Congressional Research Service
Informing the legislative debate since 1914

SBA Small Business Investment Company Program

Updated December 26, 2018

Congressional Research Service
https://crsreports.congress.gov
R41456

CRS REPORT
Prepared for Members and
Committees of Congress

Summary

The Small Business Administration's (SBA's) Small Business Investment Company (SBIC) program is designed to enhance small business access to venture 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." Facilitating the flow of capital to small businesses to stimulate the national economy was, and remains, the SBIC program's primary objective.

As of September 30, 2018, there were 305 privately owned and managed SBA-licensed SBICs providing small businesses private capital the SBIC has raised (called regulatory capital) and funds the SBIC borrows at favorable rates (called leverage) because the SBA guarantees the debenture (loan obligation). SBICs pursue investments in a broad range of industries, geographic areas, and stages of investment. Some SBICs specialize in a particular field or industry, and others invest more generally. Most SBICs concentrate on a particular stage of investment (i.e., startup, expansion, or turnaround) and geographic area.

The SBIC program currently has invested or committed about $30.1 billion in small businesses, with the SBA's share of capital at risk about $14.3 billion. In FY2018, the SBA committed to guarantee $2.52 billion in SBIC small business investments. SBICs invested another $2.98 billion from private capital for a total of $5.50 billion in financing for 1,151 small businesses.

In recent years, some Members of Congress have argued that the program should be expanded as a means to stimulate economic activity and create jobs. For example, P.L. 113-76, the Consolidated Appropriations Act, 2014, increased the annual amount of leverage the SBA is authorized to provide to SBICs to $4 billion from $3 billion. P.L. 114-113, the Consolidated Appropriations Act, 2016, increased the amount of outstanding leverage allowed for two or more SBIC licenses under common control (the multiple licenses/family of funds limit) to $350 million from $225 million. P.L. 115-187, the Small Business Investment Opportunity Act of 2017, increased the amount of outstanding leverage allowed for individual SBICs to $175 million from $150 million. Others worry that an expanded SBIC program could result in losses and increase the federal deficit. In their view, the best means to assist small business, promote economic growth, and create jobs is to reduce business taxes and exercise federal fiscal restraint.

Some Members have also proposed that the program target additional assistance to startup and early stage small businesses, which are generally viewed as relatively risky investments but also as having a relatively high potential for job creation. During the Obama Administration, the SBA established a five-year, early stage SBIC initiative. Early stage SBICs are required to invest at least 50% of their investments in early stage small businesses, defined as small businesses that have never achieved positive cash flow from operations in any fiscal year. The SBA stopped accepting new applicants for the early stage SBIC initiative in 2017.

This report describes the SBIC program's structure and operations, focusing on SBIC eligibility requirements, investment activity, and program statistics. It also includes information concerning the SBIC program's debenture SBIC program, participating securities SBIC program, impact investment SBIC program (targeting underserved markets and communities facing barriers to access to credit and capital), and early stage SBIC initiative.

Contents

SBIC Program Overview 1
SBIC Types 3
SBIC Eligibility Requirements 4
SBIC Application Process 5
SBIC Capital Investment Requirements 6
Debenture SBICs 6
Participating Securities SBICs 7
Impact Investment SBICs 8
Early Stage SBICs 9
Key Features of Regular SBIC Types 11
SBIC Investments in Small Businesses 12
Leverage 15
Leverage Drawdown 15
Debenture SBIC Leverage Requirements 16
Participating Securities SBIC Leverage Requirements 17
Impact Investment SBIC Leverage Requirements 18
Early Stage SBIC Leverage Requirements 19
Reporting Requirements 20
SBIC Program Statistics 20
Total Financing 21
Financing to Specific Demographic Groups 23
Financing by State 24
Legislative Activity 26
Legislation to Target Additional Assistance to Startup and Early Stage Small Businesses 27
Discussion 28
Legislation to Increase SBIC Financing Levels 29
Discussion 31
Concluding Observations 32

