This document is scheduled to be published in the
Federal Register on 03/17/2014 and available online at
http://federalregister.gov/a/2014-05549, and on **FDsys.gov**

Billing Code: 8025-01

SMALL BUSINESS ADMINISTRATION

13 CFR Part 120

Docket No. SBA-2013-0002

RIN: 3245-AG53

Microloan Program Expanded Eligibility and Other Program Changes

AGENCY: U.S. Small Business Administration (SBA).

ACTION: Proposed rule.

SUMMARY: This proposed rule would amend certain existing regulations for the Microloan Program. The Microloan Program assists women, low income, veteran, and minority entrepreneurs, and others capable of operating a small business that are in need of small amounts of financial assistance. Specifically, this proposed rule would allow any Microloan Program Intermediary to make microloans (loans of $50,000 or less) to businesses with an Associate who is on probation or parole, except in limited circumstances; it would increase the minimum number of loans that microloan Intermediaries must make annually; and it would remove the requirement that the Microloan Revolving Fund (MRF) and the Loan Loss Reserve Fund (LLRF) be held in interest-bearing Deposit Accounts. In addition, the proposed rule includes technical amendments that would conform the regulations to current statutory authority.

DATES: Comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by RIN: 3245-AG53, docket number [SBA-2013-0002] by any of the following methods:

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Jody Raskind, Chief, Microenterprise Development Branch, U.S. Small Business Administration, 409 3rd Street, S.W., 8th floor, Washington, D.C. 20416.
- Hand Delivery/Courier: Jody Raskind, Chief, Microenterprise Development Branch, U.S. Small Business Administration, 409 3rd Street, S.W., 8th floor, Washington, D.C. 20416.

All comments will be posted on www.regulations.gov. If you wish to submit confidential business information (CBI) as defined in the User Notice at www.regulations.gov, please submit the information to Jody Raskind, Chief, Microenterprise Development Branch, U.S. Small Business Administration, 409 3rd Street, SW, 8th Floor, Washington, DC 20416, or send an email to jody.raskind@sba.gov._Highlight the information that you consider to be CBI and explain why you believe SBA should hold this information as confidential. SBA will review the information and make the final determination whether it will publish the information.

FOR FURTHER INFORMATION CONTACT: Jody Raskind, Chief, Microenterprise Development Branch, at (202) 205-7076 or Jody.Raskind@sba.gov.

SUPPLEMENTARY INFORMATION:

I. Background Information

Section 7(m) of the Small Business Act (15 U.S.C. 636(m)) ("Act") authorizes SBA's Microloan Program, which assists small businesses that need small amounts of financial assistance. Under the program, SBA makes direct loans to Intermediaries, as defined in §120.701(e), that use the loan proceeds to make microloans to eligible borrowers. SBA is also authorized to make grants to Intermediaries to be used for marketing, management, and technical assistance.

This proposed rule includes several regulatory changes, as well as technical amendments that conform the regulations to current statutory authority. SBA is proposing these changes in order to clarify certain program requirements that have caused confusion and in response to feedback from existing Intermediaries.

II. Section by Section Analysis

Intermediaries must keep their Microloan Revolving Funds (MRFs) and Loan Loss Reserve Funds (LLRFs) at insured depository institutions. See 13 CFR §§120.701(a), 120.709, and 120.710. SBA proposes to revise the definition of insured depository institution in §120.701(d) to specifically include Federally-insured credit unions. The current definition specifies only insured banks and savings associations. SBA is proposing this change to clarify inconsistent interpretations of this definition through a clear statement that such credit unions are included.

Section 120.707(a), What conditions apply to loans by Intermediaries to Microloan borrowers?, sets forth the eligibility conditions placed on loans between Intermediaries and microloan borrowers. However, the current language of §120.707(a) has caused some confusion among Intermediaries as to which businesses are eligible for microloans. Currently, §120.707(a) states that "An intermediary may make Microloans to any small business eligible to receive financial assistance under this part." SBA interprets this language to mean that microloan borrowers must meet the same eligibility criteria as borrowers under the Agency's 7(a) and 504 business loan programs (except that nonprofit child care businesses are eligible for microloans). See 13 CFR §120.110.

The proposed rule would revise this language to clarify that microloan borrowers must meet the same eligibility requirements as borrowers in the 7(a) and 504 programs, except as specifically set forth in §120.707(a).

