SMALL BUSINESS ADMINISTRATION

Notice of Change to SBA Secondary Market Program

SUMMARY: The purpose of this notice is to inform the public of a program change in SBA's Secondary Market Loan Pooling Program. This change is being made to permit the SBA Loan Pooling Program to continue to operate at a zero subsidy. The change described in this notice will be incorporated, as needed, into the Secondary Market Program Guide, and all other appropriate secondary market documents.

DATES: The change in the notice will apply to loan pools with an issue date on or after October 1, 2005.

ADDRESSES: Address comments concerning this notice to James W. Hammersley, Director, Loan Programs Division, U.S. Small Business Administration, 8th floor, 409 3rd St., SW., Washington, DC 20416 or *james.hammersley@sba.gov.*

FOR FURTHER INFORMATION CONTACT: James W. Hammersley, Director, Loan Programs Division, U.S. Small Business Administration, 8th floor, 409 3rd St., SW., Washington, DC 20416, telephone 202–205–7505 or e-mail at *james.hammersley@sba.gov.*

SUPPLEMENTARY INFORMATION: When Congress enacted the Small Business Secondary Market Improvements Act of 1984, it authorized SBA to guaranty the timely payment of principal and interest on pool certificates representing an ownership interest in a pool of guaranteed portions of loans made under SBA's section 7(a) guaranteed loan program (''SBA 7(a) loans''). Congress anticipated that the timely payment guaranty could be structured so that SBA would have no additional budgetary exposure and no need for any direct taxpayer subsidy of this cost.

SBA established the Master Reserve Fund (''MRF''), which has served as a self-funding mechanism to cover the cost of the timely payment guaranty. Borrower payments on the guaranteed portions of pooled SBA 7(a) loans, as well as any SBA guaranty payments on defaulted SBA 7(a) loans, are deposited into the MRF, and all payments to investors (''Registered Holders'') are made from the MRF. Interest earned while the borrower and guaranty payments are in the MRF is used, as needed, to make the timely payments to the Registered Holders.

Under the Federal Credit Reform Act of 1990 (''FCRA''), 2 U.S.C. 661 *et seq.,* SBA was required to develop a model of Secondary Market activity to estimate whether there will be sufficient funds in the MRF to meet the timely payment obligations to the Registered Holders of pool certificates. This is the same process that SBA follows every year to estimate the subsidy cost of the section 7(a) and section 504 loan programs. The subsidy model was developed based on assumptions related to several factors, including interest rates and prepayments over the lives of the pools.

Last year, SBA's forecast for pools expected to be originated in FY 2005 (the ''FY 2005 pools'') indicated that the interest that would be earned in the MRF in connection with those pools would not be sufficient to make all timely payments of principal and interest due to the Registered Holders. Consequently, effective October 1, 2004, SBA published in the **Federal Register** three minor changes to the Secondary Market Loan Pooling Program. *See* 69 FR 56472, September 21, 2004.

SBA's current forecast for pools to be originated in FY 2006 (the ''FY 2006 pools'') indicates that the interest that will be earned in the MRF in connection with the FY 2006 pools will not be sufficient to make all timely payments of principal and interest due to the Registered Holders under the current program terms implemented on October 1, 2004. Under FCRA, SBA must address this shortfall. Without statutory authority to charge a fee for this purpose, SBA must address the shortfall by making an administrative change to the requirements for a loan pool that will allow the program to operate at no cost to the taxpayers. The change being adopted will reduce the maximum variation in the remaining term to maturity between loans in the same pool.

To understand this program change, it would be helpful to first summarize certain features of the loan pooling program. To facilitate the formation of loan pools, SBA permits loans with different remaining terms to maturity to be put into the same pool. The pool certificates have the maturity of the loan with the longest remaining term to maturity in the pool. Currently, the remaining term on the loan with the shortest remaining maturity of any loan in a pool must be at least 70 percent as long as the maturity of the loan with the longest remaining term. For example, if the longest remaining term of a loan in a pool is 120 months (10 years), the loan with the shortest remaining term must have at least 84 months until the maturity of the loan. The extent of the average maturity difference between a pool certificate and its underlying loans is an important driver of the loan pooling program costs. Larger differences increase the disparity in the amortization rates between the pool certificate and the underlying loans. This increases principal that accumulates in the MRF. Costs result as the MRF must make interest payments to Registered Holders at pool certificate interest rates while earning interest on accumulated loan principal at Treasury rates.

To keep the program at a zero subsidy, SBA is reducing the maximum spread permitted between the longest and shortest remaining term on loans in each pool. For pools with an issue date on or after October 1, 2005, the shortest remaining term of any loan in a pool must be at least 80 percent of the remaining term on the loan with the longest remaining term to maturity. Reducing the maximum allowed loan-to-pool certificate maturity spread to 80 percent will reduce the program costs associated with the loan and pool amortization disparities. This reduction occurs because the program costs attributable to the MRF's payment of interest at pool certificate interest rates from funds invested at Treasury rates is reduced. The 80 percent minimum was calculated in compliance with the requirements of FCRA, based on loan and pool characteristics and SBA's forecast of future program performance.

Although this change is expected to affect approximately 93 percent of future pools, SBA believes that pool assemblers will be able to continue forming pools. Some pools may be smaller due to the new requirement; however, in Calendar Year 2004, the average pool size was $8,300,000, well in excess of the $1,000,000 minimum size required by SBA.

This program change will be incorporated as necessary into the appropriate secondary market documents. The change will be effective on October 1, 2005, and will modify the guidance on loan pool characteristics included in the SBA Secondary Market Program Guide. SBA is making this change pursuant to its authority under Section 5(g)(2) of the Small Business Act, 15 U.S.C. 634 (g)(2).

It is important to note that there is no change to SBA's obligation to honor its guaranty of the timely payment of amounts owed to Registered Holders on all SBA loan pools and that such guaranty continues to be backed by the full faith and credit of the United States.

Authority: 15 U.S.C. 634(g)(2).

Dated: July 20, 2005.

Hector V. Barreto,

Administrator.

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