

Accordingly, the Office of Thrift Supervision amends part 561, chapter V, title 12, Code of Federal Regulations as set forth below:

PART 561—DEFINITIONS

1. The authority citation for part 561 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a.

§§ 561.13, 561.47, 561.48 [Removed]

2. Sections 561.13, 561.47 and 561.48 are removed.

Dated: December 18, 1998.

By the Office of Thrift Supervision.

Ellen Seidman,

Director.

[FR Doc. 99-2865 Filed 2-9-99; 8:45 am]

BILLING CODE 6720-01-P

SMALL BUSINESS ADMINISTRATION

13 CFR Part 120

Business Loan Programs

AGENCY: Small Business Administration.

ACTION: Final rule.

SUMMARY: The U.S. Small Business Administration (SBA) is promulgating a final rule to allow all participating Lenders to securitize the unguaranteed portion of, sell, sell a participating interest in, or pledge 7(a) loans. The rule has two components: securitizations; and pledges, sales of participations, and sales other than for the purpose of securitizing. In the first component, SBA establishes a three level unified approach to regulating securitizations. In the second component, SBA sets out rules to govern all pledges of, sales of a participating interest in, and sales of, other than for the purpose of securitizing, 7(a) loans. The components apply equally to all depository and nondepository Lenders, leveling the playing field for all SBA Lenders. Both components were drafted to protect the safety and soundness of SBA's 7(a) loan program.

DATES: Effective Date: This rule is effective April 12, 1999.

FOR FURTHER INFORMATION CONTACT: James W. Hammersley, Director, Secondary Market Sales, (202) 205-6490.

SUPPLEMENTARY INFORMATION:

Background

SBA is promulgating a final rule to govern the securitization of the unguaranteed portion of and the sale, sale of a participating interest in, or pledge of 7(a) loans. The rule has two

components. The first component governs securitizations ("securitization component"). For purposes of this regulation, a securitization is the pooling and sale of the unguaranteed portion of 7(a) loans, usually to a trust or special purpose vehicle, and the issuance of securities backed by those loans to investors in either a private placement or a public offering ("securitization"). In the securitizations of 7(a) loans to date, each investor has received an undivided ownership interest in the right to receive the principal of the unguaranteed portion of the pooled 7(a) loans, together with interest.

The second component of this final rule governs pledges of, sales of participating interests in, and sales of, other than for the purpose of securitizing, 7(a) loans ("other conveyances").

I. Securitization Component

Regulatory History

Congress and SBA have examined extensively whether and under what conditions SBA should permit Lenders to securitize the unguaranteed portion of 7(a) loans. Because Small Business Lending Companies ("SBLCs"), Business and Industrial Development Companies ("BIDCOs") and other nondepository institutions (collectively the "nondepository Lenders") do not have customer deposits to fund 7(a) lending, SBA, in 1992, permitted nondepository Lenders to securitize. Recognizing that securitization may benefit all Lenders, in 1996, SBA and Congress considered extending the securitization option to depository Lenders. On September 29, 1996, Congress enacted legislation requiring SBA to either promulgate regulations allowing both depository and nondepository Lenders to securitize or cease approving any securitizations.

Because securitization and, more particularly, securitization of the unguaranteed portion of 7(a) loans is relatively new and involves significant risk, SBA officials went to great lengths to fashion this final rule responsibly. On November 29, 1996, SBA published the first of a series of **Federal Register** notices designed to elicit public participation in SBA's development of the securitization regulation (61 FR 60649). SBA hoped to receive comments to assist SBA to craft a regulation allowing all Lenders to reap securitizations' benefits without compromising the safety and soundness of the 7(a) program.

On February 26, 1997, SBA published its first proposed securitization

regulation (62 FR 8640). The proposed regulation required all securitizations to include a 5 percent retention. SBA received approximately 25 comments. The commenters were divided almost equally on the proposal. Mindful of Congress' mandate to promulgate a regulation or cease approving all securitizations, on April 2, 1997, SBA promulgated an interim final rule (62 FR 15601) to govern securitizations. The regulation allowed all SBA Lenders to securitize while SBA continued its thorough review of securitization issues. Under the interim final rule, SBA would review each proposed securitization on a case-by-case basis for safety and soundness concerns.

Following SBA's promulgation of the proposed regulation, SBA held a public hearing, met with banking experts, and consulted with bank regulators from the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Department of Treasury, the Federal Reserve Board, the Office of Federal Housing Enterprise Oversight, and the Office of Thrift Supervision ("bank regulators"). SBA carefully considered the comments provided by the experts, the bank regulators, and the industry before drafting another proposed regulation. SBA tested the economics of the current proposal. A Big Six accounting firm then validated all calculations.

On May 18, 1998, SBA published the current proposed securitization regulation (63 FR 27219). It linked SBA securitization approval to a securitizer's credit quality and incorporated incentives for securitizers to safely securitize and service loans effectively. It provided a three level unified regulatory approach to securitizations. The three levels included: (1) a minimum capital requirement consistent with that imposed by bank regulators; (2) a retention requirement in the form of a subordinated tranche; and (3) a monitoring component whereby a decline in a securitizer's Currency Rate (as defined in the rule) would trigger PLP loan approval and securitization approval suspension. The multi-faceted rule: (1) conditioned a securitizer's ability to securitize on the securitizer's financial strength; (2) set the required retention based on the individual securitizer's credit quality history; and (3) invoked PLP benefits as an incentive for a securitizer to continue underwriting and servicing loans properly. The rule rewarded securitizers responsibly for past performance, current performance, and future performance, measuring current performance against past and that of the industry.

