

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.

FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

5 CFR Parts 1605, 1620, 1651, and 1655

Correction of Administrative Errors; Expanded and Continuing Eligibility; Death Benefits; Loan Program

AGENCY: Federal Retirement Thrift Investment Board.

ACTION: Proposed rule with request for comments.

SUMMARY: The Executive Director of the Federal Retirement Thrift Investment Board (Board) proposes to revise the Board's Uniformed Services Employment and Reemployment Rights (USERRA) regulations regarding Thrift Savings Plan (TSP) contributions and loan payments, and to update the definitions used in those regulations. The Executive Director also proposes to amend the Board's death benefit regulations to allow the spouse of a deceased participant to transfer a TSP death benefit payment to an eligible retirement plan or to the spouse's existing TSP account. Finally, the Executive Director proposes to amend the Board's loan regulations to explain that the Soldier's and Sailors' Civil Relief Act of 1940 allows a participant returning to civilian service from active duty military service to reduce to 6 percent the interest rate owed on a TSP loan for the period of missed TSP loan payments due to military leave.

DATES: Comments must be received on or before June 17, 2002.

ADDRESSES: Comments may be sent to Patrick J. Forrest, Federal Retirement Thrift Investment Board, 1250 H Street, NW., Washington, DC 20005. The Board's Fax number is (202) 942-1676.

FOR FURTHER INFORMATION CONTACT: Patrick J. Forrest on (202) 942-1661.

SUPPLEMENTARY INFORMATION: The Board administers the TSP, which was established by the Federal Employees' Retirement System Act of 1986 (FERSA), Public Law 99-335, 100 Stat. 514. The TSP provisions of FERSA have

been codified, as amended, largely at 5 U.S.C. 8351 and 8401-79. The TSP is a tax-deferred retirement savings plan for Federal civilian employees and members of the uniformed services which is similar to cash or deferred arrangements established under section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)).

Contributions

Section 4(a)(1) of the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), codified at 5 U.S.C. 8351(b)(8) and 8432b, describes the rights to TSP benefits afforded to civilian TSP participants who are reemployed in civilian service or restored from a nonpay status to pay status following a release from military service, discharge from hospitalization related to that service, or other similar event. On June 9, 1999, the Board published a final rule in the **Federal Register** (64 FR 31052) to explain how TSP participants can obtain the benefits of USERRA. The rule is codified at 5 CFR part 1620, subpart E; this proposed rule amends the final rule.

Current § 1620.42 explains that a participant can make up TSP contributions missed due to military service if he or she is reemployed or restored to pay status in the civilian service under USERRA. It provides that a participant can file a contribution election immediately when he or she returns to civilian service under USERRA, and does not have to wait for an Open Season to begin making current TSP contributions. Section 1620.42 does not place a time limit on making an immediate contribution election under USERRA. Under 5 CFR 1600.12(a)(1) and 1604.3(b), new civilian employees and service members can file a TSP contribution election any time within the first 60 days of their hiring or appointment, without waiting for a TSP Open Season. Experience has shown this to be an adequate time for making a contribution election. Therefore, the Executive Director proposes to amend § 1620.42 to adopt a 60-day time limit for the filing of contribution elections under USERRA.

The regulation at 5 CFR 1605.31, published by the Board in the **Federal Register** on August 22, 2001 (66 FR 44276), explains how to compute USERRA makeup contributions. It does

not explain how a participant's right to make up contributions under USERRA is affected by contributions the participant made to a uniformed services TSP account under 5 U.S.C. 8440e during his or her period of military service. The Executive Director proposes to revise § 1605.31(c) to explain that the amount of employee makeup contributions must be reduced by the amount the participant contributed to his or her uniformed services TSP account. In addition, proposed § 1605.31(c) explains that a FERS participant who made contributions from basic pay to a uniformed services account during a period of military service will immediately upon return to civilian service or pay status receive agency matching makeup contributions to his or her civilian account for those uniformed services contributions. Finally, proposed § 1605.31(c) explains that a participant who makes up missed employee contributions will receive attributable agency matching contributions to the extent he or she did not receive matching contributions on employee contributions made to a uniformed services account.

