

# A SUMMARY OF THE SBIC PROGRAM

## **Abstract**

The Small Business Investment Company Program, or SBIC Program, has provided over \$85 billion in funding to more than 100,000 small businesses. This article summarizes the program and outlines the process for obtaining an SBIC license, and outlines how to operate an SBIC fund.

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## **BACKGROUND AND CURRENT STATE OF THE SBIC PROGRAM**

The Small Business Investment Company (SBIC) Program enables private equity fund managers to access government leverage at rates typically lower than traditional lending sources. The SBIC Program aims to grow small businesses by facilitating the access to growth capital for middle-market companies.

Congress enacted the Small Business Investment Act of 1958 (the SBIC Act), as amended from time to time, and the rules and regulations promulgated thereunder, to create the SBIC Program.<sup>1</sup> The U.S. Small Business Administration (SBA) conducts the SBIC Program through its Investment Division, located in Washington, D.C. The SBIC Program encourages the creation of SBIC funds to increase the flow of investment capital to small businesses and smaller enterprises in the United States. Since the establishment of the SBIC Program, SBIC funds have provided billions of dollars of investment and financing.

Private fund managers own and operate SBIC funds and have sole responsibility for their investment decisions. One of the most compelling benefits of the SBIC Program is that licensed SBIC funds gain access to long-term financing through securities sold in the public market and guaranteed by the U.S. government. The SBIC Act authorizes SBIC funds to obtain long-term leveraged funds at favorable interest rates in order to fund loans to, and investments in, qualifying small businesses.<sup>2</sup> The leveraged funds obtained under the SBIC Program generally carry rates lower than would otherwise be available from traditional lending sources. This enables SBIC funds to make investments in greater amounts than would be possible solely with private funds. The size of an SBIC fund's private capital commitments determines the amount of SBA funding for which the SBIC fund is eligible. SBIC funds are generally eligible for up to two tiers of leverage on their private capital<sup>3</sup>, meaning an SBIC fund with \$75 million in private commitments could have a total fund size of up to \$225 million, with up to \$150 million of SBA leverage.

Today, more than 300 licensed SBIC funds operate with \$10 billion in SBA leverage. To date, SBIC funds have provided financing in excess of \$85 billion to more than 100,000 small businesses. Well known recipients of SBIC funding include:

- Apple,
- AOL,
- Amgen,
- FedEx,
- Outback Steakhouse,
- Intel,
- Costco, and
- Whole Foods.

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<sup>1</sup> 15 U.S.C. §661, *et. seq.* (1958)

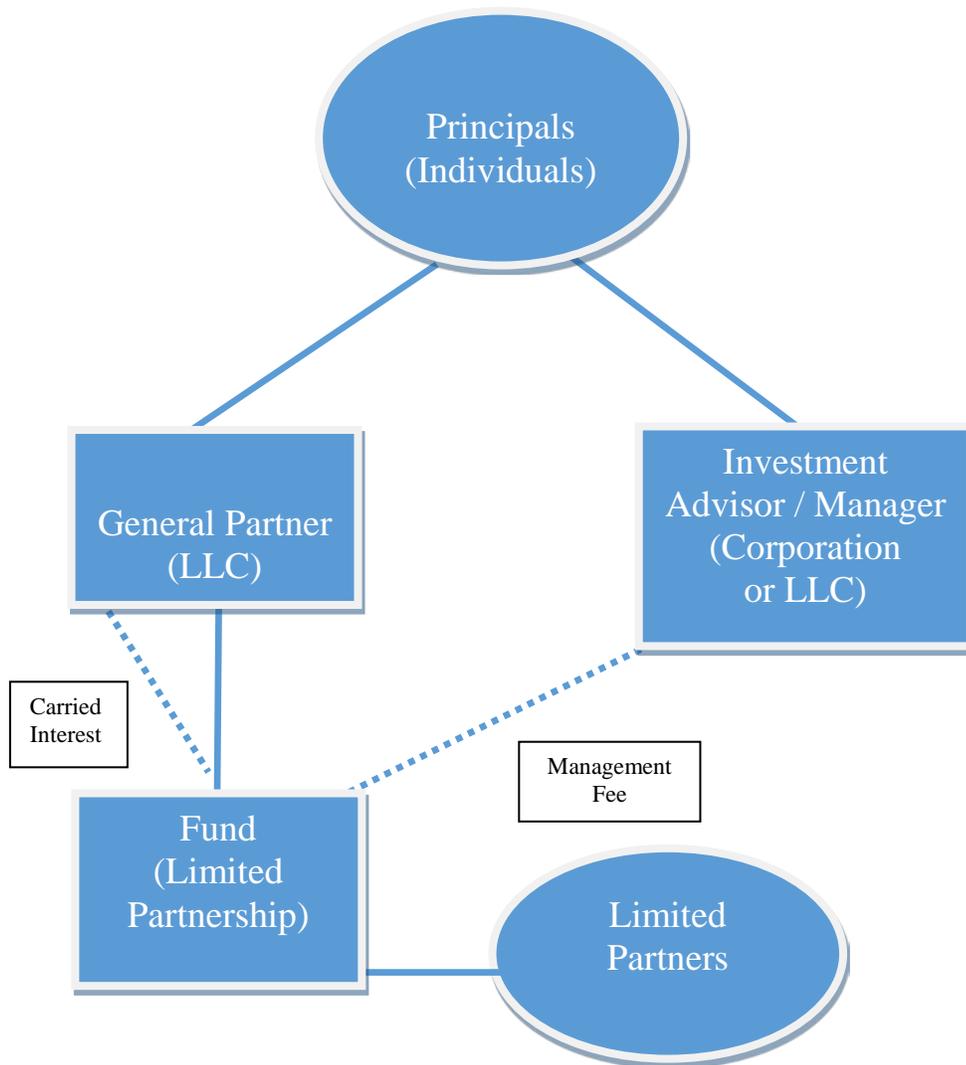
<sup>2</sup> 15 U.S.C. §685, *inter alia*

<sup>3</sup> 13 C.F.R. §107.1150(a)

## RAISING AN SBIC FUND

### FORMATION & STRUCTURE

Fund managers typically form SBIC funds as limited partnerships, managed by a general partner.