Tables

Table 1. Key Features of the SBA's Debenture, Participating Securities, and Impact Investment Debenture Programs and Early Stage Debenture Initiative 11
Table 2. Number of Licensed SBICs by Type, FY2010-FY2018 21
Table 3. SBIC Investments, FY2007-FY2018 22
Table 4. SBIC Financing, Minority-Owned Small Businesses, FY2018 23
Table 5. SBIC Financing by State, FY2018 25

Appendixes

Appendix. Small Business Eligibility Requirements and Application Process 35

Contacts

Author Information..... 38

SBIC Program Overview

The Small Business Administration (SBA) administers several programs to support small businesses, including loan guaranty programs to enhance small business access to capital; programs to increase small business opportunities in federal contracting; direct loans for businesses, homeowners, and renters to assist their recovery from natural disasters; and access to entrepreneurial education to assist with business formation and expansion.[1] It also administers the Small Business Investment Company (SBIC) program.

Authorized by P.L. 85-699, the Small Business Investment Act of 1958, as amended, the SBIC program is designed to "improve and stimulate the national economy in general and the small-business segment thereof in particular" by stimulating and supplementing "the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply."[2]

The SBIC program was created to address concerns raised in a Federal Reserve Board report to Congress that identified a gap in the capital markets for long-term funding for growth-oriented small businesses. The report noted that the SBA's loan programs were "limited to providing short-term and intermediate-term credit when such loans are unavailable from private institutions" and that the SBA "did not provide equity financing."[3] Equity financing (or equity capital) is money raised by a company in exchange for a share of ownership in the business. Ownership is represented by owning shares of stock outright or having the right to convert other financial instruments into stock. Equity financing allows a business to obtain funds without incurring debt, or without having to repay a specific amount of money at a particular time. The Federal Reserve Board's report concluded there was a need for a federal government program to "stimulate the availability of capital funds to small business" to assist these businesses in gaining access to long-term financing and equity financing.[4] Facilitating the flow of capital to small businesses to stimulate the national economy was, and remains, the SBIC program's primary objective.

The SBA does not make direct investments in small businesses. It partners with privately owned and managed SBICs licensed by the SBA to provide financing to small businesses with private capital the SBIC has raised (called regulatory capital) and with funds (called leverage) the SBIC borrows at favorable rates because the SBA guarantees the debenture (loan obligation).[5] As of

[1] U.S. Small Business Administration (SBA), "Fiscal Year 2019 Congressional Budget Justification and FY2017 Annual Performance Report," pp. 2-4, at https://www.sba.gov/sites/default/files/aboutsbaarticle/SBA_FY_2019_CBJ_APR_2_12_post.pdf.

[2] 15 U.S.C. §661.

[3] U.S. Congress, House Committee on Banking and Currency, *Small Business Investment Act of 1958*, report to accompany S.3651, 85th Cong., 2nd sess., June 30, 1958, H.Rept. 85-2060 (Washington: GPO, 1958), pp. 4, 5.

[4] Ibid., p. 5.

[5] Small business investment companies must invest in small businesses, which are defined as those with less than $19.5 million in tangible net worth and average after-tax income for the preceding two years of less than $6.5 million, or businesses qualifying as small under the SBA's NAICS industry code size standards.

September 30, 2018, there were 305 licensed SBICs participating in the SBIC program.[6] In FY2018, the SBA provided $2.52 billion in leverage to SBICs.[7]

In recent years, some Members of Congress have argued that the program should be expanded as a means to stimulate economic activity and create jobs. For example, P.L. 113-76, the Consolidated Appropriations Act, 2014, increased the annual amount of leverage the SBA is authorized to provide to SBICs to $4 billion from $3 billion and P.L. 114-113, the Consolidated Appropriations Act, 2016, increased the amount of outstanding leverage allowed for two or more SBIC licenses under common control (the multiple licenses/family of funds limit) to $350 million from $225 million.[8] In addition, P.L. 115-187, the Small Business Investment Opportunity Act of 2017, increased the amount of outstanding leverage allowed for individual SBICs to $175 million from $150 million.