Loans and Withdrawals

The repayment of a TSP loan is governed by FERSA, the Internal Revenue Code, and by the regulations issued by the Internal Revenue Service (IRS) and the Board. Section 414(u) of the Internal Revenue Code (26 U.S.C. 414(u)) establishes the Federal income tax rules relating to USERRA. Under section 414(u)(4) and the IRS regulations interpreting that provision (26 CFR 1.72(p)-1, Q&A-9), a retirement plan may suspend a participant's obligation to make loan payments during a period of military service.

Under the Board's current regulations, the TSP will declare a loan to be a taxable distribution if a participant separates from service without repaying the loan or is in nonpay status for more than one year. 5 CFR 1655.13(a)(1), (a)(2). A participant may be eligible to have the taxable distribution reversed if he or she is reemployed or restored to pay status under USERRA. 5 CFR 1620.45(b). If the participant is eligible to have the distribution reversed, the TSP will reinstate the loan so that the participant can resume loan payments, subject to limitations on the term of a

TSP loan, or give the participant an opportunity to repay the loan in full. If reinstated, a general purpose TSP loan must be repaid within five years of disbursement; a residential TSP loan must be repaid within 18 years of disbursement.

The Executive Director proposes to amend § 1620.45 to provide for the suspension of loan payments for a participant who enters nonpay status to perform military service beyond one year, thereby avoiding a taxable distribution. Interest will accrue on the loan during the period that payments are suspended. When the participant returns to pay status, the loan payments will resume and the period of military service will be added to the loan repayment period. Therefore, the participant or the employing agency must notify the TSP record keeper of the beginning and ending dates of military service.

Under the proposed amendment, the TSP will continue to close a loan account and declare a taxable distribution if a participant separates from government employment and does not repay the loan, or if the participant is in nonpay status for more than one year and the TSP does not receive documentation that the nonpay status is due to military service. However, if the participant in fact separated or entered nonpay status to perform military service, he or she can later request that the loan be reinstated when the participant is reemployed or returns to pay status under USERRA.

Current § 1620.45(c) allows a participant who is reemployed pursuant to USERRA one year to decide whether to reinstate a loan or to return a mandatory withdrawal that was paid out when the participant separated from civilian service. In analogous situations, where participants are separated from Federal service and later reinstated, TSP regulations give participants 90 days to decide whether to reinstate a loan or return a withdrawal. See 5 CFR 1605.13(d) and (e). In the interest of conformity, the Executive Director proposes to amend § 1620.45 to provide a 90-day period for the same decisions by members of the uniformed services.

The Executive Director also proposes an amendment to the Board's loan regulations which is unrelated to USERRA. The TSP's loan regulations were first published in the **Federal Register** on January 10, 1990, and amended on November 18, 1996, and August 26, 1998 (55 FR 978, 61 FR 58754, 63 FR 45391, respectively). Those regulations are codified at 5 CFR part 1655. Current § 1655.7 states that the interest rate for a TSP loan is

established at the time the loan is approved and remains constant for the life of the loan. However, under the Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C. app. 526, when a person enters active duty military service, no obligation or liability incurred before entry into active duty military service may continue to bear an interest rate in excess of 6 percent per annum. The Board interprets the term "obligation" to apply to a TSP loan because a participant is required by statute and regulation to repay a TSP loan with interest, even though the repayment is to his or her own account. Therefore, the Executive Director is proposing to amend § 1655.7 to provide that a participant who returns to civilian service from active duty military service may request that the interest rate on his or her TSP loan be reduced to 6 percent for the period the participant was in active duty military service. The proposed amendment also explains the process for requesting this benefit.

