

# 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 120

RIN 3245-AE83

#### Business Loans and Development Company Loans; Liquidation and Litigation Procedures

AGENCY: Small Business Administration.

ACTION: Proposed rule.

**SUMMARY:** This proposed rule: Establishes procedures for Certified Development Companies (CDCs) that are eligible for, and that request, authority from SBA to handle liquidation and litigation of loans that are funded with the proceeds of debentures guaranteed by the SBA under the 504 business loan program, and rights of appeal from denied applications; provides for new liquidation and debt collection litigation procedures for authorized CDCs and for lenders participating in the 7(a) business loan program (Lenders); establishes procedures for, and restrictions on, the payment by SBA of legal fees and expenses to CDCs and Lenders; requires Lenders to complete all cost-effective debt recovery actions prior to requesting guaranty purchase by SBA; limits to 120 days the number of days of interest that SBA will pay Lenders on 7(a) loans that have gone into default; revises SBA regulations pertaining to loan servicing actions; states that for 7(a) loans approved after the effective date of this rule, a Lender's consent to SBA's sale of certain 7(a) loans after guaranty purchase is granted; and clarifies existing regulations regarding the applicability of SBA regulations and loan program requirements, and regarding SBA purchases of guaranties.

**DATES:** Comments must be received on or before January 3, 2006.

**ADDRESSES:** You may submit written comments, identified by agency name and RIN number for this rulemaking, by any of the following methods: Follow instructions for submitting electronic comments through the Federal

eRulemaking Portal: <http://www.regulations.gov>; E-mail: [james.hammersley@sba.gov](mailto:james.hammersley@sba.gov), Include RIN number in the subject line of the message; Fax: (202) 481-2381; Mail or Hand Delivery/Courier: James Hammersley, Acting Assistant Administrator, Office of Portfolio Management, Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

#### FOR FURTHER INFORMATION CONTACT:

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**SUPPLEMENTARY INFORMATION:** Section 7(a) of the Small Business Act ("Act"), 15 U.S.C. 636(a), authorizes SBA to guarantee loans made by Lenders to eligible small businesses ("7(a) loans"). Under the 504 business loan program, as authorized by Title V of the Small Business Investment Act ("SBI Act"), 15 U.S.C. 695-697g, SBA guarantees the repayment of debentures issued by CDCs for purchase by investors. The proceeds from the sale of 504 debentures are loaned to eligible small businesses to finance up to 40% of the cost of long-term fixed assets ("504 loans"). If the borrower defaults on the repayment of a 504 or 7(a) loan, liquidation of the collateral securing the loan and debt collection litigation generally take place to recover as much of the loan balance as possible.

Historically, SBA approval was needed for many servicing actions by Lenders and CDCs, and Agency personnel handled most liquidation and debt collection litigation on defaulted loans. In the past decade, however, Congress and SBA have delegated increased responsibilities to certain Lenders and CDCs to perform liquidation and debt collection litigation of 7(a) and 504 loans. SBA has now implemented a transformation initiative to streamline its small business loan assistance programs by delegating greater servicing and liquidation responsibilities to Lenders and CDCs, thereby reducing the SBA personnel needed to manage these programs and simplifying procedures for Lenders and CDCs through reducing their need to seek the prior approval of SBA for various actions.

This proposed rule implements § 307(b) of Pub. L. 106-554, which requires SBA to promulgate regulations

to carry out § 510 of the SBI Act.

Publication of the rule has been delayed because of a need to modify program responsibilities in the face of reduced Agency staffing. In addition, SBA's increased reliance on Lenders and CDCs to perform servicing, liquidation and debt collection litigation has led the Agency to conclude that other revisions are necessary to SBA's liquidation and debt collection litigation regulations. These proposed regulations will promote better understanding of Agency requirements and better oversight and management by SBA of Lender and CDC liquidation and debt collection litigation.

The proposed regulations would, among other things: (1) Establish procedures for CDCs to request authority for and to conduct liquidation and debt collection litigation; (2) eliminate the current requirement for the submission of liquidation plans by Lenders, other than Certified Lender Program (CLP) Lenders which are required to submit plans by § 7(a)(19) of the Act (15 U.S.C. 636(a)(19)(C)), and revise the current requirements for the submission of litigation plans by Lenders and CDCs; (3) provide for rights of appeal from adverse decisions by SBA offices regarding liquidation plans or litigation plans; (4) establish procedures for, and restrictions on, the payment of legal fees and other costs of liquidation or debt collection litigation incurred by Lenders and CDCs; and (5) impose performance standards for servicing and liquidation efforts by Lenders and CDCs.

With regard to the proposed regulations concerning performance by CDCs of liquidation and debt collection litigation activities with respect to their 504 loans, the proposed rule contemplates that SBA will not reimburse CDCs for their internal administrative costs associated with such activities, whether such activities are performed by a CDC or a CDC's contractor. SBA recognizes, however, that this decision may adversely affect the ability of some CDCs to liquidate and litigate their 504 loans and, therefore, is soliciting comments on this topic. However, subject to the provisions of proposed new § 120.542, SBA would reimburse CDCs for their reasonable, customary and necessary expense disbursements related to liquidation activities on particular

loans, which would include title reports and title insurance on real estate collateral; appraisals; costs for the care and preservation of collateral; fees for lien recordings, filings and lien searches; and fees for legal services provided by outside counsel in litigating on a particular loan account.

As part of its transformation initiative, SBA is also proposing to revise current procedures which allow a Lender to request that SBA purchase its guaranteed portion of a 7(a) loan prior to the completion of liquidation efforts. Under current practices, SBA personnel may be required, for a single loan, to review a liquidation plan, various requests for approval of liquidation actions, liquidation status updates, and a liquidation wrap-up report. In addition, under existing practices, Lenders that are paid the guaranty prior to liquidation must then remit to SBA its guaranteed share of any moneys obtained through liquidation and debt collection litigation, and seek SBA's payment of the Agency's pro rata share of expenses they incur throughout the liquidation and litigation process. In addition, payment of a guaranty to Lenders prior to completion of liquidation gives lenders less incentive to diligently liquidate their loans.

Proposed § 120.520 would preclude Lenders from requesting purchase of a loan guaranty until after liquidation is completed for all loans approved after the effective date of these regulations, except for earlier purchases as permitted by SBA in certain protracted liquidation situations. SBA would consider liquidation to be completed when the Lender has exhausted all prudent and commercially reasonable efforts to collect the debt. This will allow SBA personnel in most cases to review a Lender's complete administration of a loan only once at the completion of liquidation efforts. Deferring a guaranty purchase review until after liquidation is completed will also limit the need for ongoing payments of expenses because SBA would normally make only one payment at the conclusion of liquidation. This proposed revision also would require lenders to conduct liquidation and debt collection litigation in a prompt and cost-effective manner.

SBA is also proposing to revise current regulations regarding the Agency's payment of interest to Lenders on defaulted 7(a) loans. Under current regulations, Lenders in certain loan programs that submit a complete guaranty purchase request to SBA within 120 days of an uncured payment default are entitled to the payment of SBA's pro rata share of the interest on the loan from the interest paid-to-date

until the date of purchase by SBA. Lenders that do not submit a purchase request within 120 days of default are only entitled to 120 days of interest. Payment of more than 120 days of interest has served as a disincentive for Lenders to liquidate prior to requesting purchase. Consequently, and also to increase consistency among SBA's loan programs, SBA is proposing to limit payment of interest after default to 120 days on all 7(a) loans approved after the effective date of the regulations except for those loans where the guaranteed portion has been sold in the SBA Secondary Market (as described in 13 CFR part 120, subpart F). Nothing in the proposed rule would change the payment of interest and principal to Secondary Market investors.

Finally, SBA is proposing another regulatory revision to facilitate SBA's transformation initiative through the sale of groups of 7(a) and 504 loans in asset sales. SBA has determined that regulatory revisions are needed to address the issue of a Lender's consent to the sale of 7(a) loans whose guaranteed portions Lender had sold in the Secondary Market and that SBA subsequently purchased from the Secondary Market investor after loan default, as well as those loans whose guaranteed portions SBA purchased prior to the completion of recovery efforts because of protracted liquidation proceedings. Accordingly, SBA is proposing to require, for all 7(a) loans approved after the effective date of the regulations, that Lenders which do not exercise their option to purchase the guaranteed portion of a defaulted 7(a) loan from a Registered Holder in the Secondary Market, as well as Lenders with respect to any loan whose guaranteed portion SBA has purchased prior to the completion of liquidation, will be deemed to have consented to the sale of that loan in an asset sale. In addition, SBA is proposing that after SBA has purchased a debenture as the result of a default of a 504 loan (other than a 504 loan made by a PCLP CDC), SBA may in its sole discretion place such loan in an asset sale conducted or overseen by SBA. For PCLP loans, SBA proposes that prior to including such loans in an asset sale, it will provide advance notice to the PCLP CDCs that made such loans, as required by § 508(d)(1) of the SBI Act (15 U.S.C. 697e(d)(1)).

#### Section-by-Section Analysis

*Section 120.10—Definitions of Authorized CDC Liquidator, Loan Program Requirements and SOPs.* SBA proposes to add a new definition in § 120.10, "Authorized CDC Liquidator"

to describe CDCs that have been delegated authority to perform liquidation and debt collection litigation pursuant to § 120.975. This term is used on numerous occasions throughout these proposed regulations.

SBA also proposes to add a definition for the term "Loan Program Requirements" which include requirements imposed upon Lenders or CDCs by statute, SBA regulations, any agreement the Lender or CDC has executed with SBA, SBA Standard Operating Procedures (SOP), official SBA notices and forms applicable to the 7(a) and 504 loan programs, and loan authorizations. For CDCs, this term also includes requirements imposed by Debentures, as that term is defined in § 120.802. SBA proposes to make several conforming amendments to the following sections in order to use this new defined term consistently throughout part 120: §§ 120.826; 120.841(c); 120.845(c)(1); 120.846(a)(3); 120.848(a); 120.854(a)(2); and 120.970(a).

The proposed regulations also modify the definition of the term "SOPs" to provide notice of availability of Agency SOPs on SBA's Web site, <http://www.sba.gov>.

*Section 120.180—Compliance with Loan Program Requirements.* SBA proposes to revise current § 120.180 to clarify that Loan Program Requirements in effect when a Lender or CDC undertook a particular action with respect to a specific 7(a) or 504 loan will govern that action, and that any subsequent changes in program requirements will govern actions by a Lender or CDC that occur after the revision of the requirement had been implemented. For example, if a Lender closed a 7(a) loan in 2003, the Loan Program Requirements in effect at that time would govern the Lender's closing of the loan. However, if SBA subsequently revised the requirements for liquidation in 2004, the Lender would be subject to the 2004 liquidation requirements to the extent that the Lender's liquidation actions occur after the time of the revision. The proposed regulation also codifies longstanding Agency, Lender and CDC practice that Lenders and CDCs must comply with Agency Loan Program Requirements including SOPs and official notices.

*Section 120.181—SBA control over Lenders and CDCs.* Proposed § 120.181 would clarify that Lenders or CDCs, and their contractors, are independent contractors and that SBA is not responsible or liable for actions taken by Lenders, CDCs or their contractors.