Others worry that an expanded SBIC program could result in losses and increase the federal deficit. In their view, the best means to assist small business, promote economic growth, and create jobs is to reduce business taxes and exercise federal fiscal restraint.

Some Members and small business advocates have also proposed that the program target additional assistance to startup and early stage small businesses, which are generally viewed as relatively risky investments but also as having a relatively high potential for job creation. For example, during the 113th Congress, S. 1285 and H.R. 30, the Small Business Investment Enhancement and Tax Relief Act, would have authorized the Administration to establish a separate SBIC program for early stage small businesses. In addition, as part of the Obama Administration's Startup America Initiative, the SBA established a five-year, $1 billion early stage SBIC initiative in 2012. Early stage SBICs are required to allocate at least 50% of their investments in early stage small businesses, defined as small businesses that have never achieved positive cash flow from operations in any fiscal year.

The SBA stopped accepting new applicants for the early stage SBIC initiative in 2017. In addition, on June 11, 2018, the SBA withdrew a proposed rule published on September 19, 2016, to amend the initiative to make it "more attractive and ... a permanent part of the SBIC program."[9] The SBA indicated that it withdrew the proposed rule "because very few qualified

---

[6] SBA, "SBIC Program: Fiscal Year Data for the period ending September 30, 2018," at https://www.sba.gov/article/2018/nov/16/fiscal-year-data-period-ending-september-30-2018.

[7] Ibid.

[8] According to a U.S. Government Accountability (GAO) report released on January 27, 2016, "About 70% (130 of 187) of debenture SBICs—the most common SBIC fund type—were managed by 69 multiple licensees in 2014.... The proportion of debenture SBICs managed by multiple licensees has sharply increased, rising from about 20% in 2005 to about 70% in 2014... For debenture SBICs specifically, multiple licensees also increased their share of total SBA leverage during 2005–2014. These SBICs held about 24% of SBA leverage in 2005, but about 74% of the approximately $7 billion in SBA leverage in 2014.... from 2009 to 2014, no more than 2.8% of multiple licensees reached the then-applicable $225 million leverage limit ... The Small Business Investor Alliance and some SBIC fund managers told us they believed the leverage limit nonetheless has a significant effect because it deters some SBIC managers who want to substantially grow their fund over the long-term from continuing to participate in the program.... SBIC characteristics, including geographic distribution and management demographics, were largely similar for single and multiple licensees.... Multiple licensees, in the aggregate, demonstrated better investment performance than single licensees from 2005 to 2014." See GAO, *Small Business Investment Companies: Characteristics and Investment Performance of Single and Multiple Licensees*, GAO-16-107, January 27, 2016, pp. 8, 10, 11, 13, at https://www.gao.gov/assets/680/674813.pdf.

[9] The proposed changes would have allowed early stage applicants to apply at any time, similar to other SBIC applicants, instead of only during limited time frames identified in the Federal Register (which the SBA has published on an annual basis since 2012); allowed early stage SBICs to obtain an unsecured line of credit without SBA approval under specified conditions; allowed an application from an applicant under common control with an existing early stage

funds applied to the Early Stage SBIC initiative, the costs were not commensurate with the results, and the comments to the proposed rule did not demonstrate broad support for a permanent Early Stage SBIC program."[10]

This report examines the SBIC program's structure and operations, focusing on SBIC eligibility requirements, investment activity, and program statistics. It includes information concerning the SBA's debenture SBIC program, participating securities SBIC program, impact investment SBIC program (targeting underserved markets and communities facing barriers to access to credit and capital), and early stage SBIC initiative.