**Figure 1**

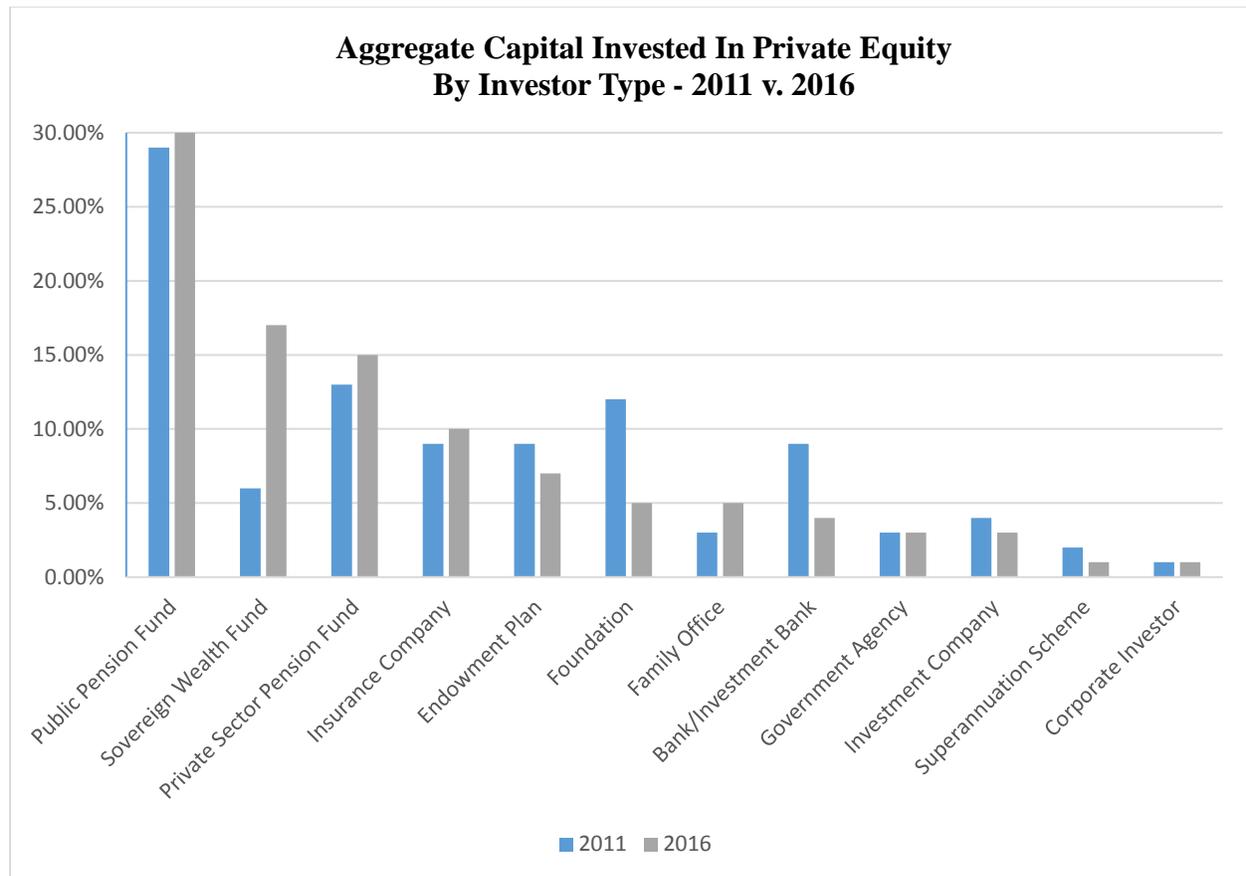
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### FUNDRAISING

Typical investors that provide private capital include:

- public and private pension funds,
- banks and other financial institutions,
- institutional investors, and
- other high net worth individuals.

The chart below shows the amount of aggregate capital invested generally in private equity funds, by type, as compared between 2011 and 2016:



**Figure 2. Source: Preqin, as of January 15, 2016  
(Excludes fund of funds managers and asset managers.)**

SBA regulations require funds to raise a minimum of \$5 million in private capital.<sup>4</sup> In practice, however, SBIC funds raise significantly more capital in order to execute their investment strategy. A fund will typically hold an initial closing in the final stages of receiving its SBIC license (described below) to meet SBA's minimum capital requirements. The fund then has an additional 12-18 months to complete its fundraising and hold additional closings.