*Section 120.197—Notifying SBA's Office of Inspector General of suspected*

*fraud.* SBA proposes to add this new section regarding notification to SBA's Office of Inspector General (OIG) of fraud. The OIG's mission includes investigating potential fraud for criminal prosecution. This provision is designed to ensure that Lenders, CDCs and others who may have knowledge of suspected fraud in the 7(a) and 504 loan programs provide this information to the OIG.

*Section 120.440—Minor Revision to Certified Lenders Program (CLP).* Under the CLP, designated Lenders process, close, service and liquidate SBA guaranteed loans. The proposed revision of this section deletes the word "may" so that it is clear that CLP lenders must liquidate their 7(a) loans as do all other 7(a) Lenders.

*Section 120.453—Revisions to Preferred Lender Program (PLP) responsibilities.* SBA proposes to revise § 120.453, which addresses servicing and liquidation by participants in the PLP. The revised regulation would delete the requirement that PLP Lenders submit liquidation plans to SBA, the performance standards for PLP Lender liquidation, and the need to obtain SBA consent to certain actions. Under the proposed rule, PLP Lenders will be treated the same as all 7(a) Lenders with respect to servicing and liquidation performance standards, the exemption from liquidation plan submission requirements, and the need to obtain SBA consent for non-delegated actions.

*Section 120.500—Loan servicing.* The title for Subpart E is being revised to read Servicing and Liquidation. Therefore, SBA proposes to delete current § 120.500 because it would be rendered obsolete by these regulations.

*Section 120.510—Servicing Direct and Immediate Participation Loans.* SBA no longer makes direct loans under the 7(a) program and proposed § 120.520(b) requires that Lenders perform loan servicing. Therefore, SBA proposes to delete this section because it is no longer needed.

*Section 120.511—Servicing guaranteed loans.* Under proposed § 120.536, Lenders are required to service 7(a) loans. Therefore, SBA proposes to delete this section because it is no longer needed.

*Section 120.512—Servicing a loan after SBA honors the guarantee.* Under proposed § 120.520, Lenders normally would not be able to request purchase until after completion of liquidation efforts on a loan. Further, the last sentence in current § 120.512 regarding SBA discretion to take over loan servicing has been incorporated into proposed § 120.536(d). Therefore, SBA

proposes to delete this section because it is no longer needed.

*Section 120.513—Servicing actions that require prior written consent of SBA.* SBA is amending these requirements and promulgating the revised regulations under new § 120.536. Therefore, SBA proposes to delete this section because it is no longer needed.

*Section 120.520—Servicing and SBA honoring of its guarantee.* SBA proposes to revise this section to implement the requirement, for all loans approved after the effective date of the regulations, that Lenders normally must perform liquidation before requesting purchase, as discussed above. In addition, proposed paragraph (b) would also codify existing SBA policy that SBA will not purchase a guaranty unless the Lender has provided sufficient documentation, as described by SBA in its SOPs, which includes a listing of the documents in Lender's possession that Lender must copy and submit to SBA with Lender's purchase request, to allow the Agency to perform a guaranty purchase review. SBA's ability to enforce Lender compliance with the requirements of the 7(a) program requires that Lenders provide adequate documentation to allow the Agency to review the Lender's administration of a particular loan. The proposed paragraph also would retain the existing regulatory provision that SBA may purchase a 7(a) guaranty at any time in its discretion.

Proposed paragraph (c) would clarify purchase requirements in the event that a Lender sells the guaranteed portion of a loan in the Secondary Market as permitted by Subpart F of Part 120. Consistent with existing SBA policy, this provision would make clear that a Lender's failure to provide adequate documentation to SBA regarding a guaranty that has been sold in the Secondary Market may be considered a material failure to comply with SBA loan program requirements, and may lead to an enforcement action under § 120.524. As noted above, it is critical to SBA's oversight responsibility that Lenders provide adequate documentation to allow the Agency to conduct a guaranty purchase review, including those that take place subsequent to a Secondary Market purchase made by SBA.

Proposed paragraph (d) would largely incorporate and clarify language that currently exists in § 120.520(b). The proposed paragraph would also refer to the guaranty purchase standards in § 120.524(a).

*Section 120.522—Payment of interest.* The proposed revision of this regulation would eliminate the current regulatory

provision which provides that SBA may pay more than 120 days of interest depending upon when the Lender submits a complete purchase request to SBA. As discussed above, SBA's proposed regulation would require that Lenders normally complete liquidation prior to requesting purchase. Therefore, the proposed regulation would limit interest purchased to 120 days to prevent SBA from having to pay excessive interest on defaulted loans. This provision does not affect the payment of interest to Secondary Market investors.

*Section 120.524—Guaranty purchase standards and procedures.* SBA is proposing to revise paragraph (a)(1) to codify SBA policy that a Lender's material failure to comply with a Loan Program Requirement, as defined in § 120.10, discussed above, can constitute a basis for the denial of a guaranty. The Agency is proposing additional minor clarifications of § 120.524 to amend paragraph (a)(8) because the existing provision would be rendered obsolete by the proposed requirement that Lenders normally complete liquidation prior to requesting purchase of a guaranty. Currently, Lenders can lose a guaranty if they do not request purchase within 120 days after a note has matured. Under the proposed regulations, it is possible that liquidation could be ongoing at that time. Inasmuch as proposed § 120.520 precludes Lenders from requesting purchase prior to the completion of liquidation except in certain protracted liquidation situations, § 120.524(a)(8) could cause confusion for Lenders as to whether they would potentially lose an SBA guaranty if they didn't request guaranty purchase prior to the completion of liquidation. Therefore, SBA proposes to amend this provision to address this situation and also to increase the time limit to 180 days. SBA is also proposing to revise paragraphs (b), (c), and (d) to incorporate minor clarifications of the Agency's guaranty purchase rights.

*Section 120.535—Servicing and liquidation performance standards.* SBA is proposing to add paragraphs (a) and (b) to include standards of performance for loan servicing and loan liquidation, which include the requirements that Lenders and CDCs service and liquidate their SBA loans using prudent lending standards and do so with no less diligence than their practice on their non-SBA loans. These standards would codify long standing SBA policy and are necessary so that SBA can effectively enforce Lender and CDC performance in the 7(a) and 504 Programs. Paragraph (c) would incorporate language set forth in

§ 510(c)(3) of the SBI Act (15 U.S.C. 697g(c)(3)). Paragraph (d) would incorporate existing language in current § 120.512, which, as noted above, is being deleted. However, paragraph (d) would expand the existing language in that section to cover 504 loans as well as 7(a) loans. SBA must retain this authority in order to be able to assume loan servicing or liquidation of either a 7(a) or 504 loan if it is in the Agency's interest to do so.

*Section 120.536—Servicing and liquidation actions that require the prior written consent of SBA.* This proposed provision would incorporate and revise regulations currently set forth at § 120.513, but would expand the existing regulations to include additional limitations on servicing and liquidation actions by CDCs that previously had been imposed by SBA policy as set forth in Agency SOPs.

*Section 120.540—Uniform Liquidation and Debt Collection Procedures.* Pursuant to § 510 of the SBI Act (15 U.S.C. 697g), and the broad authority to manage the 7(a) loan guaranty program which § 5(b)(7) of the Act (15 U.S.C. 634(b)(7)) confers upon SBA, SBA proposes to add new regulations establishing uniform procedures for the performance of liquidation and debt collection litigation actions by Lenders and CDCs. These proposed regulations revise the requirements for submission of liquidation and litigation plans for SBA's prior review by Lenders and those CDCs that are authorized to conduct liquidation and debt collection litigation (which SBA has defined in these proposed regulations as Authorized CDC Liquidators, see proposed § 120.10 above.) The proposed regulations also clarify the types of liquidation actions that require prior written consent from SBA, and establish rights of appeal for Lenders or Authorized CDC Liquidators from decisions by SBA offices regarding liquidation or litigation plans.

Under current regulations and procedures, many Lenders are required to submit liquidation plans to SBA for review prior to conducting liquidation efforts and to provide SBA with liquidation wrap-up reports at the conclusion of liquidation. These requirements are contained in the current version of § 120.512, and SBA SOP 50 51, Loan Liquidation and Acquired Property, and SOP 70 50, Legal Responsibilities. (SBA SOPs are available on SBA's Web site, <http://www.sba.gov>, in the online library.)

SBA proposes to redesignate the existing § 120.540 as § 120.545 and to add a new § 120.540 regarding the

submission of liquidation and litigation plans. Proposed § 120.540 would delete the liquidation plan submission requirement for Lenders, except for loans made by Lenders under the Certified Lender Program (CLP) as required by § 7(a)(19)(C) of the Act (15 U.S.C. 636(a)(19)(C)). Instead, Lenders (other than CLP Lenders) would only need to submit liquidation wrap-up reports to SBA at the conclusion of liquidation. Other than the elimination of the requirement for the submission of liquidation plans by Lenders (other than CLP Lenders), SBA does not intend that these proposed regulations significantly alter current procedures for the performance of liquidation by Lenders.

SBA has retained the requirement that CLP Lenders and Authorized CDC Liquidators submit liquidation plans to SBA in accordance with the requirements of § 7(a)(19)(C) of the Act (15 U.S.C. 636(a)(19)(C)), and § 510 of the SBI Act (15 U.S.C. 697g). In addition to the fact that the SBI Act requires Authorized CDC Liquidators to submit liquidation plans, SBA believes that differences between the 7(a) and 504 loan programs also warrant continued submission of liquidation plans by CDCs. Although CDCs are responsible for their actions taken in connection with 504 loans, most CDCs do not have a direct financial interest in 504 loans funded by the issuance of SBA-guaranteed debentures. SBA, therefore, believes that it is in the Agency's interest to require additional oversight of Authorized CDC Liquidator efforts.

Section 120.540 of the proposed regulations would also modify the existing requirement that Lenders and Authorized CDC Liquidators submit litigation plans to SBA for review of certain debt collection litigation. Current Agency procedures require Lenders to submit litigation plans for litigation defined as "Non-Routine Litigation," which includes contested litigation or litigation with expected or actual costs in excess of \$5,000. Litigation can be very costly and, because SBA is required to pay its pro rata share of certain of these expenses, the Agency believes that there is considerable need to review and approve Non-Routine Litigation prior to its initiation to prevent payment of excessive fees. SBA is also concerned that debt collection litigation by Lenders and Authorized CDC Liquidators, unlike the liquidation of collateral, raises the prospect of adverse judicial decisions that could serve as harmful precedent restricting future debt collection litigation by SBA or other governmental agencies. Accordingly, the proposed regulations would codify the existing

litigation plan requirement. However, in order to reduce the burden on SBA personnel and delegate greater responsibilities to Lenders and Authorized CDC Liquidators, the proposed regulations raise the dollar threshold for what is considered Non-Routine Litigation from litigation costing \$5,000 to \$10,000, thereby reducing the frequency of plan submissions for Agency review.

