FILING INSTRUCTIONS: Remove existing Revision 6 to Part 107. Insert corrected Revision 6. Appendices remain unchanged.

SMALL BUSINESS ADMINISTRATION

13 CFR Part 107

[Rev. 6]

Small Business Investment Companies

AGENCY: Small Business Administration.

ACTION: Final regulations.

SUMMARY: The Office of Finance and Investment, SBA, has generally revised and reorganized the regulations governing the operations of Small Business Investment Companies. The supplementary information section below explains the revisions and reorganization undertaken. The three appendices to Part 107 are not affected by this revision. The purpose of this revision is to incorporate and put into context all incremental changes made since the previous revision, as well as current needed items.

EFFECTIVE DATE: September 30, 1983.

ADDRESS: Associate Administrator for Finance and Investment, Small Business Administration, 1441 L Street, NW., Washington, D.C. 20416.

FOR FURTHER INFORMATION CONTACT: Robert G. Lineberry, Deputy Associate Administrator for Investment, Small Business Administration, 1441 L Street, NW., Washington, D.C. 20416, 202-653-6848.

SUPPLEMENTARY INFORMATION: On August 16, 1982, notice of proposed rule making was published in the **Federal Register** concerning the revision of Part 107 of the SBA regulations (47 FR 35499-35517). After careful consideration of the comments received, SBA has determined to adopt the revised provisions, set forth below, as being in the best interests of the SBIC program. Textual changes have been made to modify and clarify regulations. It is felt that these changes will facilitate a better understanding of the regulations and their intent by the Licensee companies.

The definition of "Close Relative" has been revised to include "aunt" and "uncle". SBA has determined that the definition as revised would be beneficial to Licensees who qualify for Leverage in excess of three hundred percent and who must subordinate Debt Securities and Loans to all borrowings except borrowings from officers, directors and owners of the Small Concern, or Close Relatives thereof.

The definition of "Cost of Money" has been changed substantially by SBA after review of comments received on the proposed definition. The final definition has been revised from the proposed definition to eliminate charges paid by the Small Concern to Persons other than the Licensee or its Associates. Reference to redemption provisions and distributions from retained earnings of the Small Concern has also been eliminated in order to preclude any possible interpretation that income derived from the sale of Equity Securities to third parties, or from their repurchase or redemption in accordance with the terms of Section 107.321, is includible in Cost of Money. The definition has also been clarified to permit "front end" costs to be prorated over the "stated term of Financing" in order to prevent a prepayment from turning a lawful Financing into one that violates SBA's Cost of Money ceiling. If the Licensee has imposed front end costs upon a Small Concern the amount of any reasonable prepayment penalty that may also be imposed is to be added to the Small Concern's Cost of Money for the purpose of determining how much in unearned front end costs must be returned to the Small Concern to avoid a violation of the Cost of Money ceiling.

The definition of Debt Securities has been revised to eliminate the subordination requirement and the definition of Investment Adviser has been amended to indicate that such a Person performing the operating activities for a Licensee will be deemed an officer. This clarification was transferred from § 107.101(a).

The SBA has determined that it would be advisable to continue the definition of "Short-term Financing" as Financing for a term of less than five years rather than the seven years published as proposed. Therefore, all minimum periods that stated seven years in the proposed regulations have been changed to five years. The five year reference relating to Section 301(d) SBIC has been changed to four years.

The definition of "Private Capital" has been changed to accommodate the ruling of the Federal District Court for the District of Columbia, Civil Action No. 82-0269 (January 3, 1983), concerning Leveraging to Section 301(d) Licensees. That ruling is currently on appeal. Following a determination it may be appropriate further to amend this definition.

Section 107.102 was amended by adding a new paragraph [Section 107.102(b)] to provide for a $200 processing fee for each request for approval of a new officer, director, Control Person or owner of ten or more percent of a Licensee's Private Capital, where a transfer of control of a Licensee is not involved. Under the proposed regulation, the processing fee for changes that do not involve a transfer of control could conceivably be $5,000 which would have been exorbitant.

Section 107.201 is editorially changed to restore the requirement that any Licensee, including a Section 301(d), Licensee, that applies for Leverage must demonstrate its need for such Leverage. The requirement presently set forth in Revision 5 of Part 107 was inadvertently omitted from the proposed regulations. SBA does not consider itself obliged to solicit public comment on this point, for the same reason given when Revision 5 was amended by publication of the final rule on July 1, 1981 (46 FR 34309) without prior publication as a proposal: the language in question can only apply to parties that would not be adversely affected thereby—to SBIC's that have no need for Leverage funds.

Section 107.202(b)(3) has been liberalized to permit Licensees qualifying for Leverage in excess of three hundred percent not to have to subordinate Debt Securities or Loans to a small concern's borrowings from its officers, directors and owners of the Small Concern, or close Relatives thereof.

Section 107.203(d) has also been liberalized to provide that a section 301(d) Licensee whose earnings deficit exceeds seventy-five percent of Private Capital shall not be deemed capitally impaired for a period of five years after the effective date of these regulations unless its earnings deficit exceeds one hundred percent of Private Capital.

Section 107.301(a) has been amended to require that Financings provided Disadvantaged Concerns may be for four years instead of five, however, the aggregate of such Financings for less than five years shall not exceed fifty percent of the Licensee's portfolio.

Section 107.302(b) has been amended to provide that if the current FFB Rate is 8 percent or lower, the Cost of Money shall not exceed 14 percent, instead of 12 percent as proposed; and if the FFB Rate exceeds 8 percent, the Cost of Money shall not exceed the sum of the FFB Rate plus 6 percentage points instead of the proposed 4 percentage points.

Section 107.303(b) has been amended by clarifying language changes, corrections of typographical errors and requiring that one of the market makers have offices in at least ten states. The intent of the change is to make it clear that the appreciation upon which the Licensee's increased overline limit has been predicated, actually reflects the existence of a reasonably substantial market for the securities in question.

Section 107.320(b) has been amended to clarify SBA's intention that the expiration date of any options or

warrants should be tied to the actual date of discharge of the Small Concern's indebtedness to the Licensee.

Section 107.321 was revised by having a minimum holding period of five years rather than seven, deleting the reciprocal redemption right requirement and changing the redemption price from book value per share or a multiple of earnings not to exceed six to a formula which is reasonable and legal, and is based on book value or earnings.

Section 107.402 has been clarified to ensure that commitments are to be in writing. Also a reference to the amortization provisions of § 107.301 appears in the language of § 107.503 of Revision 5. The reference was inadvertently dropped from the text of proposed § 107.402 of Revision 6. It was not intended that § 107.402 would exempt disbursements made under a commitment from the restrictions set forth in § 107.301(b) of proposed Revision 6; and, accordingly, the reference is restored. The restoration is consistent with the expressed intent of the proposed rule, which created only a limited exemption from the maturity restrictions of § 107.301, as set forth in § 107.301(a).

Sections 107.501, 107.602, and 107.802 have been changed for clarifying purposes, but no substantive changes were made.

Section 107.708 would allow Licensees to maintain idle funds in money market funds insured by Agencies of the Federal Government and to exempt an Unincorporated Licensee's corporate general partner's assets not invested in the Licensee from the time limits imposed by this section. In addition the period of investments in obligations of the United States has been extended from 12 to 15 months.

Language changes were made in § 107.802 to eliminate any reference to a Licensee's purchase of its own stock, to prevent any misinterpretation.

Section 107.901(e) has been amended to allow foreign joint ventures and to define "major" as fifty-one percent. A proviso has been added to § 107.901(f) which will permit Licensees to invest in a holding company which wholly owns a concern which is engaged in a regular and continuous business as long as both concerns are eligible Small Concerns. In addition clarifying language has been added to § 107.901(g) to make clear that proceeds of an SBIC Financing may not be used by a Small Concern to purchase capital goods from an associate of the Licensee, and that goods and services provided by an associate supplier shall be at a price no greater than that charged other customers.

A proviso has been added to § 107.902 to permit a larger percentage of idle funds to be maintained in certain instances with SBA approval.

As in the proposed Regulation, this final rule [§ 107.903(d)] removes the exception [previously contained in [§ 107.1004(d)] of closing costs paid to an Associate from the requirement of prior SBA approval as a conflict of interest transaction. This change is not intended to prohibit, or to subject to prior SBA approval, the collection of closing costs by the Licensee and payment of such costs to the Associate, which was similarly permitted in § 107.1004(d) of the prior Revision 5.

Section 107.903(f) has been amended by substituting the word "equity" for the "net worth" as the basis for measuring the "de minimis" interest a "watchdog" director may personally have in a portfolio Small Concern without losing his or her eligibility as a "watchdog." The intent of the proposal was to make it possible for potential "watchdogs" to have a minimal interest in a Small Concern with an extremely small, or even a deficit, net worth, a situation particularly likely to occur in the case of start-up concerns.

Section 107.1001(a) has been rewritten to make clear that examinations of Licensees will be initiated by SBA and that Licensees must make all pertinent materials available for the conduct of such examination.

Section 107.1002(b)(1) has been changed to require, for SBA purposes, that certain records shall be preserved for twenty years instead of permanently.

Review for Executive Order 12291 and the Regulatory Flexibility Act.

For the purpose of Executive Order 12291, effective February 17, 1981, SBA hereby certifies that these final regulations, taken either individually or as a whole, do not constitute a major rule(s) within the meaning of the Executive Order.

For the purpose of the Regulatory Flexibility Act, 5 U.S.C. 601 et seq., SBA has determined that certain of these rules will have a significant economic impact on a substantial number of small businesses. These individual regulations are identified below, and a regulatory flexibility analysis for each is also provided.

1. Definition of Private Capital, § 107.3. Reason for action: On July 29, 1980, the Comptroller General issued a decision [59 Comp. Gen. 635], holding that SBA has no authority to leverage Federal Funds invested as Private Capital in SBICs unless the funds are made available under statutory authority which stipulates that such funds shall be included in private capital. A subsequent opinion of the Comptroller General dated January 30, 1981 [60 Comp. Gen. 210] specifically held that SBA is authorized to include certain Community Development Block Grant funds in the Private Capital of an SBIC. SBA has decided, based on these decisions, to recognize as Private Capital, for Leverage purposes, only those funds so mandated by statute and Community Development Block Grant funds invested in SBICs before August 16, 1982, which was the date of publication of this regulation in proposed form. However, on January 3, 1983, the United States District Court for the District of Columbia issued a judgment and order which, among other things, stipulated that for purposes of calculating the amount of Leverage for which Section 301(d) Licensees are eligible for purposes of section 303(c) of the Act, SBA shall not exclude from the term private paid in capital and surplus those funds received from Federal entities other than SBA. The Department of Justice is appealing this decision. Accordingly, the definition of Private Capital is being adopted with the proviso that SBA will provide leverage on Federal Funds as may be judicially mandated.

Objectives: To stimulate and supplement the flow of Private Capital and long-term loan funds to Small Concerns.

Public Comments: Five letters were received from the public objecting to the non-leveraging of Federal Funds.

Increased Recordkeeping: None.

Significant Alternatives: None.

2. Definition of Cost of Money, § 107.3. Reason for action: To eliminate confusion as to what elements will be considered in computing cost of money and to reduce the amount an SBIC may charge a Small Concern when purchasing a Debt Security.

Objective: To clarify for the SBIC industry and Federal examiners the elements and non-elements to consider in determining the cost of money and to provide a lesser cost of money for a Small Concern which is willing to give a portion of its equity to the investor.

Public Comments: Twelve letters were received from the public concerning the definition of Cost of Money. The concerns expressed by these letters were as follows: (1) That expenses incurred by the Small Concern paid to other than the SBIC or its Associate would be computed in the Cost of Money, (2) That the difference between the price paid for an Equity Security, option or warrant by an SBIC and the redemption price paid by the Small Concern may be construed to be an element of Cost of Money, and (3) That the proposed Cost of Money applicable to Debt Securities which was three percentage points less than that applicable to Loans would encourage SBICs to make Loans in a greater number than has been the practice of the industry.

SBA has revised the definition of Cost of Money taking into consideration the comments received and the revised definition clearly states that only consideration received by the SBIC or its Associate would be included in Cost of Money. References to redemption payments and distributions from retained earnings have been eliminated from the definition to assure that any profits received from the sale of Equity Securities, options or warrants would not be included in Cost of Money. SBA has also amended the maximum Cost of Money applicable to the purchase of Debt Securities by eliminating the requirement that they be subordinated and by increasing the percentage that an SBIC may charge from four percentage points above the FFB Rate to six percentage points.

Increased Recordkeeping: None.

Significant Alternatives: None.

