



U.S. Small Business
Administration

SBIC Program Reforms

Regulatory and Procedural Considerations

August 2023

ABOUT THE SBIC PROGRAM

About the SBIC Program

Purpose

The SBIC Program is designed to “**improve and stimulate** the national economy in general and the small business segment thereof in particular” by **stimulating and supplementing “the flow of private equity capital and long-term loan funds** which small-business concerns need for the sound **financing of their business operations and for their growth, expansion, and modernization**, and which are **not available in adequate supply.**”

What is an SBIC?

An SBIC is a **privately owned and managed investment fund** licensed and regulated by the SBA. An SBIC invests private capital and borrowed capital with an SBA guarantee to **make long-term debt and/or equity investments** in qualifying U.S. small businesses.

Driving Innovation and Job Creation

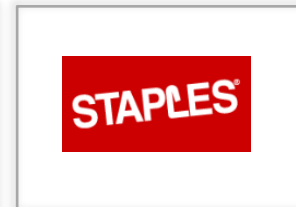
THE SBIC PROGRAM

The U.S. Federal Government's **Public – Private Investment Partnership Program** managed by the U.S. Small Business Administration (SBA).

SBA commits up to \$5 billion annually to guarantee low-cost loans designed to scale and enhance the risk-adjusted returns of private equity and private credit funds focused on investing in U.S. small businesses and startups.

- ✓ Over \$40 billion in assets under management
- ✓ Over \$8 billion of financing in fiscal year 2022
- ✓ Over 3,000 funds licensed as SBICs since program inception
- ✓ Over 300 funds with active SBIC licenses today
- ✓ Over 129,000 jobs created or sustained
- ✓ Over 1,200 small businesses and startups financed by SBIC licensed funds in fiscal year 2022

PORTFOLIO COMPANIES OF SBIC LICENSED PRIVATE FUNDS



SBIC Financing Requirements

SBICs must invest in...

- At least 75% of total capital in U.S. “small” businesses
 - At least 25% of total capital in U.S. “smaller” enterprises
- ✓ SBICs **may** invest in businesses located anywhere in the U.S. or its territories
 - ✓ SBICs **may** control a small business for up to seven years, or longer with SBA approval
 - ✓ SBICs **may** invest using loans, equity securities or debt securities with equity features such as warrants
 - ✗ SBICs **may not** invest in businesses with over 49% of their employees located outside the U.S. or its territories
 - ✗ SBICs **may not** invest in project finance, real estate, farmland, financial intermediaries or passive businesses

SBIC Investment Diversification & Growth Rule

The U.S. Small Business Administration (“SBA”) final rulemaking seeks, through a risk-aware approach, to significantly **reduce barriers to program participation** for new funds, small/micro funds, funds investing in **underserved communities and geographies, capital intensive investments, and technologies critical to national security and economic development.**

SBA introduces an additional category of **SBICs (“Accrual” SBICs)** to **increase program investment diversification and long-duration financing for small businesses.**

This rule will **reduce friction points for current program participants** in an effort to strengthen SBA’s partnership with Licensees and ultimately increase the efficiency and reach of financing to small businesses.

Rulemaking Reforms - BLUF

Addresses capital access gaps related to private investment in:

1. Technologies critical to national security
2. Underserved communities and geographies
3. Emerging managers
4. Supply chain and innovation investment

REGULATORY AND PROCEDURAL REFORMS – COMMON CONSIDERATIONS

AGENDA

1. Accrual Debentures – Leverage Commitments, Leverage Availability and Leverage Repayment
2. Fund-of-Funds Reinvestor SBICs
3. Pre-Screening and Application Process
4. Timelines, Prioritization and Fees
5. Licensee Qualifications
6. Expedited Subsequent Funds Processing
7. Watchlist Considerations
8. Q&A

Accrual Debenture

The introduction of the Accrual Debenture instrument is intended to ensure that SBA can support the full spectrum private market investments in Small Businesses.

- Introduces the Accrual Debenture, a debenture instrument without a semi-annual interest payment requirement (required for the existing Standard Debenture product) issued at face value that accrues interest over its ten-year term.
- SBA guarantees all principal and unpaid accrued interest. Interest and Annual Charge must be paid in advance of distributions to limited partners.
- Licensees issuing Accrual Debentures shall not be permitted to make distributions within 12 months of Licensure.
- To determine the maximum amount of leverage that Accrual SBICs and Reinvestor SBICs may have outstanding, SBA will aggregate the total principal leverage plus ten years of accrued interest on such principal to determine the total Accrual Debentures that the Accrual SBIC or Reinvestor SBIC may issue based on the statutory limitation.
- Accrual SBICs maximum leverage = 1.25x tiers (ratio of SBA debenture leverage to private regulatory capital of 1.25:1.00).
- Reinvestor SBIC max leverage = 2.0x tiers.

