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Part IV

Small Business Administration

13 CFR Part 122

**Business Loans; Microloan Demonstration
Program; Interim Rule**

SMALL BUSINESS ADMINISTRATION**13 CFR Part 122****Business Loans; Microloan Demonstration Program****AGENCY:** Small Business Administration.**ACTION:** Interim rule.

SUMMARY: On October 28, 1991 the President signed Public Law 102-140 (1991 legislation), the Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act of 1992. Section 609(h) of that law added a new subsection (m) to section 7 of the Small Business Act, 15 U.S.C. 636. Such new subsection authorizes the Small Business Administration (SBA) to establish a Microloan Demonstration Program (Program). This interim final rule, published as such in accordance with Public Law 102-140, implements this new Program.

DATES: This rule shall be effective January 31, 1992. Comments by March 2, 1992.

ADDRESSES: Written comments should be addressed to John Cox, Director, Office of Financing, U.S. Small Business Administration, 409 Third Street, SW., Eighth Floor, Washington, DC 20416.

FOR FURTHER INFORMATION CONTACT: John Cox, 202-205-6490.

SUPPLEMENTARY INFORMATION: Public Law 102-140, enacted October 28, 1991, established a Microloan Demonstration Program. The rule states that the Program, in accordance with the 1991 legislation, is effective for five years and that its purpose is to assist women, low-income, and minority entrepreneurs, business owners, and other individuals possessing the capability to operate successful business concerns and to assist small business concerns in those areas suffering from a lack of credit due to economic downturn. Under the Program, SBA is authorized to make direct loans to qualified intermediary lenders who will use the proceeds to make short-term, fixed interest rate microloans, of not more than \$25,000, to startup, newly established and growing small business concerns. Further, SBA may make grants to such intermediaries to be used to provide intensive marketing, management, and technical assistance to any microloan borrower. In addition, SBA is authorized to make two (2) grants for each year of the Program to nonprofit third party entities to provide marketing, management, and technical assistance to assist low-income individuals obtain, with or without loan guarantees, private sector financing for their businesses.

Under the rule, an intermediary lender is a private, nonprofit entity or a nonprofit community development corporation. It is eligible to participate in this Program if it has at least one year of experience making microloans to startup, newly established, or growing small business concerns and providing, through its own organization, intensive marketing, management, and technical assistance to its borrowers. SBA believes it essential that the intermediary itself provide the required marketing, management, and technical assistance to its microloan borrowers. As such, an intermediary is prohibited from contracting for or engaging the services of another entity for the provision of such services, whether or not such entity is affiliated with the intermediary.

An intermediary lender's application to SBA for a loan must include certain specified information. Among other items, the application must describe the type of businesses to be assisted, the geographic area to be served and its economic and unemployment characteristics, and the local economic credit markets.

Additionally, the application must describe the extent to which the intermediary will provide microloans to small business concerns located in rural areas. A rural area is defined to mean any political subdivision or unincorporated area (1) in a nonmetropolitan county (as defined by the Secretary of Agriculture) or its equivalent, or (2) in a metropolitan county or its equivalent that has a resident population of less than 20,000 if the SBA has determined such political subdivision or area to be rural. The 1991 legislation requires, and this rule so states, that at least one half of all the intermediaries receiving SBA loans under this Program shall agree to provide microloans to small business concerns in rural areas. SBA has interpreted this provision to mean that one-half of the intermediaries funded will provide a significant percentage of microloans to small business concerns located in rural areas.

The rule requires each participating intermediary to establish a Microloan Revolving Fund (MRF) comprised of the proceeds of any SBA loan extended to the intermediary together with a required match of funds from non-Federal sources. The MRF will be used for no purpose other than this Program. Each intermediary lender shall be required to contribute to its MRF, from non-Federal sources, fifteen percent (15%) of the total amount of SBA loans made to an intermediary. All microloan disbursements and repayments must be

made from and paid into this fund. Further, the intermediary will repay its obligations to SBA from this fund. SBA shall perfect a first lien security interest in the MRF.