3. Minimum Capital Standard § 107.101(d). Reason for action: To assure viability of SBICs.

Objective: To increase capital base of SBICs to assure greater viability. Public comments: Six letters were received from the public. Two of the comments expressed opinions that the minimum capital requirement should be not less than two million dollars instead of the proposed one million dollars. The other comments expressed opinions that it is possible for SBICs to be viable with capitalization of less than one million dollars. The final rule does not contemplate any change from the proposed one million dollar minimum capital.

Increased Recordkeeping: None.

Significant Alternatives: 1) To keep the current five hundred thousand minimum capital requirement. Based on its experience SBA is rejecting this alternative since it has found that this minimum is insufficient for viability. 2) To increase the minimum to two million dollars. Although SBA does not dispute the argument that a capital base of this size would assure greater viability of SBICs, it rejects this alternative since SBA is of the opinion, based on its experience with the program, that the one million capital base is adequate to assure a reasonable prospect that SBICs will be operated soundly and profitably, and managed actively and prudently in accordance with the Small Business Investment Act.

4. Minimum Period of Financing: § 107.301. Reason for action: To provide more long-term funds to Small Concerns.

Objectives: To make funds available on a longer term and to reduce the debt service for Small Concerns.

Public Comments: One hundred and eight letters were received, all of which protested the increase in the minimum period from five to seven years. The opinions expressed by these letters were that government was interfering with free market negotiations; that SBICs normally provide "risk" financings and the increased minimum period would increase the risk factor and the increased minimum period would dramatically alter the cash flow projections of the SBICs to their detriment; that no Small Concerns had complained that the current five year minimum was unduly burdensome; and that the majority of SBICs generally make Financings of seven years or more so there is no reason for a rule extending the minimum period.

After reviewing the comments, SBA is withdrawing the proposed rule extending the minimum period to seven years. SBA statistics of the SBIC industry regarding financing bear out the fact that SBICs do generally make financing for seven years or more. However, the proposed rule increased the minimum period of Financing to Disadvantaged Concerns from thirty months to five years and in the final rule the minimum period of financings to these Disadvantaged Concerns will be four years.

Increased Recordkeeping: None.

Significant Alternatives: Not applicable.

5. Proposed Overline Limit § 107.303. Reason for action: Encourage SBICs to make equity investments in Small Concerns.

Objective: To increase the number of equity investments by SBICs.

Public Comments: Two letters were received commenting on the proposed rule. The comments made were that once a Financing was made to a Small Concern based on appreciated marketable securities the size of the Financing should be legitimate regardless of the fluctuation of the price of the marketable securities. The SBA has determined that the final rule will be as proposed to insure that SBICs who avail themselves of this increased limit will do so with prudent judgment.

Increased Recordkeeping: SBICs who avail themselves of this rule will be required to maintain quarterly records in their files for SBA review.

Significant Alternatives: None.

6. Redemption Provisions § 107.321. Reason for action: To prevent redemption provisions detrimental to Small Concerns.

Objectives: To protect Small Concerns from exorbitant redemption requirements and to provide a just return to SBICs who purchase equity which has no market.

Public Comments: One hundred and fourteen letters were received regarding this proposed rule. Although most of the comments agreed in principle with the proposed rule, all argued that the formula proposed (book value per share or a multiple of net earnings or net operating income per share not to exceed a multiple of six) was too narrow and not appropriate, since the spectrum of the industries in which the SBICs invested was so broad and different industries used various means of determining the value of shares which would not fall within the proposed formula. After reviewing these comments and the examples which demonstrated that the proposed formula would not be workable, SBA revised the rule to eliminate the reciprocal redemption right and changed the formula by requiring that the redemption price must be determined by a formula which is legal and reasonable and based on book value or earnings of the Small Concern. SBA anticipates that the broader formula will meet all situations that may arise, however, should an SBIC invest in a Small Concern in an industry that is so unique that the final rule could not be accommodated, the SBIC may apply for a written exemption from this rule under § 107.1201, Exemptions.

Increased Recordkeeping: None.

Significant Alternatives: None.

7. Inactivity Standard, § 107.902. Reason for action: To provide SBA with an enforceable inactivity rule.

Objective: To require SBICs to be actively engaged in the purposes for which they have been licensed.

Public Comments: Thirty-six letters were received commenting on this proposed rule. None of the comments opposed the rule, however, all the comments pointed out that there were situations that could cause a SBIC to be in technical violation of this rule when they were in fact not inactive. Some examples put forth to demonstrate this were situations where an SBIC might receive a disproportionate number of prepayments, or an SBIC may raise additional capital, or receive Leverage from SBA, or sell equity of a Portfolio

Concern at an appreciated value. After considering these comments SBA has amended this rule by adding a proviso which will permit a SBIC, subject to SBA approval, to maintain a larger percentage of idle funds in appropriate cases.

Increased Recordkeeping: None.

Significant Alternatives: None.

Lists of Subjects in 13 CFR Part 107

Investment companies, Loan programs/business, Small businesses.

Accordingly, pursuant to authority contained in Section 308 of the Small Business Investment Act of 1958, as amended, [15 U.S.C. 687(c)], Part 107 of Title 13 of the Code of Federal Regulations is amended by revising §§ 107.1 through 107.1202. Appendices A, B, and C remain the same and are not affected.

(Catalogue of Federal Domestic Assistance Program No. 59.011, Small Business Investment Companies.)

Dated: August 4, 1983.

James C. Sanders,

Administrator.

[FR Doc. 83 26294 Filed 9-29-83; 8:45 am]

BILLING CODE 8025-01-M

Published: September 30, 1983
Effective: September 30, 1983
Cite: 48 FR 45014

PART 107—SMALL BUSINESS INVESTMENT COMPANIES

EDITORIAL NOTE: The following text of 13 CFR Part 107 is from the FEDERAL REGISTER of Sept. 30, 1983, at 48 FR 45017, as corrected at 49 FR 13864, Apr. 9, 1984.

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AUTHORITY: Sec. 308(c), 72 Stat. 694, as amended (15 U.S.C. 687(c)); sec. 312, 78 Stat. 147 (15 U.S.C. 687d); sec. 315, 80 Stat. 1364 (15 U.S.C. 687g).

SOURCE: 48 FR 45017, Sept. 30, 1983, unless otherwise noted.

REGULATIONS

§ 107.1 Scope of Part 107.

The regulations in this part implement Title III of the Small Business Investment Act of 1958, as amended. All Licensees, including section 301 (d) Licensees, must comply with all applicable regulations and appendices.[1]

[1] The accounting guidelines for SBICs include Audit Guide for SBICs, Guide for the Preparation of the Annual Report, SBA Form 468, and the System of Account Classification, and are set forth as Appendices A, B, and C to these regulations.

§ 107.2 Information, forms, instructions and captions.

All references in this Part to SBA forms, and instructions for their preparation, are to the current issue of such forms. The forms have been filed with the Office of the Federal Register with the original document. Copies may be obtained from SBA. Captions are used for convenience only and are not part of these regulations.

DEFINITIONS

§ 107.3 Definition of terms. [2]

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

Articles. "Articles" means articles of incorporation or charter for a Corporate Licensee and the partnership agreement or certificate for an Unincorporated Licensee.

Assistance. "Assistance" or "Assisted" means Financing of or Management Services rendered to a Small Concern by a Licensee pursuant to the Act and these regulations.

Associate of a Licensee. "Associate of a Licensee" means:

(a)(1) An officer, director, employee or agent of a corporate Licensee; (2) a Control Person, employee or agent of an Unincorporated Licensee; (3) a manager or Investment Adviser of any Licensee, which terms (manager or Investment Adviser) include any Person contracting with a Control Person of an Unincorporated Licensee to serve as manager or Investment Adviser to such Licensee, or (4) any Person regularly serving a Licensee on retainer in the capacity of attorney at law; or

(b) Any Person owning or controlling, directly or indirectly, ten percent or more of any class of stock of a Corporate Licensee or of the partnership capital of an Unincorporated Licensee;

(c) Any officer, director, partner, manager, or employee of any Associate described in paragraph (a) or (b) of this definition: *Provided, however,* That subject to paragraph (b) of this definition, a Person with no other relationship to any Associate described in paragraph (a) or (b) of this definition but that of a limited partner shall not be considered an Associate of such Associate.

(d) Any Person which directly or indirectly Controls or is Controlled by, or is under common Control with, a Licensee or any Person described in paragraphs (a) and (b) of this definition; or

(e) Any Close Relative of any Person described in paragraphs (a) and (b) of this definition; or

[2] Terms defined in this section are capitalized hereafter.

(f) Any concern in which (1) any Person described in paragraphs (a) through (e) of this definition is an officer of director or (2) any such Person (or group of two or more such Persons acting in concert) who owns or Controls, directly or indirectly, a ten or more percent equity interest (exclusive of any interest attributable solely because of ownership of an equity interest in the Licensee).

(g) For the purposes of this definition, any Person in any of the relationships described in paragraphs (a) through (f) of this definition within six months before or after the date on which the Licensee provided Assistance, shall be deemed to have been in such relationship as of the date of the Licensee's Assistance.

(h) A Section 301(d) Licensee and a participant Licensee owning stock thereof, or securities evidencing a contribution to the partnership capital thereof, pursuant to § 107.712 as well as Associates of such section 301(d) Licensee and such participant Licensee shall be deemed Associates of each other.

Close relative. "Close relative" means ancestor, lineal descendant, brother or sister and lineal descendants of either, spouse, aunt, uncle, father-in-law, mother-in-law, son-in-law, brother-in-law, daughter-in-law, or sister-in-law.

Control. "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 a Small Concern whether through the ownership of voting securities, by contract, or otherwise.

Control Person. "Control Person" means (a) a general partner of an Unincorporated Licensee, including all general partners of a partnership serving as general partner of an Unincorporated Licensee; (b) any officer, director, agent or employee of a corporate general partner of an Unincorporated Licensee, including any corporation that is a general partner in a partnership serving as general partner of an Unincorporated Licensee; and (c) any Person owning 10 percent or more of the stock of a corporate general partner of an Unincorporated Licensee.

Cost of Money. Generally, cost of money includes the total consideration given to a Licensee and its Associates by, or for the benefit of, the Small Concern, such as interest, discounts, points, fees, commissions, closing costs and any other thing of value given for financings in the form of Loans and Debt Securities and shall be prorated over the stated term of the financing. Cost of Money does not include fees for management services pursuant to § 107.501, bona fide commitment fees pursuant to § 107.402, or prepayment penalties pursuant to § 107.301(a). *Provided, however,* That if a Licensee has imposed a front end charge, such charge shall be prorated over the stated term of the financing. In that case, the sum of interest, unearned charges, and prepayment penalties shall not exceed the cost of money limit in effect at the time of the financing; and in the event of prepayment any excess shall be returned to the Small Concern.[3]

Corporate License: see Licensee.

Debt Securities. "Debt securities" means securities evidencing a Loan with options or any right to acquire Equity Securities in a Small Concern or its affiliates (as defined in § 121.3-2) or which are convertible to such equity position.

Debtor Licensee. "Debtor Licensee" means a Licensee which has Leverage from SBA.

Disadvantaged Concern. "Disadvantaged Concern" means a Small Concern owned by a person or persons whose participation in the free enterprise system is hampered because of social or economic disadvantages.

Equity Securities. "Equity Securities" means stock of any class in an incorporated Small Concern, or limited partnership interests in an unincorporated Small Concern or joint venture interests. Equity Securities redeemable in a manner other than provided in § 107.321 shall be considered Loans.

FFB Rate. "FFB Rate" means the interest rate, as published from time to time in the Federal Register by SBA, for ten year debentures sold by Licensees to the Federal Financing Bank (FFB).

Financing. "Financing" or "Financed" means outstanding financial assistance provided to a Small Concern by a Licensee, whether through (a) Loans, (b) guaranties, (c) Debt Securities, (d) Equity Securities, (e) commitments or (f) purchases of securities of a Small Concern through or from an underwriter. (see § 107.404).

Investment Adviser/Manager. "Investment Adviser/Manager" of a Licensee means any person who pursuant to written contract executed in accordance with the provisions of § 107.709 furnishes advice or assistance with respect to operations of a Licensee.

Lending Institution. "Lending Institution" means a concern operating under regulations of a state or Federal licensing, supervising, or examining body and which 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. "Leverage" means financial assistance provided to a Licensee by SBA, either through the purchase or guaranty of debentures, or through the purchase of preferred securities (see §§ 107.201 through 107.205).

Licensee. "Licensee" means either a corporation ('Corporate Licensee'), or a limited partnership organized pursuant to § 107.4 ('Unincorporated Licensee'), to which a license has been granted pursuant to the Act. For section deeming ' Licensee' to include the corporate general partner of an Unincorporated Licensee, see § 107.4(b)(2).

Loan. "Loan" means a debt with no provision for the Licensee to acquire Equity Securities.

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

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

Person. "Person" means a natural person or legal entity.

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

Portfolio Concern. "Portfolio Concern" means a Small Concern Assisted by a Licensee.

