragraph (c) of this section and the Profit Participation Rate using paragraphs (d) through (g) of this section. You must compute your Earmarked Profit (Loss) under § 107.1510 and your Prioritized Payments and Adjustments under § 107.1520 before you can compute Profit Participation.

(b) *How to keep track of Profit Participation.* You must establish a Profit Participation Account to record your computations under this section and payments under §§ 107.1550 and 107.1560. Its balance represents your unpaid Profit Participation.

(c) *How to compute the Base.* As of the end of each fiscal year and any year-to-date interim period (one or more fiscal quarters) for which you want to make a Distribution, compute your Base using the following formula:

B = EP − PPA − UL

where:

B = Base
EP = Earmarked Profit (Loss) for the period from § 107.1510
PPA = Prioritized Payments from § 107.1520(a)(1) and Adjustments (if applicable) from § 107.1520(f)
UL = ''Unused Loss'' as determined in this paragraph (c).

(1) If you have never computed a Base before, or if the Base as of the end of your last fiscal year (your ''Previous Base'') was zero or greater, your Unused Loss is zero with the following exception: If, at the end of your last fiscal year, you computed a negative result under paragraph (h)(3) of this section, your Unused Loss equals that negative result.

(2) If your Previous Base was less than zero, your Unused Loss equals your Previous Base.

(d) *How to compute the Profit Participation Rate.* You must determine your Profit Participation Rate each time you compute a Base that is greater than zero. Compute the Rate by following the steps in paragraphs (e) through (g) of this section.

(e) *Compute the ''PLC ratio''.* (1) *General rule.* The ''PLC ratio'' is the highest ratio of outstanding Participating Securities to Leverageable Capital that you have ever attained.

(2) *Exception.* You may reduce the ratio computed under paragraph (e)(1) of this section if you have increased your Leverageable Capital above its highest previous level. The increase must have taken place at least 120 days before the date as of which your Base is computed. In addition, the increase must have been expressly provided for in a plan of operations submitted to and approved by SBA in writing, or must be the result of the takedown of commitments or the conversion of non-cash assets that were included in your Private Capital. To reduce your PLC ratio:

(i) Determine the increase in your Leverageable Capital over its highest previous level.

(ii) Find your highest previous ratio of Participating Securities to Leverageable Capital. If you have attained your highest ratio more than once, with different numerators and denominators, choose the ratio with the highest numerator.

(iii) Add the increase in Leverageable Capital to the denominator of the ratio chosen in paragraph (e)(2)(ii) of this section, and divide the numerator by the revised denominator. The result is your new PLC ratio.

(3) Once you compute a PLC ratio under either paragraph (e)(1) or (e)(2) of this section, do not recompute it unless there has been a change in your outstanding Participating Securities or your Leverageable Capital.

(4) *Example.*

	Participating Securities (A)	Leverageable Capital (B)	A/B	PLC Ratio
End of period 1	1,000	1,000	1.00	1.00
End of period 2	1,500	1,000	1.50	1.50
End of period 3	1,200	900	1.33	1.50
End of period 4	750	500	1.50	1.50
End of period 5	750	1,500	0.50	1.00

Explanation of PLC Ratio calculation following increase in Leverageable Capital:
Step 1: Increase in Leverageable Capital over highest previous level=1,500 − 1,000=500.
Step 2: Highest previous ratio of Participating Securities to Leverageable Capital=1.50 (attained two times, at end of periods 2 and 4).
Step 3: Highest numerator associated with highest ratio=1,500 (at end of period 2); associated denominator=1,000.
Step 4: Add the increase in Leverageable Capital (from step 1) to the denominator (from step 3): 500+1,000=1,500.
Step 5: Divide the numerator (from step 3) by the revised denominator (from step 4): 1,500/1,500=1.00.

(f) *Compute the Profit Participation Rate (before indexing).* Compute the Profit Participation Rate (before indexing) using the table in this paragraph (f). Then go to paragraph (g) of this section to determine whether to index the Profit Participation Rate.

If your PLC ratio is:	Then your Profit Participation Rate is:
1 or less	9%×PLC Ratio.
More than 1	9%+[3%×(PLC ratio-1)].

(g) *Indexing the Profit Participation Rate.* The Profit Participation Rate is

indexed, up or down, to the yield-to-maturity on Treasury bonds with a remaining term of ten (10) years (the ''Treasury Rate''). You must perform the indexing procedures in this paragraph (g) unless the Treasury Rate was exactly 8 percent on every date that you issued Participating Securities.

(1) *Licensees that have issued Participating Securities on only one occasion.* Determine the Treasury Rate for the date you issued your Participating Security. Adjust the Profit Participation Rate from paragraph (f) of this section by the percentage difference between the Treasury Rate and 8 percent. For example, assume that you issued Participating Securities when the Treasury Rate was 10 percent. The percentage difference between 10 percent and 8 percent is 25 percent. If you had a PLC ratio of 1, the Profit Participation Rate before indexing would be 9 percent. You would increase this rate by 25 percent, giving you a Profit Participation Rate of 11.25 percent.

(2) *Licensees that have issued Participating Securities on more than one occasion.* Determine the Treasury Rate for each of the dates you issued Participating Securities.

(i) Compute an average of all such Treasury Rates, weighted to reflect the dollar amount of each issuance (ignoring any redemptions) and the number of days from the date of each issuance to the date as of which you are computing the Profit Participation Rate.

Example to paragraph (g)(2)(i) of this section. If you issued $10 million of Participating Securities on the 60th day of Fiscal Year 1 when the Treasury Rate was 8 percent, and another $15 million on the 100th day of Fiscal Year 3 when the Treasury Rate was 10 percent, then the weighted average Treasury Rate computed as of the end of Fiscal Year 3 would be 8.55 percent. [Days elapsed since first issuance of Participating Securities = 1,035; days elapsed since second issuance of Participating Securities = 265; weighted amount of first issuance = $10,000,000 × 1,035/1,035 = $10,000,000; weighted amount of second issuance = $15,000,000 × 265/1035 = $3,840,579; weighted average amount of Participating Securities issued = $10,000,000 + $3,840,579 = $13,840,579; weighted average Treasury Rate= {(.08 × $10,000,000) + (.10 × $3,840,579)} / $13,840,579 = 8.55%]

(ii) Adjust the Profit Participation Rate from paragraph (f) of this section by the percentage difference between the weighted average Treasury Rate and 8 percent. In the example given in paragraph (g)(2)(i) of this section, if the PLC ratio were equal to 2, the Profit Participation Rate for the fiscal year would be 12.83 percent. [{((.0855 − .08) ÷.08) + 1} × .12 × 100 = 12.83%]

(h) *Computing SBA's Profit Participation.* If the Base from paragraph (c) of this section is greater than zero, you must compute SBA's Profit Participation as follows:

(1) Multiply the Base by the Profit Participation Rate to determine the Profit Participation for the fiscal year or year-to-date interim period.

(2) If your last Profit Participation computation was for an interim period during the same fiscal year and used a higher Profit Participation Rate than that used in paragraph (h)(1) of this section, multiply the Base for that period by the Profit Participation Rate used in paragraph (h)(1) of this section.

(3) Reduce the Profit Participation from paragraph (h)(1) of this section by any amounts of Profit Participation that you distributed or reserve for distribution to SBA, or its designated agent or Trustee, for any previous interim period during the fiscal year, or by the amount you computed in paragraph (h)(2) of this section, whichever is less. If the result is less than zero, SBA's Profit Participation is zero. If you obtain a negative result as of the end of your fiscal year, you must add it to your Unused Loss the next time you compute your Base under paragraph (c)(1) of this section.