Any loan made by SBA to an intermediary shall be for a term of 10 years and the interest rate shall be fixed, at the time of loan approval, at a rate equal to the rate determined by the Secretary of the Treasury for obligations of the United States with a maturity of 5 years, adjusted to the nearest one-eighth of 1 percent. An intermediary shall not be required to make any repayment of principal or interest during the first year of any loan made by SBA to the intermediary. SBA shall receive a first security position on the note receivable with respect to each microloan made by the intermediary under this Program.

The 1991 legislation imposes limits on the amount an intermediary may borrow from SBA under this Program. Specifically, the statute states that no loan shall be made to an intermediary by SBA if the total amount outstanding and committed to the intermediary from the fund established under section 4(c) of the Small Business Act would, as a result of such loan, exceed \$750,000 in the first year of the intermediary's participation in this program, and \$1,250,000 in the remaining years of the intermediary's participation. Further, in no case shall the intermediaries in any one State receive more than \$1,000,000, in the aggregate (excluding grants), from SBA during such State's first year of Program participation or more than \$1,500,000, in the aggregate (excluding grants), from SBA in any subsequent year of Program participation.

The 1991 legislation imposes several restrictions on the microloan made by an intermediary which are codified in this regulation. First, the proceeds of any microloan made by an intermediary under this Program shall be used by the small business concern exclusively for working capital and/or the acquisition of materials, supplies, furniture, fixtures, and equipment. Further, under the 1991 legislation, the maximum rate of interest which an intermediary may charge on a microloan shall be not more than four percentage points above the prime lending rate as determined by the SBA and published quarterly in the Federal Register. Third, a microloan should generally be not more than \$10,000. An intermediary may make a microloan of more than \$15,000 only if the borrower demonstrates that it is unable to obtain credit elsewhere at comparable interest rates and that it has good prospects of success. However, in no case shall an intermediary make a microloan of more

than \$25,000 to one borrower, or have more than \$25,000 outstanding and committed to any one borrower, including any affiliates. The maturity of a microloan by an intermediary shall not exceed six (6) years.

Under the 1991 legislation SBA shall not review a microloan prior to the intermediary's approval of such loan. However, any microloan borrower shall be required to meet SBA's business eligibility requirements as set forth in part 120 and elsewhere in part 122 of title 13, Code of Federal Regulations (CFR). Further, the rule also makes it clear that the microloan borrowers must comply with parts 112, 113, 116, and 117 of title 13, CFR. There parts generally prohibit discrimination on the grounds of race, color, age, national origin, religion, sex, marital status, or disability.

This rule requires each intermediary establish a loan loss reserve fund (LLRF) in addition to the MRF which must be maintained until all obligations owed to the SBA under this Program are repaid. The LLRF, in which the SBA shall have a security interest, would be used to supplement the MRF when the intermediary incurs losses as a result of microloans made under this Program. In the first year of an intermediary's participation in this Program the LLRF must be maintained at a level equal to fifteen percent (15%) of the outstanding balance of the notes receivable owed to the intermediary under the Program. After the first year, LLRF for each intermediary must be maintained at a level, determined by SBA, which reflects the intermediary's total loss experience attributable to microloans made under this Program, but in no event shall the level exceed fifteen percent (15%). The funds used to create the LLRF may come from the MRF.

The 1991 legislation authorizes SBA to make grants to an intermediary for marketing, management, and technical assistance to be provided to borrowers in conjunction with the microloan. In the first and second years of an intermediary's participation in the Program, the SBA may make a grant in an amount not in excess of twenty percent (20%) of the total outstanding balance of SBA loans made to such intermediary. After the second year, the SBA grants shall not exceed ten percent (10%) of such balance. With respect to any grant made by the SBA the intermediary shall contribute an amount equal to one-half of the amount of the grant, such contribution to be obtained solely from non-Federal sources, and may include indirect costs or in-kind

contributions paid for under non-Federal programs.