This report also discusses legislative efforts that led to an increase in (1) the maximum annual leverage the SBA is authorized to provide to SBICs and (2) the maximum amount of outstanding leverage allowed for two or more SBIC licenses under common control.[11]

SBIC Types

There are two types of SBICs. Investment companies licensed under Section 301(c) of the Small Business Investment Act of 1958, as amended, are referred to as *original*, or regular, SBICs. Investment companies licensed under Section 301(d) of the act, called *Specialized Small Business Investment Companies* (SSBICs), focus on providing financing to small business entrepreneurs "whose participation in the free enterprise system is hampered because of social or economic disadvantage."[12] Section 301(d) was repealed by P.L. 104-208, the Omnibus Consolidated Appropriations Act, 1997 (Title II of Division D, the Small Business Programs Improvement Act of 1996). As a result, no new SSBIC licenses have been issued since October 1, 1996. However, existing SSBICs were "grandfathered" and allowed to remain in the program.

With few exceptions, SBICs and SSBICs are subject to the same eligibility requirements and operating rules and regulations. Therefore, the term SBIC is usually used to refer to both SBICs and SSBICs.

Five types of regular SBICs exist. *Debenture* SBICs, *impact investment* SBICs, and *early stage* SBICs receive leverage through the issuance of debentures.[13] Debentures are debt obligations

SBIC that has outstanding debentures or debenture commitments; and increased the initiative's maximum leverage commitment of 100% of regulatory capital or $50 million, whichever is less, to 100% of regulatory capital or $75 million, whichever is less. See SBA, "Small Business Investment Companies (SBIC); Early Stage Initiative," 83 *Federal Register* 26875, June 11, 2018; and SBA, "Small Business Investment Companies (SBIC); Early Stage Initiative," 81 *Federal Register* 64075-64080, September 19, 2016.

[10] SBA, "Small Business Investment Companies (SBIC); Early Stage Initiative," 83 *Federal Register* 26875, June 11, 2018.

[11] In addition, S. 2831, A bill to amend the Small Business Investment Act of 1958 to provide priority for applicants for a license to operate as a small business investment company that are located in a disaster area, was introduced on April 21, 2016, and reported favorably, with an amendment, by the Senate Committee on Small Business and Entrepreneurship on May 24, 2016. The bill would require the SBA Administrator to give priority to an application for a license to operate as a SBIC that is from an applicant located in a disaster area. The bill would also prohibit the SBA from including the cost basis of any investment made by a SBIC in a small business concern located in a major disaster area during the one-year period beginning on the date of the disaster declaration when determining if that SBIC has reached its leverage limit.

[12] P.L. 92-595, the Small Business Investment Act Amendments of 1972.

[13] A debenture SBIC may issue and have outstanding both guaranteed debentures and participating securities, provided that the total amount of participating securities outstanding does not exceed 200% of its private capital. See 13 C.F.R. §107.1170. The SBA stopped issuing new commitments for participating securities on October 1, 2004.

issued by SBICs and held or guaranteed by the SBA.[14] *Participating securities* SBICs receive leverage through the issuance of participating securities. Participating securities are redeemable, preferred, equity-type securities, often in the form of limited partnership interests, preferred stock, or debentures with interest payable only to the extent of earnings.[15] *Bank-owned*, *non-leveraged* SBICs do not receive leverage.[16] This report focuses on the four types of regular SBICs that receive leverage from the SBA.

SBIC Eligibility Requirements

A SBIC can be organized in any state as either a corporation, a limited partnership (LP), or a limited liability company (LLCs must be organized under Delaware law). Most SBICs are owned by relatively small groups of local investors, although many are partially owned, and some (47 of 305) are wholly owned, by commercial banks. A few SBICs are corporations with publicly traded stock.[17]

One of the primary criteria for licensure as a SBIC is having qualified management. The SBA reviews and approves a prospective SBIC's management team based upon its professional capabilities and character. Specifically, the SBA examines the SBIC's management team and looks for

- at least two principals with substantive and analogous principal investment experience;
- realized track record of superior returns, based on an overall evaluation of appropriate quantitative performance measures;
- evidence of a strong rate of business proposals and investment offers (deal flow) in the investment area proposed for the new fund;
- a cohesive management team, with complementary skills and a history of working together;
- managerial, operational, or technical experience that can add value at the portfolio company level; and
- a demonstrated ability to manage cash flows so as to provide assurance the SBA will be repaid on a timely basis.[18]

[14] 13 C.F.R. §107.50.