(i) *Allocation of Profit Participation.* Before any Distribution and in any case within 120 days following the end of your fiscal year, you must add the amount of Profit Participation computed under this § 107.1530 to the Profit Participation Account. You must reserve funds equal to this amount for distribution to SBA, or its designated agent or Trustee; you may not reinvest these funds or use them for any other purpose.

[61 FR 3189, Jan. 31, 1996; 61 FR 41496, Aug. 9, 1996]

§107.1540 Distributions by Licensee—Prioritized Payments and Adjustments.

After you compute Prioritized Payments and Adjustments under §107.1520, you must distribute them in accordance with this §107.1540.

(a) *Requirement to distribute Prioritized Payments and Adjustments.* This paragraph (a) applies only if you satisfy the liquidity requirement in §107.1505. All Distributions under this paragraph (a) go to SBA or its designated agent or trustee.

(1) You must distribute the balance in your Distribution Account from §107.1520 annually on the first or second Payment Date following your fiscal year end, and on any date when you are making any other Distribution.

(2) You may distribute all or part of the balance in your Distribution Account on any Payment Date regardless of whether you are making any other Distribution on that date.

(b) *Additional requirement for Licensees with undistributed Prioritized Payments.* This paragraph (b) applies if you do not distribute the full amount in your Distribution Account by the second Payment Date following the end of your fiscal year. At the end of each fiscal quarter, until you reduce the balance in your Distribution Account to zero, you must:

(1) Do all the steps in §107.1520; and

(2) Distribute the balance in your Distribution Account on the next Payment Date following the end of your fiscal quarter, provided you satisfy the liquidity requirement in §107.1505.

§107.1550 Distributions by Licensee—permitted "tax Distributions" to private investors and SBA.

If you have outstanding Participating Securities or Earmarked Assets, and you are a limited partnership, ''S Corporation'', or equivalent pass-through entity for tax purposes, you may make an annual ''tax Distribution'' to your investors, whether or not they have an actual tax liability. SBA receives a share of any tax Distribution you make. This section tells you when you may make a ''tax Distribution'' and how to compute it.

(a) *Conditions for making a tax Distribution.* You may make a tax Distribution only if:

(1) You have paid all your Prioritized Payments and Adjustments, so that the balance in both your Distribution Account and your Accumulation Account is zero (see §107.1520).

(2) You satisfy the liquidity requirement in §107.1505.

(3) The tax Distribution does not exceed your Retained Earnings Available for Distribution.

(4) The tax Distribution does not exceed the Maximum Tax Liability from paragraph (b) of this section.

(b) *How to compute the Maximum Tax Liability.* (1) Compute your Maximum Tax Liability for a full fiscal year only. Use the following formula:

M = (TOI x HRO) + (TCG x HRC)

where:

M = Maximum Tax Liability.
TOI = Total ordinary income (less ordinary deductions) allocated to your partners or shareholders for Federal income tax purposes.
HRO = The highest combined marginal Federal and State income tax rates for corporations or individuals (whichever is higher), on ordinary income.
TCG = Total capital gains allocated to your partners or shareholders for Federal income tax purposes.
HRC = The highest combined marginal Federal and State income tax rates for corporations or individuals (whichever is higher), on capital gains.

(2) For purposes of this paragraph (b), the ''State income tax'' is that of the State where your principal place of business is located.

(c) *SBA's share of the tax Distribution.* (1) SBA's percentage share of the tax Distribution is equal to the Profit Participation Rate computed under §107.1530.

(2) SBA may direct you to pay its share of the tax Distribution to its designated agent or Trustee.

(3) SBA will apply its share of the tax Distribution to the Profit Participation you owe SBA under §107.1530.

(d) *Paying a tax Distribution.* You may make a tax Distribution only on the first or second Payment Date following the end of your fiscal year or, if your fiscal year end is December 31, during the period beginning March 1 and ending April 15.

§ 107.1560 Distributions by Licensee—required Distributions to private investors and SBA.

You must make Distributions under this § 107.1560 if you have outstanding Participating Securities or Earmarked Assets and you satisfy the conditions in paragraph (a) of this section. Distributions under this section are determined as of the end of each fiscal year.

(a) *Conditions for making Distributions.* Distributions under this section are subject to the following conditions:

(1) You must have paid all your Prioritized Payments and Adjustments, so that the balance in both your Distribution Account and your Accumulation Account is zero (see §§ 107.1520 and 107.1540).

(2) You must have made any permitted tax Distribution that you choose to make under § 107.1550.

(3) You must satisfy the liquidity requirement in § 107.1505.

(4) The amount you distribute under this section must not exceed your Retained Earnings Available for Distribution.

(b) *Total amount you must distribute.* Unless SBA permits otherwise, the total amount you must distribute equals the result (if greater than zero) of the following computation:

(1) Your Retained Earnings Available for Distribution as of the end of your fiscal year; minus

(2) All previous Distributions under this § 107.1560 that were applied as redemptions or repayments of Leverage; plus

(3) All previous Distributions under § 107.1570(b) that reduced your Retained Earnings Available for Distribution.

(c) *When you must make Distributions.* You must make the required Distributions on either the first or second Payment Date following the end of your fiscal year.

(d) *Effect of Distributions on Retained Earnings Available for Distribution.* Distributions under this § 107.1560 have the following effect on your Retained Earnings Available for Distribution:

(1) All Distributions to private investors reduce Retained Earnings Available for Distribution.

(2) Distributions to SBA, or its designated agent or Trustee, reduce Retained Earnings Available for Distribution if they are applied as payments of Profit Participation or distributions on Preferred Securities (see paragraph (g) of this section).

(3) Distributions to SBA, or its designated agent or Trustee, do not reduce Retained Earnings Available for Distribution if they are applied as a repayment or redemption of Leverage (see paragraph (g) of this section).

(e) *SBA's share of the total Distribution.* Use the following table to determine the percentage share of the total Distribution (from paragraph (b) of this section) that goes to SBA (or its designated agent or Trustee):

SBA'S PERCENTAGE SHARE OF TOTAL DISTRIBUTION

If your ratio of Leverage to Leverageable Capital as of the fiscal year end is:	Then SBA's percentage share of the Distribution is:
Over 200%	[Leverage / (Leverage + Leverageable Capital)] × 100.
Over 100% but not over 200%.	50%.
100% or less	Profit Participation Rate from § 107.1530.

(f) *Exceptions to the Distribution requirement.* (1) With SBA's prior written approval, you may withhold from distribution reasonable reserves necessary to protect your investments or relative position in Loans and Investments and to meet contingent liabilities.

(i) If you submit a written request for SBA approval, you may consider it approved unless SBA notifies you otherwise within 30 days from receipt.

(ii) Reserves that you withhold from distribution may not be used to make investments in additional portfolio companies.

(iii) Withholding of reserves under this paragraph (f)(1) is not a ''payment failure'' in violation of § 107.1820(e)(6).

(2) SBA may restrict Distributions under this § 107.1560 if SBA determines that the value of your assets is materially overstated. SBA must give you notice of such a determination in advance of your proposed Distribution.

(g) *How SBA will apply your Distributions.* Your Distributions to SBA (or its designated agent or Trustee) under this § 107.1560 will be applied in the following order:

(1) First, to Profit Participation;

(2) Second, to the extent there remain any Retained Earnings Available for Distribution, to distributions on Preferred Securities;

(3) Third, as a redemption of Participating Securities in order of issue;

(4) Fourth, as a redemption of Preferred Securities; and

(5) Fifth, as the repayment of principal of any outstanding Debentures, with such repayment to be made into escrow on terms and conditions SBA determines.

§107.1570 Distributions by Licensee—optional Distribution to private investors and SBA.

If you have outstanding Participating Securities or Earmarked Assets, you may make two types of optional Distributions under this §107.1570: quarterly Distributions determined the same way as the required annual Distributions in §107.1560, and Distributions allocated between SBA and your private investors in proportion to the capital contributions of each.

