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## SMALL BUSINESS ADMINISTRATION

13 CFR Part 120

RIN: 3245-AG97

Streamlining and Modernizing Certified Development Company Program (504 Loan Program) Corporate Governance Requirements

AGENCY: U.S. Small Business Administration.

ACTION: Final rule.

**SUMMARY:** This final rule streamlines and updates the operational and organizational requirements for Certified Development Companies (CDCs) in order to improve efficiencies and reduce costs without unduly increasing risk in the 504 Loan Program.

The changes include streamlining the requirements that apply to the corporate governance of CDCs, and updating the requirements that apply to professional services contracts entered into by CDCs, the requirements related to the audit and review of a CDC's financial statements, and the requirements related to the balance that a Premier Certified Lender Program (PCLP) CDC must maintain in its Loan Loss Reserve Fund.

**DATES:** This rule is effective on [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN FEDERAL REGISTER].

**FOR FURTHER INFORMATION CONTACT:** Linda Reilly, Chief, 504 Program Branch, Office of Financial Assistance, U.S. Small Business Administration, 409 3rd Street, SW, Washington, DC 20416; telephone: (202) 205-9949; email: [linda.reilly@sba.gov](mailto:linda.reilly@sba.gov).

**SUPPLEMENTARY INFORMATION:**

## I. Background

The 504 Loan Program is a U.S. Small Business Administration (SBA) financing program authorized under Title V of the Small Business Investment Act of 1958, 15 U.S.C. 695 et seq. The core mission of the 504 Loan Program is to provide long-term financing to small businesses for the purchase or improvement of land, buildings, and major equipment in an effort to facilitate the creation or retention of jobs and local economic development. Under the 504 Loan Program, loans are made to small businesses by Certified Development Companies (CDCs), which are certified and regulated by SBA to promote economic development within their community. In general, a project in the 504 Loan Program (a 504 Project) is financed with: a loan obtained from a private sector lender with a senior lien covering at least 50 percent of the project cost (the Third Party Loan); a loan obtained from a CDC (the 504 Loan) with a junior lien covering up to 40 percent of the total cost (backed by a 100 percent SBA-guaranteed debenture sold in private pooling transactions); and a contribution from the Borrower of at least 10 percent equity.

On April 15, 2019, SBA published a proposed rule in the *Federal Register* to simplify, streamline, and update SBA's regulations relating to CDC operational and organizational requirements in order to improve efficiencies and achieve cost savings without compromising performance in the 504 Loan Program. *See* 84 FR 15147. The comment period was open until June 14, 2019. SBA received a total of 100 comments from 58 CDCs, 18 individuals who are employed by or otherwise associated with a CDC, 11 other individuals, 2 trade associations, 4 banks (SBA received two comments from the

same bank for a total of 5 comments from banks), 3 from other private companies, and 3 from anonymous sources. The comments are summarized and addressed below.

## II. Summary of Comments Received

### A. Section 120.818 Applicability to existing for-profit CDCs.

SBA proposed to amend § 120.818 to reinstate the prohibition, which was inadvertently eliminated from the regulations in 2014, against any person or entity owning or controlling more than ten percent of a for-profit CDC's voting stock. The purpose of the 10 percent limit on stock ownership was to ensure that no one person or entity can control a for-profit CDC. SBA received 55 comments on § 120.818; all but one of the commenters supported reinstating this requirement. One of the commenters who supported reinstating an ownership limit argued that the 10 percent limit is lower than needed to prevent control by a person or entity and recommended a 20 percent limit instead.

The one opposing commenter argued that there is no rational basis for the 10 percent limit and that imposing this limit on for-profit CDCs is inconsistent with the intent behind 13 CFR 120.818 that for-profit and non-profit CDCs be subject to the same regulations. The commenter also argued that SBA must either compensate the stockholders who would have to divest as a result of the 10 percent limit or phase in the requirement over the course of a number of years to allow recovery on the investment; otherwise, the commenter argued, the 10 percent limit would be subject to challenge as a regulatory "taking." In addition, the commenter disagreed with SBA's conclusion that this change will not have a significant impact on a substantial number of small entities

and contended that this change requires SBA to conduct an initial regulatory flexibility analysis under 5 U.S.C. 603.

SBA has considered these comments and has decided to adopt the proposed changes to the ownership and control requirements with two revisions: (1) the 10 percent limit on the ownership of stock by any one person or entity will be raised to 25 percent; and (2) for non-profit CDCs with a Board of Directors elected or appointed by the CDC's membership, no person or entity can control more than 25 percent of the voting membership of the CDC.

With respect to the first revision, SBA reviewed the current ownership percentages for each of the four for-profit CDCs and determined that the largest stock ownership by any one shareholder is just under 24 percent. (SBA notes that a CDC's corporate (or treasury) stock should not be included in the calculation of the ownership percentage of the CDC's voting stock.) With the increase of the limit to 25 percent, no person or entity currently owning any stock in a for-profit CDC will be required to divest any portion of their stock ownership and, thus, there will be no significant economic impact on any small entity as a result of this provision.

With respect to the second revision, SBA agrees with the commenter that for-profit and non-profit CDCs should be subject to the same standards governing control of a CDC. Almost half of non-profit CDCs have chosen to continue to have memberships since the membership requirement was eliminated in 2014 and, under the bylaws of many of these CDCs, the members appoint or elect directors to the CDC's Board. To ensure that no one individual or entity can control the voting membership of a CDC when the members elect or appoint directors to the Board, the 25 percent limit should apply to

these non-profit CDCs in the same manner that the 25 percent limit will apply to for-profit CDCs. Accordingly, in response to the comments, SBA is revising § 120.816 by adding a paragraph (d) to provide that, if a non-profit CDC's membership elects or appoints the voting directors to the CDC's Board of Directors, no one person or entity can control more than 25 percent of the voting membership of the CDC.

These two revisions will reinstate what has long been a feature of SBA's development company programs – that no one person or entity can control a CDC. Before the 10 percent limit was inadvertently removed from the regulations in 2014, it had been SBA's policy since 1982, nearly from the beginning of the 503 Development Company Program<sup>1</sup>, to limit the ownership or control that any one person or entity could have over a development company to 10 percent. See 13 CFR 108.503-1(c)(1) (1983) (“No member or stockholder [of a 503 company] may own or control more than ten percent of the development company's stock or voting membership”). In addition, as early as 1973, SBA prohibited any shareholder or member of a development company participating in the 502 Local Development Company Program (which is no longer funded) from owning in excess of 25 percent of the voting control in the development company under certain circumstances. See 13 CFR 108.2(d)(2) (1974).