<sup>4</sup> 13 C.F.R. §107.210(a)(1)

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### Private Investors

Both individuals (domestic or foreign) and entities (including banks and other financial institutions) may invest in SBIC funds. Applicants to the SBIC Program must disclose any investor owning more than 10% of an SBIC fund (and each 10% investor of those 10% investors).<sup>5</sup> Additionally, the SBA requires investors owning 33% or more of an SBIC fund to submit to a formal background check.<sup>6</sup>

SBA regulations require a levered SBIC fund to obtain at least 30% of its private capital from at least three investors who are not affiliated with the general partner or the management of the SBIC fund.<sup>7</sup> This is referred to as the Management-Ownership Diversity requirement.

SBIC funds should generally offer limited partnership interests to accredited investors. Additionally, SBA requires investors be broken down between Institutional Investors (both entity and individual, as defined by SBA) and non-Institutional Investors. Institutional Investor entities generally consist of corporations, limited liability companies, and limited partnerships with a net worth of at least \$10 million (exclusive of unfunded commitments), as well as:

- banks or other financial institutions or their holdings companies,
- insurance companies,
- pension plans, or
- tax-exempt foundations or trusts,

each of which must have a net worth of at least \$1 million.<sup>8</sup>

Individual Institutional Investors have a net worth of at least:

- (i) \$10 million (exclusive of the value of any equity in his or her most valuable residence) or
- (ii) \$2 million (exclusive of the value of any equity in his or her most valuable residence) and at least ten times the amount of his or her commitment to the SBIC fund.

### Banks

Banks often provide a source of significant private capital for SBIC funds because bank investments into SBIC funds:

- (i) are exempt from the Volcker Rule otherwise restricting bank investments into private equity funds,<sup>9</sup>
- (ii) are exempt from certain portions of the Gramm-Leach-Bliley Act<sup>10</sup>,
- (iii) may generate Community Reinvestment Act credit for those investments,<sup>11</sup> and

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<sup>5</sup> SBA Form 2183, OMB Approval No. 3245-0062.

<sup>6</sup> SBA Form 2182, OMB Approval No. 3245-0062.

<sup>7</sup> 13 C.F.R. §107.150(c)

<sup>8</sup> *Ibid.*

<sup>9</sup> 12 U.S.C. §1851 (d)(1)(E)

<sup>10</sup> Capital; Leverage and Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Non-Financial Equity Investments, 67 Fed. Reg. 3784 (January 25, 2002).

<sup>11</sup> Interagency Questions and Answers Regarding Community Investments, §\_\_.12(g)(3)-1. “The agencies will presume that any loan or service to or investment in a SBDC, SBIC, Rural Business Investment Company, New

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(iv) have traditionally generated strong returns and increased deal flow for the bank.

However, the SBIC Act restricts banks from investing more than 5% of the bank's capital and surplus in SBIC funds, measured on an aggregate basis.<sup>12</sup>

### *Volcker Rule Exemption*

The Volcker Rule, promulgated under the Dodd-Frank Wall Street Reform and Consumer Protection Act, limits aggregate commitments to private equity and similar funds which financial institutions can make. However, the Volcker Rule contains a specific exception for SBIC funds, meaning the Volcker Rule's limitations do not apply to investments by financial institutions into SBIC funds.<sup>13</sup>

### *Gramm-Leach-Bliley Exemption*

The Gramm-Leach-Bliley (GLB) Act exempts investments by banks into SBIC funds from the capital charges otherwise required under the GLB Act, so long as they represent in the aggregate less than 15% of the tier one capital of the bank or the bank holding company.<sup>14</sup> Furthermore, ownership of 15% or more of the equity interests in a small business financed by an SBIC fund affiliated with a bank will not give rise to the presumption that the small business is an affiliate of the bank or the bank holding company.<sup>15</sup>

### *Community Reinvestment Act Credit*

As an additional benefit, banks, federal savings associations, and their holding companies may receive Community Reinvestment Act (CRA) credit for a limited partnership investment into an SBIC fund. An investment in an SBIC fund whose regional focus includes the financial institution's CRA assessment area is specifically identified as a type of investment that will be presumed by the regulatory agencies to promote economic development and meet the standards of a "qualified investment" for CRA purposes.<sup>16</sup> SBIC funds provide these types of financial institutions with an attractive alternative to grants, pools of mortgages in low and moderate income areas, qualified tax benefit transactions, and other investments routinely used to satisfy CRA requirements.

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Markets Venture Capital Company, New Markets Tax Credit-eligible Community Development Entity, or Community Development Financial Institution that finances small businesses or small farms, promotes economic development.”

<sup>12</sup> 15 U.S.C. § 682 (b)(1)

<sup>13</sup> 12 U.S.C. §1851 (d)(1)(E)

<sup>14</sup> Capital; Leverage and Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Non-Financial Equity Investments, 67 Fed. Reg. 3784 (January 25, 2002).

<sup>15</sup> *Ibid*

<sup>16</sup> Interagency Questions and Answers Regarding Community Investments, §\_\_.12(t)-4.

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### *Historically Strong Returns and Increased Deal Flow*

Bank investments in SBIC funds have historically generated competitive returns when compared to other investments eligible for CRA credit. In addition, investing in an SBIC fund can also provide banks with an opportunity to establish a referral relationship and improve their commercial lending and deposit opportunities, including providing cash management or other services to the SBIC fund or its portfolio companies. SBIC fund investments may also enhance business development opportunities for these financial institutions as the small business portfolio companies expand and need expanded financial and banking services.