USERRA Definitions

The Executive Director also proposes to revise the definition section of the USERRA regulation, 5 CFR 1620.41. Specifically, the definitions "basic pay" and "leave without pay" are deleted because they are not used in the regulatory text. In addition, the definitions "current contributions" and "reemployed or reemployment" are simplified; the definition "separation or separated" is rewritten as "separate from civilian service" to conform to the usage in the proposed rule; and the definitions "retroactive period," "retroactive period beginning date," and "retroactive period ending date" are updated and condensed into one definition to reflect a recent amendment to FERSA allowing employees who are reemployed or returned to pay status immediately to begin making TSP contributions.

Death Benefits

FERSA provides that a deceased participant's TSP account will be paid to his or her beneficiary or beneficiaries. 5 U.S.C. 8433(e) and 8424(d). The Board's regulations governing the payment of a TSP death benefit were published in the **Federal Register** on June 13, 1997 (62 FR 32426) and are codified at 5 CFR part 1651.

Current § 1651.14(c) states that a deceased participant's spouse may transfer a TSP death benefit payment to an individual retirement account (IRA), but not to another eligible retirement plan. That provision is based on section 402(c)(9) of the Internal Revenue Code (26 U.S.C. 402(c)(9)), in effect before

January 1, 2002. However, the Internal Revenue Code was amended effective January 1, 2002, to provide that a death benefit may be transferred to any eligible retirement plan described at 26 U.S.C. 402(c)(8). See The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, Public Law 107-16, sec. 641(d), 115 Stat. 38, at 120. The Executive Director is proposing to adopt this policy for the TSP by amending § 1651.14(c).

Since the TSP itself is an eligible retirement plan, the Executive Director also proposes to permit the spouse of a deceased TSP participant to transfer a TSP death benefit payment from the deceased participant's account to the spouse's TSP account (if he or she has one). Proposed § 1651.14(c) explains how such a transfer can be requested.

Finally, the proposed rule amends §§ 1651.2, 1651.5, and 1651.14 to substitute the word "spouse" for the words "widow" and "widower." This change conforms the terms used in the death benefit regulations to those used in TSP publications.

Regulatory Flexibility Act

I certify that these regulations will not have a significant economic impact on a substantial number of small entities. They will affect only employees of the Federal Government.

Paperwork Reduction Act

I certify that these regulations do not require additional reporting under the criteria of the Paperwork Reduction Act of 1980.

Unfunded Mandates Reform Act of 1995

Pursuant to the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 602, 632, 653, 1501-1571, the effects of this regulation on state, local, and tribal governments and the private sector have been assessed. This regulation will not compel the expenditure in any one year of \$100 million or more by state, local, and tribal governments, in the aggregate, or by the private sector. Therefore, a statement under § 1532 is not required.

List of Subjects

5 CFR Part 1605

Claims, Employment benefit plans, Government employees, Military personnel, Pensions, Retirement.

5 CFR Part 1620

District of Columbia, Employment benefit plans, Government employees, Military personnel, Pensions, Retirement.

5 CFR Part 1651

Employment benefit plans,
Government employees, Pensions,
Retirement.

5 CFR Part 1655

Employment benefit plans,
Government employees, Military
personnel, Pensions, Retirement.

Roger W. Mehle,

*Executive Director, Federal Retirement Thrift
Investment Board.*

For the reasons set forth in the
preamble, the Board proposes to amend
5 CFR chapter VI as follows:

PART 1605—CORRECTION OF ADMINISTRATIVE ERRORS

1. The authority citation for part 1605
is revised to read as follows:

Authority: 5 U.S.C. 8351, 8432a, and
8474(b)(5) and (c)(1).

Section 1605.14 also issued under Title II,
Pub. L. 106–265, 114 Stat. 770.

Subpart D also issued under 5 U.S.C.
8432b(b)(4) and (i); Div. A, Title VI, sec.
661(b), Pub. L. 106–65, 114 Stat. 1654.

Subpart D—Miscellaneous Provisions

2. Section 1605.31 is revised to read
as follows:

§ 1605.31 Contributions missed as a result of military service.

(a) *Applicability.* This section applies
to employees who meet the conditions
specified at 5 CFR 1620.40 and who are
eligible to make up employee
contributions or to receive employing
agency contributions missed as a result
of military service.