Proposed § 120.540 also would:

(1) Require submission of an amended liquidation or litigation plan for SBA approval if material changes occur during the course of liquidation or litigation, such as when Routine Litigation changes to Non-Routine Litigation;

(2) Provide for emergency situations by allowing a Lender or Authorized CDC Liquidator to undertake urgent liquidation or litigation actions by obtaining SBA's prior written approval where practicable, but without the need to submit a liquidation or litigation plan prior to taking an urgent action;

(3) Provide a right of appeal in the event that a Lender or Authorized CDC Liquidator disagrees with a decision by an SBA field office or servicing center regarding a liquidation or litigation plan; and

(4) Identify when SBA's prior written consent is required for specific liquidation actions.

*Section 120.541—Deadlines for SBA approval.* Section 510(c)(2) of the SBI Act (15 U.S.C. 697g), imposes deadlines on SBA approval of CDC liquidation plans and other actions that could arise during the servicing or liquidation phase of a loan. So that Authorized CDC Liquidators and Lenders will be treated similarly, SBA is proposing in § 120.541 uniform deadlines for SBA's approval of proposed liquidation plans, litigation plans and other requests. These deadlines will expedite SBA consideration of these requests. At the same time, as recognized in § 510(c)(2) of the SBI Act, SBA will be able to notify a Lender or Authorized CDC Liquidator if it is unable to meet the deadline and request additional information as necessary to be able to process the request. The section also incorporates specific language in § 7(a)(19)(C) of the Act (15 U.S.C. 636(a)(19)(C)) relating to submission of liquidation plans by Lenders which have made a loan under their CLP authority.

*Section 120.542—Payment of legal fees and other expenses incurred in liquidation, debt collection litigation and other litigation.* SBA is proposing new regulations regarding the reimbursement and payment of legal

fees and other costs to Lenders and CDCs for liquidation, debt collection litigation, and any other litigation. Proposed § 120.542(a) prohibits the reimbursement of legal fees incurred by a Lender or Authorized CDC Liquidator in the following situations: (1) When a Lender or Authorized CDC Liquidator asserts claims against SBA in any type of litigation, unless payment of such fees is otherwise required by federal law; (2) when outside counsel of a Lender or Authorized CDC Liquidator performs non-legal work in connection with liquidation or debt collection litigation without SBA consent; and (3) when a Lender or Authorized CDC Liquidator undertakes actions in connection with liquidation or debt collection litigation which only benefit the Lender or CDC.

Proposed § 120.542(b) also clarifies that SBA will not pay for legal fees or costs incurred by a Lender or CDC in defending against a bad faith lending claim or any other claim brought by a borrower or guarantor against a Lender or CDC, or for the settlement of, or adverse judgment incurred in, any such suit unless SBA specifically directed the Lender or CDC to take the allegedly wrongful action in question.

In order to ensure that Lenders and Authorized CDC Liquidators comply with the SBA requirements for liquidation and debt collection litigation, proposed § 120.542(c) allows SBA to deny legal fees and other costs incurred during the liquidation or debt collection litigation in connection with a 7(a) or 504 loan if a Lender or Authorized CDC Liquidator: (1) Fails to act in accordance with commercially reasonable lending standards, in a prudent manner, or in compliance with SBA requirements; (2) fails to obtain SBA prior written approval (using procedures described in Agency SOPs) of a liquidation and/or litigation plan, or an amended plan, when such approval is required by these regulations; or (3) fails to obtain prior SBA approval (using procedures described in Agency SOPs) of other servicing or liquidation actions if approval is required by § 120.536. To limit the expense of unnecessary or unreasonable legal expenses, SBA also proposes to be able to deny legal fees and other litigation or liquidation expenses that SBA had not previously approved if such fees or expenses are not reasonable, customary or necessary in the locality where the Lender or Authorized CDC Liquidator is conducting the liquidation or litigation. Proposed §§ 120.542(d) and (e) also provide rights of appeal to specific officials in SBA's Headquarters if a Lender or Authorized CDC Liquidator

disagrees with an SBA determination to deny reimbursement of liquidation or litigation fees or costs.

*Section 120.546—Loan asset sales.* As discussed above, SBA wants to facilitate its transformation initiative by proposing certain changes to its loan asset sale program. The proposed section would impose a requirement, for all 7(a) loans made after the effective date of the regulations, that Lenders will be deemed to have consented to the sale of a loan in an asset sale under the specified circumstances. This provision is needed to facilitate an effective asset sales program by SBA. The proposed section also addresses 504 loans to be sold in asset sales.

*Section 120.848—PCLP CDC servicing and liquidation actions.* SBA is proposing a minor revision of this section to include a cross-reference to the proposed servicing regulations in subpart E of part 120.

*Section 120.970—CDC servicing actions.* SBA is proposing a minor revision of this section to include a cross-reference to the proposed servicing regulations in subpart E of part 120.

*Section 120.975—CDC Authority to Perform Liquidation and Debt collection Litigation.* Section 510(c) of the SBI Act (15 U.S.C. 697g) authorizes certain CDCs to perform liquidation and debt collection litigation with respect to 504 loans. SBA proposes adding a new regulation, § 120.975, to establish criteria for CDCs that request authority to become an Authorized CDC Liquidator, with authority delegated from SBA to conduct foreclosure and other liquidation actions, and debt collection litigation, on behalf of SBA. Section 510(b)(1) of the SBI Act (15 U.S.C. 697g(b)(1)) provides that CDCs qualified to receive such delegated authority are those that participated in the loan liquidation pilot program established by the Small Business Programs Improvement Act of 1996; are participating in the Premier Certified Lenders Program (PCLP); or have made an average of at least ten 504 loans per year during the three fiscal years immediately prior to the date on which the CDC requests this authority to liquidate and litigate, as well as show that it has trained employees, or has engaged contractors satisfactory to SBA, to perform these actions.

PCLP CDCs are already required to perform liquidation and debt collection litigation on their PCLP loans, pursuant to § 508(e)(1) of the SBI Act (15 U.S.C. 697e(e)(1)) and the existing § 120.848(f). This proposed rule would require PCLP CDCs that meet the statutory test, consisting of having either trained

employees or having engaged contractors satisfactory to SBA, as determined by SBA, to exercise their delegated authority to perform liquidation and debt collection litigation on their other 504 loans as well, upon receiving written notice from SBA that the CDC has met the statutory test and without the CDC first having to apply for SBA approval to exercise such delegated authority. All other CDCs would be required to apply for SBA approval.

In accordance with § 510(b)(2) of the SBI Act (15 U.S.C. 697g(b)(2)), a qualified non-PCLP CDC requesting to handle liquidation and debt collection litigation must submit an application to SBA. The proposed regulations also provide for rights of appeal from the denial by SBA of applications from non-PCLP CDCs.

#### **Compliance With Executive Orders 12866, 12988, and 13132, the Regulatory Flexibility Act (5 U.S.C. 601–612), and the Paperwork Reduction Act (44 U.S.C., Ch. 35)**

##### *Executive Order 12866*

The Office of Management and Budget has determined that this rule constitutes a “significant regulatory action” under Executive Order 12866 thus requiring Regulatory Impact Analysis, as set forth below.

##### **A. Regulatory Objective of Proposed Rule**

The objective of the proposed rule is to clarify and make uniform SBA's existing regulations governing lenders participating in the 7(a) business loan program (Lenders) and Certified Development Companies (CDCs) that are performing loan servicing, liquidation and debt collection litigation. The proposed rule will promote better understanding of Agency requirements by Lenders and CDCs, and improve oversight and management by SBA of Lender and CDC liquidation and debt collection litigation.

##### **B. Baseline Costs of Existing Regulatory Framework**

SBA 7(a) loan programs presently require Lenders to submit liquidation plans for most defaulted loans, except for those made pursuant to the SBAExpress program. SBA estimates that these requirements currently result in the submission of about 4,000 liquidation plans per year. The approximate time needed for lenders to complete a liquidation plan is two hours at an average cost of \$30 per hour, resulting in a total annual cost to Lenders of \$240,000.

Presently, CDCs that are authorized to perform liquidation activities on 504 loans submit about 100 liquidation plans per year. The approximate time needed for CDCs to complete a liquidation plan is two hours at an average cost of \$30 per hour, resulting in a total annual cost to CDCs of \$6,000.

SBA's 7(a) loan programs also presently require Lenders to submit litigation plans to SBA for approval. Lenders currently submit to SBA approximately 3,000 litigation plans per year. Preparation of each plan takes about one hour, at an average cost of \$150 per hour for private counsel time, for a total annual cost to Lenders of \$450,000. SBA reimburses Lenders for their share of reasonable, customary and necessary attorney fees, including those incurred for the preparation of litigation plans. CDCs submit to SBA only a small number of litigation plans presently, because SBA currently handles most litigation involving 504 loans.

SBA takes an average of one hour to review and respond to each liquidation and litigation plan submitted by Lenders and CDCs. This equates to 4,000 hours for Lender liquidation plans at an average cost of \$30 per hour, for a total of \$120,000. For review of CDC liquidation plans by SBA, 100 hours is required at an average cost of \$30 per hour, for a total of \$3,000. For Lender litigation plans, 3,000 hours of SBA review time is required at an average cost of \$30 per hour, for a total of \$90,000. SBA processes approximately 54,000 servicing and liquidation actions per year for Lenders and CDCs. The average action takes one-half hour for SBA to process, for a total of 27,000 hours processing time. At \$30 per hour, this equates to a total cost to SBA of \$810,000. Therefore, the total administrative cost to SBA under the current regulatory framework for these activities is approximately \$1,023,000.

#### C. Potential Benefits and Costs of the Proposed Rule

*1. Potential Benefits and Costs to Lenders.* The proposed rule would provide benefits for Lenders because it reduces the costs for those institutions to participate in the 7(a) program by eliminating the need to submit liquidation plans to SBA (except for lenders under the Certified Lenders Program which are required to submit liquidation plans by statute). Submission of liquidation plans is currently required in most lending programs by SBA procedures and regulations. SBA estimates that ending this requirement will enable Lenders to eliminate the preparation and submission to SBA of at least 4,000

liquidation plans a year. The approximate time to complete and submit a plan to SBA is about two hours at an average cost of \$30 per hour. Consequently, eliminating the requirement to submit liquidation plans will save Lenders about \$240,000 per year.

Other benefits for Lenders would result from the proposal to raise the dollar threshold for non-routine litigation (for which submission to SBA for pre-approval is required) from \$5,000 to \$10,000. Because fewer cases would rise above that higher threshold, Lenders would be required to submit fewer litigation plans to SBA. The Agency anticipates that approximately 500 fewer plans annually would be required to be submitted to the Agency as a result of this change. Because preparation of each plan takes about one hour at an average cost of \$150 per hour, SBA estimates that the proposed rule would result in a cost savings of \$75,000.

Lenders also would benefit under a provision of the proposed rule which defers, until after liquidation is complete, SBA's guaranty purchase on loans whose guaranteed portions have not been sold in the Secondary Market. Currently, Lenders whose loans SBA has purchased are required to process paperwork (SBA Form 172, Transaction Report on Loan Serviced by Lender) in connection with the remittance to SBA of the Agency's portion of any collections the Lender receives subsequent to guaranty purchase. Under the proposed rule, Lenders that are required to complete liquidation prior to purchase would not remit any payments to SBA along with a Form 172 unless collections are obtained by the Lenders subsequent to guaranty purchase.