[15] Ibid.

[16] Commercial banks may invest up to 5% of their capital and surplus to partially or wholly own a SBIC. Bank investments in a SBIC are presumed by federal regulatory agencies to be a "qualified investment" for Community Reinvestment Act purposes. See P.L. 90-104, the Small Business Act Amendments of 1967; The Board of Governors of the Federal Reserve Board, "Small Business Investment Companies," 33 *Federal Register* 6967, May 9, 1968; and SBA, "Small Business Investment Companies (SBICs)," *Small Business Notes*, 2009, at http://www.smallbusinessnotes.com/business-finances/small-business-investment-companies-sbics.html. H.R. 2364, the Investing in Main Street Act of 2017, would increase to 15% the 5% limit on commercial bank investments in SBICs. The bill was favorably reported by the House Committee on Small Business on June 15, 2017.

[17] SBA, "For SBIC Applicants: Phase III: Licensing Review," at https://www.sba.gov/content/phase-iii-licensing-review.

[18] SBA, "For SBIC Applicants: Phase I, Initial Review," at https://www.sba.gov/content/phase-i-initial-review.

SBIC Application Process

Applying for a SBIC debenture license is a multi-step process, beginning with the submission of the SBA Management Assessment Questionnaire (MAQ) and an initial, nonrefundable licensing fee of $10,000.[19] The questionnaire includes, among others, questions concerning

- the fund's legal name and the name and addresses of its principals and control persons;[20]
- the fund's investment strategy (including geographic focus, industry focus, diversification strategy, primary types of securities to be used, whether it plans to be primarily an equity or debt investor, etc.);
- the management team's history and professional experience;
- the fund's investment decisionmaking process, from deal origination to portfolio monitoring;
- the fund's economics (including a description of the fund's carried interest,[21] the formula used to calculate management fees and the fund's policy on the allocation of fees between the fund and any management or other affiliated entities, details concerning compensation the principals earn outside of this partnership, etc.);
- the fund's capitalization (including investment strategy, whether a placement agent has been or will be hired, information concerning any third-party borrowing arrangements, etc.);
- the fund's governance structure (including an organizational chart); and
- a 10-year financial forecast for the fund.[22]

After receiving the firm's application, a member of the SBA's Program Development Office reviews the MAQ; assesses the investment company's proposal in light of the program's minimum requirements and management qualifications; performs initial due diligence, including making reference telephone calls; and prepares a written recommendation to the SBA's Investment Division's Investment Committee (composed of senior members of the division).

If, after reviewing the MAQ and the SBA's Program Development Office's evaluation, the Investment Committee concludes, by majority vote at a regularly scheduled meeting, that the investment company's management team may be qualified for a license, that management team is invited to the SBA's headquarters in Washington, DC, for an in-person interview. If, following

[19] SBA, "Small Business Investment Companies-Administrative Fees," 82 *Federal Register* 52174-52186, November 13, 2017. An applicant under common control with one of more licenses must submit a written request to the SBA, and the initial licensing fee, to be considered for a license and is exempt from the requirement to submit a MAQ unless otherwise determined by the SBA in its discretion.

[20] A control person is generally defined as someone with the power to direct corporate management and policies.

[21] General partners in most private equity and hedge funds are compensated in two ways. First, to the extent that they contribute their capital in the funds, they share in the appreciation of the assets. Second, they charge the limited partners two kinds of annual fees: a percentage of total fund assets (usually in the 1% to 2% range) and a percentage of the fund's earnings (usually 15% to 25%, once specified benchmarks are met). The latter performance fee is called "carried interest" and is treated, or characterized, as capital gains under current tax rules. See CRS Report RS22717, *Taxation of Private Equity and Hedge Fund Partnerships: Characterization of Carried Interest*, by Donald J. Marples.

[22] SBA, "SBIC Management Assessment Questionnaire and License Application: Form 2181," at https://www.sba.gov/content/application-forms.

the interview, the Investment Committee votes to proceed, the investment company is provided a "Green Light" letter formally inviting it to proceed to the final licensing phase of the application process.