SBA encouraged feedback from experts, the industry, and the bank regulators. On June 15, 1998, SBA held a public hearing to discuss the current proposed regulation. SBA also received and reviewed approximately 16 written comments. SBA has carefully considered the oral and written comments, incorporating many recommendations into this final rule.

Comments

Commenters generally applauded the current proposed securitization rule (the "proposed regulation"). Some stated that it "encouraged prudent credit quality management by Lenders" and "achiev[ed] the Congressionally-mandated requirement of parity between depository and nondepository Lenders." Commenters declared the proposed regulation a substantial improvement over the February 1997 proposal, expressing appreciation to SBA for carefully and deliberately rethinking its earlier approach. The positive comments were accompanied by suggestions to refine SBA's three level unified regulatory approach to securitizations.

Capital Requirement

As stated in the proposed rule preamble, a capital requirement is a basic component in regulating any financial institution. It is a common method for measuring a Lender's financial strength. Requiring a securitizer to maintain a minimum level of capital encourages prudent underwriting and servicing practices. Credit quality is fundamental to the maintenance of capital. Loan losses erode capital. Eroding capital is a measure of reduced financial strength and may signal weakening credit quality.

SBA's proposed securitization regulation required "all securitizers * * * [to] maintain minimum capital consistent with the requirements imposed on depository Lenders by the bank regulatory agencies." For depository institutions, SBA would consider compliance with the capital requirements of the bank regulatory agencies as compliance with the regulation. The proposal also required that nondepository institutions meet the capital requirements of the bank regulatory agencies and, in addition, maintain minimum unencumbered paid in capital and paid in surplus of at least \$1 million.

SBA received some comments recommending that SBA clarify its proposed capital requirement. Commenters pointed out that bank capital requirements were complex and

varied among regulators. In addition, they noted that nondepository Lenders were not familiar with the capital requirements of bank regulatory agencies. The commenters suggested that SBA simplify its capital requirement for nondepository institutions in the final rule. SBA agrees.

SBA also received comments recommending that SBA increase its proposed capital level to 10 percent of a securitizer's unguaranteed loan assets consistent with SBA's policy of reducing risk discussed in the proposed rule. By requiring the slightly higher minimum capital requirement, SBA limits securitization to financially strong Lenders. It is these Lenders that will best be able to weather a downturn in the economy, lessening SBA's exposure to risk. Finally, commenters requested that SBA clarify that the capital charge applies not only to the unguaranteed portion of the securitizer's 7(a) loans in the portfolio but also to the remaining balance outstanding in the securitization pools. SBA also agrees with both of these recommendations and has incorporated them into the final rule.

The final rule provides that all securitizers must be considered to be "well capitalized" by their regulator. SBA will consider a depository institution to be in compliance with this section if it meets the definition of "well-capitalized" used by its bank regulator. SBA will consider a nondepository institution to be "well capitalized" and have met this requirement if it maintains a minimum unencumbered paid in capital and paid in surplus equal to at least 10 percent of its assets, excluding the guaranteed portion of its 7(a) loans. SBA eliminated the \$1 million minimum capital requirement for nondepository institutions contained in the proposed regulation to make the final rule more consistent between nondepository and depository institutions.

The Subordinated Tranche

The second level of SBA's unified approach to regulating securitizations is risk retention in the form of a subordinated tranche. In the final rule, a securitizer must retain a tranche of the securities in the securitization ("subordinated tranche") equal to the greater of two times the securitizer's loss rate on the securitizer's 7(a) loans disbursed for the preceding 10-year period or 2 percent of the principal balance outstanding at the time of securitization of the unguaranteed portion of the loans in the securitization. The Securitization

Committee may modify the formula for determining the tranche size for a securitizer creating a securitization from a pool of loans located in a region affected by a severe economic downturn if the Securitization Committee concludes that enforcing this section might exacerbate the adverse economic conditions in the region. SBA will monitor the initial retention level contained in the final rule and, should economic conditions and policy considerations warrant, SBA may modify the multiplier or minimum level to protect the safety and soundness of the 7(a) program. SBA will publish notice of any modification in the **Federal Register** and provide an opportunity to comment.

Tying the required retention to a securitizer's historical performance is fair and a common industry practice. It gives securitizers a greater incentive to originate and service high quality loans. The subordinated tranche would be subordinate to all other tranches issued. SBA believes the minimum subordinated tranche is necessary to counter the potential risks of securitizing elaborated in the proposed rule's preamble.

Generally, commenters praised SBA's proposed tranche noting "it has great merit" in that it: 1) "ties benefits directly to performance;" and 2) is "a credit enhancement tool." Commenters recognized the importance of requiring an "originating lender to maintain an economic interest in [its] loan." Some praised the subordinated tranche for offering flexibility to securitizers in their "asset/liability management" and as a "fail safe" to "ensure that even the top quality securitizers retain some measure of principal at risk until the securitization matures."

The comments SBA received addressing the details of the tranche varied greatly. Many commenters supported the use of a loss-based formula. Some suggested that SBA should decrease the loss multiple. Others recommended that SBA increase required retention. SBA determined to keep the proposed rule retention level, allowing for changes as economic conditions and policy considerations warrant. Empirical evidence supports the proposed rule retention level. Historical data reveals that most securitizers' retention levels would fall between 12 and 2 percent. The average is expected to be approximately 5.4 percent. SBA believes that this retention level is reasonable at this time. The 2 percent minimum also is reasonable at this time because it approximates twice the cumulative loss rate of the best performing 7(a) loan originators.