This rule would also amend §120.707(a) to allow Intermediaries to make loans to businesses with an Associate, as defined in §120.10, who is currently on probation or parole, except in limited circumstances. Businesses with an Associate who is incarcerated, on probation, on parole, or currently under indictment for a felony or a crime of moral turpitude are ineligible for assistance under the 7(a) or 504 programs under §120.110(n); therefore, such businesses are currently ineligible for assistance under the Microloan Program as well. SBA is proposing this change as a result of a regulatory review conducted in connection with SBA's participation on the Federal Interagency Reentry Council (Reentry Council), http://www.nationalreentryresourcecenter.org/reentry-council. The Reentry Council is an interagency task force led by the Department of Justice which seeks to explore ways in which agencies can reduce the Federal barriers to successful reentry of formerly incarcerated individuals in order to assist them in becoming productive citizens. Formerly incarcerated individuals who maintain steady employment are less likely to return to jail; however, many formerly incarcerated individuals have difficulty finding steady employment. The Microloan Program offers an opportunity for such individuals who meet the Intermediaries' lending criteria to receive financing and technical assistance to start their own businesses. Under the amended rule, businesses with an Associate on probation or parole for an offense involving fraud or dishonesty would be ineligible, as would child care businesses with an Associate on probation or parole for an offense against children. Also, under the proposed rule, individuals who are currently incarcerated or under indictment would remain ineligible for microloans.

In §120.709, What is the Microloan Revolving Fund?, and §120.710(a), What is the Loan Loss Reserve Fund?, SBA proposes to remove the requirement that Deposit Accounts, as defined in §120.701(a), be interest-bearing. SBA is proposing this change after receiving information from several Intermediaries that interest-bearing accounts are not readily available or require Intermediaries to pay a fee. This proposed rule eliminates the requirement that the Deposit Accounts be interest-bearing and, as a result, would reduce the burden and costs faced by microloan Intermediaries.

In §120.712, How does an Intermediary get a grant to assist Microloan borrowers?, SBA proposes to remove paragraph (c) to conform to current statutory authority. Section 120.712(c) states that Intermediaries that make at least 50 percent of their loans to small businesses located in or owned by residents of Economically Distressed Areas are not subject to the 25 percent grant contribution requirement. This Intermediary contribution waiver authority was removed from the statute in 2010. See 15 U.S.C. 636(m)(4), as amended by Pub. L. 111-240. Paragraphs (d) and (e) would be redesignated as paragraphs (c) and (d).

SBA proposes to add a new §120.716, What is the minimum number of loans an Intermediary must make each Federal fiscal year?, which would contain the minimum loan requirement for Intermediaries. The minimum loan requirement is currently contained in §120.1425(d)(2), Grounds for enforcement actions – Intermediaries participating in the Microloan Program and NTAPs, which is located in Subpart I, "Risk-Based Lender Oversight" (including oversight of Intermediaries). SBA is proposing to move the minimum loan requirement to Subpart G, which contains the other regulations specific to the Microloan Program. The new §120.716 would also specifically state that Intermediaries that do not meet the minimum loan requirement are not eligible to receive new grant funding. This is consistent with SBA's current policy and practice. SBA determines whether an Intermediary is eligible for grant funding based on the number of microloans made in the previous Federal fiscal year. An Intermediary that is ineligible for a grant due to failure to make the minimum number of microloans in the previous Federal fiscal year may become eligible for grant funding the following year by meeting the minimum number of loans for the current year. Section 120.1425(d)(2) would be revised to include a cross reference to the new §120.716.

Proposed §120.716 would also increase the minimum number of microloans that Intermediaries must close and fund each year. Currently, Intermediaries must close and fund (i.e., make an initial disbursement on) at least four loans each Federal fiscal year. Under the proposed rule, the minimum number of microloans will gradually increase to twelve per year. In FY2015, the minimum loan requirement will be six microloans. In FY2016, the requirement will increase to eight microloans. In FY2017 and thereafter, the requirement will increase to a minimum of twelve microloans each year.

SBA proposes to increase the minimum loan requirement for several reasons. First, many existing Intermediaries have repeatedly requested an increase in the requirement so that more grant funding is available for those Intermediaries that generate higher numbers of loans. Second, increasing the minimum number of loans will expand access to capital by increasing the total number of microloans made each year by Intermediaries. Finally, SBA believes that a minimum requirement of twelve loans, which represents approximately one microloan per month, is a reasonable standard that active lenders should be able to meet. Increasing the minimum loan requirement will require Intermediaries that currently make less than the minimum number of microloans per year to increase their lending. SBA proposes a graduated increase in the minimum loan requirement to allow Intermediaries sufficient time to build scale to meet the higher requirements.

