Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

SMALL BUSINESS ADMINISTRATION

13 CFR Part 107

Small Business Investment Companies

AGENCY: Small Business Administration.

ACTION: Proposed rule.

SUMMARY: The Small Business Reauthorization Act of 1997 made a number of changes to the Small Business Investment Act of 1958, as amended. For the Small Business Investment Company (SBIC) Program, the changes include provisions affecting capital requirements, Leverage eligibility, and the timing of tax distributions by SBICs that have issued Participating Securities. This proposed rule would implement these statutory provisions; in addition, it would prohibit political contributions by SBICs and would modify regulations governing the refinancing of real estate by SBICs, portfolio diversification requirements, takedowns of Leverage, and in-kind distributions by Participating Securities issuers.

DATES: Submit comments on or before May 14, 1999.

ADDRESSES: Address comments to Don A. Christensen, Associate Administrator for Investment, U.S. Small Business Administration, 409 3rd Street, SW., Suite 6300, Washington, DC 20416.

FOR FURTHER INFORMATION CONTACT: Leonard W. Fagan, Investment Division, at (202) 205–7583.

SUPPLEMENTARY INFORMATION: This proposed rule would implement the provisions of Subtitle B of Pub. L. 105–135 (December 2, 1997), the Small Business Reauthorization Act of 1997, which relate to small businesses investment companies (SBICs). This rule would also establish regulations prohibiting political contributions by SBICs and would modify regulations governing the refinancing of real estate by SBICs, portfolio diversification requirements, procedures for drawing down Leverage from SBA, and in-kind distributions by SBICs that have issued Leverage in the form of Participating Securities.

Private Capital

Section 213 of Pub. L. 105–135 amended the statutory definition of private capital to include certain funds invested in a Licensee by a federally chartered or Government-sponsored corporation established prior to October 1, 1987. Under the revised definition, private capital may include funds obtained from the business revenues of such entities; appropriated Government funds are specifically excluded. Proposed § 107.230(b)(3) would implement this change by incorporating the statutory language in the regulatory definition of Private Capital. In this context, SBA's view is that ''business revenues'' means earnings that are generated by a corporation through activities of a commercial nature and that are reflected in the retained earnings of the corporation.

Definition of ''Associate''

SBA is proposing a technical correction in the definition of ''Associate'' in § 107.50. Under paragraph (8)(i) of the current definition, a business concern becomes an Associate of an SBIC if it has one or more officers who have a business or personal relationship with the SBIC of a type listed in subparagraphs (1) through (6) of the definition. This provision does not explicitly encompass business concerns organized as partnerships or limited liability companies, which may be managed by persons who are not designated as officers. To clarify the applicability of paragraph (8)(i) to all concerns, regardless of their form of organization, the proposed rule would replace ''officer'' with ''officer, general partner, or managing member.''

Leverageable Capital

An SBIC's Leverageable Capital is a subset of its Private Capital. It is used to determine the maximum amount of SBA Leverage funds which the SBIC may have outstanding. The current definition of Leverageable Capital in § 107.50 excludes ''Qualified Non-private Funds [as defined in § 107.230(d)] whose source is Federal funds.'' SBA has determined that the Act does not require this exclusion and is proposing to remove it.

Internet Access and Electronic Mail

As the SBIC program grows in size and sophistication, SBA is seeking ways to improve administrative efficiency. The Agency is particularly interested in improving its ability to communicate with Licensees electronically. Many SBICs are already using the Internet to obtain updated regulations and software from SBA and to submit financial statements and other required information. To further promote the use of this highly efficient means of communication, proposed § 107.504(a) would require all SBICs to have Internet access and Internet electronic mail no later than June 30, 1999.

To improve the organization of the regulations, the proposed rule also would consolidate three current sections into a single section. Current §§ 107.504, 107.505, and 107.508 would become § 107.504 (a), (b), and (c), respectively. These sections require an SBIC to maintain an office accessible to the public and to have certain office equipment to facilitate communications with SBA. Except for the proposed new requirement for Internet access and electronic mail, there would be no substantive change in these provisions.

Political Contributions

It has come to SBA's attention that a few SBICs have made contributions to organizations formed to promote the election of political candidates or the advancement of a political or legislative agenda. In at least one case, an SBA examiner cited an SBIC's contribution to an organization of this type as an ''activity not contemplated by the Act.'' SBA has upheld this interpretation of the Act and would apply it even where the SBIC has no outstanding Leverage at the time of the contribution.

The Act states that the purpose of the SBIC program is ''to stimulate and supplement the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization. . . .'' 15 U.S.C. 661. Under a longstanding interpretation of this statutory provision, SBA does not permit activities by an SBIC that do not contribute to the growth, expansion, and modernization of a small business. Since SBA is concerned that an SBIC's political contributions can have, at best,

only a remote and speculative connection to the growth, expansion, and modernization of small businesses, SBA is proposing this rule to confirm that such activities are not permissible.

SBA believes that a regulation on political contributions by Licensees is necessary to prevent any confusion on this subject in the future. In proposing this regulation, SBA does not seek to limit impermissibly any form of constitutionally protected speech. However, restrictions on the use of SBIC funds for political contributions appear to be required by the Act.

U.S. taxpayers support SBICs and their investors through the use of Government-guaranteed Leverage and various tax benefits. SBICs and their investors are also the recipients of assorted governmental benefits of a non-tax nature, including exemption from certain provisions of banking and other statutes. SBA believes that it is appropriate to require that, in exchange for these benefits, SBICs use their funds only for the purposes referred to in 15 U.S.C. 661. This also would eliminate any possibility that a particular contribution by an SBIC could be misperceived as having been endorsed by SBA.