A few commenters suggested that SBA set retention at 2 percent of the securitization plus any part of the securitization that does not receive an investment grade rating. In addition, some commenters suggested that SBA only approve a securitization if it contains no non-investment grade securities. SBA believes that these requirements might be too restrictive, as some securitizers have chosen to structure their securitizations to include non-investment grade rated securities which they may sell. As stated in the proposed rule preamble, SBA will not rely solely on rating agencies to set retention levels.

Some commenters suggested that SBA shorten the 10-year "look back" period. SBA has decided to retain the 10-year "look back" period because it considers the securitizer's loan performance over several economic cycles. The 10-year "look back" period provides a securitizer ample opportunity to demonstrate quality lending and servicing without unduly penalizing the securitizer for cyclical economic downturns.

At least one commenter recommended that SBA shorten the 6-year holding period proposed in the rule. Conversely, other commenters supported the 6-year holding period. The final rule includes the 6-year holding period. SBA's historical loss data indicates that SBA Lenders incur most losses between years three and five of a loan. If the loans do not perform as expected, not only may the securitizer suffer losses, but the tranche will have significantly less value if the securitizer tries to sell it after the holding period ends. The holding period reinforces the incentive to originate and service high quality loans.

PLP Loan Approval Suspension

In response to many comments, SBA has revised the formula triggering PLP unilateral loan approval privilege suspension. The proposed rule provided that "[i]f a PLP securitizer's currency rate declines, SBA may suspend the securitizer's PLP unilateral loan approval privileges (PLP approval privileges) under either of the following circumstances: 1) If the decline is more than 110 percent of the rate of the decline of the currency rate of all loans approved under the PLP program (PLP Program Loans) as calculated from quarter to quarter; or 2) If the decline is more than five percentage points and the currency rate for the PLP Program remains stable or increases. In the event of a severe downturn in a regional economy, a securitizer's currency rate is adversely affected, SBA may waive

privilege suspension for all securitizers in the region, if it concludes that enforcing this section might exacerbate the adverse economic conditions in the region."

Many commenters stated that the 110 percent benchmark was too sensitive and that the five-percentage point benchmark was too large. SBA agrees. Several commenters noted that the proposed rule failed to consider cumulative deterioration in a securitizer's Currency Rate. Others requested that securitizers that perform better than the SBA portfolio should not be unduly penalized. To accommodate these concerns, SBA modified the benchmark to provide greater flexibility to securitizers.

The final rule provides that SBA will calculate an Initial Currency Rate ("ICR")—the securitizer's benchmark Currency Rate as of the end of the calendar quarter immediately prior to the first securitization completed after SBA promulgates these regulations, and an Initial Currency Rate Percentage ("ICRP")—the securitizer's Initial Currency Rate compared to that of the SBA portfolio as of the end of the calendar quarter immediately prior to the first securitization completed after SBA promulgates these regulations. Each quarter, SBA will compare each securitizer's Currency Rate to its ICR. If a securitizer's Currency Rate on all of its 7(a) loans declines, SBA may suspend the securitizer's PLP unilateral loan approval privileges (PLP approval privileges) if: 1) the decline from the ICR is more than the Benchmark Number as published in the **Federal Register** from time to time; and 2) the securitizer's Currency Rate Percentage is less than its ICRP.

The Benchmark Number referred to in the rule is the maximum number of percentage points that a securitizer's Currency Rate can decrease without triggering the PLP suspension provision contained in 13 CFR 120.425. The flexibility contained in the final rule is consistent with the concept proposed in 13 CFR 120.425(c)(2). SBA will publish the Benchmark Number in the **Federal Register** from time to time. SBA will monitor the Benchmark Number and, if economic conditions or policy considerations warrant, SBA may modify it to protect the safety and soundness of the 7(a) program.

SBA will establish a Benchmark Number of 2.5 percentage points initially. The 2.5 percentage points Benchmark Number was proposed by some commenters. SBA considers a 2.5 percentage point decline in Currency Rate a significant event warranting action. Some commenters requested that

SBA clarify the "due process" procedures in the PLP suspension provision. Other commenters suggested that SBA incorporate an intermediate step before suspending PLP approval privileges. SBA agrees with both suggestions.

The final rule provides that a securitizer will first be placed on probation for one quarter. At the end of the probationary quarter, if: 1) the securitizer has improved its Currency Rate to above its ICR less the Benchmark Number; or 2) its Currency Rate Percentage is either the same or greater than its ICRP, the probation will end. If at the end of the probationary quarter, the securitizer has not met either condition 1 or 2, SBA will suspend the securitizer's PLP approval privileges and will not approve additional securitization requests from that securitizer. SBA will provide written notice at least 10 days prior to the effective date of the suspension. The suspension will last a minimum of three months. During the suspension period, the securitizer must use Certified Lender or Regular Procedures to process 7(a) loan applications.