The limitation on ownership and control was carried over into the 504 Loan Program in 1986, with the former § 108.503-1(d)(1) (1987) requiring a CDC to have at least 25 members (if non-profit) and 25 stockholders (if for-profit) and prohibiting any one person or entity from owning or controlling more than 10 percent of the CDC's stock or voting membership. With the Board of a nonprofit CDC chosen from the CDC's

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<sup>1</sup> The 503 Development Company Program was authorized by § 113 of P.L. 96-392, approved July 2, 1980 (94 Stat. 833). This program was the predecessor program to the 504 Loan Program.

membership, and the Board of a for-profit CDC chosen by the CDC's stockholders, it was necessary to prohibit any one person or entity from controlling the voting membership or stock of the CDC to avoid any one person or entity from being able to control the Board. Thus, SBA has consistently applied the same ownership and control standards to both for-profit and non-profit CDCs and is continuing that practice in this final rule.

The opposing commenter also argued that fewer owners of a for-profit CDC generally means a greater investment by those owners and that, with a greater investment, the owners have more to lose from non-performing loans and more incentive to comply with SBA's Loan Program Requirements. SBA notes that all CDCs are required to comply with SBA's Loan Program Requirements, and the commenter provided no evidence to support the view that permitting a greater financial stake in a CDC by individual owners would increase the likelihood of such compliance. In any event, SBA believes that a greater financial stake by an individual shareholder should not be necessary to ensure such compliance or to motivate the CDC to make successful loans. As reflected in the long regulatory history of the program, the primary purpose of the 504 Loan Program (and its predecessor development company programs) is to foster economic development, and SBA has long emphasized the *pro bono publico* nature of the 504 Loan Program over the profit incentive and that the program was not intended to be a profit center for owners. See, e.g., 13 CFR 108.2 (1995) (Definition of "Development company") ("the primary objective of the development company must be the benefit to the community as measured by increased employment, payroll, business volume...rather than monetary profits to its shareholders or members; any monetary profits or other

benefits which flow to the shareholders or members of the local development company must be merely incidental thereto) (emphasis added); see also 51 FR 20764, 20765 (June 6, 1986) (“The nature of the 503 company is to be a catalyst in fostering economic development, and not a profit center for owners or members”).

SBA believes that the public purpose of the 504 Loan Program is best achieved when the profit motive is not amplified by allowing the control of a for-profit CDC to be concentrated in any one person or entity. Moreover, SBA believes that economic development is best fostered by having a wider range of views and interests represented in the CDC’s decision-making and that, by not allowing the ownership or control of a CDC to be concentrated in any one individual or entity, it is more likely that the economic benefits of the 504 Loan Program will be dispersed throughout the community. Therefore, after consideration of the comments, SBA is finalizing the proposal with the two changes described above.

B. Section 120.823 CDC Board of Directors.

SBA proposed to amend § 120.823 by:

(1) revising paragraph (a) to lower the minimum number of directors required for the CDC’s Board from nine to seven, which reduces the number needed for a quorum from five to four. For consistency with this change, SBA also proposed to amend § 120.823(d)(4)(ii)(B) to reduce the number of members needed for a quorum of the CDC’s Loan Committee from five to four;

(2) removing the provision in § 120.823(a) that recommends that a CDC have no more than 25 directors;

(3) clarifying in paragraphs (a) and (d)(4)(ii)(E) that Board and Loan Committee members are required “to live or work in the CDC’s State of incorporation”. SBA proposed to use this simpler phrase instead of the current language – which states that members are required “to live or work in the Area of Operations of the State where the 504 project they are voting on is located” – because today the minimum Area of Operations for each CDC is the State in which the CDC is incorporated. SBA also proposed to allow Board members to live or work in an area that would meet the definition of a Local Economic Area (LEA) for the CDC. For consistency, the rule proposed to apply this same standard to Loan Committee members;

(4) deleting the requirement in § 120.823(a) that CDCs must have at least one voting director who only represents the economic, community, or workforce development fields, and adding “the economic, community, or workforce development fields” to the five other areas of expertise identified in the current § 120.823(a) that must be represented on the Board; and

(5) removing § 120.823(c)(4), which limits the number of directors in the commercial lending field to less than 50 percent of the Board of Directors.

SBA received 58 comments on the above changes, with 56 commenters supporting all of the changes and two commenters opposing a few of the changes. One CDC opposed deleting the requirement that the Board have at least one voting director to represent the economic, community, or workforce development fields (described in paragraph (4) above). The commenter stated that the CDC has benefited from having a director devoted to the economic field, and that this expertise has proven invaluable to lending in rural areas. The commenter believes that it would be a loss from a national

perspective to eliminate the requirement. SBA appreciates the commenter's perspective, but points out that, with this change, the CDC would still be required to have the economic, community or workforce development fields represented on the Board. The difference is that the Board member would be able to represent more than one area of expertise and not only the economic, community or workforce development fields.

The same commenter also opposed removing the requirement that limits the number of directors in the commercial lending field to less than 50 percent of the Board (described in paragraph (5) above). The commenter stated that this change could result in a Board composed of all commercial lenders, which may not serve the 504 Loan Program's purpose of promoting economic development. However, as noted in the proposed rule, the regulation will continue to require that the Board include members with background and expertise in the five other identified areas, including the economic, community or workforce development fields; internal controls; financial risk management; legal issues relating to commercial lending; and corporate governance. SBA believes that this requirement will ensure an appropriate level of diversity of experience on the Board.

Another commenter wrote in opposition to the change described in paragraph (3) above. This commenter argued that requiring Board members to live or work in the CDC's Area of Operations is a new legal requirement that provides no benefit to the program and deprives CDCs of the assistance of individuals who own second homes in the State or temporarily reside outside the State for work or other reasons while retaining a strong connection to the State. However, as noted in the proposed rule, it has long been SBA's policy to require Board members to live or work in the CDC's Area of Operations

(today, the minimum Area of Operations for each CDC is the State in which the CDC is incorporated and, therefore, it is more accurate to use the phrase “State of incorporation” instead of “Area of Operations” in connection with this policy). This requirement to live or work in the CDC’s State of incorporation furthers the local nature of the 504 Loan Program, obligates Board members to have more than a temporary or tenuous connection to the CDC’s State of incorporation, and ensures that the CDC is under the control of individuals with a vested and demonstrable interest in the community in which the CDC is investing. In addition, members who live or work in the CDC’s State of incorporation will have a better knowledge of the Area’s economic environment. By reducing the required number of Board members from 9 to 7, SBA is also making it less difficult for CDCs to find individuals to serve on the Board.