(a) *Quarterly Distributions subject to conditions in §107.1560.* (1) You may make Distributions under this paragraph (a) as of the end of any fiscal quarter, giving SBA (or its designated agent or Trustee) a percentage share determined under §107.1560(e).

(2) Such Distributions are subject to all the provisions in §107.1560 (a)(1), (a)(3), (a)(4), (d), (f)(2), and (g).

(3) You may make such Distributions only on the next Payment Date following the end of your fiscal quarter.

(4) The total amount of such Distributions may not exceed the result of the following computation:

(i) Your Retained Earnings Available for Distribution as of the end of your fiscal quarter; minus

(ii) All previous Distributions under this paragraph (a) or §107.1560 that were applied as redemptions or repayments of Leverage; plus

(iii) All previous Distributions under paragraph (b) of this section that reduced your Retained Earnings Available for Distribution.

(b) *Other optional Distributions.* On any Payment Date, you may make additional Distributions to your private investors and to SBA (or its designated agent or Trustee) under this paragraph (b).

(1) *Conditions for making Distribution.* You may make a Distribution under this paragraph (b) only if:

(i) You have distributed all Earned Prioritized Payments and earned Adjustments, so that the balance in your Distribution Account is zero (see §107.1520).

(ii) You have distributed all Profit Participation computed under §107.1530 and made all required Distributions under §107.1560.

(iii) You satisfy the liquidity requirement in §107.1505 or obtain SBA's prior written approval of the Distribution.

(iv) You do not have a condition of Capital Impairment.

(v) The Distribution does not reduce your Regulatory Capital (excluding commitments from Institutional Investors) below the minimum required under §107.210, unless SBA approves the reduction as part of a plan of liquidation.

(vi) The Distribution does not cause you to have excess Leverage contrary to section 303 of the Act.

(2) *SBA's share of Distribution.* (i) If your Capital Impairment Percentage under §107.1840 is zero, SBA's percentage share of any Distribution under this paragraph (b) equals:

$$[\text{Leverage}/(\text{Leverage} + \text{Leverageable Capital})] \times 100$$

In this formula, use Leverage and Leverageable Capital as of the date of the Distribution, after giving effect to any Distribution under §107.1560 and paragraph (a) of this section.

(ii) If your Capital Impairment Percentage under §107.1840 is greater than zero, you must modify the formula in paragraph (b)(2)(i) of this section by replacing Leverageable Capital with:

$$\text{Leverageable Capital} \times (100\% - \text{CIP})$$

where "CIP" is your Capital Impairment Percentage or 100 percent, whichever is less.

(3) *How SBA will apply Distributions.* Any amounts you distribute to SBA, or its designated agent or Trustee, under this paragraph (b) will be applied as a repayment or redemption of Leverage in the order set forth in §107.1560 (g)(3) through (g)(5).

(4) *Effect of Distributions on Retained Earnings Available for Distribution.* Any

amounts you distribute to non-SBA investors under this paragraph (b) must reduce your Retained Earnings Available for Distribution to zero before reducing your Private Capital.

(5) *Permitted exception to § 107.585.* You may make any Distribution permitted by this paragraph (b), even if the result is a reduction in your Regulatory Capital that would otherwise be prohibited under § 107.585.

§ 107.1580 Special rules for In-Kind Distributions by Licensees.

(a) *In-Kind Distributions while Licensee has outstanding Participating Securities.* A Distribution under §§ 107.1560 or 107.1570 may consist of securities (an ''In-Kind Distribution''). Such a Distribution must satisfy the conditions in this paragraph (a).

(1) You may distribute only securities that are Publicly Traded and Marketable at the time of the Distribution.

(2) You must distribute each security pro-rata to all investors and to SBA or its designated agent or Trustee, based on the amounts that each party would receive if the Distribution were in cash.

(3) You must impute a gain (loss) on each security being distributed as if it were being sold, using the value of the security as of the declaration date of the Distribution (if you are a Corporate Licensee) or the distribution date (if you are a Partnership Licensee).

(4) You must deposit SBA's share of the securities being distributed with the CRA, who will select a Disposition Agent (a person who is knowledgeable about and proficient in the marketing of thinly traded securities). As an alternative, if you agree, SBA may direct you to dispose of its share. In this case, you must promptly remit the proceeds to SBA.

(b) *In-Kind Distributions after Licensee has redeemed all Participating Securities.* This paragraph (b) applies from the time you redeem all your Participating Securities until you dispose of all your Earmarked Assets.

(1) You may make an In-Kind Distribution of an Earmarked Asset only if you pay SBA the lower of:

(i) An amount equal to the Unrealized Appreciation on the asset; or

(ii) The full amount of your Accumulated Prioritized Payments and unpaid Adjustments.

(2) You must obtain SBA's prior written approval of any In-Kind Distribution of an Earmarked Asset that is not Publicly Traded and Marketable, specifically including approval of the valuation of the asset.

§ 107.1590 Special rules for companies licensed on or before March 31, 1993.

This section applies to companies licensed on or before March 31, 1993 that apply to issue Participating Securities.

(a) *Election to exclude pre-existing portfolio.* You may choose to exclude all (but not a portion) of your Loans and Investments as of March 31, 1993, from classification as Earmarked Assets if:

(1) The proceeds of your first issuance of Participating Securities are not used to refinance outstanding Debentures (see paragraph (c) of this section). SBA will consider payment or prepayment of any outstanding Debenture to be a refinancing unless you demonstrate to SBA's satisfaction that you can pay the Debenture principal without relying on the proceeds of the Participating Securities.

(2) SBA, in its sole discretion, approves the exclusion.

(b) *Treatment of pre-existing portfolio if not excluded.* If you do not choose to exclude your Loans and Investments as of March 31, 1993, they will be Earmarked Assets for all purposes.

(c) *Refinancing Debentures with Participating Securities.* SBA may permit you to use the proceeds of a Participating Security to pay the principal amount due on an outstanding Debenture if:

(1) You have outstanding Equity Capital Investments (at cost) equal to the amount of the Debentures being refinanced.

(2) You have not elected to exclude Loans and Investments from Earmarked Assets under paragraph (a) of this section.

(d) *Requirements for Licensee's first issuance of Participating Securities.* When you apply for your first issuance of Participating Securities, you must comply with the following:

(1) For each of your Loans and Investments, you must submit:

(i) The most recent annual report (or fiscal year-end financial statements) and the most recent interim financial statements of the Small Business; and

(ii) Your valuation reports on the Small Business, prepared as of the end of each of your last three fiscal years. If you have applied for Participating Securities on the basis of interim financial statements, you must also submit a valuation report as of your interim financial statement date.

(2) If you have negative Undistributed Net Realized Earnings and/or a net Unrealized Loss on Securities Held, SBA may require you to undergo a quasi-reorganization in accordance with generally accepted accounting principles.

(3) If your financial statements accompanying the Participating Securities application are for an interim period, you must have your SBA-approved independent public accountant perform a limited-scope audit of the statements. For purposes of this paragraph (d)(3), ''limited scope audit'' means auditing procedures sufficient to enable the independent public accountant to express an opinion on the Statement of Financial Position and the accompanying Schedule of Loans and Investments.

FUNDING LEVERAGE BY USE OF SBA-GUARANTEED TRUST CERTIFICATES (''TCS'')

§107.1600 SBA authority to issue and guarantee Trust Certificates.

(a) *Authorization.* Sections 321 (a) and (b) of the Act authorize SBA or its CRA to issue TCs, and SBA to guarantee the timely payment of the principal and interest thereon. Any guarantee by SBA of such TC is limited to the principal and interest due on the Debentures or the Redemption Price of and Prioritized Payments on Participating Securities in any Trust or Pool backing such TC. The full faith and credit of the United States is pledged to the payment of all amounts due under the guarantee of any TC.