Proposed § 107.505 would prohibit contributions by an SBIC to any political campaign, party, or candidate, or to any political action committee. The proposed regulation is written broadly enough to cover all political contributions, including so-called ''soft money'' contributions, that are used by organizations to support activities other than the influencing of federal elections. Nothing in the proposed rule would affect the right of investors in and managers of SBICs to make political contributions with their own funds, outside of the SBIC.

SBA encourages comment from the SBIC industry and, in particular, from the legal community on this proposed change.

Financing of Smaller Enterprises

Since April 1994, SBICs have been required to direct a certain percentage of their investment activity to businesses that fall significantly below the maximum size permitted for a Small Business. These businesses are referred to as ''Smaller Enterprises.'' This proposed rule includes three changes related to the financing of Smaller Enterprises; one implements a provision of Pub. L. 105–135, the second is a technical correction, and the third is an editorial change.

Section 215(b) of Pub. L. 105–135 increased the maximum amount of SBA Leverage for which an SBIC could be eligible (see the section of this preamble entitled ''Maximum Amount of Leverage''). The statute further required that 100 percent of any Leverage over $90 million the previous limit, be invested in Smaller Enterprises. Proposed § 107.710(d) would implement this financing requirement, which is in addition to the Smaller Enterprise financing requirements in § 107.710(b) and (c). For example, an SBIC is required under current § 107.710(b) to make at least 20 percent of its total cumulative investments in Smaller Enterprises. If the SBIC has $100 million of outstanding Leverage at the end of its fiscal year, it must meet the 20 percent standard and have at least $10 million of additional investments in Smaller Enterprises in its portfolio.

Current § 107.710(c), which was effective February 5, 1998, implemented a provision of Pub. L. 104–208 that required certain SBICs to make at least 50 percent of their total investments in Smaller Enterprises. The Licensees to whom the provision applies are those licensed on or before September 30, 1996, that issued Leverage after that date, and whose Regulatory Capital is ''less than $10 million if such Leverage was Participating Securities'' or ''less than $5 million if such Leverage was Debentures.'' The regulation does not make clear which standard applies to an SBIC that has issued both Participating Securities and Debentures. Proposed § 107.710(c)(1) would clarify that the $10 million threshold applies to a Licensee that has issued any amount of Participating Securities, while the $5 million applies to a Licensee that has issued Debentures only.

Finally, in proposed § 107.710(f), the cross-reference to certain paragraphs in § 107.1120 would be revised to reflect proposed revisions in that section.

Real Estate Refinancing

Current § 107.720(c)(2) permits SBICs to provide financing to a Small Business for the purpose of acquiring or refinancing real estate only under certain conditions. Specifically, the Small Business must either be acquiring real property or building or renovating a building. The regulation does not permit refinancing of real estate currently owned and occupied by the Small Business. SBA believes that Small Businesses should be able to obtain financing from SBICs for this purpose, just as they currently can refinance other debt. Accordingly, proposed § 107.720(c)(2)(iii) would allow proceeds to be used to refinance debt obligations on property that is owned and occupied by a Small Business, provided it uses at least 67 percent of the usable square footage for an eligible business purpose. The occupancy requirement is the same as that applied to a building that is being built or renovated by a Small Business.

Co-Investment With Associates

Section 107.730(d)(3) sets forth circumstances under which an SBIC's co-investment with an Associate is presumed to be on terms that are equitable to the SBIC, so that no specific demonstration of fairness is required. Under current § 107.730(d)(3)(iv), this presumption applies to co-investments by two non-leveraged SBICs, or by a non-leveraged SBIC and its non-SBIC Associate. The proposed rule would modify this provision by removing the term ''non-leveraged'' and referring instead to Licensees that ''have no outstanding Leverage and do not intend to issue Leverage in the future.'' Thus, the provision would apply only to an SBIC that intends to operate permanently as a non-leveraged company. SBA is proposing this change to protect its interests in all cases where the Agency may have either current or future financial exposure.

Portfolio Diversification Requirement (''Overline'' limit)

In a final rule published on February 5, 1998 (63 FR 5859), SBA made certain changes to § 107.740, under which a leveraged SBIC may not have more than 20 percent of its Regulatory Capital invested in or committed to a single Small Business or group of related businesses without SBA's prior written approval (for SSBICs, the limit is 30 percent of Regulatory Capital). The changes addressed the problem faced by an SBIC that reduced its Regulatory Capital in a manner permitted by the regulations, and then found that one or more of its existing investments exceeded its reduced overline limitation. The solution to this problem was to base a Licensee's maximum permitted investment in or commitment to a Small Business on its Regulatory Capital at the time the investment or commitment is made.

When this regulatory change was proposed, SBA received several comments suggesting that SBA should make further changes. The commenters argued that an SBIC, particularly a limited life partnership that expects to return capital to investors as investments are harvested, should be permitted to base its overline limit on its original Regulatory Capital, with no reduction for subsequent returns of capital. The rationale was that an SBIC should not be forced to reduce the intended investment size reflected in its

business plan because of an early distribution. One commenter pointed out that this imposes a penalty that is particularly unjustified in the case of an SBIC which makes a distribution resulting from a profitable realization of a portfolio company investment.

SBA understood these concerns, but the comments were not adopted because SBA believed that the suggested changes were prohibited by section 306(a) of the Act. Since that time, the Agency has reconsidered its position on the proper interpretation of the statutory provision, and has now concluded that the statute permits SBA to determine, by regulation, the point as of which Regulatory Capital is measured for the purpose of establishing an SBIC's overline limit.