SBA is adopting all of the changes to § 120.823 as proposed. In addition, to conform § 120.823(d)(4)(i)(B) to the change described in paragraph (1) above, SBA is reducing the minimum number of voting members who must be present to conduct business on the CDC’s Executive Committee (if established) from five to four.

C. Section 120.824 Professional management and staff.

1. Professional Services Contracts between CDCs

SBA proposed to amend § 120.824 to permit a CDC to contract with another CDC for marketing, packaging, processing, closing, servicing, or liquidation functions under the following conditions:

(1) a CDC may enter into a professional services contract with another CDC even if the arrangement would give rise to an affiliation between the CDCs based on an “identity of interest”, as defined under 13 CFR 121.103(f)<sup>2</sup>;

(2) the contract between the CDCs must be pre-approved by the Director of the Office of Financial Assistance (D/FA) (or designee), in consultation with the Director of the Office of Credit Risk Management (D/OCRM) (or designee), who will determine in his or her discretion that such approval is in the best interests of the 504 Loan Program and that the contract includes terms and conditions satisfactory to SBA. (The proposed rule also provided that a contract for management services with another CDC may be entered into only in accordance with redesignated § 120.824(a)(1)(ii) and with the prior approval of the D/FA (or designee), in consultation with the D/OCRM (or designee));

(3) the CDCs entering into the contract must be located either in the same SBA Region or, if not in the same SBA Region, must be located in contiguous States;

(4) a CDC may provide assistance to only one CDC per State;

(5) no CDC may provide assistance to another CDC in its State of incorporation or in any State in which the CDC has Multi-State authority;

(6) the Board of Directors for each CDC entering into the contract must be separate and independent and may not include any common directors, whether voting or non-voting. In addition, if either of the CDCs is for-profit, neither CDC may own any stock in the other CDC (notwithstanding § 120.820(d), which allows a CDC to invest in

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<sup>2</sup> Under 13 CFR 121.103(f), an identity of interest is created when the CDCs have identical or substantially identical business or economic interests or are economically dependent through contractual or other relationships. For example, under § 121.103(f), if all or most of the CDC’s key functions (including 504 and non-504 functions in the aggregate) are performed by staff that is obtained under contract with another CDC, the two CDCs may be affiliated based on an identity of interest.

or finance another CDC with the prior written approval of SBA officials). The CDCs are also prohibited from comingling any funds;

(7) the CDCs and the contract must comply with the other requirements for professional services contracts set forth in the proposed § 120.824(a) (which are now set forth in the final rule in § 120.824(c));

(8) a contract between CDCs may not include services for either independent loan reviews or management services (except rural CDCs could continue to contract for management services with another CDC as described in the current § 120.824(a)(2)); and

(9) affiliation between CDCs based on grounds other than identity of interest, including but not limited to, through ownership or common management under § 121.103(c) and (e), respectively, would continue to be prohibited.

SBA received a total of 63 comments on some or all of the above changes. Most expressed general support for the flexibility that the above changes would provide with respect to the contracts between CDCs, but nearly all expressed opposition to the following two changes: (A) the geographic restrictions on contracts between CDCs (paragraphs (3), (4), and (5) above), and (B) the prohibition against CDCs conducting independent loan reviews for each other (paragraph 8 above).

(A) Geographic Restrictions on Contracts Between CDCs.

SBA received 62 comments on the changes described in paragraphs (3), (4), and (5) above which place geographic limits on these contracts, with one commenter writing to generally support the geographic restrictions and the remaining 61 commenters writing to oppose them. Nearly all of the opposing commenters argued that these contracts should be evaluated primarily on the quality of the CDC service provider, not on

geography. They contended that permitting a CDC to contract with another CDC outside its SBA Region would allow a CDC to select from a larger and more competitive field of qualified providers and avoid concerns about sharing market and customer data with a potential competitor. Some also objected to applying this restriction to contracts currently in place, and state that SBA's concerns can be addressed through the current contract review process.

In addition, four commenters suggested that a CDC should not be able to provide services to more than three other CDCs in its SBA Region (one of the commenters suggested that the limit should be two), arguing that this limit would prevent CDCs from essentially becoming regional through these agreements, and that it would ensure that the assisting CDC continues to focus on its primary area of operation. Two commenters stated that a CDC should be allowed to service another CDC only if the CDC has demonstrated its first responsibility to its primary market by making an average of 10 or more loans in its primary State during the previous 3 years.

SBA has considered these comments and has decided to adopt the geographic restrictions on these contracts as proposed, with exceptions for liquidation services and independent loan reviews as described below. SBA's decision to not allow CDCs to contract outside their SBA Region or a contiguous State is based on its commitment to maintaining a balance among three factors: the local nature of the 504 Loan Program, SBA's interest in helping smaller CDCs obtain assistance from their larger counterparts when needed to function in the best interests of the 504 Loan Program, and SBA's current regulatory framework that allows CDCs to expand their Area of Operations only under certain prescribed conditions, *e.g.*, Multi-State and Local Economic Area

expansions under § 120.835. SBA has long been concerned about CDCs using these contracts to circumvent the established expansion standards and to encroach into areas far beyond their established Area of Operations. In balancing these factors, SBA continues to conclude that CDCs should be able to contract with each other even if the arrangement gives rise to an affiliation based on identity of interest, but only under the conditions described above, including that the CDCs must be located within the same SBA Region or in a contiguous State. SBA also believes that the proposed geographic restrictions taken together – including that CDCs entering into the contract must be located either in the same SBA Region or in a contiguous State, that a CDC may provide assistance to only one CDC per State, and that no CDC may provide assistance to another CDC in its State of incorporation or in any State in which the CDC has Multi-State authority – will adequately protect against any one CDC dominating its SBA Region. SBA further expects that a CDC in need of assistance from another CDC will be motivated to contract only with those CDCs that have demonstrated their ability and capacity to perform effectively in their primary market.

With respect to the comments that object to applying the geographic restrictions to any contract currently in place between CDCs, SBA begins by noting that current § 120.820(a) requires CDCs to be independent (with exceptions for certain types of affiliations). To ensure that contracts between CDCs would not undermine the intent of this regulation, SBA has required since 2015 that contracts between CDCs be limited in time and scope and have a transition phase leading to contract termination. *See* SOP 50 10 5(H), Subpart A, Chapter 3, ¶ II.A.7.(e)(ii). (To provide more certainty with respect to the permitted duration for these contracts, SBA added a 5-year limit to the SOP in

January 2018. *See* SOP 50 10 5(J), Subpart A, Chapter 3, ¶ II.A.8.d(ii)). Any CDC that currently contracts with another CDC outside its SBA Region has, therefore, been on notice for several years that SBA policy prohibited its contract from continuing indefinitely. There are four CDCs that currently have contracts with five other CDCs outside their SBA Region. As stated in the proposed rule, these CDCs will be permitted to continue these contracts until the current term of the contract expires, giving them the opportunity to make the changes necessary to comply with the final rule.