(b) *Periodic exercise of authority.* SBA will issue guarantees of Debentures and Participating Securities under section 303 and of TCs under section 321 of the Act at three month intervals, or at shorter intervals, taking into account the amount and number of such guarantees or TCs.

(c) *SBA authority to arrange public or private fundings of Leverage.* SBA in its discretion may arrange for public or private financing under its guarantee authority. Such financing arranged by SBA may be accomplished by the sale of individual Debentures or Participating Securities, aggregations of Debentures or Participating Securities, or Pools or Trusts of Debentures or Participating Securities.

(d) *Pass-through provisions.* TCs shall provide for a pass-through to their holders of all amounts of principal and interest paid on the Debentures, or the Redemption Price of and Prioritized Payments on the Participating Securities, in the Pool or Trust against which they are issued.

(e) *Formation of a Pool or Trust holding Leverage Securities.* SBA shall approve the formation of each Pool or Trust. SBA may, in its discretion, establish the size of the Pools and their composition, the interest rate on the TCs issued against Trusts or Pools, fees, discounts, premiums and other charges made in connection with the Pools, Trusts, and TCs, and any other characteristics of a Pool or Trust it deems appropriate.

§107.1610 Effect of prepayment or early redemption of Leverage on a Trust Certificate.

(a) The rights, if any, of a Licensee to prepay any Debenture or make early redemption of any Participating Security are established by the terms of such securities, and no such right is created or denied by the regulations in this part.

(b) SBA's rights to purchase or prepay any Debenture without premium are established by the terms of the Guaranty Agreement relating to the Debenture. SBA's rights to redeem, at any time, any Participating Security without premium are established by the terms of the Guaranty Agreement relating to the Participating Security.

(c) Any prepayment of a Debenture or early redemption of a Participating Security pursuant to the terms of the

Guaranty Agreement relating to such securities, shall reduce the SBA guarantee of timely payment of principal and interest on a TC in proportion to the amount of principal or Redemption Price that such prepaid Debenture or redeemed Participating Security represents in the Trust or Pool backing such TC.

(d) SBA shall be discharged from its guarantee obligation to the holder or holders of any TC, or any successor or transferee of such holder, to the extent of any such prepayment, whether or not such successor or transferee shall have notice of any such prepayment.

(e) Interest on prepaid Debentures and Prioritized Payments on Participating Securities shall accrue only through the date of such voluntary prepayment or SBA payment, as the case may be.

(f) In the event that all Debentures or Participating Securities constituting a Trust or Pool are prepaid, the TCs backed by such Trust or Pool shall be redeemed by payment of the unpaid principal and interest on the TCs; *Provided, however,* that in the case of the prepayment of a Debenture pursuant to the provisions of the Guaranty Agreement relating to the Debenture, the CRA shall pass through pro rata to the holders of the TCs any such prepayments including any prepayment penalty paid by the obligor Licensee pursuant to the terms of the Debenture.

§ 107.1620 Functions of agents, including Central Registration Agent, Selling Agent and Fiscal Agent.

(a) *Agents.* SBA will appoint or cause to be appointed agent(s) to perform functions necessary to market and service Debentures, Participating Securities, or TCs pursuant to this part.

(1) *Selling Agent.* As a condition of guaranteeing a Debenture or Participating Security, SBA shall cause each Licensee to appoint a Selling Agent to perform functions which include, but are not limited to:

(i) Selecting qualified entities to become pool or Trust assemblers (''Poolers'').

(ii) Receiving guaranteed Debentures and Participating Securities as well as negotiating the terms and conditions of periodic offerings of Debentures and/or TCs with Poolers on behalf of Licensees.

(iii) Directing and coordinating periodic sales of Debentures and Participating Securities and/or TCs.

(iv) Arranging for the production of the Offering Circular, certificates, and such other documents as may be required from time to time.

(2) *Fiscal Agent.* SBA shall appoint a Fiscal Agent to:

(i) Establish performance criteria for Poolers.

(ii) Monitor and evaluate the financial markets to determine those factors that will minimize or reduce the cost of funding Debentures or Participating Securities.

(iii) Monitor the performance of the Selling Agent, Poolers, CRA, and the Trustee.

(iv) Perform such other functions as SBA, from time to time, may prescribe.

(3) *Central Registration Agent.* Pursuant to a contract entered into with SBA, the CRA, as SBA's agent, will do the following with respect to the Pools or Trust Certificates for the Debentures or Participating Securities:

(i) Form an SBA-approved Pool or Trust;

(ii) Issue the TCs in the form prescribed by SBA;

(iii) Transfer the TCs upon the sale of original issue TCs in any secondary market transaction;

(iv) Receive payments from Licensees;

(v) Make periodic payments as scheduled or required by the terms of the TCs, and pay all amounts required to be paid upon prepayment of Debentures or redemption of Participating Securities;

(vi) Hold, safeguard, and release all Debentures and Participating Securities constituting Trusts or Pools upon instructions from SBA;

(vii) Remain custodian of such other documentation as SBA shall direct by written instructions;

(viii) Provide for the registration of all pooled Debentures and Participating Securities, all Pools and Trusts, and all TCs;

(ix) Perform such other functions as SBA may deem necessary to implement the provisions of this section.

(b) *Functions.* The function of locating purchasers, and negotiating and closing the sale of Debentures, Participating Securities and TCs, may be performed either by SBA or an agent appointed by SBA. Nothing in the regulations in this part shall be interpreted to prevent the CRA from acting as SBA's agent for this purpose.

§107.1630 SBA regulation of Brokers and Dealers and disclosure to purchasers of Leverage or Trust Certificates.

(a) *Disclosure to purchasers.* Prior to any sale of a Debenture, Participating Security, or TC, SBA shall require the seller, or the broker or dealer as agent for the seller, to disclose to the purchaser, in a form prescribed or approved by SBA, specified information on the terms, conditions, and yield of such instrument.

(b) *Brokers and Dealers.* Each broker, dealer, and Pool or Trust assembler approved by SBA pursuant to these regulations shall either be regulated by a Federal financial regulatory agency, or be a member of the National Association of Securities Dealers (NASD), and shall be in good standing in respect to compliance with the financial, ethical, and reporting requirements of such body. They also shall be in good standing with SBA as determined by the SBA Associate Administrator for Investment (see paragraph (d) of this section) and shall provide a fidelity bond or insurance in such amount as SBA may require.

(c) *Suspension and/or termination of Broker or Dealer.* SBA shall exclude from the sale and all other dealings in Debentures, Participating Securities or TCs any broker or dealer:

(1) If such broker's or dealer's authority to engage in the securities business has been revoked or suspended by a supervisory agency. When such authority has been suspended, such broker or dealer will be suspended by SBA for the duration of such suspension by the supervisory agency.

(2) If such broker or dealer has been indicted or otherwise formally charged with a misdemeanor or felony bearing on its fitness, such broker or dealer may be suspended while the charge is pending. Upon conviction, participation may be terminated.

(3) If such broker or dealer has suffered an adverse final civil judgment, holding that such broker or dealer has committed a breach of trust or violation of law or regulation protecting the integrity of business transactions or relationships, participation in the market for Debentures, Participating Securities or TCs may be terminated.

(4) If such broker or dealer has failed to make full disclosure of the information required by SBA in paragraph (a) of this section, such broker's or dealer's participation in the market for Debentures, Participating Securities or TCs may be terminated.