Accordingly, under proposed § 107.740(a), an SBIC's overline limit would be computed based on the sum of: (1) Its Regulatory Capital at the time an investment or commitment is made, and (2) any distributions permitted under the regulations that were made within the preceding 5 years and reduced Regulatory Capital. The effect of this change would be greatest for SBICs that issue Participating Securities. Under § 107.1570(b), these Licensees are permitted to make distributions that reduce Regulatory Capital, as long as they also redeem outstanding Participating Securities on a pro rata basis. Such distributions can be substantial; since 1995, when Participating Securities were first issued, 15 SBICs have elected to make distributions that reduced Regulatory Capital by a total of about $39 million. SBA expects the frequency and amount of such distributions to grow as Licensees' portfolios mature.

For SBICs that use other forms of SBA Leverage (Debentures or Preferred Securities), the proposed rule would be less significant, although it could have some effect. Under current § 107.585, such SBICs cannot reduce their Regulatory Capital by more than 2 percent in any fiscal year without SBA's prior written approval. Any distribution that falls within the 2 percent limitation could be added back to Regulatory Capital for overline purposes. SBA would determine whether a distribution exceeding 2 percent of Regulatory Capital could be added back to the Licensee's overline limit. SBA believes that it must have this discretion because of the wide variety of circumstances under which various SBICs may seek to reduce their Regulatory Capital.

SBA is also proposing a clarification of the introductory text in § 107.740(a). The proposed rule states that the provisions of § 107.740 would apply to Licensees that ''have outstanding Leverage or intend to issue Leverage in the future.'' This phrase would replace current language referring to Licensees that ''have outstanding Leverage or want to be eligible for Leverage.'' The purpose of the proposed change is to clarify that the overline limit does apply to ''temporarily'' non-leveraged SBICs whose business plans indicate that they expect to become leveraged.

Leverage Application Procedures and Eligibility

SBA is proposing a technical correction in § 107.1100(b) to reflect recent changes in Leverage funding procedures, under which a Licensee can issue Leverage only by first obtaining a Leverage commitment from SBA, and then drawing down funds against the commitment.

Proposed § 107.1120(d) would implement a requirement in section 215(b)(1) of Pub. L. 105–135 that applies to Licensees seeking Leverage in excess of $90 million. To be eligible for the Leverage, such Licensees must certify that they will use 100 percent of all proceeds over $90 million to provide financing to Smaller Enterprises. See also the section of this preamble entitled ''Financing of Smaller Enterprises.''

Maximum Amount of Leverage

Section 215(b) of Pub. L. 105–135 increased the maximum amount of SBA Leverage for which an SBIC could be eligible. The previous limit, for either a single SBIC or a group of SBICs under common control, was $90 million. The statute indexed this amount to the Consumer Price Index (CPI) retroactive to March 1993, with annual adjustments to take place following the initial adjustment.

Proposed § 107.1150(a) and (b)(1) would implement the statutory change. The Leverage eligibility table in § 107.1150(a)(1) reflects increases in the CPI from March 1993, through September 1998, the final month of the Federal Government's 1998 fiscal year. SBA proposes to make subsequent adjustments each year based on the September-to-September increase in the CPI. The proposed rule would result in a new Leverage ceiling of $102.5 million.

Below the overall Leverage ceiling, there are also several Leverageable Capital brackets within which a Licensee is eligible for certain maximum Leverage amounts. These individual brackets would also be indexed to the CPI. For example, the first bracket currently consists of Leverageable Capital of not more than $15 million on which a Licensee may be eligible for maximum Leverage in the ratio of 3:1. Based on increases in the CPI from March 1993 to September 1998, the $15 million cutoff would increase to $17.1 million.

Under proposed § 107.1150(a)(2), SBA would publish an annual notice in the **Federal Register** to update the maximum Leverage amounts. The Bureau of Labor Statistics normally publishes the CPI for September in mid-October, and SBA would expect to publish its **Federal Register** notice shortly thereafter.

Draws Against SBA Leverage Commitments

In May 1998, SBA instituted a new interim Leverage funding mechanism, sometimes described as ''just-in-time'' funding. Under the new procedures, an SBIC that has obtained a Leverage commitment from SBA may draw funds against the commitment on any business day. All SBICs with Leverage commitments must file quarterly financial statements on SBA Form 468 within 30 days after the end of each fiscal quarter. Under current §§ 107.1220 and 107.1230(d)(1), if an SBIC wishes to draw funds after the end of a quarter, but before the normal quarterly reporting deadline, it must submit quarterly financial statements with its draw request. With the advent of just-in-time funding, these provisions can result in an SBIC having as little as 1 week after the end of a quarter to prepare and submit financial statements to SBA.

SBA believes that most SBICs cannot reasonably comply with such a tight time frame, and that attempts to do so may result in the filing of incomplete or erroneous statements. Furthermore, the Agency believes that it can properly evaluate a draw request based on financial statements from a Licensee's previous fiscal quarter, together with the Licensee's certification that there has been no material adverse change in its financial condition since that time. Therefore, proposed §§ 107.1220 and 107.1230(d)(1) would eliminate the requirement that draw requests submitted within 30 days of the end of a Licensee's fiscal quarter be accompanied by updated quarterly financial statements. In addition, proposed § 107.1230(d)(1) would clarify that every draw request must be accompanied by a statement certifying that there has been no material adverse change in the Licensee's financial condition since its last filing of SBA Form 468.