### **LICENSING**

The SBA thoroughly vets an applicant for an SBIC license and its management team prior to issuing an SBIC license. Typically, applicants undergo an initial review after the filing of a Management Assessment Questionnaire (MAQ) with the SBA.<sup>17</sup> If the SBA’s investment committee issues a “green light letter”, the applicant can then go raise additional private capital before filing its formal SBIC license application. The license application includes formal background checks on each of the principals of the applicant, a review of their proposed investment strategy and processes, and their investment track record.<sup>18</sup>

### **Administrative Fees**

As of December 13, 2017, the SBA has implemented a new fee structure for applicants. The SBA has mandated a \$10,000.00 Initial Licensing Fee for the first phase, due with the submission of the MAQ. In the final stages of licensing, the SBA has established a fee structure, which will escalate over the next five years, according to the chart below<sup>19</sup>:

<b>Time Period</b>	<b>Final Licensing Fee</b>
December 13, 2017 to September 30, 2018	\$20,000.00
October 1, 2018 to September 30, 2019	\$25,000.00
October 1, 2019 to September 30, 2020	\$30,000.00
October 1, 2020 to September 30, 2021	\$35,000.00

**Figure 3**

Beginning October 1, 2021, subsequent increases will be determined by inflation. The SBA will calculate its “Inflation Adjustment” using the Consumer Price Index for Urban Consumers (CPI-

<sup>17</sup> 13 C.F.R. §107.300

<sup>18</sup> 13 C.F.R. §107.305; see also SBA. “The SBIC Program Application Instructions.” OMB Approval No. 3245-0062. December 31, 2016.

<sup>19</sup> 13 C.F.R. §107.300, *et. seq.*

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U), formulated by the United States Bureau of Labor and Statistics (BLS), using the national city average.<sup>20</sup> The SBA will publish a Notice in the Federal Register identifying the amount of the fee prior to such adjustments.

### Anticipated Timing

Funds applying for an SBIC license should anticipate eight to ten weeks for the processing of their MAQ,<sup>21</sup> a period of up to eighteen months to raise the necessary private capital (this window is driven exclusively by the applicant's fundraising success), and an additional three weeks for the review and processing of the formal license application.<sup>22</sup>



\*Time periods are estimates provided by SBA. Actual processing times may differ significantly.

**Figure 4**

### Pre-Licensing Investments

After the SBA accepts the formal SBIC license application, and prior to receipt of a license to operate as an SBIC, an SBIC fund has the option to hold interim closings and consummate qualifying investments in small businesses (prelicensing investments). Prelicensing investments qualify as part of the SBIC fund's private capital used to calculate the amount of SBA leverage available to the fund after licensing. The amount of private capital invested in prelicensing investments, therefore, can accelerate an SBIC fund's ability to access SBA leverage once it receives its SBIC license. All such prelicensing investments must be submitted to the SBA for prior approval. The SBA will not underwrite such investments, but merely determine whether they comply with SBIC regulations. Following receipt of the license, prior approval of investments by an SBIC fund is not required.

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<sup>20</sup> 13 C.F.R. §107.50

<sup>21</sup> "Phase I: Initial Review." *Small Business Administration*, [www.sba.gov/sbic/applying-be-sbic/phase-i-initial-review](http://www.sba.gov/sbic/applying-be-sbic/phase-i-initial-review).

<sup>22</sup> "Phase III: Licensing Review | The U.S. Small Business Administration." *Small Business Administration*, [www.sba.gov/sbic/applying-be-sbic/phase-iii-licensing-review](http://www.sba.gov/sbic/applying-be-sbic/phase-iii-licensing-review).

## OPERATING AN SBIC FUND

### OBTAINING LEVERAGE

The SBA currently provides leverage to SBIC funds through SBIC debentures. SBIC debentures are unsecured debt instruments issued by the SBIC fund which are ultimately pooled with all other debentures issued by SBIC funds in a six-month period and sold to investors in an SBA-guaranteed bond offering. SBIC debentures have an interest rate fixed within six months of their issuance at a stated premium over the 10-year U.S. Treasury note.<sup>23</sup>

SBIC debentures require semiannual interest payments, have 10-year maturities, and are not amortized prior to maturity. SBIC debentures may be prepaid without penalty. The maximum amount of SBA leverage available to a single SBIC fund is \$150 million;<sup>24</sup> the maximum leverage available to a family of SBIC funds is \$350 million.<sup>25</sup>

An SBIC fund may apply for a leverage commitment from the SBA in an amount up to two times its Regulatory Capital<sup>26</sup> (and in rare instances, up to three times its Regulatory Capital<sup>27</sup>). Regulatory Capital equals the amount of paid-in capital plus binding, unfunded commitments from the SBIC fund's Institutional Investors (as defined in the SBIC regulations). Leverage commitments expire on September 30 of the fourth federal fiscal year following the issuance of the commitment.<sup>28</sup>

SBIC funds may draw down committed SBA leverage on one day's notice through an interim credit facility provided by the Federal Home Loan Bank of Chicago. The rate on the interim facility equals a spread over the short-term LIBOR rate. Every six months, the SBA pools the interim leverage and establishes a new interest rate. This new interest rate is based upon the average yield on U.S. Treasury obligations of comparable maturity, and remains fixed until the SBIC debentures are repaid. The SBA pools SBIC debentures in March and September of each year, fixing the rates through maturity. The table below provides historical information on the pooling of 10-year SBIC debentures.

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<sup>23</sup> 13 C.F.R. §107.1530, *inter alia*.