Private Capital. On and after August 16, 1982, "Private Capital" for licensing, Leverage and regulatory purposes means the combined private paid-in capital and paid-in surplus of a Corporate Licensee, or in the case of an Unincorporated Licensee, the partnership capital. Private Capital does not include Leverage provided by SBA, funds borrowed by a Licensee from any source, or funds invested by any State or any subdivision or instrumentality of a State, or funds invested directly or indirectly by any other Federal governmental entity ("public funds"); *Provided, however,* that for licensing, Leverage and regulatory purposes Private Capital shall include Federal funds invested in a Licensee pursuant to a statute, such as 42 U.S.C. § 9815, which expressly requires that such funds invested in a Licensee shall be included in Private Capital; and *Provided further,* that for Leverage and regulatory purposes only, Private Capital shall include Community Development Block Grant funds invested in a Licensee pursuant to the Housing and Community Development Act of 1974 not later than August 16, 1982, and such other public funds received from Federal governmental entities as may be judicially mandated.

[3] The SBA will use the latest edition of the *Financial Compound Interest and Annuity Tables,* Financial Publishing Company, Boston, Mass. 02215, in computing Cost of Money charged Small Concerns by SBICs.

Real Estate Investment. "Real Estate Investment" means a Licensee's Financing of a Small Concern which is classified as a real estate concern under Industry Numbers 6531, 6541 and 6552 of the SIC Manual. For restrictions governing Real Estate Investments, see §§ 107.101(c) and 107.901(c).

SBA. "SBA" means the Small Business Administration, 1441 L Street, N.W., Washington, D.C. 20416.

Section 301 (d) Licensee. "Section 301 (d) Licensee" means a Licensee organized under a State business or nonprofit corporation statute, or a limited partnership organized pursuant to § 107.4, and licensed pursuant to Section 301(d) of the Act, the investment policy of which is limited to making investments solely in small concerns which will contribute to a well balanced national economy by facilitating ownership in such concerns by persons whose participation in the free enterprise system is hampered because of social or economic disadvantages.

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

SIC Manual. "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.[4]

Small Concern. "Small Concern" means a small business concern as defined in section 103(5) of the Act (including affiliates as defined in § 121.3-2 of this chapter), which for purposes of size eligibility, meets the applicable criteria set forth in § 121.3-11 of Part 121 of this chapter.

Unincorporated Licensee: see Licensee.

§ 107.4 Limited partnership SBIC.

(a) *General.* 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 pursuant to Section 301(c) or Section 301 (d) of the Act.

(b) *Application.* The following requirements shall apply to an application submitted by or on behalf of a limited partnership:

(1) *Number of General Partners.* Unless the applicant has a corporate general partner, it shall not have fewer than two individual general partners initially, and thereafter for not more than sixty days at any one time. Some or all of the general partners may be members of a separate partnership that serves as a general partner of such Licensee; but all general partners of such separate partnership shall be considered for all purposes to be general partners of the Unincorporated Licensee. A limited partnership may not serve as a general partner of an Unincorporated Licensee.

(2) *Corporate General Partner.* A corporate general partner shall be organized under State law solely for service as such and its Articles (which shall accompany the License Application) shall specify that no person shall serve as an officer or director without SBA's approval. No corporate general partner may serve as such for any other Licensee. The corporate capital of such general partner which is not invested in the Unincorporated Licensee shall be invested only as permitted by the last sentence of section 308(b) of the Act, pursuant to § 107.708 or in accordance with § 107.903(c), or any of them. A corporate 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 § 107.203(b)(2) and (3)(iii) and by §§ 107.601, 107.603, 107.701, 107.702, 107.703, 107.708, 107.709, 107.801, 107.802, 107.803, 107.1001, 107.1002, and 107.1004 apply also to a corporate general partner of a Licensee.

(3) *Articles of Partnership.* The Articles shall be transmitted to SBA with the application and shall provide that (i) the partnership shall have a duration of not less than thirty years unless sooner dissolved by the partners; (ii) no general partner may be removed or replaced by the limited partners without prior written approval of SBA; and (iii) any transferee of, or successor in interest to, a general partner shall have only the rights and liabilities of a limited partner pending SBA's written approval of such transfer or succession.

(c) *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 §§ 107.602, 107.701 and 107.1004 includes a Control Person of a Licensee. The term "Licensee" as used in § 107.1101 includes only a general partner. The events of default specified in §§ 107.203(b)(1) (ii), (iii) and (iv) and in § 107.203(b)(2) shall apply to all general partners; the events of default specified in § 107.203(b)(4) shall apply to all Control Persons. The events of default enumerated in the preceding sentence shall be deemed to have been agreed to by the Unincorporated Licensee.

(d) *Liability of general partner for partnership debts to SBA.* Subject to section 314 of the Act, the general partner of an Unincorporated Licensee shall not be liable solely by reason of its status as a general partner for repayment of any debts owed by the Licensee to SBA unless SBA, in the exercise of reasonable investment prudence, and with regard to the financial soundness of such Unincorporated Licensee, shall determine otherwise prior to the purchase or guaranty of such Unincorporated Licensee's debentures.

(e) *Reorganization of Corporate Licensee.* A corporate Licensee wishing to reorganize as an Unincorporated Licensee, or an Unincorporated Licensee wishing to reorganize as a Corporate Licensee, may apply to SBA for approval pursuant to § 107.803 of these Regulations.

OPERATIONAL REQUIREMENTS

§ 107.101 Operational requirements.

All Licensees shall comply with the following requirements:

(a) *Management.* Each Licensee shall have and maintain qualified management (including management pursuant to § 107.709) in charge of its operations who will be available at its office to the public. A manager of a Licensee shall be deemed an officer.

(b) *Office.* The Licensee shall maintain a reasonably accessible office, which will display the license, and the name of the Licensee, have a listed telephone number, and be open to the public during regular business hours.

(c) *Diversified investment policy-real estate and motion pictures.* Unless specifically authorized in writing by SBA:

(1) *General rule.* No Licensee shall maintain more than one-third of its portfolio, as of the close of any full fiscal year, in: (i) Permitted real estate investments, or (ii) investments in Small Concerns engaged in motion picture production and distribution (classified under Industry Nos. 7813, 7814, 7823, and 7824 of the SIC Manual). For further provisions governing real estate investments, see §107.901(c). For statement of general policy concerning motion picture specialist-Licensees, see 42 FR 60729, November 29, 1977.

(2) *Licensees other than real estate specialists.* Where a Licensee does not operate as an approved real estate specialist subject to paragraph (c)(3) of this section, its investments in Small Concerns classified under Major Groups 15, 65 and/or 70 of the SIC Manual shall not exceed one-third of its Portfolio in any one such Major Group, nor two-thirds for any combination of such Major Groups, as of the close of any full fiscal year.

(3) *Real estate specialists.* Where a Licensee maintains more than one-third of its Portfolio in Real Estate Investments pursuant to an investment policy approved by SBA, the total of its investments in Small Concerns classified under Major Group 15 (Building

[4] As of the effective date of this Revision 6 the latest issue of the SIC Manual was 1972.

Construction-General Contractors and Operative Builders) and Major Group 70 (Hotels, Rooming Houses, Camps and Other Lodging Places) of the SIC Manual shall not exceed twenty percent of its Portfolio as of the close of any full fiscal year.

(4) *Prepayments.* Prepayments of outstanding Financing or similar events occurring beyond the control of the Licensee within the fiscal year shall be disregarded in determining whether the Licensee meets the foregoing requirements as of the close of its fiscal year.

(d) *Minimum Capital.* Every Licensee shall have:

(1) Private Capital of at least $1,000,000: *Provided, however,* That this $1,000,000 minimum capital requirement shall not apply with respect to any license application on file with SBA on the date of publication of this regualtion in final form nor with respect to any license issued on the basis of such application. Licensees licensed on or after October 1, 1979 and before the effective date of this regulation shall have a Private Capital of at least $500,000; Licensees licensed prior to October 1, 1979 shall have a Private Capital of at least $150,000; and

(2) Taking additional resources into account, adequate capital to assure a reasonable prospect that it will be operated soundly and profitably, and managed actively and prudently in accordance with the Act and regulations.

(e) *Borrowed funds.* Persons owning directly or indirectly, beneficially or of record, an equity interest of ten or more percent of a Licensee's Private Capital may not use borrowed funds in purchasing such interest, unless the net worth of such person is at least twice the amount borrowed, or unless such person obtains SBA's prior written approval of a lesser ratio on the grounds that it is adequate in light of all the circumstances.

LICENSE

§ 107.102 License application and fees.

(a) *Initial Application.* The license application shall be submitted on SBA Form 415 (OMB Approval No. 3245-0062) together with a processing fee of $5,000 in accordance with accompanying instructions.

(b) *Post-licensing changes.* A processing fee of $200 shall accompany each request for approval, not subject to § 107.601, of a new officer, director, Control Person or owner of ten or more percent of the Licensee's Private Capital.

§ 107.103 Public notice

SBA shall publish notice of the license application in the FEDERAL REGISTER. It shall include such appropriate information as the name and location of the proposed Corporate Licensee, its area of operation, the names and addresses of its officers, directors, and owners of, or persons controlling 10 or more percent of its voting stock; and in the case of an Unincorporated Licensee, its name, location, and area of operation, and the names and addresses of its Control Persons. If any Control Person is a corporation, the notice shall set forth the names and addresses of any officers, directors, and owners of, or persons controlling 10 percent or more of the stock of such corporation. In the case of an Unincorporated Licensee, the notice shall also include the name and address of each owner of 10 percent or more of the Licensee's Private Capital. The public shall be afforded reasonable opportunity for the submission of written comments. The proposed Licensee shall publish a similar notice in a newspaper of general circulation in the city or proposed area of operation, and shall furnish a certified copy to SBA within 10 days of the date of publication.

§ 107.104 Transferability of license.

A license shall not be transferred in any manner without SBA's prior written approval.

§ 107.105 Surrender of license.

A License shall not be surrendered without SBA's prior written approval. Request for approval shall be accompanied by an offer of immediate repayment of all Leverage, or by a plan satisfactory to SBA for the orderly liquidation thereof. Upon receipt of Licensee's request, SBA may remove Licensee's name from published lists of Licensees, and may conduct an examination or investigation of its affairs pursuant to section 310 of the Act.

BORROWING BY LICENSEE

§ 107.201 Funds to licensee.

(a) *Application procedure.*—(1) *Licensees other than Section 301(d) Licensees.* A Licensee (other than a Section 301(d) Licensee) may apply for Leverage pursuant to section 303(b) of the Act on SBA Form 1022 in accordance with accompanying instructions. Applications for Leverage must be accompanied by evidence demonstrating to SBA's satisfaction the need therefor. Prior to the extension of any Leverage, an Unincorporated Licensee must furnish SBA with a ruling by the Internal Revenue Service that it qualifies as a partnership for tax purposes: *Provided, however,* That where a delay in obtaining an IRS ruling would cause a hardship to the Licensee, SBA may, pending receipt of such a ruling, make leverage funds available under interim financial arrangements which in SBA's judgment are satisfactory to protect SBA's creditor or guarantor position from an adverse IRS determination.

(2) *Section 301(d) Licensees.* A Section 301(d) Licensee may apply for Leverage pursuant to section 303(c) of the Act [5] on SBA Form 1022A (for purchase of preferred securities and debentures), on SBA Form 1022B (for exchange of debentures for preferred securities), or on SBA Form 1022 (for guaranty of debentures) in accordance with accompanying instructions. Applications for Leverage must be accompanied by evidence demonstrating to SBA's satisfaction the need therefor.

(b) *SBA Guaranty.*

(1) SBA may in its discretion agree to guaranty a Licensee's debentures unconditionally, irrespective of the validity, regularity or enforceability of such debentures or any other circumstances which might constitute a legal or equitable discharge or defense of a guarantor and, pursuant to its guaranty, to make timely payments of principal and interest, irrespective of any default by the issuing Licensee or acceleration of the maturity thereof by SBA.

(2) Persons interested in providing funds to Licensees under such guaranty may notify SBA by letter, certifying whether such lender has a direct or indirect beneficial interest of ten or more percent of the actual or potential voting rights in any Licensee, or in any person directly or indirectly controlling, controlled by or under common control with, any Licensee. Such certification will not be required from lenders where the borrowing Licensees will be selected or approved by SBA or its agents. SBA will endeavor to match such offers with applications pursuant to paragraph (a) of this section but cannot assure that such offers will be accepted. SBA in its discretion may also arrange for public or private financings under its guaranty authority. These reporting requirements are approved under OMB No. 3245-0081.

(3) No SBA guaranty shall be extended to a lender:

(i) Having a direct or indirect beneficial interest of ten or more percent in the Private Capital of the Licensee to be guaranteed, or in any Person directly or indirectly controlling, controlled by, or under common control with, such Licensee; or

(ii) Having such interest involving another Licensee which has received or is about to receive pursuant to any understanding, arrangement, cross-dealing, reciprocal or circular arrangement any direct or indirect financing (or a commitment for financing) from another lender with SBA's guaranty.

