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

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Subpart A—Introduction to Part 107

§ 107.20 Legal basis and applicability of this part 107.

(a) The regulations in this part implement Title III of the Small Business Investment Act of 1958, as amended. All Licensees must comply with all applicable regulations, accounting guidelines and valuation guidelines for Licensees.

(b) Provisions of this part which are not mandated by the Act shall not supersede existing State law. A party claiming that a conflict exists shall submit an opinion of independent counsel, citing authorities, for SBA's resolution of the issues involved.

§ 107.30 Amendments to Act and regulations.

A Licensee shall be subject to all existing and future provisions of the Act and parts 107 and 112 of title 13 of the Code of Federal Regulations.

§ 107.40 How to read this part 107.

(a) *Center Headings.* All references in this part to SBA forms, and instructions for their preparation, are to the current issue of such forms. Center headings are descriptive and are used for convenience only. They have no regulatory effect.

(b) *Capitalizing defined terms.* Terms defined in § 107.50 are capitalized in this part 107.

(c) The pronoun "you" as used in this part 107 means a Licensee or license applicant, as appropriate, unless otherwise noted.

Subpart B—Definition of Terms Used in Part 107

§ 107.50 Definition of terms.

Accumulated Prioritized Payments has the meaning set forth in § 107.1520.

Act means the Small Business Investment Act of 1958, as amended.

Adjustments has the meaning set forth in § 107.1520.

Affiliate or *Affiliates* has the meaning set forth in § 121.103 of this chapter.

Articles mean articles of incorporation or charter for a Corporate Licensee and the partnership agreement

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or certificate for a Partnership Licensee.

Assistance or *Assisted* means Financing of or management services rendered to a Small Business by a Licensee pursuant to the Act and these regulations.

Associate of a Licensee means any of the following:

(1)(i) An officer, director, employee or agent of a Corporate Licensee;

(ii) A Control Person, employee or agent of a Partnership Licensee;

(iii) An Investment Adviser/Manager of any Licensee, including any Person who contracts with a Control Person of a Partnership Licensee to be the Investment Adviser/Manager of such Licensee; or

(iv) Any Person regularly serving a Licensee on retainer in the capacity of attorney at law.

(2) Any Person who owns or controls, or who has entered into an agreement to own or control, directly or indirectly, at least 10 percent of any class of stock of a Corporate Licensee or a limited partner's interest of at least 10 percent of the partnership capital of a Partnership Licensee. However, a limited partner in a Partnership Licensee is not considered an Associate if such Person is an entity Institutional Investor whose investment in the Partnership, including commitments, represents no more than 33 percent of the partnership capital of the Licensee and no more than five percent of such Person's net worth.

(3) Any officer, director, partner (other than a limited partner), manager, agent, or employee of any Associate described in paragraph (1) or (2) of this definition.

(4) Any Person that directly or indirectly Controls, or is Controlled by, or is under Common Control with, a Licensee.

(5) Any Person that directly or indirectly Controls, or is Controlled by, or is under Common Control with, any Person described in paragraphs (1) and (2) of this definition.

(6) Any Close Relative of any Person described in paragraphs (1),(2), (4), and (5) of this definition.

(7) Any Secondary Relative of any Person described in paragraphs (1), (2), (4), and (5) of this definition.

(8) Any concern in which—

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

(ii) Any such Person(s) singly or collectively Control or own, directly or indirectly, an equity interest of at least 10 percent (excluding interests that such Person(s) own indirectly through ownership interests in the Licensee).

(9) Any concern in which any Person(s) described in paragraph (7) of this definition singly or collectively own (including beneficial ownership) a majority equity interest, or otherwise have Control. As used in this paragraph (9), "collectively" means together with any Person(s) described in paragraphs (1) through (7) of this definition.

(10) For the purposes of this definition, if any Associate relationship described in paragraphs (1) through (7) of this definition exists at any time within six months before or after the date that a Licensee provides Financing, then that Associate relationship is considered to exist on the date of the Financing.

(11) If any Licensee has any ownership interest in another Licensee, the two Licensees are Associates of each other.

Capital Impairment has the meaning set forth in §107.1830(c).