Finally, proposed § 107.1230(d)(2) would require a Licensee to provide preliminary unaudited year end

financial statements when it submits a draw request more than 30 days following the end of its fiscal year if the Licensee has not yet filed its audited annual financial statements. SBA expects these preliminary financial statements to be as close to final as possible, but understands that they may not be exactly the same as the audited statements submitted later.

Under current § 107.1230(d)(3), which is proposed to be redesignated as § 107.730(d)(4), an SBIC applying for a draw must submit a statement of need showing the names of the Small Businesses that will be financed with the proceeds. SBA recognizes that an SBIC may sometimes wish to draw funds to provide necessary liquidity for its day-to-day operations, and is willing to consider draw requests for this purpose. Accordingly, under proposed § 107.1230(d)(4), the Licensee could apply for a draw based on operating liquidity needs, on specific financings it expects to close, or on a combination of the two.

Tax Distributions

Section 215(c) of Pub. L. 105–135 amended provisions of the Act governing the timing of ''tax distributions'' that SBICs with outstanding Participating Securities may make to their private investors and SBA. Previously, such distributions could be made once a year, based on the income allocated by a Licensee to its investors for Federal income tax purposes for the fiscal year immediately preceding the distribution. The statutory change now gives a Licensee the option of making a tax distribution at the end of any calendar quarter based on a quarterly estimate of tax liability. However, if the aggregate quarterly distributions made during any fiscal year exceed the amount that the Licensee would have been permitted to make based on a single computation performed for the entire year, future tax distributions must be reduced by the amount of the excess.

Proposed §§ 107.1550 and 107.1575 would implement these changes. The timing of tax distributions is addressed in proposed § 107.1550(d) and § 107.1575(a). SBA believes that the statutory language permitting tax distributions ''at the end of any calendar quarter'' does not require that such distributions be made only on the last day of a quarter, and wishes to give Licensees the flexibility to make the distributions later if they so choose. The proposed rule would permit interim tax distributions to be made on the last day of a calendar quarter or on any succeeding day through the first Payment Date following the end of the quarter (Payment Dates are February 1, May 1, August 1, and November 1 of each year). As before, Licensees would be able to make annual tax distributions as late as the second Payment Date following the end of their fiscal year. If the distribution is not made on a Payment Date, SBA's prior approval would be required (see the current introductory text of § 107.1575(a), which SBA does not propose to change).

Proposed § 107.1550(e) implements the statutory provision concerning excess tax distributions. The determination of the excess amount and the corresponding reduction of future distributions should be straightforward in most cases. One complexity that may arise is best illustrated by an example. Assume that an SBIC made quarterly tax distributions of $2.5 million in year 1. At the end of the year, it was determined that the permitted tax distribution for the full year would have been only $2 million so the excess tax distribution for the year was $500,000. In year 2, the SBIC computes a first quarter tax distribution of $900,000. It must reduce this distribution by the $500,000 excess from year 1, so its actual distribution is only $400,000. It then makes additional quarterly tax distributions of $1.5 million and $1.1 million during the year, so that its actual aggregate quarterly distributions are $3 million. At the end of year 2, the SBIC determines that its maximum permitted tax distribution for the full year would have been $3 million. Although it appears at first glance that there is no excess tax distribution for year 2, this is not the case. Under proposed § 107.1550(e)(2), the SBIC must recompute its aggregate quarterly distributions, ignoring the $500,000 reduction that was required in the first quarter. Taking this adjustment into account, the aggregate quarterly distributions would be $900,000 + $1,500,000 + $1,100,000 = $3,500,000. Thus, there would be an excess tax distribution of $500,000. SBA believes this formulation yields a result that is consistent with the intent of the Act. The point can best be seen by looking at years 1 and 2 together: Actual tax distributions were $5.5 million while the total that would have been permitted based on full-year computations was only $5 million. Thus, it is appropriate for the SBIC to have a $500,000 excess tax distribution computed as of the end of year 2.

Distributions on Other Than Payment Dates

SBA is proposing a technical correction in § 107.1575 to resolve a potential conflict between two provisions governing the timing of distributions. Current § 107.1575(a)(1) permits Licensees to make annual distributions, as required or permitted under various sections of the regulations, on dates other than one of the four quarterly Payment Dates. Clearly, in order to retain their character as ''annual'' distributions, such amounts must be computed as of the end of a Licensee's fiscal year, regardless of the date on which payment is actually made. However, under current § 107.1575(b)(2), any distribution made on a date other than a Payment Date must be computed as of the distribution date. To resolve this inconsistency, the proposed rule would modify § 107.1575(b)(2) so that annual distributions would be computed as of a Licensee's fiscal year end but could be paid at a later date other than a Payment Date.

In-Kind Distributions

SBA is proposing two substantive changes in § 107.1580, which governs in-kind distributions by SBICs that have issued Participating Securities. First, under proposed § 107.1580(a)(1), all in-kind distributions would require SBA's prior approval. This change represents a slight expansion of the requirement in current § 107.1570(a) that SBA approve distributions made on dates other than Payment Dates. Because in-kind distributions may subject SBA to significant market risk, the Agency strongly believes that it must have the ability to review and approve all such distributions, regardless of when they are made.

Second, under proposed § 107.1580(a)(2), only ''Distributable Securities'' could be distributed in kind. This new term, which is defined in proposed § 107.50, would replace the term ''Publicly Traded and Marketable'' that currently appears in § 107.1580 (''Publicly Traded and Marketable'' securities would continue to be used in the Capital Impairment computation under § 107.1840). Although the two terms are technically different, SBA does not expect the change to have a major effect on Licensees' ability to distribute securities.