(b) *Missed employee contributions.*
An employee who separates or enters
nonpay status to perform military
service may be eligible to make up TSP
contributions when he or she is
reemployed or restored to pay status in
the civilian service. Eligibility for
making up missed employee
contributions will be determined in
accordance with the rules specified at 5
CFR part 1620, subpart E. Missed
employee contributions must be made
up in accordance with the rules set out
in § 1605.11(c) and the following
procedures:

(1) The employing agency will use the
contribution election on file for the
employee at the time he or she
separated or was placed in nonpay
status. If an employee terminated TSP
contributions within two months before
entry into military service, he or she
may make a retroactive election to
resume contributions for the first open
season following the termination. The
employee may also make retroactive

contribution elections for any open
season that occurred during the period
of military service, as described at 5
CFR 1620.42.

(2) The pay used to determine the
amount of contributions eligible for
makeup is the pay the employee would
have earned had he or she remained
continuously employed in the position
held immediately before the separation
or placement in nonpay status.

(3) If the employee contributed to a
uniformed services TSP account during
the period of military service, the
amount of employee contributions
available for makeup will be reduced by
the total amount of employee
contributions made to the uniformed
services TSP account. (This includes
contributions from basic pay, incentive
pay, and special pay, including bonus
pay.)

(c) *Missed agency contributions.* A
FERS employee who separates or enters
nonpay status to perform military
service is eligible to receive agency
makeup contributions when he or she is
reemployed or restored to pay status in
the civilian service, as follows:

(1) The employee is entitled to receive
the agency automatic (1%) contributions
that he or she would have received had
the employee remained in civilian
service or pay status. Within 60 days of
the employee's reemployment or
restoration to pay status, the employing
agency must calculate the agency
automatic (1%) makeup contributions
and report those contributions to the
record keeper. After the contribution
has been reported, the agency must
submit lost earnings records for the
contribution.

(2) An employee who contributed to
a uniformed services TSP account
during the period of military service is
also immediately entitled to receive
agency matching makeup contributions
to his or her civilian account for the
employee contributions to the
uniformed services account that were
deducted from his or her basic pay,
subject to any reduction in matching
contributions required by paragraph
(c)(4) of this section. However, an
employee is not entitled to receive
agency matching makeup contributions
on contributions that were deducted
from his or her incentive pay or special
pay, including bonus pay, while
performing military service.

(3) An employee who makes up
missed contributions is entitled to
receive attributable agency matching
makeup contributions (unless the
employee has already received the
maximum amount of matching
contributions, as described in

paragraphs (c)(2) and (c)(4) of this
section).

(4) If the employee received
uniformed services matching
contributions, the agency matching
makeup contributions will be reduced
by the amount of the uniformed services
matching contributions.

(d) *Lost earnings.* The employing
agency will submit lost earnings records
pursuant to 5 CFR part 1606 for missed
agency contributions received by the
employee under paragraph (c) of this
section. The employee will elect to have
the lost earnings calculated using either
the rates of return based on the
contributions allocation(s) on file for the
participant during the period of military
service or using the rates of return for
the G Fund; the participant must make
this election at the same time his or her
makeup schedule is established
pursuant to § 1606.11(c).

PART 1620—EXPANDED AND CONTINUING ELIGIBILITY

3. The authority citation for part 1620
continues to read as follows:

Authority: 5 U.S.C. 8474(b)(5) and (c)(1).

Subpart C also issued under 5 U.S.C.
8440a(b)(7), 8440b(b)(8), and 8440c(b)(8).

Subpart D also issued under Pub. L. 104–
106, sec. 1043(b), 110 Stat. 186, 434–5; and
Pub. L. 101–508, sec. 7202(m)(2), 104 Stat.
1388.

Subpart E also issued under 5 U.S.C.
8432b(i) and Div. A, Title VI, sec. 661(b),
Pub. L. 106–65, 114 Stat. 1654.