Once an applicant receives a Green Light letter, the applicant typically has up to 18 months to raise the requisite private capital. During this time frame, the SBA "keeps in touch with the applicant, conducts SBIC training classes, and provides guidance as needed."[23] Final licensing occurs when the SBA accepts an applicant's complete licensing application (consisting of an updated SBA Form 2181 and complete SBA Forms 2182 and 2183), which is submitted after raising sufficient private capital, and receives a final licensing fee, currently $20,000.[24] Obtaining a SBIC license for the first time usually takes six to eight months from the initial MAQ submission to the license issuance.[25]

As discussed below, new applications for the participating securities program, impact investment program, and early stage SBIC initiative are no longer being accepted.

The eligibility requirements and application process for small businesses requesting financial assistance from a SBIC is provided in the **Appendix**.

SBIC Capital Investment Requirements

Debenture SBICs

P.L. 85-699 authorized the SBA to select companies to participate in the SBIC program and to purchase debentures from those companies to provide additional funds to invest in small businesses. Initially, debenture SBICs were required to have a private capital investment of at least $300,000 to participate in the SBIC program.

Debenture SBICs are now required to have a private capital investment of at least $5 million (called regulatory capital).[26] The SBA has discretion to license an applicant with regulatory capital of $3 million if the applicant has satisfied all licensing standards and requirements, has a viable business plan reasonably projecting profitable operations, and has a reasonable timetable for achieving regulatory capital of at least $5 million.[27] At least 30% of a debenture SBIC's regulatory and leverageable capital must come from three people unaffiliated with the fund's management and unaffiliated with each other.[28] Also, no more than 33% of a SBIC's regulatory capital may come from state or local government entities.[29]

[23] SBA, "Small Business Investment Companies-Administrative Fees," 82 *Federal Register* 52179, November 13, 2017.

[24] The final licensing fee is $20,000 from December 13, 2017, to September 30, 2018; and is scheduled to increase to $25,000 from October 1, 2018, to September 30, 2019; $30,000 from October 1, 2019, to September 30, 2020; and $35,000 from October 1, 2020, to September 30, 2021. The final SBIC licensing fee is in addition to the initial SBIC licensing fee (currently a combined total of $35,000). Beginning on October 1, 2021, the SBA will annually adjust both the initial and final SBIC licensing fees for inflation. See ibid., p. 52185.

[25] SBA, "SBIC Program: Fiscal Year Data for the period ending September 30, 2018," at https://www.sba.gov/article/2018/nov/16/fiscal-year-data-period-ending-september-30-2018.

[26] 13 C.F.R. §107.210.

[27] Ibid.

[28] 13 C.F.R. §107.150.

[29] 13 C.F.R. §107.230.

Participating Securities SBICs

P.L. 102-366, the Small Business Credit and Business Opportunity Enhancement Act of 1992 (Title IV, the Small Business Equity Enhancement Act of 1992), authorized the SBA to guarantee participating securities. Participating securities are redeemable, preferred, equity-type securities issued by SBICs in the form of limited partnership interests, preferred stock, or debentures with interest payable only to the extent of earnings.

In 1994, the SBA established the SBIC Participating Securities Program (SBIC PSP) to encourage the formation of participating securities SBICs that would make equity investments in startup and early stage small businesses. The SBA created the program to fill a perceived investment gap created by the SBIC debenture program's focus on mid- and later-stage small businesses. The SBA stopped issuing new commitments for participation securities on October 1, 2004, beginning a process to end the program, which continues.[30]

The SBA stopped issuing new commitments for participating securities primarily because the program experienced a projected loss of $2.7 billion during the early 2000s as investments in technology startup and early stage small businesses lost much of their stock value at that time. The SBA found that "the fees payable by SBICs for participating securities leverage are not sufficient to cover the projected net losses in the participating securities program."[31] The SBA continued to honor its existing commitments to participating securities SBICs, which were allowed to continue operations. However, these securities SBICs were required to comply with special rules concerning minimum capital, liquidity, non-SBA borrowing, and equity investing.[32] In recent years, some Members have expressed interest in either revising the program or starting a new program modeled on certain aspects of the SBIC PSP to assist startup and early stage small businesses.[33]