As indicated above, SBA is adopting an exception to the geographic restriction for contracts for liquidation services. (The second exception for independent loan reviews is discussed in paragraph (B) below.) SBA believes that it will be beneficial to the 504 Loan Program to allow a CDC to assist another CDC with liquidation services when needed, regardless of the location of the CDCs. Because liquidation services are provided at the final stage of a 504 loan, there is no risk of a CDC using a liquidation services contract as a means to expand its 504 operations into other SBA Regions. Accordingly, SBA is revising the rule to allow a CDC to contract with another CDC outside its SBA Region for liquidation services.

(B) Independent Loan Reviews.

SBA received a total of 54 comments on the prohibition in paragraph (8) against a CDC contracting with another CDC for services for independent loan reviews. One commenter supported this prohibition due to the potential conflict of interest problems that could arise, and the remaining 53 opposed the prohibition (except that one of these commenters argued that two CDCs should not be able to conduct reviews for each other). The opposing commenters observed that CDCs are currently allowed to perform these

reviews internally if they use staff that are independent from the function being reviewed and, therefore, they argued that CDCs should be able to provide this service to each other. The commenters recognized that SBA would need to carefully monitor the contracts between CDCs and that CDCs would also need to carefully consider potential conflicts of interest. They argued that SBA would have the opportunity to evaluate the quality of these reviews when they are submitted with the CDC's Annual Report.

Based on these comments, SBA has decided to allow a CDC to contract with another CDC for independent loan review services without any geographic restriction subject to the following two conditions. First, to avoid any possibility of a quid-pro-quo, the CDCs may not review each other's portfolios or exchange any other services, nor may they enter into any other arrangement with each other that could appear to bias the outcome or integrity of the independent loan review. Second, due to the potential conflicts of interest that may arise, the contracts between CDCs for independent loan reviews must be pre-approved by the D/FA (or designee) in consultation with the D/OCRM (or designee).

## 2. Other Changes that Would Apply to All Professional Services Contracts

SBA proposed the following changes to § 120.824 that would apply to all professional services contracts (including professional services contracts between CDCs):

(1) SBA's prior approval would be required for co-employment contracts that a CDC wants to enter into with a third party, such as a professional employer organization, to obtain employee benefits, such as retirement and health benefits, for the CDC's staff. These contracts must provide that the CDC retains the final authority to hire and fire the CDC's employees;

(2) Services for information technology and independent loan reviews would be added to the list of the types of contracts that CDCs may enter into without obtaining prior SBA approval (except, as discussed above, the proposed rule prohibited CDCs from contracting with another CDC for independent loan reviews);

(3) SBA proposed to make the following clarifying and technical changes to § 120.824:

(a) Under the current § 120.824(c) (to be redesignated in the final rule as § 120.824(c)(2)(ii)), the contracts must clearly identify terms and conditions satisfactory to SBA that permit the CDC to terminate the contract prior to its expiration date on a reasonable basis. To give CDCs procuring services maximum flexibility, SBA proposed to revise the standard under which the CDC procuring the services may terminate the contract to “with or without cause”;

(b) Under the current § 120.824(d), the CDC must provide copies of these contracts to SBA for review annually. SBA proposed to revise this provision (to be redesignated in the final rule as § 120.824(c)(4)) to clarify that the CDC procuring the services must provide a copy of all executed contracts to SBA as part of the CDC’s Annual Report submitted under § 120.830(a) unless the CDC certifies that it has previously submitted an identical copy of the executed contract to SBA;

(c) Under the current § 120.824(e)(1), the CDC’s Board must demonstrate to SBA that “the compensation under the [professional services] contract is only from the CDC”. For clarity, SBA proposed to revise this provision (to be redesignated in the final rule as § 120.824(c)(2)(i)) to state that “the compensation under the contract is paid only by the CDC”;

(d) Under the current § 120.824(e)(3), the CDC’s Board must demonstrate that the contracts do not “evidence” any actual or apparent conflict of interest or self-dealing. For clarity, SBA proposed to revise this provision (to be redesignated as § 120.824(c)(2)(iii)) to require the Board to demonstrate that there is no actual or apparent conflict of interest or self-dealing in the negotiation, approval or implementation of the contract;

(e) Under the current § 120.824(f) (to be redesignated in the final rule as § 120.824(c)(3)), no contractor or Associate of a contractor may be a voting or non-voting member of the CDC’s Board. The term “Associate” is generally defined in § 120.10 with respect to a lender, CDC or small business, but not with respect to a contractor of a CDC. SBA proposed to replace the phrase “Associate of a contractor” with text that is consistent with the definition of Associate in § 120.10: “Neither the contractor nor any officer, director, 20 percent or more equity owner, or key employee of a contractor may be a voting or non-voting member of the CDC’s Board.”

SBA received no comments opposing these changes and is adopting the changes to § 120.824 as proposed except that, as discussed above in SBA’s response to the comments on the geographic limits on contracts between CDCs, the D/FA (or designee), in consultation with the D/OCRM (or designee), must pre-approve contracts between CDCs for independent loan reviews.

In addition, SBA is reorganizing this section to make it simpler and clearer. Specifically, in the final rule, subsection (a) of 120.824 now addresses the management requirements that apply to CDCs and under what circumstances a CDC may request a waiver of the requirement that the CDC directly employ the CDC manager and obtain

management services through a contract; subsection (b) now addresses the functions that the professional staff of the CDC must be capable of performing; subsection (c) now addresses the requirements that apply when a CDC obtains services through a professional services contract; and subsection (d) now addresses the additional requirements that apply to professional services contracts between CDCs. The reorganization of this section is not intended to make any substantive changes to the content of the rule other than as described above in this section C.

D. Section 120.826 Basic requirements for operating a CDC.

SBA proposed to increase the dollar threshold that triggers an annual audit of the CDC's financial statements under § 120.826 from \$20 million to \$30 million. Under the rule as proposed, for loan portfolio balances of less than \$30 million, the CDC would be able to submit a financial statement that is reviewed by an independent certified public accountant in accordance with generally accepted accounting principles (GAAP) instead of an audited financial statement. There are currently 60 CDCs with a portfolio balance under \$20 million and the increase to \$30 million would add 19 CDCs to the number of CDCs that may submit reviewed financial statements, for a total of 79 CDCs that would save the difference in cost between an audited financial statement and a reviewed financial statement. SBA estimates the cost savings to be \$15,000 annually for each CDC. As noted in the proposed rule, a CDC with a portfolio balance of less than \$30 million may be required to provide audited financial statements at the discretion of the D/OCRM when the CDC is in material noncompliance with SBA's Loan Program Requirements (defined in § 120.10), such as with requirements related to financial solvency or business integrity.