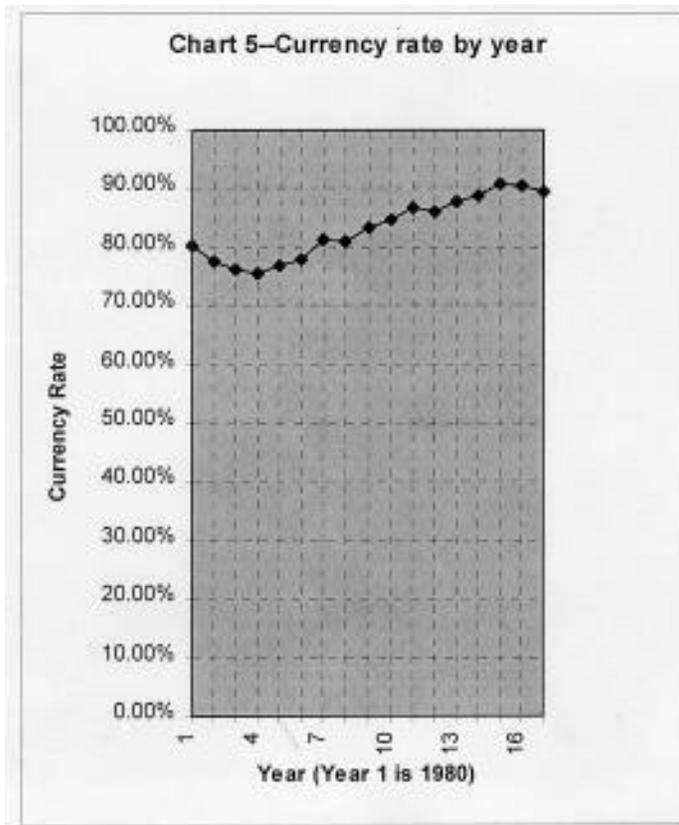
The suspension will remain in effect until the securitizer meets either condition 1 or 2 as discussed above. If the securitizer meets either condition by the end of the 3-month period, notifies SBA with acceptable documentation, and SBA agrees, SBA will reinstate the securitizer. If the securitizer cannot meet either condition, the suspension will remain in effect and the securitizer may then petition the SBA Securitization Committee (to be formed after SBA publishes this rule) for reinstatement. The Securitization Committee may consider the economic conditions in the securitizer's market area, the securitizer's efforts to improve its Currency Rate and the quality of the securitizer's 7(a) loan packages and servicing. This language is intended to replace the economic waiver provision in the proposed rule. This provision was broadened in response to comments to allow the Securitization Committee to consider additional factors warranting waiver. The Securitization Committee will consider only one petition by a securitizer per quarter. SBA will calculate Currency Rate and Currency Rate Percentages quarterly from financial information securitizers provide using SBA Form 1502.

By incorporating an ICR into the PLP formula, the formula takes cumulative decline into account. SBA incorporated the ICR "safe-harbor" in response to the requests that securitizers who perform better than the SBA portfolio should not be unduly penalized. SBA

believes the ICRP safe-harbor is fair and consistent with the proposed rule's provision to monitor Currency Rate in

relation to the SBA portfolio. SBA does not want to preclude a securitizer's use of PLP approval privileges if the

securitizer's and the industry's portfolios are both declining due to general economic conditions.



Year ending:	Percent ¹	Change ²
1980	80.20	
1981	77.70	2.50
1982	76.20	1.50
1983	75.50	0.70
1984	76.80	-1.30
1985	78.00	-1.20
1986	81.30	-3.30
1987	80.90	0.40
1988	83.50	-2.60
1989	84.70	-1.20
1990	86.90	-2.20
1991	86.20	0.70
1992	87.60	-1.40
1993	88.80	-1.20
1994	90.90	-2.10
1995	90.60	0.30
1996	89.40	1.20
Average Change		1.59

¹ SBA portfolio currency rate.
² Value of year to year change.

Some commenters suggested that SBA adopt a numeric "safe-harbor," such as a 95 percent Currency Rate. If the securitizer's Currency Rate remained above the numeric safe harbor, the PLP suspension provision would not be triggered. SBA chose not to select a numeric safe harbor. Doing so might encourage good securitizers with a

Currency Rate above the safe harbor level to accept lower quality credits. A few commenters suggested that SBA's quarterly review of Currency Rates may be too short. After reviewing the matter, SBA reaffirmed its decision to review Currency Rates quarterly. This third level of the unified regulatory approach is intended to be an early warning trigger to alert SBA and a securitizer of the securitizer's declining performance. Ideally, SBA will be able to identify declining loan performance before it can threaten a securitizer's entire portfolio and financial condition. This monitoring may assist the securitizer to improve credit practices while protecting the safety and soundness of the 7(a) program.

Several commenters conveyed concern over SBA's ability to calculate Currency Rates accurately. SBA, with the assistance of private sector contractors, has overhauled its financial data management system. This system will perform the Currency Rate calculations. Securitizers will forward loan status data to SBA monthly. SBA will use this data to calculate securitizers' Currency Rates. SBA will

give securitizers the opportunity to verify the calculations. A few commenters suggested that the third level was unnecessary—that SBA's PLP Reviews would uncover a securitizer's decline in credit quality. PLP review and securitization Currency Rate tracking are two separate, though complementary components, of SBA's overall Lender oversight program. The PLP suspension provision is designed as an early warning trigger to notify SBA and the securitizer of declining Currency Rates and possible declining credit quality. SBA reviews all PLP Lenders (approximately 500) annually. The PLP review is an in-depth review geared to assess the long-term policy compliance and credit quality of our PLP Lenders. Finally, SBA received some requests to extend the securitization regulation's PLP suspension provision to all PLP Lenders. At this time, SBA declines to extend the provision. As elaborated in the proposed rule preamble, SBA has imposed this level of protection in the securitization regulation because securitization, in conjunction with PLP approval privileges, magnifies risk to SBA. The PLP suspension provision is

designed to serve as an incentive to securitizers to maintain or improve their lending and sends a timely warning signal to SBA that a securitizer's credit quality may be declining. If SBA were to extend this to all PLP Lenders, it would require a separate rulemaking.

Additional Level

In the current proposed regulation, SBA requested comments and suggestions for adding a fourth level to SBA's securitization regulation. SBA envisioned that under a fourth level, SBA would monitor a securitizer's loss rate after the securitization and assess a supplemental payment against securitizers who experience long-term performance declines. The fourth level would have provided securitizers an additional incentive to maintain credit quality.