Subpart E—Uniformed Services Employment and Reemployment Rights Act (USERRA)—Covered Military Service

4. Section 1620.41 is revised to read
as follows:

§ 1620.41 Definitions.

As used in this subpart:

Current contributions means
contributions that must be made for the
current pay date which is reported on
the journal voucher that accompanies
the payroll submission.

Nonpay status means an employer-
approved temporary absence from duty.

Reemployed or returned to pay status
means reemployed in or returned to a
pay status, pursuant to 38 U.S.C.
chapter 43, to a position that is subject
to 5 U.S.C. 8351 or chapter 84.

Retroactive period means the period
for which an employee can make up
missed employee contributions and
receive retroactive agency contributions.
It begins the day after the employee
separates or enters nonpay status to
perform military service and ends when
the employee is reemployed or returned
to pay status.

Separate from civilian service means to cease employment with the Federal Government, the U.S. Postal Service, or with any other employer from a position that is deemed to be civilian Government employment for purposes of participating in the TSP, for 31 or more full calendar days.

5. Section 1620.42 is revised to read as follows:

§ 1620.42 Processing TSP contribution elections.

(a) *Time for filing election.* Upon reemployment or return to pay status, an employee has 60 days to submit contribution elections to make current contributions and to make up missed contributions. An employee's right to make a retroactive TSP contribution election will expire if the election is not made within 60 days of the participant's reemployment or return to pay status. After the 60-day contribution election period expires, the employee must wait for an open season to submit a contribution election to make current contributions.

(b) *Current contributions.* An election to make current contributions will be effective as soon as administratively feasible, but no later than the first day of the first full pay period after it is received by the employing agency.

(c) *Makeup contributions.* An election to make up contributions will be processed as follows:

(1) If the employee had a valid contribution election on file when he or she separated or entered nonpay status to perform military service, that election form will be reinstated for purposes of makeup contributions, unless the employee submits new contribution elections effective for any missed open season.

(2) An employee who terminated contributions within two months of entering military service will be eligible to make a retroactive contribution election for the first open season that occurs after the effective date that the contributions were terminated. This election may be made even if the termination was made outside an open season.

6. Section 1620.44 is amended by revising the last sentence to read as follows:

§ 1620.44 Restoring forfeited agency automatic (1%) contributions.

* * * The employing agency will follow the procedure described in § 1620.46(e) to have those funds restored.

7. Section 1620.45 is revised to read as follows:

§ 1620.45 Suspending TSP loans, restoring post-employment withdrawals, and reversing taxable distributions.

(a) *Suspending TSP loans during nonpay status.* If the TSP is notified that an employee entered into a nonpay status to perform military service, any outstanding TSP loan from a civilian TSP account will be suspended, that is, it will not be declared a taxable distribution while the employee is performing military service.

(1) Interest will accrue on the loan balance during the period of suspension. When the employee returns to civilian pay status, the employing agency will resume the deduction of loan payments from the participant's basic pay and the TSP will reamortize the loan (which will include interest accrued during the period of military service). The loan repayment term will be extended by the employee's period of military service. Consequently, when the employee returns to pay status, the TSP record keeper must receive documentation to show the beginning and ending dates of military service.

(2) If the TSP does not receive documentation that the employee entered into nonpay status to perform military service and the period of missed loan repayments extends beyond one year, the loan will be closed and the outstanding loan balance (including accrued interest) will be declared a taxable distribution. However, the taxable distribution can be reversed in accordance with paragraph (c) of this section.

(b) *Restoring post-employment withdrawals.* An employee who separates from civilian service to perform military service and who receives an automatic cashout of his or her account may return to the TSP an amount equal to the amount of the payment. The employee must notify the TSP record keeper of his or her intent to return the withdrawn funds within 90 days of the date the employee returns to civilian service or pay status; if the employee is eligible to return a withdrawal, the TSP record keeper will then inform the employee of the actions that must be taken to return the funds.

