

develop, implement and actively monitor effective internal control systems and processes that will ensure continued conformance with the requirements of the PCLP. These systems should provide PCLP CDCs with early information on their performance. SBA also has developed management control systems to monitor individual PCLP CDCs, specifically the portfolio benchmark data and the management oversight reviews, and SBA provides this information to PCLP CDCs. With these internal and external control systems, SBA expects PCLP CDCs to constantly monitor their performance as a CDC and as a PCLP CDC and to be in a position to take appropriate and timely corrective action when necessary. Due to the risk inherent in the delegation of authority under the PCLP, SBA will move to timely suspend, terminate or decline to renew the PCLP status of PCLP CDCs that do not comply with the requirements of the PCLP. Significant problems with respect to liquidation and litigation activities by either a PCLP CDC or its contractor may, at SBA's option, also lead to the non-renewal of PCLP status.

Section 120.847, requirements for the loan loss reserve fund, is implemented as proposed, except for one change as discussed below.

To mitigate some of the potential risk of delegating additional authority to PCLP CDCs, pursuant to section 508(c)(1) of the Act, PCLP CDCs must establish and make deposits to a Loan Loss Reserve Fund ("LLRF"). The LLRF is a restricted account established for the purpose of accumulating deposits and limiting withdrawals to those SBA specifically authorizes. The PCLP CDC may use the deposits to reimburse SBA for 10 percent of any loss sustained by SBA as a result of a default in the payment of principal or interest on a debenture issued by the PCLP CDC using PCLP procedures ("PCLP debenture"). Pursuant to section 508(c)(3) of the Act, the LLRF must be composed of: (1) Segregated deposit accounts at one or more federally insured depository institutions subject to a collateral assignment to SBA; (2) irrevocable letters of credit in favor of SBA; or (3) some combination of the above. Due to the characteristics and cost of letters of credit, and in consultation with the CDC industry, SBA has determined that letters of credit do not currently represent a feasible option for PCLP CDCs. Consequently, SBA is not addressing letters of credit in this rule. However, SBA will continue to explore this option with the CDC industry, and will

promulgate regulations addressing letters of credit to the extent this becomes a feasible option.

Pursuant to section 508(b)(2)(c) of the Act, PCLP CDCs must reimburse SBA for 10 percent of any loss SBA incurs in connection with a default on a PCLP debenture and the regulation proposes how to measure SBA's loss. The statute and proposed rule also require that the LLRF maintain a deposit equal to one percent of the original principal amount of each PCLP debenture.

The LLRF must be a deposit account with a federally insured depository institution selected by the PCLP CDC. Following discussions with the CDC industry, SBA is aware that alternative accounts and financial instruments may offer greater returns on the LLRF. However, the Act restricts LLRFs to federally insured depository institutions and that language as well as other applicable law greatly limit the investment alternatives. This rule elaborates on what constitutes a deposit account acceptable to SBA. Also, to simplify the administration of the LLRF, this rule allows PCLP CDCs to pool loss reserves in a single segregated account. SBA generally does not anticipate that PCLP CDCs will incur significant fees in connection with their LLRFs, although PCLP CDCs will need to be mindful of breakage fees, should they place funds into certificates of deposit ("CDs"). This final rule goes on to make clear that the PCLP CDC will be responsible for any fees, costs and expenses incurred in connection with the LLRF.

Pursuant to section 508(c)(3) of the Act, any LLRF established by a PCLP CDC must be subject to a collateral assignment in favor of, and in a format acceptable to, SBA. Accordingly, a PCLP CDC must give SBA a first priority perfected security interest in each LLRF. The PCLP CDC must grant the security interest pursuant to a security agreement between the PCLP CDC and SBA, and the security interest must be subject to a control agreement between SBA, the PCLP CDC, and the applicable depository institution. The control agreement will include provisions requiring a depository institution to follow instructions from SBA regarding withdrawals without further consent from the PCLP CDC. The laws governing security interests in deposit accounts are complex, vary by jurisdiction, and are undergoing change. Therefore, when establishing an LLRF, a PCLP CDC must coordinate with the Lead SBA Office to develop, execute and deliver the required documentation. SBA field counsel will have a model control agreement, which they may need to modify to meet local legal requirements.

This final rule provides that the CDC must provide to the Lead SBA office a fully executed original copy of the security and control agreements which the Lead SBA Office will retain in its files. All associated documents must meet SBA requirements and occasional changes may be necessary. If a depository institution will not enter into or modify a control agreement or violates the terms of any such agreement, the PCLP CDC cannot maintain an LLRF with that institution.

Pursuant to section 508(c)(4) of the Act, PCLP CDCs are allowed to make required deposits to the LLRF associated with each loan in as many as three deposits, but specifies the minimum amount and timing of those deposits. This final rule sets forth the amount and timing of those deposits.

Due to its management control and oversight responsibilities, SBA must ensure that LLRFs: (1) Are properly established; (2) contain the required reserve amounts; and (3) are appropriately administered and controlled. Periodic reporting by PCLP CDCs to SBA on the amount of funds maintained in LLRFs is critical to ensuring that LLRFs are properly established and maintained. However, while LLRFs must contain deposits equal to one percent of each PCLP debenture, the deposits associated with each PCLP debenture may be made in as many as three installments. Also, during the normal course of a PCLP CDC's operations, LLRFs will be subject to a variety of other deposits and withdrawals (e.g., withdrawals associated with loans paid in full and defaults). As a result, reporting and reconciling LLRFs might become quite complex. SBA is concerned with the potential burden such reporting could represent to PCLP CDCs. SBA continues to work with the CDC industry to develop and test efficient and effective reporting procedures, and will publish appropriate procedural guidance as those procedures are finalized.

SBA will allow PCLP CDCs to withdraw any funds from the LLRFs that exceed required minimums, at SBA's discretion. Section 120.847(g) provides that requests for withdrawals must be forwarded to the Lead SBA Office, which will check the balances to ensure the required minimums are maintained and authorize withdrawals as appropriate.

Section 120.847(h) provides that when a PCLP CDC has submitted a liquidation wrap-up report to SBA, or SBA otherwise has determined that all reasonable collection efforts have been exhausted, the Lead SBA Office will calculate the SBA's loss and notify the