<sup>24</sup> 13 C.F.R. §107.150(a)(2)

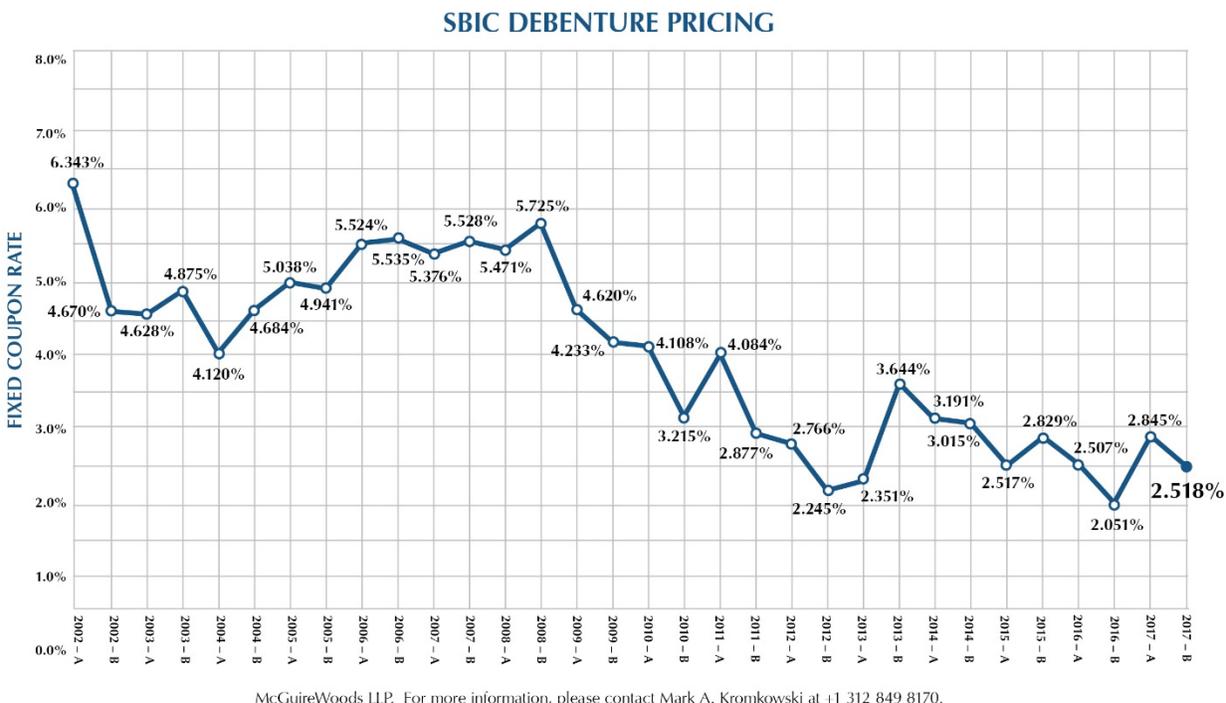
<sup>25</sup> 13 C.F.R. §107.150(b)

<sup>26</sup> 13 C.F.R. §107.1150

<sup>27</sup> *Id.*

<sup>28</sup> 13 C.F.R. §107.1200(d)

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**Figure 5**

The SBA also charges fees related to the debentures. Currently, these include a one-time commitment fee (payable at the time a leverage commitment is issued) and an annual charge fee (included in the semiannual interest payment) on outstanding SBIC debentures. Additionally, the SBA charges a one-time fee, deducted from each leverage draw, for capital calls, administrative expenses, and underwriting fees. The capital, administrative, and underwriting fees are deducted from each draw of SBA leverage.

The use of SBIC debentures by an SBIC fund will not cause unrelated business taxable income for tax-exempt entity investors provided certain ownership requirements are met.<sup>29</sup> Potential investors should consult independent tax counsel prior to investing in an SBIC fund.

### **MAKING INVESTMENTS AND FINANCING SMALL BUSINESSES**

Following its initial closing, an SBIC fund typically has a five to six year period during which it can make investments. Investments can be in the form of Equity Securities (equity only), Loans (debt only), or Debt Securities (debt with equity features).<sup>30</sup>

<sup>29</sup> 26 U.S.C. §514(c)(6)

<sup>30</sup> 13 C.F.R. §§107.800; 107.810; 107.815.

## Qualifying Portfolio Investments

SBIC funds may invest only in what the SBA defines as “Small Business Concerns”. Small Business Concerns generally include companies with a tangible net worth of less than or equal to \$19.5 million, and average after-tax profits in the prior two years of less than or equal to \$6.5 million.<sup>31</sup> At least 25% of an SBIC fund’s investments must be in what the SBA calls “Smaller Enterprises”.<sup>32</sup> Smaller Enterprises are companies with a tangible net worth of less than or equal to \$6 million, and average after-tax profits in the prior two years of less than or equal to \$2 million.<sup>33</sup>

There is an alternative test based on industry-specific thresholds expressed in terms of revenues and number of employees, which may allow investments that do not meet the smaller enterprise tests.<sup>34</sup> Additional restrictions apply if the SBIC fund’s investment will finance a change of ownership of a business.<sup>35</sup> An SBIC fund may continue to own its interest and make follow-on investments in portfolio companies which no longer qualify as small businesses as long as the portfolio company was a small business at the time the initial investment was made.<sup>36</sup>

## Limitations on Investments and Fees

SBIC funds may provide financing or a commitment to a small business if the resulting amount of the SBIC’s fund’s aggregate financings and commitments to such small business and its affiliates does not exceed 30% of the SBIC fund’s Regulatory Capital (as defined in the SBIC regulations) as of the date of the financing or commitment. This is referred to as the SBIC fund’s “Overline Limit.”<sup>37</sup>