Central Registration Agent or *CRA* means one or more agents appointed by SBA for the purpose of issuing TCs and performing the functions enumerated in §107.1620 and performing similar functions for Debentures and Participating Securities funded outside the pooling process.

Charge means an annual fee on Leverage issued on or after October 1, 1996 (except for Leverage issued pursuant to a commitment made by SBA before October 1, 1996), which is payable to SBA by Licensees, subject to the terms and conditions set forth in §107.1130(d).

Close Relative of an individual means:

(1) A current or former spouse;

(2) A father, mother, guardian, brother, sister, son, daughter; or

(3) A father-in-law, mother-in-law, brother-in-law, sister-in-law, son-in-law, or daughter-in-law.

Combined Capital means the sum of Regulatory Capital and outstanding Leverage.

Commitment means a written agreement between a Licensee and an eligible Small Business that obligates the Licensee to provide Financing (except a guarantee) to that Small Business in a fixed or determinable sum, by a fixed or determinable future date. In this context the term “agreement” means that there has been agreement on the principal economic terms of the Financing. The agreement may include reasonable conditions precedent to the Licensee’s obligation to fund the commitment, but these conditions must be outside the Licensee’s control.

Common Control means a condition where two or more Persons, either through ownership, management, contract, or otherwise, are under the Control of one group or Person. Two or more Licensees are presumed to be under Common Control if they are Affiliates of each other by reason of common ownership or common officers, directors, or general partners; or if they are managed or their investments are significantly directed either by a common independent investment advisor or managerial contractor, or by two or more such advisors or contractors that are Affiliates of each other. This presumption may be rebutted by evidence satisfactory to SBA.

Control means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a Licensee or other concern, whether through the ownership of voting securities, by contract, or otherwise.

Control Person means any Person that controls a Licensee, either directly or through an intervening entity. A Control Person includes:

- (1) A general partner of a Partnership Licensee;
- (2) Any Person serving as the general partner, officer, director, or manager (in the case of a limited liability company) of any entity that controls a Licensee, either directly or through an intervening entity;
- (3) Any Person that—
 - (i) Controls or owns, directly or through an intervening entity, at least 10 percent of a Partnership Licensee or

any entity described in paragraphs (1) or (2) of this definition; and

- (ii) Participates in the investment decisions of the general partner of such Partnership Licensee;

- (4) Any Person that controls or owns, directly or through an intervening entity, at least 50 percent of a Partnership Licensee or any entity described in paragraphs (1) or (2) of this definition.

Corporate Licensee. See definition of Licensee in this section.

Cost of Money has the meaning set forth in §107.855.

Debenture Rate means the interest rate, as published from time to time in the FEDERAL REGISTER by SBA, for ten year debentures issued by Licensees and funded through public sales of certificates bearing SBA’s guarantee. User or guarantee fees, if any, paid by a Licensee are not considered in determining the Debenture Rate.

Debentures means debt obligations issued by Licensees pursuant to section 303(a) of the Act and held or guaranteed by SBA.

Debt Securities has the meaning set forth in §107.815.

Disadvantaged Business means a Small Business that is at least 50 percent owned, and controlled and managed, on a day to day basis, by a person or persons whose participation in the free enterprise system is hampered because of social or economic disadvantages.

Distributable Securities means equity securities that are determined by SBA (with the advice of a third party expert in the marketing of securities) to meet each of the following requirements:

- (1) The securities (which may include securities that are salable pursuant to the provisions of Rule 144 (17 CFR 230.144) under the Securities Act of 1933, as amended) are salable immediately without restriction under Federal and state securities laws;
- (2) The securities are of a class:
 - (i) Which is listed and registered on a national securities exchange, or
 - (ii) For which quotation information is disseminated in the National Association of Securities Dealers Automated Quotation System and as to which transaction reports and last sale data are disseminated pursuant to Rule

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11Aa3-1 (17 CFR 240.11Aa3-1) under the Securities Exchange Act of 1934, as amended; and

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

Distribution means any transfer of cash or non-cash assets to SBA, its agent or Trustee, or to partners in a Partnership Licensee, or to shareholders in a Corporate Licensee. Capitalization of Retained Earnings Available for Distribution constitutes a Distribution to the Licensee's non-SBA partners or shareholders.