(d) *Termination/suspension proceedings.* A broker's or dealer's participation in the market for Debentures, Participating Securities or TCs will be conducted in accordance with part 134 of this chapter. SBA may, for any of the reasons stated in paragraphs (b)(1) through (b)(4) of this section, suspend the privilege of any broker or dealer to participate in this market. SBA shall give written notice at least ten (10) business days prior to the effective date of such suspension. Such notice shall inform the broker or dealer of the opportunity for a hearing pursuant to part 134 of this chapter.

§107.1640 SBA access to records of the CRA, Brokers, Dealers and Pool or Trust assemblers.

The CRA and any broker, dealer and Pool or Trust assembler operating under the regulations in this part shall make all books, records and related materials associated with Debentures, Participating Securities and TCs available to SBA for review and copying purposes. Such access shall be at such party's primary place of business during normal business hours.

MISCELLANEOUS

§107.1700 Transfer by SBA of its interest in Licensee's Leverage security.

Upon such conditions and for such consideration as it deems reasonable,

SBA may sell, assign, transfer, or otherwise dispose of any Preferred Security, Debenture, Participating Security, or other security held by or on behalf of SBA in connection with Leverage. Upon notice by SBA, Licensee will make all payments of principal, dividends, interest, Prioritized Payments, and redemptions as shall be directed by SBA. Licensee will be liable for all damage or loss which SBA may sustain by reason of such disposal, up to the amount of Licensee's liability under such security, plus court costs and reasonable attorney's fees incurred by SBA.

§ 107.1710 SBA authority to collect or compromise its claims.

SBA may, upon such conditions and for such consideration as it deems reasonable, collect or compromise all claims relating to Preferred or Participating Securities or obligations held or guaranteed by SBA, and all legal or equitable rights accruing to SBA.

Subpart J—Licensee's Noncompliance With Terms of Leverage

§ 107.1800 Licensee's agreement to terms and conditions in §§ 107.1810 and 107.1820.

Any Licensee that violates the terms and conditions of its Leverage is subject to SBA remedies. The terms, conditions and remedies in § 107.1810 apply to outstanding Debentures issued after April 25, 1994. The terms, conditions and remedies in § 107.1820 apply to outstanding Preferred Securities and Participating Securities issued after April 25, 1994, or if you have Earmarked Assets in your portfolio.

§ 107.1810 Events of default and SBA's remedies for Licensee's noncompliance with terms of Debentures.

(a) *Applicability of this section.* This § 107.1810 applies to Debentures issued after April 25, 1994. By issuing such Debentures, you automatically agree to the terms, conditions and remedies in this section, as in effect at the time of issuance and as if fully set forth in the Debentures. Debentures issued before April 25, 1994 continue to be governed by the remedies in effect at the time of their issuance.

(b) *Automatic events of default.* The occurrence of one or more of the events in this paragraph (b) causes the remedies in paragraph (c) of this section to take effect immediately.

(1) *Insolvency.* You become equitably or legally insolvent.

(2) *Voluntary assignment.* You make a voluntary assignment for the benefit of creditors without SBA's prior written approval.

(3) *Bankruptcy.* You file a petition to begin any bankruptcy or reorganization proceeding, receivership, dissolution or other similar creditors' rights proceeding, or such action is initiated against you and is not dismissed within 60 days.

(c) *SBA remedies for automatic events of default.* Upon the occurrence of one or more of the events in paragraph (b) of this section:

(1) Without notice, presentation or demand, the entire indebtedness evidenced by your Debentures, including accrued interest, and any other amounts owed SBA with respect to your Debentures, is immediately due and payable; and

(2) You automatically consent to the appointment of SBA or its designee as your receiver under section 311(c) of the Act.

(d) *Events of default with notice.* For any occurrence (as determined by SBA) of one or more of the events in this paragraph (d), SBA may avail itself of one or more of the remedies in paragraph (e) of this section.

(1) *Fraud.* You commit a fraudulent act which causes detriment to SBA's position as a creditor or guarantor.

(2) *Fraudulent transfers.* You make any transfer or incur any obligation that is fraudulent under the terms of 11 U.S.C. 548.

(3) *Willful conflicts of interest.* You willfully violate § 107.730.

(4) *Willful non-compliance.* You willfully violate one or more of the substantive provisions of the Act, specifically including but not limited to the provisions summarized in section 310(c) of the Act, or any substantive regulation promulgated under the Act.

(5) *Repeated Events of Default.* At any time after being notified by SBA of the occurrence of an event of default under

paragraph (f) of this section, you engage in similar behavior which results in another occurrence of the same event of default.

(6) *Transfer of Control.* You violate § 107.475 and/or willfully violate § 107.410, and as a result of such violation you undergo a transfer of Control.

(7) *Non-cooperation under § 107.1810(h).* You fail to take appropriate steps, satisfactory to SBA, to accomplish any action SBA may have required under paragraph (h) of this section.

(8) *Non-notification of Events of Default.* You fail to notify SBA as soon as you know or reasonably should have known that any event of default exists under this section.

(9) *Non-notification of defaults to others.* You fail to notify SBA in writing within ten days from the date of a declaration of an event of default or nonperformance under any note, debenture or indebtedness of yours, issued to or held by anyone other than SBA.

(e) *SBA remedies for events of default with notice.* Upon written notice to you of the occurrence (as determined by SBA) of one or more of the events in paragraph (d) of this section:

(1) SBA may declare the entire indebtedness evidenced by your Debentures, including accrued interest, and/or any other amounts owed SBA with respect to your Debentures, immediately due and payable; and

(2) SBA may avail itself of any remedy available under the Act, specifically including institution of proceedings for the appointment of SBA or its designee as your receiver under section 311(c) of the Act.

(f) *Events of default with opportunity to cure.* For any occurrence (as determined by SBA) of one or more of the events in this paragraph (f), SBA may avail itself of one or more of the remedies in paragraph (g) of this section.

(1) *Excessive Management Expenses.* Without the prior written consent of SBA, you incur Management Expenses in excess of those permitted under § 107.520.

(2) *Improper Distributions.* You make any Distribution to your shareholders or partners, except with the prior written consent of SBA, other than:

(i) Distributions permitted under § 107.585;

(ii) Payments from Retained Earnings Available for Distribution based on either the shareholders' pro-rata interests or the provisions for profit distributions in your partnership agreement, as appropriate; and

(iii) Distributions by Participating Securities issuers as permitted under §§ 107.1540 through 107.1580.

(3) *Failure to make payment.* Unless otherwise approved by SBA, you fail to make timely payment of any amount due under any security or obligation of yours that is issued to, held or guaranteed by SBA.

(4) *Failure to maintain Regulatory Capital.* You fail to maintain the minimum Regulatory Capital required under these regulations or, without the prior written consent of SBA, you reduce your Regulatory Capital, except as permitted by §§ 107.585 and 107.1560 through 107.1580.

(5) *Capital Impairment.* You have a condition of Capital Impairment as determined under § 107.1830.

(6) *Cross-default.* An obligation of yours that is greater than $100,000 becomes due or payable (with or without notice) before its stated maturity date, for any reason including your failure to pay any amount when due. This provision does not apply if you pay the amount due within any applicable grace period or contest the payment of the obligation in good faith by appropriate proceedings.

(7) *Nonperformance.* You violate or fail to perform one or more of the terms and conditions of any security or obligation of yours that is issued to, held or guaranteed by SBA, or of any agreement with or conditions imposed by SBA in its administration of the Act and the regulations promulgated under the Act.

(8) *Noncompliance.* Except as otherwise provided in paragraph (d)(5) of this section, SBA determines that you have violated one or more of the substantive provisions of the Act, specifically including but not limited to the provisions summarized in section 310(c) of the Act, or any substantive regulation promulgated under the Act.