SBIC funds generally may not charge interest on a Loan in excess of 19% or 14% for a Debt Security.<sup>38</sup> This is referred to as the “cost of money limitation.”<sup>39</sup> In addition, SBIC funds will be able to charge certain closing and application fees at closing which, subject to certain limitations, are excluded from the cost of money limitation.<sup>40</sup> Finally, an SBIC fund may be reimbursed for out of pocket costs incurred in performing due diligence and closing the transaction (including legal fees), which would be excluded from the cost of money calculation.<sup>41</sup>

There also are restrictions on the ability of an SBIC fund to invest in certain categories of small businesses. The SBA does not permit SBIC funds to invest in:

- project financing,

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<sup>31</sup> 13 C.F.R. §121.301(c)(2)(i-iii)

<sup>32</sup> 13 C.F.R. §107.710(b)

<sup>33</sup> 13 C.F.R. §107.710(a)(2)

<sup>34</sup> 13 C.F.R. §121.201

<sup>35</sup> 13 C.F.R. §§107.710(d); 107.750

<sup>36</sup> 13 C.F.R. §121.302(d)

<sup>37</sup> 13 C.F.R. §107.740(b); See also SBIC TechNote 9. September 2014.

<https://www.sba.gov/sites/default/files/files/SBICTechnote09.pdf>

<sup>38</sup> 13 C.F.R. §107.855(c)

<sup>39</sup> *Id.* at §107.855

<sup>40</sup> *Id.* at §107.855(g)

<sup>41</sup> 13 C.F.R. §107.860, *et. seq.*

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- relenders or reinvestors,
- passive businesses (subject to certain exceptions for holding companies and blocker corporations),
- farmland,
- real estate businesses,
- businesses contrary to the public interest,
- associated suppliers, or
- other financial intermediaries.

Equity Securities may be required to be redeemed after a one-year period (subject to certain limited exceptions)<sup>42</sup> at a price based on a pre-determined formula, often founded on fair market value determined by a qualified third party appraiser, or based on a multiple of earnings or revenue.<sup>43</sup>

## REGULATION

### REPORTING AND EXAMINATION REQUIREMENTS

#### General Requirements

The SBA subjects SBIC funds to certain reporting and examination requirements. Additionally, the regulations require SBIC funds to maintain certain minimum levels of capital, keep certain books and records, and make them available for SBA examination, and prepare valuations of their portfolio securities in accordance with prescribed valuation guidelines. They are also required to file annual reports containing financial, management and other information, and to file notices of certain material changes in their ownership and operations.<sup>44</sup>

#### SBA Oversight

Once licensed, the SBIC fund is subject to a regulatory review no less than every two years by the Office of SBIC Examinations. These examinations are designed to ensure SBIC funds operate in compliance with the SBIC regulations, or determine those instances when they have failed to do so.<sup>45</sup>

#### *Financial Reports & Valuations*

The SBA requires each SBIC fund to submit an audited annual financial report at the close of its fiscal year.<sup>46</sup> The annual financial report consists of the financial statements and other schedules included in SBA Form 468.<sup>47</sup> The preparation of the annual financial report is the responsibility

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<sup>42</sup> 13 C.F.R. §107.850(a)

<sup>43</sup> 13 C.F.R. §107.850(b)

<sup>44</sup> See generally, 13 C.F.R. §§107.630 – 107.692

<sup>45</sup> 15 U.S.C. §687b(c). See also, 13 C.F.R. §§107.690 – 107.692

<sup>46</sup> 13 C.F.R. §107.630(a)

<sup>47</sup> *Ibid*

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of the SBIC fund. SBA regulations require an independent public accountant perform the audit and express an opinion on financial statements and supplementary schedules based on the audit.<sup>48</sup>

Additionally, the general partner is required to value the SBIC fund's assets semi-annually for leveraged SBIC funds.<sup>49</sup> The SBIC fund must have a written valuation policy approved by the SBA; the SBA provides a model policy, but the fund may deviate from this policy with the prior written approval of the SBA.<sup>50</sup> An SBIC fund's audited annual financial statements (SBA Form 468) must include a statement from an independent public account that the valuations were prepared in accordance with the SBIC fund's approved valuation policy.<sup>51</sup> The SBA's guidelines for valuation policies, and the model policies, can be found online.<sup>52</sup>

### *Changes In Control*

Among its other regulatory powers, the SBA has the right to approve or disapprove any significant change in ownership or control of an SBIC fund subject to the terms of the SBIC fund's limited partnership agreement.<sup>53</sup> Accordingly, no change in the identity of the general partner of an SBIC fund or its controlling persons can occur without SBA approval.<sup>54</sup> Furthermore, prior SBA approval is required before the admission of any limited partner owning 10% or more of the interests in an SBIC fund.<sup>55</sup> SBA may condition its approval of a change in control on such requirements as it deems necessary, and make its approval contingent upon:

- full disclosure of the real parties in interest,
- the source of funds used to acquire control, and
- other information requested by the SBA.<sup>56</sup>

The general partner may not take any action that defers, reduces, or terminates the obligation of any limited partner to make capital contributions to the SBIC fund without the consent of the SBA.