The 1991 legislation also authorizes SBA to make grant money available to nonprofit entities, which are not participating intermediaries, to provide marketing, management and technical assistance to low-income individuals seeking to start or enlarge their small businesses. The grant can only be made if the nonprofit entity agrees to work with the individuals to secure loans in amounts not to exceed \$15,000, in the aggregate, from private sector lenders. In each year of this Program, SBA is authorized to make no more than two grants to non-intermediaries, each not to exceed \$125,000. The nonprofit entity must contribute an amount equal to twenty percent (20%) of the amount of the SBA grant from non-Federal sources.

Compliance With Executive Order 12291 and 12612, the Regulatory Flexibility Act, 5 U.S.C. 601 et seq., and Paperwork Reduction Act, 44 U.S.C. ch. 35

For purposes of Executive Order 12291, SBA certifies that this rule will not constitute a major rule because it is not likely to have an annual effect on the economy of \$100 million or more, will not result in a major increase in costs for consumers, individual industries, Federal, State, or local government agencies, or geographic regions, and will not have significant adverse effects on competition. SBA makes this certification based upon the fact that the appropriation for the demonstration Program established herein totals \$15 million and does not affect State or local government.

For purposes of the Regulatory Flexibility Act, SBA certifies that this rule will not have a significant economic impact on a substantial number of small entities for the same reason that it would not be a major rule.

For purposes of the Paperwork Reduction Act, SBA certifies that no new paperwork requirements are imposed by this rule.

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

List of Subjects in 13 CFR Part 122

Loan Programs—business, Small business.

For the reasons set out in the preamble, part 122 of title 13, Code of Federal Regulations, is amended as follows:

PART 122—[AMENDED]

1. The Authority citation for part 122 is revised to read as follows:

Authority: 15 U.S.C. 634(b)(6), 15 U.S.C. 636(a), and Pub. L. 102-140.

2. Part 122 of title 13, Code of Federal Regulations is amended by adding to subpart B, §§ 122.61 and 122.61-1 through 122-61-11 to read as follows:

§ 122.61 Microloan Demonstration Program.

§ 122.61-1 Policy.

(a) *Program.* The Act authorizes a five (5) year Microloan Demonstration Program through which the SBA is to make direct loans to qualified intermediary lenders who will use the proceeds to make short-term, fixed interest rate microloans to startup, newly established, and growing small business concerns. In conjunction with loans to qualified intermediaries, the Agency is also authorized to make grants to such intermediaries to be used to provide intensive marketing, management, and technical assistance to any borrower of a microloan. In addition, the Act authorizes the SBA to make grants to nonprofit entities to provide marketing, management, and technical assistance to assist low-income individuals obtain, with or without loan guarantees, private sector financing for their businesses. This Microloan Demonstration Program terminates October 28, 1996.

(b) *Purpose.* The purpose of the Microloan Demonstration Program is to assist women, low-income, and minority entrepreneurs, as well as business owners, and other individuals possessing the capability to operate successful business concerns and to assist small business concerns in those areas suffering from a lack of credit due to economic downturn.

§ 122.61-2 Definitions.

(a) *Deposit account* means a demand, time, savings, passbook, or like account maintained with an insured depository institution, other than an account evidenced by a certificate of deposit.

(b) *Grant* shall have the same meaning as in section 3 of the Federal Grant and Cooperative Agreement Act, 31 U.S.C. 6302.

(c) *Insured depository institution* shall have the same meaning as in section 3(c) of the Federal Deposit Insurance Act, 12 U.S.C. 1813(c).

(d) *Intermediary* means a private, nonprofit entity or a private nonprofit community development corporation, as approved by SBA.

(e) *Microloan* means a short-term, fixed interest rate loan of not more than \$25,000 made by an intermediary to a startup, newly established or growing small business concern.

(f) *Non-Federal sources* means funds acquired from other than the Federal Government and may include indirect costs or in-kind contributions paid for under non-Federal programs.

(g) *Rural area* means any political subdivision or unincorporated area.