Accrual Debenture Leverage

Accrual SBICs are eligible for Accrual Debenture Leverage (principal) up to 1.25x private capital

Reinvestor SBICs are eligible for Accrual Debenture Leverage (principal) up to 2x private capital.

SBA's maximum *Total Intended Leverage Commitment* represents principal. As with Standard Debenture SBICs, SBA will provide Leverage Commitments which represent principal only.

However, SBA is required to guarantee all principal and interest for debenture trust certificate holders. To safeguard against a default scenario in which the combined interest and principal balance grow in excess of \$175m, Accrual Debenture *Total Intended Leverage Commitments* will be below \$175m.

Accrual Debenture Leverage Repayment

Reserve Leverage Commitment – After paying off Annual Charges and all accrued interest, Accrual SBICs and Reinvestor SBICs are to repay Outstanding Leverage principal pari passu with limited partners up to the value of Outstanding Leverage.

SBA does not participate in the profits of Licensees, however SBA will track the profit potential SBA could have participated in by utilizing Leverage Commitment cancellation tracking. **Please note, assuming a Licensee is in good standing,** SBA will allow the SBIC to apply for the reinstatement of a cancelled debenture *Commitment Amount*. Commitment requests are limited to the *Total Intended Leverage Commitment Amount**.

**With the exception of Low-income and Energy Saving Qualified Investments eligible for additional leverage subject to the limitations expressed in section 303 of the SBIC Act and its implementing regulations.*

Fund-of-Funds Reinvestor SBICs

Reduces regulatory restrictions on investments in reinvestors to permit fund-of-funds or “Reinvestor SBICs” with a focus on underserved communities and markets. Reinvestor SBICs can make Equity Capital Investments in underserved non-SBA leveraged limited partnerships, SBICs or non-SBIC licensed funds, that:

- finance businesses that meet SBA’s small business size standards,
- are owned and controlled by U.S. citizens and/or entities headquartered in the United States, and
- have at least 50 percent of employees based in the United States at the time of investment.

SBA's prior written approval is not required in connection with Reinvestor SBIC co-investments if an unaffiliated and unassociated third-party investor is contributing Equity Capital Investments to the portfolio concern alongside the Reinvestor SBIC. At least one substantial third-party investor, unaffiliated and unassociated with the Reinvestor SBIC, must be investing on the same terms as the Reinvestor SBIC.

Application Pre-Screening

Prior to August 17, 2023, the SBIC Application Pre-Screening form and pre-screen meeting were separate and distinct from the SBIC licensing process.

The Application Pre-Screening form is now a **subset** of the Management Assessment Questionnaire (MAQ) to help prospective applicant begin developing an application and to support evaluation of potential program fit.

Prospective Applicants are encouraged to download the Pre-screen form 2181 on SBA.gov, complete the form and submit to SBA via SBIC_Applications@sba.gov. Once received, SBA will follow up to schedule a courtesy pre-screen meeting to answer questions and discuss your completed form.

Application and Green Light Process

After the pre-screen, or as the first step if the pre-screen is omitted, the prospective applicant completes SBA Long Form 2181, the *Management Assessment Questionnaire* (MAQ), including relevant legal documentation that is required to be submitted as set forth in the Form 2181 Attachment Checklist.

The MAQ must be filed, in its entirety, during one of four quarterly filing windows designated below. Contemporaneously, the non-refundable Initial Licensing Fee must be paid on Pay.gov.

