

the entire indebtedness of the Licensee being declared due and payable.

v. If SBA decides to demand payment in accordance with the acceleration provisions of the debentures, such demand ordinarily will be presented in a letter specifying the violations that have occurred.

T. Leverage—Participating Securities Guaranteed by SBA

i. Participating Securities are redeemable preferred equity-type securities. Issuers are required to make equity investments in an amount at least equal to the amount of Participating Securities issued (see the defined term "Equity Capital Investments" in § 107.3 for the specific categories of investments permitted). The structure, terms and conditions of the Participating Security are set forth in detail in §§ 107.240 through 107.247.

ii. The Act authorizes SBA to guarantee Participating Securities issued in the form of limited partnership interests, preferred stock, or debentures with interest payable only to the extent of earnings. Currently, the only form of Participating Security for which documentation has been created is a limited partnership interest to be held by SBA. Other forms will be made available in the future as required to meet the needs of Licensees.

iii. The Participating Security has the following significant features:

(1) Licensees issue Participating Securities to SBA, which in turn assigns certain of its interests in such securities to a pool. Investors (known as "certificate holders") then purchase interests in the pool through a public offering. Each Licensee issuing Participating Securities pays a cumulative preferred return ("Prioritized Payments") which is passed through to the certificate holders, but such payments are contingent upon the profitability of the issuer. Any Prioritized Payments which exceed the cumulative earnings of a Licensee will be paid to the certificate holders by SBA as guarantor. The Licensee, however, will be ineligible to make any other profit distributions until it has paid all of its Prioritized Payments (including reimbursement of amounts previously advanced on its behalf by SBA).

(2) In consideration for SBA's guarantee, profitable Licensees must pay a percentage of earnings to SBA as "Profit Participation". SBA's profit percentage (the "Profit Participation Rate") depends upon the Licensee's ratio of Participating Securities issued to Leverageable Capital, as well as the interest rate on 10-year Treasury securities at the time each Participating Security was issued.

(3) Except for Prioritized Payments, SBA (the "Preferred Limited Partner") and the Licensee's private limited partners receive distributions at the same time, allocated in accordance with legislative formulas.

(4) The securities have a 10-year term, at the end of which redemption is mandatory. It is expected, however, that most Participating Securities will be redeemed, at least in part, before the mandatory redemption date.

iv. Participating Securities will be reported in a "Redeemable Securities" section of the

Statement of Financial Position on SBA Form 468. The amount of Participating Securities issued represents the capital contribution of SBA, the Preferred Limited Partner. SBA's capital account will increase by the amount of any Prioritized Payments or Profit Participation which the Licensee becomes obligated to pay on the basis of profits earned, and will decrease as distributions are actually received. Distributions to SBA will be applied as Prioritized Payments, Profit Participation, or redemptions of outstanding leverage in accordance with §§ 107.243 through 107.245.

v. In a footnote to the financial statements, the Licensee shall provide a description of the terms of the Participating Securities issued, including disclosure of the mandatory redemption date. If there are any "accumulated" Prioritized Payments (representing a contingency for amounts paid to certificate holders by SBA on the Licensee's behalf, which the Licensee must repay as profits are realized), a footnote shall provide the dollar amount of the accumulation for the current fiscal year period and the aggregate amount accumulated.

vi. For companies licensed after March 31, 1993, the obligation to pay Prioritized Payments and Profit Participation is conditioned upon the profitability of the Licensee as a whole. Those licensed earlier, however, may be permitted to exclude profits attributable to portfolio assets in existence as of March 31, 1993.

vii. Because of the complexity of the required profit and distribution computations, all Licensees issuing Participating Securities shall use SBA-provided software to perform such computations.

U. Preferred Securities Leverage for Section 301(d) Licensees

i. *Four Percent Preferred Securities.* Section 301(d) Licensees which qualify on the basis of financial soundness and regulatory compliance are eligible to receive long-term leverage by selling 4% redeemable preferred securities (either preferred stock or a preferred limited partnership interest) directly to SBA. Such securities must be redeemed not later than 15 years from the date of issuance, at which time any unpaid portion of the preferred and cumulative 4% return due to SBA must also be paid. No distributions may be made to any investor other than SBA unless the Licensee is current on all amounts due SBA.

ii. Like Participating Securities, 4% preferred securities will be reported in the "Redeemable Securities" section of the Statement of Financial Position on SBA Form 468. Unlike Participating Securities, however, which specifically provide for the extinguishment of any obligation to pay Prioritized Payments in excess of the issuer's profits, the legislation which authorized 4% preferred securities does not set forth any circumstances in which the 4% return would be extinguished.

iii. The initial carrying amount of 4% preferred securities shall be the purchase price paid by SBA at the date of issue (for 4% preferred stock issued by corporate

Licensees, this amount must be equal to the par value). At the end of each accounting period, the carrying amount shall be increased by the amount of any 4% returns not currently paid or declared. A breakdown of the total carrying amount, showing separately the purchase price of 4% preferred securities and the accrued 4% returns in arrears, is reported on the Statement of Financial Position.

iv. Cumulative 4% returns in arrears must be recorded as a charge against Undistributed Net Realized Earnings. For some Section 301(d) Licensees, these amounts may exceed Undistributed Net Realized Earnings. Ordinarily, a company in these circumstances would reduce paid-in capital or partners' contributed capital by the amount of the excess. Because such treatment would reduce Regulatory Capital, however, it could result in certain unintended regulatory compliance problems for Licensees (such as overline violations). Therefore, on SBA Form 468, Licensees shall report all 4% returns in arrears as a reduction of Undistributed Net Realized Earnings, even though this treatment may result in a deficit, and shall not reduce paid-in capital or partners' contributed capital.

v. Because Section 301(d) Licensees must charge the 4% return to Undistributed Net Realized Earnings whether it is paid or not, any unpaid amounts must be added back in order to determine a Licensee's Retained Earnings Available for Distribution. Unpaid 4% returns must be paid in full from Retained Earnings Available for Distribution before any other distributions can be made.

vi. In a footnote to the financial statements, the Licensee must provide a description of the terms of the preferred securities issue, including disclosure of the mandatory redemption date. If there are 4% returns in arrears, a footnote shall provide the dollar amount of the arrearage for the current fiscal period, the aggregate amount in arrears, and the number of periods in arrears.

vii. *Three Percent Preferred Stock.* Before November 21, 1989, corporate Section 301(d) Licensees were eligible to receive long-term leverage by issuing 3% cumulative preferred stock to SBA at par value. Three percent preferred stock has no mandatory redemption date and is classified as equity for financial reporting purposes. However, it shall not be treated as Regulatory or Leverageable Capital for any purpose.

viii. No dividends may be paid to any investor other than SBA unless the Licensee is current on all 3% preferred dividends due SBA.

ix. *Three Percent Preferred Stock Repurchase Program.* SBA published in the **Federal Register** a notice announcing the implementation of a program under which Section 301(d) Licensees may apply to repurchase their outstanding 3% preferred stock from SBA at a set price of 35 percent of par value. Specific guidelines governing repurchase transactions are set forth in SBA Policy and Procedural Release #2021, issued June 14, 1994. Licensees will have three years from the date of the Policy and Procedural Release during which to apply for and complete the Repurchase Program.

x. Participants in the Repurchase Program will receive detailed accounting guidance