Earmarked Assets has the meaning set forth in §107.1510(b). (See also §107.1590.)

Earmarked Profit (Loss) has the meaning set forth in §107.1510.

Earned Prioritized Payments has the meaning set forth in §107.1520.

Equity Capital Investments means investments in a Small Business in the form of common or preferred stock, limited partnership interests, options, warrants, or similar equity instruments, including subordinated debt with equity features if such debt provides only for interest payments contingent upon and limited to the extent of earnings. Equity Capital Investments must not require amortization. Equity Capital Investments may be guaranteed; however, neither Equity Capital Investments nor such guarantee may be collateralized or otherwise secured. Investments classified as Debt Securities (see §§107.800 and 107.815) are not precluded from qualifying as Equity Capital Investments.

Equity Securities has the meaning set forth in §107.800.

Financing or *Financed* means outstanding financial assistance provided to a Small Business by a Licensee, whether through:

- (1) Loans;
- (2) Debt Securities;
- (3) Equity Securities;
- (4) Guarantees; or
- (5) Purchases of securities of a Small Business through or from an underwriter (see §107.825).

Guaranty Agreement means the contract entered into by SBA which is a guarantee backed by the full faith and

credit of the United States Government as to timely payment of principal and interest on Debentures or the Redemption Price of and Prioritized Payments on Participating Securities and SBA's rights in connection with such guarantee.

Includible Non-Cash Gains means those non-cash gains (as reported on SBA Form 468) that are realized in the form of Publicly Traded and Marketable securities or investment grade debt instruments. For purposes of this definition, investment grade debt instruments means those instruments that are rated "BBB" or "Baa", or better, by Standard & Poor's Corporation or Moody's Investors Service, respectively. Non-rated debt may be considered to be investment grade if Licensee obtains a written opinion from an investment banking firm acceptable to SBA stating that the non-rated debt instrument is equivalent in risk to the issuer's investment grade debt.

Institutional Investor means:

(1) *Entities*. Any of the following entities if the entity has a net worth (exclusive of unfunded commitments from investors) of at least \$1 million, or such higher amount as is specified in paragraph (1) of this definition. (See also §107.230(b)(4) for limitations on the amount of an Institutional Investor's commitment that may be included in Private Capital.)

(i) A State or National bank, trust company, savings bank, or savings and loan association.

(ii) An insurance company.

(iii) A 1940 Act Investment Company or Business Development Company (each as defined in the Investment Company Act of 1940, as amended (15 U.S.C. 8a-1 *et seq.*)).

(iv) A holding company of any entity described in paragraph (1)(i), (ii) or (iii) of this definition.

(v) An employee benefit or pension plan established for the benefit of employees of the Federal government, any State or political subdivision of a State, or any agency or instrumentality of such government unit.

(vi) An employee benefit or pension plan (as defined in the Employee Retirement Income Security Act of 1974, as amended (Pub. L. 93-406, 88 Stat. 829), excluding plans established under

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section 401(k) of the Internal Revenue Code of 1986 (26 U.S.C. 401(k)), as amended).

(vii) A trust, foundation or endowment exempt from Federal income taxation under the Internal Revenue Code of 1986, as amended.

(viii) A corporation, partnership or other entity with a net worth (exclusive of unfunded commitments from investors) of more than \$10 million.

(ix) A State, a political subdivision of a State, or an agency or instrumentality of a State or its political subdivision.

(x) An entity whose primary purpose is to manage and invest non-Federal funds on behalf of at least three Institutional Investors described in paragraphs (1)(i) through (1)(ix) of this definition, each of whom must have at least a 10 percent ownership interest in the entity.

(xi) Any other entity that SBA determines to be an Institutional Investor.

(2) *Individuals.* (i) Any of the following individuals if he/she is also a permanent resident of the United States:

(A) An individual who is an Accredited Investor (as defined in the Securities Act of 1933, as amended (15 U.S.C. 77a-77aa)) and whose commitment to the Licensee is backed by a letter of credit from a State or National bank acceptable to SBA.