Incomplete MAQ submissions will not be accepted for processing. If an applicant fails to file by the deadline date for a quarterly filing window, it must wait until the next quarterly window to refile – late applications will not be accepted. MAQ submissions should be emailed to SBIC_Applications@SBA.gov. The four quarterly filing windows are as follows:

- (1) December 31
- (2) March 31
- (3) June 30
- (4) September 30

SBA will hold **an interim filing window on November 1, 2023.**

Licensing Prioritization

- SBA will prioritize all complete MAQ applications submitted by the quarterly deadline.
- If applications are still in process upon the subsequent quarterly deadline, they will **not** be deprioritized behind new applicants received a quarter later.
- SBA has established the following strategic priority investment themes to be implemented through licensed SBICs:
 - ✓ Under-licensed States
 - ✓ National Security
 - ✓ Domestic Manufacturing and Production
 - ✓ Underserved Communities
 - ✓ Climate Change Mitigation, Adaptation and Renewable Energy
 - ✓ Adequacy of Financing Types and Sources

Licensing Timelines

- The complexity of an application can impact processing time (e.g., number of side letters, non-standard LPA terms, complex entity structures).
- That said, for applicants utilizing the SBIC Model LPA and with standard Management Company, GP, LP structures, SBA endeavors to move to schedule a manager interview to begin the Green Light Approval process within 4-12 weeks, depending on priority, of each quarterly submission deadline.
- Assuming no material adverse changes (MACs) after issuance of Green Light Letter and raising sufficient capital for an initial close, following payment of the Final Licensing Fee and submission of final license application documents, applicants should anticipate license approval in ~4 weeks*.

*MACs or other changes can significantly impact the timelines for issuance of license.

Licensing Fees

SBA will determine the applicant's Fund Sequence based on the management team composition and experience as a team, including the business plan (also known as the strategy) of the fund.

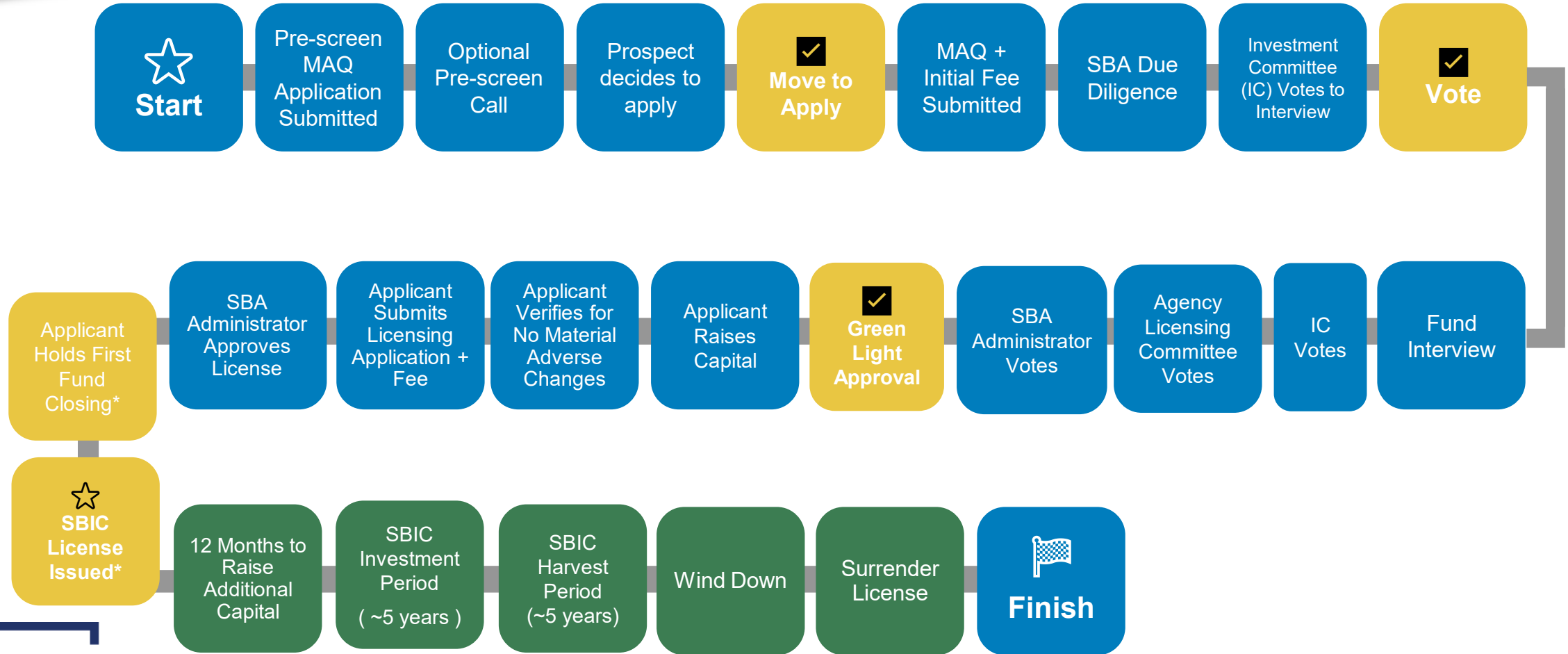
The Final Licensing Fee is calculated as the Final Licensing Base Fee plus 1.25 basis points multiplied by the Leverage dollar amount requested by the applicant, where the Final Licensing Base Fee is based on the applicant's Fund Sequence as follows:

Fund Sequence	Initial Licensing Fee
Fund I	\$5,000
Fund II	\$10,000
Fund III	\$15,000
Fund IV+	\$20,000

Fund Sequence	Final Licensing Base Fee
Fund I	\$10,000
Fund II	\$15,000
Fund III	\$25,000
Fund IV+	\$30,000

SBIC Program
Start to Finish

IMPROVED SBIC LICENSING AND OPERATIONAL LIFECYCLE POST REFORMS



*First close and License issuance to occur together.

The Green Light letter is a certification that the management team will be issued an SBIC license and the intended financial commitment from SBA at fund closing, provided that terms and conditions are met.



Licensee Qualifications

- a) Management qualifications.** Management qualifications, including demonstrated investment skills and experience as a principal investor, or a combination of investment skill and relevant industry operational experience; business reputation; adherence to legal and ethical standards; record of active involvement in making and monitoring investments and assisting portfolio companies; managing a regulated business, if applicable; successful history of working as a team; and experience in developing appropriate processes for evaluating investments and implementing best practices for investment firms.
- b) Demonstrated investment acumen.** Performance of proposed investment team's prior relevant industry investments as well as any supporting operating experience, including investment returns measured both in percentage terms and in comparison to appropriate industry benchmarks; the extent to which investments have been realized as a result of sales, repayments, or other exit mechanisms; evidence of previous investment or operational experience contributing to U.S. domestic job creation and, when applicable, demonstrated past adherence to statutory and regulatory SBIC program requirements.
- c) Strategy and fit.** Applicant's proposed investment strategy as presented in its business plan, including adherence to the Statement of Policy as stated in section 102 of the Act, clarity of objectives; strength of management's rationale for pursuing the selected strategy; compliance with this part and applicable provisions of part 121 of this chapter; fit with management's skills and experience; and the availability of sufficient resources to carry out the proposed strategy. As determined by SBA, a Licensee may not materially deviate from the proposed investment strategy after three years of Licensure.
- d) Structure and economics.** Applicant's proposed organizational structure and fund economics, including compliance with this part 107; soundness of financial projections and underlying assumptions; a compensation plan that provides managers with appropriate economic incentives; a reasonable basis for allocations of profits and fees to Persons not involved in management; and governance procedures that provide appropriate checks and balances.

Licensee Qualifications (continued)

- a) Experience investing or providing long-term loans to private small businesses and evidence of potential for strong “deal flow” **relevant to the proposed investment strategy of the fund.** In evaluating the relevance of prior investment experience to the investment strategy for the proposed SBIC, SBA considers such factors as the size, stage and structure of deals planned by the fund, as well as the targeted industries, geographic areas, and company characteristics.
- b) An applicant management team must, at a minimum, include two named senior principals (general partner or equivalent) with meaningful time commitments and substantial professional experience supportive of the fund’s proposed investment strategy and business plan. A “meaningful” time commitment does not have to be full-time, but it will be evaluated by SBA in the context of the proposed team as a whole, the applicant’s business plan, and the investment strategy of the fund. **At least one of these principals must possess substantial relevant investing or long-term lending experience aligned to the investment strategy proposed by the applicant.**
- c) **In alignment with the proposed investment strategy of the fund, evidence of a combined track record that contains a meaningful proportion of successful financial transactions, full or partial realizations or portfolio valuation mark-ups by unaffiliated outside third-parties which have occurred within the ten years prior to application,** and overall evidence of professional performance outcomes that are indicative of strong investment acumen, ability to manage an investment organization, and good stewardship of investor capital. Among other things, SBA will consider such factors as the asset class, strategy of investments, expected duration, and performance on an absolute and relative basis compared to standard industry benchmarks for similar types of investment strategies to assess track record. SBA will also consider the age of the investment, transaction, and operations track record and, for investments and transactions, **such “quality” factors as the number of deals, the manager’s involvement in deals from start to finish, and whether the overall returns are largely dependent on a single deal.**
- d) Cohesive management team, with complementary skills and alignment of incentives and structure to maintain such cohesion over the life of the fund. The management team preferably will include principals who have previously worked together in some capacity in a corporate, investment, or non-profit capacity. **SBA will consider a history of co-investing or other successful working relationships. SBA will evaluate the balance in the skills, experience, and influence among each of the team members as well as the potential influence of any anchor investors or other outside parties having ownership interests in the applicant’s GP/management company.**

Expedited Subsequent Fund Processing

SBA has introduced an expedited subsequent fund licensing process for eligible applicants while maintaining current risk management standards and practices.