[5] Section 303(c) of the Act authorizes SBA to purchase nonvoting preferred securities, and to purchase or guaranty debentures issued by Section 301(d) Licensees, which may be subordinated in accordance with Section 303(b) of the Act.

SBA may void any guaranty obtained in violation of this paragraph (b)(3), but the foregoing shall not apply to lenders whose borrowers are selected or approved by SBA or its agents.

§ 107.202 Leverage in excess of three hundred percent.

(a) *Qualification.* In order to qualify for Leverage exceeding three hundred percent of Private Capital, at least sixty-five percent of the Licensee's Total Funds Available for Investment must be invested (or committed) in Venture Capital Financing of Small Concerns: *Provided, however,* That section 301(d) Licensees shall have thirty percent so invested.

(b) *Venture Capital Financing.* "Venture Capital Financing" shall mean:

(1) Equity Securities as defined in § 107.3 with no repurchase requirement for five years, except as may be specifically approved by SBA under § 107.801 for purposes of relinquishing Control over a Small Concern.

(2) Any right to purchase Equity Securities.

(3) Debt Securities or Loans which are subordinated by their terms to all borrowings of the issuer, except borrowings from officers, directors and owners of the Small Concern, or Close Relatives thereof, and have no part amortized during the first three years.

(c) *Total Funds Available for Investment.* The term "Total Funds Available for Investment" shall mean ninety percent of the sum of total current assets and loans and investments on a cost basis net of current maturities. (Based on the Statement of Financial Position, "total current assets" is the aggregate of lines 14 through 23 and "loans and investments on a cost basis net of current maturities" is line 10, column 1 less line 11.) Venture capital investments shall be valued on the same basis as Licensee's assets comprising its "Total Funds Available for Investment". A Financing carried as "assets acquired in liquidation of portfolio securities" or "operating concerns acquired" which originally qualified as venture capital shall retain the venture capital qualification.

(d) *Maintenance of Ratio.* The ratio prescribed by paragraph (a) of this section shall be maintained as of the end of each fiscal year: *Provided, however,* That prepayment of venture capital investments, raising additional Private Capital and additional Leverage recently provided shall be disregarded in determining whether the Licensee meets the foregoing requirements as of the close of its fiscal year. Failure to maintain the ratio prescribed by this section shall be a violation of these regulations.

§ 107.203 SBA purchase, sale, or guaranty of securities evidencing Leverage; events of default.

(a) *SBA Disposal of Securities.* SBA may, upon such conditions and for such consideration as it deems reasonable, sell, assign, transfer, or otherwise dispose of any preferred security, debenture, or other security held in connection with Leverage. In such event and upon notice thereof by SBA, Licensee will make all payments of principal and of dividends or interest as shall be directed by SBA. Licensee shall hold SBA harmless from all damage or loss which SBA may sustain by reason of such disposal, limited, however, to the extent of Licensee's liability under such security, plus court costs and reasonable attorney's fees incurred by SBA.

(b) *Leverage Conditions: General.* A Licensee issuing debentures pursuant to section 303 (b) and (c) of the Act after May 2, 1972, or preferred securities after August 16, 1982, shall be deemed to have agreed to the following terms and conditions, as in effect at the time of such issuance and as if fully set forth in such debentures or preferred securities:

(1) Upon written notice by SBA, the entire indebtedness and/or the principal amount of preferred securities of the Licensee issued to, held or guaranteed by SBA may be declared immediately due and payable to SBA upon the happening of any one or more to the following events:

(i) Default in the payment of the principal or interest, under any debenture, note or obligation of the Licensee, issued to, held or guaranteed by SBA;

(ii) Nonperformance or violation by the Licensee, as determined by SBA, of any one or more of the terms and conditions of any loan, obligation or preferred security of the Licensee, issued to, held or guaranteed by SBA, or of any agreement with or conditions imposed by SBA;

(iii) Failure of the Licensee, as determined by SBA, to comply with any one or more of the provisions of the Act or regulations promulgated thereunder, as they may be amended from time to time;

(iv) Failure of the Licensee to notify SBA within twenty days from the date of an event of default or nonperformance by the Licensee under any debenture, note or indebtedness of the Licensee issued to or held by anyone other than SBA.

(2) The entire indebtedness and principal amount of preferred securities of the Licensee issued to, held or guaranteed by SBA shall immediately become due and payable to SBA without notice, presentation or demand, whenever:

(i) Licensee is insolvent; or

(ii) Not having sufficient property to pay all of its debts, Licensee makes a voluntary assignment thereof; or

(iii) Licensee makes any transfer or incurs any obligation that is fraudulent under the terms of 11 USC 548; or

(iv) A petition is filed in commencement of any bankruptcy or reorganization proceeding, receivership, dissolution or other similar creditors' rights proceeding, by or against the Licensee, whichever event shall first occur.

(3) Except with the prior written consent of SBA, Licensee shall not:

(i) Repurchase or retire any of its Private Capital, except as permitted by § 107.802; or

(ii) Make any distribution to its shareholders or partners other than periodic payments out of retained earnings based on the capital contributions of the recipient; or

(iii) Increase the aggregate amount of salaries or other compensation of officers, directors, or employees beyond the amount previously approved by SBA. In applying this provision, compensation to officers, directors, or employees of a wholly-owned corporation shall be deemed paid by the Licensee.

(4) Except with the prior written consent of SBA, Licensee will not employ or tender any offer of employment to, or retain for professional services, for a period of two years after the date of the latest debenture or preferred security issued by Licensee pursuant to section 303 (b) and (c) of the Act (or any SBA assistance as defined in Part 105 of this chapter) any person who on or within one year prior to said date:

(i) Shall have served as an officer, attorney, agent, or employee of SBA; and;

(ii) As such, shall have occuped a position or engaged in activities which SBA shall have determined involved discretion with respect to the granting of assistance under the Act.

(5) Any failure on the part of SBA at any time to require the performance by Licensee of any one or more of the terms or provisions of any debt instrument or preferred security of Licensee issued to, held, or guaranteed by SBA shall in no way affect SBA's right thereafter to enforce the same, nor shall the waiver by SBA of any term or provision of any debt instrument or preferred security of Licensee issued to, held, or guaranteed by SBA be taken or held to be a waiver of any succeeding breach of any such term or provision.

(6) If the Licensee fails to maintain either the capital requirement or the investment ratio requirement under section 303(b)(2) of the Act, and the regulations promulgated thereunder from time to time, then the aggregate amount of the outstanding indebtedness evidenced by any debt instruments or principal amount of pre-

ferred securities issued to, held, or guaranteed by SBA which exceeds the maximum amount permitted under section 303(b)(1) shall (subject to the provisions of § 107.202(d)), and upon written notice by SBA, be immediately due and payable to SBA. In the event of such acceleration of payment, SBA in its sole discretion shall determine which preferred securities or debenture instrument or instruments, or parts thereof, shall be subject thereto.

(7) The debentures hereafter issued by a Licensee pursuant to section 303(b) of the Act, and SBA's claims relating thereto, shall be subordinate to all other debts of the Licensee unless such debentures provide otherwise, but shall have priority over all ownership interest in the Licensee upon any dissolution, winding-up, liquidation or reorganization of the Licensee.

(c) *Debenture Conditions. Section 301(d) Licensees.* Paragraph (b) of this section shall be applicable to section 301(d) Licensees obtaining Leverage pursuant to section 303(c) (1) or (2) of the Act: *Provided, however,* That the capital and investment ratio requirements referred to in paragraph (b)(6) shall be those prescribed by section 303(c) of the Act and § 107.202(a) of these regulations.

(d) *Capital Impairment.* In addition to the events of default set forth in paragraph (b) of this section, capital impairment occurring after November 7, 1973 (or, in the case of a section 301(d) Licensee, ninety days from September 30, 1983, shall also constitute an event of default if Licensee fails to give SBA prompt written notice as soon as it knows or should reasonably have known thereof, or if, following such notice, Licensee fails to cure the impairment within time limits set by SBA in writing; *Provided, however,* That a Section 301(d) Licensee whose undistributed net realized earnings deficit exceeds seventy-five percent of private capital within ninety days after September 30, 1983 shall not be deemed capitally impaired for a period of five years after September 30, 1983 unless, during such five-year period, its undistributed net earnings deficit shall exceed 100 percent of private capital. In either such event, SBA may, in its discretion, by written notice declare the entire principal amount of preferred securities and indebtedness of the Licensee, issued to, held or guaranteed by SBA, immediately due and payable. Capital impairment shall be deemed to exist when the undistributed net realized earnings deficit of a section 301(d) Licensee exceeds seventy-five percent, or that of any other Licensee exceeds fifty percent of Private Capital. Treasury stock shall be deducted from paid-in capital stock and paid-in surplus in determining Private Capital. Where unrealized appreciation is not sufficient to offset unrealized depreciation on loans and investments, the resulting unrealized loss on securities held will reduce undistributed net realized earnings.

§ 107.204 Collection or compromise of SBA claims.

SBA may, upon such conditions and for such consideration as it deems reasonable, collect or compromise all claims relating to preferred securities or obligations held or guaranteed by SBA, and all legal or equitable rights accruing to it.

§ 107.205 Leverage for Section 301(d) Licensees.

(a) *General.* SBA may provide Leverage to any section 301(d) Licensee through the purchase or guaranty of debentures, or to a section 301(d) Licensee organized as a corporation, through the purchase of nonvoting preferred stock (or nonvoting preferred securities other than stock, but only if applicable law precludes the issuance of nonvoting preferred stock) pursuant to application filed under § 107.201(a)(2).

(b) *Charter requirements for Leveraging.* No Leverage will be extended to any section 301(d) Licensee unless the following matters are appropriately provided for in the Licensee's articles:

(1) *Investment Policy.* Statement of Investment Policy in conformity with section 301(d) of the Act.

(2) *Prior SBA approval to amend articles.* The articles shall not be amended without SBA's prior written approval.

(3) *Additional requirements for nonvoting preferred securities Leverage.* No nonvoting preferred securities may be purchased by SBA from any corporate section 301(d) Licensee unless its articles make appropriate provision for the following additional matters:

(i) *Payment of dividends to SBA.* Subject to the sound discretion of the board of directors, SBA shall be paid from retained earnings an annual three percent dividend on the par value of its preferred securities. Such dividends shall be payable before any amount shall be set aside for or paid to any other class of stock, and shall be preferred and cumulative, so that in the event SBA has received less than three percent in any fiscal year, such dividends shall be payable on a preferred basis from subsequent retained earnings without interest thereon. Before any declaration of dividends or any distribution (other than to SBA), all dividends accumulated and unpaid on preferred securities issued to SBA shall be paid.

(ii) *Redemption rights.* A section 301(d) Licensee shall be entitled at its option to redeem in whole or in part preferred securities purchased by SBA, on any dividend date (after giving SBA at least thirty days written notice) by paying SBA the par value of such securities, but not less than $50,000 par value in any one transaction, and any dividends accumulated and unpaid to the date of redemption.

(iii) *Redemption, liquidation, or distribution of assets.* Before any redemption of securities not purchased by SBA, or liquidation in whole or in part, or any distribution of assets to other stockholders, SBA shall be paid any amounts due pursuant to paragraph (b)(3)(i) of this section, and the par value of its preferred securities; *Provided, however,* That such par value need not be paid to SBA before the distribution of ordinary dividends from retained earnings.

(c) *Sale of debentures to SBA.* Debentures purchased by SBA but not debentures guaranteed by SBA pursuant to section 303(c) of the Act, shall be entitled to a reduced interest rate determined according to section 317 of the Act. Such debentures shall specify the interest rates prescribed by sections 317 and 303(b) of the Act, together with the dates between which each applies. With respect to payment of interest SBA shall have the same priority as applies to debentures purchased or guaranteed under section 303(b) of the Act.

(d) *Preferred Securities Leverage in Excess of 100 percent*—(1) *General.* Subject to the following restrictions, SBA is authorized to purchase preferred securities in amounts in excess of 100 percent of Private Capital, but not in excess of 200 percent of Private Capital:

(i) From any corporate section 301(d) Licensee licensed on or before October 13, 1971; or

(ii) From any corporate section 301(d) Licensee licensed after October 13, 1971, and having Private Capital of $500,000 or more. SBA has no authority to purchase preferred securities in excess of 100 percent of Private Capital from any corporate section 301(d) Licensee licensed after October 13, 1971, if the private Capital of such Licensee is less than $500,000.