SBA received 62 comments on the proposed changes to § 120.826, and all 62 comments supported the proposal but requested that SBA increase the amount that triggers the annual audit requirement to \$50 million instead of \$30 million. SBA considered these comments but, due to the inherent risks of a larger portfolio and due to the fact that SBA is already raising the amount that triggers the audit by 50 percent, SBA believes that it would not be prudent to raise the amount further. SBA is adopting the changes to § 120.826 as proposed.

E. Section 120.835 Application to expand an Area of Operations.

SBA proposed to amend paragraph (c) of § 120.835 to offer the following alternative to establishing a Loan Committee in each State into which the CDC expands as a Multi-State CDC: if the CDC has established a Loan Committee in its State of incorporation, then when voting on a Project in the additional State, the CDC must include at least two individuals who live or work in that State on the CDC's Loan Committee. To make it clear that the two individuals added to the Loan Committee are permitted to vote only on the Projects located in the additional State into which the CDC expands and would not be eligible to participate in voting on Projects in the CDC's State of incorporation, SBA proposed to add the term "only" after "[c]onsist" in § 120.823(d)(4)(ii)(E). If the CDC has not established a Loan Committee in its State of incorporation, the alternative would allow two individuals who live or work in the additional State to be included on the CDC's Board of Directors when voting on a Project in that State. SBA also proposed to amend three other provisions to conform the rules to this amendment, including adding a reference about the alternative in § 120.823(d)(4)(ii)(E), removing the reference to § 120.839 in § 120.823(d)(4)(ii)(E), and

using the phrase “live or work in the CDC’s State of incorporation” instead of “live or work in the Area of Operations of the State where the 504 project they are voting on is located”.

SBA received a total of 57 comments on this proposed change. There were no opposing comments, though two commenters submitted differing points of view with respect to whether the two individuals added to the Loan Committee or Board should only be able to vote on Projects located in the additional State. One commenter requested that the two individuals be able to vote on all of the CDC’s Projects, and the second commenter argued that the two members who represent the additional State on the CDC’s Loan Committee or Board should be different persons than those serving on the Loan Committee or Board in the CDC’s State of incorporation.

The latter commenter’s suggestion is consistent with SBA’s intent in providing this alternative option and is the reason why SBA proposed to revise § 120.823(d)(4)(ii)(E) to require that the Loan Committee consist only of members who live or work in the CDC’s State of incorporation or in an area that would qualify as an LEA. The purpose behind this change was to give CDCs an alternative that would be less costly to creating a separate Loan Committee in the additional State, and not to expand the area from which a CDC could choose the members for its Board or Loan Committee in its State of incorporation.

Based on the comments, SBA believes that it can be made clearer that the two individuals who are added to either the Board or the Loan Committee under the alternative option may vote only on Projects in the additional State and, accordingly,

SBA is adding the following sentence at the end of § 120.835(c)(2): “These two members may vote only on Projects located in the additional State.”

SBA is adopting the rule as proposed with this revision.

F. Section 120.839 Case-by-case application to make a 504 loan outside of a CDC’s Area of Operations.

SBA proposed to expand paragraph (a) of § 120.839 to allow a CDC to apply to make a 504 loan outside its Area of Operations if the CDC has previously assisted either the business “or its affiliate(s).” SBA received a total of 57 comments in support of this change. One commenter requested that SBA allow a CDC to make loans outside its Area of Operations based on a Third Party Lender’s prior lending relationship with a business. However, what is important to SBA is that the CDC have the prior lending relationship with the business or its affiliates and, thus, SBA will not expand the change to allow CDCs to make loans outside their Area of Operations based on the prior relationship of a Third Party Lender. SBA is adopting the changes to § 120.839 as proposed.

G. Section 120.847 Requirements for the Loan Loss Reserve Fund (LLRF).

SBA proposed to revise paragraph (b) of this section to allow PCLP CDCs to maintain a balance in the LLRF equal to one percent of the current principal amount, instead of one percent of the original principal amount, of the PCLP Debenture after the loan is seasoned for 10 years. However, SBA proposed that a CDC may not use the declining balance methodology: (1) with respect to any PCLP Debenture that has been purchased, in which case the CDC must restore the balance maintained in the LLRF with respect to that Debenture to one percent of the original principal amount within 30 days after purchase; or (2) with respect to any other PCLP Debenture if SBA notifies the CDC

in writing that it has failed to satisfy the requirements in paragraphs (e), (f), (h), (i) or (j) of § 120.847. In the latter case, the CDC would not be required to restore the balance maintained in the LLRF to one percent of the original principal amount of the Debenture but must base the amount maintained in the LLRF on one percent of the principal amount of the Debenture as of the date of notification. The CDC may not begin to use the declining balance methodology again until SBA notifies the CDC in writing that SBA has determined, in its discretion, that the CDC has corrected the noncompliance and has demonstrated its ability to comply with these requirements. In paragraph (g), SBA also proposed to change the official to whom withdrawal requests should be forwarded from the Lead SBA Office to the D/OCRM (or designee).

SBA received a total of 55 comments supporting the proposed changes to § 120.847. There were no opposing comments. SBA is adopting the changes to § 120.847 as proposed, except that, upon further consideration, SBA has decided to retain the Lead SBA Office as the office to which the PCLP CDC must forward requests for withdrawals.

III. Compliance with Executive Orders 12866, 13563, 12988, 13771, and 13132, 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 (OMB) determined that this rule is not a “significant” regulatory action for the purposes of Executive Order 12866. In addition, this is not a major rule under the Congressional Review Act, 5 U.S.C. 800.

Executive Order 13563

The Agency coordinated outreach efforts to engage stakeholders before proposing this rule. The 504 Loan Program operates through the Agency's lending partners, which for this program are CDCs. The Agency has participated in lender conferences and trade association meetings and received feedback from CDCs, a trade association, and third-party lenders that provided valuable insight to SBA.

#### Executive Order 12988

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

#### Executive Order 13771

This final rule is an EO 13771 deregulatory action with an annualized savings of \$273,515 and a net present value of \$3,907,360 in savings, both in 2016 dollars.