(9) *Failure to maintain investment ratio.* You fail to maintain the investment ratio for Leverage in excess of 300 percent of Leverageable Capital (see

§§ 107.1150(b)(2) and 107.1160(c)), if applicable to you, as of the end of each fiscal year. In determining whether you have maintained the ratio, SBA will disregard any prepayment, sale, or disposition of Venture Capital Financing, any increase in Leverageable Capital, and any receipt of additional Leverage, within 120 days prior to the end of your fiscal year.

(10) *Failure to maintain diversity.* You fail to maintain diversity between management and ownership as required by § 107.150, if applicable to you.

(g) *SBA remedies for events of default with opportunity to cure.* (1) Upon written notice to you of the occurrence (as determined by SBA) of one or more of the events of default in paragraph (f) of this section, and subject to the conditions in paragraph (g)(2) of this section:

(i) SBA may declare the entire indebtedness evidenced by your Debentures, including accrued interest, and/or any other amounts owed SBA with respect to your Debentures, immediately due and payable; and

(ii) SBA may avail itself of any remedy available under the Act, specifically including institution of proceedings for the appointment of SBA or its designee as your receiver under section 311(c) of the Act.

(2) SBA may invoke the remedies in paragraph (g)(1) of this section only if:

(i) It has given you at least 15 days to cure the default(s); and

(ii) You fail to cure the default(s) to SBA's satisfaction within the allotted time.

(h) *Repeated non-substantive violations.* If you repeatedly fail to comply with one or more of the non-substantive provisions of the Act or any non-substantive regulation promulgated under the Act, SBA, after written notification to you and until you cure such condition to SBA's satisfaction, may deny you additional Leverage and/or require you to take such actions as SBA may determine to be appropriate under the circumstances.

(i) *Consent to removal of officers, directors, or general partners and/or appointment of receiver.* The Articles of any Licensee issuing Debentures after April 25, 1994 must include the following provisions as a condition to the purchase or guarantee by SBA of such Leverage. Upon the occurrence of any of the events specified in paragraphs (d)(1) through (d)(6) or (f)(1) through (f)(3) of this section as determined by SBA, SBA shall have the right, and your consent to SBA's exercise of such right:

(1) With respect to a Corporate Licensee, upon written notice, to require you to replace, with individuals approved by SBA, one or more of your officers and/or such number of directors of your board of directors as is sufficient to constitute a majority of such board; or

(2) With respect to a Partnership Licensee, upon written notice, to require you to remove the person(s) responsible for such occurrence and/or to remove the general partner of Licensee, which general partner shall then be replaced in accordance with Licensee's Articles by a new general partner approved by SBA; and/or

(3) With respect to either a Corporate or Partnership Licensee, to obtain the appointment of SBA or its designee as your receiver under section 311(c) of the Act for the purpose of continuing your operations. The appointment of a receiver to liquidate a Licensee is not within such consent, but is governed instead by the relevant provisions of the Act.

§ 107.1820 Conditions affecting issuers of Preferred Securities and/or Participating Securities.

(a) *Applicability of this section.* This section applies if you have Preferred Securities issued after April 25, 1994, or if you issue Participating Securities or have Earmarked Assets in your portfolio. Your Articles must include the provisions of this § 107.1820 as a condition to SBA's purchase of Preferred Securities or guarantee of Participating Securities and for as long as you own Earmarked Assets. Preferred Securities issued before April 25, 1994 continue to be governed by the remedies in effect at the time of their issuance.

(b) *Removal Conditions.* Upon the occurrence (as determined by SBA) of any of the following conditions (''Removal Conditions''), SBA may avail itself of one or more of the remedies in paragraph (d) of this section:

(1) *Insolvency or extreme Capital Impairment.* You become equitably or legally insolvent, or have a Capital Impairment Percentage of 100 percent or more (''extreme Capital Impairment'') and have not cured such Capital Impairment within the time limits set by SBA in writing. In this regard:

(i) You are not considered to have a condition of extreme Capital Impairment during the first eight years following your first issuance of Participating Securities.

(ii) This paragraph (b)(1) does not give you an additional opportunity to cure if you have already had an opportunity to cure your Capital Impairment under paragraph (e)(3) of this section.

(2) *Voluntary assignment.* You make a voluntary assignment for the benefit of creditors.

(3) *Bankruptcy.* You begin any bankruptcy or reorganization proceeding, receivership, dissolution or other similar creditors' rights proceeding, or such action is initiated against you and is not dismissed within 60 days.

(4) *Transfer of Control.* You violate § 107.475 and/or willfully violate § 107.410, and such violation results in a transfer of Control.

(5) *Fraud.* You commit a fraudulent act which causes serious detriment to SBA's position as a guarantor or investor.

(6) *Fraudulent transfers.* You make any transfer or incur any obligation that is fraudulent under the terms of 11 USC 548.

(c) *Contingent Removal Conditions.* Upon the occurrence (as determined by SBA) of any of the following conditions (''Contingent Removal Conditions''), SBA may avail itself of one or more of the remedies in paragraph (d) of this section, but only if you fail to remove the person(s) SBA identifies as responsible for such occurrence and/or cure such occurrence to SBA's satisfaction within a time period determined by SBA (but not less than 15 days):

(1) *Willful conflicts of interest.* You willfully violate § 107.730.

(2) *Willful or repeated noncompliance.* You willfully or repeatedly violate one or more of the substantive provisions of the Act, specifically including but not limited to the provisions summarized in section 310(c) of the Act, or any substantive regulation promulgated under the Act.

(3) *Failure to comply with restrictions under paragraph (f) of this section.* You fail to comply with the restrictions imposed by SBA under paragraph (f) of this section.

(d) *SBA remedies for Removal Conditions and Contingent Removal Conditions.* Upon the occurrence (as determined by SBA) of any Removal Condition, or any Contingent Removal Condition accompanied by your failure to act as set forth in paragraph (c) of this section, SBA has the following rights, and you consent to SBA's exercise of any or all of such rights:

(1) With respect to a Corporate Licensee, upon written notice, to require you to replace, with individuals approved by SBA, one or more of your officers and/or such number of directors as is sufficient to constitute a majority of your board of directors; or

(2) With respect to a Partnership Licensee, upon written notice, to require you to remove the person(s) responsible for such occurrence and/or to remove your general partner, who shall then be replaced in accordance with your Articles by a new general partner approved by SBA; and/or

(3) With respect to either a Corporate or Partnership Licensee, to the appointment of SBA or its designee as your receiver under section 311(c) of the Act for the purpose of continuing your operations. The appointment of a receiver to liquidate a Licensee is not within such consent, but is governed instead by the relevant provisions of the Act.

(e) *Restricted Operations Conditions.* Upon the occurrence (as determined by SBA) of any of the following conditions (''Restricted Operations Conditions''), SBA may avail itself of any of the remedies in paragraph (f) of this section.

(1) *Removal Conditions or Contingent Removal Conditions.* Any condition occurs which is listed in paragraphs (b) or (c) of this section.

(2) *Failure to maintain Regulatory Capital.* You fail to maintain the minimum Regulatory Capital required by this part.

(3) *Capital or Liquidity Impairment.* You have a condition of Capital Impairment as determined under § 107.1830 or, if applicable, a condition of Liquidity Impairment as determined under § 107.1505, and you fail to cure the impairment within time limits set by SBA in writing.

(4) *Improper Distributions.* You make any Distribution to your shareholders or partners other than those permitted by §§ 107.585 and 107.1560 through 107.1580.

(5) *Excessive Management Expenses.* Without the prior written consent of SBA, you incur Management Expenses in excess of those permitted under § 107.520.

(6) *Failure to make payment.* You fail to pay any amounts due under Preferred Securities or required by §§ 107.1500 through 107.1590, unless otherwise permitted by SBA.