Finally, the proposed rule would reduce the number of loan servicing and liquidation actions taken by Lenders that require prior SBA approval as compared with existing SBA requirements, and make remaining SBA prior approval requirements similar among the various SBA loan programs. These changes would simplify and reduce the costs of loan servicing and liquidation processes for Lenders.

SBA does not know of any specific costs that would be imposed on Lenders as a result of this proposed rule except for the loss of income that would result from the proposed limitation on interest on guarantees purchased by SBA to 120 days. However, such a limitation would affect only a small percentage (estimated at around 10%) of SBA guaranty purchases, and Lenders typically place loans on interest non-accrual after 90 days delinquency. SBA is requesting

comments from the public on any monetized, quantitative or qualitative costs of Lenders' compliance with this rule. Please send comments to the SBA official referenced in the **ADDRESSES** section of the preamble.

*2. Potential Benefits and Costs to CDCs.* As provided by statute, this proposed rule would enable qualified CDCs to seek authority to perform liquidation and debt collection litigation, and by doing so, qualified CDCs would be determining that the benefits of conducting their own recovery on defaulted loans would outweigh any burdens associated with the preparation and submission to SBA of liquidation and litigation plans as set forth in these proposed regulations. Such benefits would include the ability to pursue quicker liquidations and possibly achieve higher recoveries as a result.

SBA expects that CDCs would incur some additional costs as a result of this proposed rule. SBA anticipates that CDCs would be required to submit to the Agency for approval about 300 liquidation plans per year, an increase of 200 from the approximately 100 liquidation plans CDCs currently submit annually. SBA estimates that the average time for completion of each plan would consist of two hours at an average cost of \$30 per hour. Therefore, the annual cost of submitting the plans under the proposed rule would be \$18,000 per year, for an overall cost increase of \$12,000 from the \$6,000 annual cost under the current regulatory framework. CDCs that receive delegated liquidation authority under the proposed rule would also incur added costs through acquiring resources and creating the necessary internal structures to engage in liquidation and litigation activities. SBA is requesting comments from the public on any other monetized, quantitative or qualitative costs of CDCs' compliance with this rule. Please send comments to the SBA official referenced in the **ADDRESSES** section of the preamble.

*3. Potential Benefits and Costs for SBA and the Federal Government.* The proposed rule would benefit SBA because it would eliminate the need for most Lenders to submit liquidation plans to SBA (the exception is for Lenders under the Certified Lenders Program, which are required to submit liquidation plans by statute; the number of liquidation plans submitted by such Lenders currently is minimal, and SBA expects even further reduction under the proposed rule). SBA estimates that ending this requirement would eliminate the need for SBA to review about 4,000 liquidation plans a year.

The approximate time required for SBA to review a liquidation plan is one hour at an average cost of \$30 per hour. Consequently, there would be a cost savings to SBA of \$120,000 per year.

Another benefit for SBA would result from the proposal to raise the dollar threshold for non-routine litigation (for which submission to SBA for pre-approval is required) from \$5,000 to \$10,000. SBA anticipates that approximately 500 fewer plans annually would be required to be submitted to the Agency as a result of this change. Because review of each plan takes about one hour at an average cost of \$30 per hour, SBA estimates that the proposed rule would result in a cost savings of \$15,000. In addition, SBA would not be required to reimburse Lenders for the Agency's proportionate share of the costs incurred by Lenders in connection with the preparation of these litigation plans, resulting in a further savings of approximately \$50,000.

SBA would also benefit under a provision of the proposed rule which defers, until after Lender liquidation is complete, SBA's guaranty purchase on loans whose guaranteed portion has not been sold in the Secondary Market (except for earlier purchases as permitted by SBA in certain protracted liquidation situations). This would allow SBA personnel, in most cases, to review a Lender's complete administration of a loan, including liquidation expenses incurred and recoveries received, only once at the completion of liquidation efforts. Currently, Lenders whose loans SBA has purchased are required to submit SBA Form 172 (Transaction Report on Loan Serviced by Lender) in connection with the remittance to SBA of the Agency's portion of any collections the Lender receives subsequent to guaranty purchase. Under the proposed rule, Lenders that are required to complete liquidation prior to purchase would not remit any payments to SBA along with a Form 172 unless collections are obtained by the Lenders subsequent to guaranty purchase. Consequently, SBA would be relieved of the administrative burden of reviewing and processing a large number of lender payments under the proposed rule.

Although under the proposed rule SBA would be required to review liquidation plans submitted by qualified CDCs (estimated at 300 liquidation plans per year), this would not represent a significant increase in SBA administrative costs because currently SBA reviews approximately 100 such plans per year as well as provides assistance to CDCs on the preparation of such plans.

The proposed rule would also reduce SBA administrative costs associated with oversight of the Agency's business loan assistance programs by delegating greater servicing and liquidation responsibilities to Lenders and CDCs, and reducing their need to seek the prior approval of SBA for their proposed recovery activities and for various specific liquidation actions. This would decrease the amount of time required for SBA personnel to manage these programs. It is estimated that reviews of at least 30% (16,200) of the approximately 54,000 servicing and liquidation actions SBA currently processes annually would be eliminated. This would save an average of one-half hour processing time per action for a total time savings of 8,100 hours at \$30 per hour, or \$243,000.

In addition to increasing consistency among SBA's loan programs and creating more uniformity in processing of guaranty purchase requests, the proposed rule would save taxpayer dollars by limiting payment of interest to Lenders on purchased loans to 120 days, except for loans where the guaranteed portion has been sold in the Secondary Market. This change would not be a burden on Lenders because Lenders typically place loans on interest non-accrual after 90 days of delinquency and SBA already limits interest purchased to 120 days in two of the existing 7(a) loan programs, including the fastest growing program (SBAExpress). However, it is estimated that such a limitation in the proposed rule would affect only a small percentage (estimated at around 10%) of future SBA guaranty purchases.

Finally, the proposed rule would facilitate SBA's transformation initiative through enabling the sale of groups of 7(a) and 504 loans in asset sales. To this end, the rule provides that Lenders that do not exercise their option to purchase the guaranteed portion of a defaulted 7(a) loan from a Registered Holder in the Secondary Market, as well as Lenders with respect to any loan whose guaranteed portion SBA has purchased prior to the completion of liquidation, would be deemed to have consented to the sale of that loan in an asset sale. In addition, SBA is proposing that after SBA has purchased a debenture as the result of a default of a 504 loan, SBA may place such loan in an asset sale conducted or overseen by the Agency.

Costs imposed on SBA as a result of the proposed rules would include personnel and administrative costs associated with implementing appeals processes to which Lenders and Authorized CDC Liquidators may be entitled under the proposed rule when

they disagree with a decision by an SBA field office or servicing center regarding a liquidation or litigation plan, when they disagree with an SBA determination to deny reimbursement of liquidation or litigation fees or costs, or when SBA denies applications from non-PCLP CDCs requesting authority to handle liquidation and debt collection litigation.

#### D. Proposed Rule Is the Best Available Means To Reach the Regulatory Objective

This proposed rule is SBA's best available means for achieving its regulatory objective of clarifying and making uniform existing SBA regulations and policy, which currently only partially address liquidation and debt collection litigation and vary across Agency lending programs. SBA is requesting comments from the public on any potentially effective and reasonably feasible alternatives to this rule as it applies to Lenders, and the costs and benefits of those alternatives. Please send comments to the SBA official referenced in the **ADDRESSES** section of the preamble.

With respect to CDCs that are eligible for and request liquidations and debt collection authority from SBA, the proposed rule merely implement § 307(b) of Pub. L. 106-554, which requires SBA to promulgate regulations to carry out § 510 of the SBI Act, 15 U.S.C. 697g, regarding CDC liquidation and debt collection litigation authority. SBA considers those statutory provisions applicable to CDCs to be mandatory, and SBA has not identified any reasonable alternative to this proposed rule implementing the statutory mandate.

#### Executive Order 12988

This proposed action meets applicable standards set forth in §§ 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. In particular, the proposed regulations provide for rights of appeal to Lenders and CDCs in the event they are aggrieved by an Agency decision, thereby limiting the possibility of litigation by these entities. The proposed action does not have retroactive or preemptive effect.

#### Executive Order 13132

This proposed rule would not have substantial direct effects on the States, on the relationship between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, for the



purposes of Executive Order 13132, SBA has determined that this proposed rule has no federalism implications warranting preparation of a federalism assessment.

#### *Regulatory Flexibility Act*

Based on the following analysis, SBA certifies that the proposed rule would not have a significant economic impact on a substantial number of small entities under the Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601 *et seq.*

This proposed rule directly affects only those CDCs that are eligible for, and that request, authority from SBA to conduct liquidation and debt collection litigation, of which SBA estimates that there are approximately 80 out of about 270 active CDCs, and an unknown number of small lending institutions. SBA assumes, therefore, that this proposed rule may have an impact on a substantial number of small entities. However, the proposed rule merely implements statutory mandates and, further, SBA has determined that the impact on entities affected by the proposed rule will not be significant for the reasons set forth below.

The proposed rule would not impose a significant economic impact on small lending institutions because it in fact reduces the costs for those institutions to participate in the 7(a) program by eliminating the need to submit liquidation plans to SBA (except for Lenders under the Certified Lenders Program which are required to submit liquidation plans by statute), which is currently required by SBA procedures and regulations. SBA estimates that ending this requirement will enable Lenders to eliminate the preparation and submission to SBA of at least 4,000 liquidation plans a year. The approximate time to complete and submit these plans to SBA is about two hours at an average cost of \$30 per hour. The average cost is based on a mid-level professional salary level of \$60,000 per year. Consequently, eliminating the requirement to submit liquidation plans will save Lenders about \$240,000 per year. The proposed rule also reduces the number of loan servicing and liquidation actions taken by Lenders that require prior SBA approval as compared with existing SBA requirements, and makes the remaining prior approval requirements similar among the various SBA loan programs, thereby simplifying the loan servicing and liquidation process for SBA participating Lenders. In addition, as pointed out above, small lending institutions will be required to submit fewer litigation plans since the proposed rule raises the dollar threshold

for Non-Routine Litigation from \$5,000 to \$10,000. SBA anticipates that approximately 500 fewer plans will be required to be submitted to the Agency as a result of this change. Since preparation of each plan takes about one hour at an average cost of \$150 per hour, which is based on a nationwide estimate of the billing level for attorneys qualified to perform this type of work, SBA estimates that the proposed rule will result in a cost savings of \$75,000.

The proposed rule also would not have a significant economic impact on CDCs, which are entities that are licensed and regulated by SBA. As provided by statute, the rule would enable qualified CDCs to seek authority to perform liquidation and debt collection litigation, and by doing so, qualified CDCs would be determining that the benefits of conducting their own recovery on defaulted loans would outweigh any burdens associated with the preparation and submission to SBA of liquidation and litigation plans as set forth in these proposed regulations. Such benefits include the ability to pursue quicker liquidations and possibly achieve higher recoveries. In the loan liquidation pilot program established by the Small Business Programs Improvement Act of 1996, CDCs that conducted their own liquidation achieved a slightly higher overall recovery rate than did SBA in the comparison group of cases handled directly by the Agency. Subject to the provisions of proposed new § 120.542, SBA would reimburse CDCs for their reasonable, customary and necessary expense disbursements related to liquidation activities on particular loans, which would include title reports and title insurance on real estate collateral; appraisals; costs for the care and preservation of collateral; fees for lien recordings, filings and lien searches; and fees for legal services provided by outside counsel in litigating on a particular loan account.