---

[30] U.S. Congress, House Committee on Small Business, *Private Equity for Small Firms: The Importance of the Participating Securities Program*, 109th Cong., 1st sess., April 13, 2005, Serial No. 109-10 (Washington: GPO, 2005), pp. 5, 33; and SBA, "SBIC Program: FAQs 7. What is the status of the Participating Securities Program?" at https://www.sba.gov/content/faqs.

[31] SBA, "Offering Circular, Guaranteed 4.727% Participating Securities Participation Certificates, Series SBIC-PS 2009-10 A," February 19, 2009, at https://www.sba.gov/content/sbic-ps-2009-10-cusip-831641-ep6.

[32] 13 C.F.R. §107.1500. A SBIC that wishes to be eligible to issue participating securities must have regulatory capital of at least $10 million unless it can demonstrate to the SBA's satisfaction that it can be financially viable over the long-term with a lower amount, but not less than $5 million. See 13 C.F.R. §107.210. It must also maintain sufficient liquidity to avoid a condition of "Liquidity Impairment," defined as a liquidity ratio (total current funds available divided by total current funds required) of less than 1.2. See 13 C.F.R. §107.1505. The only type of debt, other than leverage, than a SBIC that has applied to issue participating securities or have outstanding participating securities is permitted to incur is temporary debt. Temporary debt is defined as short-term borrowings from a regulated financial institution, a regulated credit company, or a non-regulated lender approved by the SBA for the purpose of maintaining the SBIC's operating liquidity or providing funds for a particular financing of a small business. The total outstanding borrowings, not including leverage, may not exceed 50% of a SBIC's leveraged capital, and all such borrowings must be fully paid off for at least 30 consecutive days during a SBIC's fiscal year so that it has no outstanding third-party debt for 30 days. See 13 C.F.R. §107.570. A SBIC issuing participating securities is required to invest an amount equal to the original issue price of such securities solely in equity capital investments (e.g., common or preferred stock, limited partnership interests, options, warrants, or similar equity instruments). See 13 C.F.R. §107.1505.

[33] U.S. Congress, House Committee on Small Business, *Subcommittee Markup of Legislation Affecting the SBA Capital Access Programs*, 111th Cong., 1st sess., October 8, 2009, H.Doc. no. 111-050 (Washington: GPO, 2009), pp. 7, 10, 11, 187-194; U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Increasing Capital for Small Business*, 111th Cong., 1st sess., October 14, 2009, H.Doc. no. 111-051 (Washington: GPO, 2009), pp. 1, 2, 40, 98; and U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009),

The SBA is no longer issuing new commitments for participating securities, and each year several participating securities SBICs leave the program because their leverage commitments are retired. As of September 30, 2018, there were 25 participating securities SBICs in the SBIC program, with $18.0 million in outstanding capital at risk.[34] Participating securities SBIC are required to have regulatory capital of at least $10 million. The SBA has discretion to require less than $10 million in regulatory capital if the licensee can demonstrate that it can be financially viable over the long term with a lower amount. In this circumstance, the regulatory amount required may not be lower than $5 million.[35] At least 30% of a participating securities SBIC's regulatory and leverageable capital must come from three people unaffiliated with the fund's management and unaffiliated with each other.[36] Also, no more than 33% of a SBIC's regulatory capital can come from state or local government entities.[37]

Impact Investment SBICs

On April 7, 2011, the SBA announced it was establishing a $1 billion impact investment SBIC initiative (up to $150 million in leverage in FY2012 and up to $200 million in leverage per fiscal year thereafter until the limit is reached). SBA-licensed impact investment SBICs are required to invest at least 50% of their financings, "which target areas of critical national priority including underserved markets and communities facing barriers to access to credit and capital."[38] These areas initially included businesses located in underserved communities (as defined by the SBA), the education sector, and the clean energy sector.[39] Impact investment SBICs are required to have a minimum private capital investment of at least $5 million and are subject to the same conditions as debenture SBICs concerning the source of the funds.