The first difference between the current and proposed rules involves ''Rule 144'' stock, i.e., stock that is subject to resale volume restrictions pursuant to Rule 144 under the Securities Act of 1933, as amended. The definition of ''Publicly Traded and Marketable'' includes securities that are ''salable within 12 months pursuant to Rule 144''. The proposed definition of ''Distributable Securities'' would also include Rule 144 stock, but only if SBA

determined that it could immediately sell all of its shares without exceeding the volume restrictions. For purposes of determining whether a security meets this requirement, SBA would assume a ''worst-case'' scenario in which all the securities of the issuer being distributed by a Licensee were being sold simultaneously by the distributees.

The second difference between the current and proposed rules involves securities that are not traded on a regulated stock exchange or listed in the National Association of Securities Dealers Automated Quotation System (NASDAQ), such as stocks traded on the ''pink sheets.'' The definition of ''Publicly Traded and Marketable'' includes such securities if they have at least two market makers, while the proposed definition of ''Distributable Securities'' would exclude them. SBA is proposing this change because it believes that the current regulation may encompass stocks with extremely low trading volume, the disposition of which may be a prolonged and high-risk process. As a practical matter, no Licensee has sought to distribute such securities and SBA believes the change would have no effect on the vast majority of in-kind distributions proposed by Licensees.

SBA is also proposing a non-substantive change in § 107.1580(a)(4), which deals with the disposition of securities distributed to SBA. The current provision requires an SBIC distributing securities to deposit SBA's share with the Central Registration Agent (an agent employed by SBA to handle certain functions related to the pooling of Debentures and Participating Securities) who then selects a disposition agent. Having gained some experience with in-kind distributions, SBA has found it unnecessary to involve the CRA in the process. Accordingly, proposed § 107.1580(a)(4) would direct an SBIC to deposit SBA's share of securities directly with a disposition agent designated by SBA.

Compliance With Executive Orders, 12612, 12778, and 12866, the Regulatory Flexibility Act (5 U.S.C. 601, et seq.), and the Paperwork Reduction Act (44 U.S.C. Ch. 35)

SBA certifies that this proposed rule would not be a significant regulatory action for purposes of Executive Order 12866 because it would not have an annual effect on the economy of more than $100 million, and that it would not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq. The purpose of the proposed rule is to implement provisions of Pub. L. 105–135 which relate to small business investment companies, and to make certain other changes, primarily technical corrections and clarifications, to the regulations governing SBICs. There are 330 SBICs, not all of which are small businesses. In addition, the changes would have little or no effect on small businesses seeking funding from SBICs; rather they would only affect definitions for and activities of the SBICs.

For purposes of the Paperwork Reduction Act, 44 U.S.C. Ch. 35, SBA certifies that this proposed rule, if adopted in final form, would contain no new reporting or recordkeeping requirements.

For purposes of Executive Order 12612, SBA certifies that this rule would not have any federalism implications warranting the preparation of a Federalism Assessment.

For purposes of Executive Order 12778, SBA certifies that this rule is drafted, to the extent practicable, in accordance with the standards set forth in Section 2 of that Order.

List of Subjects in 13 CFR Part 107

Investment companies, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

For the reasons stated above, the SBA proposes to amend 13 CFR part 107 as follows:

PART 107—SMALL BUSINESS INVESTMENT COMPANIES

1. The authority citation for part 107 continues to read as follows:

Authority: 15 U.S.C. 681 *et seq.*, 683, 687(c), 687b, 687d, 687g and 687m.

2. In § 107.50 revise paragraph (8)(i) of the definition of Associate and the definition of Leverageable Capital, and add in alphabetical order a definition of Distributable Securities to read as follows:

§ 107.50 Definitions of terms.

* * * * *

Associate of a Licensee means any of the following:

* * * * *

(8) * * *

(i) Any person described in paragraphs (1) through (6) of this definition is an officer, general partner, or managing member; or

* * * * *

Distributable securities means equity securities that meet each of the following requirements:

(1) The securities (which may include securities that are salable pursuant to the provisions of Rule 144 (17 CFR 230.144) under the Securities Act of 1933, as amended) are determined by SBA, in its sole discretion, to be salable immediately without restriction under Federal and state securities laws;

(2) The securities are of a class:

(i) Which is listed and registered on a national securities exchange, or

(ii) For which quotation information is disseminated in the National Association of Securities Dealers Automated Quotation System and as to which transaction reports and last sale data are disseminated pursuant to Rule 11Aa3–1 (17 CFR 240.11Aa3–1) under the Securities Exchange Act of 1934, as amended; and

(3) The quantity of such securities to be distributed to SBA can be sold over a reasonable period of time without having an adverse impact upon the price of the security.

* * * * *

Leverageable Capital means Regulatory Capital, excluding unfunded commitments.

* * * * *

3. In § 107.230, revise paragraph (b)(3) to read as follows:

§ 107.230 Permitted sources of Private Capital for Licensees.

* * * * *

(b) *Exclusions from Private Capital.*

* * *

(3) Funds obtained directly or indirectly from any Federal, State, or local government agency or instrumentality, except for:

(i) Funds invested by a public pension fund;

(ii) Funds obtained from the business revenues (excluding any governmental appropriation) of any federally chartered or Government-sponsored corporation established before October 1, 1987, to the extent that such revenues are reflected in the retained earnings of the corporation; and

(iii) ''Qualified Non-private Funds'' as defined in paragraph (d) of this section.