This rule is expected to produce \$15,000 of savings for each of the 19 CDCs that currently have 504 loan portfolio balances between \$20 million and \$30 million and will no longer be required to provide audited financial statements. This estimate of savings is based on conversations with CDCs. In addition, SBA is decreasing the number of members that a CDC is required to appoint to its Board of Directors from nine to seven and reducing the amount that PCLP CDCs need to maintain in the Loan Loss Reserve Fund. While it is difficult to quantify the benefits of these changes, they are meant to provide more flexibility and options to CDCs.

Any costs to CDCs due to changes in this rule are difficult to quantify but are likely to be insignificant.

#### Executive Order 13132

SBA has determined that this final 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 final rule has no federalism implications warranting preparation of a federalism assessment.

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

SBA has determined that, while this final rule will not impose new reporting or recordkeeping requirements, some of the regulatory amendments require changes to SBA Form 1253 to clarify existing requirements, such as the type of contracts that CDCs must report to SBA, and to remove certain reporting requirements that are no longer applicable as a result of the rule changes. Accordingly, SBA Form 1253, Certified Development Company (CDC) Annual Report Guide (OMB Approval 3245-0074), will be revised to clarify or add information that CDCs are required to submit with their Annual Report, including:

(a) With respect to the information required to be submitted in the Operating Report (Tab 2A) related to the members of the CDC's Board of Directors and the Loan Committee, in the event that a Multi-State CDC chooses the option created under the new § 120.835(c)(2), the form will be revised to inform CDCs to provide information on the two additional members who are appointed to the Board or to the Loan Committee, if established, to vote on Projects in the State into which the CDC expanded.

(b) With respect to the information that the CDC is required to provide in the Operating Report (Tab 2C) related to contracts requiring SBA's prior written

approval, the form currently instructs the CDC to submit a copy of all contracts for management and/or staff in place during the reporting period. The form currently identifies examples of the types of contracts subject to this requirement. It will be revised to add co-employment contracts (which SBA proposed to add in the proposed rule) and contracts for independent loan reviews between CDCs (which SBA has added to this final rule in response to comments received) to the list. However, as stated in the proposed rule, SBA determined that, as currently written, the requirement to submit a copy of all contracts with the Annual Report could result in duplicative reporting since CDCs should have provided SBA with a fully executed copy of any contract after obtaining SBA's prior approval. As a result, SBA is revising the instruction in the form to make it clear that CDCs would no longer be required to submit a copy of these contracts with the Annual Report if a copy of the current and executed contract was previously submitted to SBA. The CDC will be required to provide a certification with its Annual Report that it has previously submitted a copy of the executed contract to SBA and that no changes have been made to it. The certification will also need to state to whom and on what date the contract was provided to SBA.

In addition, the form will be changed to no longer require the CDC to provide a copy of other documents that SBA already has in its possession, including SBA's approval of each contract or management waiver, a copy of the Board's resolution approving the contract, or a copy of the Board's explanation for why it believes that it is in the best interest of the CDC to enter into the contract.

(c) With respect to the information required to be submitted in the Operating Report (Tab 2F) related to the Independent Loan Review Package, as noted

above, the final rule will allow a CDC to contract with another CDC to perform the independent loan review but only with SBA's prior written approval, and the form will be revised to reflect this change.

(d) With respect to the Financial Report (Tab 3) of the form, a CDC is currently allowed to submit a reviewed financial statement instead of an audited financial statement if it has a 504 loan portfolio balance of less than \$20 million. This final rule raises this threshold to \$30 million and, therefore, it will be necessary to revise the instruction in the form accordingly. The substance of the information that would be collected is not being changed, only that fewer CDCs would need to submit audited financial statements.

SBA invited comments on the proposed changes to the underlying regulations that would impact Form 1253. SBA received five comments on Form 1253. The commenters requested that CDCs only be required to include in the Annual Report information related to Board minutes, financial statements, tax returns, and jobs and other economic development activity. This change would eliminate several items from the Annual Report, including information related to the Board of Directors, Executive Committee, Loan Committee, professional staff, contracts, affiliations, legal certifications, and compensation. The commenters argued that, with the changes planned in SBA's electronic records system, SBA will have ready access to the information currently provided with the Annual Report. However, SBA has concluded that all of the

information that will be submitted with this form continues to be needed to support SBA's efforts to maintain quality control in the 504 Loan Program.<sup>3</sup>

SBA has determined that the changes needed for the form described above are non-substantive in nature and do not need to be submitted to OMB for approval.

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

When an agency issues a final rulemaking, section 604 of the Regulatory Flexibility Act (RFA), 5 U.S.C. 601-612, requires the agency to "prepare and make available for public comment a final regulatory flexibility analysis" which will "describe the impact of the final rule on small entities, significant issues raised by the public about the impact on small entities and the steps that the agency has taken to minimize the significant economic impact on small entities." Section 605 of the RFA allows an agency to certify a rule in lieu of preparing an analysis, if the rule will not have a significant economic impact on a substantial number of small entities. Although the rulemaking will impact all 210 CDCs (all of which are small), SBA continues to believe the economic impact will not be significant. The final rule will streamline the operational and organizational requirements that CDCs must satisfy and reduce their costs.

For example, under the final rule, the 19 CDCs that currently have 504 loan portfolio balances between \$20 million and \$30 million will no longer be required to provide audited financial statements but may submit reviewed financial statements instead. As noted above, SBA estimates that the elimination of the audited review for

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<sup>3</sup> Under the proposed rule, SBA gave notice that SBA Form 2233 would be revised to change the office to which this form is submitted from the "Lead SBA Office" to the "Office of Credit Risk Management". SBA received no comments on this form. Form 2233 will no longer need to be revised because the final rule will retain the Lead SBA Office as the office to which PCLP CDCs must submit requests for withdrawal from the Loan Loss Reserve Fund.

these CDCs will save each CDC approximately \$15,000 per year. This estimate is based on conversations with CDCs.

In addition, SBA is reducing the regulatory requirements imposed on CDCs related to corporate governance. For example, SBA is decreasing the number of members that a CDC is required to appoint to its Board of Directors from nine to seven. This change will also make it easier for a CDC to meet the quorum requirements for conducting its business. In addition, SBA is: (1) expanding the area in which Board and Loan Committee members may work or live; (2) removing the limit on the number of members that may serve on the Board from the commercial lending fields; (3) allowing CDCs in need of assistance to contract for services with another CDC under certain circumstances even if the CDCs would become affiliated as a result; (4) eliminating the requirement that CDCs establish a separate Loan Committee in each State into which the CDC expands as a Multi-State CDC; (5) expanding the criteria under which a CDC may make a 504 loan outside its Area of Operations; and (6) allowing a CDC to contract with another CDC to perform the required independent loan reviews under certain circumstances and with SBA's prior written approval.