(1) in a nonmetropolitan county (as defined by the Secretary of Agriculture), or its equivalent thereof; or

(2) in a metropolitan county or its equivalent that has a resident population of less than 20,000 if the Administration has determined such political subdivision or area to be rural.

§ 122.61-3 Participation of intermediary.

(a) *Eligibility.* An intermediary shall be eligible to receive loans and grants under the Microloan Demonstration Program if it has at least one year of experience making and servicing microloans to startup, newly established, or growing small business concerns and by itself providing intensive marketing, management, and technical assistance to its borrowers.

(b) *Application.* Each application submitted by an intermediary to the SBA for a loan under this program shall include a description of:

- (1) The type of businesses to be assisted;
- (2) The average size of the loans to be made;
- (3) The geographic area to be served and its economic and unemployment characteristics;
- (4) The economic status of the businesses in such geographic area and an analysis of their credit and technical assistance needs;
- (5) Any marketing, management, and technical assistance to be provided in connection with microloans made;
- (6) The local economic credit markets, including the costs associated with obtaining credit locally;
- (7) The qualifications of the applicant to carry out the purpose of this program as set forth in § 122.61-1(b);
- (8) Any plan of the intermediary to involve private sector lenders in assisting selected microloan borrowers;
- (9) The extent to which the intermediary will provide microloans to small business concerns in rural areas; and
- (10) Such other information as may be required by the SBA, and as provided for in the official Program Announcement, to adequately evaluate the applicant's management and

technical expertise and operational history.

§ 122.61-4 Microloan Revolving Fund.

(a) *Establishment of fund.* Every participating intermediary shall establish a Microloan Revolving Fund comprised of the proceeds of any SBA loan extended to the intermediary pursuant to this program along with the contribution from non-Federal sources required in § 122.61-5. The intermediary shall maintain such Microloan Revolving Fund as a deposit account with an insured depository institution.

(b) *Disbursements and repayments.* All microloan disbursements made by an intermediary and repayments by microloan borrowers under this program shall come from and be repaid to the intermediary's Microloan Revolving Fund. Additionally, each intermediary shall repay all obligations owed the SBA under this program from such fund (the fund, at SBA's direction shall be supplemented for this purpose, when necessary, with proceeds from the Loan Loss Reserve Fund established pursuant to § 122.61-8). Except as otherwise provided by SBA, each Microloan Revolving Fund shall be used for no other purpose.

(c) *SBA lien.* SBA shall perfect a security interest in the Microloan Revolving Fund of each intermediary participant in this program. Such security interest shall provide SBA a first lien position with respect to such fund. SBA may foreclose on such security interest upon default of the intermediary participant or upon violation of these regulations or the terms of the loan agreement, entered into pursuant to § 122.61-11, by the intermediary participant.

§ 122.61-5 Portion of Intermediary's Microloan Revolving Fund From Non-Federal Sources.

As a condition of any loan made by the SBA to an intermediary, each intermediary shall be required to contribute, from non-Federal sources, fifteen percent (15%) of the loan amount to its Microloan Revolving Fund. Such contribution may be used to establish the Loan Loss Reserve Fund as required pursuant to § 122.61-8.

§ 122.61-6 Conditions on SBA loan to intermediary.

(a) *Loan Maturity and Interest Rate.* Any loan made by the SBA to an intermediary under this program shall be for a term of 10 years and the interest rate shall be fixed, at the time of approval of the loan by SBA, at a rate equal to the rate determined by the Secretary of the Treasury for obligations of the United States for a maturity

period of 5 years, adjusted to the nearest one-eighth of 1 percent.

(b) *Repayment by Intermediary.* An intermediary shall not be required to make any repayment of principal or interest during the first year of any loan made by the Agency to such intermediary. However, interest will accrue during such time period.

(c) *Fees and Collateral.* Except as otherwise provided in this section, the Agency shall not charge an intermediary any fee with respect to a loan it makes to the intermediary under this program. The SBA shall receive a first lien position on the note receivable with respect to each microloan which the intermediary makes under this program.