* * * * *

4. Revise § 107.504 to read as follows:

§ 107.504 Equipment and office requirements.

(a) *Computer capability.* You must have a personal computer with a modem, and be able to use this equipment to prepare reports (using SBA-provided software) and transmit them to SBA. In addition, by June 30, 1999, you must have access to the Internet and the capability to send and receive electronic mail via the Internet.

(b) *Facsimile capability.* You must be able to receive facsimile messages 24 hours per day at your primary office.

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

5. Revise § 107.505 to read as follows:

§ 107.505 Prohibition against political contributions.

You may not make a contribution to any national, State, or local political party, campaign or candidate, or to any political action committee that makes contributions to one or more political parties, campaigns, or candidates.

6. Remove § 107.508.

§ 107.508 [Removed]

7. In § 107.710 revise paragraphs (c)(1)(i) and (ii), redesignate paragraphs (d) and (e) as paragraphs (e) and (f), revise the last sentence of new paragraph (f), and add a new paragraph (d) to read as follows:

§ 107.710 Requirement to Finance Smaller Enterprises.

* * * * *

(c) Special requirement for certain leveraged Licensees.

(1) * * *

(i) Less than $10,000,000 if such Leverage included Participating Securities; or

(ii) Less than $5,000,000 if such Leverage was Debentures only.

* * * * *

(d) *Special requirement for Leverage over $90,000,000.* In addition to the applicable requirements in paragraphs (b) and (c) of this section, at the close of each of your fiscal years, 100 percent of any outstanding Leverage over $90,000,000 (including aggregate Leverage over $90,000,000 issued by two or more Licensees under Common Control) must have been invested in Smaller Enterprises.

* * * * *

(f) *Non-compliance with this section.* * * * However, you will not be eligible for additional Leverage until you reach the required percentage (see § 107.1120(c) through (e)).

8. In § 107.720 revise paragraph (c)(2) to read as follows:

§ 107.720 Small Businesses that may be ineligible for Financing.

* * * * *

(c) *Real Estate Businesses.* * * *

(2) You are not permitted to finance a business, regardless of SIC classification, if the Financing is to be used to acquire or refinance real property, unless the Small Business:

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

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

(iii) Occupies the subject property and uses at least 67 percent of the usable square footage for an eligible business purpose.

* * * * *

9. In § 107.730 revise paragraph (d)(3)(iv) to read as follows:

§ 107.730 Financing which constitute conflicts of interest.

* * * * *

(d) *Financings with Associates.* * * *

(3) *Exceptions to paragraphs (d)(1) and (d)(2) of this section.* * * *

(iv) You have no outstanding Leverage and do not intend to issue Leverage in the future, and your Associate either is not a Licensee or has no outstanding Leverage and does not intend to issue Leverage in the future.

* * * * *

10. In § 107.740 revise paragraph (a) to read as follows:

§ 107.740 Portfolio diversification (''overline'' limitation).

(a) *General rule.* This § 107.740 applies if you have outstanding Leverage or intend to issue Leverage in the future. Without SBA's prior written approval, you may provide Financing or a Commitment to a Small Business only if the resulting amount of your aggregate outstanding Financings and Commitments to such Small Business and its Affiliates does not exceed:

(1) For a Section 301(c) Licensee, 20 percent of the sum of:

(i) Your Regulatory Capital as of the date of the Financing or Commitment; plus

(ii) Any Distribution(s) you made under § 107.1570(b), during the 5 years preceding the date of the Financing or Commitment, which reduced your Regulatory Capital; plus

(iii) Any Distribution(s) you made under § 107.585, during the 5 years preceding the date of the Financing or Commitment, which reduced your Regulatory Capital by no more than 2 percent or which SBA approves for inclusion in the sum determined in this paragraph (a)(1).

(2) For a Section 301(d) Licensee, 30 percent of a sum determined in the manner set forth in paragraph (a)(1)(i) through (iii) of this section.

* * * * *

11. In § 107.1100, revise the section heading and paragraph (b) to read as follows:

§ 107.1100 Types of Leverage and application procedures.

* * * * *

(b) *Applying for Leverage.* The Leverage application process has two parts. You must first apply for SBA's conditional commitment to reserve a specific amount of Leverage for your future use. You may then apply to draw down Leverage against the commitment. See §§ 107.1200 through 107.1240.

* * * * *

12. In § 107.1120 redesignate paragraphs (d) through (f) as paragraphs (e) through (g) and add a new paragraph (d) to read as follows:

§ 107.1120 General eligibility requirements for Leverage.

* * * * *

(d) Certify, if applicable, that you will use 100 percent of any Leverage over $90,000,000 (including aggregate Leverage over $90,000,000 issued by two or more Licensees under Common Control) to provide Financing to Smaller Enterprises (see also § 107.710).

* * * * *

13. In § 107.1150 revise paragraph (a) and the first sentence of paragraph (b)(1) to read as follows:

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

(a) *Maximum amount of Leverage.*

(1) *Amounts before indexing.* If you are a Section 301(c) Licensee, the following table shows the maximum amount of Leverage you may have outstanding at any time, subject to the indexing adjustment set forth in paragraph (a)(2) of this section:

If your Leverageable Capital is:	Then your maximum Leverage is:
(1) Not over $17,100,000	300 percent of Leverageable Capital
(2) Over $17,100,000 but not over $34,100,000	$51,300,000 + [2 × (Leverageable Capital − $17,100,000)]
(3) Over $34,100,000 but not over $51,300,000	$85,300,000 + (Leverageable Capital − $34,100,000)
(4) Over $51,300,000	$102,500,000

(2) *Indexing of maximum amount of Leverage.* SBA will adjust the amounts in paragraph (a) of this section annually to reflect increases through September in the Consumer Price Index published by the Bureau of Labor Statistics. SBA will publish the indexed maximum Leverage amounts each year in a Notice in the **Federal Register**.