Another change is the reduction in the amount that PCLP CDCs need to maintain in the Loan Loss Reserve Fund. By allowing PCLP CDCs to utilize a declining balance methodology for the LLRF after a Debenture has been outstanding for 10 years, more cash will be available to support the CDC's operations or to invest in other economic development activities without unduly increasing risk.

In addition, SBA received one comment opposing the certification of the proposed rule because of the proposal to prohibit any person or entity from owning or

controlling more than 10 percent of a for-profit CDC's voting stock. As discussed above, this final rule provides that an individual or entity will be limited to owning no more than 25 percent of a CDC's stock. With this change, no individual or entity will be required to divest any stock because no stockholder of any for-profit CDC currently owns more than 25 percent of the CDC's stock and, thus, SBA concludes that the 25 percent limit will not have a significant economic impact on any small entities. Similarly, this final rule applies the 25 percent limit to membership interests in a non-profit CDC. Applying the 25 percent limit to non-profit CDCs would not have a significant economic impact on any small entity because a membership interest in a CDC has no economic value to the member. A membership interest in a non-profit CDC does not entitle the member to receive any distribution of income or assets from the CDC.

Except for the change in the audit requirements discussed above, the total costs to CDCs due to the other changes in this rule are difficult to quantify. However, based on the nature of the changes, SBA believes that CDCs are likely to experience cost reductions if there is any cost impact at all. SBA believes that this final rule is the Agency's best available means for facilitating American job preservation and creation by removing unnecessary regulatory requirements. The preamble sections above provide additional detailed explanations regarding how and why this final rule will reduce regulatory burdens and responsibly increase program participation flexibility and discusses the high level of public support for these changes.

For these reasons, SBA has determined that the final rule will not have a significant economic impact on a substantial number of small entities and certifies this rule as such.

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 is amending 13 CFR part 120 as follows:

**PART 120 - BUSINESS LOANS**

1. The authority for 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 (7), and 697(a) and (e); Pub. L. 111-5, 123 Stat. 115, Pub. L. 111-240, 124 Stat. 2504.

2. Amend § 120.816 by adding paragraph (d) to read as follows:

§ 120.816 CDC non-profit status and good standing.

\* \* \* \* \*

(d) If a non-profit CDC has a membership and the members are responsible for electing or appointing voting directors to the CDC's Board of Directors, no person or entity can control more than 25 percent of the CDC's voting membership.

3. Amend § 120.818 by designating the undesignated paragraph as paragraph (a) and adding paragraph (b) to read as follows:

§ 120.818 Applicability to existing for-profit CDCs.

\* \* \* \* \*

(b) No person or entity can own or control more than 25 percent of a for-profit CDC's stock.

4. Amend § 120.823 by:

- a. Revising paragraph (a);
- b. Removing paragraph (c)(4) and redesignating paragraph (c)(5) as paragraph (c)(4);
- c. In paragraph (d)(4)(i)(B), by removing “five” and adding “four” in its place;
- d. In paragraph (d)(4)(ii)(B), by removing “five (5)” and adding “four” in its place; and
- e. Revising paragraph (d)(4)(ii)(E).

The revisions read as follows:

§ 120.823 CDC Board of Directors.

(a) The CDC, whether for-profit or non-profit, must have a Board of Directors with at least seven (7) voting directors who live or work in the CDC’s State of incorporation or in an area that is contiguous to that State that meets the definition of a Local Economic Area for the CDC. The Board must be actively involved in encouraging economic development in the Area of Operations. The initial Board may be created by any method permitted by applicable State law. At a minimum, the Board must have directors with background and expertise in internal controls, financial risk management, commercial lending, legal issues relating to commercial lending, corporate governance, and economic, community or workforce development. Directors may be either currently employed or retired.

\* \* \* \* \*

(d) \* \* \*

(4) \* \* \*

(ii) \* \* \*

(E) Consist only of Loan Committee members who live or work in the CDC's State of incorporation or in an area that meets the definition of a Local Economic Area for the CDC, except that, for Projects that are financed under a CDC's Multi-State authority, the CDC must satisfy the requirements of either § 120.835(c)(1) or (2) when voting on that Project.

\* \* \* \* \*

5. Revise § 120.824 to read as follows:

§ 120.824 Professional management and staff, and contracts for services.

(a) Management. A CDC must have full-time professional management, including an executive director or the equivalent (CDC manager) to manage daily operations. This requirement is met if the CDC has at least one salaried professional employee that is employed directly (not a contractor or an officer, director, 20 percent or more equity owner, or key employee of a contractor) on a full-time basis to manage the CDC. The CDC manager must be hired by the CDC's Board of Directors and subject to termination only by the Board. A CDC may obtain, under a written contract, management services provided by a qualified individual under the following circumstances:

(1) The CDC must submit a request for the D/FA (or designee) to approve, in consultation with the D/OCRM (or designee), a waiver of the requirement that the manager be employed directly by the CDC. In its request, the CDC must demonstrate that:

(i) Another non-profit entity (that is not a CDC) that has the economic development of the CDC's Area of Operations as one of its principal activities will

provide management services to the CDC and, if the manager is also performing services for the non-profit entity, the manager will be available to small businesses interested in the 504 program and to 504 loan borrowers during regular business hours; or

(ii) The CDC submitting the request for the waiver is rural, has insufficient loan volume to justify having management employed directly by the CDC, and is requesting to contract with another CDC located in the same general area to provide the management.

(2) The CDC must submit a request for the D/FA (or designee), in consultation with the D/OCRM (or designee), to pre-approve the contract for management services. This contract must comply with paragraphs (c)(2) through (4) and, if applicable, paragraph (d) of this section.

(b) Professional staff. The CDC must have a full-time professional staff qualified by training and experience to market the 504 Loan Program, package and process loan applications, close loans, service, and, if authorized by SBA, liquidate the loan portfolio, and to sustain a sufficient level of service and activity in the Area of Operations.

(c) Professional services contracts. Through a written contract with qualified individuals or entities, a CDC may obtain services for marketing, packaging, processing, closing, servicing, or liquidation functions, or for other services (*e.g.*, legal, accounting, information technology, independent loan reviews, and payroll and employee benefits), provided that:

(1) The contract must be pre-approved by the D/FA (or designee), subject to the following exceptions:

(i) CDCs may contract for legal, accounting, and information technology services without SBA approval, except for legal services in connection with loan liquidation or litigation.