(d) *Loan Limits by SBA.* Notwithstanding any other provision of law to the contrary, no loan shall be made to an intermediary by SBA under this program if the total amount outstanding and committed (excluding outstanding grants) to such intermediary (and its affiliates, if any) from the business loan and investment fund established under section 4(c) of the Act would, as a result of such loan, exceed \$750,000 in the first year of such intermediary's participation in this program, and \$1,250,000 in the remaining years of the intermediary's participation in the program.

(e) *Rural assistance.* At least one-half of all the intermediaries receiving a loan pursuant to this program shall agree to provide a significant percentage of microloans to small business concerns located in rural areas.

§ 122.61-7 Microloan made by intermediary to eligible concern.

(a) *General.* An intermediary shall make short-term, fixed interest rate microloans to startup, newly established, and growing small business concerns. Such concerns must be eligible to receive financial assistance under section 7(a) of the Act.

(b) *Purpose.* The proceeds of a microloan made under this program shall be used exclusively for working capital and/or the acquisition of materials, supplies, furniture, fixtures, and equipment.

(c) *Interest rate.* The Act provides that notwithstanding any provision of the laws of any State or the constitution of any State pertaining to the rate or amount of interest that may be charged, taken, received or reserved on a loan, the maximum rate of interest which an intermediary may charge on a microloan under this program shall be not more than four (4) percentage points above the prime lending rate as determined by

the SBA and published in the Federal Register on a quarterly basis.

(d) *Amount of microloan.* Generally, a microloan made under this program should be not more than \$10,000. An intermediary may make a microloan of more than \$15,000 only if the borrower demonstrates that it is unable to obtain credit elsewhere at comparable interest rates and that it has good prospects for success. In no case shall an intermediary make a microloan of more than \$25,000 to one borrower, or have more than \$25,000 outstanding and committed to any one borrower, including affiliates, under this program.

(e) *Maturity of microloan.* No microloan made by an intermediary under this program shall exceed six (6) years.

(f) *Review.* The SBA shall not review a microloan made under this program prior to the approval of such loan by the intermediary.

(g) *Compliance with other Parts.* All microloans made by intermediaries under this program must comply with parts 112, 113, 116, and 117 of this title. Part 112 prohibits discrimination on the grounds of race, color, or national origin. Part 113 prohibits discrimination based upon race, color, religion, sex, marital status, disability, or national origin. Part 116 prescribes policies of general application. Part 117 prohibits discrimination based upon age.

§ 122.61-8 Intermediary Loan Loss Reserve Fund.

(a) *General.* Each intermediary shall establish a Loan Loss Reserve Fund (LLRF), as a deposit account with an insured depository institution. The LLRF, and earnings thereon, shall be maintained until all obligations owed to the SBA under this program are repaid. Such LLRF shall account for losses incurred in the Microloan Revolving Fund. The LLRF may be established using the funds required to be contributed from non-Federal sources pursuant to § 122.61-5.

(b) *Level of Loan Loss Reserve Fund in first year.* In the first year of an intermediary's participation in this program its LLRF shall be maintained in an amount equal to fifteen percent (15%) of the outstanding balance of the notes receivable owed to the intermediary under this program.

(c) *Level of Loan Loss Reserve Fund in subsequent years.* For each year subsequent to its first year of participation, an intermediary shall maintain its LLRF at a level which reflects the intermediary's total loss experience as a result of participation in this program, as determined by the SBA on a case-by-case basis, but in no event

shall the intermediary be required to maintain the LLRF at a level which exceeds fifteen (15) percent of the outstanding balance of the notes receivable owed to the intermediary under this program.

(d) *SBA lien.* SBA shall perfect a security interest in the LLRF of each intermediary participant in this program. Such security interest shall provide SBA a first lien position with respect to such fund. SBA may foreclose on such security interest upon default of the intermediary participant or upon a violation of these regulations or the terms of the loan agreement, entered into pursuant to § 122.61-11, by the intermediary participant.