(2) *Qualified Investments.* In no event shall the amount of preferred securities purchased by SBA in excess of 100 percent of Private Capital exceed the amount of the Licensee's funds invested in, or legally committed to, qualified investments. As used herein, "qualified investments" means, subject to §§ 107.320 and 107.801, stock of any class (including preferred stock) or limited partnership interests in eligible small concerns, or shares of any eligible syndicate, business trust, joint stock company or association, mutual corporation, cooperative or other joint venture for profit; or unsecured debt instruments which are subordinated by their terms to all other borrowings (as distinguished from all other debts and obligations) of the issuer.

(3) *Maintenance of Qualified Investment Portfolio.* Any Licensee that has sold preferred securities to SBA in excess of 100 percent of its Private Capital shall maintain its portfolio of "qualified investments" at not less than the amount of such preferred securities. If, as of the end of its fiscal year, the amount of such Licensee's "qualified investments" is less than the amount required by this paragraph (d)(3) the Licensee shall be deemed in violation of these regulations unless the Licensee redeems promptly such excess securities, or unless SBA shall authorize temporarily a lesser amount of "qualified investments."

(e) *Exchange of outstanding debentures for Preferred Stock.*

(1) Subject to the conditions applicable to the issuance of preferred securities to SBA, a section 301(d) Licensee may, in SBA's discretion, retire debentures against issuance of preferred securities to SBA. A section 301(d) Licensee proposing to exchange its outstanding debentures shall be required to pay SBA all unpaid interest accruing to the date of the exchange.

(2) Notwithstanding the provisions of the preceding paragraph, debentures purchased or guaranteed by SBA on the basis of funds not includible in Private Capital, as defined in § 107.3, may not be retired against issuance of preferred stock on or after August 16, 1982. Such debentures, to the extent purchased or guaranteed by SBA on the basis of ineligible funds, shall be paid at maturity. SBA may at its discretion extend such maturity, not to exceed fifteen (15) years from the date of issuance if necessary for an orderly liquidation.

(f) *State law.* SBA does not intend that provisions of this section not mandated by the Act shall supersede existing State law. Whenever a party claims that a conflict exists, it shall submit an opinion of independent counsel, citing authorities, for SBA's resolution of the issues involved.

Financing of Small Concerns (Loan and Debt Financing; Equity Capital Financing; Guaranties and Commitments)

§ 107.301 Financing term and amortization.

(a) *Minimum period of Financing.* Except as otherwise provided for in these regulations, Financings of Disadvantaged Concerns may be made for a minimum period of four years, the aggregate of such Financings for less than five years not to exceed fifty percent of the Licensee's Portfolio at the end of any fiscal year, determined without regard to prepayments (or similar events beyond the Licensee's control) which occur during that fiscal year,[6] but all other Financings shall be for a minimum period of five years. Voluntary prepayment shall be permitted at any time, but a reasonable prepayment penalty may be agreed upon. (See definition of Cost of Money § 107.3). Any other restriction on prepayment shall require SBA's prior written approval.

(b) *Maximum amortization.* Amortization during the first five years (or during the first three years of an authorized Financing for at least four years) shall not be required at a rate exceeding an accumulated average based on the straight line method of amortization.[7]

§ 107.302 Cost of Money; Loans and Debt Securities.

Subject to lower ceilings prescribed by local law, Cost of Money on Loans and Debt Securities shall not exceed the following:

(a) *Loans.* (1) If the current FFB Rate is 8 percent per annum or lower, Cost of Money shall not exceed 15 percent.

(2) If the current FFB Rate is in excess of 8 percent per annum, Cost of Money shall not exceed the sum of the current FFB Rate plus 7 percentage points, but rounded off to the next lowest eighth of one percent.

(b) *Debt Securities.* (1) If the current FFB Rate is 8 percent per annum or lower, Cost of Money shall not exceed 14 percent.

(2) If the current FFB Rate is in excess of 8 percent per annum, Cost of Money shall not exceed the sum of the current FFB Rate plus 6 percentage points, but rounded off to the next lowest eighth of one percent.

(c) *Ceiling on specific Financing.* The maximun Cost of Money on any specific Financing shall be determined with reference to the FFB Rate in effect at the time of first disbursement or when a legally binding written commitiment was issued ("current FFB Rate") whichever shall first occur. A fluctuating interest rate is nevertheless subject to the maximum Cost of Money limitation in effect at the time of commitment, or of first disbursement if no legally binding written commitment was issued.

(d) *Applicability to existing Financings.* The maximum annual Cost of Money on any Financing made or committed before April 16, 1980 shall in no event exceed the lesser of 15 percent or any lower rate prescribed by local law.

(e) *Commitments.* All commitments for Financing are subject to the provisions of § 107.402.

[6] For other short-term financing and amortization, see § 107.403(b) (1) and (2).

[7] (Ibid.)

§107.303 Overline limitation.

(a) *General.* Without written SBA approval, the aggregate amount of funds disbursed for securities acquired (exclusive of write-down), and of commitments and guaranties issued for a Small Concern (including affiliated concerns as defined in § 121.3-2 (a) of this Chapter) shall not exeed twenty percent of Licensee's Private Capital: *Provided, however,* That for section 301(d) Licensees the limitation shall be thirty percent.

(b) *Increased Limit.* For purposes of this section only, Private Capital may include the net unrealized gains of a Licensee represented by marketable securities and support an additional overline limitation ("increased limit") subject to the following conditions:

(1) "Marketable securities" means securities that are traded on a regulated stock exchange, or that are listed in the Automated Quotation System of the National Association of Securities Dealers (NASDAQ), or that have, at a mimimum, at least three market makers as defined in Section 3(a)(38) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(38)) one of which has offices in at least ten States.

(2) Unrealized losses on marketable and unmarketable securities must be deducted from unrealized gains on marketable securities (net unrealized gains).

(3) Valuation of marketable securities shall be at the lowest bid price.

(4) Licensee must have positive retained earnings (undistributed net realized earnings less allowances for losses on loans and investments).

(5) At the time of the first use of this subsection, and thereafter as of the first business day of each calendar quarter as long as Licensee avails itself of this increased limit, it shall retain in its files copies of the NASDAQ listings (or the Wall Street Journal) or written quotations from the market makers quoting the marketable securities which support the increased limit.

(6) By availing itself of this increased limit, Licensee agrees that, in the event the net unrealized gains show a reduction on the first business day of any calendar quarter and for at least thirty days thereafter, below seventy percent of the net unrealized gains, Licensee will (not later than ninety (90) days from such date) cause to be injected sufficient private Capital to restore support for the increased limit or reduce the increased limit of its investments to a point at which no investment exceeds 20 percent of the sum of its Private Capital plus the remaining net unrealized appreciation represented by marketable securities.

(7) Failure to maintain or restore support for the increased limit or to reduce investments as required by paragraph (6) shall be a violation of these Regulations.

Example: On January 15, 1982 the Licensee documents net unrealized gains of $100,000. Licensee adds $100,000 to its Private Capital and increases its overline limitation accordingly. Licensee now makes one or more investments in reliance on this increased limit. Hereafter, on each subsequent first business day of April, July, October, and January, Licensee must document net unrealized gains of a least $100,000. On April 15, 1982 Licensee can document further net unrealized gains for an aggregate of $150,000 and invest pursuant to an increased limit of $30,000 (20% of $150,000). Following the first business day of April, 1983, Licensee documents net unrealized gains of only $120,000. All investments within the incerased limit remain undiminished in the portfolio. Licensee is now required to cause to be injected sufficient cash into Private Capital before July 1, 1983, so that the sum of the remaining net unrealized gains and the added cash equals at least five times the increased limit of its largest investment. In the alternative, Licensee must reduce before July 1, 1983, its "overline " investments made in reliance on this subsection so that none will exceed 20 percent of Private Capital plus $24,000. Any further reduction of net unrealized gains will require additional proportionate injection of cash or reduction of investments.

§ 107.304 Size status and nondiscrimination.

No Assistance shall be provided unless: (a) The Licensee and the Small Concern have executed SBA Form 480, Size Status Declaration, including Licensee's determination that applicable size standards have been met, or SBA has determined at the request of the Licensee or such concern that the latter is a Small Concern: and (b) The Small Concern has certified on SBA Form 652-D that it will not illegally discriminate in its operations, employment practices or facilities as set forth in Part 113 of this chapter. Such forms shall be kept available for SBA's examination: *Provided, however,* That the foregoing shall not apply when the Licensee acquires the securities from an underwriter in a public offering (see § 107.404), in which event the Licensee shall keep the prospectus showing the small size status of the issuer as part of its records for SBA's examination.

EQUITY CAPITAL

§ 107.320 Equity securities.

(a) *General.* A Licensee may be a source of equity capital for incorporated and unincorporated small concerns. Such equity capital may be supplied by the purchase of Equity Securities: *Provided, however,* That a Licensee shall not become a general partner in any unincorporated concern, or otherwise become jointly or severally liable for the general obligations of an unincorporated concern, inadvertently or otherwise.

(b) *Options.* A Licensee may acquire options or warrants (including conversion rights) in a Portfolio Concern or in an affiliate of such concern, as defined in § 121.3-2(a) of this chapter. Such options or warrants shall expire not later than six years from the termination of the Licensee's Financing by prepayment or at maturity. For exercise of options after the Portfolio Concern becomes large, see § 107.706.

§ 107.321 Redemption provisions.

Subject to the following restrictions, a Licensee may acquire Equity Securities, options or warrants on terms that may include redemption by the issuer (Put).

(a) No redemption shall be required for the first five years.

(b) The redemption price shall not exceed a price to be agreed upon not later than the date of the Licensee's first disbursement and such price shall not be pre-determined but must be determined by a formula which is legal and reasonable and based on book value or earnings of the Small Concern.

§ 107.322 Refinancing; first refusal on new indebtedness.

Whenever a Licensee purchases Equity Securities from a Small Concern, it may require it to:

(a) Refinance any or all of its outstanding indebtedness so that the Licensee is the only holder of any evidence of indebtedness of such concern, and:

(b) Agree not to incur any new indebtedness without Licensee's approval and affording it an opportunity to finance such new indebtedness: *Provided, however,* That the Licensee shall allow appropriate exceptions for open account or other short-term credit.

GUARANTIES AND COMMITMENTS

§ 107.401 SBIC guaranty of Loans.

(a) Subject to § 107.301(a) (Minimum Period of Financing), a Licensee may guaranty to any non-Associate creditor the monetary obligation of a Small Concern: *Provided, however,* That:

(1) No such guaranty shall be issued where Licensee would become subject to State regulation as an insurance, guaranty or surety business;

(2) No such guaranty may be issued except at the request of the Small Concern or where necessary to protect Licensee's existing investment;

(3) Any direct Financing plus the amount of the guaranties does not exceed the overline limits under § 107.303;

(4) The total financing cost to the Small Concern may not exceed the limits set by § 107.302;

(5) The total guaranties issued and outstanding for all Small Concerns shall not exceed one hundred percent of Private Capital.

(6) A Licensee may guarantee an Associate creditor on the same conditions pursuant to § 107.903.

§ 107.402 Commitments.

(a) *General.* A Licensee is authorized to enter into a commitment to furnish Financing to a Small Concern. Such commitment shall be in writing and a reasonable commitment fee may be charged.

(b) *Repayment period as to funds advanced pursuant to Licensee's commitment.*

(1) Where a Licensee enters into a commitment to finance a Small Concern, disbursement to be made at the latter's request, it shall be lawful (notwithstanding the maturity provisions of § 107.301(a)) to provide for repayment as follows:

(i) Funds advanced during the first two years of the commitment period shall become payable not less than five years after date of the commitment; and

(ii) Funds subsequently advanced shall become payable not less than three years of the respective disbursement dates.

(c) Amortization of each disbursement shall not be required at an annual average rate in excess of the principal amount thereof divided by the number of years of the respective repayment period.

§ 107.403 Other permissible Financing.

(a) *Authorization.* A Licensee may furnish Financing pursuant to paragraph (b) of this section, within the overline limits of § 107.303, but the aggregate of all such Financing to any one or all Small Concerns shall not at any time exceed twenty percent of the Licensee's total adjusted assets. "Total Adjusted Assets" means total assets reduced by all outstanding Leverage provided by SBA and current liabilities.

(b) *Investments permitted.* Notwithstanding §§107.301 (a) and (b) and 107.320, a Licensee may make the following investments in Small Concerns:

(1) *Short-term Financing.* Financing with a term of less than five years when it constitutes interim financing in contemplation of long-term Financing of a Small Concern, the protection of prior investments or financing ownership change pursuant to § 107.711. The maximum aggregate period for this short-term financing cannot exceed one year. This paragraph (b)(1) supplements the authority to make short-term investments in Disadvantaged Concerns under § 107.301(a).

(2) *Amortization rate of forty percent per annum.* Financing with the minimum term of five years amortized at a rate not exceeding forty percent per annum of the declining principal balance outstanding, except for the final year of the term.