(7) *Noncompliance.* Except as otherwise provided for in paragraphs (c)(1) and (c)(2) of this section, SBA determines that you have failed to comply with one or more of the substantive provisions of the Act, specifically including but not limited to the provisions summarized in section 310(c) of the Act, or any substantive regulation promulgated under the Act.

(8) *Failure to maintain diversity.* You fail to maintain diversity between management and ownership as required by § 107.150, if applicable to you.

(9) *Failure to maintain investment ratios.* You fail to maintain the investment ratios or amounts required for Participating Securities (§ 107.1500(b)(4)) or Leverage in excess of 300 percent of Leverageable Capital (§ 107.1160(c)) or Preferred Securities in excess of 100 percent of Leverageable Capital (§ 107.1160(d)), if applicable to you, as of the end of each fiscal year. In determining whether you have maintained the ratios or amounts, SBA will disregard any prepayment, sale, or disposition of Equity Capital Investments or Venture Capital Financings, as appropriate, any increase in Leverageable Capital, and any receipt of additional Leverage, within 120 days prior to the end of your fiscal year.

(10) *Nonperformance.* You violate or fail to perform one or more of the terms and conditions of any Participating Security or Preferred Security or of any agreement with or condition imposed by SBA in its administration of the Act and the regulations promulgated thereunder.

(11) *Noncooperation under paragraph (g) of this section.* You fail to take appropriate steps, satisfactory to SBA, to accomplish such action as SBA may have required under paragraph (g) of this section.

(f) *SBA remedies for Restricted Operations Conditions.* Upon the occurrence of any Restricted Operations Condition, and until such condition(s) are cured to SBA's satisfaction within a time period determined by SBA (but not less than 15 days), upon written notice SBA shall have the following rights, and you consent to SBA's exercise of any or all of such rights:

(1) To prohibit you from making any additional investments except for investments under legally binding commitments you entered into before such notice and, subject to SBA's prior written approval, investments that are necessary to protect your investments;

(2) Until all Leverage is redeemed and amounts due are paid, to prohibit Distributions by you to any party other than SBA, its agent or Trustee;

(3) To require all your commitments from investors to be funded at the earliest time(s) permitted in accordance with your Articles; and

(4) To review and re-determine your approved Management Expenses.

(g) *Repeated non-substantive violations.* If you repeatedly fail to comply with one or more of the non-substantive provisions of the Act or any non-substantive regulation promulgated thereunder, SBA, after written notification to you and until such condition is cured to SBA's satisfaction, will deny you additional Leverage and/or require you to take such actions as SBA may determine to be appropriate under the circumstances.

COMPUTATION OF LICENSEE'S CAPITAL IMPAIRMENT

§ 107.1830 Licensee's Capital Impairment—definition and general requirements.

(a) *Applicability of this section.* This § 107.1830 applies to you if you have any outstanding Leverage issued on or

after April 25, 1994. If you only have outstanding Leverage issued before April 25, 1994, you must comply with paragraphs (e) and (f) of this section and the Capital Impairment regulations in this part in effect when you issued your Leverage.

(b) *Significance of Capital Impairment condition.* If you have a condition of Capital Impairment, you are not in compliance with the terms of your Leverage. As a result, SBA has the right to impose the applicable remedies for noncompliance in §§107.1810(g) and 107.1820(f).

(c) *Definition of Capital Impairment condition.* You have a condition of Capital Impairment if your Capital Impairment Percentage, as computed in §107.1840, exceeds:

(1) For Section 301(d) Licensees, 75 percent.

(2) For Section 301(c) Licensees, the appropriate percentage from the following table:

MAXIMUM PERMITTED CAPITAL IMPAIRMENT PERCENTAGES FOR SECTION 301(C) LICENSEES

If the percentage of equity capital investments (at cost) in your portfolio is:	And your ratio of outstanding leverage to leverageable capital is:	Then your maximum permitted capital impairment percentage is:
67%	100% or less	70
	Over 100% but not over 200%	60
	Over 200%	50
At least 40% but under 67%	100% or less	55
	Over 100% but not over 200%	50
	Over 200%	40
Under 40%	100% or less	45
	Over 100% but not over 200%	40
	Over 200%	35

(d) *Phase-in of maximum permitted Capital Impairment Percentages for Section 301(c) Licensees.* If you are a Section 301(c) Licensee, regardless of your maximum permitted Capital Impairment Percentage under paragraph (c) of this section, you will not have a condition of Capital Impairment if:

(1) Your Capital Impairment Percentage does not exceed 50 percent; and

(2) You have not reached your first fiscal year end occurring after April 25, 1995.

(e) *Quarterly computation requirement and procedure.* You must determine whether you have a condition of Capital Impairment as of the end of each fiscal quarter. You must notify SBA promptly if you are capitally impaired.

(f) *SBA's right to determine Licensee's Capital Impairment condition.* SBA may make its own determination of your Capital Impairment condition at any time.

§107.1840 Computation of Licensee's Capital Impairment Percentage.

(a) *General.* This section contains the procedures you must use to determine your Capital Impairment Percentage if you have outstanding Leverage issued after April 25, 1994. You must compare your Capital Impairment Percentage to the maximum permitted under §107.1830(c) to determine whether you have a condition of Capital Impairment.

(b) *Preliminary impairment test.* If you satisfy the preliminary impairment test, your Capital Impairment Percentage is zero and you do not have to perform any more procedures in this §107.1840. Otherwise, you must continue with paragraph (c) of this section. You satisfy the test if the following amounts are both zero or greater:

(1) The sum of Undistributed Net Realized Earnings, as reported on SBA Form 468, and Includible Non-Cash Gains.

(2) Unrealized Gain (Loss) on Securities Held.

(c) *How to compute your Capital Impairment Percentage.* (1) If you have an Unrealized Gain on Securities Held, compute your Adjusted Unrealized Gain using paragraph (d) of this section. If you have an Unrealized Loss on

Securities Held, continue with paragraph (c)(2) of this Section.

(2) Add together your Undistributed Net Realized Earnings, your Includible Non-cash Gains, and either your Unrealized Loss on Securities Held or your Adjusted Unrealized Gain.

(3) If the sum in paragraph (c)(2) of this section is zero or greater, your Capital Impairment Percentage is zero.

(4) If the sum in paragraph (c)(2) of this section is less than zero, drop the negative sign, divide by your Regulatory Capital (excluding Treasury Stock), and multiply by 100. The result is your Capital Impairment Percentage.

(d) *How to compute your Adjusted Unrealized Gain.* (1) Subtract Unrealized Depreciation from Unrealized Appreciation. This is your ''Net Appreciation''.

(2) Determine your Unrealized Appreciation on Publicly Traded and Marketable securities. This is your ''Class 1 Appreciation''.

(3) Determine your Unrealized Appreciation on securities that are not Publicly Traded and Marketable and meet the following criteria, which must be substantiated to the satisfaction of SBA (this is your ''Class 2 Appreciation''):

(i) The Small Business that issued the security received a significant subsequent equity financing by an investor whose objectives were not primarily strategic and at a price that conclusively supports the Unrealized Appreciation;

(ii) Such financing represents a substantial investment in the form of an arm's length transaction by a sophisticated new investor in the issuer's securities; and

(iii) Such financing occurred within 24 months of the date of the Capital Impairment computation, or the Small Business' pre-tax cash flow from operations for its most recent fiscal year was at least 10 percent of the Small Business' average contributed capital for such fiscal year.