SBA anticipates that CDCs will be required to submit to the Agency for approval, as required by statute, about 300 liquidation plans per year. SBA estimates that the average time for completion of each plan will necessitate two hours at an average cost of \$30 per hour, which is based on a mid-level professional salary level of \$60,000 per year. Therefore, the total annual cost for all plans would be \$18,000 per year.

CDCs participating in the Premier Certified Lenders Program (PCLP) would not be required to seek authority to conduct liquidation and debt collection litigation on their PCLP loans since they are already required to do so by statute and regulation. PCLPs will be

also be required to liquidate and litigate their non-PCLP loans by this rule in order to have one consistent standard for all their loans.

In addition, this regulation merely codifies the existing SBA practice of requiring the submission of liquidation and litigation plans by Lenders and CDCs, but reduces any burden from this requirement as to litigation plans by raising the dollar threshold for Non-Routine Litigation from \$5,000 to \$10,000, as noted above. Further, the performance standards for 7(a) and 504 loan servicing and liquidation contained in these proposed regulations merely codifies existing SBA policy as set forth in SOPs and currently existing lending standards. In addition, it is a prudent lending practice for Lenders to prepare plans prior to undertaking liquidation and debt collection litigation. Therefore, this rule does not impose any new or unnecessary requirements on these small entities.

Accordingly, SBA certifies that this rule will not have a significant economic impact on a substantial number of small entities. SBA invites comments from members of the public who believe there will be significant impact either on CDCs, small lending institutions, or small businesses that receive funding from, or with the assistance of, CDCs or such institutions.

#### *Paperwork Reduction Act*

SBA has determined that this proposed rule imposes additional reporting or recordkeeping requirements under the Paperwork Reduction Act ("PRA"), 44 U.S.C. 3501–3520. This collection of information, as defined by the PRA, includes four different reporting requirements which are (1) the application for CDCs to apply for liquidation and debt collection litigation authority on 504 loans, (2) a liquidation plan describing proposed collection activities for defaulted 504 loans, (3) a litigation plan describing proposed debt collection litigation for defaulted 7(a) or 504 loans, and (4) a request for a waiver of the need for a written liquidation or litigation plan. The titles, descriptions and respondent descriptions of the information collections are discussed below with an estimate of the annual reporting burden. Included in the estimate is the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing each collection of information.

SBA invites comments on: (1) Whether the proposed collection of information is necessary for the proper performance of SBA's functions,



including whether the information will have a practical utility; (2) the accuracy of SBA's estimate of the burden of the proposed collections of information, including the validity of the methodology and assumptions used; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of the collection of information on respondents, including the use of automated collection techniques, when appropriate, and other forms of information technology.

Please send comments by the closing date for comment for this proposed rule to David Rostker, Office of Management and Budget, Office of Information and Regulatory Affairs, 725 17th Street, NW., Washington, DC 20503 and to James Hammersley, Acting Assistant Administrator, Office of Portfolio Management, Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

#### A. Application for Liquidation Authority

*Title:* CDC Application for Authority to Perform Liquidation and Debt Collection Litigation on 504 Loans [No SBA Form Number].

*Summary:* As described in proposed § 120.975, certain CDCs that seek authority from SBA to perform liquidation and debt collection litigation in connection with defaulted loans will submit the application to the Agency. SBA will review the application to determine whether the CDC has participated in the CDC loan liquidation pilot program, is participating in the PCLP, or has made sufficient loans in the past three years, as specified in the SBI Act and the proposed rule, and has trained employees or contractors, satisfactory to SBA, to perform liquidation and litigation in a manner that will reduce the risk of loss to the Agency. Recoveries from these liquidation efforts and debt collection litigation will be remitted to SBA to reduce the Agency's loss on the loan.

*Need and Purpose:* Section 510 of the SBI Act (15 U.S.C. 697g) authorizes certain CDCs to conduct liquidation and debt collection litigation in connection with section 504 loans that have gone into default, and specifies the criteria that CDCs must meet to apply for this authority. The proposed regulation incorporates the statutory criteria. SBA will use the information CDCs submit to determine whether the CDC meets the qualifications.

*Description of Respondents:* CDCs that have requested authority to handle liquidation and litigation and which meet the specified criteria. SBA

estimates that approximately 40 CDCs annually will apply for the liquidation authority.

SBA estimates the burden of this collection of information as follows: An applicant will complete this collection normally only once. SBA estimates that the time needed to complete this collection will average one hour. SBA estimates that the cost to complete this collection will be approximately \$30 per hour. Therefore, SBA estimates that the total annual burden for the 40 applications per year is 40 hours per year and the total cost is \$1,200 per year.

#### B. The Liquidation Plan

*Title:* SBA Liquidation Plan [SBA Form 1979].

*Summary:* The liquidation plan will describe the specific steps that CDCs anticipate using to recover through liquidation of collateral and other actions, debts owed on their defaulted 504 loans.

*Need and Purpose:* This plan is required under proposed § 120.540(a), and is needed for SBA to oversee recovery actions of CDCs because SBA, as guarantor on CDC debentures, may incur financial losses of 100% on defaulted 504 loans funded by these debentures. Thus, SBA must oversee and manage the liquidation actions of CDCs to ensure that they will take action to maximize recovery, minimize risks, and limit unnecessary and excessive costs. SBA is authorized to require submission of this plan under several statutory provisions: sections 5(b)(7), 7(a)(2)(C), and 7(a)(19) of the Act (15 U.S.C. 634(b)(7), 636(a)(2)(C) and (a)(19)), and section 510 of the SBI Act (15 U.S.C. 697g).

*Description of Respondents:* The respondents are CDCs that have made 504 loans funded by SBA guaranteed debentures and that are authorized to conduct liquidation (Authorized CDC Liquidation). SBA estimates that such CDCs would submit approximately 300 liquidation plans each year.

SBA estimates that the average amount of time for an Authorized CDC Liquidator to complete this collection is two hours. SBA estimates that the cost to complete this collection will be approximately \$30 per hour. Therefore, we estimate that the total annual burden for all CDCs affected by this requirement is 600 hours and the total cost is \$18,000 per year.

#### C. The Litigation Plan

*Title:* SBA Litigation Plan [No SBA Form Number].

*Summary:* The litigation plan will describe the proposed conduct of debt

collection litigation that Lenders/CDCs anticipate using to recover debts owed on their defaulted 7(a) and 504 loans where litigation is not anticipated to be Non-Routine Litigation.

*Need and Purpose:* This plan is required under proposed § 120.540(b), and is needed for SBA to oversee and manage debt collection litigation by Lenders and CDCs because SBA, as guarantor on 7(a) loans and 504 debentures, may incur financial losses of up to 90% on defaulted 7(a) loans and 100% on defaulted 504 loans. Thus, SBA must oversee the liquidation actions of Lender/CDCs to ensure that they will take action to maximize recovery, minimize risks, and limit unnecessary and excessive costs. SBA is authorized to require submission of this plan under several statutory provisions: sections 5(b)(7), 7(a)(2)(C), and 7(a)(19) of the Act (15 U.S.C. 634(b)(7), 636(a)(2)(C) and (a)(19)), and section 510 of the SBI Act (15 U.S.C. 697g).

*Description of Respondents:* Respondents include Lenders that have made 7(a) guaranteed loans and CDCs that have made 504 loans funded by SBA guaranteed debentures. A Litigation plan will only be needed if litigation falls within the definition of Non-Routine Litigation. However, SBA has not maintained data on how many debt collection actions are initiated in connection with defaulted 7(a) or 504 loans or the average litigation costs or contested nature of such litigation. Therefore, SBA is calculating that an applicant will complete this collection once per defaulted loan. SBA estimates that such Lenders and CDCs will submit approximately 3,000 litigation plans each year.

SBA estimates that the average amount of time needed to complete this collection is one hour. SBA anticipates that the work will be done largely by private sector attorneys and estimates that this will cost approximately \$150 per hour. Therefore, we estimate that the total annual burden for all entities affected by this requirement is 3,000 hours per year and the total cost is \$450,000 per year.

#### D. Request for Emergency Waiver

*Title:* Request for waiver of need for written liquidation or litigation plan [No SBA Form Number].

*Summary:* As described in proposed § 120.540(f), Lenders and Authorized CDC Liquidators who are required to submit written liquidation or litigation plans to SBA for advance approval, may request a waiver of such requirement under urgent circumstances (for example, when an immediate response to litigation is required). Such Lenders

and Authorized CDC Liquidators would be required to apply for and obtain SBA's consent to such a waiver before taking the urgent action.

**Need and Purpose:** SBA must oversee Lenders' and CDCs' liquidation and litigation actions for the reasons described above. However, SBA recognizes that circumstances may arise in which obtaining prior SBA approval may be impracticable and potentially delay urgently-needed liquidation or litigation action. Therefore, SBA proposes to create a limited waiver to address such circumstances.

**Description of Respondents:** The respondents are Lenders and CDCs who are subject to the requirement to submit liquidation or litigation plans. SBA estimates that SBA will receive 500 waiver requests each year.

SBA estimates that the average amount of time for a Lender or CDC to complete this collection is one-half hour. SBA anticipates that this work will be done largely by private sector attorneys and expects will cost approximately \$150 per hour. Therefore, SBA estimates that the total annual burden for Lenders and CDCs affected by this requirement is 250 hours and the total cost is \$37,500 per year.

#### List of Subjects in 13 CFR Part 120

Loan programs—business, Reporting and recordkeeping requirements, Small businesses.

For the reasons set forth above, SBA proposes to amend 13 CFR part 120 as follows:

### PART 120—BUSINESS LOANS

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

**Authority:** 15 U.S.C. 634(b)(6), 636(a) and (h), 696(3), 697(a)(2), and 697(g).

2. Amend § 120.10 by adding the definitions of “Authorized CDC Liquidator” and “Loan Program Requirements” and by adding a sentence to the end of the definition of “SOPs” to read as follows:

#### § 120.10 Definitions.

\* \* \* \* \*

**Authorized CDC Liquidator:** A CDC in good standing with authority under the Act and SBA regulations to conduct liquidation and certain debt collection litigation in connection with 504 loans, as authorized by § 120.975.

\* \* \* \* \*

**Loan Program Requirements:** Requirements imposed upon Lenders or CDCs by statute, SBA regulations, any agreement the Lender or CDC has executed with SBA, SBA SOPs, official SBA notices and forms applicable to the

7(a) and 504 loan programs, and loan authorizations, as such requirements are issued and revised by SBA from time to time. For CDCs, this term also includes requirements imposed by Debentures, as that term is defined in § 120.802.