(3) *Securities purchased from nonissuer.* Securities of a Small Concern purchased from a seller other than the issuer or his underwriter (see § 107.404), when such acquisition constitutes a reasonably necessary part of the overall sound financing of such concern pursuant to the Act or when the securities are acquired to finance a change of ownership pursuant to § 107.711. See also § 107.304 regarding size status and nondiscrimination certification. See § 107.404 for purchases of securities through or from an underwriter.

§ 107.404 Purchase of Securities through or from underwriter.

A Licensee may purchase securities issued by a Small Concern through or from an underwriter, within 90 days of the date a public offering is first lawfully made: *Provided, however,* That (a) such purchase may not be made at more than the original public offering price; (b) the underwriter certifies in writing whether it is an Associate of any Licensee, that the portion of the offering purchased by the Licensee represents only newly issued Securities, and that an amount equal to the amount paid by the Licensee (less reasonable and customary underwriting and related charges permitted to be charged by the underwriter in connection with the Licensee's purchase) has been, or will be, paid to the small concern; (c) if the underwriter is an Associate of any Licensee, no fees or charges may be retained by such underwriter with respect to the portion of the offering purchased by any Licensee; and (d) Licensee maintains records available for SBA inspection showing relevant details of the transaction, including date, price, commissions, etc. paid, if any, and underwriter's certificate. See also § 107.304 regarding size status and nondiscrimination certification.

MANAGEMENT SERVICES

§ 107.501 Management services.

(a) *General.* Management services may be advisory only or may, subject to §107.801, include performance of any technical service relating to the financial, management, administrative, or operating activity of a Small Concern. Services shall be deemed "advisory only" where the Small Concern is free to accept or reject the advice rendered.

(b) *Conditions.* (1) Where a Licensee directly or indirectly provides management services to a Small Concern and such services are advisory only, no SBA approval is required. The Licensee shall maintain a record for examination by SBA of the time spent and charges made for such services and such charges shall not exceed comparable charges by established professional non-Licensee consultants.

(2) Where a Licensee directly or indirectly provides management services to a Small Concern that is being Financed by it and such services are not advisory only, such services shall be performed pursuant to a written contract with such Small Concern and the contract shall be approved in advance by the board of directors or principals of the Small Concern and by SBA. Such contracts shall thereafter be approved annually by the board of directors or principals of the Small Concern and the Licensee. In the event of a material change, the revised contract shall also be approved in advance by SBA. A doubt regarding materiality of a change shall be resolved by submission to SBA. An agreement to perform such services for a Small Concern that is not being Financed by the Licensee shall not require such annual approval. Records shall be kept and charges made in accordance with paragraph (b)(1) of this section.

(3) Where an Associate of a Licensee provides management services to a Small Concern that is being Financed by such Licensee and such services are advisory only, such advice shall be rendered pursuant to a written contract, and the contract shall be approved in advance by the board of directors or the principals of the Small Concern and by SBA. Such contracts shall thereafter be approved annually by such board of directors, or principals and the Licensee. In the event of a material change, the revised contract shall also be approved in advance by SBA. A doubt regarding materiality of a change shall be resolved by submission to SBA. The Licensee shall maintain records of time spent and charges made in accordance with paragraph (b)(1) of this section. Such services rendered to a Small Concern not being Financed by such Licensee are not subject to regulation by SBA until such time as Financing is provided.

(4) Where an Associate of a Licensee provides management services to a Small Concern that is being Financed by such Licensee and such services are not advisory only, such services shall be performed pursuant to a written contract, and the contract shall be approved in advance by the board of directors or the principals of the Small Concern and by SBA. Such contracts shall thereafter be approved annually by the board of directors or principals of the Small Concern and the Licensee. In the event of a material change, the revised contract shall also be approved in advance by SBA. A doubt regarding materiality of a change shall be resolved by submission to SBA. Records shall be kept and charges made in accordance with paragraph (b)(1) of this section. Such services rendered to a Small Concern not being Financed by the Licensee are not subject to regulation by SBA until such time as Financing is provided.

(c) *Management Services Corporation.* A Licensee may organize a corporation solely to provide management services. All of its stock shall be owned and held by such Licensee, and the Licensee shall be responsible for the compliance by such corporation with the Act and regulations. In the case of a Debtor Licensee, the remuneration paid to officers, directors and employees of such corporation and any changes therein, shall be subject to SBA written approval. Reports submitted to SBA by the Licensee shall reflect consolidated figures when both are corporations. The corporation shall maintain adequate records and make any separate reports required by SBA and it shall submit to SBA examination. Failure to do so shall be deemed noncompliance by the Licensee. Licensee's investments in and receivables from such corporation shall not exceed 3 percent of the Licensee's Private Capital.

CONTROL OF LICENSEE

§ 107.601 Changes in ownership or control of Licensee.

(a) *General.* Transfer of Control over a Licensee by any means whatsoever shall be subject to prior written approval of SBA.

(b) *Prior approval requirements.* Prior written approval of SBA shall be required in case of:

(1) A proposed transfer which would result in the beneficial ownership by any Person, or group of Persons acting in concert, of ten or more percent of any class of its stock or partnership capital; or

(2) Any proposed transfer which results in a change in Control over a Licensee.

(c) *Acts prohibited.* Without prior written approval of SBA, no such transaction shall be consummated and no officer, director, employee or other Person acting on the Licensee's behalf shall:

(1) Register on its books any transfer of ownership interest to the proposed new owner (or owners); or

(2) Permit the proposed new owner (or owners) to exercise voting rights with respect to said ownership interest or participate in any manner in the conduct of Licensee's affairs.

(d) *Terms used:*

(1) "Transfer," "stock transfer," "transfer of shares," or "ownership interest" refers to the aggregate amount of shares or partnership capital which any Person or group of Persons acting in concert transfers or undertakes to transfer during any six month period.

(2) "Exercise of voting rights" with respect to ownership interest of Licensee's capital shall include directly or indirectly procuring or voting any proxy, consent or authorization as to such voting rights at any shareholders' or partnership meeting.

(3) "Participation in the conduct of Licensee's affairs" shall include control over Licensee's books, records, funds or other assests; participation directly or indirectly in any disposition thereof; or serving as an officer, director, partner, employee or agent of such Licensee.

(e) *Transferors' Liability.* SBA may in its discretion as a condition of a Licensee's Leverage, require the Control Person(s) to assume in writing personal liability for such Licensee's Leverage, effective only in the event of their direct or indirect participation in any violation of the requirements of this section applicable to transfers of Control, and terminable if SBA subsequently approves the transfer of Control and so notifies the transferor(s) in writing.

(f) *Application for approval.* Written application for prior SBA approval shall be promptly made by the Licensee and by other parties in interest. A processing fee of $5,000 shall accompany any application for approval of one or more transfers of stock or of partnership interests that will result in acquisition of control over the Licensee by a Person(s) not previously approved by SBA. For applications not involving control, see § 107.102.

(g) *Public Notice.* SBA shall publish notice in the FEDERAL REGISTER concerning the application for approval of a proposed transfer of Control over a Licensee, including such appropriate information as the name and location of the Licensee and of the proposed transferees who will own ten or more percent of any class of its Private Capital. The notice shall provide an opportunity to submit written comments. A similar notice shall also be published in a newspaper of general circulation in the city or locality where the Licensee is or will be located (or conduct operations), and a certified copy shall be furnished to SBA within ten days.

(h) *Standards governing SBA approval.*

(1) SBA may, as a condition of approving a proposed transfer of Control, require an increase in Licensee's Private Capital.

(2) SBA may condition its approval on the assumption in writing by the new owners of contractual liability pursuant to paragraph (e) of this section, and such other requirements as SBA deems necessary.

(3) SBA approval shall be contingent upon full disclosure of the real parties in interest, the source of funds used, and other data requested by SBA.

(i) *Reporting transactions involving possible transfer of Control.* The Licensee shall, upon obtaining knowledge thereof, promptly report to SBA the facts pertaining to any transaction or event which affords reasonable grounds for belief that a transfer of Control over such Licensee is likely to occur. If there is any doubt as to whether a particular transaction or event will result in a change of Control, such doubt shall be resolved in favor of reporting the facts to SBA.

§ 107.602 Common control.

Without prior written SBA approval, a Licensee shall not have an officer, director, manager, nor a Control Person or a stockholder or partner owning or controlling directly or indirectly ten or more percent of its stock or ownership interest who at the same time is:

(a) An officer, director, manager or Control Person, or such stockholder or partner of another Licensee; or

(b) An officer or director of any Person which directly or indirectly controls, or is controlled by, or is under common Control with, another Licensee: *Provided, however,* That officerships or directorships in, and management, ownership or Control of stock or partnership capital of, a section 301(d) Licensee shall be excepted from the foregoing provisions.

§ 107.603 Pledge of Licensee's shares.

Whenever ten or more percent of a Licensee's Private Capital is pledged by any Person (or group of Persons acting in concert) as collateral for indebtedness, and such pledge does not involve any transfer for which prior approval is required under § 107.601, written notice of the terms of such transaction shall be furnished to SBA by the pledgor within thirty calendar days from the date of the pledge.

LAWFUL OPERATIONS

§ 107.701 Amendments to Act and regulations.

A Licensee shall be subject to all existing and future provisions of the Act and these regulations, including Parts 112, 113 and 116 of Title 13 of the Code of Federal Regulations.

§ 107.702 Other laws.

Each Licensee shall comply with all applicable State and Federal law.

§ 107.703 Operations under Act.

A Licensee shall engage only in the activities contemplated by the Act and in no other activities.

§ 107.704 Identification as an SBIC.

Any written communications made by a Licensee shall identify that Licensee as "a Federal Licensee under the Small Business Investment Act of 1958."

§ 107.705 Consideration for issuance of Licensee securities.

(a) *General.* A Licensee may issue its securities or other ownership interests, including stock options to management and employees, for:

(1) Cash;

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

(3) Securities of which it is the issuer, in connection with a reclassification approved by SBA;

(4) Services previously rendered or to be rendered to the Licensee not to exceed the fair value thereof;

(5) Physical assets to be currently employed in Licensee's operation at the fair market value thereof;

(6) As a dividend; and

(7) In connection with a merger, consolidation, or reorganization approved by SBA: *Provided, however,* That any evidence of ownership interest issued as a part of Licensee's minimum capital pursuant to § 107.101(d) must be paid for in cash or securities permitted by the last sentence of section 308(b) of the Act; *And provided, further,* That a section 301(d) Licensee which has received Portfolio securities from a participant Licensee pursuant to § 107.712(c), may issue shares for such securities at their cost or fair market value, whichever is lower.

(b) *Stock options.*

(1) Licensees may issue stock options. A 1940 Act Company or a 1980 Act Company may issue stock options as permitted under such Acts or orders issued thereunder.

(2) *Stock options not deemed compensation.* Stock options issued by any Licensee including a 1940 or 1980 Act company, shall be deemed not to constitute "compensation" for purposes of any requirement of prior written consent of SBA with respect to increases of salaries or other compensation beyond the amounts approved by SBA.

§ 107.706 Retention of investments.

A Licensee may retain its investment in a concern which qualified as small at the time of initial financing, but which subsequently became large. Securities received in connection with a portfolio concern's merger, consolidation, or affiliation with a large business may be retained until Licensee has recovered its investment plus a reasonable return thereon, and thereafter, so long as continued ownership does not interfere with the Financing of Small Concerns. Subject to § 107.303, additional Financing may be provided only to the extent necessary (a) to honor a commitment made while the concern was small, or (b) to protect Licensee's original investment, or (c) to exercise stock options or other rights to purchase Equity Securities pursuant to such options or rights acquired as part of the initial Financing.

§ 107.707 Purchases of securities from another Licensee.

A Licensee may exchange with or purchase for cash from another Licensee Portfolio securities (or any interest therein): *Provided, however,* That: (a) Licensee shall not have at any time more than one-third of its total assets (valued at cost) invested in such securities; and (b) the amount for which the selling Licensee may be contingently liable shall be included in its overline limit under § 107.303.

§ 107.708 Deposits and Investments of idle funds.

Except as hereinafter set forth, all funds of a Licensee shall be deposited without delay in an account in a financial institution insured by the Federal Deposit Insurance Corporation (FDIC) or by the Federal Savings and Loan Insurance Corporation (FSLIC). Funds of a Licensee not invested in Small Concerns and not reasonably needed for its day-to-day operations shall be invested in (a) direct obligations of, or obligations guaranteed as to principal and interest by the United States, the remaining maturities of which do not exceed fifteen months; or (b) in certificates of deposit maturing within one year or less, or in an insured deposit account of an institution insured by the FDIC or FSLIC; or (c) deposited in a savings account subject to a withdrawal restriction not to exceed one year in any institution insured by the FDIC or FSLIC: *Provided, however,* That (1) a Licensee may maintain a petty cash fund of up to $500 and (2) corporate assets of a corporate general partner not invested in the Licensee shall be excluded from the time limits imposed by this section.