### *Non-Discrimination*

SBIC applicants must certify they will adhere to SBA non-discrimination regulations.<sup>57</sup> SBIC funds may not discriminate on the basis of race, color, national origin,<sup>58</sup> religion, sex, handicap,<sup>59</sup> or age.<sup>60</sup> Further, these regulations extend to the portfolio concerns of an SBIC fund.<sup>61</sup> An SBIC

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<sup>48</sup> *Id.* at §107.630(a)(1)

<sup>49</sup> 13 C.F.R. §107.503(d)

<sup>50</sup> *Id.* at §107.503(a)-b)

<sup>51</sup> *Id.* at §107.503(e)

<sup>52</sup> [https://www.sba.gov/sites/default/files/files/inv\\_valuation.pdf](https://www.sba.gov/sites/default/files/files/inv_valuation.pdf)

<sup>53</sup> 13 C.F.R. §107.410(a)

<sup>54</sup> *Ibid*

<sup>55</sup> 13 C.F.R. §107.400(a)

<sup>56</sup> 13 C.F.R. §107.440, *et. seq.*

<sup>57</sup> See generally 13 C.F.R §§112, 113, and 117, *inter alia*.

<sup>58</sup> 13 C.F.R §§112.3(a)

<sup>59</sup> 13 C.F.R §§113.3(a)

<sup>60</sup> 13 C.F.R §§117.3(a)

<sup>61</sup> SBA Form 652

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fund must keep documentation necessary to substantiate its adherence to these non-discrimination policies.<sup>62</sup>

### *Enforcement Powers*

If an SBIC fund defaults in its payment obligations under the SBIC debentures, fails to comply with any term of its securities, or violates any applicable law or regulation, the SBA has the right to accelerate the maturity of all amounts due under its SBIC debentures.<sup>63</sup> Additionally, the SBA can bring suit for the appointment of a receiver for the SBIC fund and for its liquidation.<sup>64</sup>

### **EXAMINATION FEES**

The SBA (or its outside third party contractors) conducts examinations of all SBIC funds to evaluate regulatory compliance. The SBA calculates this examination fee by starting with a base fee and adding a percentage of the SBIC fund's total assets (at cost). The SBA then adjusts this calculation with discounts or additional fees based on the SBIC fund's activities.

As of December 13, 2017, the SBA uses a new fee structure for examinations. The fee structure includes a schedule to escalate those fees over the next five years according to the following chart.<sup>65</sup>

<b>Time Period (Based on the examination start date)</b>	<b>Minimum Base Fee</b>	<b>Maximum Base Fee (Non-Leveraged SBICs)</b>	<b>Maximum Base Fee (Leveraged SBICs)</b>
December 13, 2017 to September 30, 2018	\$6,000.00	\$22,500.00	\$26,000.00
October 1, 2018 to September 30, 2019	\$7,000.00	\$25,000.00	\$32,000.00
October 1, 2019 to September 30, 2020	\$8,000.00	\$27,500.00	\$38,000.00
October 1, 2020 to September 30, 2021	\$9,000.00	\$30,000.00	\$44,000.00

**Figure 6**

Beginning October 1, 2021, subsequent increases will be determined by inflation. The SBA will calculate its "Inflation Adjustment" using the Consumer Price Index for Urban Consumers (CPI-U), determined by the United States Bureau of Labor and Statistics (BLS), using the national city average.<sup>66</sup> The SBA will publish a Notice in the Federal Register identifying the amount of the fee prior to such adjustments.

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<sup>62</sup> *Ibid*

<sup>63</sup> 13 C.F.R. §107.1810(c)

<sup>64</sup> *Ibid*

<sup>65</sup> 13 C.F.R. §107.692

<sup>66</sup> 13 C.F.R. §107.50

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### MANAGEMENT FEES

Management fees for leveraged SBIC funds must be approved by SBA in connection with its licensing process.<sup>67</sup> In general, SBA permits leveraged SBIC funds to pay a management fee to the general partner or an Investment Adviser/Manager (usually affiliated with the general partner) pursuant to a management agreement in an amount not to exceed 2.5% of Regulatory Capital plus up to two tiers of SBA leverage, if such leverage was approved as part of the SBIC fund's business plan.<sup>68</sup> The permissible management fee rate declines to 2% if the SBIC fund has at least \$60 million in private capital.<sup>69</sup> After the expiration of five years after the date on which a management fee was first charged based on SBA leverage, there is a step down in the management fee base to the cost basis of financings and investments by the SBIC fund in active portfolio companies.<sup>70</sup>

Regulations require management fees be offset by 100% of the consulting, board, and other similar fees received from portfolio companies by the SBIC fund's general partner or its affiliates (excluding the SBIC fund itself).<sup>71</sup>

### DISTRIBUTIONS

An SBIC fund with outstanding leverage may distribute its undistributed net realized cumulative earnings less unrealized depreciation (READ) to its limited partners.<sup>72</sup> However, without SBA's prior consent, an SBIC fund may not reduce its Regulatory Capital by more than 2% in any fiscal year.<sup>73</sup>

### THIRD PARTY INDEBTEDNESS

SBIC funds are not permitted to incur secured indebtedness without SBA's prior consent. However, SBIC funds may incur unsecured indebtedness, such as subscription or capital call lines of credit, without SBA's consent.<sup>74</sup>

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<sup>67</sup> 13 C.F.R. §107.140

<sup>68</sup> SBIC TechNote 7A, page 3. April 2008. <https://www.sba.gov/sites/default/files/files/SBICTechnote09.pdf>

<sup>69</sup> *Ibid*

<sup>70</sup> *Id.* at 2

<sup>71</sup> *Ibid*

<sup>72</sup> 13 C.F.R. §107.50

<sup>73</sup> 13 C.F.R. §107.585

<sup>74</sup> 13 C.F.R. §107.550(b); See also SBIC TechNote 5. November 2000. <https://www.sba.gov/sites/default/files/files/SBICTechNote05.pdf>

## OTHER TOPICS

### UNLEVERED SBICs

An SBIC fund can be either levered or unlevered. An unlevered SBIC fund does not have access to SBIC debentures, while a levered SBIC fund does.<sup>75</sup> Although an unlevered SBIC fund is not eligible for the benefits of SBA leverage, it is subject to fewer restrictions while remaining a qualified investment for Community Reinvestment Act purposes.<sup>76</sup> Bank-owned SBIC funds are typically unlevered.