(c) *Reversing taxable distributions.* An employee may request that a taxable loan distribution be reversed if the taxable distribution resulted from the employee's separation or placement in nonpay status to perform military service. The TSP will reverse the taxable distribution under the process described as follows:

(1) An employee who received a post-employment withdrawal when he or she separated to perform military service can have a taxable distribution reversed

only if the withdrawn amount is returned as described in paragraph (b) of this section;

(2) A taxable loan distribution can be reversed either by reinstating the loan or by repaying it in full. The TSP loan can be reinstated only if the employee agrees to repay the loan within the original loan repayment term plus the length of military service, and if, after reinstatement of the loan, the employee will have no more than two outstanding loans, only one of which is a residential loan; and

(3) The employee must notify the TSP record keeper of his or her intent to reverse a taxable loan distribution within 90 days of the date the employee returns to civilian service or pay status; if the employee is eligible to reverse a taxable loan distribution, the TSP record keeper will then inform the employee of the actions that must be taken to reverse the distribution.

(d) *Earnings.* Employees will not receive retroactive earnings on amounts returned to their accounts under this section.

PART 1651—DEATH BENEFITS

8. The authority citation for part 1651 is revised to read as follows:

Authority: 5 U.S.C. 8424(d), 8432(j), 8433(e), 8435(c)(2), 8474(b)(5) and 8474(c)(1).

9. Section 1651.1 is amended by adding a new definition, in alphabetical order, to read as follows:

§ 1651.1 Definitions.

* * * * *

Eligible retirement plan means an individual retirement account described in I.R.C. section 408(a) (26 U.S.C. 408(a)); an individual retirement annuity described in I.R.C. section 408(b) (26 U.S.C. 408(b)) (other than an endowment contract); a qualified trust; an annuity plan described in I.R.C. section 403(a) (26 U.S.C. 403(a)); an annuity contract described in I.R.C. section 403(b) (26 U.S.C. 403(b)); and an eligible deferred compensation plan described in I.R.C. section 457(b) (26 U.S.C. 457(b)) which is maintained by an eligible employer described in I.R.C. section 457(e)(1)(A) (26 U.S.C. 457(e)(1)(A)).

* * * * *

10. Section 1651.2 is amended by revising paragraph (a)(2) to read as follows:

§ 1651.2 Entitlement to benefits.

(a) * * *

(2) If there is no designated beneficiary, to the spouse of the participant in accordance with § 1651.5;

* * * * *

11. Section 1651.5 is amended by revising the section heading and the first sentence to read as follows:

§ 1651.5 Spouse of the participant.

For purposes of payment under § 1651.2(a)(2), the spouse of the participant is the person to whom the participant was married on the date of death. * * *

12. Section 1651.14 is amended by revising paragraph (c) to read as follows:

§ 1651.14 How payment is made.

* * * * *

(c) *Payment to the participant's spouse.* The spouse of the participant may request that the TSP transfer all or a portion of the payment to an eligible retirement plan (including the spouse's TSP account, if he or she already has one). A transfer to a spouse's TSP account is permitted only if the spouse is not receiving monthly payments from the account. In order to request such a transfer, a spouse must file Form TSP-13-S, Spouse's Election to Transfer to IRA or Other Eligible Retirement Plan, with the TSP record keeper.

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PART 1655—LOAN PROGRAM

13. The authority citation for part 1655 is revised to read as follows:

Authority: 5 U.S.C. 8433(g) and 8474; 50 U.S.C. App. 526.

14. Section 1655.7 is amended by revising paragraph (c) to read as follows:

§ 1655.7 Interest rate.

* * * * *

(c) The interest rate calculated under this section remains fixed until the loan is repaid, unless the participant informs the TSP record keeper that he or she entered into active duty military service and requests that the interest rate on a loan issued before entry into active duty military service be reduced to an annual rate of 6 percent for the period of such service. The participant must provide the record keeper with the beginning and ending dates of active duty military service.

[FR Doc. 02-12344 Filed 5-16-02; 8:45 am]

BILLING CODE 6760-01-P

SMALL BUSINESS ADMINISTRATION

13 CFR Part 107

RIN 3245-AE88

Small Business Investment Companies

AGENCY: Small Business Administration (SBA).