SBA invites comments on all aspects of the proposed rule and, in particular, whether the proposed minimum loan requirements are achievable without sacrificing prudent lending standards. SBA would also like comments regarding the limitation on making of microloans to businesses with an Associate who is on probation or parole for certain offenses, and on how Intermediaries would comply with this requirement.

Compliance with Executive Orders 12866, 12988, 13132, and 13563, the Paperwork Reduction Act (44 U.S.C. Ch. 35) and the Regulatory Flexibility Act (5 U.S.C. 601-612)

Executive Order 12866

The Office of Management and Budget has determined that this proposed rule is a "significant" regulatory action for the purposes of Executive Order 12866. Accordingly, the next section contains SBA's Regulatory Impact Analysis. However, this is not a major rule under the Congressional Review Act, 5 U.S.C. 800.

A. Regulatory Objective of the Proposal

The proposed rule would allow any Microloan Program Intermediary to make microloans (loans of $50,000 or less) to businesses with an Associate who is on probation or parole; it increases the minimum number of loans that microloan Intermediaries must make annually; and it removes the requirement that the Microloan Revolving Fund

(MRF) and the Loan Loss Reserve Fund (LLRF) be held in interest-bearing Deposit Accounts. In addition, the proposed rule includes technical amendments that conform the regulations to current statutory authority.

B. Benefits of the Rule

The small business borrowers that receive loans from Microloan Program Intermediaries directly benefit from the Microloan Program. The most significant benefit to small business borrowers as a result of this proposed rule is increased access to capital. This proposed rule would allow Microloan Program Intermediaries to make loans to businesses with an Associate who is on probation or parole, except in limited circumstances. This change would meet the unmet financing and employment opportunity needs of this segment of the population.

Additionally, this proposed rule would require Intermediaries to meet a higher standard in terms of minimum loan production. Once fully implemented, this new standard will represent an increase of approximately 400 microloans per year. During FY 2012, 77 Intermediaries (approximately half of Intermediaries) made fewer than 12 microloans. As proposed, Intermediaries would be required to increase the number of microloans made each year in order to receive grant funding, which is used to provide technical assistance to borrowers and prospective borrowers. As a result, this proposed rule change would also increase the number of microborrowers receiving training with limited technical assistance resources. Finally, the rule change would encourage the expansion of Intermediaries into new lending territories to broaden the base of customers from which borrowers can be drawn. This expansion represents geographic growth in availability of capital for small business borrowers.

The final element of the proposed rule change, the removal of the interest-bearing requirement on deposit accounts, will ultimately mean more financing capital and technical assistance training for small business borrowers. Banks often charge monthly fees for use of interest-bearing deposit accounts. By allowing microloan Intermediaries to use non-interest bearing accounts, the Intermediaries will have additional resources to use toward providing loans or technical assistance.

C. Costs of the Rule

The proposed rule changes would impact the approximately 77 Intermediaries making fewer than twelve microloans per year. However, the graduated introduction of the higher minimum loan requirement will lessen the cost faced by the Intermediaries by allowing additional time to ramp up loan production. Because the financing capital is provided by SBA, the only cost to the Intermediaries will be the operating expenses associated with the increased number of loans that are not covered by the interest rate spread allowed by the program.

SBA does not anticipate that the proposed rule changes will impact the program's subsidy model. For loans to businesses with an associate on parole or probation, SBA believes that Intermediaries will continue to make prudent lending decisions regardless of whether a micro-borrower is a member of the newly eligible population. Because SBA does not expect the new population of borrowers to have a different repayment rate than the rest of the borrowers, inclusion of this population in the model will not impact subsidy.

Since the subsidy models do not use as an input the number of microloans made by Intermediaries to micro-borrowers, increasing the minimum number of loans made per year will not impact subsidy. Finally, SBA believes that a change in the interest-bearing nature of the MRF and LLRF accounts will not impact subsidy. The MRF and LLRF are established for each loan made to an intermediary. MRF consists of loan proceeds from SBA to the Intermediary. Microloans to micro-borrowers and microloan repayments are processed through this account. A Loan Loss Reserve Fund (LLRF) is established and maintained at 15% of the outstanding balance of microloans owed to the Intermediary under the corresponding loan from SBA. In the event that an Intermediary defaults on its payments or goes out of business or ceases to participate in the Microloan program, SBA will have right to the proceeds in the MRF and LLRF up to the amount due to SBA under the program.