(B) An individual whose personal net worth is at least \$2 million and at least ten times the amount of his or her commitment to the Licensee. The individual's personal net worth must not include the value of any equity in his or her most valuable residence.

(C) An individual whose personal net worth (determined in accordance with paragraph (2)(i)(B) of this definition) is at least \$10 million.

(ii) Any individual who is not a permanent resident of the United States but who otherwise satisfies paragraph (2)(i) of this definition *provided* such individual has irrevocably appointed an agent within the United States for the service of process.

Investment Adviser/Manager means any Person who furnishes advice or assistance with respect to operations of a Licensee under a written contract exe-

cuted in accordance with the provisions of § 107.510.

Lending Institution means a concern that is operating under regulations of a state or Federal licensing, supervising, or examining body, or whose shares are publicly traded and listed on a recognized stock exchange or NASDAQ and which has assets in excess of \$500 million; and which, in either case, holds itself out to the public as engaged in the making of commercial and industrial loans and whose lending operations are not for the purpose of financing its own or an Associate's sales or business operations.

Leverage means financial assistance provided to a Licensee by SBA, either through the purchase or guaranty of a Licensee's Debentures or Participating Securities, or the purchase of a Licensee's Preferred Securities, and any other SBA financial assistance evidenced by a security of the Licensee.

Leverageable Capital means Regulatory Capital, excluding unfunded commitments.

Licensee means either a corporation (Corporate Licensee), or a limited partnership organized pursuant to § 107.160 (Partnership Licensee), to which a license has been granted pursuant to the Act. For certain purposes, the Entity General Partner of a Partnership Licensee is treated as if it were a Licensee (see § 107.160(b)(2)).

LMI Enterprise means:

(1) A Small Business that has at least 50% of its employees or tangible assets located in LMI Zone(s) or in which at least 35% of the full-time employees have primary residences in LMI Zone(s), in either case determined as of the time of application for SBIC financing; or

(2) A Small Business that does not meet the requirements of paragraph (1) of this definition as of the time of application for SBIC financing but that certifies at such time that it intends to meet the requirements within 180 days after the closing of the SBIC financing. A Small Business qualifying under this paragraph (2) will no longer be an LMI Enterprise as of the 180th day after the closing of the SBIC financing unless, on or before such date, at least 50% of its employees or tangible assets are located in LMI Zones or at least 35% of

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its full-time employees have primary residences in LMI Zones.

LMI Investment means a financing of an LMI Enterprise, made after September 30, 1999, in the form of equity securities or debt securities that are junior to all existing or future secured borrowings of the business. The debt securities may be guaranteed and may be secured by the assets of the LMI Enterprise, but the guarantee may not be collateralized or otherwise secured.

LMI Zone means any area located within a HUBZone (as defined in 13 CFR 126.103), an Urban Empowerment Zone or Urban Enterprise Community (as designated by the Secretary of the Department of Housing and Urban Development), a Rural Empowerment Zone or Rural Enterprise Community (as designated by the Secretary of the Department of Agriculture), an area of Low Income or Moderate Income (as recognized by the Federal Financial Institutions Examination Council), or a county with Persistent Poverty (as classified by the Economic Research Service of the Department of Agriculture).

Loan has the meaning set forth in §107.810.

Loans and Investments means Portfolio Securities, Assets Acquired in Liquidation of Portfolio Securities, Operating Concerns Acquired, and Notes and Other Securities Received, as set forth in the Statement of Financial Position of SBA Form 468.

Management Expenses has the meaning set forth in §107.520.

1940 Act Company means a Licensee which is registered under the Investment Company Act of 1940.

1980 Act Company means a Licensee which is registered under the Small Business Investment Incentive Act of 1980.

Original Issue Price means the price paid by the purchaser for securities at the time of issuance.

Participating Securities means preferred stock, preferred limited partnership interests, or similar instruments issued by Licensees, including debentures having interest payable only to the extent of earnings, all of which are subject to the terms set forth in §§107.1500 through 107.1590 and section 303(g) of the Act.

Partnership Licensee. See definition of Licensee in this section.

Payment Date means, for a Participating Securities issuer, each February 1, May 1, August 1, and November 1 during the term of a Participating Security.