- ✓ must be in good operational and regulatory compliance standing with SBA
- ✓ must have at least two full years of operations from date of licensing of the most recently licensed SBIC
- ✓ The financial performance and portfolio valuations of the current licensee(s) must demonstrate adequate coverage for any outstanding SBA Leverage
- ✓ present a clean audit opinion from the SBIC's independent public accountant, covering the most recent, full year of operations, and no unresolved regulatory violations for the most recent SBA exam covering a period ended within 12 months of the request being filed

Application Criteria for Subsequent Fund Expedited Processing

- (1) Consistent strategy and fund size**—proposed fund size is $\leq 133\%$ the size of their most recent licensee and same investment strategy.
- (2) Clean Regulatory History**—no major findings, significant “other matters” or unresolved “other matters” in the previous 10 years.
- (3) Consistent LP-GP Dynamics**—a new limited partner will not represent $\geq 33\%$ of the Private Capital of the licensee upon final close. The two largest investors in the current licensee have verbally committed. LPA and any Side Letters are not materially changing for the applicant fund.
- (4) Investment Performance Stability**—the most recent licensee net DPI and net TVPI are at or above median Cambridge performance benchmarks for the relevant asset class and strategy for the prior 3 quarters. Current licensee not in default or with high Capital Impairment (CIP).
- (5) Consistent or Reduced Leverage Management**— the applicant is requesting a leverage to Private Capital ratio \leq the current or most recent SBIC licensee at target fund size or hard cap.
- (6) Firm stability**—subject to SBA’s determination, no material changes to the broader firm to include resignations, terminations, or retirements by members of the General Partnership, investment committee, broader investment team or key finance and operations personnel.
- (7) Promotions from within**—demonstration of promoting internal investment team talent from the firm/organization sponsoring the license.
- (8) Inclusive equity**—demonstration of increased sharing of carry and/or management company economics with promoted talent or distribution of more equitable economics among the partnership.
- (9) Clean Criminal Record**
- (10) No Outstanding or Unresolved Material Litigation Matters**
- (11) No Outstanding Tax Liens**

See SOP 10 10 0 for more specific detail

Watchlist

Watchlist triggers. SBA **MAY** place you on the Watchlist for any of the following:

- (1) You perform an investment that is a direct violation of your fund's stated investment policy as identified in its limited partnership agreement (or other governing agreement) or as presented to SBA in its license application under § 107.300.
- (2) The key person clause in your limited partnership agreement (or other governing agreement) is invoked due to a change in personnel of management team members identified as key persons.
- (3) You or your General Partner has been named as a party in litigation proceedings brought by a Federal agency, involving felony charges, or allegations of dishonesty, fraud, or breach of fiduciary duty.
- (4) You have violated a material provision in your limited partnership agreement (or other governing agreement) or any side letter agreement.
- (5) You rank in the bottom quartile for the primary strategy benchmark, as identified by the Licensee at the time of licensure, by vintage year, defined as the year in which you were licensed as an SBIC, after three years based on the private investor's total value to paid-in capital (TVPI), where TVPI is calculated as (cumulative distributions to private investors plus net asset value minus expenses and carried interest)/cumulative private investor paid in capital.
- (6) Your leverage coverage ratio (LCR) falls below 1.25, where LCR is calculated as (unfunded Regulatory Capital commitments plus net asset value minus outstanding Leverage)/outstanding Leverage or a Capital Impairment Percentage approaching your threshold set forth in § 107.1830.
- (7) You default on your interest payment and fail to pay within 30 days of the date it is due. (Note: This event represents an event of default under § 107.1810(f) for which SBA maintains its rights under § 107.1810(g) if the Licensee does not cure to SBA's satisfaction.)
- (8) Outstanding or unresolved regulatory matters.