D. Alternatives

SBA received a number of recommendations and support for the proposed changes on numerous occasions from Intermediaries. Such comments came during conference calls, training conferences, and in some cases, letters from Intermediaries. The Intermediaries that have provided input to SBA seek more efficient ways to use limited resources, ensure that resources are going where most needed, and to reduce administrative costs. The proposed regulatory changes will move the Microloan Program to the next level of market expansion, cost reduction, and better utilization of taxpayer dollars. SBA believes that this rule is SBA's best available means for increasing access to capital for women, low income individuals, minority entrepreneurs, and other small businesses which need small amounts of financial assistance. SBA also believes that it will encourage self-employment as an option for those not easily employable due to mistakes in their past.

Executive Order 12988

This action meets applicable standards set forth in §§3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. This action does not have retroactive or preemptive effect.

Executive Order 13132

SBA has determined that the proposed rule will not have substantial, direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, for the purposes of Executive Order 13132, SBA has determined that this proposed rule has no federalism implications warranting preparation of a federalism assessment.

Executive Order 13563

Executive Order 13563 reaffirms the principles of E.O. 12866 while calling for improvements in the nation's regulatory system to promote predictability, to reduce uncertainty, and to use the best, most innovative, and least burdensome tools for achieving regulatory ends. The executive order directs agencies to consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public where these approaches are relevant, feasible, and consistent with regulatory objectives. E.O. 13563 emphasizes further that regulations must be based on the best available science and that the rulemaking process must allow for public participation and an open exchange of ideas. We have developed this rule in a manner consistent with these requirements. This rule is also part of the Agency's commitment under the Executive Order to reduce the number and burden of regulations.

A description of the need for this regulatory action and benefits and costs associated with this action is included above in the Regulatory Impact Analysis under Executive Order 12866. SBA discussed implementing these proposed rule changes with Microloan Program Intermediary associations and representatives from Intermediaries during conference calls. In addition, these issues were discussed during the Microloan Training Conference with Intermediaries in 2012. Most of these proposed changes were specifically requested by Intermediaries.

Paperwork Reduction Act, 44 U.S.C., Ch. 35

SBA has determined that this proposed rule would not impose any new reporting and recordkeeping requirements under the Paperwork Reduction Act, 44 U.S.C. Chapter 35. The Microloan Program Electronic Reporting System (MPERS) is approved under OMB Control Number 3245-0352, ICR Reference Number 201011-3245-004 and the SBA Lender Microloan Intermediary and NTAP Reporting Requirements are approved under OMB Control Number 3245-0365, ICR Reference Number 201203-3245-001.

Regulatory Flexibility Act 5 U.S.C. 601-612

The Regulatory Flexibility Act (5 U.S.C. 601-612) (RFA) requires administrative agencies to consider the economic impact of their actions on small entities, which includes small businesses, small nonprofit businesses, and small local governments. The RFA requires agencies to prepare a regulatory flexibility analysis, which describes the economic impact that the rule will have on small entities, or certify that the rule will not have a significant economic impact on a substantial number of small entities.

SBA has determined that this rule affects a substantial number of small entities, but that it will not have significant impact on those entities. All of the Intermediaries that participate in the Microloan program are small nonprofit or quasi-governmental entities. Approximately half of the 148 existing Intermediaries will be required to increase loan production in order to meet the new minimum loan requirements. SBA anticipates that approximately 15 of these Intermediaries may choose not to participate in the Microloan Program as result of the increased lending requirement. These 15 Intermediaries made fewer than 4 loans in FY 2012 and may choose not to increase loan production to meet the higher requirements. These entities are making so few loans, and generating so little revenue from those loans, that exiting the program will not cause a significant economic impact.

SBA estimates that entities leaving the program will lose approximately $15,000 in annual revenue associated with microloans that would have been made under the SBA Microloan Program. The $15,000 represents approximate annual interest and fee income for 3 microloans of $50,000. An organization making just three microloans a year is not sustainable and must rely on other sources of income to operate. Additionally, these entities are already out of compliance with program requirements and as a result, do not receive grants through the Microloan Program.