Person means a natural person or legal entity.

Pool means an aggregation of SBA guaranteed Debentures or SBA guaranteed Participating Securities approved by SBA.

Portfolio means the securities representing a Licensee's total outstanding Financing of Small Businesses. It does not include idle funds or assets acquired in liquidation of Portfolio securities.

Portfolio Concern means a Small Business Assisted by a Licensee.

Preferred Securities means nonvoting preferred stock or nonvoting limited partnership interests issued to SBA prior to October 1, 1996, by a Section 301(d) Licensee. Such securities were issued at par value in the case of preferred stock, or at face value in the case of preferred limited partnership interests.

Prioritized Payments has the meaning set forth in §107.1520.

Private Capital has the meaning set forth in §107.230.

Profit Participation has the meaning set forth in §107.1500(c)(3).

Publicly Traded and Marketable means securities that are salable without restriction or that are salable within 12 months pursuant to Rule 144 (17 CFR 230.144) of the Securities Act of 1933, as amended, by the holder thereof (or in the case of an In-kind Distribution by the distributee thereof), and are of a class which is traded on a regulated stock exchange, or is listed in the Automated Quotation System of the National Association of Securities Dealers (NASDAQ), or has, at a minimum, at least two market makers as defined in the relevant sections of the Securities Exchange Act of 1934, as amended (15 U.S.C. 77b *et seq.*), and in all cases the quantity of which can be sold over a reasonable period of time without having an adverse impact upon the price of the stock.

Qualified Non-private Funds has the meaning set forth in §107.230.

Redemption Price means the amount required to be paid by the issuer, or successor to the issuer, of Preferred or Participating Securities to repurchase such securities from the holder. The Redemption Price shall be the Original Issue Price less any prepayments or prior redemptions.

Regulatory Capital means:

(1) *General.* Regulatory Capital means Private Capital, excluding non-cash assets contributed to a Licensee or a license applicant, and non-cash assets purchased by a license applicant, unless such assets have been converted to cash or have been approved by SBA for inclusion in Regulatory Capital. For purposes of this definition, sales of contributed non-cash assets with recourse or borrowing against such assets shall not constitute a conversion to cash.

(2) *Exclusion of questionable commitments.* An investor's commitment to a Licensee is excluded from Regulatory Capital if SBA determines that the collectibility of the commitment is questionable.

Retained Earnings Available for Distribution means Undistributed Net Realized Earnings less any Unrealized Depreciation on Loans and Investments (as reported on SBA Form 468), and represents the amount that a Licensee may distribute to investors (including SBA) as a profit Distribution, or transfer to Private Capital.

SBA means the Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

Secondary Relative of an individual means:

(1) A grandparent, grandchild, or any other ancestor or lineal descendent who is not a Close Relative;

(2) An uncle, aunt, nephew, niece, or first cousin; or

(3) A spouse of any person described in paragraph (1) or (2) of this definition.

Section 301(c) Licensee has the meaning set forth in §107.100.

Section 301(d) Licensee means a company licensed prior to October 1, 1996 under section 301(d) of the Act as in effect on the date of licensing, that may provide Assistance only to Disadvantaged Businesses. A Section 301(d) Licensee may be organized as a for-profit

corporation, as a non-profit corporation, or as a limited partnership.

Short-term Financing means Financing for a term of less than five years in accordance with the regulations.

SIC Manual means the latest issue of the Standard Industrial Classification Manual, prepared by the Office of Management and Budget, and available from the U.S. Government Printing Office, Superintendent of Documents, P.O. Box 371954, Pittsburgh, Pa., 15250-7954.

Small Business means a small business concern as defined in section 103(5) of the Act (including its Affiliates), which for purposes of size eligibility, meets the applicable criteria set forth in part 121 of this chapter.

Smaller Enterprise has the meaning set forth in §107.710.

Start-up Financing means an Equity Capital Investment in a Small Business that—

(1) Has not had sales exceeding \$3,000,000 or positive cash flow from operations in any of its last three full fiscal years; and

(2) Was not formed to acquire any existing business, unless the acquired business satisfies paragraphs (1) and (2) of this definition.