(b) *Exceptions to maximum Leverage provisions*—(1) *Licensees under Common Control.* Two or more Licensees under Common Control may have aggregate outstanding Leverage over $102,500,000 (subject to indexing as set forth in paragraph (a)(2) of this section) only if SBA gives them permission to do so. * * *

* * * * *

14. Revise § 107.1220 to read as follows:

§ 107.1220 Requirement for Licensee to file quarterly financial statements.

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

15. In § 107.1230(d) revise paragraph (d)(1), redesignate paragraphs (d)(2) and (d)(3) as paragraphs (d)(3) and (d)(4), add a new paragraph (d)(2), and revise the first sentence of redesignated paragraph (d)(4) to read as follows:

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

* * * * *

(d) *Procedures for funding draws.*

* * *

(1) A statement certifying that there has been no material adverse change in your financial condition since your last filing of SBA Form 468 (see also § 107.1220 for SBA Form 468 filing requirements).

(2) If your request is submitted more than 30 days following the end of your fiscal year, but before you have submitted your annual filing of SBA Form 468 (Long Form) in accordance with § 107.630(a), a preliminary unaudited annual financial statement on SBA Form 468 (Short Form).

* * * * *

(4) A statement that the proceeds are needed to fund one or more particular Small Businesses or to provide liquidity for your operations. * * *

* * * * *

16. In § 107.1550 revise the first sentence of the introductory text, paragraph (b)(1) and paragraph (d), and add a new paragraph (e) to read as follows:

§ 107.1550 Distributions by Licensee-permitted ''tax Distributions'' to private investors and SBA.

If you have outstanding Participating Securities or Earmarked Assets, and you are a limited partnership, ''S Corporation'', or equivalent pass-through entity for tax purposes, you may make ''tax Distributions'' to your investors in accordance with this § 107.1550, whether or not they have an actual tax liability. * * *

* * * * *

(b) *How to compute the Maximum Tax Liability.* (1) You may compute your Maximum Tax Liability for a full fiscal year or for any calendar quarter. Use the following formula:

$M = (TOI \times HRO) + (TCG \times HRC)$

where:

M = Maximum Tax Liability

TOI = Net ordinary income allocated to your partners or other owners for Federal income tax purposes for the fiscal year or calendar quarter for which the Distribution is being made, excluding Prioritized Payments allocated to SBA.

HRO = The highest combined marginal Federal and State income tax rate for corporations or individuals on ordinary income, determined in accordance with paragraphs (b)(2) through (b)(4) of this section.

TCG = Net capital gains allocated to your partners or other owners for Federal income tax purposes for the fiscal year or calendar quarter for which the Distribution is being made, excluding Prioritized Payments allocated to SBA.

HRC = The highest combined marginal Federal and State income tax rate for corporations or individuals on capital gains, determined in accordance with paragraphs (b)(2) through (b)(4) of this section.

* * * * *

(d) *Paying a tax Distribution.* You may make an annual tax Distribution on the first or second Payment Date following the end of your fiscal year. You may make a quarterly tax Distribution on the first Payment Date following the end of the calendar quarter for which the Distribution is being made. See also § 107.1575(a).

(e) *Excess tax Distributions.* (1) As of the end of your fiscal year, you must determine whether you made any excess tax Distributions for the year in accordance with paragraph (e)(2) of this section. Any tax Distributions that you make for a subsequent period must be reduced by the excess amount distributed.

(2) Determine your excess tax Distributions by adding together all your quarterly tax Distributions for the year (ignoring any required reductions for excess tax Distributions made in prior years), and subtracting the maximum tax Distribution that you would have been permitted to make based upon a single computation performed for the entire fiscal year. The result, if greater than zero, is your excess tax Distribution for the year.

17. In § 107.1575, revise paragraphs (a)(1) and (b)(2) and add a new paragraph (a)(4) to read as follows:

§ 107.1575 Distributions on other than Payment Dates.

(a) *Permitted Distributions on other than Payment Dates.* * * *

(1) Required annual Distributions under § 107.1540(a)(1), annual Distributions under § 107.1550, and any Distributions under § 107.1560 must be made no later than the second Payment Date following the end of your fiscal year.

* * * * *

(4) Quarterly Distributions under § 107.1550 must be made no earlier than the last day of the calendar quarter for which the Distribution is being made and no later than the first Payment Date following the end of such calendar quarter.

(b) *Conditions for making a Distribution.*

* * * * *

(2) The ending date of the period for which you compute your Earmarked Profits, Prioritized Payments, Adjustments, Charges, Profit Participation, Retained Earnings Available for Distribution, liquidity ratio, Capital Impairment, and any other applicable computations required under §§ 107.1500 through 107.1570, must be:

(i) The distribution date, or

(ii) If your Distribution includes annual Distributions under §§ 107.1540(a)(1), 107.1550 and/or 107.1560, your most recent fiscal year end;

* * * * *

18. In § 107.1580, redesignate paragraphs (a)(1) through (a)(4) as paragraphs (a)(2) through (a)(5), add a new paragraph (a)(1) and revise paragraph (b)(2) to read as follows:

§ 107.1580 Special rules for In-Kind Distributions by Licensees.