The graduated introduction of the minimum loan requirement will allow Intermediaries additional time to ramp up loan production. The proposed rule would require six microloans in 2015, eight microloans in 2016, and twelve loans per year in 2017 and thereafter. This graduated approach allows Intermediaries to adapt business practices to meet higher loan requirements. For example, rural Intermediaries may seek out new ways to utilize technology to more efficiently serve rural areas and therefore, make more microloans. Additionally, the graduated approach allows Intermediaries to anticipate and seek out future funding needs to meet increased microloan requirements. Finally, SBA will offer a series of training events for Intermediaries to share best practices related to building up an organization's capacity to make more microloans.

Accordingly, the Administrator of SBA hereby certifies that this rule will not have a significant economic impact on a substantial number of small entities. SBA invites comment from members of the public who believe there will be a significant impact either on Microloan Intermediaries, or on microborrowers that receive funding from Microloan Intermediaries.

List of Subjects in 13 CFR Part 120

Community development, Equal employment opportunity, Loan programs-business, Reporting and recordkeeping requirements, Small business.

For the reasons stated in the preamble, SBA proposes to amend 13 CFR Part 120 as follows:

PART 120 - BUSINESS LOANS

1. The authority citation for 13 CFR Part 120 continues to read as follows:

Authority: 15 U.S.C. 634(b)(6), (b)(7), (b)(14), (h), and note, 636(a), (h) and (m), 650, 687(f), 696(3), and 697(a) and (e); Pub. Law 111–5, 123 Stat. 115, Pub. Law 111–240, 124 Stat. 2504.

2. Amend §120.701 by revising paragraph (d) to read as follows:

§120.701 Definitions.

* * * * *

(d) Insured depository institution means any Federally insured bank, savings association, or credit union.

* * * * *

3. Amend §120.707 by revising paragraph (a) to read as follows:

§120.707 What conditions apply to loans by Intermediaries to Microloan borrowers?

(a) Except as otherwise provided in this paragraph, an Intermediary may only make Microloans to small businesses eligible to receive financial assistance under this part. A borrower may also use Microloan proceeds to establish a nonprofit child care business. An Intermediary may also make Microloans to businesses with an Associate who is currently on probation or parole, provided, however, that the Associate is not on probation or parole for an offense involving fraud or dishonesty or, in the case of a child care business, is not on probation or parole for an offense against children. Proceeds from Microloans may be used only for working capital and acquisition of materials, supplies, furniture, fixtures, and equipment. SBA does not review Microloans for creditworthiness.

* * * * *

4. Amend §120.709 by revising the first sentence to read as follows:

§120.709 What is the Microloan Revolving Fund?

The Microloan Revolving Fund ("MRF") is a Deposit Account into which an Intermediary must deposit the proceeds from SBA loans, its contributions from non-Federal sources, and payments from its Microloan borrowers. * * *

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5. Amend §120.710 by revising paragraph (a) to read as follows:

§120.710 What is the Loan Loss Reserve Fund?

(a) General. The Loan Loss Reserve Fund ("LLRF") is a Deposit Account which an Intermediary must establish to pay any shortage in the MRF caused by delinquencies or losses on Microloans.

* * * * *

§120.712 [Amended]

6. In §120.712, remove paragraph (c) and redesignate paragraphs (d) and (e) as paragraphs (c) and (d), respectively.

7. Add new §120.716 to read as follows:

§120.716 What is the minimum number of loans an Intermediary must make each Federal fiscal year?

(a) Minimum loan requirement. Intermediaries must close and fund the required number of microloans per year (October 1 – September 30) as follows:

(1) For fiscal year 2015, six microloans,

(2) For fiscal year 2016, eight microloans, and

(3) For fiscal years 2017 and following, twelve microloans per year.

(b) Failure to meet minimum loan requirement. Intermediaries that do not meet the minimum loan requirement are not eligible to receive new grant funding.

8. Amend §120.1425 by revising paragraph (d)(2) to read as follows:

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

* * * * *

(d) * * *

(2) Failure to close and fund the required number of microloans per year under §120.716.

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Dated: March 6, 2014.

Marianne O. Markowitz,
Acting Administrator.

[FR Doc. 2014-05549 Filed 03/14/2014 at 8:45 am; Publication Date: 03/17/2014]