(4) Perform the appropriate computation from the following table:

ADJUSTED UNREALIZED GAIN BEFORE ESTIMATED TAX EFFECTS

If:	And:	Then adjusted unrealized gain before taxes is:
Class 1 Appreciation ≤ Net Appreciation.	Class 1 Appreciation + Class 2 Appreciation ≤ Net Appreciation.	(80% × Class 1 Appreciation) + (50% × Class 2 Appreciation).
Class 1 Appreciation ≤ Net Appreciation.	Class 1 Appreciation + Class 2 Appreciation > Net Appreciation.	(80% × Class 1 Appreciation) + [(50% × (Net Appreciation − Class 1 Appreciation)].
Class 1 Appreciation > Net Appreciation.	.....	80% × Net Appreciation.

(5) Reduce the gain computed in paragraph (d)(4) of this section by your estimate of related future income tax expense. Subject to any adjustment required by paragraph (d)(6) of this section, the result is your Adjusted Unrealized Gain for use in paragraph (c)(2) of this section.

(6) If any securities that are the source of either Class 1 or Class 2 Appreciation are pledged or encumbered in any way, you must reduce the Adjusted Unrealized Gain computed in paragraph (d)(5) of this section by the amount of the related borrowing or other obligation, up to the amount of the Unrealized Appreciation on the securities.

§ 107.1850 Exceptions to Capital Impairment provisions for Licensees with outstanding Participating Securities.

The provisions in this § 107.1850 apply only if at least two-thirds of your outstanding Leverage consists of Participating Securities, and at least two-thirds of your Loans and Investments (at cost) consist of Equity Capital Investments.

(a) *Forbearance period for Participating Securities issuers.* During the first forty-eight (48) months following your first issuance of Participating Securities, you will not have a condition of Capital Impairment if your Capital Impairment Percentage is below 85 percent.

(b) *Extended forbearance period for early stage investors.* If at least two-thirds of your Loans and Investments (at cost) are in Start-Up Financings, the forbearance period in paragraph (a) of this section is extended to 60 months.

(c) *Forbearance based on actions by Licensee.* The provisions of this paragraph (c) apply only during the fifth and sixth years following your first issuance of Participating Securities. If your Capital Impairment Percentage, as determined either by you or by SBA, exceeds the maximum permitted under §107.1830(c) but is below 85 percent, you will not have a condition of Capital Impairment if you do either of the following within thirty (30) days of such determination:

(1) Increase your Regulatory Capital by a cash contribution placed in an escrow account or other account satisfactory to SBA, for its benefit. The contribution must equal, during the fifth year, 15 percent of your outstanding Leverage or, during the sixth year, 30 percent.

(2) Provide a guarantee, satisfactory to SBA and for its benefit, for the amount of the cash contribution required in paragraph (c)(1) of this section. SBA will credit any escrowed funds or guarantee received in the fifth year toward the requirements for the sixth year.

(d) *Conditions for forbearance under paragraph (c) of this section.* (1) You cannot count any funds placed in an escrow or other account under paragraph (c) of this section as Leverageable Capital.

(2) Any fee and/or any claim to repayment by the party making the capital contribution or by the guarantor must be deferred and subordinate to all outstanding Leverage plus any unpaid Earned Prioritized Payments and earned Adjustments.

(3) If there is an acceleration or mandatory redemption under §107.1810 or §107.1820, any funds in the escrow account and/or any guarantee received under paragraph (c) of this section will be applied toward repaying any amounts due SBA.

(4) If you reduce your Capital Impairment Percentage to zero, SBA will release and return any escrowed funds and/or any guarantee received under paragraph (c) of this section.

Subpart K—Ending Operations as a Licensee

§107.1900 Surrender of license.

You may not surrender your license without SBA's prior written approval. Your request for approval must be accompanied by an offer of immediate repayment of all of your outstanding Leverage (including any prepayment penalties thereon), or by a plan satisfactory to SBA for the orderly liquidation of the Licensee.

Subpart L—Miscellaneous

§107.1910 Non-waiver of SBA's rights or terms of Leverage security.

SBA's failure to exercise or delay in exercising any right or remedy under the Act or the regulations in this part does not constitute a waiver of such right or remedy. SBA's failure to require you to perform any term or provision of your Leverage does not affect SBA's right to enforce such term or provision. Similarly, SBA's waiver of, or failure to enforce, any term or provision of your Leverage or of any event or condition set forth in §107.1810 or §107.1820 does not constitute a waiver of any succeeding breach of such term or provision or condition.

§107.1920 Licensee's application for exemption from a regulation in this part 107.

You may file an application in writing with SBA to have a proposed action exempted from any procedural or substantive requirement, restriction, or prohibition to which it is subject under this part, unless the provision is mandated by the Act. SBA may grant an exemption for such applicant, conditionally or unconditionally, provided the exemption would not be contrary to the purposes of the Act. Your application must be accompanied by supporting evidence which demonstrates to SBA's satisfaction that:

(a) The proposed action is fair and equitable; and

(b) The exemption requested is reasonably calculated to advance the best interests of the SBIC program in a

manner consonant with the policy objectives of the Act and the regulations in this part.

§ 107.1930 Effect of changes in this part 107 on transactions previously consummated.

The legality of a transaction covered by the regulations in this part is governed by the regulations in this part in effect at the time the transaction was consummated, regardless of later changes. Nothing in this part bars SBA enforcement action with respect to any transaction consummated in violation of provisions applicable at the time, but no longer in effect.

PART 112—NONDISCRIMINATION IN FEDERALLY ASSISTED PROGRAMS OF SBA—EFFECTUATION OF TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Sec.

112.1 Purpose.
112.2 Application of this part.
112.3 Discrimination prohibited.
112.4 Discrimination in employment.
112.5 Discrimination in providing financial assistance.
112.6 Discrimination in accommodations or services.
112.7 Illustrative applications.
112.8 Assurances required.
112.9 Compliance information.
112.10 Conduct of investigations.
112.11 Procedure for effecting compliance.
112.12 Effect on other regulations; forms and instructions.

APPENDIX A TO PART 112

AUTHORITY: Sec. 602, 78 Stat. 252 (42 U.S.C. 2000d–1).

SOURCE: 30 FR 298, Jan. 9, 1965, unless otherwise noted.

§ 112.1 Purpose.

The purpose of this part is to effectuate the provisions of Title VI of the Civil Rights Act of 1964 (hereinafter referred to as the *Act*) to the end that no person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under any financial assistance activities of the Small Business Administration to which the Act applies.

§ 112.2 Application of this part.

(a) This part applies to all recipients of assistance under programs administered by the Small Business Administration. (See appendix A)

(b) The term *Federal financial assistance* includes: (1) Grants and loans of Federal funds; (2) the grant or donation of Federal property and interests in property; (3) the detail of Federal personnel; (4) the sale and lease of, and the permission to use (on other than a casual or transient basis), Federal property or any interest in such property without consideration, or at a nominal consideration, or at a consideration which is reduced for the purpose of assisting the recipient, or in recognition of the public interest to be served by such sale or lease to the recipient; and (5) any Federal agreement, arrangement, or other contract which has as one of its purposes the provision of assistance.

(c) This part does not apply to financial assistance extended by way of insurance or guarantee.

(d) The terms *applicant* and *recipient* mean, respectively, one who applies for and one who receives any of the financial assistance under any of the statutes referred to in paragraph (a) of this section. The term *recipient* also shall be deemed to include *subrecipients* of SBA financial assistance, i.e., concerns which secondarily receive financial assistance from the primary recipients of such financial assistance.

[30 FR 298, Jan. 9, 1965, as amended at 38 FR 17934, July 5, 1973; 50 FR 1441 Jan. 11, 1985]

§ 112.3 Discrimination prohibited.

(a) *General.* To the extent that this part applies, no person in the United States shall, on the ground of race, color or national origin be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination by any business or other activity.

(b) *Specific discriminatory actions prohibited.* (1) To the extent that this part applies, a business or other activity may not, directly or through contractual or other arrangements, on ground of race, color or national origin: