Billing C

SMALL BUSINESS ADMINISTRATION

13 CFR Parts 107 and 121

RIN 3245-AH90

Small Business Investment Company Investment Diversification and Growth

AGENCY: U.S. Small Business Administration.

ACTION: Final rule.

SUMMARY: On October 19, 2022, the U.S. Small Business Administration ("SBA" or "Agency") published a notice of proposed rulemaking ("NPRM" or "proposed rule") to revise the regulations for the Small Business Investment Company ("SBIC") program to significantly reduce barriers to program participation for new SBIC fund managers and funds investing in underserved communities and geographies, capital intensive investments, and technologies critical to national security and economic development. The proposed rule introduced an additional type of SBIC ("Accrual SBICs") to increase program investment diversification and patient capital financing for Small Businesses, modernize rules to lower financial barriers to program participation, and incorporate the statutory requirements of the Spurring Business in Communities Act of 2017, which was enacted on December 19, 2018. This final rule implements proposed regulatory changes as modified to address comments SBA received.

DATES: This rule is effective [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT:

Policy: Bailey G. DeVries, Associate Administrator of the Office of Investment and Innovation, Small Business Administration, oii.frontoffice@sba.gov, 202-941-6064. This phone number can also be reached by individuals who are deaf or hard of hearing, or who have speech disabilities, through the Federal Communications Commission's TTY-Based Telecommunications Relay Service teletype service at 711.

Regulatory Comments/Federal Register Docket: Nathan Putnam, Office of Investment and Innovation, Small Business Administration, oii.frontoffice@sba.gov, 202-699-1746. This phone number can also be reached by individuals who are deaf or hard of hearing, or who have speech disabilities, through the Federal Communications Commission's TTY-Based Telecommunications Relay Service teletype service at 711.

SUPPLEMENTARY INFORMATION:

I. **Background Information**

A. Small Business Investment Company Program

The mission of the SBIC program is to enhance small business access to capital 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." SBA carries out this mission by licensing and monitoring privately owned and managed investment funds that raise capital from private investors ("Private Capital") and issue SBA-guaranteed Debentures ("Debentures") to make private long-term equity and debt investments into qualifying Small Businesses.

SBA currently has two types of Debentures available for private funds that have received an SBIC license: a current pay (or "Standard") Debenture and a "Discount" Debenture. The vast majority of licensed SBICs applying for SBA Leverage use the Standard Debenture with a ten-year maturity and interest due and payable on a semi-annual basis. This structure aligns with the cash flows of a subset of private fund strategies, including funds with mezzanine, private credit, and leveraged buyout strategies because private funds utilizing such mezzanine, private credit, or leveraged buyout strategies typically generate fund-level cash liquidity within the time period required to meet semi-annual interest payments. The Discount Debenture is issued at a steep discount to face value and accrues to face value over five years, at which time SBICs must pay current interest; this Debenture is only available for low and moderate income (LMI)

investments and Energy Saving Qualified Investments (as defined in 13 CFR 107.50). Although SBICs have invested almost 20% of their investments in LMI areas, as of December 31, 2021, less than 0.5% of Debentures committed and issued since Fiscal Year ("FY") 2000 used the Discount Debenture to make such investments. No SBIC has used the Discount Debenture for Energy Saving Qualified Investments. Market feedback suggests that the reason SBICs do not utilize the Discount Debenture is due to the steep discount at issue and the misalignment of the required interest payments commencing at year five to the typical cash flow patterns of patient capital investors, such as long-duration private equity funds. Between FYs 1994 through 2004, SBA was authorized to issue Participating Securities, which were an SBIC Program instrument designed to support equity investors. The program ceased due to losses in that program.

Based on SBA's analysis of SBICs licensed for the legacy Participating Securities instrument, SBA found widespread evidence that participating security SBIC losses were largely due to the instrument's statutorily mandated structural flaws and regulations which enabled high risk portfolio construction decisions. These issues were further exacerbated by macro-economic conditions, concentration in early-stage venture (which, at the time, was an emerging alternative investment strategy), and pervasive information asymmetry in the venture market in the early 2000s. One of the major flaws in the participating security was that SBA advanced interest payments (known as "prioritized payments") on behalf of the Licensee and was only repaid out of the Licensee's profits. Since over half of these SBICs were not profitable, less than half of the $2.8 billion in prioritized payments advanced by SBA were reimbursed by SBICs licensed in the Participating Securities program. Due to the complexities associated with the statutory Participating Securities distribution waterfall, computing a single distribution required a significant amount of time and effort on the part of the Licensee and SBA. For example, Licensees were required to file hard copies of the computation documents with SBA for regulatory monitoring and examination purposes. These complications increased the workload on SBA to calculate each distribution, increased fund administration expenses for the Licensee,

and created loopholes whereby Licensees could sequence profits distributions such that SBA would receive only its capped share of profits (typically less than 10%). In several cases, private investors received substantial returns based on early profit distributions and the SBIC would subsequently incur losses, resulting in SBA being the only party not fully repaid. Further, Licensees in the Participating Securities program typically did not have diverse portfolios and SBA did not consider portfolio diversification at the fund-of-fund level as a means to mitigate risk, an important consideration in modern portfolio theory. As a result, about half of the participating securities financings prior to 2001 were in computers, information technology, and related professional technical services. Additionally, almost half of the participating securities financings prior to 2001 were in companies under two years of age at first financing. As a result, when the "dot com" bubble financial downturn arrived in 2000, the SBIC portfolio was not appropriately diversified for sustained portfolio financial performance.

Between October 1, 2016, and September 30, 2021, SBICs provided over $29 billion in financings to Small Businesses. However, only 18 percent of Debenture SBIC financings were in the form of patient capital equity investments, and less than a quarter of SBICs licensed were focused on equity. Over 75 percent of all financings of Small Businesses by Debenture SBICs included a debt component. During this same timeframe, SBA licensed 116 SBICs with almost $7.8 billion in initial Private Capital, and two-thirds of licenses were approved for subsequent funds from asset management firms that had previously received an SBIC license. As of December 31, 2021, SBA had 298 operating SBICs across 207 asset management firms with almost $35 billion in Regulatory Capital and Debentures, including undrawn commitments.

B. Notice of Proposed Rulemaking

The Small Business Investment Act of 1958, as amended (the "Act") declares to be the policy of the Congress and the purpose of the Act to improve and stimulate the national economy in general and the small-business segment thereof. The Act states as the intention of Congress "financial assistance under this Act, when practicable, priority be accorded to small business

concerns which lease or purchase equipment and supplies which are produced in the United States" and "financial assistance provided hereunder shall not result in a substantial increase of unemployment in any area of the country." The Act further authorizes the SBA Administrator "to prescribe regulations governing the operations of small business investment companies."

On October 19, 2022, SBA proposed changes to 13 CFR part 107 (87 FR 63436) to reduce barriers to program participation for new SBIC fund managers and funds investing in (i) underserved communities and geographies, (ii) capital intensive investments, and (iii) technologies critical to national security and economic development. This rule also was intended to implement Executive Order ("E.O.") 13985, Advancing Racial Equity and Support for Underserved Communities Through the Federal Government, by reducing financial and administrative barriers to participation in the SBIC program and modernizing the program's license offerings to align with a more diversified set of new funds investing in underserved small businesses. Changes included 1) implementing a new type of Debenture ("Accrual Debenture") designed to align with the cash flows of long-term, equity-oriented funds ("Accrual SBICs"); 2) revising the existing prohibited investment requirements under 13 CFR 107.720 that permit SBICs to invest in relenders or reinvestors under specific circumstances; 3) modernizing the licensing, operations, and examinations rules to lower costs and administrative barriers faced by new funds applying to the SBIC program; 4) implementing a formal licensee "Watchlist" process; 5) implementing a consistent approach to investor and SBA distributions; 6) implementing some of the modernization improvements it received through a **Federal Register** notification (82 FR 38617) and round tables in 2017; and 7) formally implementing the Spurring Business in Communities Act, Pub. L. 115-333.

C. Comments

SBA received 15 comment letters related to the proposed rule or the SBIC program and two comments that were not related to the proposed rule or the SBIC program. Those comments that

addressed the content of the proposed rule or were pertinent to the rule are discussed in the Section-by-Section Analysis below. Some of the comments related to the SBIC program were not directly within the scope of the rule but are briefly addressed below.

Comments Related to the SBIC Program But Not Directly Within Scope of the Proposed Rulemaking

Three comments focused on the timeline of the SBIC licensing process, a matter addressed in the context of applicants from Underlicensed States within proposed changes to 13 CFR 107.300. One comment focused on whether anticipated approval timeframes for applicants who have successfully raised Private Capital could be shortened. Two comments focused on how an expedited licensing process would be valuable and how a clear, defined, expedited timeline could be critical to increasing underserved fund manager applications. In response to these comments, SBA intends to move forward with two courses of action: (1) introduce an expedited subsequent fund licensing process for eligible applicants while maintaining current risk management standards and practices (see discussion of Expedited Subsequent Fund licensing in section II.D. and revisions to 13 CFR 107.305, below), and (2) modify standard operating procedures to increase transparency in the licensing process and decrease potential tail-end delays.

One commenter recommended an amendment to 13 CFR 107.501 requiring SBA to publish in the **Federal Register** the names of SBICs that were licensed and the dates on which SBICs were licensed. SBA appreciates this recommendation and will publish license approvals in the **Federal Register** within 30 business days of the end of the month in which the license was approved by the SBA Administrator.

One commenter encouraged SBA to underscore the importance of operational capability to the SBIC program by adopting an exclusion from the management fee offset requirement for fees paid by portfolio companies to operations teams aligned formally with an SBIC licensee. SBA agrees that operating partners, venture partners, portfolio services teams and venture studio

models provide valuable technical assistance and networking for SBIC portfolio concerns. SBA recognizes the management fee offset (including fees for services provided to portfolio concerns) is often negotiated between private funds and their limited partners and will approve the scope and type of services included or excluded from management fee offsets during the licensing process. Upon licensure, an SBIC Licensee must adhere to the scope of the approved management fee plan.

One commenter suggested, in pursuit of increased fund manager diversity, that SBA create new programs that help Licensees, particularly new Licensees, increase their chances of success while gaining valuable experience. SBA agrees with the posture of "field-building" and seeks to do so in this final rule through (a) reducing regulatory restrictions on investments in reinvestors and (b) the introduction of the Accrual Debenture, both of which will enable access to capital to more first-time and emerging fund managers through SBIC fund-of-funds strategies.

One commenter suggested putting processes in place for SBICs to collect and share data of entrepreneurs obtaining capital disaggregated by gender, race, and ethnicity. SBA agrees that transparency into the demographics, as well as more detailed geographic data, of portfolio concerns and licensees will enable greater public understanding of the SBIC program impact. As such, SBA is making modifications to existing data collections that enable voluntarily reporting of this information from licensees and their portfolio concerns.

One commenter suggested SBA work more closely with limited partners (investors in SBICs) and share SBIC program financial returns information, as it could help first-time and emerging managers raise more Private Capital. SBA agrees with this comment. As such, SBA is considering modifications to the existing Form 468 to consistently collect industry standard investment performance metrics including Total Value to Paid-in Capital, Distributed to Paid-in Capital, Residual Value to Paid-in Capital, and Gross and Net Internal Rate of Return on a quarterly and annual basis. This will enable SBA to publicly report on the investment performance of the overall SBIC portfolio, by vintage year, investment strategy and emerging vs.

established SBIC funds. SBA will not publicly disclose the investment returns of individual Licensees.

One commenter suggested SBA create a diversity working group which would include SBA staff, principals of SBIC Licensees, and industry participants. This working group would support the stated efforts of SBA to recruit a more diverse set of managers to the SBIC program. SBA agrees with the substance of this comment and believe that this can be addressed through the Agency's recently announced Federal Advisory Committee (the SBA Investment Capital Advisory Committee) established under the Federal Advisory Committee Act.

One commenter requested SBA consider rule changes now and in the future that would further encourage the SBIC program to focus on technology and tech-driven companies which address critical national priorities, including addressing climate change, strengthening supply chains, improving health outcomes, and bolstering national security. SBA agrees with the substance of this comment. The program-wide diversification rules support prioritization of undercapitalized industries and technologies, particularly those aligned to seeding, scaling and transitioning technologies critical to U.S. national security.

One commenter expressed support for SBA's proposed rule extending the affiliation exceptions under 13 CFR 121.103(b)(5) to private equity partnerships organized as a 3(c)(7) funds. The commentator also referenced a 2015 comment letter concerning 13 CFR 107.720(b) and suggested further modification to SBA's passive business investment rule. SBA does not intend to change the passive investment rules.

One commenter supports a rule that lowers barriers and advances racial equity and asks that the rule consider opportunities to support emerging managers. SBA agrees with the substance of this comment and is implementing several program modernizations to support this objective including removal of "reinvestment" restrictions which prohibit Section 301(c) Licensees from investing in a fund-of-funds capacity in emerging managers, scaled licensing fees, and reductions in administrative burdens.

One commenter suggested SBICs licensed under the proposed rule should be allowed to participate to a limited degree (10-15 percent of the total invested into a company) in secondary sales—*i.e.,* supplementary funding provided at financing for purposes other than funding the operations of a Small Business. SBA agrees this has become a standard industry practice. Current regulations do not restrict partial secondary sales from current investors in future financing rounds.

One commenter proposed an additional change to the definition of Leverageable Capital by suggesting a definition change to the sum of Regulatory Capital, excluding unfunded commitments, and the greater of $0 or 50 percent times the total of the financed investments made by the Licensee less the Leverage provided by SBA and Regulatory Capital, excluding unfunded commitments. SBA appreciates this suggestion and notes that SBA is revising the definition of Regulatory Capital to be more explicit regarding how to interpret the exclusion clause. As such, SBA is revising the *exclusion of questionable commitments* to clarify that an unfunded commitment may be questionable due to lack of enforceable legal agreements under United States law or an issue of collectability for financial or any other reason, or both. SBA notes that the unfunded commitment of an investor that has satisfied the applicable net worth test set forth in the definition of Institutional Investor will not be of questionable collectability (for financial reasons) if the Licensee's Limited Partnership Agreement (or other governing agreement) contains sufficient remedies against defaulting investor to ensure collection. Furthermore, SBA is revising the definition of *Regulatory Capital* to highlight the distinction between Regulatory Capital and Leverageable Capital—*i.e*., that Regulatory Capital which is not in the form of unfunded commitments is Leverageable Capital.

General Comments About the Rulemaking

One commenter asked why the proposed rule refers to October 1, 2023, several times. SBA is removing the reference to October 1, 2023, except with respect to implementation of the

minimum Annual Charge. One commenter suggested that SBA follow this comment period with an "Interim Final Rule" instead of a final rule. SBA has followed the Federal rulemaking and comment process. During the 60-day public comment period, SBA raised awareness for the proposed rule through events noted on the **Federal Register**. (*See, e.g.*, 87 FR 68109) The comments received by SBA are robust and significant relative to historical rulemaking feedback received on regulations governing the SBIC program. SBA is confident that the robust engagement from the public enables the agency to publish and implement a final rule.

One commenter stated that they are supportive of increased "underserved" focus. SBA appreciates support for the increased focus on underserved communities and industries.

II. **Section by Section Analysis**

A. Section 107.50 Definition of terms.

In the proposed rulemaking, SBA proposed adding two terms associated with the new Accrual Debenture discussed in section I.B. of this rule: "Accrual Debenture" and "Accrual Small Business Investment Company ("Accrual SBIC")." The Accrual Debenture means a Debenture issued at face value that accrues interest over its ten-year term, where SBA guarantees all principal and unpaid accrued interest. As discussed in the preamble, SBA believes that the Standard Debenture does not align with the cash flows needed for patient capital strategies primarily investing in the equity of or providing revenue-based financing to Small Businesses.

One commenter supported the introduction of Accrual Debenture SBICs and administrative changes to facilitate access for first-time fund managers. SBA appreciates this support for the Accrual Debenture financial instrument and administrative changes to facilitate access.

Two commenters supported expansion of the asset classes and strategies of private funds participating in the SBIC program, yet had concerns about incorporating "highly risky, very long-term, early investments which may span 10-15 years before failure or success are determined." There were additional comments regarding the management and oversight of

taxpayer exposure to potential defaults and losses in the SBIC Program. One commenter urged SBA to publicly produce the distribution models displaying how the SBIC program will maintain a zero-subsidy rate with the addition of an alternative debenture instrument to the existing semi-annual interest payment debenture instrument. SBA appreciates the public's concern for portfolio risk management and credit risk management processes in a Federal credit program. Among others, risks in private investing come in many forms. including illiquidity risk, duration risk, volatility risk, concentration risk, credit risk, and tail-event risk. Over several decades, SBA has found that illiquidity risk, duration risk, and strategy concentration risk correlate with the highest risk of overall program losses. The Accrual Debenture instrument combined with the portfolio diversification rules address these three primary risk considerations through cash flow matching, duration and repayment management, and guardrails to prevent the overall program from over-concentrating in more volatile 'risk-on' strategies. As with all private fund investments, proper investment and operational due diligence and ongoing portfolio monitoring is essential to safeguarding capital.

Three comments remarked on the control provisions related to Accrual SBICs. One comment was concerned that by excluding control equity funds from securing licenses for the Accrual Debenture, SBA will hamper its ability to achieve the goals of the SBIC program noting that allowing control equity strategies will reduce the overall risk of the new Accrual class. Another comment encouraged SBA to include buyout funds in Accrual SBICs by removing the restriction that they are required to own less than 50 percent at the time of initial financing. SBA also received a comment noting that strict requirements may limit the universe of investible companies and interest from investors and suggested that SBA further study the potential impact of these requirements. Finally, two comments raised general concerns around the provision that Accrual SBIC licensees will generally own no more than 50 percent of the Small Business at initial Financing. SBA agrees with the recommendation to encourage more private markets flexibility and dynamism with the adoption of the Accrual Debenture instrument. As such, SBA

is removing both the language in the proposed rule which restricted ownership of a portfolio concern at the time of initial Financing to less than 50% and the guidance that at least 75% of financing by an Accrual SBIC be classified as equity. SBA's objective with the introduction of the Accrual Debenture is to offer a financial product aligned to investment strategies with longer duration and strategies with more episodic distributions to investors. The introduction of the Accrual Debenture instrument is intended to ensure that SBA can support the full spectrum and the dynamic nature of private market investments in Small Businesses. Between the existing Standard Debenture and the Accrual Debenture instrument, SBA will increase program flexibility for greater private market participation resulting in increased benefits to small businesses. One comment stated that the increase in the oversight that the rule implements would result in costs to the taxpayer or increased fees. That commenter further noted that fee changes should consider rising interest rates and that when capital is drawn incrementally, taxpayer losses associated with rising inflation and interest rates are reduced. SBA has taken such factors into account in the program subsidy model which includes the President's Economic Assumptions. The model forecasts interest rates based on macro-economic conditions. Interest rates are set at the time of funding draws which mitigates risk of future taxpayer losses.

One commenter expressed concerns that the nature of the repayment terms of the Accrual Debenture could pose the same type of issues that resulted from the Participating Securities program. SBA performed extensive analysis and modeling of the historical defaults, repayments, recoveries and losses across Debenture instruments and the Participating Securities instrument when preparing the proposed rulemaking.

The following table summarizes preliminary modeling outputs for anticipated fiscal year cohort 2024 Accrual SBIC commitments.

SBIC Type	Fiscal Year Cohort	Lifetime Defaults (% of Disbursements)	Lifetime Recoveries (% of Defaults)	Net Loss Rate (% of Disbursements)
Accrual	2024	35.78	67.77	11.53

SBA assumes a higher default risk profile and net loss rate for anticipated Accrual Debenture Leverage compared to Standard Debenture leverage. This assumption is supported by an analysis of third-party private equity industry data and historical SBIC debenture performance data. Because accrued interest and leverage is repaid as profit distributions become available, SBA considered how fund performance will impact the expected loss rate on Accrual Debentures. SBA therefore estimated distribution to paid-in capital (DPI) and total value to paid-in capital (TVPI) assumptions for the Accrual SBIC population using custom venture capital and private equity benchmarks relevant to anticipated Accrual SBIC funds. These distributional assumptions are fed into a cash flow engine to estimate leverage repayments and defaults for anticipated Accrual SBIC Leverage commitments. SBA estimates the terminal DPI distribution for Accrual SBIC funds in the table shown below. The median terminal DPI assumption is just above the forecasted breakeven point to repay all accrued interest and leverage (approximately 1.20). SBA forecasts defaults on funds assumed to have a DPI at debenture maturity below the forecasted breakeven point.

Metric	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile
DPI	0.26	0.68	1.26	1.98	3.62

After blending forecasted cash flows for anticipated Accrual and Standard SBIC leverage and factoring in the estimated composition of debenture leverage by fund type (Accrual vs. Standard), SBA forecasts a 0.00 percent subsidy rate in the debenture program. To maintain a

0.00 percent subsidy rate in the debenture program, SBA estimates an annual fee charge landing between the annual charge implemented for fiscal years 2022 and 2023.

Further, SBA has taken several steps to mitigate risk to the program, such as limiting the leverage available to individual Accrual SBICs to one and one quarter tiers of leverage in relation to their Leverageable Capital and modifying the distribution waterfall for Accrual Debenture SBICs to ensure that SBA receives distributions on accrued interest and pro rata on principal with distributions to the private investors. SBA retains the ability to take action for regulatory defaults including uncured capital impairment, which remains vital to protecting U.S. taxpayer dollars.

The Accrual Debenture instrument is based on the successful features of the existing Debenture instrument with modifications to the distribution waterfall and timing of interest payments to reduce the risk of default and losses. The requirement for pro rata distributions to SBA is specifically designed to avoid the repayment issues that occurred in the Participating Securities program which included a flawed time-based return metric that enabled Participating Securities Licensees to pay a minimum amount to SBA and then forego future distributions if the SBIC subsequently performed poorly.

After consideration of all public comments, SBA has modified the final rule to state that the Accrual Debenture will only be available to Accrual SBICs and Reinvestor SBICs, defined in § 107.720, to align with the types of long-duration growth investing they primarily perform. Standard SBICs may only issue Standard Debentures and Discount Debentures. Approval to operate as an Accrual SBIC or Reinvestor SBIC is subject to SBA's investment due diligence, credit procedures, and statutory limitations. The final rule defines an Accrual SBIC as a Section 301(c) Licensee that elects at the time of licensing to issue Accrual Debentures. SBA expects that Accrual SBICs will most commonly be formed as limited partnerships that are subject to 13

CFR 107.160. These regulations will limit the Accrual Debenture to SBICs that focus on stimulating and supporting the creation and growth of Small Businesses.

A limitation of the Accrual Debenture is the amount of SBA leverage available to Accrual SBICs and Reinvestor SBICs. In order 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 may issue based on the statutory limitation. For example, if an Accrual SBIC has $100 million in Regulatory Capital, the total Accrual Debenture principal it may be approved for may be only $118 million if the forecast interest would accrue to approximately $57 million over a ten-year timeframe at a four percent interest rate, since higher amounts would result in SBA guaranteeing outstanding leverage amounts in excess of $175 million, the current statutory maximum for Leverage available to a single Licensee. SBIC applicants will be required to identify whether they intend to use Standard or Discount Debentures or if they intend to use the Accrual Debenture as an Accrual SBIC or Reinvestor SBIC.

SBA proposed modifying the definition of "Associate" regarding the status of an entity Institutional Investor based on its ownership interest in a Licensee. Currently an entity Institutional Investor whose ownership represents over 33 percent of the Licensee's Private Capital is considered an "Associate". SBA is revising regulations to change this to 50 percent or more to align with the financing practices of Community Development Corporations and other institutional investors seeking patient capital investment funds and first-time funds. Under the proposal, an entity Institutional Investor, as a limited partner in a partnership Licensee, will not be considered an Associate solely because that entity's investment in the Partnership, including commitments, represents 10 percent or more but less than 50 percent of the Licensee's Private Capital, provided that such investment also represents no more than five percent of the entity's net worth.

One commenter asked whether the definition of Associate is applicable to all types of SBICs and expressed reservations around financing practices misalignment between taxpayer-guaranteed Federal programs and not-for-profit community development corporations, which often focus heavily on real estate and affordable housing. SBA clarifies that the definition of Associate is applicable to all SBICs. Notwithstanding the focus of any type of potential Licensee, SBA regulations already restrict financings to certain real estate businesses. (See 13 CFR 107.720(c)) Moreover, SBA carefully evaluates the proposed investment strategy of each license applicant to ensure conformance with SBA regulations.

One commenter raised the potential unintended consequences of increasing, within the definition of Associate, the threshold percentage under which an entity Institutional Investor will be considered an Associate (from 33 percent to 50 percent) including the risk of giving a single investor nearly full control over governance matters including future amendments to a licensee's limited partnership agreement (LPA). The commenter recommended SBA withdraw the amendment and retain the current 33 percent threshold or, if it is raised, not increase beyond 35 percent. SBA seeks to increase regulatory flexibility through this final rule. The increased ownership threshold is a reflection of this principle. SBA appreciates that investors hold different governance and investment policy expectations which often must be agreed to by fund managers in order to receive a funding commitment. To protect the interests of limited partners in SBICs licensed prior to a final rule, SBA asserts this rule change *only* applies to funds licensed after the rule is implemented. Limited partners can align with the principals of SBICs on investor concentration and rights through their limited partnership agreement.

The proposed rule defined the term "Annual Charge" that is currently defined as "Charge" under current 13 CFR 107.50. SBA is implementing this change because this is typically the term used to refer to the annual fee associated with SBA-guaranteed Leverage in both SBA's website and much of its documentation, and more appropriately refers to the recurring payment associated with this Leverage fee. SBA will maintain the term "Charge" in its

regulations for backwards compatibility, but indicate it has the same meaning as "Annual Charge". Currently, the term "Charge" is defined as the annual fee on Leverage issued on or after October 1, 1996. Since there is no outstanding Leverage issued prior to October 1, 1996, this language will be removed from the definition. The current definition also states that the Leverage is subject to the terms and conditions set forth in § 107.1130(d). This final rule adds a reference to § 107.585. Although current § 107.585 identifies restrictions regarding reductions in Regulatory Capital (which are typically performed in conjunction with a distribution to its private investors), this final rule expands § 107.585 to define new distribution requirements for Accrual SBICs issuing Leverage. (See § 107.585 later in this final rule.) The final rule adopts the definition substantially as proposed.

SBA proposed amending the definition of "Control Person" under § 107.50 to clarify what constitutes a controlling relationship over a Limited Partnership Licensee with a government sponsored non-profit management company relationship. Section 107.50 is amended to state that when over 30 percent of the Private Capital managed by the Licensee comes from unaffiliated and unassociated entities (outside of their association as an investor in the Licensee), the management company of the Licensee is a government sponsored non-profit entity and the general partner(s) of the Licensee are bound by a fiduciary duty to the investors in the Licensee, the management of the Licensee can be determined to be free from outside control.

One commenter noted it would be helpful to the public if SBA would (i) provide an example or examples of situations that meet the proposed definition of "Control Person", and (ii) provide additional information in the rule that explains how changing the definition of "Control Person" does not further lessen SBA's control of Licensees, which exists with the current definition of "Control Person". SBA respectfully notes that it does not exert control over Licensees. SBA further notes that as set forth in 13 CFR 107.305, appropriate evaluation and risk mitigation measures including but not limited to: due diligence, background checks, review of

governance documents, transferee's liability contract and applicant certifications etc. are in place to ensure that SBA has properly evaluated any persons exerting control over Licensees.

Another commenter noted licensees or anchor funds that seek intentional or known future ownership of small businesses appears to be outside the intention or Statement of Policy by Congress in the Small Business Investment Act of 1958 for capital supplementation to small businesses versus control and ownership of small businesses. The SBA could not substantiate the commenters interpretation based on the Small Business Investment Act of 1958 and adds that permissive SBIC control of portfolio concerns for up to seven years is a longstanding principle of the program. The final rule adopts the definition substantially as proposed. In the proposed rulemaking, SBA sought public input for any suggested changes to "Equity Capital Investments" that SBA should consider. One commenter suggested that SBA adopt the definition of "qualifying investment[s]" for a venture capital fund from 17 CFR 275.203(l)-1 (Rule 203(l)-1 under the Investment Advisers Act of 1940) (or a substantially similarly definition). SBA will continue to maintain its definition of "equity capital investments." The proposed rule included under § 107.50 the terms "Final Licensing Fee" and "Initial Licensing Fee," as these terms have been defined in § 107.300 and used in § 107.410. The final rule adopts the definition substantially as proposed.

The proposed rule defined the term "GAAP" as "Generally Accepted Accounting Principles" as established by the Financial Accounting Standards Board (FASB), which refer to financial accounting and reporting standards for public and private companies and not for profit organizations in the United States. The U.S. Securities and Exchange Commission has recognized the financial accounting and reporting standards of the FASB as "generally accepted" under section 108 of the Sarbanes-Oxley Act. SBA is defining this term as the final rule refers to GAAP in various locations in the regulations.

SBA proposed amending the term "Leverage" to remove the inclusion of "Participating Securities" and "Preferred Securities" which are no longer available in the SBIC program and no

longer outstanding in operating SBICs. While SBICs with outstanding Participating Securities Leverage remain in the Office of SBIC Liquidation, those Licensees are subject to the regulations at the time that Leverage was issued. SBA also is amending the term Leverage to clarify that Leverage and SBA's guarantee would apply to both the principal and unpaid accrued interest associated with the Accrual Debenture. This definition will clarify SBA's guarantee in relation to the new security and the Leverage maximum restrictions regarding Accrual Leverage. For example, SBA will not approve Accrual Debentures for an amount in which the principal balance and ten years of accrued interest are projected to exceed the statutory maximum for leverage available to any single licensee (currently $175 million). This definition also clarifies the total capital that SBA is guaranteeing at any time. For example, if an Accrual SBIC had $20 million principal in Accrual Debentures that accrued $4 million in interest, SBA's guarantee would be $24 million, as SBA's guarantee extends to the accrued interest. SBA is required under statute to guarantee both principal and interest on outstanding leverage. This final rule requires SBA to estimate the interest rate associated with any Accrual Debenture commitment in a conservative manner to ensure that the total capital that SBA guarantees does not exceed its overall authority set forth in the Act or other applicable Federal laws.

SBA proposed the terms "Leveraged Licensee" and "Non-leveraged Licensee" in § 107.50. Current regulations provide greater flexibility to Licensees that do not have outstanding Leverage and do not intend to issue leverage since SBA has no credit risk. This final rule will provide further benefits and flexibility to such Licensees. In order to simplify the regulations, Leveraged Licensees would include any Licensee with outstanding Leverage, Leverage commitments, Earmarked Assets (which are only associated with Licensees that issued Participating Securities), and any Licensee that intends to issue Leverage in the future. The intent of the certification is to ensure that SBA applies the appropriate scrutiny to any Licensee that intends to seek Leverage in the future. This regulation is not intended to prohibit subsequent SBIC funds from seeking Leverage. This final rule also defines Non-leveraged Licensee as a

Licensee that has no outstanding Leverage or Leverage commitment, certifies (in writing) that such Licensee will not seek Leverage throughout the life of the fund, and has no Earmarked Assets. For example, if ABC, LP has outstanding Leverage of $10 million and subsequently (a) fully repays its outstanding Leverage, (b) has no further Leverage commitments, (c) has no Earmarked Assets, and (d) certifies that it will not seek any Leverage in the future, ABC, LP would be considered a Non-leveraged Licensee, even if the management company of ABC, LP also has a Leveraged Licensee (ABC II, LP) with outstanding Leverage of $20 million. As another example, if DEF, LP is granted an SBIC License and certifies to SBA (in writing) that it does not intend to issue Leverage, SBA would consider DEF, LP to be a Non-leveraged Licensee. This final rule adds the proposed terms substantially as proposed.

In the proposed rule, SBA proposed to define the term "Qualified Line of Credit" to describe a form of secured borrowing which would be available to leveraged licensees under § 107.550(c). Considering the matter further, SBA decided to use the more descriptive term "Capital Call Line" to align with industry terminology and to better describe what is essentially the same type of borrowing to be permitted under § 107.550(e). (See section II.I. of this rule.)

SBA proposed changing regulations to modify the term "Retained Earnings Available for Distribution" to include the acronym "READ" and to clarify that READ distributions must be performed in accordance with the proposed § 107.585. This final rule adopts the modification and clarifies that READ distributions must be performed in accordance with the revised § 107.585.

SBA proposed changing regulations to add the terms "SBIC" or "Small Business Investment Company" to have the same meaning as Licensee. SBA uses the terms "SBIC" and "Licensee" interchangeably throughout the regulations and in its policies and documents. SBA also proposed changing regulations to add the term "SBIC website" as www.sba.gov/sbics, which is the public website that SBA maintains all information on the SBIC program, including all standard operating procedures, policies, SBIC forms, and any reports that SBA publishes

from time to time. Regulations refer to this site throughout the regulations. This final rule adopts the changes as proposed.

The proposed rule added the terms "State" and "Underlicensed State" in § 107.50 to support implementation of Pub. L. 115-333 which gives priority in Licensing to applicants headquartered in Underlicensed States with below median SBIC financing. The term "State" will be defined to include all fifty States, the Commonwealth of Puerto Rico, the District of Columbia, and all U.S. territories with permanent populations (Guam, U.S. Virgin Islands, Northern Mariana Islands, and American Samoa). The term "Underlicensed State" means a State in which the number of operating licensees per capita is fewer than the median number for all States. To determine the per capita per State, SBA will use the most recent resident population from the U.S. Census as of the date of the calculation. SBA will publish the list of Underlicensed States periodically on the SBIC website.

One commenter expressed support of the "under-licensed state" concept and suggested expanding the concept to "under-licensed region." Another commenter requested as an extension of the proposed change to include Underlicensed States where there are little to no licenses for minority and women-led SBIC funds. In this final rule, SBA is implementing regulations in support of the "Spurring Business Act of 2017." Additionally, SBA has outlined an increased focus on "underserved" broadly in this final rule which includes geographies as well as communities. The final rule adds the terms substantially as proposed.

SBA proposed to add the term "Total Leverage Commitment" to have the meaning as defined in proposed § 107.300. This final rule adds the term "Total Intended Leverage Commitment" to have the meaning as defined in revised § 107.300. As discussed under that section, SBA is changing regulations to approve the Total Intended Leverage Commitment at the time of licensing.

SBA proposed changing regulations to add the term "Enhanced Monitoring" as defined in the proposed §107.1850. As discussed under that section, SBA has replaced "Enhanced

Monitoring" with "Watchlist" and is implementing the Watchlist process in this final rule (previously outlined under Standard Operating Procedures) to better monitor SBICs.

SBA proposed changing regulations to change the term "Wind-up" Plan to "Wind-down" Plan throughout part 107 because SBA believes that it better reflects the wind-down of a fund at the end of its life cycle. This final rule adopts the change as proposed.

B. Section 107.150 Management ownership diversification requirements.

This regulation identifies the SBIC ownership diversification requirement under section 302(c) of the Act (also referenced in part 107 as the "diversification requirement"). That section requires SBIC ownership be "sufficiently diversified from and unaffiliated with the ownership of the licensee in a manner that ensures independence and objectivity in the financial management and oversight of the investments and operations of the licensee." To ensure independence per statute, current § 107.150(b) requires that "no Person or group of Persons who are Affiliates of one another may own or control, directly or indirectly, more than 70 percent of your Regulatory Capital or your Leverageable Capital." In the proposed rulemaking, SBA proposed changing regulations to remove the "indirectly" requirement to provide greater clarification as to sources of Regulatory Capital available to an SBIC.

As an exception to the diversification ownership requirement under § 107.150(b)(1), SBA allows an investor that is a Traditional Investment Company (a term defined in 13 CFR 107.150(b)(2)) to own and control more than 70 percent of the Licensee's Regulatory Capital. Such SBICs are essentially drop-down funds for that Traditional Investment Company and are structured exclusively to pool capital from more than one source for the purpose of investing and generate profits. SBA proposed changing regulations also to include non-profit entities to also own more than 70 percent of the Licensee's Regulatory Capital to facilitate capital raising efforts, particularly for first-time funds and funds targeting investments in underserved geographies and critical technologies.

By meeting the requirements of § 107.150(c)(2), such non-profit entities would be exempt from requirements under § 107.150(c)(1) which state that the management of the Licensee must be unaffiliated from the sources of Regulatory Capital. It should be noted that SBA will continue to review and monitor such entities to ensure that the SBIC is a for-profit vehicle for the non-profit, the management of the Licensee is bound by a fiduciary duty to investors, and to ensure such entities do not pose undue investment or operational risk to SBA.

Two commenters supported the regulation as proposed. One commenter suggested allowances for non-profit entities to control more than 70 percent of the Licensee's Regulatory Capital. SBA appreciates the comment. In terms of extending the allowance beyond that of "traditional investment companies", SBA believes, at this time, consistency with existing practices and regulations is most prudent and will not extend beyond the 70 percent threshold.

One commenter opposed the proposed modification to the definition of "traditional investment company" to include non-profit entities. SBA appreciates the comment and seeks to clarify that this modification to the existing regulations does not permit SBA to license a non-profit entity as an SBIC. By statute, SBICs must be for-profit entities. The modification to the regulation permits up to 70 percent of the regulatory capital contributed to the for-profit SBIC to come from non-profit management company of a limited partnership SBIC. Non-profit entities are already permitted as the management company of limited partnership SBICs. The final rule provides guidance as to the extent of Regulatory Capital that can be provided by a management company with non-profit status. After consideration of all public comments, the final rule adopts the proposed § 107.150 without change.

C. Section 107.210 Minimum capital requirements for Licensees.

This section identifies minimum Private Capital requirements for SBICs. In the proposed reulemaking, SBA proposed amending the term "Wind-up" to "Wind-down" as previously discussed in section II.A. of this rule discussing § 107.50. SBA also proposed removing all references to "Participating Securities" since SBA no longer issues such leverage and any SBICs

in SBA's portfolio that issued such leverage are either in Wind-down or are monitored by the Office of SBIC Liquidations.

Paragraph (a)(1) requires SBICs (with the exception of Early Stage SBICs) to have Regulatory Capital of at least $5 million, but provides an exception for SBA, in its sole discretion and based on a showing special circumstances and good cause, to license an applicant with only $3 million if the applicant: (i) meets its licensing standards with the exception of minimum capital; (ii) has a viable business plan reasonably projecting profitable operations; and (iii) has a reasonable timetable for achieving Regulatory Capital of at least $5 million. Pub. L. 115-333 specifically allows an applicant licensed under this exception and located in an Underlicensed State to receive up to 1 tier of Leverage until the Licensee meets the $5 million minimum Regulatory Capital requirement. SBA proposed changing regulations to specify that one example of "good cause" would be the applicant is headquartered in an Underlicensed State. If licensed, Leveraged Licensees from Underlicensed States would be eligible for up to 1 tier of Leverage until they raise the $5 million minimum Regulatory Capital requirement.

One commenter supports the regulations and encourages clarification and expansion of "good cause" to ensure the exception is applied fairly and not solely based on geography. SBA appreciates the comment and notes that the "good cause" exception is not solely based on geography. Consistent with existing regulations, "good cause" factors may be applied in a non-exclusive manner based on criteria already specified in § 107.210. Further, SBA notes that any SBIC licensee that receives a license under the "good cause" exception must satisfy the requirements of 13 CFR 107.210, including satisfaction of all licensing standards and requirements except the minimum capital requirement, as determined solely by SBA, a viable business plan reasonably projecting profitable operations, and a reasonable timetable for achieving Regulatory Capital of at least $5,000,000.

One commenter asserted hesitation with the low thresholds established by statute under the regulation because of the potential risk to the program from licensing under-capitalized

licensees. The commenter also suggested SBA publish objective, quantifiable standards for fund sizes, ask Congress for higher "low limit", and warned SBA that using the "good cause" exception other than in rare instances involving a licensee's narrowly tailored circumstances would inject higher risk into the SBIC program that could trigger unintended consequences. Finally, the commenter suggested that Licensees should be allowed to accept "indirect" government funds, but this capital should not be leverageable. Further, it should not be used for satisfying the private market validation expectations for a license. SBA seeks to implement the statute as established by Congress. SBICs can accept government funds to the extent permitted by the Act. During the licensing process, SBA will continue to employ the concepts such as external validation and fund size viability when assessing applicants.

One commenter encouraged SBA to allow first-time managers to lower the Private Capital commitment threshold to between $10 to 15 million, in an effort to reduce barriers to program participation for first time and diverse fund managers. SBA shares the value of reducing barriers to participation for emerging and diverse managers. The expansion of reinvestor provisions coupled with the introduction of the Accrual Debenture seeks to enable access to capital to more first-time and emerging fund managers through targeted fund-of-funds SBIC relationships. SBA notes that SBICs with at least $5 million (or $3 million for "good cause") satisfies minimum capital requirements set forth in 13 CFR 107.210—however, SBICs must also meet the minimum adequacy requirements set forth in section 302(a)(3) of the Act. The final rule adopts the proposed § 107.210 without change.

D. Section 107.300 License application form and fee.

This regulation identifies the process and rules regarding applying for a License and the associated Licensing Fees. SBA proposed amending the introductory paragraph to give priority to applicants headquartered in Underlicensed States with below median SBIC financing dollars, in accordance with Pub. L. 115-333. Applicants may have branch offices in other locations, but the headquarters for the applicant must be in an Underlicensed State with below median SBIC

financing dollars to receive priority. The proposed regulation provides that SBA will publish the list of States in a notice on the SBIC website, which was previously discussed under section II.A. of this rule. SBA also proposed changing regulations to ensure that once priority is established, such applicants will continue to receive priority throughout the licensing process. For example, if Iowa is identified as an Underlicensed State with below median financing and an applicant headquartered in Iowa applies to receive an SBIC license, SBA would give them priority in licensing. If SBA then published a new list of States qualifying for licensing priority after the applicant was given priority, the applicant would continue to have priority in both phases of the licensing process (initial review and final licensing) even if Iowa is no longer identified as an Underlicensed State with below median SBIC financing dollars.

SBA proposed amending paragraph (b) to identify that SBA will approve the total leverage commitments for the life of the Licensee at licensing. SBA believes that similar to private investors, SBA should approve the entire leverage commitment at licensing, based on the evaluation criteria set forth in § 107.305 and the maximum leverage commitment limits set forth in § 107.1150. This change is intended to (1) reduce the burden associated with separate commitment requests performed after the fund has been licensed and (2) reduce the uncertainty with regard to SBA's leverage commitment and consequently reduce the Private Capital raise timeframe for a prospective Licensee. SBA recognizes that Licensees often raise capital after licensing. However, SBA notes that it is important for Licensees to raise their capital prior to submitting their Licensing application for Final Review, as this practice will help SBA better evaluate applicants, monitor for potential risks, and process applications faster. SBA will continue to maintain its right to deny any new issuance of Leverage at the time of a debenture commitment funding draw request and to exercise other rights and remedies as discussed in part 107, subpart J, in the event of regulatory violations, including capital impairment. SBA is also seeking to better diversify its leverage portfolio for maximum impact across underserved sectors as finalized under § 107.320.

SBA proposed modifying its Licensing fees to lower financial barriers for new funds. Effective October 1, 2022, the Initial Licensing Fee is $11,500 and the Final Licensing Fee is $40,200 for a combined Licensing Fee of $51,700. Each year, SBA adjusts these fees based on the Consumer Price Index. Although larger more established funds can easily afford these fees, smaller funds and new fund managers view the fees as prohibitive to SBIC program participation given their smaller size. Additionally, SBA charges the same fee for applicants seeking to issue Debentures as those who do not intend to issue Debentures. SBA proposed to revise the Initial Licensing Fees based on its fund sequence (meaning the order of succession of the fund) as follows:

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

SBA will determine the applicant's Fund Sequence based on the applicant's management team composition and experience as a team, including the business plan (also known as the strategy) of the fund provided in Phase I of the application process. For example, if the management team of applicant DEF I consists primarily of the same team members of funds ABC I and ABC II, SBA will consider the fund sequence of DEF I as a Fund III, regardless of the number in the applicant's name.

SBA proposed changing the Final Licensing Fee 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 would be as follows:

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

For example, a fourth time fund seeking $175 million in Leverage would pay a Final Licensing Base Fee of $51,875, computed as $30,000 plus 1.25 basis points (or .0125 percent) times $175 million.

SBA believes that its Non-leveraged Licensees present less credit risk to SBA, while accomplishing the SBIC mission of providing equity and long-term loans to Small Businesses. SBA's final changes would effectively lower the combined Licensing Fee for all Non-leveraged applicants and lower the fees for applicants with less SBA leverage at risk and new funds. Fund managers seeking a fourth or later fund and seeking leverage would pay a higher fee, and the fee would scale with the dollar amount of SBA leverage sought by the Applicant. SBA notes that SBA's licensing costs are substantially higher than even the highest final combined Licensing Fee. SBA believes this modernized licensing fee model, which is designed to make fees commensurate with years of participation in the SBIC program and the dollar amount of SBA leverage at risk, will reduce cost barriers for small funds and new funds applying to the SBIC program.

SBA also proposed an application resubmission penalty fee of $10,000 for any applicant that has previously withdrawn or otherwise is not approved for a license that must be paid in addition to the Initial and Final Licensing Fees. SBA's final licensing fees remain below SBA's expenses required to process such applications. The intent of the resubmission fee is to impose a penalty for each time an applicant resubmits its application to offset the outlay of additional SBA time and resources. Applicants can request SBA approval to waive the resubmission penalty fee that SBA may consider on a case-by-case basis.

One commenter agreed with the proposed $10,000 application resubmission fee and encouraged SBA to have written, clear, consistent, objective, licensing criteria that are published and applied evenly and consistently across all applicants. Another comment suggested: (1) lower license fees should be exclusive to "small" applicants, (2) clarifying licensing metrics, (3) expanding the definition of qualifying experience to include relevant operating or investment

experience. A third comment noted that the proposed regulatory changes are intended to expand the program and make it easier for applicants in certain geographical areas, but that this may take place at the expense of applicants that are otherwise equally qualified. A fourth comment agrees with the resubmission fee and suggested increased transparency to the applicant surrounding the application review process and timely communication from the licensing committee through the process. The commenter further suggested that if an exam finding during the application review process is the cause of denial, the applicant should be given a reasonable amount of time to resolve the finding. SBA agrees with the concept of reduced fees for first-time SBIC applicants. Consistent with the items raised by these commenters, SBA will implement an expedited licensing process for eligible subsequent license applicants (discussed below) and modernize standard operating procedures and policies to further reduce administrative, cost and time burdens on applicants.

Regarding Licensees with multiple SBIC licenses, one commenter noted opposition to proposed higher fees for licensing and examinations, noting the relative ease of processing those licenses. The commenter recommended that SBA include an optional accelerated license for qualified repeat SBIC managers, which option would be worth the increased fee. The commenter also recommends that SBA establish an accelerated licensing process for non-leveraged bank-owned SBICs, as it would improve the licensing process and justify the proposed fee increase. Another commenter believes increased fees for subsequent licenses penalizes funds with an established track record and may deter SBIC managers from continuing to obtain new licenses. In response to these comments, SBA will not implement changes to examination fees which were included in the proposed rule. Furthermore, SBA is introducing regulatory reforms which will reduce time and cost burdens associated with licensing for qualifying subsequent funds as a result of an expedited licensing process. Regulatory reforms to support an expedited and streamlined licensing process for qualifying subsequent fund applications are as follows:

Expedited Subsequent Fund Licensing: Management teams that are already operating one or more licensed SBICs must be in good operational and regulatory compliance standing with SBA in order to submit a license application for a subsequent fund. Subsequent fund license applicants must have at least two full years of operations from date of licensing of the most recently licensed SBIC (a longer or shorter operating history may be merited based on track record and prior performance). The financial performance and portfolio valuations of the current licensee(s) must demonstrate adequate coverage for any outstanding SBA Leverage. The current licensee(s) must also be able to 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.

SBA will consider a series of factors when determining whether a subsequent fund applicant has demonstrated a commitment to best practices within the SBIC program.

Streamlined Application Requirements for Subsequent Fund License Applicants: Applicants operating an active Licensee, can apply under a "Short-Form Subsequent Fund MAQ" application by meeting the following eligibility criteria:

- *Consistent strategy and fund size*—targeted Regulatory Capital to be raised is ≤133% the size of their most recent SBIC fund (inflation adjustments will be considered). Same asset class and investment strategy as most recent license.
- *Clean Regulatory History*—no major findings, significant "other matters" or unresolved "other matters" related to licensees managed by the principals of applicant in the previous ten years.
- *Consistent LP-general partnership (GP) Dynamics*—no new limited partner will represent ≥33% of the Private Capital of the licensee upon reaching final close at target fund size or hard cap. The two largest investors in terms of committed capital have

verbally committed to invest in the new fund pending receipt of license. The most recent Limited Partnership Agreement of the active Licensee and all Side Letters will have no substantive changes for the applicant fund.

- *Investment Performance Stability*—the most recent licensee net distributions to paid-in capital (DPI) and net total value to paid-in capital (TVPI) are at or above median vintage year and strategy performance benchmarks for the prior three quarters. The principals of the applicant are not managing a licensee in default or with high Capital Impairment (CIP).
- *Consistent or Reduced Leverage Management*—the applicant is requesting a leverage to Private Capital ratio ≤ the current or most recent SBIC licensee at target fund size or hard cap.
- *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 that have a material adverse impact on the stability of the SBIC.
- *Promotions from within*—demonstration of a commercially reasonable effort of promoting internal investment team talent from within the firm/organization sponsoring the license.
- *Inclusive equity*—demonstration of a commercially reasonable effort of the appropriate/increased sharing of carry and/or management company economics with promoted talent or distribution of equitable or increasingly equitable economics among the partnership.
- *Federal Bureau of Investigation (FBI) Criminal and Internal Revenue Service (IRS) Background Check No Findings*—the sponsoring entity and all principals of the Licensee do not have an FBI criminal record and do not have IRS violations from the date of their most recent SBIC fund licensure.

- *No Outstanding or Unresolved Material Litigation Matters*—no outstanding or unresolved litigation matters involving allegations of dishonesty, fraud, or breach of fiduciary duty or otherwise requiring a report under § 107.660(c) or (d) as to a prior Licensee, the prospective Applicant's general partner, or any other person who was required by SBA to complete a personal history statement in connection with the license application.
- *No Outstanding Tax Liens*—on the principals applying to manage the licensee, on the most recent or active licensee, and on the sponsoring entity of the licensee.

Should an applicant fulfill and formally attest to meeting *all* of the above eligibility criteria, the applicant can submit a streamlined "Short-Form Subsequent Fund MAQ".

All named principals of the applicant will be subject to FBI criminal and IRS background checks as well as reference checks. Applicants with minimal and non-material changes to the active or most recent licensee LPA and any Side Letters, will be designated for expedited processing.

Regarding capital at licensure, one commenter welcomes the change to the licensing application fee but requested further clarity on the fee structure. One commenter had concerns regarding fund-raising challenges faced by first-time applicants fundraising at time of application. The commenter suggested SBA approve a specific maximum ratio of Leverage to Regulatory capital for the Licensee. Further, the commenter suggested that SBA implement a specific upper limit of Regulatory Capital that would be leverageable at the approved ratio. Another commenter expressed concern that the revised regulations could limit sources of capital and leverage, noting that SBICs could potentially be subject to upfront fees on unutilized leverage within the investment period. A third commenter noted capital flow into the program could be negatively impacted by licensing revisions, effectively eliminating post-license capital raise campaigns and requiring greater commitments up front from capital investors/limited

partners. And finally, a fourth commenter recommended amending the proposal to continue to allow leverage commitments on capital raised post-licensing. The commenter noted concerns that the current proposal may negatively impact capital flow, limiting fund size, capacity to finance small businesses, and negatively impacting investors. In response, SBA clarifies that SBA Leverage commitments, up to the dollar amount indicated in the letter of intent to commit, must equal the ratio of SBA-to-private capital commitments indicated in that letter. Such SBA commitments be extended following Closings occurring within 12 months of licensing. These requests will be filled automatically, contingent upon the licensee certifying no material adverse changes (MACs) have occurred since licensing. This is intended to streamline and expedite the commitment request process. SBA further seeks to clarify language to distinguish between a 'Total Intended Leverage Commitment' letter of intent indicating a specific intended commitment dollar amount at Green Light and ratio of SBA leverage to Private Capital from SBA available upon licensing. Additionally, SBA seeks to further clarify the difference between the 'Total Intended Leverage Commitment' and 'commitment requests' made toward the amount indicated in the letter of intent to commit.

SBA seeks to clarify that SBA's commitment dollar amount will be limited such that leverage principal and projected interest must be less than or equal to the statutory cap on individual Licensee leverage, currently $175 million, for a Licensee issuing Accrual Debentures or leverage principal less than or equal to the statutory leverage cap for a Licensee issuing Standard Debentures. For both debenture instruments, Total Intended Leverage Commitment dollar amounts made to the applicant represents leverage principal. SBA defines the term "Total Intended Leverage Commitment" to mean the dollar amount or ratio of SBA Leverage Commitments to Private Capital that SBA will approve conditional upon closing the applicant's stated Private Capital target and conditional upon maintaining acceptable capital impairment (CIP) levels and regulatory compliance during the life of the license. SBA will provide the 'Total Intended Leverage Commitment' to the applicant in the Green Light Letter. The Total Intended

Leverage Commitment dollar amount will be made final within 12 months of licensure or upon the Licensee's final closing, whichever occurs first. Licensees issuing Accrual Debentures shall not be permitted to make distributions within 12 months of Licensure.

Finally, it should be noted that SBA is amenable to and expects that most applicants will have multiple fund closings. It is acceptable to SBA for an applicant to have a fund closing and begin making investments prior to Licensing. However, the applicant bears the burden of assuming any risk should a license not be approved. One commenter identified that SBIC program administrative and operating costs are not covered by subsidy, noting that in 2017, less than 40 percent of SBA's administrative costs were offset by fees, leaving the taxpayer to bear the costs. The commenter stated that SBA should seek ways to reduce taxpayer costs associated with SBIC program expenses.

The table below displays the cost to administer the SBIC program. It includes direct costs from the operating budget, including contracts; compensation and benefits; Agency-wide costs, such as rent and telecommunications; and indirect costs.

FY 2020 Actual	FY 2021 Actual	FY 2022 Actual
$24,254,000	$21,492,000	$28,211,000

In FY2022, the return-on-investment (ROI) of taxpayer dollars as measured by the ratio of FY2022 financings to U.S. small businesses relative to program cost was 28,003 percent or $7.9 billion divided by $28,211,000. The same $28,211,000 resulted in 129,098 U.S. small business jobs created and sustained and enabled the program to operate with the necessary risk management and oversight practices and procedures to provide Federal funding to SBICs at zero subsidy to U.S. taxpayers. The final rule includes an expedited and streamlined licensing process for qualifying subsequent fund applications and SBA is finalizing § 107.300 substantially as proposed.

E. Section 107.305 Evaluation of license applicants.

Current § 107.305 discusses how SBA evaluates an applicant to the program. Paragraph (a) describes management qualifications. SBA is proposing to amend paragraph (a) to include two additional management qualifications. The first is relevant industry operational experience, which may be combined with investment skill to demonstrate managerial capacity. The second, if applicable, is the applicant's experience in managing a regulated business, including but not limited to an SBIC. Paragraph (b) describes how SBA evaluates an applicant's track record. SBA is amending paragraph (b) to include two additional performance qualifications. The first is the inclusion of an applicant's operating experience, which when combined with an investment team's prior relevant industry investing experience, is relevant in assessing an applicant's investment performance. The second addition, when applicable, is the applicant's past adherence to statutory and regulatory SBIC program requirements. This addition will be considered for applicants with past SBIC program experience.

Paragraph (c) describes how SBA evaluates the applicant's investment strategy. SBA is amending paragraph (c) to clarify that the applicant's investment strategy is to be contained in its business plan, as well as to underscore the importance of section 102 "Statement of Policy" of the Act which describes the public purpose of the SBIC program.

Two commenters encouraged SBA to continue making the licensing process more transparent and inclusive, noting current criteria limiting the potential pool of qualified managers. SBA is updating standard operating procedures and policies to reduce the burden of the licensing process on applicants and to improve transparency in the licensing process.

One commenter requested, in addition to relevant industry operational experience, inclusion of financial portfolio management experience in adjacent areas such as relevant experience in lending and early-stage equity investments. SBA agrees that relevant investment experience in adjacent areas is a valid consideration in the licensing process. SBA considers the totality of experience of the principals of the applicant during the licensing process. As the

proposed rule is consistent with these principles, SBA is finalizing § 107.305 substantially as proposed.

F. Section 107.320 Leverage portfolio diversification.

Current § 107.320 discusses how SBA evaluates Early Stage SBICs and reserves the right for SBA to maintain diversification among Early Stage SBICs with respect to the year they commence operations and their geographic location. In light of the fact that SBA used its entire Leverage authorization in FY 2021, SBA proposed modifying this regulation to reserve SBA's right to maintain Leverage portfolio diversification in approving Leverage commitments with respect to the year in which they commenced, the SBIC's geographic location, giving first priority to Licensees from Underlicensed States with below median SBIC financing dollars, their asset class and investment strategy. SBA's intent is to maximize the SBIC program's economic impact to underserved Small Businesses while managing risk through portfolio diversification. SBA notes that SBA will continue to license all qualified applicants based on its evaluation criteria and will not take into consideration any projected shortage or unavailability of leverage when reviewing and processing SBIC license applications.

One commenter believes 13 CFR 107.320 should remain unchanged, noting the SBIC Debenture program doesn't currently exhibit outsized losses due to a lack of portfolio diversification. The same commentor also expressed concern that the proposed rule could result in SBA having too great discretion in selecting program participants. The purpose of portfolio diversification is to ensure that SBA successfully meets the mission and intent of the SBIC program (as established by Congress) while mitigating overall SBIC program concentration risk in strategies which could present higher repayment risk and volatility risk and thus compromise the program's zero subsidy status. Ensuring SBA has discretion to mitigate program concentration in risk assets to mitigate against the potential for taxpayer losses is in line with best

practice portfolio risk management approaches of public and private institutional investment programs.

One commenter stated that by prioritizing the approval of leverage commitments based on geographical characteristics, it may prolong the process for Licensees that are not headquartered in these areas. The final rule balances shifting licensing timelines with mitigating program risk. Through the introduction of expedited licensing for eligible subsequent funds and updates to standard operating procedures, SBA will improve licensing and leverage commitment timelines across the program, thus mitigating any risk of prolonged leverage commitment processes for Licensees. SBA is finalizing § 107.320 substantially as proposed.

G. Section 107.501 Identification.

This regulation identifies requirements related acknowledgment of a Licensee as "a Federal licensee under the Small Business Investment Act of 1958, as amended."

One commenter recommended an amendment to 13 CFR 107.501 requiring SBA to publish in the **Federal Register** the names of SBICs that were licensed and the dates on which SBICs were licensed. Based on this comment, SBA is finalizing § 107.501 to include a requirement for SBA to publish license approvals in the **Federal Register** within 30 business days of the end of the month in which the license was approved by the SBA Administrator.

H. Section 107.503 Licensee's adoption of an approved valuation policy.

This regulation requires Licensees to prepare and maintain a valuation policy that must be approved by SBA for use in determining the value of its investments. Current regulations require that Licensees adopt without change the model valuation policy set forth in SBA's Valuation Guidelines for SBICs or obtain SBA's prior approval of an alternative valuation policy. SBA established this requirement to ensure it could adequately monitor the SBIC portfolio, that valuations were performed in a reasonable and standard fashion, and to minimize Leverage losses in order to maintain zero subsidy cost. SBA recognizes that private equity typically uses valuations performed in accordance with GAAP and that many SBIC private

investors require GAAP. This causes many SBICs to maintain two sets of valuations. SBA is currently working to re-evaluate this requirement for Leveraged Licensees. SBA is requiring both valuations based on SBA Valuation guidelines and those reported to their private investors in accordance with GAAP to assess the potential impact. SBA is also working with its valuation contractor to evaluate what changes to SBA's Valuation Guidelines would be necessary to make them GAAP compliant and the impact to SBA's monitoring and risk should SBA adopt GAAP compliant guidelines. SBA sought input from the public on this issue as part of this rulemaking. However, SBA recognizes that Non-leveraged Licensees pose no credit risk to SBA. In the proposed rule, SBA proposed that Non-leveraged Licensees (which include both those licensed as Non-leveraged Licensees and Licensees that fully repay Leverage and seek no further Leverage) may adopt a Valuation Policy in accordance with GAAP. SBA believes this will lower the burden associated with current regulations.

Current paragraph (d) requires licensees with outstanding Leverage or Earmarked assets to value their portfolio twice a year (at the end of the second quarter and the end of the fiscal year). SBA proposed to clarify that this requirement applies to all Leveraged Licensees and increase reporting from semi-annually to quarterly, commensurate with the required quarterly reporting of the Form 468.

One commenter agreed with the revision as written.

One commenter gave feedback including (1) the Form 468 is not accommodating of GAAP reporting, (2) that SBICWeb requires a redesign, (3) new reporting requirements can put undue burden on analysts, (4) reporting is cumbersome, (5) by changing accounting principles, it would be difficult to compare year over year results, (6) unlevered SBICs could be at a disadvantage with respect to determining when to make READ. With respect to the first five items, SBA is updating its technology, data collection, and filing processes to accommodate new reporting requirements and reduce the reporting burden on managers and SBA analysts. Further, SBA notes that if the valuations are not changing significantly, the level of effort to update the

reporting is limited. If valuations do change significantly, this does increase the level of effort required in updating the reporting, however SBA believes that sufficient program oversight of this federally regulated financial institution necessitates this level of effort and unlevered SBICs are not positioned to be disadvantaged. After consideration of all comments, SBA is finalizing §107.503 substantially as proposed.

I. Section 107.504 Equipment and office requirements.

This regulation identifies the equipment and office requirements needed by SBICs to operate within the program. The current regulation requires a personal computer with a modem and internet access under paragraph (a) and the need for a facsimile capability under paragraph (b). SBA received industry comments that this regulation was outdated. Some SBICs indicated that they bought facsimile machines to ensure they complied with the requirement. The intent of this regulation is to ensure that SBICs can properly communicate with SBA, receive official correspondence, prepare and provide electronic reporting, and apply for Leverage. The proposed changes would eliminate the modem requirement under paragraph (a); eliminate the facsimile requirement under paragraph (b); and modify paragraph (a) to more broadly require that SBICs must have technology to securely send and receive emails, scan documents, and prepare and submit electronic information and reports required by SBA. This language would allow for reasonable changes in technology without the need to modify regulations. All SBICs already utilize this technology in their day-to-day operations. This change should reduce costs by eliminating unnecessary equipment.

One commenter concurred with the changes as written. SBA is finalizing § 107.504 substantially as proposed.

J. Section 107.550 Prior approval of secured third-party debt of Leveraged Licensees.

This regulation requires SBICs to obtain prior SBA approval for secured third-party debt for Leveraged Licensees.

Section 107.550(a) defines secured third-party debt to include Temporary Debt, a defined term in § 107.570 that applies only to SBICs with outstanding Participating Securities. Since there are no operating SBICs with outstanding Participating Securities, except in the Office of SBIC Liquidation, SBA proposed removing § 107.570 and references to Temporary Debt and Participating Securities in § 107.550.

Section 107.550(c) identifies rules associated with secured lines of credit in existence on April 8, 1994. SBA proposed to remove that requirement since it is obsolete.

SBA proposed replacing § 107.550(c) with a secured "Qualified Line of Credit" which SBICs could utilize without SBA prior approval. One commenter recommended clarifying the language in this section, and one commenter stated that the proposed terms will increase the administrative burden on Licensees as they would need to call capital more often. SBA agrees that the language required clarification and the terms should be more aligned to industry standard practices. Consequently, SBA is rescinding the proposed changes to § 107.550(c) and replacing it with this simplified update to the existing regulations by defining a "Capital Call Line".

Since the final rule provides an exemption from SBA approval for Capital Call Lines that SBA would likely have otherwise approved, the final rule eliminates paragraph (e) which discusses automatic 30-day approval for secured third-party debt. With the replacement of "Qualified Line of Credit" with "Capital Call Line", SBA is finalizing § 107.550 substantially as proposed.

K. Section 107.570 Restrictions on third-party debt of issuers of Participating Securities.

This regulation identifies restrictions on third-party debt for SBICs that issued Participating Securities. As discussed under section II.L. of this rule, no operating SBICs have outstanding Participating Securities and SBA is no longer authorized to provides such Leverage. SBA proposed to remove this regulation.

SBA received no comments on this section. This final rule adopts the proposed removal of § 107.570.

L. Section 107.585 Distributions and reductions in Regulatory Capital.

This section is currently titled "Voluntary decrease in Licensee's Regulatory Capital" and requires Licensees to obtain SBA's prior written approval to reduce Regulatory Capital by more than two percent in any fiscal year. Current § 107.1000(b)(2) exempts Non-leveraged Licensees from § 107.585 if the decrease does not result in Regulatory Capital below what is required by the Act and the regulations and is reported to SBA within 30 days. Typically, reductions in capital are performed in conjunction with a distribution that represents a return of capital, to its private investors. SBA allows profit distributions, also known as "Retained Earnings Available for Distribution" or "READ" without SBA prior approval, unless the Licensee was licensed as an Early Stage SBIC or if the SBIC issued Participating Securities.

SBA received comments from private investors that the existing regulations (prior to the proposed rule) were unclear as to when a Licensee could distribute to its investors. SBA has also had instances in which Leveraged Licensees made "READ" distributions, and subsequently wrote down assets that would have reduced or removed "READ". Leveraged Licensees must consider such write-downs before making such distributions to avoid "improper" distributions. SBA is also concerned that Accrual Licensees may distribute profits without repaying Leverage. In particular, equity investors often have returns that are less consistent than private creditor or mezzanine funds. SBA has incurred losses in several Licensees that returned profits to its private investors through early profit distributions and then wrote down assets later in the fund's life.

In the proposed rulemaking, SBA proposed to retitle this regulation to "Distributions and Reductions in Regulatory Capital" and modify the requirements to address these concerns. Three commenters raised that a change to the distribution waterfall of the Traditional Debenture. The SBA has considered this feedback and intends to apply the new pro rata distribution waterfall exclusively to the Accrual Debenture instrument and to institute a more flexible repayment

timeframe to align with existing debenture pre-payment processes. Based on public comment, in issuing the final rule, SBA will not apply the modified distribution waterfall to Standard Debenture Licensees. This final rule thus separates distribution requirements based on three categories of SBICs: (1) Non-leveraged Licensees; (2) Standard Debenture SBICs; and (3) Accrual SBICs and Reinvestor SBICs. The rationale for these categories and the specific requirements follows.

1) *Non-leveraged Licensees*. SBA is setting a separate set of requirements for Non-leveraged Licensees because they pose no credit risk to SBA. Final rules would allow Non-leveraged Licensees to distribute to their private investors without SBA prior approval as long as they retain sufficient Regulatory Capital to meet minimum capital requirements under §107.210, unless such amounts are in accordance with their SBA approved Wind-up Plan. If a Non-leveraged Licensee does not have an SBA approved Wind-up Plan, they may make distributions, as long as such Non-leveraged Licensees retain sufficient Regulatory Capital to meet minimum capital requirements under § 107.210. If a Non-leveraged Licensee has an SBA-approved Wind-down Plan, their Regulatory Capital can drop below the minimum capital requirements if such amounts are in accordance with that plan. This requirement should provide even greater flexibility to Non-leveraged Licensees. In accordance with current policies, the final rule would clarify that Non-leveraged Licensees must report any reductions in Regulatory Capital to SBA within 30 days on an updated Capital Certificate, which is Exhibit K in SBA form 2181.

2) *Standard Debenture SBICs*. SBA recognizes that existing licensees and current applicants to the program expect to be able to distribute READ based on current regulations. Standard Debenture SBICs will remain under the current rules.

3) *Accrual SBICs and Reinvestor SBICs*. SBA is requiring, in the regulations for these SBICs, a distribution waterfall that repays SBA the principal balance on outstanding Leverage on at least a pro rata basis with private investors. Accrual SBICs and Reinvestor SBICs must repay

Leverage at its ten-year maturity and may prepay Leverage at any time. SBA is requiring the following waterfall:

a. Payment of Annual Charges and accrued interest associated with Leverage. (Interest will be paid to the bond holders based on the Leverage terms.)

b. Calculate SBA's share based on the ratio of SBA Total Intended Leverage Commitment and Total Private Capital Commitments, inclusive of Qualified Non-Private Funds, determined within 12 months of Licensure established as follows: SBA Share = Total Distributions x [Total Intended Leverage Commitment/(Total Intended Leverage Commitment + Total Private Capital Commitments)].

c. Repay SBA Leverage to bond holders in an amount no less than SBA's Share to the extent of outstanding Leverage. If SBA's share is more than the Outstanding Leverage held by the Licensee and the Licensee has unfunded Leverage Commitments, the Licensee must submit a Leverage Commitment cancellation equal to SBA's share minus SBA Leverage redemptions. The rationale for this cancellation requirement is to minimize the risk that the SBIC will distribute significant profits to its private investors, then issue additional SBA leverage that results in losses, leaving SBA with losses after the private investors made significant profits.

d. Distribute to private investors the remaining amount.

e. Report the distribution to SBA. You must report the distribution and calculations to SBA on your Form 468 submission(s).

If permitted under a Licensee's partnership agreement, a Licensee may choose to reserve capital or reinvest all or a portion of it instead of distributing to SBA and investors. In this circumstance, a Licensee would decrease the amount distributed to its investors so that the private investors receive no more on a pro rata basis as the repayment of SBA Leverage and interest due. SBA is only concerned that private investors bear at least the same risk for loss as SBA.

One commenter provided the following feedback: a) tax distributions due to ordinary income must flow to limited partners for tax liabilities; b) Debenture securities must be paid in full, which could limit SBIC ability to repay Debentures in full and provide sufficient distributions to limited partners to pay taxes; c) potential unintended consequence of outcome of "trapping" cash in SBIC. SBA clarifies that Accrual SBICs are not prohibited from tax distributions in this final rule and encourages SBICs to consider smaller distributions that can be repaid in full. SBA underscores that the intent of the changes is to reduce the risk to the taxpayer by ensuring that debentures backed by an SBA guarantee are repaid.

One commenter concurred with SBICs being allowed to make distributions without prior SBA approval and with SBA proposing that future material adverse changes be taken into consideration for leveraged funds licensed before October 1, 2023. The same commenter raised that the proposed waterfall also does not differentiate between READ and return of capital proceeds, which would result in the repayment of leverage being misaligned with what may be laid out in a Licensee's wind down plan. As stated above, SBA has not included changes to the waterfall or READ requirements for Standard Debentures and is finalizing § 107.585 with the modified distribution requirements based on three categories of SBICs: (1) Non-leveraged Licensees; (2) Standard Debenture SBICs; and (3) Accrual SBICs and Reinvestor SBICs.

M. Section 107.590 Licensee's requirement to maintain active operations.

This regulation identifies requirements for Licensees to maintain active operations and submit a Wind-up Plan when they decide they are no longer making any new investments. SBA proposed implementing regulations to change the name to "Wind-down Plan" as discussed under section II.A. of this rule.

SBA received no comments on this section. This final rule adopts the proposed § 107.590 without change.

N. Section 107.620 Requirements to obtain information from Portfolio Concerns.

This regulation specifies the threshold of information requested by SBICs from Portfolio Concerns. In the proposed rulemaking, SBA proposed implementing regulations to amend specified information collections for Financings after the effective date of the rule to provide certain optional demographic information on Portfolio Concerns. The SBA is amending information collections to enhance reporting accuracy and consistency around the small business demographic impact of the SBIC program.

One commenter expressed concern that including voluntary reporting of demographic data could be viewed as mandatory by licensees and their portfolio companies and could be costly, while another commenter expressed concern that making this voluntary may discourage Licensees from providing it. SBA notes that voluntary reporting of demographic information balances flexibility for program participants with providing SBA and taxpayers with adequate transparency into the community impact of the SBIC program overall, in accordance with the President's Executive Order ("E.O.") 13985, Advancing Racial Equity and Support for Underserved Communities Through the Federal Government. Additionally, SBA notes that such information is collected post-licensing and is not a component of the SBIC licensing process. This final rule adopts the proposed § 107.620 without change.

O. Section 107.630 Requirement for Licensees to file financial statements with SBA (Form 468).

This regulation identifies requirements associated with Licensee's financial statements on Form 468. Paragraph (a) requires the annual Form 468 to be submitted on or before the last day of the third month following the end of the fiscal year, except for information in paragraph (e). This is not consistent with § 107.650 which requires that portfolio valuations be submitted on the Form 468 within 90 days following the end of the fiscal year. Current § 107.630 also does not have a paragraph (e). SBA believes the entire Form 468 should be due at the same time.

Therefore, in the proposed rulemaking, SBA proposed implementing regulations to make the annual Form 468 due date consistent with § 107.650.

Paragraph (d) requires certain economic information regarding each Licensee's portfolio companies, so that SBA can assess the program's economic impact. SBA proposed implementing regulations adding information to help SBA determine net jobs created and total jobs created or retained, including identifying the number of jobs added due to a business acquisition versus growth in the business.

SBA also proposed to add fund management contact information and optional demographic information. SBA is seeking to collect management contact information in order to improve its customer relationship management and to better assess relationships between its Licensees. Demographic information regarding fund management is requested for reporting purposes only and on a voluntary basis.

Two commenters agreed with the proposal as written. One commentor asked whether the Form 468 could be filed on a Monday if the deadline falls on a weekend. Form 468 instructions will now provide the following procedural accommodation: when a deadline falls on a weekend the form can be filed on the next day which is not a Saturday, a Sunday, or a Federal holiday.

One commentor agreed that SBA can improve its oversight of SBICs through timely reporting requirements. SBA appreciates the support for timely reporting. This final rule adopts the proposed § 107.630 substantially without change.

P. Section 107.640 Requirement to file Portfolio Financing Reports (SBA Form 1031).

This regulation currently requires Licensees to submit a Portfolio Financing Report on SBA Form 1031 within 30 days of the closing date of the Financing. To reduce the burden on Licensees, SBA proposed to make this a quarterly submission in which the Licensee must report the financing within 30 calendar days of the calendar year quarter following the closing date of the Financing. For example, if a Licensee closes a financing on February 10, 2023, the Licensee

will need to submit the related Form 1031 no later than April 30, 2023. If the Licensee is identified as meeting the Watchlist criteria, as finalized under § 107.1850, SBA may require more frequent reporting.

One commenter noted that new deadlines might have a negative impact on Bank limited partners with regard to federally required reporting and examination obligations and might elongate the time it takes SBIC licensees to report to SBA. Another commenter opposed quarterly submissions within 30 calendar days of quarter following closing or financing, noting generating a quarter's worth of Form 1031s would be burdensome. In response, SBA will allow for Form 1031s within 30 days of quarter end. To mitigate concerns around the burden of the reporting requirement when SBICs have a large number of 1031 filings due at one time, SBA permits Form 1031s for portfolio company financings to be disaggregated and submitted on a more frequent basis. The option to submit a single Form 1031 within 30 days of quarter end rather than within 30 days of financing is intended to reduce the administrative filing burden on SBICs. Bank limited partners are encouraged to establish reporting expectations with SBICs through their limited partnership agreements. SBA's intent is to provide additional regulatory flexibility, when and where possible, with respect to 1031 filings. SBA agrees with commenters who were supportive of changes that allow more time for SBICs to make timely submissions, and therefore SBA is issuing the final rule as set forth in 13 CFR 107.740.

Q. Section 107.650 Requirement to report portfolio valuations to SBA.

This regulation currently requires Licensees to report portfolio valuations within 90 days of the end of the Licensee's fiscal year and quarterly valuations 30 days following the close of each quarter. SBA proposed implementing regulations to clarify that only Leveraged Licensees are required to report for quarterly reporting periods. All Licensees must report at least annually. SBA proposed implementing regulations to expand the timeframe for quarterly valuations,

including material adverse changes, to 45 calendar days following the close of each quarter. This is intended to give Licensees additional time to prepare reports.

One commenter stated they do not believe the benefits of reporting changes outweigh the costs unless SBA reports and publicly releases in a timely manner aggregate program data and analysis. As part of the final rule, SBA is modernizing data collection and reporting processes which will enable the timely reporting of existing program economic and operational performance measures and the introduction of new metrics related to the investment performance of the program. Quarterly reporting will be limited to a "short form" version of the Form 468 to reduce the reporting burden while enabling transparency into program investment performance and improved monitoring.

One commenter asked for clarification as to whether SBA will continue to allow data collections and metrics regarding net jobs created and total jobs created and retained to be provided on a quarter lag after year end, as the data may not be readily available within 90 days of an SBICs fiscal year end. SBA confirms that the 90-day lag is intended to represent a one quarter lag after fiscal year end. This final rule adopts the proposed § 107.650 without change.

R. Section 107.660 Other items required to be filed by Licensee with SBA.

This regulation identifies other items required by the Licensee. Paragraph (a) requires the Licensee to provide to SBA a copy of any report it gives to its private investors. Although the Licensee is required under current regulations to provide to SBA report they provide to their private investors, SBA proposed implementing regulations to specify valuation data items to improve clarity. SBA also proposed implementing regulations to specify that Licensees should submit to SBA any report it gives to its private investors no later than 30 days after the date on which such SBIC sent any report to its private investors. This requirement is intended to keep SBA aware of any important communications regarding the licensee in a timely fashion.

Regarding submission of the reports provided to the private investors, one commenter noted it would be helpful for SBA to specify the types of reports they are looking for and their

purpose. SBA specifies that quarterly and annual financial reports and fund investment performance reports are examples of reports frequently delivered to private investors with the intended purpose of providing transparency into portfolio holdings and investment returns. This final rule adopts the proposed § 107.660 without change.

S. Section 107.692 Examination fees.

This regulation identifies how SBA calculates examination fees. Currently under paragraph (b), SBA charges a Minimum Base Fee + .024% of assets at cost up, not to exceed a Maximum Base Fee. SBA adjusts the Minimum Base Fee and the Maximum Base Fee annually. Although current regulations give Non-leveraged Licensees a lower Maximum Base Fee, this formula does not fully address the risk and additional monitoring required for Leveraged Licensees. SBA proposed to change and streamline this formula to $10,000 + .035% of their Total Leverage Commitment established at Licensing (see section II.D. of this rule). By establishing the examination fee up front, SBA believes this will reduce uncertainty in cashflows. Because SBICs licensed prior to the proposed rule may not have a Total Leverage Commitment, SBA proposed that the formula for existing licensees be $10,000 + .035% of their outstanding Leverage plus SBA's undrawn commitment amount. Since the proposed formula would give all Non-leveraged licensees a flat rate of $10,000 and SBA incurs more costs based on the assets of the Licensee, SBA proposed that any Non-leveraged Licensee with over $50 million in assets at cost pay an additional $20,000. Although SBA recognizes that a Leveraged Licensee with over $50 million in assets at cost and $30 million in leverage commitments would only pay $20,500 in exam fees versus $30,000 for a Non-leveraged Licensee, SBA nevertheless proposed this additional fee for larger Non-leveraged Licensees with over $50 million in assets based on the infrequency of requests for less than one tier of leverage. Two commenters opposed the proposed fee changes. Regarding Licensees with multiple SBIC licensed funds or “repeat licensees”, one commenter noted opposition to proposed higher fees for examinations for repeat licensees. One commenter requested that SBA annually publish the top-ten most common exam

findings so SBICs can proactively remedy their own practices. SBA appreciates these comments and will not be moving forward with modifications to Examination fees.

One commentor encouraged SBA to consider enhancing its credit standard to require examinations within an 18-month time period for all SBICs with SBA-guaranteed leverage. SBA appreciates the comment and, as stated prior in response to broader comments regarding licensing and examination fees, SBA withdraws the proposed changes to § 107.692 and will not be moving forward with modifications to Examination frequency because it believes that the incremental risk mitigation would be minimal and would not warrant the additional resources required.

T. Section 107.720 Small Businesses that may be ineligible for financing.

This regulation identifies small businesses in which Licensees may not invest. Paragraph (a) restricts Licensees from making investments into relenders or reinvestors as defined under paragraph (a)(1). In the existing regulation, paragraph (a)(2) currently gives an exception for Venture Capital Financings to relenders or reinvestors that qualify as Disadvantaged Businesses unless the Disadvantaged Business is a bank or savings and loan not insured by agencies of the Federal Government or agricultural credit companies. In the proposed rule, SBA proposed modifying the exception to permit Licensees to make equity investments in certain underserved relenders or reinvestors that make financings solely to Small Business Concerns that a Licensee may directly finance under part 107. Based on the comments discussed below, SBA is now modifying this exception to permit reinvestors which are Accrual SBICs (*i.e.*, "Reinvestor SBICs") to make equity investments in certain underserved reinvestors that, in turn, make financings solely to Small Businesses which meet the Act size standards (set forth in 13 CFR 107.700 and 121.301(c)(2)) or the Small Business Act alternative size standards (set forth in 13 CFR 121.301(c)(1)) with at least 50 percent of employees in the United States, at the time of investment. SBA believes expanding this provision will significantly help expand the SBIC program's footprint in underserved communities. By more broadly defining "underserved,"

SBA can maintain flexibility and agility to align with evolving market conditions by clarifying what constitutes "underserved" through policy notices in order to increase its economic impact to underserved communities. While Disadvantaged Business will continue to be considered underserved, rural and low-and-moderate-income areas may also be applicable to this group. To ensure that capital continues to be directed to SBA's mission, SBA also is implementing regulations to limit reinvestor financing to those that existing SBICs could generally finance. This limitation is designed to help SBA grow a national emerging fund manager pipeline focused on supporting the financing needs of U.S. small businesses.

Two commenters noted that the definition of "underserved" could be further clarified. However, another commenter was supportive of leaving "underserved" not fully defined and proposed including clear safe harbors for SBICs serving rural, low-income areas, and veteran-owned businesses. SBA notes that a broad interpretation of underserved, consistent with the text of Executive Order 13985, "Advancing Racial Equity and Support for Underserved Communities," and a requirement to provide a justification in the applicant's business plan as to how a particular geographic, industry or market segment is underserved and how the investment strategy and approach addresses this underserved part of the market. A safe harbor will not be required as SBA will approve the business plan prior to the licensee making investments. Investments are to be made in accordance with the approved business plan.

Two commenters recommended that SBA revise the language to ensure that SBICs are not precluded from making investments in Minority Depository Institutions (MDIs). SBA appreciates the suggested comment. SBA notes that Licensees are permitted to make investments in certain types of *relenders* and *reinvestors* which, for Section 301(d) Licensees, which may include Minority Depository Institutions that qualify as Disadvantaged Businesses. Section 301(c) Licensees are permitted to make investments in reinvestors under the Act.

One commenter suggested SBA define Fund-of-Funds as *Reinvestor SBICs* in regulations and standard operating procedures. SBA appreciates and agrees with the comment and will

define *Reinvestor SBIC*. SBA will also clarify that there is no restriction on the type of capital that can be invested by a *Reinvestor SBIC*.

Two commenters suggested that the requirements limiting investments in re-investors to only those who have complied with SBA cost of money and conflict of interest regulations could mean that not many qualified fund-of-funds managers will be able to access the program. One commenter suggested SBA clarify which specific rules it intended to capture and that all restrictions on existing SBICs be applied to the ultimate recipients of the capital. One commenter believes it would be necessary to permit potential reinvestor SBIC funds-of-funds to invest all of their capital into underserved underlying funds. In addition, the underlying funds in which an SBIC is investing pursuant to the exception should not be controlled by the SBICs or the SBIC's management. They should also be allowed to provide capital to non-levered SBICs but not to SBICs with any type of leverage. Another commenter expressed concern around permitting Fund-of-Funds to invest only their Regulatory Capital into underlying re-lenders and re-investors.

SBA appreciates suggested revisions to permitted investments by the underlying funds of the *Reinvestor SBICs* and has revised this final rule to define and clarify that *Reinvestor SBICs* can make Equity Capital Investments in underserved non-SBA leveraged limited partnerships, SBIC or non-SBIC licensed, 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.

In terms of "cost of money", SBA notes that § 107.855 defines "Cost of Money" to mean "the interest and other consideration that you receive from a Small Business." Subject to lower ceilings prescribed by local law, the Cost of Money to the Small Business must not exceed the

ceiling determined under § 107.855 introductory text and (a). In connection with this requirement, SBA notes that this section applies to all Loans and Debt Securities.

Regarding conflicts of interest, given the nature of private markets, SBA anticipates *Reinvestor SBICs* are likely to invest in the portfolio concerns of underlying funds. Consistent with the safe harbors to conflicts of interest being implemented in this rule, SBA's prior written approval is not required in connection with such co-investments if a third-party investor unaffiliated and unassociated with the *Reinvestor SBIC* and the underlying fund investor is contributing Equity Capital Investments to the portfolio concern alongside the *Reinvestor SBIC* investing directly into the portfolio concern held by the underlying fund. 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.*

One commenter noted a lack of clarity around monitoring and reporting of reinvestors. SBA clarifies that *Reinvestor SBICs* will be expected to submit reporting of all underlying portfolio concern holdings including information regarding the limited partnership investor in the portfolio concern, name of the concern, industry, size and type of investment, most recent valuation, tax identification number, industry, location and number of employees at time of initial investment. Such reporting will be provided as an exhibit to the Form 468 for *Reinvestor SBICs.*

One commenter expressed concern that expanding opportunities for reinvestors will confuse investors who consider the SBIC program. SBA appreciates the concern. With more diversification of asset classes and alternative investments strategies included in the SBIC Program, investors should consider each prospective SBIC fund investment’s risks and benefits on a case-by-case basis before investing.

Finally, one commenter encouraged SBA to consult with Congressional Committees to clarify whether these changes require new authorities granted by Congress. SBA notes that

section 310(c) states that each small business investment company shall be examined at least every two years in such detail so as to determine whether or not it has engaged in relending. Permitting *Reinvestor SBICs* as Section 301(c) Licensees is consistent with the Act and aligns with the stated policy set forth in the SBIC Act of stimulating and supplementing the flow or 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.

SBA has included clarification around Reinvestor SBICs and is finalizing § 107.720 substantially as proposed.

U. Section 107.730 Financings which constitute conflicts of interest.

Current § 107.730 prohibits Licensees from transactions that constitute conflicts of interest, as required by the Act. Paragraph (a) provides a general rule that Licensees may not self-deal to the prejudice of a Small Business, the Licensee, its shareholders or partners, or SBA, and must obtain prior written exemptions for transactions that may constitute a conflict of interest and specifies certain transactions in paragraphs (a)(1) through (5) that would constitute a conflict of interest. Paragraph (a)(1) identifies (as one specific prohibition) a Financing to a Licensee's Associate, as defined in § 107.50, unless the Small Business being financed is only an Associate because another the Licensee's Associate investment fund holds a ten percent or greater interest in the Small Business, the Associate investment fund previously invested in the Small Business at the same time and on the same terms and conditions, and the Associate investment fund is providing a follow-on financing to the Small Business at the same time and on the same terms and conditions as the Licensee.

Based on market feedback and an analysis of conflict-of-interest approval requests from Licensees, the current safe harbor provisions for follow-on financings to small business portfolio companies are resulting in delays providing capital to small businesses. This potentially hurts the small businesses and increases the burden on Licensees and SBA. SBA proposed implementing

regulations to include a safe harbor for financing a portfolio concern by an Associate when an outside third-party participates in the equity financing of the Licensee's portfolio concern.

Paragraph (d) identifies Financings with Associates that also constitute conflicts of interest requiring SBA prior approval but provides exceptions under paragraph (d)(3). Paragraph (d)(3)(iii) identifies exceptions for SBICs with outstanding Participating Securities. Since no operating Licensees remain in SBA's portfolio, SBA is implementing regulations to remove this exception. Paragraph (d)(3)(iv) identifies exceptions involving Non-leveraged Licensees. SBA is implementing regulations to revise this exception to incorporate the new Non-leveraged Licensee term and simplify this regulation.

One commenter agreed with the regulation as proposed. This final rule adopts the proposed § 107.730 substantially as set forth in the proposed rule.

V. Section 107.830 Minimum duration/term of financing.

Paragraph (c)(2) discusses "prepayments" and states: "You [Licensee] must permit voluntary prepayment of Loans and Debt Securities by the Small Business. You must obtain SBA's prior written approval of any restrictions on the ability of the Small Business to prepay other than the imposition of a reasonable prepayment penalty under paragraph (c)(3) of this section."

SBA considered in the proposed rulemaking process whether it should make changes to § 107.830(c)(2) regarding prepayment restrictions for Loans and Debt Securities to remove the requirement for SBA's prior written approval regarding any restriction on the ability of a small business to prepay (other than the imposition of a reasonable prepayment penalty). SBA had become concerned that certain terms in unitranche or multi-lender transactions that require voluntary prepayments to be distributed on a pro rata basis to all lenders in a transaction could be considered a prepayment restriction. Generally, SBA does not view a financing term that requires a portfolio concern to make prepayment distributions on a pro rata basis to all lenders in a transaction to be a prepayment restriction.

One commenter supported the regulation as proposed with two suggestions: a) support a clarifying statement within § 107.830(c)(2) that "[r]equirements to apply prepayments pro rata among a group of lenders that is pari passu in rights to payment will not be deemed to constitute a restriction on prepayments hereunder" and b) adding to 13 CFR 107.830(c) a safe harbor for a reasonable restriction on the minimum increments in which partial prepayments can be made by small businesses. SBA supports the proposed suggestions and, in response, added in the final rule a clarifying statement within § 107.830(c)(2) that "[r]equirements to apply prepayments pro rata among a group of lenders that is pari passu in rights to payment will not be deemed to constitute a restriction on prepayments hereunder" and added to 13 CFR 107.830(c) a safe harbor for a reasonable restriction on the minimum increments in which partial prepayments can be made by small businesses.

One commenter indicated that small businesses should not be discouraged from making prepayments. SBA agrees that the small business must be the first consideration and does not seek to discourage prepayment for small businesses. However, in order to encourage funds to participate in the SBIC program and provide such capital, SBA must consider reasonable market terms for such securities that balances these objectives. SBA incorporated the proposed clarification into § 107.830(c)(2) and is finalizing the proposed §107.830 substantially as proposed.

W. Section 107.865 Control of a Small Business by a Licensee.

This regulation identifies limitations on the ability a Licensee to take "Control" as defined in § 107.50, over a Small Business. In general, the regulations permit Licensees to take Control for up to seven years. In the proposed rule, SBA proposed that Accrual SBICs should limit ownership at first Financing to less than 50 percent.

One commenter was concerned that the seven-year control provision is insufficient to enable SBICs to repay leverage in a timely manner. This provision has been in place for several years. As stated in 13 CFR 107.865(d), with SBA's prior written approval an SBIC Licensee may

retain Control of a Small Business for such additional period as may be reasonably necessary to complete divestiture of Control or to ensure the financial stability of the portfolio company. SBA seeks to maintain alignment with SBIC licensees and welcomes discussing situations on a case-by-case basis.

In response to public comment, this final rule rescinds the proposed requirement that Accrual SBICs own less than 50 percent of small business concerns at initial financing in an effort to encourage the inclusion of long-term buy-and-build strategies. Proposed changes to § 107.865 are not adopted.

X. Section 107.1000 Non-leveraged Licensees—exceptions to this part.

This regulation identifies exceptions to the regulations for Licensees without Leverage. SBA is implementing regulations to incorporate the term Non-leveraged Licensee as discussed in section II.A. of this rule. There were no comments on this section. This final rule adopts the proposed § 107.1000 without substantial change.

Y. Section 107.1120 General eligibility requirements for Leverage.

This regulation identifies general requirements to be eligible for Leverage. Paragraph (c) references § 107.210 concerning minimum Private Capital requirements. SBA proposed to amend paragraph (c) to incorporate Pub. L. 115-133 by adding an exception to the $5 million minimum Regulatory Capital requirement if the SBIC was licensed because they are headquartered in an Underlicensed State. As identified in § 107.1150, such Licensees will be limited to Leverage up to 100 percent of Regulatory Capital until they raise $5 million in Regulatory Capital.

One commenter believes benefits associated with Underlicensed States should be limited to those both headquartered in an Underlicensed State and deploying capital to portfolio concerns headquartered in that State. With respect to licensing priority, the Act defines an Underlicensed State as a State in which the number of licensees per capita is less than the median number of licensees per capita for all States—further, the Act provides first priority for SBIC

applicants in Underlicensed States with below median financing. Additionally, Pub. L. 115–333 permits Licensees. Changing this language would be inconsistent with statute. This final rule adopts the proposed § 107.1120 without change.

Z. Section 107.1130 Leverage fees and Annual Charges.

This regulation identifies the fees and charges associated with SBA guaranteed Leverage. Currently the title identifies Annual Charges as "additional charges". SBA proposed changing the title to clarify that the additional charge refers to the Annal Charge as discussed in § 107.50.

Paragraph (d)(1) discusses the Annual Charge required for Debentures, noting that it only applies to Debentures issued on or after October 1, 1996, and that it does not apply to Leverage issued prior to that date. Since all Debentures outstanding were issued on or after October 1, 1996, SBA proposed implementing regulations to remove this language.

SBA further proposed implementing regulations to set the minimum Annual Charge to 0.4 percent or 40 basis points which would be achieved over a number of years. The fiscally responsible administration of the program requires a minimum Annual Charge on outstanding leverage be established to address the long-term variances in losses. The historical losses vary greatly as a result of national economic health and private equity and venture fund vintage year performance. As a consequence, SBA experiences many years in which there are zero or minimal SBIC transfers to liquidation status and a few years in which there are numerous failures with resulting losses to SBA.

The change will protect the government from significant losses, increase the prospects of preserving a zero or negative subsidy cost across program cohorts, enhance the long-term ability of SBA to provide guarantees to SBICs, license more applicants, and indirectly provide greater patient capital to qualifying small businesses.

Two commentors expressed concerns that the 50 basis points (bps) minimum annual charge poses a significant cost to licensees. The average annual charge over the last twenty years

is 57 bps. SBA appreciates these concerns, and in response will reduce the minimum annual charge floor to 40 bps and phase in the floor over time for a smooth transition:

- FY24 – 10 bps
- FY25 – 20 bps
- FY26 – 25 bps
- FY27 – 30 bps
- FY28 – 35 bps
- FY 29 – 40 bps (capped floor)

One commenter recommends SBA use a different subsidy model to set Leverage fees and Annual Charges. The SBA appreciates the suggestion and will continue to work with the White House Office of Management and Budgets (OMB) to ensure the subsidy model remains robust and aligned to the requirements of the Federal Credit Reform Act of 1990. It is the objective of SBA to operate the SBIC program at a zero-subsidy rate while achieving the mission and intent of Congress in establishing the program in 1958. SBA has integrated the phased-in annual charge floor schedule into the final regulation and is finalizing § 107.1130.

AA. Section 107.1150 Maximum amount of Leverage.

Current § 107.1150 identifies the maximum amount of a Leverage for a Section 301(c) Licensee. SBA approves Leverage commitments for those Licensees that were licensed under the now repealed section 301(d) for Specialized SBICs. SBA proposed implementing regulations to correct the language to apply to all Leveraged Licensees.

Paragraph (a) sets forth the maximum Leverage for an "Individual Licensee." SBA proposed implementing regulations to clarify that per the revised definition of "Leverage," the maximum Leverage includes both the principal and accrued interest associated with the Accrual Debenture. SBA also proposed implementing regulations to add that if a Licensee is headquartered in an Underlicensed State and has less than $5 million in Regulatory Capital, it is limited to one tier of Leverage.

Paragraph (b) sets the maximum Leverage for multiple licensees under Common Control, as defined under § 107.50. SBA is implementing regulations to clarify that similar to the requirements for an "Individual Licensee," the interest associated with the Accrual Debenture will be used to calculate the maximum Leverage across all Licensees under Common Control.

One commenter suggested increasing maximum leveraged capital provided. SBA notes that increasing the maximum amount of leverage available to Licensees is not within the authority of the rulemaking and will require an act of Congress. This final rule adopts the proposed § 107.1150 without change.

BB. Section 107.1220 Requirement for Licensee to file quarterly financial statements.

This regulation currently requires SBICs with outstanding Leverage commitments to submit quarterly Form 468s within 30 days after the close of each quarter. SBA proposed implementing regulations to clarify that this requirement pertains to all Leveraged Licensees and to allow 45 days after the close of each quarter, commensurate with portfolio valuation due dates as finalized under §§ 107.503 and 107.650. There were no comments on this section. This final rule adopts the proposed § 107.1220 without change.

CC. Section 107.1830 Licensee's Capital Impairment—definition and general requirements.

This regulation currently requires Leveraged Licensees to calculate their capital impairment percentage ("CIP"), identifies the maximum CIP allowable, and requires them to report to SBA if they have a condition of capital impairment. Paragraph (a) currently identifies that this section only applies to leverage issued on or after April 25, 1994, and identifies alternate requirements for Leverage issued prior to that date. Since all Leverage currently held by operating SBICs was issued after April 25, 1994, SBA is removing obsolete language in this paragraph. Section 107.1850 applies to all Leveraged Licensees with outstanding Leverage.

Paragraph (e) requires Licensees to calculate their CIP and notify SBA if they have a condition of capital impairment. Paragraph (f) gives SBA the right to redetermine the CIP at any time. SBA proposed to change this requirement such that SBA will calculate the Licensee's CIP

each quarter and notify the SBIC if they are capitally impaired. Since SBA is calculating the CIP, SBA also is implementing regulations to remove paragraph (f).

Two commenters suggested SBA considering public disclosure of Capital Impairment (CIP) results. SBA notes that the Form 468 updates include automatic calculations of both the CIP and leverage coverage ratios. SBA is concerned that public disclosure of CIP ratios (based on SBA's valuation policy which can result in significantly lower valuations than FASB GAAP) might cause unintended harm and violate statutory restrictions on disclosure of SBIC licensee data. SBA is updating theForm 468 which will enable transparency into the overall aggregated SBIC program portfolio investment performance and aggregated SBIC licensed funds' investment performance by strategy and vintage year for the public. SBA believes such industry standard metrics will provide value to the public and, in particular, current and prospective investors in SBIC licensed funds. This final rule adopts the proposed § 107.1830 without change.

DD. Section 107.1840 Computation of Licensee's Capital Impairment Percentage.

This regulation defines how to compute a Licensee's CIP. Since SBA proposed to calculate the CIP and notify Licensees if they have a condition of Capital Impairment, SBA proposed implementing regulations to make related changes to this regulation.

One commenter concurred with the changes as written. This final rule adopts the proposed § 107.1840 without change.

EE. Section 107.1845 Determination of Capital Impairment Percentage for Early Stage SBICs.

This regulation defines how to compute an Early Stage SBIC's CIP. Since SBA proposed to calculate the CIP and notify Licensees if they have a condition of Capital Impairment, SBA proposed implementing regulations to make related changes to this regulation.

SBA received no comments on the proposed regulation. This final rule adopts the proposed § 107.1845 without change.

FF. Section 107.1850 Watchlist.

For more than twenty years, Licensee Leverage default rates have averaged less than 16 percent. While this is a relatively small percentage of Licensees, these Licensees introduce risk to the sustainability of the SBIC program and to SBA. In an effort to proactively identify and manage risk, SBA is implementing regulations to introduce a Watchlist (previously referred to as *Enhanced Monitoring* in the proposed rule). A Licensee can be added to the Watchlist for a series of actions, including but not limited to, bottom quartile performance relative to the Licensee's stated benchmark for more than four consecutive quarters, or reporting failures defined in SBIC program policies and procedures. While on the Watchlist, the Licensee will be required to file Form 1031 on a more frequent basis, and upon request, conduct portfolio review meetings with SBA. The Licensee will be notified when added to the Watchlist upon determination. Once the events that warranted Watchlist status are addressed to SBA's satisfaction, Licensees will be notified that they are removed from the Watchlist. A series of performance metrics will be reviewed collectively to assess a holistic picture of performance. Of those metrics, TVPI or DPI metrics in the bottom quartile for four consecutive quarters relative to the Licensee's primary benchmark for the applicable vintage year can result in a Licensee being added to the Watchlist.

Two commenters disagree with the proposed regulation and believes it should be withdrawn in favor of using existing oversight tools. One commentor also posed suggestions of how to limit watchlist status and suggested giving SBICs early warning and allow challenges in the event that SBA does decide to include watchlist status in the final rule. SBA responds that maintaining the Watchlist does not result in additional enforcement actions and the objective of the proposal is to formalize existing 'watchlist' practices which have existed in SBIC Program Standard Operating Procedures for several years. The goal of the Watchlist is to identify SBICs for which there is potential for concern prior to their reaching violation or default and then increase communication with the licensee to remain aligned on potential steps to ensure sound

operations of the licensee to mitigate the risk of a potential default. In that respect, SBA believes that the concept of the Watchlist aligns with the commentor's expressed goal of providing SBICs with 'early warning'. To increase understanding and clarify as to what SBA is proposing in this section, SBA is renaming 'enhanced monitoring' to 'watchlist' consistent with industry best practices and longstanding SBA SBIC Program Standard Operating Procedure guidance.

One commenter disagreed with putting the bottom quartile of SBICs on the Watchlist. SBA clarifies multiple factors and considerations will be assessed as part of the Watchlist process and incorporated these factors and considerations into 13 CFR 107.1850. SBA also clarifies that the bottom quartile of SBICs will not be put on the Watchlist, rather the SBICs that fall in the bottom quartile of the applicable vintage year and investment strategy industry benchmarks, not bottom quartile among the universe of SBIC licensees, will be identified as part of the broader watchlist process.

One commenter requested clarification around the consequences of a fund being on Watchlist status for a prolonged period, and whether SBA is taking other factors into consideration when looking at the bottom quartile, such as capital impairment, operating plan, and the source of the performance issues. SBA clarifies that identification for watchlist does not result in enforcement action. The consequence of a licensee being identified for the Watchlist is increased communication with SBA to ensure alignment of objectives and mitigate the risk of potential future enforcement action.

One commenter suggested SBA should require examinations within an 18-month time period for leveraged Licensees. While SBA sets a goal to examine Leveraged Licensees within an 18-month period, the SBIC is not considered at fault if SBA needs to extend the examination date due to resource issues. SBA does prioritize exams based on credit risk among other factors. SBA updated the regulation to reflect the considerations raised by the commenter related to enforcement and SBAhas replaced "enhanced monitoring" with "watchlist." The final rule adopts § 107.1850 substantially as proposed.

GG. Section 121.103 Small Business Size Regulations: How does SBA determine affiliation?

In 13 CFR part 121, SBA sets forth size standards and defines a business's size to include the size of the affiliates of the business, subject to certain exceptions. One of these exceptions, § 121.103(b)(5)(vi), applies only to financial, management, and assistance under the Act and is intended to exclude Traditional Investment Companies which includes funds exempt from registration under the 1940 Act from affiliation coverage. As noted above, the term Traditional Investment Companies, generally includes non-profits, in the capacity as the management company of a for-profit fund, and issuers that would be "investment companies," as defined under the Investment Company Act of 1940 (the "1940 Act"). It also includes all 3(c)(1) and 3(c)(7) private funds not registered under the 1940 Act. This exception to SBA affiliation requirement was provided to allow SBIC Financings with other private equity, private credit, and venture capital funds since co-investment and syndication between such funds is typical and increases the amount of Private Capital available for small businesses. It should be noted that SBA's regulations and determinations are not determinative as to whether a licensed Traditional Investment Company must comply with the 1940 Act.

One commenter supports expanding the size standard exception to include "qualified purchasers" because it would conform to the SEC's definition of "private fund" that includes both 3(c)(1) and 3(c)(7) funds and offer material relief and clarity to SBICs in applying the SBA

size standards when investing in sponsored transactions. The SBA appreciates this support for expanding the size standard exception.

One commenter questioned whether SBA would be able to determine affiliate relationship because 3(c)(7) funds do not have traditional SEC registration or disclosure requirements. SBA responds that these funds are similar to private funds under 3(c)(1) of the 1940 Act which are also exempt from registration except that (i) 3(c)(7) funds are not limited in beneficial owners and (ii) all investors in a 3(c)(7) fund must be qualified purchasers. SBA also notes that since 1996, the regulations have excepted from affiliation coverage 3(c)(1) funds (which are also exempt from registration) and this exception from affiliation coverage has never posed risk to the program. SBICs often invest with others, thereby increasing the amount of capital to these underserved businesses. SBA notes that removing such funds from the exceptions to affiliation coverage would greatly reduce the ability for SBICs to provided needed financings to Small Businesses, which is core to the mission of the program.

SBA received one comment seeking clarification as to the applicability of § 121.103(b), *Exceptions to affiliation coverage,* for Accrual SBICs. SBA confirms that the Agency has historically interpreted 13 CFR 121.103(b)(1) to mean that a Small Business that is owned, in whole or in substantial part, by a Licensee will remain unaffiliated from the Licensee, and confirms that the exception set forth in 13 CFR 121.103(b)(1) applies to Accrual SBICs. SBA is finalizing the proposed Section § 121.103 substantially as proposed.

HH. Severability.

One comment recommended that SBA include in this rule an express provision addressing the effect of a judicial declaration of invalidity as to any section or portion of this rule or part 107. The question of severability addresses whether a judicial finding of a provision's invalidity should extend to other provisions or applications or whether it should be limited to the invalid provision or application, leaving in effect the remainder of the rule. Like the entirety of part 107, this rule seeks to implement, to the maximum extent possible, the stated congressional

purpose of the Act itself—*i.e.*, "to improve and stimulate the national economy in general and the small-business segment thereof in particular by establishing a program to stimulate and supplement 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." *See* 15 U.S.C. 661. Although this rule includes numerous enhancements to the SBIC program, most of the individual sections added or modified in this rule, like those which remain in part 107 from prior rulemakings, may operate independently in service of the stated congressional purposes and the objectives set forth above for this rule.

Accordingly, in the event that any portion or application of the rule is declared invalid, SBA intends that the various other provisions and applications of part 107, including those added or modified in this rule, be severable from the unlawful portion, unless such declaration of invalidity renders another section or provision meaningless or deprives that other section or provision of its functionality. Moreover, such collateral invalidity is intended only to the extent required by logic or loss of functionality. Section 107.25 is therefore drafted to express and implement SBA's intent relative to severability within part 107. For example, if a court were to find unlawful this rule's establishment of the Accrual SBIC—a Section 301(c) Licensee which is authorized to issue Accrual Debentures—such finding would have no effect upon this rule's definition of unrelated terms (§ 107.50), its changes to the management-ownership diversification requirements (§ 107.150), its changes to licensee fees (§ 107.300), its provisions for expedited review of subsequent fund applicants (§ 107.305), or various other provisions which in no way are dependent upon the Accrual SBIC or the Accrual Debenture. Such finding would, however, deprive the "Reinvestor SBIC" concept of its functionality, since a Reinvestor SBIC is indeed a type of Accrual SBIC (*i.e.*, one which at the time of licensing is authorized to issue Accrual debentures in the execution of a specific investment strategy), and where such a related provision could not "function sensibly without the stricken provision," the invalidity of that

related provision would be required as well, *cf. Belmont Mun. Light Dep't v. FERC*, 38 F.4th 173, 187–88 (D.C. Cir. 2022), though only in such circumstances. The foregoing is merely an example and does not express an intent that any other provision be considered non-severable. SBA reiterates that where any provision of this part is declared invalid, any collateral invalidity is intended to the least extent necessary, in order to advance program objectives to the maximum extent possible.

III. **Compliance with Executive Orders 12866, 12988, 13132, 13563, 13175, and 14094 the Paperwork Reduction Act (44 U.S.C., Ch. 35), and the Regulatory Flexibility Act (5 U.S.C. 601-612))**

A. <u>Executive Order 12866</u>

The Office of Management and Budget has determined that this rule constitutes a "significant regulatory action" under Executive Order 12866, as amended by Executive Order 14094. SBA has drafted a Regulatory Impact Analysis for the public's information below. Each section begins with a core question.

1. Regulatory Objective of the Proposal

Is there a need for this regulatory action?

This final rule is intended to reduce barriers to program participation for funds investing in (i) underserved communities and geographies, (ii) capital intensive investments, and (iii) technologies critical to national security and economic development. In this final rule, SBA is introducing additional types of SBICs ("Accrual" SBICs and "Reinvestor" SBICs) to increase program investment diversification and patient capital financing for small businesses and modernize rules to lower financial barriers to program participation. The new Accrual Debenture allows more flexibility in financing to increase participation of SBICs capable of addressing identified capital access gaps and vulnerability in the U.S. small business segment. Additionally, this final rule introduces a "Capital Call Line," a form of credit line that does not

require SBA approval. The aforementioned benefits and attractiveness of the Accrual Debenture will also reduce some of the previously perceived disadvantages to being an SBIC, as opposed to the non-SBIC private market. The revisions to 13 CFR 107.720 should improve the SBIC program's investment diversification and create more program entry points for new fund managers. This final rule also reduces barriers by revising reporting requirements that may allow increased use of valuation policies that are consistent with GAAP. This rule will help SBA implement Executive Order ("E.O.") 13985, "Advancing Racial Equity and Support for Underserved Communities Through the Federal Government," by reducing financial and time barriers to participate in the SBIC program and modernizing the program's license offerings to align with a more diversified set of funds investing in underserved small businesses. The final rule would also incorporate the statutory requirements under Pub. L. 115-333, titled "Spurring Business in Communities Act of 2017", enacted on December 19, 2018.

The Agency believes it is necessary to reduce barriers to participation and diversify its patient capital and long-term loan program for long-term program stability and mission effectiveness. This will simultaneously diversify the sources and types of financing available to underserved small businesses and small businesses manufacturing products and technologies critical to national security and U.S. economic competitiveness. The Agency also believes that to be effective in delivery, it needs to streamline and reduce regulatory burdens to facilitate robust participation in its patient capital and long-term loan program which are responsible for enabling access to capital for underserved U.S. small businesses across the country.

By offering an alternative to a semi-annual interest payment Debenture structure for all SBIC licensees investing in small businesses to help them grow and scale, SBA strives to increase equity and growth capital available to underserved small business owners and unlock equity and equity-like loan financing as sources of funding for many small business owners while still maintaining an expected zero subsidy cost in the program. This alternative structure accommodates a longer horizon for investments in small businesses that might require more

patient capital. SBA has confidence this goal will be achieved while continuing to maintain a zero-subsidy based on extensive analysis of the performance of private funds over the last 20 years from Pitchbook and as supported by the *2021 Knight Diversity of Asset Manager Research Series*[1] which found that, "diverse-owned firms have low levels of representation across each asset class; however, they exhibit returns that are not significantly different than non-diverse-owned firms." SBA is revising its Debenture and license regulations in response to continuing requests by SBA's participating SBIC licensees and the public. SBA believes that revising its Debenture and license regulations will result in expansion of access to capital for those who cannot obtain adequate patient capital from traditional sources of funding, while decreasing time and cost associated with applying for an SBIC license. Greater access to capital is bolstered by the revisions enabling SBA to offer a debenture with terms and regulations aligned to the cash flows of a broader base of private funds as well as a reduction in cost burden to apply for and participate in the SBIC Program.

2. **Benefits and Costs of the Rule**

What are the potential benefits and costs of this regulatory action?

SBA does not anticipate significant additional costs or impact on the subsidy to operate the SBIC program under these final regulations. Since SBA has existing authority to license and provide funding to equity-oriented and debt-oriented private funds, there is no request for additional funding.

Currently, SBICs distribute about $1.5 billion or more per year in profit distributions to Limited Partners. SBA's regulations permit SBICs to distribute profits to Limited Partners without any corresponding repayment of SBA Leverage. SBA is proposing that Accrual SBICs and Reinvestor SBICs pay all accrued interest and annual charges, then repay its Leverage on a pro rata basis (in step) with its Limited Partners. Based on analysis of average cash flows regarding private funds, SBA expects that this will improve the likelihood that SBA will be

[1] Knight Foundation, "Diversity of Asset Managers Research Series: Industry," December 7, 2021.

repaid on the same schedule as Limited Partners regardless of the investment strategy of the Accrual SBIC or Reinvestor SBIC fund.

Under these final regulations, SBA anticipates SBIC program administrative costs to decline over time due to streamlining of regulatory filing and reduction in duplicative data reporting across multiple filings. Furthermore, the final regulations include changes which reduce bureaucratic processes, such as approving the SBIC's Total Intended Leverage Commitment at licensing, reducing SBA approvals for certain conflicts of interest by creating additional safe harbors, and approving GAAP-compliant valuations for Non-leveraged licensees. SBA believes such changes will help SBA improve its response times and enable personnel to focus on customer relationships and monitoring its funds. In revising the SBIC Debenture offering into two categories of Debentures, "Standard Debenture" and "Accrual Debenture," available to eligible SBIC licensees under 13 CFR 107.50, SBA anticipates de minimis impact on the subsidy for the SBIC program. Currently, as part of its licensing process, SBA reviews approximately 70 license requests annually and declines 10 to 15 percent (or 8 to 10 requests) due to poor performance, negative diligence and/or regulatory conflict issues. These 70 applications represent the total annual license applications for non-levered and Debenture SBICs combined. Two-thirds of these applications are submitted by entities with existing SBIC licensees requesting a license for a subsequent licensed SBIC fund. The approximate total number of licenses approved annually in the SBIC program is 25. Additionally, federally regulated private equity funds must comply with the requirements from relevant Federal regulating entities. Private equity funds must also abide by the terms of their investor agreements, such as a limited partnership agreement, and fulfill their fiduciary obligation to their investors. Because of these requirements, SBA anticipates these licensed SBIC funds will continue making investment decisions based on their fiduciary responsibility and terms of their investor agreements which limits risk to SBA. Regulated SBIC licensees must comply with the business plan and investor agreements approved by SBA while operating an SBIC license.

Licensees will benefit by no longer being required to submit 1031 financing reports within 30-days of financing pursuant to § 107.640, instead filing at the end of each quarter, unless the licensee is subject to the Watchlist, as previously mentioned. This will reduce paperwork and the reporting burden on SBIC licensees. As a result of this revision, SBA expects a decrease in the time required for small businesses to access capital at critical moments, which will in turn help more small businesses grow and scale. Furthermore, these changes will decrease SBA's administrative costs.

SBA does not anticipate significant additional costs or impact on the subsidy to operate the SBIC program under the final regulations at 13 CFR 107.50 regarding the accrual license and Accrual Debenture. One Debenture structure limits accessibility to SBA's patient equity and long-term private loan program, with an outsized impact on underserved small business owners who may struggle to access traditional sources of capital. SBA anticipates that providing clear and streamlined regulatory guidance, regulatory fees aligned with the size and scale of SBIC applicants and licensees, and a second Debenture structure to capital access gaps will result in an increase in the number of and diversity of participating SBIC licensees and will result in more underserved small business owners obtaining access to patient equity capital or long-term loans.

3. **Alternatives**

What alternatives have been considered?

SBA considered eliminating additional regulatory burdens, such as shifting entirely to FASB GAAP-compliant valuation reports, and determined that this final rule strikes the appropriate balance between responsibly streamlining regulations without increasing the risk of waste, fraud, or abuse of the programs or otherwise threatening the integrity of the SBIC program or taxpayer dollars. Possible alternatives included eliminating more regulatory burdens, but such a course would require additional time for SBA to consider the impact of these eliminations. After considering feedback from stakeholders during the public comment period of the notice of proposed rulemaking, SBA qualitatively determined that benefits of a timely

issuance of a rule with the included regulatory relief and measures to implement Executive Order 13985 outweighed the benefits of a delay to give the agency more time to consider further eliminations of regulatory burdens. Regarding Debenture instrument structure and license type, SBA has implemented several variations of its SBIC Debentures to increase program alignment and accessibility for new patient capital funds in the past as discussed above, and SBA has determined from these past experiences that the simplest rules finalized herein were the least burdensome.

B. Executive Order 12988

This action meets applicable standards set forth in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have preemptive effect or retroactive effect.

C. Executive Order 13132

This final rule does not have federalism implications as defined in Executive Order 13132. It will not have substantial direct effects on the States, on the relationship between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government, as specified in the Executive order. As such it does not warrant the preparation of a federalism assessment.

D. Executive Order 13175

This final rule does not have tribal implications under Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, because it would not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes.

E. Executive Order 13563

1. Did the agency use the best available techniques to quantify anticipated present and future costs when responding to E.O. 12866 (*e.g.*, identifying changing future compliance costs that might result from technological innovation or anticipated behavioral changes)?

A description of the need for this regulatory action and benefits and costs associated with this action, including possible distributional impacts that relate to Executive Order 13563, are included above in the Regulatory Impact Analysis under Executive Order 12866.

2. Public participation: Did the agency: (a) Afford the public a meaningful opportunity to comment through the internet on any proposed regulation, with a comment period that should generally consist of not less than 60 days; (b) provide for an "open exchange" of information among Government officials, experts, stakeholders, and the public; (c) provide timely online access to the rulemaking docket on *Regulations.gov*; and (d) seek the views of those who are likely to be affected by rulemaking, even before issuing a notice of final rulemaking?

F. Paperwork Reduction Act, 44 U.S.C., Ch. 35

SBA has determined that this final rule would impose additional reporting and recordkeeping requirements under the Paperwork Reduction Act. Generally, this rule is implementing regulations changes to two information collections used in the SBIC program: 1) SBA Form 468, "SBIC Financial Reports," to include GAAP financial performance metrics, the number of jobs sustained and created, and voluntary demographic information at the SBIC management level; and, 2) SBA Form 1031, "Portfolio Financing Report," to decrease the current frequency of reporting on a per-financing basis as-of the date of a financing's close to quarterly reporting of all SBIC financings within a given quarter, no less than 30 days after the calendar year quarter-end.

The title, summary description of the information collection, and the proposed changes to SBA Form 468 and SBA Form 1031 are discussed below with an estimate of the revised annual

burden. Included in the estimates are time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing each collection of information.

Title: Portfolio Financing Report, SBA Form 468 (OMB Control Number 3245-0063).

Description of Respondents: Small Business Investment Companies.

Estimated Number of Respondents: 406.

Estimated Annual Responses: 1,002.

Estimated Annual Hour Burden: 24,708.

Summary: To obtain the information needed to carry out its oversight responsibilities under the Small Business Investment Act of 1958 (the "Act"), SBA requires SBICs to submit financial statements and supplementary information on SBA Form 468. SBA uses this information to monitor SBIC financial condition and regulatory compliance, for credit analysis when considering SBIC leverage applications, and to evaluate financial risk and economic impact for individual SBICs and the program as a whole.

Section 310(d)(1)(C)(i) of the Act requires SBICs to submit audited financial statements to SBA at least annually. SBA regulations at 13 CFR 107.630 requires the use of SBA Form 468 when submitting the financial statements and supporting documentation. The information collected is used to determine the creditworthiness of an SBIC when considering its leverage application and to monitor its financial condition after assistance is provided. The information is also used to evaluate an SBIC's compliance with certain regulations, such as the activity requirements in 13 CFR 107.590 and the portfolio diversification requirements in 13 CFR 107.740.

To date, SBA's Form 468 reporting requirements have been tailored to satisfy SBA's specific regulatory and credit risk analytical requirements using SBA's guidelines on accounting principles and valuations. Many SBIC investors request GAAP financial information from SBICs, and SBA understands that all or substantially all SBICs currently prepare data under

GAAP principles in addition to under SBA's accounting and valuation guidelines applicable to the SBA Form 468. Therefore, SBA anticipates the addition of GAAP financials in general to have a de minimis impact on calculating burden, as this information would be readily available to SBICs as part of the normal course of business.

Specifically, SBA will be requesting from SBICs on SBA Form 468 the following metrics that SBICs already calculate using GAAP-audited financial data for reports to their private investors: 1) Net Total Value to Paid In Capital (TVPI) – the total distributions, including both cash and distributed securities (valued as of the distribution date) plus the net asset value of a private fund's portfolio net of carried interest and expenses, divided by the capital that has been paid in by investors; 2) Net Distributions to Paid In Capital (DPI) – total distributions, including both cash and distributed securities (valued as of distribution date), a private fund has returned to investors net of fund expenses and carried interest, divided by the amount of money investors have paid into the fund; 3) Multiple on Invested Capital (MOIC) – the total gross realized and unrealized value generated by a private fund's portfolio, divided by the total amount of capital invested into the portfolio concerns by the fund; and, 4) Net Internal Rate of Return (IRR) – the rate at which the private investor cashflows and the unrealized net asset value minus any fund expenses and carried interest are discounted so that the net present value of cashflows equals zero.

Similarly, under this final rule, SBA seeks to obtain GAAP financial data related to valuations in SBA Form 468 supplemental valuation reports, which are currently requested semiannually. Under this final rule, the reporting frequency would increase from semiannually to quarterly to supplement the valuations data SBICs must already report on SBA Form 468 Short Form for quarterly reporting. Many SBIC investors request portfolio company valuations from SBICs using GAAP principles, and SBA understands that all or substantially all SBICs currently prepare such data under GAAP principles in addition to under SBA's valuation guidelines applicable to the SBA Form 468. Therefore, SBA anticipates the addition of GAAP

financials in general to have minimal impact on calculating increase to burden, as this information should already be available to SBICs as part of the normal course of business.

Additionally, this final rule would add three new reporting requirements to the SBA Form 468. First, SBA will request the number of jobs sustained and the number of new jobs created per each portfolio company. Currently SBA request the number of employees per financing on SBA Form 1031 with updates per follow-on financings. Under this final rule, SBA seeks to ask for the number of jobs at the time of initial financing (*i.e.*, jobs sustained) with annual updates of new jobs created (or lost) to obtain numbers of net new jobs created as a result of SBIC financings. Second, under this final rule, SBA seeks to request annual management contact and optional demographic information at the SBIC management level. SBA seeks the mandatory updates to management contact information in order to maintain and improve customer relationship between Licensees and SBA Operations Analysts. SBA seeks the voluntary information for reporting purposes to assess the current SBIC program as related to efforts undertaken in this final rule to promote reducing barriers to program participation for new funds and promoting the diversification of SBIC investments. In order to provide consistency on the distribution calculations, SBA seeks to collect the information in a new "Distribution Schedule" from Accrual SBICs. These new reporting requirements to the SBA Form 468 seek information that SBICs would have readily available under the normal course of business and therefore should have a de minimis impact on burden per SBIC.

The current annual burden for SBA Form 468 is estimated at 24,708 hours. Based on the current size of the SBIC program, SBA estimates the new reporting requirements to increase the annual hourly burden by 1,950 hours for a total estimated annual burden of 26,658 hours.

Title: Portfolio Financing Report, SBA Form 1031 (OMB Control Number 3245-0078).

Description of Respondents: Small Business Investment Companies.

Estimated Number of Respondents: 316.

Estimated Annual Responses: 2,695.

Estimated Annual Hour Burden: 728.

Summary: To obtain the information needed to carry out its program evaluation and oversight responsibilities, SBA requires SBICs to provide information on SBA Form 1031 each time financing is extended to a Small Business. SBA uses this information to evaluate how SBICs fill market financing gaps and contribute to economic growth and monitor the regulatory compliance of individual SBIC. Currently, SBA regulations require all SBICs to submit a Portfolio Financing Report using SBA Form 1031 for each financing that an SBIC provides to a Small Business within 30 days after closing an investment. Under this final rule, the reporting deadline for SBICs (except those subject to the Watchlist) would change to 30 days after the end of the calendar year quarter (March, June, September, and December) following the closing date of a financing that an SBIC provides to a Small Business, rather than 30 days after the date of each financing. Therefore, there would be no change to the annual burden estimated at 728 hours.

G. Regulatory Flexibility Act, 5 U.S.C. 601-612

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601, requires administrative agencies to consider the effect of their actions on small businesses, small organizations, and small governmental jurisdictions. According to the RFA, when an agency issues a rulemaking, it must prepare a regulatory flexibility analysis to address the impact of the rule on small entities. However, section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

This final rule likely will not impact a substantial number of small entities relative to the population of existing private market funds and private market asset management companies. This rulemaking will affect only a limited population of existing and potential SBIC Licensees. Small entities affected by this final rule are a unique class comprised of SBIC Licensees. As of

March 31, 2022, 294 SBIC Licensees were in operation.[2] SBA estimated that approximately 98 percent of these Licensees were small businesses based on North American Industry Classification System (NAICS) subsector code 523 (Securities, Commodity Contracts, and Other Financial Investments and Related Activities) with annual receipts less than $41.5 million. Of these 294 SBICs, 57 were Non-leveraged Licensees. The final rule distinguishes between Leveraged and Non-leveraged Licensees in applicability of some of its changes and other changes apply to all SBICs.

The final rule applies to all SBICs, 98 percent of which SBA estimates are small businesses. SBA estimates that the final rule may affect all of these small businesses. If SBICs are considered as a separate category from the other entities operating in the private equity, credit, and venture funds sector, then the rule does affect a substantial number of small businesses. However, the estimated burden of this final rule, detailed below, of a maximum of approximately $823 per SBIC before consideration of the offsetting cost savings of this final rule, would likely not constitute a significant economic impact on these small businesses, even where the significance threshold is as low as one percent of revenue impacted.

The final rule increases the frequency of filing Form 468 from semiannually to quarterly and requests more information on Form 468. SBA does not expect that these changes related to Form 468 will impose a significant burden because much of the required information is kept in the normal course of business. SBA also notes that the changes related to Form 468 are offset by reductions in other recordkeeping and compliance costs. The first offset is the facilitation of non-leveraged SBICs' use of valuation policies that meet GAAP, which decreases costs of reporting, recordkeeping, and compliance. The final rule's second offset is the "Capital Call Line" that provides an exception from SBA's prior approval requirement for some lines of credit, thus reducing those SBICs' compliance costs.

---

[2] Small Business Investment Company (SBIC) Program Overview Report for the Quarter Ending March 31, 2022 (sba.gov).

Importantly, this final rule does not directly impact Small Businesses receiving investments, nor any investors or small banks participating in the SBIC Licensee. This final rule regulates the relevant SBIC Licensees. The courts have held that the RFA does not require a regulatory flexibility analysis for entities not directly regulated by the agency's final rulemaking. Thus, SBA is not required to conduct a reflexibility flexibility analysis on potential downstream benefits or costs to those entities.

Even so, this final rulemaking also does not have a significant economic impact on those small entities directly regulated under this final rule. SBA expects the changes in this final rule to increase program participation, access to capital, and diversity of investment strategies. The final rule does not impose significant new compliance requirements to SBIC program participants. The final rule introduces some measures to strengthen risk controls that may impose some reporting and compliance requirements to some program participants. However, these reporting and compliance requirements comprise nominal changes to frequency and content, particularly compared to existing industry standards apart from the SBIC program. The current annual burden for SBA Form 468 is estimated at 24,708 hours. Based on the current size of the SBIC program, SBA estimates the new reporting requirements to increase the annual hourly burden by 1,950 hours for a total estimated annual burden of 26,658 hours. The current annual burden for SBA Form 1031 is estimated at 728 hours per small entity SBIC and because the deadline for reporting would only change to the quarter after the date of financing, rather than 30 days after the date of each financing, there would be no change.

This final rule also defines a new class of Debentures, called Accrual Debentures, that align with cash flows of equity-focused strategies. SBA expects benefits to program participants from this ability to align cash flows but is not able to quantify these benefits.

While SBA is unable to quantify the economic impact on small entities from these various changes, it reasonably expects these changes to not have significant impacts to the small

entities that are program participants due to Congress authorizing a $1,000,000,000 increase to the program commitment ceiling in FY2022.

Based on the foregoing, the Administrator of the SBA hereby certifies that this rulemaking will not have a significant economic impact on a substantial number of small entities. The SBA invites comments from the public on this certification.

List of Subject in 13 CFR Parts 107 and 121

Investment companies, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

Accordingly, for the reasons stated in the preamble, SBA amends 13 CFR parts 107 and 121 as follows:

PART 107 – SMALL BUSINESS INVESTMENT COMPANIES

1. The authority citation for part 107 is revised to read as follows:

Authority: 15 U.S.C. 662, 681-687, 687b–h, 687k–m.

2. Add § 107.25 to read as follows:

§ 107.25 Severability.

Any provision of this part held to be invalid or unenforceable as applied to any person, entity, or circumstance shall be construed so as to continue to give the maximum effect to such provision as permitted by law, including as applied to persons or entities not similarly situated or to dissimilar circumstances, unless such holding is that the provision of this part is invalid and unenforceable in all circumstances, in which event the provision shall be severable from the remainder of this part and shall not affect the remainder thereof.

3. Amend § 107.50 by:

a. Adding in alphabetical order the definitions of “Accrual Debenture,” “Accrual Small Business Investment Company (“Accrual SBIC”),” and “Annual Charge;”

b. Revising paragraph (2) of the definition of “Associate;”

c. Adding in alphabetical order the definition of “Capital Call Line;”

d. Revising the definition of "Charge" and paragraphs (3)(i) and (ii) of the definition of "Control Person;"

e. Adding in alphabetical order the definitions of "Final Licensing Fee," "GAAP", and "Initial Licensing Fee;"

f. Revising the definition of "Leverage;"

g. Adding in alphabetical order the definitions of "Leveraged Licensee" and "Non-leveraged Licensee;"

h. Revising the definition of "Regulatory Capital;"

i. Adding in alphabetical order the definition of "Reinvestor SBIC;"

j. Revising the definition of "Retained Earnings Available for Distribution;"

k. Adding in alphabetical order the definitions of "Revenue-Based Financing and Revenue-Based Loan", "SBIC," "SBIC website," "State," "Total Intended Leverage Commitment," "Total Private Capital Commitment," "Underlicensed State," "Watchlist," and "Wind-down Plan;" and

l. Removing the definition of "Wind-up Plan."

The additions and revisions read as follows:

§ 107.50 Definition of terms.

Accrual Debenture means a Debenture issued at face value that accrues interest over its ten-year term, as to which instrument SBA guarantees both the principal and unpaid accrued interest.

Accrual Small Business Investment Company ("Accrual SBIC") means a Section 301(c) Partnership Licensee, licensed under § 107.300 and approved by SBA to issue Accrual Debentures. Accrual SBICs shall be limited to a maximum of one and one quarter tiers of Leverage.

* * * * *

Annual Charge means an annual fee on Leverage which is payable to SBA by Licensees, subject to the terms and conditions set forth in §§ 107.585 and 107.1130(d).

* * * * *

Associate * * *

(2) Any Person who owns or controls, or who has entered into an agreement to own or control, directly or indirectly, at least 10 percent of any class of stock of a Corporate Licensee or a limited partner's interest of at least 10 percent of the partnership capital of a Partnership Licensee. However, an entity Institutional Investor, as a limited partner in a Partnership Licensee, is not considered an Associate solely because such Person's investment in the Partnership, including commitments, represents 10 percent or more but less than 50 percent of the Licensee's partnership capital, provided that such investment also represents no more than five percent of such Person's net worth and such limited partner also has no role in the management of the subject Licensee, with no right to control or approve any matter (other than such entity's vote as a limited partner) involving the Licensee.

*****

Capital Call Line has the meaning set forth in § 107.550(c).

* * * * *

Charge has the same meaning as Annual Charge.

* * * * *

Control Person * * *

(3) * * *

(i) Controls or owns, directly or through an intervening entity, at least 30 percent of a Partnership Licensee or any entity described in paragraph (1) or (2) of this definition; and

(ii) Participates in the investment decisions of the general partner of such Partnership Licensee; *provided that*, if at least 30% of Regulatory Capital is unaffiliated and unassociated with management of the Licensee, the management company of the Licensee is a government

sponsored non-profit entity, the general partners of the Licensee are bound by a fiduciary duty to the investors in the Licensee, and such members of the general partner may not be hired or removed directly or indirectly by such government sponsor, the management of the Licensee will be deemed to be free from any outside Control; and

* * * * *

Final Licensing Fee has the meaning set forth in § 107.300.

* * * * *

GAAP means Generally Accepted Accounting Principles as established by the Financial Accounting Standards Board (FASB) and refers to established financial accounting and reporting standards for public and private companies and not-for-profit organizations.

* * * * *

Initial Licensing Fee has the meaning set forth in § 107.300.

* * * * *

Leverage means financial assistance provided to a Licensee by SBA, either through the purchase or guaranty of a Licensee's Debentures, and any other SBA financial assistance evidenced by a security of the Licensee. For the Accrual Debenture, Leverage includes principal and accrued unpaid interest.

* * * * *

Leveraged Licensee means a Licensee which has outstanding Leverage, Leverage commitments, or intends to issue Leverage in the future.

* * * * *

Non-leveraged Licensee means a Licensee which has no outstanding Leverage or Leverage commitment, no earmarked assets, and certifies to SBA (in writing) that it will not seek Leverage in the future.

* * * * *

Regulatory Capital means:

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

(2) *Exclusion of questionable commitments.* An investor's commitment to a Licensee is excluded from Regulatory Capital if SBA determines that there is a lack of enforceable legal agreements under United States law or there is an issue of collectability for financial or any other reason, *provided, however*, that the unfunded commitment of an investor that has satisfied the applicable net worth test set forth in the definition of Institutional Investor will not be of questionable collectability (for financial reasons) if the Licensee's limited partnership agreement (or other governing agreement) contains sufficient provisions to ensure collectability.

Reinvestor SBIC has the meaning set forth in § 107.720(a)(2).

Retained Earnings Available for Distribution (READ) means Undistributed Net Realized Earnings less any Unrealized Depreciation on Loans and Investments (as reported on SBA Form 468) and represents the amount that a Licensee may distribute to investors (including SBA) in accordance with § 107.585 as a profit Distribution, or transfer to Private Capital.

Revenue-Based Financing and *Revenue-Based Loan* have the meaning set forth in § 107.810.

*****

SBIC means Small Business Investment Company and has the same meaning as "Licensee" as set forth in this section.

SBIC website means the website maintained by SBA at www.sba.gov/sbic, which contains information on the SBIC program, including notices, policies, procedures, and forms pertaining to the program.

* * * * *

State means one of the United States, the Commonwealth of Puerto Rico, the District of Columbia, Guam, the United States Virgin Islands, the Northern Mariana Islands, and American Samoa.

* * * * *

Total Intended Leverage Commitment means the dollar amount or ratio of SBA Leverage commitments to Private Capital commitments. The final Total Intended Leverage Commitment dollar amount applied in the Accrual Debenture SBA Share calculation will be finalized no later than 12 months after licensure or upon the Licensee's final close, whichever occurs first.

Total Private Capital Commitment has the meaning set forth in § 107.300.

* * * * *

Underlicensed State means a State in which the number of operating licensees per capita is less than the median number of operating licensees per capita for all States, where the per capita per State is based on the most recent resident population published by the U.S. Census as of the date of the calculation. SBA publishes a notice with the current list of Underlicensed States on the SBIC website.

* * * * *

Watchlist has the meaning set forth in § 107.1850.

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

4. Amend § 107.150 by:

a. Revising the section heading;

b. In paragraph (a), revising the heading and adding a parenthetical sentence at the beginning of the introductory text; and

c. Revising paragraphs (b)(1) and (2), the second sentence of paragraph (c)(1), and paragraph (c)(2).

The revisions and addition read as follows:

§ 107.150 Management-ownership diversification requirement.

(a) *Diversification requirement.* (Also referenced in this part as the "diversity requirement.") * * *

* * * * *

(b) * * *

(1) *General rule*. Except as provided in paragraph (b)(2) of this section, no Person or group of Persons who are Affiliates of one another may own, directly or indirectly, more than 70 percent of your Regulatory Capital or your Leverageable Capital.

(2) *Exception*. An investor that is a Traditional Investment Company, as determined by SBA, may own more than 70% of a Licensee's Regulatory Capital and Leverageable Capital. A Traditional Investment Company may also serve as the management company of an SBIC owning and control more than 70 percent of the Licensee's Regulatory Capital and Leverageable Capital. A non-profit entity which is a Traditional Investment Company may only serve as the management company of a Licensee and, unlike other Traditional Investment Companies, is limited to no more than 70% of the Licensee's Regulatory and Leverageable Capital. A Licensee must be a for-profit entity. In determining whether a firm is a Traditional Investment Company for purposes of this section, SBA will also consider:

(i) The degree to which the managers of the firm are unrelated to and unaffiliated with the investors in the firm or non-profit entity.

(ii) Whether the managers of the firm are authorized and motivated to make investments that, in their independent judgment, are likely to produce significant returns to all investors in the firm or non-profit entity.

(iii) Whether the firm or non-profit entity serving as the management company of a for-profit SBIC benefits from the use of the SBIC through the financial performance of the SBIC.

(iv) Other related factors.

(c) * * *

(1) * * * Such Persons must not be your Associates (except for their status as your shareholders, limited partners, or members). * * *

(2) *Look-through for Traditional Investment Company investors*. SBA, in its sole discretion, may consider the requirement in paragraph (c)(1) of this section to be satisfied if at least 30 percent of your Regulatory Capital and Leverageable Capital is owned and controlled indirectly, through a Traditional Investment Company, by Persons unaffiliated with your management.

* * * * *

5. Amend § 107.210 by:

a. Removing the phrase "Wind-Up Plan" in paragraph (a) introductory text and adding in its place the phrase "Wind-down Plan";

b. Revising paragraph (a)(1) introductory text;

c. Removing paragraph (a)(2);

d. Redesignating paragraph (a)(3) as paragraph (a)(2).

The revision reads as follows:

§ 107.210 Minimum capital requirements for Licensees.

(a) * * *

(1) *Licensees other than Early Stage SBICs*. Except for Early Stage SBICs, a Licensee must have Regulatory Capital of at least $5,000,000. As an exception to the general rule in this paragraph (a)(1), SBA in its sole discretion and based on a showing of special circumstances and good cause, which includes applicants that are headquartered in an Underlicensed State, may license an applicant with Regulatory Capital of at least $3,000,000, but only if the applicant:

* * * * *

6. Revise § 107.300 to read as follows:

§ 107.300 License application form and fee.

SBA evaluates license applicants, giving first priority to applicants headquartered in Underlicensed States with below median SBIC Financing dollars per State, as determined by SBA and published periodically in a notice on the SBIC website. Once priority is established, such applicants will continue to receive priority throughout the licensing process. SBA reviews and processes applications in two review phases (initial review and final licensing), as follows:

(a) *Initial review*. Except as provided in this paragraph (a), SBIC applicants must submit a Management Assessment Questionnaire ("MAQ") c and the Initial Licensing Fee, as defined in paragraph (c) of this section. An applicant under Common Control with one or more Licensees must submit a written request to SBA, and the Initial Licensing Fee, to be considered for a license and is exempt from the requirement in this paragraph (a) to submit a MAQ, unless otherwise determined by SBA in SBA's discretion. Eligible "Expedited Subsequent Funds" as described in § 107.305(e) are permitted to submit a streamlined "Short-Form" Subsequent Fund MAQ.

(b) *Final licensing*. An applicant may proceed to the final licensing phase only if notified in writing by SBA that it may do so. Following receipt of such notice, in order to proceed to the final licensing phase, the applicant must submit a complete license application with all required appendices, within the timeframe identified by SBA and the Final Licensing Fee, as defined in paragraph (c) of this section. If you are seeking to be licensed as a Leveraged Licensee and SBA approves your License, SBA will also approve your Total Intended Leverage Commitment amount and ratio as defined in § 107.50 based on the target fund size stated in the MAQ, which means the total Leverage commitments available to you for the life of your SBIC, subject to the provisions of §§ 107.320 and 107.1150. A Licensee is permitted to hold multiple fund closings within and for up to 12 months of receiving a License to reach the target fund size. SBA will then determine the final Total Intended Leverage Commitment which is either the dollar amount or ratio to targeted Private Capital provided at the Green Light. SBA will determine the Total Private Capital Commitment (defined as the total Private Capital committed to a Licensee within

12 months after licensure or upon the Licensee's final closing, whichever occurs first) amount for the Accrual Debenture SBA Share calculation.

(c) *Licensing Fees*. SBIC Initial and Final Licensing Fees are non-refundable fees determined as set forth in paragraphs (c)(1) and (2) of this section.

(1) *Initial Licensing Fee*. The Initial Licensing Fee is based on the applicant's fund sequence, where the fund sequence means the order of succession of private equity or private credit funds for the same fund management team and same strategy. SBA will determine the applicant's fund sequence based on the management team's composition and experience as a team. The Initial Licensing Fees are as follows:

Table 1 to paragraph (c)(1)

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

Example 1 to paragraph (c)(1): If the management team members of applicant DEF I consists primarily of the same team members of fund ABC II and ABC II represented the second fund for those team members, SBA will consider the fund sequence of DEF I as a Fund III, regardless of the number in the applicant's name.

(2) *Final Licensing Fee*. 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:

Table 2 to paragraph (c)(2)

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

(3) *Resubmission Penalty Fee*. The Resubmission Penalty Fee means a $10,000 penalty fee assessed to an applicant that has previously withdrawn or is otherwise not approved for a

license that must be paid *in addition* to the Initial and Final Licensing Fees at the time the applicant resubmits its application.

(4) *Inflation Adjustments*. SBA annually adjusts the Initial Licensing Fee, Final Licensing Base Fee, and Resubmission Penalty Fee using the Inflation Adjustment and will publish notification prior to such adjustment in the **Federal Register** identifying the amount of the fees.

7. Amend § 107.305 by:

a. Revising paragraphs (a), (b), and (c);

b. Adding a heading to paragraph (d); and

c. Adding paragraph (e).

The revisions and additions read as follows:

§ 107.305 Evaluation of license applicants.

* * * * *

(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.* ***

(e) *Subsequent fund applicants.* (1) Applicants operating an active Licensee that meet the following eligibility criteria can apply under an "Expediated Subsequent Fund" evaluation process. Should an applicant fulfill and formally attest to meeting all of the following eligibility criteria, the applicant can apply for an "Expediated Subsequent Fund" evaluation process:

(i) *Consistent strategy and fund size*. Targeted Regulatory Capital to be raised is ≤133% the size of their most recent SBIC fund (inflation adjustments will be considered). Same asset class and investment strategy as most recent license.

(ii) *Clean regulatory history*. No major findings, significant "other matters," or unresolved "other matters" related to licensees managed by the principals of applicant in the previous ten years.

(iii) *Consistent limited partnership (LP)-general partnership (GP) dynamics*. No new limited partner will represent ≥33% of the Private Capital of the licensee upon reaching final close at target fund size or hard cap. The two largest investors in terms of committed capital have verbally committed to invest in the new fund pending receipt of license. The most recent limited

partnership agreement (LPA) of the active Licensee and all side letters will have no substantive changes for the applicant fund.

(iv) *Investment performance stability*. The most recent licensee net distributions to paid-in capital (DPI) and net total value to paid-in capital (TVPI) TVPI are at or above median vintage year and strategy performance benchmarks for the prior three quarters. The principals of the applicant are not managing a licensee in default or with high Capital Impairment (CIP).

(v) *Consistent or reduced leverage management*. The applicant is requesting a leverage to Private Capital ratio ≤ the current or most recent SBIC licensee at target fund size or hard cap.

(vi) *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, subject to paragraph (e)(1)(vii) of this section.

(vii) *Promotions from within*. Demonstration of promoting internal investment team talent from within the firm/organization sponsoring the license.

(viii) *Inclusive equity*. Demonstration of appropriate/increased sharing of carry and/or management company economics with promoted talent or distribution of equitable or increasingly equitable economics among the partnership.

(ix) *Federal Bureau of Investigation (FBI) criminal and Internal Revenue Service (IRS) background check no findings*. The sponsoring entity and all principals of the Licensee do not have an FBI criminal record and do not have IRS violations from the date of their most recent SBIC fund licensure.

(x) *No outstanding or unresolved material litigation matters*. No outstanding or unresolved litigation matters involving allegations of dishonesty, fraud, or breach of fiduciary duty or otherwise requiring a report under § 107.660(c) or (d) as to a prior Licensee, the prospective Applicant's general partner, or any other person who was required by SBA to complete a personal history statement in connection with the license application.

(xi) *No outstanding tax liens*. On the principals applying to manage the licensee, on the most recent or active licensee, and on the sponsoring entity of the licensee.

(2) Should an applicant fulfill and formally attest to meeting all of the eligibility criteria in paragraph (e)(1) of this section, the applicant can submit a streamlined "Short-Form Subsequent Fund MAQ".

8. Revise § 107.320 to read as follows:

§ 107.320 Leverage portfolio diversification.

To minimize "cost" as defined in section 502(5)(A) of the Federal Credit Reform Act of 1990, SBA reserves the right to maintain broad diversification to mitigate concentration of investment risk in approving Leverage commitments for Leveraged Licensees with respect to:

(a) The year in which they commence operations;

(b) The geographic location (giving first priority to applicants from Underlicensed States with below median SBIC Financing dollars per State); and

(c) The asset class and investment strategy.

9. Revise § 107.501 to read as follows:

§ 107.501 Identification.

(a) *Publication upon issuance*. SBA shall publish in the **Federal Register** the names of SBICs with date of licensure and Total Intended Leverage Commitments approved within 30 days of the end of the month of licensure.

(b) *Identification as a Licensee*. You must display your SBIC license in a prominent location. You must also have a listed telephone number. Before collecting an application fee or extending Financing to a Small Business, you must obtain a written statement from the concern acknowledging its awareness that you are "a Federal licensee under the Small Business Investment Act of 1958, as amended."

10. Amend § 107.503 by:

a. Revising the last sentence of paragraph (a);

b. Adding a sentence at the end of paragraph (b)(2); and

c. Revising paragraphs (d)(1) and (4).

The revisions and addition read as follows:

§ 107.503 Licensee's adoption of an approved valuation policy.

(a) * * * These guidelines may be obtained from the SBIC website.

(b) * * *

(2) * * * If you are or applying to be a Non-leveraged Licensee, SBA will generally approve a valuation policy that meets GAAP.

* * * * *

(d) * * *

(1) If you are a Leveraged Licensee, you must value your Loans and Investments at the end of each quarter of your fiscal year, and at the end of your fiscal year.

* * * * *

(4) You must report material adverse changes in valuations at least quarterly, within forty-five days following the close of the quarter.

* * * * *

11. Revise § 107.504 to read as follows:

§ 107.504 Equipment and office requirements.

(a) *Technology.* You must have access to technology to securely send and receive emails, scan documents, and prepare and submit electronic information and reports required by SBA.

(b) *Accessible office.* You must maintain an office that is open to the public during normal working hours.

12. Revise § 107.550 to read as follows:

§ 107.550 Prior approval of secured third-party debt of Leveraged Licensees.

(a) *Definition.* In this section, *secured third-party debt* means any non-SBA debt secured by any of your assets, including secured guarantees and other contingent obligations that you voluntarily assume, and secured lines of credit.

(b) *General rule.* If you are a Leveraged Licensee, you must get SBA's written approval before you incur any secured third-party debt or refinance any debt with secured third-party debt, including any renewal of a secured line of credit, increase in the maximum amount available under a secured line of credit, or expansion of the scope of a security interest or lien. For purposes of this paragraph (b), "expansion of the scope of a security interest or lien" does not include the substitution of one asset or group of assets for another, provided the asset values (as reported on your most recent annual Form 468) are comparable.

(c) *Capital Call Line.* Without obtaining SBA's written approval, a Leveraged Licensee may obtain from a federally regulated financial institution, a line of credit ("Capital Call Line") that meets all of the following conditions:

(1) The maximum amount available under the Capital Call Line is no more than your unfunded Regulatory Capital, as reflected on your most recent Capital Certificate;

(2) Your payment obligations under the Capital Call Line may be secured, but only by your unfunded Regulatory Capital;

(3) The lender under the Capital Call Line may have a right to debit your depository account(s) at the lender's institution, so long as such lender's right to debit is limited to circumstances involving a default of your obligation to pay principal, interest, or fees due ("Payment Default") under the Capital Call Line and only to the amount of such Payment Default;

(4) Each borrowing under the Capital Call Line must be repaid, in full, within 120 days after it is drawn;

(5) The term of the Capital Call Line may not exceed 12 months, but may be renewable, provided that each renewal does not exceed 12 months and you remain in compliance with the conditions of this paragraph (c); and

(6) Consistent with § 107.410, the Capital Call Line contains no provision permitting the lender to dictate when capital calls are made or otherwise ceding to the lender any control of the Licensee or its operations; provided, however, that the Capital Call Line may include a provision authorizing the lender, in the event of a Payment Default, to endorse, on your behalf, checks and other forms of payment in the Lender's possession and to apply the proceeds of such instruments to such Payment Default, with unapplied and remaining proceeds promptly to be paid to you.

(d) *Conditions for SBA approval.* Excluding Capital Call Lines defined in paragraph (c) of this section, SBA approval is required for secured third-party debt. As a condition of granting such approval under this section, SBA may impose such restrictions or limitations as it deems appropriate, taking into account your historical performance, current financial position, proposed terms of the secured debt and amount of aggregate debt you will have outstanding (including Leverage). SBA will not favorably consider any requests for approval which include a blanket lien on all your assets, or a security interest in your investor commitments in excess of 125 percent of the proposed borrowing.

§ 107.570 [Removed and Reserved]

13. Remove and reserve § 107.570.

14. Revise the undesignated center heading directly preceding § 107.585 and § 107.585 to read as follows:

Distributions and Reductions in Regulatory Capital

§ 107.585 Distributions and reductions in Regulatory Capital.

(a) *Non-leveraged Licensees*. If you are a Non-leveraged Licensee, you may make distributions to your private investors without SBA prior approval. At all times, you must retain sufficient Regulatory Capital to meet the minimum capital requirements in the Act and in §

107.210, unless such amounts are in accordance with your SBA approved Wind-down Plan (see § 107.590). You must report any reductions of Regulatory Capital to SBA within 30 days via an updated Capital Certificate (see § 107.300).

(b) *Non-Accrual Leveraged Licensees*. If you are a Standard Debenture Leveraged Licensee that is also an Early Stage SBIC, you are subject to the distributions identified in § 107.1180. If you are a Standard Debenture Leveraged Licensee, you may distribute READ to your private investors without SBA approval only after considering any material adverse changes to your portfolio. You must obtain SBA's prior written approval to reduce your Regulatory Capital by more than two percent in any fiscal year. Such approved reduction amount may, for a period of five years after the reduction, be included in the sum determined under § 107.740(a). In seeking SBA's prior written approval, you must disclose any material adverse changes or certify that you have no material adverse changes and provide an updated Wind-down Plan. You must retain sufficient Regulatory Capital to meet the minimum capital requirements of § 107.210 and sufficient Leverageable Capital to avoid having excess Leverage in violation of section 303 of the Act and § 107.1150. You must report any reductions of Regulatory Capital to SBA within 30 days via an updated Capital Certificate (see § 107.300).

(c) *Accrual SBICs and Reinvestor SBICs*. If you are an Accrual SBIC or Reinvestor SBIC, unless you receive prior approval from SBA for the purposes of covering a tax distribution you may only distribute as follows:

(1) *Payment of Annual Charges and Accrued Interest*. Prior to any distributions to your private investors, you must pay to SBA any Annual Charges and all accrued interest on outstanding Leverage at the next available repayment window but no later than six months following a distribution to your private investors. Within six months of any non-tax distribution to your private investors, you must pay any Annual Charges owed to SBA and all accrued interest on your outstanding Leverage.

(2) *Calculate SBA's share of distribution*. Within six months of any non-tax distribution to your private investors, you must make payments to SBA on a pro rata basis with any distributions to your private investors based on your SBA Total Intended Leverage Commitment relative to your Total Private Capital Commitments, inclusive of Qualified Non-Private Funds, determined within 12 months of Licensure calculated as follows: SBA's Share = Total Distributions x [Total Intended Leverage Commitment / (Total Intended Leverage Commitment + Total Private Capital Commitments)] where:

(i) Total Distributions means the total amount of distributions (whether profit or return of capital) you intend to make after paying all accrued interest and Annual Charges plus any prior tax distributions.

(ii) Total Intended Leverage Commitment is as defined in § 107.300.

(iii) Total Private Capital Commitments is as defined in § 107.300.

(3) *Apply SBA Share*. You must repay SBA outstanding Leverage in an amount no less than SBA's Share to the extent of Outstanding Leverage and report the SBA calculation to SBA. If SBA's Share is greater than Outstanding Leverage and you have unfunded Leverage commitments, you must submit a Leverage commitment cancellation equal to SBA's Share minus the SBA Leverage redemption up to the unfunded Leverage commitments.

(4) *Distribute to private investors*. You must report SBA's Share calculation to SBA prior to distributing READ to your private investors without SBA approval and only after considering any adverse changes to your portfolio. You must pay Annual Charges to SBA prior to distributing READ. After repaying all accrued interest, Annual Charges, and outstanding Leverage calculated as SBA's Share, you may distribute READ to your private investors without SBA approval only after considering any adverse changes to your portfolio. You must obtain SBA's prior written approval to reduce your Regulatory Capital by more than two percent in any fiscal year. Such approved reduction amount may, for a period of five years after the reduction, be included in the sum determined under § 107.740(a). In seeking SBA's prior written approval,

you must disclose any material adverse changes or certify that you have no material adverse changes and provide an updated Wind-down Plan. You must retain sufficient Regulatory Capital to meet the minimum capital requirements of § 107.210 and sufficient Leverageable Capital to avoid having excess Leverage in violation of section 303 of the Act and § 107.1150. You must report any reductions of Regulatory Capital to SBA within 30 days. Prior to any reduction in Regulatory Capital, if you have made a tax distribution, you must make a distribution to SBA pursuant to the formula set forth in paragraph (c)(2) of this section, as if you had made a non-tax distribution.

(5) *Report distribution to SBA*. You must report to SBA the distribution, the calculations, and the amounts distributed to each party as part of your annual and quarterly Form 468 (see §§ 107.630 and 107.1220).

Example 1 to paragraph (c): Your Total Intended Leverage Commitment is $50 million, and your Total Private Capital Commitments are $25 million. You currently have $25 million in Outstanding Leverage, $25 million in unfunded Leverage commitments, and $15 million in Leverageable Capital. You owe $1 million in accrued interest and Annual Charges. You have $61 million to distribute.

Step 1: Payment of Annual Charges and all accrued interest. You would first pay the $1 million in accrued interest and Annual Charges.

Step 2: Calculate SBA's Share of Distribution. SBA's share is calculated as: $60 million x [$50 million / ($50 million + $25 million)] = $40 million.

Step 3: Apply SBA Share. You would repay $25 million in Outstanding Leverage and cancel $15 million of your unfunded Leverage commitments.

Step 4: Distribute to Private Investors. You would distribute $35 million to Private Investors.

Step 5: Report Distribution to SBA. You would then report the distribution to SBA, detailing the amounts and calculations from steps 1 through 4 of this example 1.

§ 107.590 [Amended]

15. Amend § 107.590 in paragraph (c) introductory text by removing the phrase "Wind-up Plan" wherever it appears and adding in its place the phrase "Wind-down Plan".

16. Amend § 107.620 by:

a. Redesignating paragraphs (b)(2) through (4) as paragraphs (b)(3) through (5), respectively; and

b. Adding a new paragraph (b)(2).

The addition reads as follows:

§ 107.620 Requirements to obtain information from Portfolio Concerns.

* * * * *

(b) * * *

(2) Demographic information on the Portfolio Concern's ownership is requested for reporting purposes only and is on a voluntary basis.

* * * * *

17. Amend § 107.630 by revising the last sentence of paragraph (a) introductory text and paragraph (d) and adding paragraph (e) to read as follows:

§ 107.630 Requirement for Licensees to file financial statements with SBA (Form 468).

(a) * * * You must file Annual Form 468 within 90 calendar days of the end of your fiscal year.

* * * * *

(d) *Reporting of economic impact information on Form 468.* Your annual filing of SBA Form 468 must include an assessment of the economic impact of each Financing, specifying the full-time equivalent net jobs created and total jobs created or retained, and the impact of the Financing on the revenues and profits of the business and on taxes paid by the business and its employees.

(e) *Fund management contact and optional demographic information*. The Licensee shall provide and update management contact information. Demographic information is requested for reporting purposes only and on a voluntary basis.

18. Revise § 107.640 to read as follows:

§ 107.640 Requirement to file Portfolio Financing Reports (SBA Form 1031).

For each Financing of a Small Business (excluding guarantees), you must submit a Portfolio Financing Report on SBA Form 1031 within 30 calendar days of the end of the calendar year quarter (March, June, September, and December) following the closing date of the

Financing. SBA also permits Form 1031s for portfolio company financings to be disaggregated and submitted individually for each portfolio company within 30 days of the closing of a Financing or otherwise submitted on a more frequent basis. If you are on the Watchlist, SBA may require more frequent reporting (see § 107.1850).

19. Revise § 107.650 to read as follows:

§ 107.650 Requirement to report portfolio valuations to SBA.

You must determine the value of your Loans and Investments in accordance with § 107.503. You must report such valuations to SBA within 90 calendar days of the end of the fiscal year in the case of annual valuations, and if you are a Leveraged Licensee within 45 calendar days following the close of other reporting periods. You must report material adverse changes in valuations at least quarterly, within 45 calendar days following the close of the quarter.

20. Amend § 107.660 by revising paragraph (a) to read as follows:

§ 107.660 Other items required to be filed by Licensee with SBA.

(a) *Reports to owners.* You must give SBA a copy of any report you furnish to your investors, including any prospectus, quarterly or annual valuation data, materials presented to investors during any meetings (including any annual meeting), fund management demographic information, letter, or other publication concerning your financial operations or those of any Portfolio Concern no later than 30 calendar days after you submit the report to your private investors.

* * * * *

21. Amend § 107.720 by revising paragraphs (a)(2) and (i)(1) to read as follows:

§ 107.720 Small Businesses that may be ineligible for financing.

(a) ***

(2) *Exceptions*—(i) *Reinvestor SBICs. Reinvestor SBIC* means a Section 301(c) Partnership licensed as a Reinvestor SBIC under §107.300 and approved by SBA at the time of licensing to issue Accrual Debentures and shall provide a meaningful percentage of Equity

Capital Investments to underserved Small Business reinvestors (except banks, savings and loans not insured by agencies of the Federal Government, and agricultural credit companies) that make direct financings solely to Small Businesses with at least 50% of employees in the United States, Small Businesses Concerns headquartered in the United States, owned and controlled by United States citizens and/or entities, and Small Businesses eligible for investment based on SBA size standards defined in § 121.301 of this chapter or SBIC alternative size standards defined in § 121.301(c) of this chapter at the time of initial investment. SBA may require that each Reinvestor SBIC obtain from each such Small Business reinvestor a written agreement that such Small Business reinvestor has only provided and will only provide financing in compliance with this paragraph (a)(2)(i) and will provide to such Reinvestor SBIC information reasonably necessary to verify compliance with this paragraph (a)(2)(i).

(ii) *Equity Capital Investments to Disadvantaged Businesses*. Licensees may provide Equity Capital Investments to Disadvantaged Businesses that are relenders or reinvestors (except banks or savings and loans not insured by agencies of the Federal Government, and agricultural credit companies).

* * * * *

(i) * * *

(1) To purchase stock in or provide capital to a Licensee, provided that a Reinvestor SBIC is permitted to make Equity Capital Investments in Non-leveraged Licensees.

* * * * *

22. Amend § 107.730 by:

a. Revising paragraphs (a)(1) and (d)(3)(iii); and

b. Removing paragraph (d)(3)(iv).

The revisions read as follows:

§ 107.730 Financings which constitute conflicts of interest.

(a) * * *

(1) Provide Financing to any of your Associates, except for when the Small Business that receives the Financing is your Associate, pursuant to paragraph (8)(ii) of *Associate* as defined in § 107.50, only because an investment fund that is your Associate holds a 10% or greater equity interest in the Small Business and either of the following conditions is met:

(i) You and the Associate investment fund previously invested in the Small Business at the same time and on the same terms and conditions; and you and the Associate investment fund are providing follow-on financing to the Small Business at the same time, on the same terms and conditions, and in the same proportionate dollar amounts as your respective investments in the previous round(s) of financing.

Example 1 to paragraph (a)(1)(i): If you invested $2 million and your Associate invested $1 million in the previous round, your respective follow-on investments would be in the same 2:1 ratio.

(ii) An independent third party is investing in the Small Business at the same time as the Licensee and on the same terms and conditions as the Licensee and represents a significant portion of the Financing; provided, that if the Licensee has a prior Financing in such Small Business, a Licensee's position in such prior Financing may not be diminished or diluted to the benefit of an Associate.

* * * * *

(d) * * *

(3) * * *

(iii) You are a Non-leveraged Licensee, and your Associate either is not a Licensee or is a Non-leveraged Licensee.

* * * * *

23. Revise § 107.810 to read as follows:

§ 107.810 Financing in the form of Loans.

You may make Loans to Small Businesses. A Loan means a transaction evidenced by a debt instrument with no provision for you to acquire Equity Securities. Loans may include

Revenue-Based Financing or Revenue-Based Loans in which you provide financing to a Small Business in exchange for a percentage of the Small Business's anticipated future revenue which shall not exceed 19% of the Small Business's annual gross revenue.

24. Amend § 107.830 by revising paragraph (c)(2) to read as follows:

§ 107.830 Minimum duration/term of financing.

* * * * *

(c) * * *

(2) *Prepayment.* You must permit voluntary prepayment of Loans and Debt Securities by the Small Business. You must obtain SBA's prior written approval of any restrictions on the ability of the Small Business to prepay other than the imposition of a reasonable prepayment penalty under paragraph (c)(3) of this section. For purposes of evaluating prepayment restrictions under this section, requirements to apply prepayments pro rata among a group of lenders participating in such Financing that is pari passu in rights to payment will not be deemed to constitute a restriction on prepayments.

* * * * *

25. Amend § 107.1000 by revising the section heading and introductory text to read as follows:

§ 107.1000 Non-leveraged Licensees—exceptions to this part.

The regulatory exceptions in this section apply to Non-leveraged Licensees.

* * * * *

26. Amend § 107.1120 by revising paragraph (c)(1) to read as follows:

§ 107.1120 General eligibility requirements for Leverage.

* * * * *

(c) * * *

(1) If you were licensed after September 30, 1996, under the exception in § 107.210(a)(1), you will not be eligible for Leverage until you have Regulatory Capital of at

least $5,000,000, unless you were licensed because you are headquartered in an Underlicensed State.

* * * * *

27. Amend § 107.1130 by revising the section heading and paragraph (d)(1) to read as follows:

§ 107.1130 Leverage fees and Annual Charges.

* * * * *

(d) * * *

(1) *Debentures*. You must pay to SBA an Annual Charge, not to exceed 1.38 percent per annum, on the outstanding amount of your Debentures, payable under the same terms and conditions as the interest on the Debentures. For Leverage issued pursuant to Leverage commitments approved on or after October 1, 2023, the Annual Charge, established and published, shall not be less than 0.10 percent per annum, subject to the following provisions:

(i) For Leverage issued pursuant to Leverage commitments approved on or after October 1, 2024, the Annual Charge, established and published, shall not be less than 0.20 percent per annum.

(ii) For Leverage issued pursuant to Leverage commitments approved on or after October 1, 2025, the Annual Charge, established and published, shall not be less than 0.25 percent per annum.

(iii) For Leverage issued pursuant to Leverage commitments approved on or after October 1, 2026, the Annual Charge, established and published, shall not be less than 0.30 percent per annum.

(iv) For Leverage issued pursuant to Leverage commitments approved on or after October 1, 2027, the Annual Charge, established and published annually, shall not be less than 0.35 percent per annum.

(v) For Leverage issued pursuant to Leverage commitments approved on or after October 1, 2028, the Annual Charge, established and published annually, shall not be less than 0.40 percent per annum.

* * * * *

28. Amend § 107.1150 by:

a. Revising the section heading;

b. Removing the phrase “Section 301(c) Licensee” in the introductory text and adding in its place the phrase “Leveraged Licensee”; and

c. Revising paragraphs (a) and (b).

The revisions read as follows:

§ 107.1150 Maximum amount of Leverage.

* * * * *

(a) *Individual Licensee.* Subject to SBA’s credit policies, if you are a Leveraged Licensee and not an Accrual SBIC, the maximum amount of Leverage you may have outstanding at any time is the Individual Maximum. If you are an Accrual SBIC, the maximum amount of Leverage and accrued interest you may have outstanding at any time is the Individual Maximum. The *Individual Maximum* means the lesser of:

(1) 300 percent of your Leverageable Capital;

(2) 100 percent of your Leverageable Capital if you have less than $5 Million in Regulatory Capital and you were Licensed because you are headquartered in an Underlicensed State; or

(3) The maximum Leverage available to a single Licensee under section 303(b) of the Act.

(b) *Multiple Licensees under Common Control.* Subject to SBA's credit policies, two or more Licenses under Common Control may have maximum aggregate outstanding Leverage as permitted under the Act. For any Accrual SBIC or Reinvestor SBIC under Common Control, the

aggregate accrued interest associated with Accrual Debentures will be included in determining whether this maximum has been exceeded. However, for any Leverage draw(s) by one or more such Licensees that would cause the aggregate outstanding Leverage to exceed the Individual Maximum, each of the Licensees under Common Control must certify that it does not have a condition of Capital Impairment. *See* also § 107.1120(d).

Example 1 to paragraph (b): If a fund manager has both a regular Leveraged Licensee with $250 million in outstanding Leverage and an Accrual SBIC with $50 million in Accrual Debentures that could accrue interest of $25 million at maturity, SBA will apply the principal from the regular Leverage plus the $50 million from the Accrual Debenture plus the $25 million in potential accrued interest for a combined total of $325 million.

* * * * *

29. Revise § 107.1220 to read as follows:

§ 107.1220 Requirement for Licensee to file quarterly financial statements.

Leveraged Licensees must submit to SBA a Financial Statement on SBA Form 468 (Short Form) as of the close of each quarter of your fiscal year (other than the fourth quarter, which is covered by your annual filing of Form 468 under § 107.630(a)). You must file this form within 45 days after the close of the quarter. You will not be eligible for a draw if you are not in compliance with this section.

§ 107.1540 [Amended]

30. Amend § 107.1540 by removing paragraphs (a) and (b).

31. Revise the heading for subpart J to read as follows:

Subpart J – Licensee's Noncompliance

32. Amend § 107.1830 by revising paragraph (e) to read as follows:

§ 107.1830 Licensee's Capital Impairment - definition and general requirements.

* * * * *

(e) *Quarterly computation requirement and procedure.* SBA will determine whether you have a condition of Capital Impairment as of the end of each fiscal quarter. If SBA finds you capitally impaired, they will notify you.

* * * * *

33. Amend § 107.1840 by revising paragraphs (a), (b) introductory text, (c) heading, (c)(1), and (d)(6) to read as follows:

§ 107.1840 Computation of Licensee's Capital Impairment Percentage.

(a) *General.* This section contains the procedures SBA will use to determine your Capital Impairment Percentage. SBA will compare your Capital Impairment Percentage to the maximum permitted under § 107.1830(c) to determine whether you have a condition of Capital Impairment.

(b) *Preliminary impairment test.* If you satisfy the preliminary impairment test, your Capital Impairment Percentage is zero and SBA will not have to perform any more procedures in this section. Otherwise, SBA will continue with paragraph (c) of this section. You satisfy the test if the following amounts are both zero or greater:

* * * * *

(c) *How to compute Capital Impairment Percentage.* (1) If you have an Unrealized Gain on Securities Held, SBA will compute your Adjusted Unrealized Gain using paragraph (d) of this section. If you have an Unrealized Loss on Securities Held, SBA will continue with paragraph (c)(2) of this section.

* * * * *

(d) * * *

(6) If any securities that are the source of either Class 1 or Class 2 Appreciation are pledged or encumbered in any way, SBA will reduce the Adjusted Unrealized Gain computed in paragraph (d)(5) of this section by the amount of the related borrowing or other obligation, up to the amount of the Unrealized Appreciation on the securities.

34. Amend § 107.1845 by revising paragraph (a) introductory text to read as follows:

§ 107.1845 Determination of Capital Impairment Percentage for Early Stage SBICs.

* * * * *

(a) To determine your Class 2 Appreciation under § 107.1840(d)(3), SBA will use the following provisions instead of § 107.1840(d)(3)(iii):

* * * * *

35. Revise § 107.1850 to read as follows:

§ 107.1850 Watchlist.

Under certain circumstances, SBA may place Licensees on a Watchlist as a process to increase proactive communication between SBA and the Licensee to help mitigate the potential for a future default or significant regulatory violation. Being on a Watchlist means that SBA has determined, based on certain triggers discussed in this section, a Licensee will provide a heightened level of reporting and communication with SBA.

(a) *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.

(b) *Requirements for Licensees on the Watchlist*. If SBA places you on the Watchlist, you will be required to comply with any or all of the following:

(1) You must submit Portfolio Company Financing Reports (SBA Form 1031s), required under § 107.640, within 30 calendar days of the financing date.

(2) You must participate in monthly portfolio reviews with SBA.

(3) You must file quarterly valuation reports on specific or all of your portfolio company holdings, as requested by SBA.

(4) You must submit a letter formally requesting whether you may submit a request for a subsequent fund if you are currently on the Watchlist or have managed any Licensee on a Watchlist within the last 12 months. If you have already submitted a request or are otherwise in the Licensing process (see § 107.300), SBA may suspend processing your request until it is satisfied that SBA's concerns are resolved or otherwise disapprove your request for a subsequent fund. SBA maintains the right to deny approval of any request to submit a subsequent fund request or any subsequent fund request submitted under § 107.300.

(c) *Removal from the Watchlist*. SBA will remove you from the Watchlist if the event that triggered your addition to the Watchlist (see paragraph (a) in this section) is resolved to SBA's satisfaction. Accordingly, SBA may require any or all of the following resolutions:

(1) Successful completion of a portfolio review to confirm compliance of your adherence to your investment policy.

(2) SBA's written approval of your key person resolution.

(3) SBA's written acknowledgement of pending litigation.

(4) SBA's written consent to the resolution of the LPA or side letter violation.

(5) Two quarters of performance above a bottom quartile industry benchmark based on the TVPI by vintage year and strategy, as calculated under paragraph (a) of this section.

(6) Two quarters of consistent reporting of your LCR, as calculated under paragraph (a) of this section, exceeding 1.25.

(7) You are current on your Leverage interest payments.

(8) A completed regulatory examination acceptable to SBA.

(d) *Watchlist communications*—(1) *Notification to Licensee*. If you trigger any of the events under paragraph (a) of this section, SBA will notify you in writing that you have been placed on the Watchlist, identify the event(s) which triggered your placement on the Watchlist, the actions you must take as noted under paragraph (b) of this section, and the remedies as identified under paragraph (c) of this section.

(2) *Watchlist status disclosure*. SBA will not disclose your Watchlist status publicly.

(3) *Removal from Watchlist status notification*. SBA will provide you with written notice after SBA determines that you have resolved all matter identified in your notification letter and satisfied the applicable requirements set forth in paragraph (c) of this section.

PART 121 – SMALL BUSINESS SIZE REGULATIONS

36. The authority citation for part 121 is revised to read as follows:

Authority: 15 U.S.C. 632, 634(b)(6), 636(a)(36), 662, and 694a(9).

37. Amend § 121.103 by revising paragraph (b)(5)(vi) to read as follows:

§ 121.103 How does SBA determine affiliation?

* * * * *

(b) * * *

(5) * * *

(vi) Entities determined by SBA to be Traditional Investment Companies under 13 CFR 107.150(b)(2) and private funds exempt from registration under section 3(c)(1) or 3(c)(7) of the 1940 Act.

* * * * *

Isabella Casillas Guzman,
Administrator.

[FR Doc. 2023-13981 Filed: 7/13/2023 11:15 am; Publication Date: 7/18/2023]