Temporary Debt has the meaning set forth in §107.570.

Trust means the legal entity created for the purpose of holding guaranteed Debentures or Participating Securities and the guaranty agreement related thereto, receiving, holding and making any related payments, and accounting for such payments.

Trust Certificate Rate means a fixed rate determined by the Secretary of the Treasury at the time Participating Securities or Debentures are pooled, taking into consideration the current average market yield on outstanding marketable obligations of the United States with maturities comparable to the maturities of the Trust Certificates being guaranteed by SBA, adjusted to the nearest one-eighth of one percent.

Trust Certificates (TCs) means certificates issued by SBA, its agent or Trustee and representing ownership of all or a fractional part of a Trust or Pool of Debentures or Participating Securities.

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Trustee means the trustee or trustees of a Trust.

Undistributed Net Realized Earnings means Undistributed Realized Earnings less Non-cash Gains/Income, each as reported on SBA Form 468.

Unrealized Appreciation means the amount by which a Licensee's valuation of each of its Loans and Investments, as determined by its Board of Directors or General Partner(s) in accordance with Licensee's valuation policies, exceeds the cost basis thereof.

Unrealized Depreciation means the amount by which a Licensee's valuation of each of its Loans and Investments, as determined by its Board of Directors or General Partner(s) in accordance with Licensee's valuation policies, is below the cost basis thereof.

Unrealized Gain (Loss) on Securities Held means the sum of the Unrealized Appreciation and Unrealized Depreciation on all of a Licensee's Loans and Investments, less estimated future income tax expense or estimated realizable future income tax benefit, as appropriate.

Venture Capital Financing has the meaning set forth in §107.1160.

Wind-up Plan has the meaning set forth in §107.590.

[61 FR 3189, Jan. 31, 1996; 61 FR 41496, Aug. 9, 1996, as amended at 62 FR 11759, Mar. 13, 1997; 63 FR 5865, Feb. 5, 1998; 64 FR 52645, Sept. 30, 1999; 64 FR 70995, Dec. 20, 1999]

Subpart C—Qualifying for an SBIC License

ORGANIZING AN SBIC

§ 107.100 Organizing a Section 301(c) Licensee.

Section 301(c) Licensee means a company licensed under section 301(c) of the Act. It may be organized as a for-profit corporation or as a limited partnership created in accordance with the special rules of §107.160.

§ 107.115 1940 Act and 1980 Act Companies.

A 1940 Act or 1980 Act Company is eligible to apply for an SBIC license, and an existing Licensee is eligible to apply for SBA's approval to convert to a 1940 Act or 1980 Act Company. In either case, the 1940 Act or 1980 Act Company

may elect to be taxed as a regulated investment company under section 851 of the Internal Revenue Code of 1986, as amended (26 U.S.C. 851). However, a Licensee making such election may make Distributions only as permitted under the applicable sections of this part (see the definition of Retained Earnings Available for Distribution, §107.585, and §§107.1540 through 107.1580).

§ 107.120 Special rules for a Section 301(d) Licensee owned by another Licensee.

With SBA's prior written approval, a Section 301(d) Licensee may operate as the subsidiary of one or more Licensees (participant Licensees), subject to the following:

(a) Each participant Licensee must own at least 20 percent of the voting securities of the Section 301(d) Licensee.

(b) A participant Licensee must treat its entire capital contribution to the subsidiary as a reduction of its Leverageable Capital. The participant Licensee's remaining Leverageable Capital must be sufficient to support its outstanding Leverage.

(c) A participant Licensee may not transfer its Leverage to a subsidiary Section 301(d) Licensee.

[63 FR 5865, Feb. 5, 1998]

§ 107.130 Requirement for qualified management.

When applying for a license, you must show, to the satisfaction of SBA, that your current or proposed management is qualified and has the knowledge, experience, and capability necessary for investing in the types of businesses contemplated by the Act, these regulations and your business plan. You must designate at least one individual as the official responsible for contact with SBA.

§ 107.140 SBA approval of initial Management Expenses.

If you plan to obtain Leverage, you must have your Management Expenses approved by SBA at the time of licensing. (See §107.520 for the definition of Management Expenses.)