Many commenters rejected SBA's proposal for a fourth level reasoning that the level, as discussed, could impair the securitizer, force a compromise in servicing ability, and perhaps prevent the securitization from receiving true sale treatment. Commenters further opined that the market will exact sufficient penalties for deficient portfolios. For these reasons, SBA has not added a fourth level to this securitization regulation.

Additional Clarifications

One commenter recommended that SBA clarify its Currency Rate definition. SBA has done so, clarifying that a securitizer's Currency Rate is that of its entire 7(a) loan portfolio, not just PLP loans. Using a securitizer's 7(a) loan portfolio as its Currency Rate baseline measurement is a fair approach to monitoring a securitizer's performance.

Two commenters suggested that SBA compute a securitizer's Loss Rate and Currency Rate using the static curve rather than the pooling method. SBA disagrees. SBA believes that the static curve method introduces unnecessary complexity. SBA believes that any marginal improvement to accuracy the static curve method may provide does not justify the added complexity.

A few commenters requested that SBA reconsider its earlier position to disallow securitized loan prefunding. SBA has reconsidered this issue and will allow loans to be included in a securitization that are closed within 90 days of the securitization.

Finally, SBA has always retained sole discretion to approve securitizations within its regulatory framework. SBA does not intend the regulatory framework in the final regulation to include every point that SBA may consider in the future when evaluating

a securitization request. SBA recognizes that securitization methodologies and financial markets are fluid. As securitization structures and financial markets change, SBA may establish certain policies from time to time as part of its securitization review which reflect the changes. For example, SBA may establish a minimum Currency Rate that a securitizer must maintain in order to securitize, SBA may require securitizers to maintain additional capital for loans purchased from other lenders, and SBA may establish requirements with respect to excess interest. SBA's intent in allowing such policies to be established is to encourage securitization for those Lenders that are financially strong and to protect the safety and soundness of the 7(a) program.

II. Other Conveyances Component

The Other Conveyances component governs pledges and sales other than sales for the purpose of securitizing.

Sales

This final rule requires that Lenders obtain SBA's prior written consent for the sale of a Lender's entire interest in a loan to another participating Lender. The final rule clarifies that SBA does not permit sales to nonparticipating Lenders. The rule also requires that Lenders obtain SBA's prior written consent to sales if the Lender will retain less than 10 percent of the principal outstanding on the loan. However, the rule requires only that Lenders provide written notice to SBA prior to a sale after which the SBA Lender would continue to own a portion of the unguaranteed interest equal to at least 10 percent of the outstanding principal amount of the loan. The rules for sales of participating interests mirror those for sales.

Pledges

This final rule also requires a Lender to obtain SBA's prior written consent to all pledges of 7(a) loans except for certain types of pledges enumerated in SBA's Loan Guaranty Agreement (SBA Form 750) as amended from time to time and in 13 CFR 120.435. Except for such enumerated pledges, the SBA Lender must use proceeds of the loan secured by the 7(a) loans solely for the purpose of financing 7(a) loans.

The final rule requires that a Lender be in good standing as determined by SBA. All documentation, including the multi-party agreement, must be satisfactory to SBA. Finally, the final rule also requires that a Lender or a third party acceptable to SBA hold the original promissory notes.

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 final rule does not constitute a significant rule within the meaning of Executive Order 12866, since it is not likely to have an annual effect on the economy of \$100 million or more, result in a major increase in costs or prices, or have a significant adverse effect on competition or the United States economy.

SBA certifies that this final rule does 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.* This final rule replaces SBA's Interim Final Rule published on April 2, 1997. Like the Interim Final Rule, it allows depository Lenders to securitize loans (as nondepository Lenders have done for the last six years). Since the publication of SBA's Interim Final Rule, only a very small number of depository Lenders have securitized. Moreover, those Lenders do not qualify as small under SBA's size standards. 13 CFR 121.201.

SBA certifies that this final rule does not impose any additional reporting or recordkeeping requirements under the Paperwork Reduction Act, 44 U.S.C. chapter 35.

For purposes of Executive Order 12612, SBA certifies that this final rule has no federalism implications warranting preparation of a Federalism Assessment.

For purposes of Executive Order 12778, SBA certifies that this final rule has been drafted, to the extent practicable, to accord with the standards set forth in section 2 of that Order.

List of Subjects in 13 CFR Part 120

Loan programs—business.

For the reasons set forth above, SBA amends 13 CFR part 120 as follows:

PART 120—[AMENDED]

1. The authority citation for part 120 continues to read as follows:

Authority: 15 U.S.C. 634(b)(6) and 636(a) and (h).

2. Revise the undesignated center heading immediately preceding § 120.420 to read as follows:

Participating Lender Financings

3. Revise § 120.420 to read as follows:

§ 120.420 Definitions.

(a) *7(a) Loans*—All references to 7(a) loans under this subpart include loans

made under section 7(a) of the Small Business Act (15 U.S.C. 631 *et seq.*) and loans made under section 502 of the Small Business Investment Act (15 U.S.C. 661 *et seq.*), both of which may be securitized under this subpart.

(b) *Bank Regulatory Agencies*—The bank regulatory agencies are the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

(c) *Benchmark Number*—The maximum number of percentage points that a securitizer's Currency Rate can decrease without triggering the PLP suspension provision set forth in § 120.425. SBA will publish the Benchmark Number in the **Federal Register**.

(d) *Currency Rate*—A securitizer's "Currency Rate" is the dollar balance of its 7(a) guaranteed loans that are less than 30 days past due divided by the dollar balance of its portfolio of 7(a) guaranteed loans outstanding, as calculated quarterly by SBA, excluding loans approved in SBA's current fiscal year.