§ 122.61-9 SBA grants to intermediary for marketing, management, and technical assistance.

(a) *General.* As an integral part of the receipt of a microloan under this program a borrower shall receive intensive marketing, management, and technical assistance. Any intermediary which receives a loan from the SBA under this program shall be eligible to receive from the SBA a grant, the proceeds of which shall be used to provide, through its own organization, such marketing, management, and technical assistance to microloan borrowers. In the first and second years of an intermediary's participation in the program, the SBA may give a grant to such intermediary in an amount not in excess of twenty (20) percent of the total outstanding balance of SBA loans made to such intermediary under this program. In the third and subsequent years of an intermediary's participation under this program, the amount of the SBA grant shall not exceed ten (10) percent of the total outstanding balance of SBA loans made to such intermediary under this program.

(b) *Contribution of intermediary to grant.* With respect to any grant made by the SBA under this program the intermediary shall contribute an amount equal to one-half of the amount of the grant. The intermediary's contribution shall be obtained solely from non-Federal sources, and may include indirect costs or in-kind contributions paid for under non-Federal programs.

§ 122.61-10 SBA grants to non-intermediary for marketing, management, and technical assistance.

(a) *Purpose.* In connection with this microloan program, the SBA may provide grants to nonprofit entities, which are not participating intermediaries, to provide marketing, management, and technical assistance to low-income individuals seeking to

start or enlarge their small business concerns. Such a grant may be made only if such nonprofit entity agrees to work with such individuals to secure loans in amounts not to exceed \$15,000 in the aggregate from private sector lenders, regardless of whether the nonprofit entity provides a loan guarantee.

(b) *Amount of grant.* In each year of this microloan program, the SBA may make no more than two (2) grants to non-intermediaries, each not to exceed \$125,000.

(c) *Contribution by nonprofit entity.* As a condition to its receipt of a grant from the SBA under this program, the nonprofit entity shall contribute an amount equal to twenty (20) percent of the amount of the SBA grant. The contribution from the nonprofit entity shall come solely from non-Federal sources, and may include indirect costs or in-kind contributions paid for under non-Federal programs.

§ 122.61-11 Program procedure.

(a) *Participation of intermediary by State.* Any entity believing itself qualified as an intermediary may seek to participate in the Microloan Demonstration Program by applying to SBA. SBA may approve such applications based upon criteria set forth at § 122.61-3. In no case, however, shall SBA approve more than two (2) intermediaries in any one State in any one year of the program as Microloan Demonstration Program participants. In no case shall the intermediaries in any one State receive more than \$1,000,000 in the aggregate (excluding grants), from SBA during such State's first year of Program participation. The intermediaries in any one State shall not receive more than \$1,500,000, in the aggregate (excluding grants), from SBA during any succeeding year of Program participation.

(b) *Prospective intermediaries.* (1) Necessary application forms, including the loan agreement and grant agreement, will be mailed to prospective intermediaries seeking such information from SBA as part of an official Program Announcement.

(2) The completed application shall be submitted in original and two copies to such SBA office location as designated in the Program Announcement.

(3) The applicant shall make its best effort to deliver the complete application to the designated location by the due date and time specified. Late applications may be accepted at the discretion of SBA.

(4) Submission of a completed application, including the loan

agreement and the grant agreement, by the prospective intermediary constitutes, on the part of such prospective intermediary, acceptance of and willingness to be bound by the terms and conditions set forth in the application, including the loan agreement and the grant agreement.

(c) *Grant procedure for non-intermediaries.* (1) Any nonprofit entity,

which is not a participating intermediary, believing itself qualified to provide marketing, management, and technical assistance to low-income individuals seeking to enlarge their small business concern may forward to SBA information regarding their ability to undertake such assistance, as well as any other information deemed appropriate by SBA.

(2) Any grant awarded to a non-intermediary will be awarded and administered according to the terms and conditions set forth in the grant agreement.

Dated: December 18, 1991.

Patricia Saiki,
Administrator.

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