(a) *In-Kind Distributions while Licensee has outstanding Participating Securities.* * * *

(1) You must obtain SBA's written approval before the distribution date.

(2) You may distribute only Distributable Securities.

* * * * *

(5) You must deposit SBA's share of securities being distributed with a disposition agent designated by SBA. As an alternative, if you agree, SBA may direct you to dispose of its shares. In this case, you must promptly remit the proceeds to SBA.

* * * * *

(b) *In-Kind Distributions after Licensee has redeemed all Participating Securities.* * * *

* * * * *

(2) You must obtain SBA's prior written approval of any In-Kind Distribution of Earmarked Assets that are not Distributable Securities, specifically including approval of the valuation of the assets.

Dated: March 31, 1999.

Aida Alvarez,

Administrator.

[FR Doc. 99–9265 Filed 4–13–99; 8:45 am]

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 98–CE–122–AD]

RIN 2120–AA64

Airworthiness Directives; Pilatus Aircraft Ltd. Models PC–12 and PC–12/45 Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: This document proposes to supersede Airworthiness Directive (AD) 98–13–08, which currently requires replacing and re-routing the power return cables on the starter generator and the generator 2 on certain Pilatus Aircraft Ltd. (Pilatus) Models PC–12 and PC–12/45 airplanes. AD 98–13–08 also requires inserting a temporary revision to the pilot operating handbook (POH), and installing a placard near the standby magnetic compass. The proposed AD would retain the actions currently required by AD 98–13–08 on all airplanes affected by that AD, and would require replacing the temporary revision to the POH and the placard near the standby magnetic compass with an improved procedural POH revision and placard. The proposed AD would also require the placard and the temporary revision to the POH for additional serial number Models PC–12 and PC–12/45 airplanes; and would require accomplishing improved Standby Magnetic Compass Swing procedures and incorporating a temporary revision to the maintenance manual on all of the affected airplanes. The proposed AD is the result of mandatory continuing airworthiness information (MCAI) issued by the airworthiness authority for Switzerland. The actions specified by the proposed AD are intended to prevent directional deviation on the standby magnetic compass caused by modifications made to the airplane since manufacture, which could result in flight-path deviation during critical phases of flight.

DATES: Comments must be received on or before May 19, 1999.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), Central Region, Office of the Regional Counsel, Attention: Rules Docket No. 98–CE–122–AD, Room 1558, 601 E. 12th Street, Kansas City, Missouri 64106. Comments may be inspected at this location between 8 a.m. and 4 p.m., Monday through Friday, holidays excepted. Service information that applies to the proposed AD may be obtained from Pilatus Aircraft Ltd., Marketing Support Department, CH–6370 Stans, Switzerland; telephone: +41 41–6196 233; facsimile: +41 41–6103 351. This information also may be examined at the Rules Docket at the address above.

FOR FURTHER INFORMATION CONTACT: Roman T. Gabrys, Aerospace Engineer, FAA, Small Airplane Directorate, 1201 Walnut, suite 900, Kansas City, Missouri 64106; telephone: (816) 426–6934; facsimile: (816) 426–2169.

SUPPLEMENTARY INFORMATION:

Comments Invited

Interested persons are invited to participate in the making of the proposed rule by submitting such written data, views, or arguments as they may desire. Communications should identify the Rules Docket number and be submitted in triplicate to the address specified above. All communications received on or before the closing date for comments, specified above, will be considered before taking action on the proposed rule. The proposals contained in this notice may be changed in light of the comments received.

Comments are specifically invited on the overall regulatory, economic, environmental, and energy aspects of the proposed rule. All comments submitted will be available, both before and after the closing date for comments, in the Rules Docket for examination by interested persons. A report that summarizes each FAA-public contact concerned with the substance of this proposal will be filed in the Rules Docket.

Commenters wishing the FAA to acknowledge receipt of their comments submitted in response to this notice must submit a self-addressed, stamped postcard on which the following statement is made: ''Comments to Docket No. 98–CE–122–AD.'' The postcard will be date stamped and returned to the commenter.

Availability of NPRMs

Any person may obtain a copy of this NPRM by submitting a request to the FAA, Central Region, Office of the Regional Counsel, Attention: Rules Docket No. 98–CE–122–AD, Room 1558, 601 E. 12th Street, Kansas City, Missouri 64106.

Discussion

AD 98–13–08, Amendment 39–10596 (63 FR 32975, June 17, 1998), currently requires the following on certain Pilatus Models PC–12 and PC–12/45 airplanes (serial numbers 101 through 147):

—Replacing and re-routing the power return cables on the starter generator and generator 2;

—Inserting a temporary revision to the POH; and

—Installing a placard near the standby magnetic compass, using at least ⅛-inch letters, with the following words:

''*STANDBY COMPASS* FOR CORRECT READING CHECK: WINDSHIELD DE-ICE LH & RH HEAVY & COOLING SYSTEM OFF.''

Accomplishment of the actions of 98–13–08 is required in accordance with Pilatus PC XII Service Bulletin No. 24–002, Rev. No. 1, dated September 20, 1996.

Actions Since Issuance of Previous Rule

The Federal Office for Civil Aviation (FOCA), which is the airworthiness authority for Switzerland, recently notified the FAA that an unsafe condition may exist on certain Pilatus Model PC–12 and PC–12/45 airplanes. The FOCA advises that the changes made to the systems during the accomplishment of AD 98–13–08, along with other system modifications incorporated during the service life of the affected aircraft, have made certain revisions to the standby magnetic compass swing procedures necessary.