(e) *Currency Rate Percentage*—The relationship between the securitizer's Currency Rate and the SBA 7(a) loan portfolio Currency Rate as calculated by dividing the securitizer's Currency Rate by the SBA 7(a) loan portfolio Currency Rate.

(f) *Good Standing*—A Lender is in "good standing" with SBA if it:

(1) Is in compliance with all applicable:

- (i) Laws and regulations;
- (ii) Policies; and
- (iii) Procedures;

(2) Is in good financial condition as determined by SBA;

(3) Is not under investigation or indictment for, or has not been convicted of, or had a judgment entered against it for a felony or fraud, or charges relating to a breach of trust or violation of a law or regulation protecting the integrity of business transactions or relationships; and

(4) Does not have any officer or employee who has been under investigation or indictment for, or has been convicted of, or had a judgment entered against him for a felony or fraud, or charges relating to a breach of trust or violation of a law or regulation protecting the integrity of business transactions or relationships unless, the Securitization Committee has determined that good standing exists despite the existence of such person.

(g) *Initial Currency Rate*—The Initial Currency Rate (ICR) is the securitizer's benchmark Currency Rate. SBA will calculate the securitizer's ICR as of the

end of the calendar quarter immediately prior to the first securitization completed after April 12, 1999. This calculation will include all 7(a) loans which are outstanding and were approved in any fiscal year prior to SBA's current fiscal year. Each quarter, SBA will compare each securitizer's Currency Rate to its ICR.

(h) *Initial Currency Rate Percentage*—The Initial Currency Rate Percentage (ICRP) measures the relationship between a securitizer's Initial Currency Rate and the SBA 7(a) loan portfolio Currency Rate at the time of the first securitization after April 12, 1999. The ICRP is calculated by dividing the securitizer's Currency Rate by the SBA 7(a) loan portfolio Currency Rate. SBA will calculate the securitizer's ICRP as of the end of the calendar quarter immediately prior to the first securitization completed after April 12, 1999.

(i) *Loss Rate*—A securitizer's "loss rate," as calculated by SBA, is the aggregate principal amount of the securitizer's 7(a) loans determined uncollectable by SBA for the most recent 10-year period, excluding SBA's current fiscal year activity, divided by the aggregate original principal amount of 7(a) loans disbursed by the securitizer during that period.

(j) *Nondepository Institution*—A "nondepository institution" is a Small Business Lending Company ("SBLC") regulated by SBA or a Business and Industrial Development Company ("BIDCO") or other nondepository institution participating in SBA's 7(a) program.

(k) *Securitization*—A "securitization" is the pooling and sale of the unguaranteed portion of SBA guaranteed loans to a trust, special purpose vehicle, or other mechanism, and the issuance of securities backed by those loans to investors in either a private placement or public offering.

4. Add §§ 120.421 through 120.428 to read as follows:

§ 120.421 Which Lenders may securitize?

All SBA participating Lenders may securitize subject to SBA's approval.

§ 120.422 Are all securitizations subject to this subpart?

All securitizations are subject to this subpart. Until additional regulations are promulgated, SBA will consider securitizations involving multiple Lenders on a case by case basis, using the conditions in § 120.425 as a starting point. SBA will consider securitizations by affiliates as single Lender securitizations for purposes of this subpart.

§ 120.423 Which 7(a) loans may a Lender securitize?

A Lender may only securitize 7(a) loans that will be fully disbursed within 90 days of the securitization's closing date. If the amount of a fully disbursed loan increases after a securitization settles, the Lender must retain the increased amount.

§ 120.424 What are the basic conditions a Lender must meet to securitize?

To securitize, a Lender must:

(a) Be in good standing as determined by the Associate Administrator for Financial Assistance (AA/FA);

(b) Use a securitization structure which is satisfactory to SBA;

(c) Use documents acceptable to SBA, including SBA's model multi-party agreement, as amended from time to time;

(d) Obtain SBA's written consent, which it may withhold in its sole discretion, prior to executing a commitment to securitize; and

(e) Cause the original notes to be stored at the FTA, as defined in § 120.600, and other loan documents to be stored with a party approved by SBA.

§ 120.425 What are the minimum elements that SBA will require before consenting to a securitization?

A securitizer must comply with the following three conditions:

(a) *Capital Requirement*—All securitizers must be considered to be "well capitalized" by their regulator. SBA will consider a depository institution to be in compliance with this section if it meets the definition of "well capitalized" used by its bank regulator. SBA's capital requirement does not change the requirements that banks already meet. For nondepository institutions, SBA, as the regulator, will consider a non-depository institution to be "well capitalized" if it maintains a minimum unencumbered paid in capital and paid in surplus equal to at least 10 percent of its assets, excluding the guaranteed portion of 7(a) loans. Each nondepository institution must submit annual audited financial statements demonstrating that it has met SBA's capital requirement.

(b) *Subordinated Tranche*—A securitizer or its wholly owned subsidiary must retain a tranche of the securities issued in the securitization (subordinated tranche) equal to the greater of two times the securitizer's Loss Rate or 2 percent of the principal balance outstanding at the time of securitization of the unguaranteed portion of the loans in the securitization. This tranche must be subordinate to all other securities issued

in the securitization including other subordinated tranches. The securitizer or its wholly owned subsidiary may not sell, pledge, transfer, assign, sell participations in, or otherwise convey the subordinated tranche during the first 6 years after the closing date of the securitization. The securities evidencing the subordinated tranche must bear a legend stating that the securities may not be sold until 6 years after the issue date. SBA's Securitization Committee may modify the formula for determining the tranche size for a securitizer creating a securitization from a pool of loans located in a region affected by a severe economic downturn if the Securitization Committee concludes that enforcing this section might exacerbate the adverse economic conditions in the region. SBA will work with the securitizer to verify the accuracy of the data used to make the Loss Rate calculation.