\* \* \* \* \*

**SOPs** \* \* \* SOPs are publicly available on SBA's Web site at <http://www.sba.gov> in the online library.

\* \* \* \* \*

### Subpart A—Policies Applying to All Business Loans

3–4. Revise the undesignated center heading immediately preceding § 120.180 and revise § 120.180 to read as follows:

#### Applicability and Enforceability of Loan Program Requirements

##### § 120.180 Lender and CDC Compliance with Loan Program Requirements.

Lenders must comply and maintain familiarity with Loan Program Requirements for the 7(a) program, as such requirements are revised from time to time. CDCs must comply and maintain familiarity with Loan Program Requirements for the 504 program, as such requirements are revised from time to time. Loan Program Requirements in effect at the time that a Lender or CDC takes an action in connection with a particular loan govern that specific action. For example, although loan closing requirements in effect when a Lender or CDC closes a loan will govern the closing actions, a Lender or CDC's liquidation actions on the same loan are subject to the liquidation requirements in effect at the time that a liquidation action is taken.

5. Add § 120.181 to read as follows:

##### § 120.181 Status of Lenders and CDCs.

Lenders, CDCs and their contractors are independent contractors that are responsible for their own actions with respect to a 7(a) or 504 loan. SBA has no responsibility or liability for any claim by a borrower, guarantor or other party alleging injury as a result of any allegedly wrongful action taken by a Lender, CDC or an employee, agent, or contractor of a Lender or CDC.

6. Revise the undesignated center heading immediately preceding § 120.195 to read as follows:

#### Reporting

7. Add new § 120.197 to read as follows:

##### § 120.197 Notifying SBA's Office of Inspector General of suspected fraud.

Lenders, CDCs, Borrowers, and others must notify the SBA Office of Inspector

General of any information which indicates that fraud may have occurred in connection with a 7(a) or 504 loan. Send the notification to the Assistant Inspector General for Investigations, Office of Inspector General, U.S. Small Business Administration, 409 3rd Street SW., Washington DC 20416.

### Subpart D—Lenders

8. Amend § 120.440 by revising the heading and the first sentence to read as follows:

#### § 120.440 The Certified Lenders Program.

Under the Certified Lenders Program (CLP), designated Lenders process and close 7(a) loans and service and liquidate such loans in accordance with subpart E of this part. \* \* \*

9. Amend § 120.453 by revising the heading and the section to read as follows:

#### § 120.453 Responsibilities of PLP Lenders for servicing and liquidating 7(a) loans.

Servicing and Liquidation responsibilities for PLP Lenders are set forth in subpart E of this part.

9a. Revise the heading of subpart E to read as follows:

### Subpart E—Servicing, Liquidation, and Debt Collection Litigation of 7(a) and 504 Loans

#### §§ 120.500, 120.510, 120.511, 120.512, and 120.513 [Removed]

10. Remove §§ 120.500, 120.510, 120.511, 120.512, and 120.513, and the undesignated center heading immediately preceding § 120.510 entitled “Servicing”.

11. Amend § 120.520 by revising the heading and the section to read as follows:

#### § 120.520 Purchase of 7(a) Loan Guarantees.

(a) *When SBA will purchase.* (1) *For loans approved on or after the effective date of this regulation.* A Lender must not make demand on SBA to purchase a guaranteed portion of a loan until after the Lender has completed liquidation for that loan. SBA considers liquidation to be completed when a Lender has exhausted all prudent and commercially reasonable efforts to collect upon the debt. However, a Lender may request in writing that SBA purchase the guaranteed portion of a loan prior to completion of liquidation, if a debt collection judicial or other similar proceeding involving that loan (including but not limited to foreclosure and bankruptcy proceedings) has been underway for more than eighteen (18) months. In addition, SBA, in its sole discretion, may purchase the guaranteed

portion of a loan at any time with or without a request from a Lender.

(2) *For loans approved before the effective date of this regulation.* The regulations applicable to the time that a Lender may demand purchase that were in effect immediately prior to this date will govern such loans.

(b) *Documentation for purchase.* SBA will not purchase its guaranteed portion of a loan from a Lender unless the Lender has submitted to SBA documentation that SBA deems sufficient to allow SBA to determine whether purchase of the guarantee is warranted under § 120.524.

(c) *Purchase of loans sold in Secondary Market.* When the Lender has sold the guaranteed portion of a loan in the Secondary Market, pursuant to subpart F of this part, Lenders must perform all necessary servicing and liquidation actions for such loan even after SBA has purchased the guaranteed portion of such loan from a Registered Holder (as that term is defined in § 120.600(i)). In the event that SBA purchases its guaranteed portion of such a loan from the Registered Holder, Lenders must provide documentation upon request by SBA that SBA deems sufficient to be able to review the Lender's administration of the loan under § 120.524. A Lender's failure to provide sufficient documentation may constitute a material failure to comply with SBA requirements under § 120.524(a)(1), and may lead to initiation of an action for recovery from the Lender of all or some of the moneys SBA paid to a Registered Holder on a guarantee.

(d) *No waiver of SBA's rights.* Purchase by SBA of the guaranteed portion of a loan, or of a portion of SBA's guarantee of a loan, either through a negotiated agreement with a Lender or otherwise, does not waive any of SBA's rights to recover from the responsible Lender any money paid on the guarantee based upon the occurrence of any of the events set forth in § 120.524(a) in connection with that loan.

12. Amend § 120.522 by revising the section heading and paragraph (b), and by deleting paragraph (d), to read as follows:

**§ 120.522 Payment of accrued interest to the Lender or Registered Holder when SBA purchases the guaranteed portion.**

\* \* \* \* \*

(b) *Payment to Lender.* (1) *For loans approved on or after the effective date of this regulation.* SBA will pay up to a maximum of 120 days interest to a Lender at the time of guarantee purchase.

(2) *For loans approved before the effective date of this regulation.* The regulations applicable to the amount of interest that SBA will pay to a Lender upon loan default that were in effect immediately prior to this date will govern such loans.

\* \* \* \* \*

13. Amend § 120.524 by revising paragraphs (a)(1), (a)(8), and (b) through (d) to read as follows:

**§ 120.524 When is SBA released from liability on its guarantee on loans?**

(a) \* \* \*

(1) The Lender has failed to comply materially with any Loan Program Requirement for 7(a) loans.

\* \* \* \* \*

(8) The Lender has failed to request that SBA purchase a guarantee within 180 days after maturity of the loan. However, if the Lender is conducting liquidation or debt collection litigation in connection with a loan that has matured, SBA will be released from its guarantee only if the Lender fails to request that SBA purchase the guarantee within 180 days after the completion of the liquidation or debt collection litigation;

\* \* \* \* \*

(b) If SBA determines, at any time, that any of the events set forth in paragraph (a) of this section occurred in connection with that loan, SBA is entitled to recover any moneys paid on the guarantee plus interest from the Lender responsible for those events.

(c) If the Lender's loan documentation or other information indicates that one or more of the events in paragraph (a) of this section occurred, SBA may undertake such investigation as it deems necessary to determine whether to honor or deny the guarantee, and may withhold a decision on whether to honor the guarantee until the completion of such investigation.

(d) Any information provided to SBA by a Lender or other party will not prejudice, or be construed as effecting any waiver of, SBA's right to deny liability for a guarantee if one or more of the events listed in paragraph (a) of this section occur.

\* \* \* \* \*

14–15. Add the following new § 120.535 and § 120.536 to read as follows:

**§ 120.535. Standards for Lender and CDC loan servicing, loan liquidation and debt collection litigation.**

(a) Lenders and CDCs must service 7(a) and 504 loans in their portfolio no less diligently than their non-SBA portfolio, and in a commercially reasonable manner, consistent with

prudent lending standards, and in accordance with Loan Program Requirements.

(b) Lenders and Authorized CDC Liquidators must liquidate and conduct debt collection litigation for 7(a) and 504 loans in their portfolio no less diligently than for their non-SBA portfolio, and in a prompt, cost-effective and commercially reasonable manner, consistent with prudent lending standards, and in accordance with Loan Program Requirements and with any SBA approval of either a liquidation or litigation plan or any amendment of such a plan.

(c) A CDC must not take any action in the liquidation or debt collection litigation of a 504 loan that would result in an actual or apparent conflict of interest between the CDC (or any employee of the CDC) and any Third Party Lender, associate of a Third Party Lender, or any person participating in a liquidation, foreclosure or loss mitigation action.

(d) SBA may, in its discretion, undertake the servicing or liquidation of any 7(a) or 504 loan. If SBA elects to service or liquidate a loan, it will notify the relevant Lender or CDC in writing, and, upon receiving such notice, the Lender or CDC must assign the Loan Instruments to SBA and provide any needed assistance to allow SBA to service and liquidate the loan. SBA will notify the Borrower of the change in servicing. SBA may use contractors to perform these actions.

**§ 120.536 Servicing and liquidation actions that require the prior written consent of SBA.**

(a) *Actions by Lenders and CDCs.* Except as otherwise provided in a Supplemental Guarantee Agreement with a Lender or an Agreement with a CDC, SBA must give its prior written consent before a Lender or CDC takes any of the following actions:

(1) Increases the principal amount of a loan above that authorized by SBA at loan origination.

(2) Confers a Preference on the Lender or CDC or engages in an activity that creates a conflict of interest.

(3) Compromises the principal balance of a loan.

(4) Takes title to any property in the name of SBA.

(5) Takes title to environmentally contaminated property, or takes over operation and control of a business that handles hazardous substances or hazardous wastes.

(6) Transfers, sells or pledges more than 90% of a loan.

(7) Takes any action for which prior written consent is required by a Loan Program Requirement.

(b) *Actions by CDCs only (other than PCLP CDCs).* SBA must give its prior written consent before a CDC, other than a PCLP CDC, takes any of the following actions with respect to a 504 loan:

(1) Alters substantially the terms or conditions of any Loan Instrument.

(2) Releases collateral having a cumulative market value in excess of 10 percent of the Debenture amount or \$10,000, whichever is less.

(3) Accelerates the maturity of the note.

(4) Compromises or releases any claim against any Borrower or obligor, or against any guarantor, standby creditor, or any other person that is contingently liable for moneys owed on the loan.

(5) Purchases or pays off any indebtedness secured by the property that serves as collateral for a defaulted 504 loan, such as payment of the debt(s) owed to a lien holder or lien holders with priority over the lien securing the loan.

(6) Accepts a workout plan to restructure the material terms and conditions of a loan that is in default or liquidation.

(7) Takes any action for which prior written consent is required by a Loan Program Requirement.

(c) *Documentation requirements.* For all servicing/liquidation actions not requiring SBA's prior written consent, Lenders and CDCs must document the justifications for their decisions and retain these and supporting documents in their file for future SBA review to determine if the actions taken by the Lender or CDC were prudent and commercially reasonable.

16. Remove the undesignated center heading before § 120.540 entitled "Liquidation of Collateral."

#### **§ 120.540 [Redesignated as § 120.545]**

17. Redesignate § 120.540 as § 120.545.

18. Add new § 120.540 through § 120.542 to read as follows:

#### **§ 120.540 Liquidation and litigation plans.**

(a) *SBA oversight.* SBA may monitor or review liquidation through the review of liquidation plans which all Authorized CDC Liquidators and certain Lenders must submit to SBA for approval prior to undertaking liquidation, and through liquidation wrap-up reports which Lenders must submit to SBA at the completion of liquidation. SBA will monitor debt collection litigation, such as judicial foreclosures, bankruptcy proceedings and other State and Federal insolvency proceedings, through the review of litigation plans, as set forth in this section.