ACTION: Proposed rule.

SUMMARY: This proposed rule would allow a Small Business Investment Company (SBIC) to assume control over a small business concern, without notice to the SBA and to retain such control for a period of up to five years, or longer with SBA's approval. The proposed rule would also allow an SBIC to sell equity securities in a portfolio concern to a competitor of that portfolio concern.

DATES: Comments must be received on or before June 17, 2002.

ADDRESSES: Written comments should be sent to Leonard W. Fagan, Investment Division, U.S. Small Business Administration, 409 3rd Street, SW., Washington, DC 20416.

FOR FURTHER INFORMATION CONTACT: Harry Haskins, Deputy Associate Administrator, Investment Division, 202-205-6734.

SUPPLEMENTARY INFORMATION: The Small Business Investment Corrections Act of 2000, Public Law 106-554, Title IV, section 402, amended section 103(5)(A)(i) of the Small Business Investment Act (Act) to clarify that a small business concern controlled by venture capital firms, including licensed small business investment companies (SBICs), does not for that reason cease to qualify as independently owned and operated. The statute reads, "regardless of the allocation of control during the investment period under any investment agreement between the business concern and the entity making the investment." (15 U.S.C. 662(5)(A)(i)).

This proposed rule simplifies SBA's present regulation governing control of a small business and brings it into conformity with the Act, as amended in 2000. It also removes a regulatory restriction on the right of an SBIC to sell securities of a small business to a competitor of that business.

The intent of the rule is to implement a statutory change designed to allow SBICs the freedom to operate in the fashion of modern venture capital investors. SBA intends through this rule to permit the type of control that a modern venture fund would exercise while developing an investment, yet avoid the control typical of a holding company operating a firm as a subsidiary and deriving profits through earnings and cash flow.

The legislative history indicates that Congress envisioned only the kind of control that a modern venture capital fund focusing on capital gains would exercise. The legislative history (H.Rpt. 106-520) states that Congress did not

intend for SBICs to exercise the control typical of a holding company or a continuing business operation conducted through a subsidiary for the purpose of accruing earnings on an annualized or cash flow basis.

Proposed § 107.865(a) is a statement of general policy. It differs from the present regulation by broadly permitting SBICs to exercise control over a portfolio concern through ownership of voting securities, management agreements, voting trusts, majority representation on the board of directors, or any other means. The proposed rule also changes the definition of the "Investor Group", those entities whose ownership interests are aggregated for the purpose of determining whether control exists. Under the current regulation, the Investor Group consists of all SBICs that invest in a portfolio company, even if there is no affiliation among them, and all of the SBICs' Associates as defined in § 107.50. The proposed rule defines the Investor Group as an SBIC and its Associates, but does not aggregate the interests of two or more unrelated SBICs. SBA believes that unrelated SBICs should have as much freedom to co-invest with one another as they do to co-invest with venture funds that are not SBICs.

The only restriction in proposed § 107.865(a) is a five-year limit on SBIC control. This will be measured from the initial assumption of control, regardless of interruptions in control. SBA considers five years sufficient time for a viable seed stage company to become an operating business, or to generally develop the investment in a portfolio concern prior to divestiture for gain. It should also suffice for the reversal of the declining fortunes of an operating business. Moreover, the vast majority of SBICs are organized as limited partnerships with a life span not much in excess of ten years.

The proposed rule retains § 107.865(b) with one clarification in the introductory text. Section 107.865(b) outlines the circumstances under which SBA will presume control over a small business for the purpose of determining when control begins or ends. The proposed language clarifies that this paragraph relates only to control based on ownership of voting securities. Control through other means, as specified in § 107.865(a), may still exist even if the conditions in paragraph (b) are not met.

The proposed rule retains § 107.865(c), which sets forth rebuttals to the presumption of control based on ownership of voting securities.

Proposed § 107.865(d) allows extension of control over portfolio