(c) PLP Privilege Suspension.

(1) *Suspension*: If a securitizer's Currency Rate declines, SBA may suspend the securitizer's PLP unilateral loan approval privileges (PLP approval privileges) if the decline from the securitizer's ICR is more than the Benchmark Number as published in the **Federal Register** from time to time and the securitizer's Currency Rate Percentage is less than its ICRP. The securitizer will first be placed on probation for one quarter. If, at the end of the probationary quarter the securitizer has not met either of the following conditions in paragraph (c)(1)(i) or (c)(1)(ii) of this section, SBA will suspend the securitizer's PLP approval privileges and will not approve additional securitization requests from that securitizer. SBA will provide written notice at least 10 days prior to the effective date of suspension. The suspension will last a minimum of 3 months. During the suspension period, the securitizer must use Certified Lender or Regular Procedures to process 7(a) loan applications. The prohibition will end if, at the end of the probationary quarter: (i) the securitizer has improved its Currency Rate to above its ICR less the Benchmark Number; or (ii) its Currency Rate Percentage is either the same or greater than its ICRP.

(2) *Reinstatement*: The suspension will remain in effect until the securitizer meets either the condition in paragraph (c)(1)(i) or (c)(1)(ii) of this section. If the securitizer meets either condition by the end of the 3-month period, notifies SBA with acceptable documentation, and SBA agrees, SBA will reinstate the securitizer. If the securitizer cannot meet either condition, the suspension will remain in effect. The securitizer may then petition the SBA

Securitization Committee (Committee) for reinstatement. The Committee will review the reinstatement petition and determine if the securitizer's PLP approval privilege and securitization status should be reinstated. The Committee may consider the economic conditions in the securitizer's market area, the securitizer's efforts to improve its Currency Rate, and the quality of the securitizer's 7(a) loan packages and servicing. The Committee will consider only one petition by a securitizer per quarter.

(3) *The Benchmark Number*. SBA will monitor the Benchmark Number. If economic conditions or policy considerations warrant, SBA may modify the Benchmark Number to protect the safety and soundness of the 7(a) program.

(4) *Data*. SBA will calculate Currency Rate and Currency Rate Percentages quarterly from financial information that securitizers provide. SBA will work with a securitizer to verify the accuracy of the data used to make the Currency Rate calculation.

§ 120.426 What action will SBA take if a securitizer transfers the subordinated tranche prior to the termination of the holding period?

If a securitizer transfers the subordinated tranche prior to the termination of the holding period, SBA will suspend immediately the securitizer's ability to make new 7(a) loans. The securitizer will have 30 calendar days to submit an explanation to SBA's Securitization Committee ("Committee"). The Committee will have 30 calendar days to review the explanation and determine whether to lift the suspension. If an explanation is not received within 30 calendar days or the explanation is not satisfactory to the Committee, SBA may transfer the servicing of the applicable securitized loans, including the securitizers' servicing fee on the guaranteed and unguaranteed portions and the premium protection fee on the guaranteed portion, to another SBA participating Lender.

§ 120.427 Will SBA approve a securitization application from a capital impaired Securitizer?

If a securitizer does not maintain the level of capital required by this subpart, SBA will not approve a securitization application from that securitizer.

§ 120.428 What happens to a securitizer's other PLP responsibilities if SBA suspends its PLP approval privilege?

The securitizer must continue to service and liquidate loans according to its PLP Supplemental Agreement.

5. Redesignate current section 120.430 as section 120.414.

6. Revise the undesignated center heading immediately preceding newly designated § 120.414 to read MISCELLANEOUS PROVISIONS.

7. Redesignate current section 120.431 as section 120.415.

8. Add a new undesignated center heading and §§ 120.430 through 120.435 to read as follows:

Other Conveyances

§ 120.430 What conveyances are covered by §§ 120.430 through 120.435?

Sections 120.430 through 120.435 cover all other transactions in which a Lender sells, sells a participating interest in, or pledges an SBA guaranteed loan other than for the purpose of securitizing and other than conveyances covered under Subpart F, Secondary Market, of this part.

§ 120.431 Which Lenders may sell, sell participations in, or pledge 7(a) loans?

All Lenders may sell, sell participations in, or pledge 7(a) loans in accordance with this subpart.

§ 120.432 Under what circumstances does this subpart permit sales of, or sales of participating interests in, 7(a) loans?

(a) A Lender may sell all of its interest in a 7(a) loan to another Lender operating under a current Loan Guarantee Agreement (SBA Form 750) ("participating Lender"), with SBA's prior written consent, which SBA may withhold in its sole discretion. A Lender may not sell any of its interest in a 7(a) loan to a nonparticipating Lender. The purchasing Lender must take possession of the promissory note and other loan documents, and service the sold 7(a) loan. The purchasing Lender purchases the loan subject to SBA's existing rights including its right to deny liability on its guarantee as provided in § 120.524. After purchase, the purchased loan will be subject to the purchasing Lender's Loan Guarantee Agreement.