### INVESTMENT ADVISERS ACT

An investment adviser which solely advises SBICs, entities that have received green light letters from SBA authorizing them to submit a formal SBIC license application to SBA, and an applicant that is affiliated with one or more SBICs and that has applied for another SBIC license, are expressly exempted from the Dodd-Frank Act amendments to the Investment Advisers Act of 1940 (Advisers Act) pursuant to the SBIC Advisers Relief Act.<sup>77</sup> Since this exemption only applies to those advisers who advise solely SBICs and SBIC-related entities described above, advisers who also advise venture capital funds, private funds, or other clients cannot avail themselves of this exemption. Previously, advisers could rely on the Dodd-Frank exemptions for advisers who solely advise venture capital funds (the “Venture Capital Fund Adviser Exemption”) or for advisers who solely advise private funds and have assets under management in the United States of less than \$150 million (the “Private Fund Adviser Exemption”) but could not combine the two exemptions.<sup>78</sup> The SBIC Advisers Relief Act excludes SBIC assets from the \$150 million threshold, and expressly includes SBICs in the definition of venture capital funds.<sup>79</sup> Investment advisers relying solely on the SBIC fund exemption are not required to register with the SEC as exempt reporting advisers.<sup>80</sup>

### LICENSING SUBSEQUENT SBIC FUNDS AND THE APPLICATION FAST TRACK

SBIC funds wishing to apply for a subsequent SBIC license should direct their request to the SBA analyst responsible for the existing SBIC license.<sup>81</sup> The analyst will prepare an analysis of the request and will present it to the SBA’s investment committee, which will determine whether to issue a green light letter inviting the management team to submit a formal license application for the subsequent SBIC license. SBA generally views a consistent investment strategy, a stable management team, and a returning base of limited partners as positive indicators when reviewing a request for a subsequent SBIC fund.

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<sup>75</sup> 13 C.F.R. §107.1000, *et. seq.*

<sup>76</sup> Interagency Questions and Answers Regarding Community Investments, §\_\_.12(g)(3)-1.

<sup>77</sup> 15 U.S.C. §80b-3(1)(2), aka Rule 203(1)-1 of the Advisers Relief Act.

<sup>78</sup> 15 U.S.C. §80b-3(m), aka Rule 203(m) of the Advisers Relief Act

<sup>79</sup> 15 U.S.C. §80b-3(m)(3), aka Rule 203(m) of the Advisers Relief Act.

<sup>80</sup> *Ibid*

<sup>81</sup> SBIC TechNote 14. November 1, 2009. <https://www.sba.gov/sites/default/files/files/SBICTechNote14.pdf>

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If the subsequent SBIC fund follows the investment strategy of the existing SBIC fund and the management team remains mostly unchanged, SBA has implemented a “fast track” licensing process designed to shorten the licensing process to less than six months.<sup>82</sup>

SBICs under common control, including the existing SBIC fund and any subsequent SBIC fund, must agree not to co-invest more than 30% of investable capital with the other SBIC fund.

### TRADE ASSOCIATION

The SBIC Industry has its own trade association, the Small Business Investor Alliance (SBIA) (<http://www.sbia.org/>). The SBIA:

- hosts regular industry networking events,
- serves as the industry’s advocate to the federal government (including the SBA), and
- provides regular updates on the SBIC program and the industry in general.

Brett Palmer serves as the President of the SBIA, where he serves as its principal liaison to the government and other industry organizations. He has held positions in the Executive Branch as Assistant Secretary for Legislative Affairs for the Commerce Department, and in Congress as a policy aide for the Speaker of the House.<sup>83</sup>

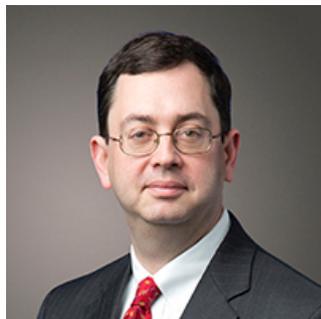
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<sup>82</sup> *Ibid*

<sup>83</sup> “IVCA Q&A: Brett Palmer, President of the Small Business Investor Alliance, on Fund Issues in 2012.” *Illinois Venture Capital Association*, 15 Feb. 2012, [https://ivca.memberclicks.net/index.php?option=com\\_content&view=article&id=1159:17978&catid=21:latest-news&Itemid=173](https://ivca.memberclicks.net/index.php?option=com_content&view=article&id=1159:17978&catid=21:latest-news&Itemid=173)

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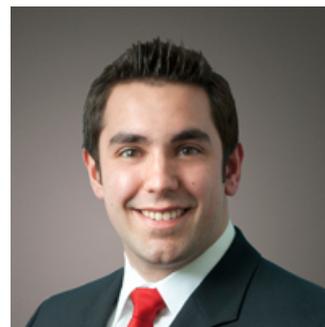
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