§ 107.709 Investment Adviser/Manager.

(a) *General.* A Licensee may employ an Investment Adviser/Manager as defined in § 107.3, subject to the supervision of the Licensee's Board of Directors or general partner and shall furnish SBA with a copy of the contract for prior written approval. Services performed may include management and operating activities. The contract shall specify the services to be rendered to the Licensee and to Portfolio Concerns, and the basis for computation of compensation. Such contracts shall thereafter be approved annually by the board of directors or principals of the Licensee. In the event of a material change, the revised contract shall be approved in advance by the Licensee and SBA. A doubt regarding materiality of change shall be resolved by submission to SBA.

(b) *Common Manager.* Two or more Licensees may, with prior written SBA approval, employ the same Investment Adviser or Manager.

§ 107.710 Assets in liquidation.

(a) *Timely Disposal.* A Licensee shall dispose of assets acquired in total or partial liquidation of a Portfolio asset, within a reasonable period of time.

(b) *Preservation of Assets.* (1) A Licensee may incur reasonably necessary expenditures for maintenance and preservation of such assets, and

(2) A Licensee may, subject to prior written SBA approval, incur reasonably necessary expenditures for improvements to render such assets saleable: *Provided, however,* That aggregate expenditures made pursuant to paragraphs (a) and (b) of this section plus Licensee's total investment attributable to such assests, shall not exceed its overline limit under § 107.303, except as specifically approved in writing by SBA.

(3) In addition to the amounts authorized by paragraphs (a) and (b) of this section, a Licensee may make the following required expenditures allocable to such assets in an aggregate amount which, together with its total investment attributable thereto, and its expenditures pursuant to paragraphs (a) and (b) of this section do not exceed 35 percent of its Private Capital, except as specifically approved in writing by SBA: Prior mortgage interest; principal payments; taxes and necessary insurance coverage.

(c) *SBA Approval.* Application for SBA approval under paragraphs (b)(2) and (b)(3) of this section shall specify all expenses estimated to be necessary pending disposal of the assets.

§ 107.711 Financing changes of ownership.

A Licensee may finance a change of ownership in a Small Concern when in the reasonable judgment of the Licensee it will promote the sound development or preserve the existence of a Small Concern as such; or will assist in the creation of a Small Concern as a result of a corporate divestiture; or will facilitate ownership in a Disadvantaged Concern. For restrictions governing purchases from nonissuer, see §107.403.

§ 107.712 Section 301(d) licensee wholly or partly owned by Licensee companies.

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

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

(b) *Participant Licensees.* Each participant Licensee shall own at least twenty percent of the voting securities of the proposed Section 301(d) Licensee, and such ownership shall constitute a presumption of active participation. Licensees proposing to own less than twenty percent of such voting securities may demonstrate to SBA's satisfaction that they will be active participants.

(c) *Capital contribution.* The capital contribution of a participant Licensee which is no part of the minimum capital ($1,000,000) of the Section 301(d) Licensee, may (notwithstanding §107.705(a)) be represented by securities of Small Concerns eligible for investment by a Section 301(d) Licensee, at cost or fair market value, whichever is lower. Assumption by the proposed Section 301(d) Licensee of any part of such participant Licensee's indebtedness held or guaranteed by SBA will not be permitted. A capital contribution shall, for purposes of the participant Licensee's Leverage be treated as a reduction of its capital, and shall not justify the retention of Leverage by such participant Licensee.

RESTRICTED ACTIVITIES

§107.801 Control of Small Concern.

(a) *General.* The Act does not contemplate that Licensees shall operate business enterprises or function as holding companies exercising control over such enterprises. Accordingly, neither a Licensee, nor a Licensee and its Associates, nor two or more Licensees may, except as hereinafter set forth, assume Control over a Small Concern pursuant to management agreements, voting trusts, majority representation on the board of directors, or otherwise.

(b) *Presumption of Control.* Control over a Small Concern will be presumed to exist whenever a Licensee or a Licensee and its Associates, or two or more Licensees, own or Control, directly or indirectly, voting securites equivalent to:

(1) Fifty percent or more of the outstanding voting securities, if held by fewer than fifty shareholders; or

(2) More than twenty-five percent or a block of twenty or more percent which is as large as or larger than the largest other outstanding block of such securities, if held by fifty or more shareholders.

(3) Potential ownership of voting securities through options or conversion privileges shall not be considered in determining whether a presumption of control exists. This presumption may be rebutted by evidence satisfactory to

SBA.

(c) *Temporary Control permitted.* A Licensee may acquire temporary Control only where reasonably necessary for the protection of its investment.

(d) *Plan to relinquish Control.* A Licensee may assume Control pursuant to paragraph (c) of this section only if it has entered into a written plan, enforceable by the small concern or its shareholders, providing for relinquishment of Control within a reasonable period, not to exceed seven years, without prior written SBA approval of any extension prior to the end of such period. Such plan shall recite the facts and circumstances necessitating Control for the protection of the Licensee's investment, and shall be filed with SBA and the Small Concern within thirty days after Control is acquired, subject to SBA's post approval as to form and substance, including fairness and the necessity for Control as a condition for the continuation of the license and shall be deemed approved unless Licensee is otherwise notified within ninety days after its receipt by SBA. Where an approved plan later becomes inadequate, a revised plan shall be submitted for SBA's approval. SBA approval shall be contingent upon disclosure of all relevant facts and be subject to such conditions as SBA may prescribe.

(e) *Enforcement actions.* A divestiture plan shall not interfere with Licensee's enforcement of its legal rights against a Portfolio Concern. If the Licensee retains or acquires Control through enforcement action, it shall immediately notify SBA and submit within thirty days a divestiture plan pursuant to paragraph (d) of this section for SBA approval. Subject to § 107.904, such plan may be negotiated with parties other than the Small Concern or its owners.

(f) *Additional Financings.* A Licensee which has assumed Control of a Small Concern may later provide additional Financing, without an exemption under § 107.903(b)(1), and shall within 30 days resubmit its divestiture plan for SBA approval only where the additional Financing requires significant changes in such SBA approved plan on file in order to effect divestiture of Control.

(g) *Control in excess of seven years.* SBA approval pursuant to paragraph (d) of this section for extension of Control in excess of seven years will only be granted if unique circumstances are demonstrated to SBA's satisfaction. Examples of such circumstances are (1) the former owners abandoned the Small Concern or became incapacitated; or (2) the only other available option is the extinction of the Small Concern as such.

§ 107.802 Voluntary capital decrease.

Without prior written approval, a Licensee shall not voluntarily reduce its Private Capital except that a Licensee in any one fiscal year may reduce its capital in an amount not exceeding two percent:" *Provided, however,* That the amount of such reduction may not reduce the Licensee's Private Capital below the minimum required by the Act nor cause the Licensee to retain excess Leverage contrary to Section 303 of the Act.

§ 107.803 Mergers, consolidations, and reorganizations.

Without prior written SBA approval, a Licensee may not merge, consolidate or reorganize.

§ 107.804 Financing of farm land purchases.

Without prior written SBA approval, a Licensee shall not, after September 8, 1976, provide financing to a Small Concern for the acquisition of farm land. For purposes of this section, farm land shall mean 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.

PROHIBITIONS

§ 107.901 Prohibited uses of funds.

No funds may be provided to a Small Concern:

(a) *Relending, reinvesting, etc.* For relending or reinvesting, if its primary business activity involves, directly or indirectly, providing funds to others, the purchase of debt obligations, factoring, or long-term leasing of equipment with no provision for maintenance or repair: *Provided however,* That Venture Capital Financing (as defined in § 107.202(b)) of any Disadvantaged Concern engaged primarily in relending or reinvesting activities shall be permitted, except for banks and savings and loan associations not insured by agencies of the Federal Government, and agricultural credit companies. Without SBA's prior written approval, all financings pursuant to this proviso shall not exceed the Licensee's Private Capital as of the close of any full fiscal year.*

(b) *Financing Licensees.* Directly or indirectly, for purchasing stock in or otherwise providing capital for a Licensee, or to repay an indebtedness to accomplish such purpose.

(c) *Real estate.* (1) If the Small Concern is classified under Major Group 65 (Real Estate) of the SIC Manual except for:

(i) Subdividers and developers (other than cemetary subdividers and developers);

(ii) Title abstract companies; and

(iii) Agents, brokers and managers, or

(2) If the Financing will be used by a Small Concern eligible under paragraph (c)(1) of this section to acquire realty or discharge an obligation relating to the prior acquisition of realty unless such realty is to be promptly and substantially improved for sale to others: *Provided, however,* That prompt improvement shall not be required where an adverse change of circumstances beyond the Small Concern's control makes leasing necessary, pending improvement or sale at the earliest feasible date. Realty acquired for sale which is promptly and substantially improved, may be leased pending sale at the earliest feasible date, where such adverse change makes immediate sale impracticable. Evidence of such adverse change shall be kept for SBA examination. Improvement shall, for the purposes of this paragraph, be deemed prompt and substantial if:

(i) An amount equal to fifty or more percent of the Financing is used for improvements; and

(ii) Such improvements are undertaken within one year from date of acquisition or date of Financing, whichever is later.

(d) *Public interest.* 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.

(e) *Foreign investment.* For use outside the United States: *Provided, however,* That a Licensee may provide funds to a domestic Small Concern;

(1) To acquire abroad materials and industrial property rights for a domestic operation; or

(2) For foreign branch operations and foreign joint ventures or for transfer to a controlled foreign subsdiary, so long as at least fifty-one percent of the assets and activities of such concern will remain within the United States.

(f) *Passive businesses.* If that concern is not engaged in a regular and continuous business operation; *Provided, however,* That this prohibition shall not apply to any Small Concern wholly owning another eligible Small Concern engaged in a regular and continuous business operation.

(g) *Associated supplier.* If fifty or more percent of the funds (or funds of the Small Concern released by such Financing) are used to purchase goods or services from a supplier which is an Associate of the Licensee: *Provided, however,* (1) Such funds may not be used to purchase capital goods from an Associate supplier; (2) That in the case of a section 301(d) Licensee, such limit shall be seventy-five percent; and (3) Goods and services shall be at a price no greater than that charged other customers of the associate supplier.

*1940 Act Companies are reminded that sections 12(d) (2) and (3) of that Act impose additional restrictions on certain investments otherwise permitted by this § 107.901(a).

§ 107.902 Inactive Licensees.

(a) *Active Operations.* The Act contemplates that a Licensee shall conduct active operations to meet the needs of Small Concerns. Accordingly, inactivity constitutes a violation of these regulations.

(b) *Activity Test.* A Licensee which on the close of any full fiscal year has more than twenty-five percent of its assets (valued at cost) in idle funds (§ 107.708) is inactive if it has not, during the past eighteen months, provided Financing aggregating at least twenty-five percent of the average amount of its said idle funds; *Provided, however,* That subject to SBA approval, a Licensee may maintain a larger percentage of idle funds. Approval may be granted in appropriate cases such as prepayments, raising of additional capital and Leverage recently received.

§ 107.903 Conflicts of interest.

(a) *General.* Self-dealing to the prejudice of the Small Concern, or of a Corporate Licensee or its shareholders, or, in the case of an Unincorporated Licensee, the partnership or its members, or of SBA, is prohibited.

(b) *Prohibitions.* Except where a written exemption may be granted by SBA in special instances in furtherance of the purposes of the Act:

(1) A Licensee shall not, directly or indirectly, provide Financing to any of its Associates.

(2) A Licensee shall not, directly or indirectly, provide Financing to an Associate of another Licensee if an Associate of the first Licensee receives, has received, or is about to receive (including receipt pursuant to any understanding, agreement, or cross-dealing, reciprocal or circular arrangement) any direct or indirect Financing or commitment for Financing from such other Licensee or a third Licensee.

(3) No Licensee or any of its Associates shall directly or indirectly borrow money from:

(i) A concern Financed by such Licensee, or

(ii) An officer, director, or owner of ten or more percent equity interest in such concern; or

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

(4) No Licensee shall directly or indirectly provide Financing to discharge or to free other funds for use in discharging an obligation to an Associate of the Licensee: *Provided, however,* That the foregoing shall not apply to transactions by Associate Lending Institutions in the normal course of business involving lines of credit or short-term Financing.

(5) No Licensee shall directly or indirectly Finance, except as permitted by § 107.901(g), the purchase of property from an Associate of the Licensee.

(c) *Joint Financing with Associate.* (1) A Licensee may provide Financing to a non-Associate also Financed by an Associate of such Licensee contemporaneously or within six months before or after the Licensee's Financing, but only on terms not less favorable to the Licensee than to the Associate. Licensee shall retain written evidence of the entire transaction. Where the Associate's Financing is of a different kind, the burden shall be on the Licensee to show that the terms of its Financing were at least as favorable as those of its Associate's Financing: *Provided, however,* That the foregoing shall not apply to transactions by Associate Lending Institutions in the normal course of business involving lines of credit or short-term Financing.