(b) A Lender may sell, or sell a participating interest in, a part of a 7(a) loan to another participating Lender. If the Lender retains ownership of a part of the unguaranteed portion of the loan equal to at least 10 percent of the outstanding principal balance of the loan, the Lender must give SBA prior written notice of the transaction, and the Lender must continue to hold the note and service the loan. If a Lender retains ownership of a part of the unguaranteed portion of the loan equal to less than 10 percent of the outstanding principal balance of the loan, the Lender must obtain SBA's prior written consent to the transaction,

which consent SBA may withhold in its sole discretion. The Lender must continue to hold the note and other loan documents, and service the loan unless SBA otherwise agrees in its sole discretion.

(c) For purposes of determining the percentage of ownership a Lender has retained, SBA will not consider a Lender to be the owner of the part of a loan in which it has sold a participating interest.

§ 120.433 What are SBA's other requirements for sales and sales of participating interests?

SBA requires the following:

(a) The Lender must be in good standing as determined by the AA/FA; and

(b) In transactions requiring SBA's consent, all documentation must be satisfactory to SBA, including, if SBA determines it to be necessary, a multi-party agreement.

§ 120.434 What are SBA's requirements for loan pledges?

(a) Except as set forth in § 120.435, SBA must give its prior written consent to all pledges of any portion of a 7(a) loan, which consent SBA may withhold in its sole discretion;

(b) The Lender must be in good standing as determined by the AA/FA;

(c) All loan documents must be satisfactory to SBA and must include a multi-party agreement among SBA, Lender, the pledgee, FTA and such other parties as SBA determines are necessary;

(d) The Lender must use the proceeds of the loan secured by the 7(a) loans only for financing 7(a) loans and for costs and expenses directly connected with the borrowing for which the loans are pledged;

(e) The Lender must remain the servicer of the loans and retain possession of all loan documents other than the original promissory notes;

(f) The Lender must deposit the original promissory notes at the FTA; and

(g) The Lender must retain an economic interest in and the ultimate risk of loss on the unguaranteed portion of the loans.

§ 120.435 Which loan pledges do not require notice to or consent by SBA?

Notwithstanding the provisions of § 120.434(d), 7(a) loans may be pledged for the following purposes without notice to or consent by SBA:

(a) Treasury tax and loan accounts;

(b) The deposit of public funds;

(c) Uninvested trust funds;

(d) Discount borrowings at a Federal Reserve Bank; or

(e) Advances by a Federal Home Loan Bank.

9. In § 120.453 revise paragraphs (a) and (b) and remove paragraph (c) to read as follows:

§ 120.453 What are the requirements of a PLP Lender in servicing and liquidating SBA guaranteed loans?

* * * * *

(a) Take any action that confers a Preference on the Lender; and

(b) Accept a compromise settlement without prior written SBA consent.

Dated: December 31, 1998.

Aida Alvarez,
Administrator.

[FR Doc. 99-3122 Filed 2-5-99; 9:29 am]
BILLING CODE 8025-01-P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 23

[Docket No. CE151, Special Condition 23-095-SC]

Special Conditions; Jetcruzer Model 500 Airplane

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final special conditions; request for comments.

SUMMARY: These special conditions are issued to Advanced Aerodynamics & Structures, Incorporated (AASI), 3501 Lakewood Blvd., Long Beach Airport, California 90808, for an Amended Type Certificate for the Jetcruzer Model 500 airplane. This airplane will have novel and unusual design features when compared to the state of technology envisaged in the applicable airworthiness standards. These novel and unusual design features include the installation of electronic flight instrument system (EFIS) displays for which the applicable regulations do not contain adequate or appropriate airworthiness standards for the protection of these systems from the effects of high intensity radiated fields (HIRF). These special conditions contain the additional safety standards that the Administrator considers necessary to establish a level of safety equivalent to the airworthiness standards applicable to these airplanes.

EFFECTIVE DATE: The effective date of these special conditions is January 29, 1999.

Comments must be received on or before March 12, 1998.

ADDRESSES: Comments may be mailed in duplicate to: Federal Aviation

Administration, Regional Counsel, ACE-7, Attention: Rules Docket Clerk, Docket No. CE151, Room 1558, 601 East 12th Street, Kansas City, Missouri 64106. All comments must be marked: Docket No. CE151. Comments may be inspected in the Rules Docket weekdays, except Federal holidays, between 7:30 a.m. and 4:00 p.m.

FOR FURTHER INFORMATION CONTACT: Ervin Dvorak, Aerospace Engineer, Standards Office (ACE-110), Small Airplane Directorate, Aircraft Certification Service, Federal Aviation Administration, 601 East 12th Street, Kansas City, Missouri 64106; telephone (816) 426-6941.

SUPPLEMENTARY INFORMATION: The FAA has determined that notice and opportunity for prior public comment hereon are impracticable because these procedures would significantly delay insurance of the approval design and thus delivery of the affected aircraft. In addition, the substance of these special conditions has been subject to the public comment process in several prior instances with no substantive comments received. The FAA, therefore, finds that good cause exists for making these special conditions effective upon issuance.

Comments Invited

Interested persons are invited to submit such written data, views, or arguments as they may desire. Communications should identify the regulatory docket or notice number and be submitted in duplicate to the address specified above. All communications received on or before the closing date for comments will be considered by the Administrator. The special conditions may be changed in light of the comments received. All comments received will be available in the Rules Docket for examination by interested persons, both before and after the closing date for comments. A report summarizing each substantive public contact with FAA personnel concerning this rulemaking will be filed in the docket. Commenters wishing the FAA to acknowledge receipt of their comments submitted in response to this notice must include a self-addressed, stamped postcard on which the following statement is made: "Comments to CE151." The postcard will be date stamped and returned to the commenter.

Background

On October 7, 1996, Advanced Aerodynamics & Structures, Incorporated, 3501 Lakewood Blvd., Long Beach Airport, CA 90808, made an