(ii) CDCs may contract for independent loan review services with non-CDC entities without SBA approval. Contracts between CDCs for independent loan reviews must be pre-approved by SBA in accordance with paragraph (d) of this section.

(2) If the contract requires SBA's prior approval under paragraph (c)(1) of this section, the CDC's Board must explain to SBA why it is in the best interest of the CDC to obtain services through a contract and must demonstrate that:

(i) The compensation under the contract is paid only by the CDC obtaining the services, is reasonable and customary for similar services in the Area of Operations, and is only for actual services performed;

(ii) The full term of the contract (including options) is necessary and appropriate and the contract permits the CDC procuring the services to terminate the contract prior to its expiration date with or without cause; and

(iii) There is no actual or apparent conflict of interest or self-dealing on the part of any of the CDC's officers, management, or staff, including members of the Board and Loan Committee, in the negotiation, approval or implementation of the contract.

(3) Neither the contractor nor any officer, director, 20 percent or more equity owner, or key employee of a contractor may be a voting or non-voting member of the CDC's Board.

(4) The CDC procuring the services must provide a copy of all executed contracts requiring SBA prior approval to SBA as part of the CDC's Annual Report submitted

under § 120.830(a) unless the CDC certifies that it has previously submitted an identical copy of the executed contract to SBA.

(5) With respect to any contract under which the CDC's staff are deemed co-employees of both the CDC and the contractor (*e.g.*, contracts with professional employer organizations to obtain employee benefits, such as retirement and health benefits, for the CDC's staff), the contract must provide that the CDC retains the final authority to hire and fire the CDC's employees.

(6) If the contract is between CDCs, the CDCs and the contract must also comply with paragraph (d) of this section.

(d) Professional Services Contracts between CDCs. Notwithstanding the prohibition in 13 CFR 120.820(d) against a CDC affiliating with another CDC, a CDC may obtain services through a written contract with another CDC for managing, marketing, packaging, processing, closing, servicing, independent loan review, or liquidation functions, provided that:

(1) The contract between the CDCs must be pre-approved by the D/FA (or designee), in consultation with the D/OCRM (or designee), who determines in his or her discretion that such approval is in the best interests of the 504 Loan Program and that the terms and conditions of the contract are satisfactory to SBA. For management services, a CDC may contract with another CDC only in accordance with paragraph (a)(1)(ii) of this section.

(2) Except for contracts for liquidation services and independent loan reviews:

(i) The CDCs entering into the contract must be located in the same SBA Region or, if not located in the same SBA Region, must be located in contiguous States. For purposes of this provision, the location of a CDC is the CDC's State of incorporation;

(ii) A CDC may provide assistance to only one CDC per State; and

(iii) No CDC may provide assistance to another CDC in its State of incorporation or in any State in which it has Multi-State authority.

(3) The Board of Directors for each CDC entering into the contract must be separate and independent and may not include any common directors. In addition, if either of the CDCs is for-profit, neither CDC may own any stock in the other CDC. The CDCs are also prohibited from comingling any funds.

(4) With respect to contracts for independent loan reviews, CDCs may not review each other's portfolios or exchange any other services, nor may they enter into any other arrangement with each other that could appear to bias the outcome or integrity of the independent loan review.

(5) The contract must satisfy the requirements set forth in paragraphs (c)(2) through (4) of this section.

§ 120.826 [Amended]

6. Amend § 120.826 in paragraph (c) by:

a. Removing the term "\$20 million" wherever it appears and adding the term "\$30 million" in its place; and

b. Removing the period at the end of the last sentence and adding ", except that the D/OCRM may require a CDC with a portfolio balance of less than \$30 million to submit an audited financial statement in the event the D/OCRM determines, in his or her

discretion, that such audit is necessary or appropriate when the CDC is in material noncompliance with Loan Program Requirements.”

7. Amend § 120.835 by:

- a. Adding a subject heading to paragraph (c);
- b. Revising the last sentence of paragraph (c); and
- c. Adding paragraphs (c)(1) and (2).

The additions read as follows:

§ 120.835 Application to expand an Area of Operations.

\* \* \* \* \*

(c) Multi-State expansion. \* \* \* A CDC may apply to be a Multi-State CDC only if the State the CDC seeks to expand into is contiguous to the State of the CDC’s incorporation and either:

(1) The CDC establishes a Loan Committee in the additional State consisting only of members who live or work in that State and that satisfies the other requirements in § 120.823(d)(4)(ii)(A) through (D); or

(2) For any Project located in the additional State, the CDC’s Board or Loan Committee (if established in the CDC’s State of incorporation) includes at least two members who live or work in that State when voting on that Project. These two members may vote only on Projects located in the additional State.

§ 120.839 [Amended]

8. Amend § 120.839 by adding the words “or its affiliate(s)” after “business” in paragraph (a).

9. Amend § 120.847 by revising the third and fourth sentences in paragraph (b) and adding paragraphs (b)(1) and (2) to read as follows:

§ 120.847 Requirements for the Loan Loss Reserve Fund (LLRF).

\* \* \* \* \*

(b) \* \* \* For each PCLP Debenture a PCLP CDC issues, it must establish and maintain an LLRF equal to one percent of the original principal amount of the PCLP Debenture. The amount the PCLP CDC must maintain in the LLRF for each PCLP Debenture remains the same even as the principal balance of the PCLP Debenture is paid down over time except that, after the first 10 years of the term of the Debenture, the amount maintained in the LLRF may be based on one percent of the current principal amount of the PCLP Debenture (the declining balance methodology), as determined by SBA. All withdrawals must be made in accordance with the requirements of paragraph (g) of this section. A CDC may not use the declining balance methodology:

(1) With respect to any Debenture that has been purchased. Within 30 days after purchase, the CDC must restore the balance maintained in the LLRF for the Debenture that was purchased to one percent of the original principal amount of that Debenture; or

(2) With respect to any other Debenture if SBA notifies the CDC in writing that it has failed to satisfy the requirements in paragraph (e), (f), (h), (i), or (j) of this section. In such case, the CDC will not be required to restore the balance maintained in the LLRF to one percent of the original principal amount of the Debenture but must base the amount maintained in the LLRF on one percent of the principal amount of the Debenture as of the date of notification. The CDC may not begin to use the declining balance methodology again until SBA notifies the CDC in writing that SBA has determined, in its discretion,

that the CDC has corrected the noncompliance and has demonstrated its ability to comply with these requirements.

\* \* \* \* \*

Dated: November 25, 2019.

Christopher M. Pilkerton  
Acting Administrator.

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