(2) The six months rule of paragraph (g) of the definition of "Associate of a Licensee" in section 107.3 shall not apply to an initial joint Financing pursuant to paragraph (1) of this subsection.

(d) *Compensation to Associates.* Without the prior written approval of SBA and subject to any limitations or restrictions of Federal or State law governing conflicts of interest and fiduciary obligations, no Associate of a Licensee shall receive from a Small Concern, directly or indirectly, any compensation in connection with Assistance rendered by such Licensee or anything of value for procuring, attempting to procure, or influencing Licensee's action with respect thereto.

(e) *Public notice.* Before SBA grants an exemption under this section, the Licensee shall publish in a newspaper of general circulation in the locality most directly affected by the transaction, a notice prescribed by SBA, and furnish a certified copy to SBA within ten days; SBA shall publish a similar notice in the FEDERAL REGISTER.

(f) *Protection of investment.* Nothing contained in this section shall preclude a Licensee from designating an Associate to serve as an officer, director or in any other capacity in the management of a Portfolio Concern to protect its investment: *Provided, however,* That such Associate has no other direct or indirect financial interest that exceeds, or has the potential to exceed, three percent of the Portfolio Concern's equity and has not served as an officer or director or in any other capacity in the management of such concern for more than thirty days prior to such Financing. This proviso may be waived by SBA's prior written approval. Remuneration or anything of value received by such Associate (excluding directors fees, expenses and distributions attributable rateably to the Associate's ownership of the Portfolio Concern's equity) from the Small Concern shall inure to the benefit of the Licensee. The Licensee shall identify the individual Associate so designated in its records pursuant to Section 107.1002.

(g) *1940 and 1980 Act Companies.* A 1940 and 1980 Act Company which has been granted an exemption by the Securities and Exchange Commission with regard to a transaction described in this section shall be exempt therefrom: *Provided, however,* That the Licensee shall promptly notify SBA and publish notice thereof pursuant to paragraph (e) of this section.

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

(a) *Sale to Associate.* Except with a prior written exemption from SBA in special instances, a Licensee shall not dispose of assets (including assets in liquidation) to any Associate. As a prerequisite to such exemption, the Licensee must demonstrate that the proposed terms of disposal are no less favorable to it than are obtainable elsewhere.

(b) *Sale to Competitor.* Except with prior written approval of the Portfolio Concern which is not Controlled by the Licensee, or of SBA, a Licensee shall not dispose of Portfolio securities to a competitor of such concern. The particulars of any such disposal shall be promptly reported to SBA.

§ 107.905 No Government sponsorship.

No Licensee shall represent or imply in any manner that any evidence of ownership interest issued or obligation incurred by it has been approved by the United States, or any agency or officer thereof, and a statement to such effect shall be included in any solicitations to investors.

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

The following shall constitute a violation of these regulations:

(a) *Nonperformance.* Nonperformance of any of the requirements of any debenture or preferred security issued to or guaranteed by SBA, or any written agreement with SBA.

(b) *False Statement.* Any false statement knowingly made, or misrepresentation or failure to state a material fact necessary in order to make a statement not misleading in the light of the circumstances under which the statement was made, in any document submitted to SBA.

EXAMINATIONS, ACCOUNTS, RECORDS AND REPORTS

§ 107.1001 Examination and fees.

(a) *Examinations.* Examinations of Licensees shall be initiated by SBA pursuant to Section 310(b) of the Act. Licensees shall make all books, records

and other pertinent materials available for the conduct of such examination.

(b) *Fees.* Examination fees will be assessed for examinations made in accordance with the Act. As a general rule, SBA will not assess examination fees for special examinations to obtain specific information.

(c) *Rates.* The fee structure provides rates based on the Licensee's assets as of the date of the latest certified financial statement submitted to SBA before the examination. The rate table is as follows:

Total assets of licensee	Base rate	Percent of assets
$500,000 or less	$800	+0.
$500,001 to $1,000,000.	800	+0.12 over 500,000.
$1,000,001 to $3,000,000.	1,400	+0.030 over 1,000,000.
$3,000,001 to $5,000,000.	2,000	+0.016 over 3,000,000.
Over $5,000,001	2,320	+0.006 over 5,000,000.

For example, a Licensee with total assets of $2,000,000 would pay an examination fee of $1,700 ($1,400 + 0.030% of $1,000,000).

(d) *Users Fee.* Whenever the length of time required for an examination is excessive because of a lack of cooperation by the Licensee or because of the condition of the Licensee's records, in the judgement of SBA an additional fee, not to exceed $250 per day for such time, may be assessed.

§ 107.1002 Records and reports.

(a) *Records.* Current financial records including books of account are to be maintained in all material respects in accordance with SBA's system of Account Classifications. All financial records, and minutes of meetings of stockholders, directors, executive committees, or other officials including partners of an Unincorporated Licensee, and all documents and supporting material relating to Licensee's transactions shall be kept at its principal office: *Provided, however,* That Portfolio items held by a custodian pursuant to written agreement shall be excepted from this requirement. All financial reports furnished to SBA shall make complete disclosure of all matters relevant to the Act and regulations.

(b) *Preservation of records.* Each Licensee shall preserve, for the periods hereinafter specified and in a manner that permits the immediate location of any record, such documents which are the basis for financial statements required by paragraph (e) of this section, and of the accompanying independent public accountant's certificate. Each Licensee shall:

(1) Preserve for a period of at least twenty years:

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

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

(iii) The Articles, bylaws, license application, and all minute books, certificates evidencing ownership or stubs relating thereto, ownership ledgers and ownership transfer registers, such documents to be kept readily accessible for the first two years.

(2) Preserve for a period of at least six years following final disposition of the related loan or investment, all applications for Financing; size status declarations; lending, participation, and escrow agreements; Financing instruments; capital stock certificates and warrants of Small Concerns not surrendered or exercised; and all other documents and supporting material relating to such loan or investment, including correspondence, such documents to be kept readily accessible for the first two years.

(3) Preserve for a period of at least six years all vouchers, checkbooks, bank statements, cancelled checks, cash reconciliations, ledger trial balances, memoranda, correspondence, and other documents forming the initial accounting data for entry in, or underlying records in support of, the records enumerated in paragraph (b)(1) of this section.

(4) Notwithstanding the provisions of paragraphs (b) (1) through (3) of this section, a micro-reproduction of any records may be substituted for the original and preserved for the required time in the required manner: *Provided, however,* That Licensee shall:

(i) Cause a duplicate micro-reproduction to be made on a current basis and stored separately from the original micro-reproduction for the time required:

(ii) At all times have available facilities for easily readable projection and the production of easily readable facsimile enlargements.

(c) *Reports to owners.* At the time any report (including any prospectus, letter, or other publication concerning the financial operations of the Licensee or any of its Portfolio Concerns) is furnished to investors, the Licensee shall file three copies with the Investment Division, SBA.

(d) *Documents filed with SEC.* Whenever a Licensee files any report, application or document with the Securities and Exchange Commission, it shall concurrently provide SBA with a copy thereof.

(e) *Filing of SBA Form 468.* Each Licensee shall submit to SBA, at the end of each fiscal year, a report containing financial statements for the fiscal year (Part I of SBA Form 468) as well as management information (Part II of SBA Form 468.) When requested by SBA, interim reports may be required, i.e., financial statements and/or management information. The reports are to be prepared in accordance with Appendix B, Guide for the Preparation of the Annual Report, SBA Form 468, which is equally applicable to interim reports, and shall be filed on the prescribed form, in triplicate, with the Investment Division, SBA, on or before the last day of the month immediately following the end of the reporting period (in the case of interim reports), and on or before the last day of the third month following the end of the reporting period (in the case of the Annual Report). These reporting requirements are approved under OMB No. 3245-0063. The financial statements contained in the Annual Report will be examined by the Licensee's independent public accountant in accordance with Appendix A, Audit Guide for Small Business Investment Companies. The 1940 and 1980 Act Companies should refer to the rules of the Securities and Exchange Commission for the reports to be filed with SEC.

(f) *Litigation reports.* When a Licensee becomes a party to litigation or other proceedings, including any action by the Licensee, or by a security holder thereof in a personal or derivative capacity, against an officer, director, Investment Adviser or other Associate of such Licensee for alleged breach of official duty, it shall within thirty days file a report with SBA describing the proceedings, identity of and Licensee's relationship to other parties involved and, upon request, submit copies of the pleadings and other documents specified by SBA. Where such proceedings have been terminated by settlement or final judgment, the Licensee shall promptly advise SBA of the terms thereof. This paragraph shall not apply to collection actions or proceedings in enforcement of Licensee's ordinary creditors' rights.

(g) *Other reports.* Each Licensee shall file with the Investment Division, SBA, such other reports as SBA shall require by written directive.

§ 107.1003 Internal control.

(a) *General.* Each Licensee shall adopt a plan designed to safeguard its assets and monitor the reliability of its financial data, personnel, Portfolio, funds, and equipment.

(b) *Dual control, Bonding.* (1) Licensees shall maintain dual control over disbursements of funds and withdrawal of securities. Disbursements shall be made only by checks requiring two or more signatures or wire transfer authorized by two or more signatures. In the case of a Corporate Licensee, the signature of two or more officers shall be required. In the case of an Unincorporated Licensee, disbursements shall require the signature of two or more general partners, or two or more officers of a corporate general partner. Notwithstanding the foregoing requirement, checks in the amount of $1,000 or less may be signed by one officer of a Corporate Licensee or by one general partner of a Licensee. Two or more officers of a Corporate Licensee, or one officer and one employee shall be required to open safe deposit boxes or withdraw securities from safekeeping. Two or more general partners, or two or more officers, or one officer and one employee of a corporate general partner shall be required to open safe deposit boxes or withdraw securities from safekeeping: *Provided, however,* That an employee of the Licensee may be substituted for any of the persons described in this sentence. Licensees shall furnish to each depository bank and custodian a certified copy of its resolution or other formal act implementing the foregoing control procedures.

(2) In lieu of or in addition to the above, Licensees may maintain a Brokers Blanket Bond, Standard Form No. 14 or Finance Companies Blanket Bond, Standard Form 15, or such other form of coverage as SBA may approve, in a minimum amount of $25,000, executed by a surety holding a certificate of authority from the Secretary of Treasury pursuant to 6 U.S.C. Section 6-13. Each Person who has control over or access to cash, securities or other property of the Licensee shall be covered by such bond. The bond shall contain minimum coverage equivalent to insuring agreements (i) Fidelity, (ii) On premises and (iii) In transit provided in Finance Companies Blanket Bond Standard Forms 15 and 14. The bond shall also contain a rider or endorsement providing that the surety notify the SBA Investment Division of its intent to cancel the bond at least 30 days in advance of the effective date of cancellation.

§ 107.1004 Reporting changes not subject to SBA approval.

(a) *Changes to be reported.* Any change of Licensee's name, address, telephone number, officers, directors, or other participants in the management of a Licensee, articles, operating area, investment policy, or increase in capitalization not otherwise required to be reported (see, for example § 107.601) shall be reported to SBA not later than thirty days after these events. All changes shall be subject to SBA postapproval as a condition for the continuance of the license.

(b) *SBA approval.* Reports and requests filed pursuant hereto shall be deemed approved unless Licensee is notified to the contrary by SBA within ninety days after receipt thereof. Approval shall be contingent upon full disclosure of all relevant facts, subject to any conditions SBA may prescribe.

Compliance

§ 107.1101 Exemption from civil penalty.

Where it is impracticable to submit any required report within the prescribed time, the Licensee may, before such time has expired, promptly file an application which:

(a) Identifies such report;

(b) Certifies to an extraordinary occurrence not within the Licensee's control which makes timely submission of such report impracticable; and

(c) Is accompanied by written evidence.

SBA may thereupon exempt the Licensee from the civil penalty provision of section 315(a) of the Act, in such manner and upon such conditions as SBA determines.

Exemptions

§ 107.1201 Exemptions.

A Licensee may file an application in writing with SBA to have a proposed action, which is subject to any procedural or substantive requirement, restriction, or prohibition specified under this Part, exempted from provisions thereof. SBA may approve such application and grant an exemption, conditionally or unconditionally, to the extent that such exemption from the requirement, restriction, or prohibition would not be contrary to the purposes of the Act. Such 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 regulations.

§ 107.1202 Savings clause.

The legality of transactions consummated pursuant to provisions of these regulations in effect at that time shall be governed thereby, notwithstanding subsequent changes. Nothing herein shall bar SBA enforcement action with respect to any transaction consummated in violation of provisions applicable at the time, but no longer in effect.

Appendix A—Audit Guide for Small Business Investment Companies

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