(b) *Liquidation plan.* An Authorized CDC Liquidator and a Lender for a loan made under its authority as a CLP Lender must, prior to undertaking any liquidation, submit a written proposed liquidation plan to SBA and receive SBA's written approval of that plan.

(c) *Litigation plan.* An Authorized CDC Liquidator and a Lender must obtain SBA's prior approval of a litigation plan before proceeding with any Non-Routine Litigation, as defined in paragraph (c)(1) of this section. SBA's prior approval is not required for Routine Litigation, as defined in paragraph (c)(2) of this section.

(1) Non-Routine Litigation includes:

(i) All litigation where factual or legal issues are in dispute and require resolution through adjudication;

(ii) Any litigation where legal fees and costs are estimated to exceed \$10,000;

(iii) Any litigation involving a loan where a Lender or Authorized CDC Liquidator has an actual or potential conflict of interest with SBA; and

(iv) Any litigation involving a 7(a) or 504 loan where the Lender or CDC has made a separate loan to the same borrower which is not a 7(a) or 504 loan.

(2) Routine Litigation means uncontested litigation, such as non-adversarial matters in bankruptcy and undisputed foreclosure actions, having estimated legal fees and costs not exceeding \$10,000.

(d) *Decision by SBA to take over litigation.* If a Lender or Authorized CDC Liquidator is conducting, or proposes to conduct, debt collection litigation on a 7(a) loan or 504 loan, SBA may take over the litigation if SBA determines that the outcome of the litigation could adversely affect SBA's administration of the loan program or that the Government is entitled to legal remedies that are not available to the Lender or Authorized CDC Liquidator. Examples of cases that could adversely affect SBA's administration of a loan program include, but are not limited to, situations where SBA determines that:

(1) The litigation involves important governmental policy or program issues.

(2) The case is potentially of great precedential value or there is a risk of adverse precedent to the Government.

(3) The Lender or Authorized CDC Liquidator has an actual or potential conflict of interest with SBA.

(4) The legal fees of the Lender or Authorized CDC Liquidator's outside counsel are unnecessary, unreasonable or not customary in the locality.

(e) *Amendments to a liquidation or litigation plan.* Lenders and Authorized CDC Liquidators must submit an amended liquidation or litigation plan to address any material changes arising

during the course of the liquidation or litigation that were not addressed in the original plan or an amended plan.

Lenders and Authorized CDC Liquidators must obtain SBA's written approval of the amended plan prior to taking any further liquidation or litigation action. Examples of such material changes that would require the approval of an amended plan include, but are not limited to:

(1) Changes arising during the course of Routine Litigation that transform the litigation into Non-Routine Litigation, such as when the debtor contests a foreclosure or when the actual legal fees incurred exceed \$10,000.

(2) If SBA has approved a litigation plan where anticipated costs of conducting the litigation exceed \$10,000, or has approved an amended plan, and thereafter the anticipated or actual costs of conducting the litigation increase by more than 15 percent.

(3) If SBA has approved a liquidation plan, or an amended plan, and thereafter the anticipated or actual costs of conducting the liquidation increase by more than 15 percent.

(f) *Limited waiver of need for a written liquidation or litigation plan.* SBA may, in its discretion, and upon request by a Lender or Authorized CDC Liquidator, waive the requirements of paragraphs (b), (c) or (e) of this section, if one of the following circumstances (Emergency) warrant such a waiver: the need for expeditious action to avoid the potential risk of loss on the loan or dissipation of collateral exists; an immediate response is required to litigation by a borrower, guarantor or third party; or another urgent reason arises. The Lender or Authorized CDC Liquidator must obtain SBA's written consent to such waiver before undertaking the Emergency action, if at all practicable. SBA's waiver will apply only to the specific action(s) which the Lender or Authorized CDC Liquidator has identified to SBA as being necessary to address the Emergency. The Lender or Authorized CDC Liquidator must, as soon after the Emergency as is practicable, submit a written liquidation or litigation plan to SBA or, if appropriate, a written amended plan, and may not take further liquidation or litigation action without written approval of such plan or amendment by SBA.

(g) *Appeals.* A Lender for loans made under its authority as a CLP Lender or an Authorized CDC Liquidator that disagrees with an SBA office's decision pertaining to an original or amended liquidation plan, other than such portions of the plan that address litigation matters, may submit a written appeal to the AA/FA within 30 days of

the decision. The AA/FA or designee will make the final Agency decision in consultation with the Associate General Counsel for Litigation. A Lender or Authorized CDC Liquidator that disagrees with an SBA office's decision pertaining to an original or amended litigation plan, or the portion of a liquidation plan addressing litigation matters, may submit a written appeal to the Associate General Counsel for Litigation within 30 days of the decision. The Associate General Counsel for Litigation will make the final Agency decision in consultation with the AA/FA.

#### **§ 120.541 Time for approval by SBA.**

(a) Except as set forth in paragraph (c) of this section, in responding to a request for approval under §§ 120.540(b), 120.540(c), 120.537(c)(5) or 120.537(c)(6), SBA will approve or deny the request within 15 business days of the date when SBA receives the request. If SBA is unable to approve or deny the request within this 15-day period, SBA will provide a written notice of no decision to the Lender or Authorized CDC Liquidator, stating the reason for SBA's inability to act; an estimate of the additional time required to act on the plan or request; and, if SBA deems appropriate, requesting additional information.

(b) Except as set forth in paragraph (c) of this section, unless SBA gives its written consent to a proposed liquidation or litigation plan, or a proposed amendment of a plan, or any of the actions set forth in § 120.536(b)(5) or § 120.536(b)(6), SBA will not be deemed to have approved the proposed action.

(c) If a Lender seeks to perform liquidation on a loan made under its authority as a CLP Lender by submitting a liquidation plan to SBA for approval, SBA will approve or deny such plan within ten business days. If SBA fails to approve or deny the plan within ten business days, SBA will be deemed to have approved such plan.

#### **§ 120.542 Payment by SBA of legal fees and other expenses.**

(a) *Legal fees SBA will not pay.* (1) SBA will not pay legal fees or other costs that a Lender or Authorized CDC Liquidator incurs:

(i) In asserting a claim, cross claim, counterclaim, or third-party claim against SBA or in defense of an action brought by SBA, unless payment of such fees or costs is otherwise required by federal law.

(ii) In connection with actions of a Lender or Authorized CDC Liquidator's outside counsel for performing non-

legal liquidation services, unless authorized by SBA prior to the action.

(iii) In taking actions which solely benefit a Lender or Authorized CDC Liquidator and which do not benefit SBA, as determined by SBA.

(2) SBA will not pay legal fees or other costs a Lender or CDC incurs in the defense of, or pay for any settlement or adverse judgment resulting from, a suit, counterclaim or other claim by a borrower, guarantor, or other party that seeks damages based upon a claim that the Lender or CDC breached any duty or engaged in any wrongful actions, unless SBA expressly directed the Lender or CDC to undertake the allegedly wrongful action that is the subject of the suit, counterclaim or other claim.

(b) *Legal fees SBA may decline to pay.* In addition to any right or authority SBA may have under law or contract, SBA may, in its discretion, decline to pay a Lender or Authorized CDC Liquidator for all, or a portion, of legal fees and/or other costs incurred in connection with the liquidation and/or litigation of a 7(a) loan or 504 loan under any of the following circumstances:

(1) SBA determines that the Lender or Authorized CDC Liquidator failed to perform liquidation or litigation promptly and in accordance with commercially reasonable standards, in a prudent manner, or in accordance with any Loan Program Requirement or SBA approvals of either a liquidation or litigation plan or any amendment of such a plan.

(2) A Lender or Authorized CDC Liquidator fails to obtain prior written approval from SBA for any liquidation or litigation plan, or for any amended liquidation or litigation plan, or for any action set forth in § 120.536, when such approval is required by these regulations or a Loan Program Requirement.

(3) If SBA has not specifically approved fees or costs identified in an original or amended liquidation or litigation plan under § 120.540, and SBA determines that such fees or costs are not reasonable, customary or necessary in the locality in question. In such cases, SBA will pay only such fees as it deems are necessary, customary and reasonable in the locality in question.

(c) *Appeals—liquidation costs.* A Lender or Authorized CDC Liquidator that disagrees with a decision by an SBA office to decline to reimburse all, or a portion, of the fees and/or costs incurred in conducting liquidation may appeal this decision in writing to the AA/FA within 30 days of the decision. The decision of the AA/FA or designee

will be made in consultation with the Associate General Counsel for Litigation, and will be the final Agency decision.

(d) *Appeals—litigation costs.* A Lender or Authorized CDC Liquidator that disagrees with a decision by SBA to decline to reimburse all, or a portion, of the legal fees and/or costs incurred in conducting debt collection litigation may appeal this decision in writing to the Associate General Counsel for Litigation within 30 days of the decision. The decision of the Associate General Counsel for Litigation will be made in consultation with the AA/FA, and will be the final Agency decision.

19. Add a new § 120.546 to read as follows:

#### **§ 120.546 Loan asset sales.**

(a) *General.* Loan asset sales are governed by § 120.845(b)(4) and by this section.

(b) *7(a) loans.* (1) *For loans approved on or after the effective date of this regulation.* The Lender will be deemed to have consented to SBA's sale of the loan (guaranteed and unguaranteed portions) in an asset sale conducted or overseen by SBA if:

(i) For a loan where the guaranteed portion has been sold in the Secondary Market pursuant to subpart F of this part and the loan subsequently goes into default, and the Lender does not exercise its option to purchase the guaranteed portion of the loan from the Registered Holder and instead SBA purchases the guaranteed portion of the loan from the Registered Holder; or

(ii) SBA has purchased the guaranteed portion of a loan prior to completion of liquidation as provided in § 120.520(a)(1).

(2) *For loans approved before the effective date of this regulation.* SBA must obtain written consent from the Lender for the sale of such loans in an asset sale.

(c) *504 loans.* (1) *PCLP Loans.* After SBA's purchase of a Debenture, SBA may at its sole discretion sell a defaulted PCLP Loan in an asset sale conducted or overseen by SBA, after providing to the PCLP CDC that made the loan advance notice of not less than 90 days before the date upon which SBA first makes its records concerning such loan available to prospective purchasers for examination.

(2) *All other 504 loans.* After SBA's purchase of a Debenture, SBA may at its sole discretion sell a defaulted 504 loan in an asset sale conducted or overseen by SBA.

20. Revise § 120.826 to read as follows:

**§ 120.826 Basic requirements for operating a CDC.**

A CDC must operate in accordance with all Loan Program Requirements. In its Area of Operations, a CDC must market the 504 program, package and process 504 loan applications, close and service 504 loans, and if authorized by SBA, liquidate and litigate 504 loans. It must supply to SBA current and accurate information about all certification and operational requirements, and maintain the records and submit the reports required by SBA.

21. Revise § 120.841(c) to read as follows:

**§ 120.841 Qualifications for the ALP.**

\* \* \* \* \*

(c) Current reviews in compliance. SBA-conducted oversight reviews must be current (within past 12 months) for applicants for ALP status, and these reviews must have found the CDC to be in compliance with Loan Program Requirements.

\* \* \* \* \*

22. Revise § 120.845(c)(1) to read as follows:

**§ 120.845 Premier Certified Lenders Program (PCLP).**

\* \* \* \* \*

(c) \* \* \*

(1) The CDC must be an ALP CDC in substantial compliance with Loan Program Requirements or meet the criteria to be an ALP CDC set forth in § 120.841(a) through (h).

\* \* \* \* \*

23. Revise § 120.846(a)(3) to read as follows:

**§ 120.846 Requirements for maintaining and reviewing PCLP Status.**

(a) \* \* \*

(3) Substantially comply with all Loan Program Requirements.

\* \* \* \* \*

**Subpart H—Development Company Loan Program (504)**

24. Amend § 120.848 by revising paragraphs (a) and (f) to read as follows:

**§ 120.848 Requirements for 504 loan processing, closing, servicing, liquidating and litigating by PCLP CDCs.**

(a) *General.* In processing closing, servicing, liquidating and litigating 504 loans under the PCLP ("PCLP Loans"), the PCLP CDC must comply with Loan Program Requirements and conduct such activities in accordance with prudent and commercially reasonable lending standards.

\* \* \* \* \*

(f) *Servicing, liquidation and litigation responsibilities.* The PCLP CDC

generally must service, liquidate and litigate its entire portfolio of PCLP Loans, although SBA may in certain circumstances elect to handle such duties with respect to a particular PCLP Loan or Loans. Additional servicing and liquidation requirements are set forth in Subpart E.

\* \* \* \* \*

25. Revise § 120.854(a)(2) to read as follows:

**§ 120.854 Grounds for taking enforcement action against a CDC.**

(a) \* \* \*

(2) The CDC has failed to comply materially with any Loan Program Requirement.

\* \* \* \* \*

24. Amend § 120.970 by revising paragraphs (a) and (h) to read as follows:

**120.970 Servicing of 504 Loans and Debentures.**

(a) In servicing 504 loans, CDCs must comply with Loan Program Requirements and in accordance with prudent and commercially reasonable lending standards.

\* \* \* \* \*

(h) Additional servicing requirements are set forth in Subpart E.

26. Add a new undesignated center heading after § 120.972 to read as follows: Authority of CDCs to Perform Liquidation and Debt Collection Litigation.

27. Add § 120.975 to read as follows:

**§ 120.975 CDC Liquidation of Loans and Debt Collection Litigation.**

(a) *PCLP CDCs.* If a CDC is designated as a PCLP CDC under § 120.845, the CDC must liquidate and handle debt collection litigation with respect to all PCLP Loans in its portfolio on behalf of SBA as required by § 120.848(f), in accordance with subpart E of this part. With respect to all other 504 loans that a PCLP CDC makes, the PCLP CDC is an Authorized CDC Liquidator and must exercise its delegated authority to liquidate and handle debt-collection litigation in accordance with subpart E of this part for such loans, if the PCLP CDC is notified by SBA that it meets either of the following requirements to be an Authorized CDC Liquidator, as determined by SBA:

(1) The PCLP CDC has one or more employees who have not less than two years of substantive, decision-making experience in administering the liquidation and workout of defaulted or problem loans secured in a manner substantially similar to loans funded with 504 loan program debentures, and who have completed a training program on loan liquidation developed by the

Agency in conjunction with qualified CDCs that meet the requirements of this section; or

(2) The PCLP CDC has entered into a contract with a qualified third party for the performance of its liquidation responsibilities and obtains the approval of SBA with respect to the qualifications of the contractor and the terms and conditions of the contract.

(b) *All other CDCs.* A CDC that is not authorized under paragraph (a) of this section may apply to become an Authorized CDC Liquidator with authority to liquidate and handle debt collection litigation with respect to 504 loans on behalf of SBA, in accordance with subpart E of this part, if the CDC meets the following requirements:

(1) The CDC meets either of the following criteria:

(i) The CDC participated in the loan liquidation pilot program established by the Small Business Programs Improvement Act of 1996 prior to the effective date of this regulation; or

(ii) During the three fiscal years immediately prior to seeking such authority, the CDC made an average of not less than ten 504 loans per year; and

(2) The CDC meets either of the following requirements:

(i) The CDC has one or more employees who have not less than two years of substantive, decision-making experience in administering the liquidation and workout of defaulted or problem loans secured in a manner substantially similar to loans funded with 504 loan program debentures, and who have completed a training program on loan liquidation developed by the Agency in conjunction with qualified CDCs that meet the requirements of this section; or

(ii) The CDC has entered into a contract with a qualified third party for the performance of its liquidation responsibilities and obtains the approval of SBA with respect to the qualifications of the contractor and the terms and conditions of the contract.

(c) *CDC counsel.* To perform debt collection litigation under paragraphs (a) or (b) of this section, a CDC must also have either in-house counsel with adequate experience as approved by SBA or entered into a contract for the performance of debt collection litigation with an experienced attorney or law firm as approved by SBA.

(d) *Application for authority to liquidate and litigate.* To seek authority to perform liquidation and debt collection litigation under paragraphs (b) and (c) of this section, a CDC other than a PCLP CDC must submit a written application to SBA and include documentation demonstrating that the

CDC meets the requirements of paragraph (b) and (c) of this section. If a CDC intends to use a contractor to perform liquidation, it must obtain approval from SBA of both the qualifications of the contractor and the terms and conditions in the contract covering the CDC's retention of the contractor. SBA will notify a CDC in writing when the CDC can begin to perform liquidation and/or debt collection litigation under this section.

**Hector V. Barreto,**  
*Administrator.*

[FR Doc. 05-21681 Filed 11-2-05; 8:45 am]

**BILLING CODE 8025-01-P**

## LEGAL SERVICES CORPORATION

### 45 CFR Part 1631

#### Expenditure of Grant Funds

**AGENCY:** Legal Services Corporation.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This Notice of Proposed Rulemaking (NPRM) proposes to delete in its entirety of the Legal Services Corporation's regulation at 45 CFR part 1631, Expenditure of Grant Funds. The proposed deletion is warranted because the statutory authority for part 1631 is no longer the prevailing rule of law.

**DATES:** Comments on this NPRM are due on December 5, 2005.

**ADDRESSES:** Written comments may be submitted by mail, fax or e-mail to Mattie C. Condray at the addresses listed below.

**FOR FURTHER INFORMATION CONTACT:** Mattie C. Condray, Senior Assistant General Counsel, Office of Legal Affairs, Legal Services Corporation, 3333 K Street, NW., Washington DC 20007; 202-295-1624 (ph); 202-337-6519 (fax); [mcondray@lsc.gov](mailto:mcondray@lsc.gov).

**SUPPLEMENTARY INFORMATION:** Part 1631 provides that LSC grant recipients may not expend LSC funds except as in accordance with the restrictions and provisions contained in the Corporation's Fiscal Year 1986 appropriations measure (Pub. L. 99-180, 99 Stat. 1136), unless such funds are expended pursuant to a waiver from the Corporation. Part 1631 was promulgated in 1986 in response to Congressional concerns that some pre-1982 funds were being held by recipients and spent on activities which were not prohibited at the time the funds were appropriated, but which were later prohibited (and on which recipients could not spend currently appropriated funds). 51 FR 24826 (July 9, 1986).

In 2005, there is no longer any concern that recipients have any pre-1982 funds to spend. In addition, in 1996, Congress adopted new restrictions and provisions applicable to recipients of LSC funds which supersede the restrictions in Public Law 99-180. Public Law 104-134, 110 Stat. 1321. These restrictions have been incorporated by reference in each subsequent appropriation, including the current appropriation. Public Law 108-447, 118 Stat. 2809. These restrictions have been separately incorporated into LSC's regulations and removal of part 1631 will have no effect on the later restrictions and provisions imposed by Pub. L. 104-134. See, e.g., 45 CFR part 1610.

As part 1631 is now obsolete, LSC believes it is appropriate at this time to delete part 1631 in its entirety. LSC believes this action will streamline LSC's regulations and avoid any potential confusion the continued existence of part 1631 might create. Accordingly, LSC proposes to remove and reserve part 1631 from Chapter XVI of Title 45 of the Code of Federal Regulations.

### PART 1631—[REMOVED AND RESERVED]

For reasons set forth above, and under the authority of 42 U.S.C. 2996g(e), LSC proposes to remove and reserve 45 CFR Part 1631.

**Victor M. Fortuno,**  
*General Counsel and Vice President for Legal Affairs.*

[FR Doc. 05-21942 Filed 11-2-05; 8:45 am]

**BILLING CODE 7050-01-P**

## DEPARTMENT OF JUSTICE

### Bureau of Prisons

#### 28 CFR Part 524

[BOP-1131-P]

**RIN 1120-AB32**

#### Classification and Program Review

**AGENCY:** Bureau of Prisons, Justice.

**ACTION:** Proposed Rule.

**SUMMARY:** In this document, the Bureau of Prisons (Bureau) proposes to revise its regulations on classification and program review to remove unnecessary regulations and to ensure that classification and program review procedures adequately address inmate needs.

**DATES:** Comments due by January 3, 2006.

**ADDRESSES:** Our e-mail address is [BOPRULES@BOP.GOV](mailto:BOPRULES@BOP.GOV). Comments should be submitted to the Rules Unit, Office of General Counsel, Bureau of Prisons, 320 First Street, NW., Washington, DC 20534. You may view an electronic version of this rule at <http://www.regulations.gov>. You may also comment via the Internet to BOP at [BOPRULES@BOP.GOV](mailto:BOPRULES@BOP.GOV) or by using the <http://www.regulations.gov> comment form for this regulation. When submitting comments electronically you must include the BOP Docket No. in the subject box.

**FOR FURTHER INFORMATION CONTACT:** Sarah Qureshi, Office of General Counsel, Bureau of Prisons, phone (202) 307-2105.

**SUPPLEMENTARY INFORMATION:** In this document, we revise and streamline the regulations which set forth the classification and program review rules, which currently describe procedure, practice, and general statements of policy, to remove an unnecessary level of operational details with regard to the classification and program review process.

Details removed from the regulations will be addressed in our corresponding policy statement on the classification and review program. We do not, by this rule, intend to make any substantive changes to the current rules or to the classification and program review system. We merely intend to clarify and streamline the existing rules.

### Executive Order 12866

This regulation has been drafted and reviewed in accordance with Executive Order 12866, "Regulatory Planning and Review", section 1(b), Principles of Regulation. The Director, Bureau of Prisons has determined that this rule is not a "significant regulatory action" under Executive Order 12866, section 3(f), and accordingly this rule has not been reviewed by the Office of Management and Budget.

### Executive Order 13132

This regulation will not have substantial direct effects on the States, on the relationship between the national government and the States, or on distribution of power and responsibilities among the various levels of government. Therefore, under Executive Order 13132, we determine that this rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

### Regulatory Flexibility Act

The Director of the Bureau of Prisons, under the Regulatory Flexibility Act (5 U.S.C. 605(b)), reviewed this regulation