Initially, an impact investment SBIC could receive up to $80 million in SBA leverage. On June 6, 2013, the SBA announced that it was increasing the maximum leverage available to impact investment SBICs to $150 million.[40]

---

pp. 3, 4, 10-12.

[34] SBA, "SBIC Program: Fiscal Year Data for the period ending September 30, 2018," at https://www.sba.gov/article/2018/nov/16/fiscal-year-data-period-ending-september-30-2018. There were 149 participating securities SBICs at the end of FY2008, 127 at the end of FY2009, 107 at the end of FY2010, 97 at the end of FY2011, 86 at the end of FY2012, 63 at the end of FY2013, 53 at the end of FY2014, 46 at the end of FY2015, 41 at the end of FY2016, and 33 at the end of FY2017.

[35] 13 C.F.R. §107.210.

[36] 13 C.F.R. §107.150.

[37] 13 C.F.R. §107.230.

[38] SBA, "Impact Investment Initiative," at https://www.sba.gov/sites/default/files/files/Impact_Investment_Call_for_Action.pdf; and SBA, Office of Congressional and Legislative Affairs, "Correspondence with the author," July 31, 2014.

[39] The SBA defines underserved communities as low or moderate income (LMI) enterprises located in LMI Zones, as defined in 13 C.F.R. 107.50; qualified low-income community investments (QLICIs) located in low-income communities (LICs), as defined by the New Markets Tax Credit (NMTC) program in 26 C.F.R. 1.45D-1(d)1; rural business concerns located in rural areas as defined in 7 C.F.R. 4290.502; and, small business concerns located in economically distressed areas (EDAs), as defined by Section 3013 of the Public Works and Economic Development Act (PWEDA) of 1965, as amended, 42 U.S.C. 3161.

[40] SBA, "SBA Announces $50 Million Increase Match in its SBIC Early Stage Fund and $70 Million Bump in its Impact Investment Fund," June 6, 2013, at https://www.sba.gov/content/sba-announces-50-million-increase-match-its-sbic-early-stage-fund-and-70-million-bump-its. Also, effective October 1, 2014, among other changes, the SBA eliminated the program's $200 million collective, per-fiscal-year leverage cap; added advanced manufacturing to the list of eligible sectors; provided eligibility to businesses that receive Small Business Innovation Research or Small Business Technology Transfer grants; and permitted, through December 1, 2014, existing debenture SBICs to apply to

Nine impact investment SBICs were licensed (two in 2011, one in 2012, two in 2014, two in 2015, and two in 2016).[41] As of September 30, 2018, they managed more than $905 million in assets and had investments in 81 small businesses. In FY2018, impact investment SBICs invested $106.8 million in 35 small businesses.[42]

On September 28, 2017, the SBA provided notice to program stakeholders that it would no longer accept new applications to be a licensed impact investment SBIC on or after November 1, 2017. The SBA also announced that it was withdrawing a proposed rule, published on February 3, 2016, that would have provided impact investment SBICs additional benefits "to encourage qualified private equity fund managers with a focus on social impact to apply to the SBIC program."[43] The SBA indicated that the cost of the proposed additional benefits was "not commensurate" with the benefits.[44] The SBA also indicated that few qualified SBICs had applied to participate in the program, and that many of the program's participants would have applied to the SBIC program "regardless of the existence of the [impact investment program]."[45]

Early Stage SBICs

On April 27, 2012, the SBA published a final rule in the *Federal Register* establishing a $1 billion early stage SBIC initiative (up to $150 million in leverage in FY2012 and up to $200 million in leverage per fiscal year thereafter until the limit is reached).[46] As mentioned previously, the SBA is no longer seeking new applicants for the early stage SBIC initiative.

Early stage SBICs are required to invest at least 50% of their financings in early stage small businesses, defined as small businesses that have never achieved positive cash flow from operations in any fiscal year.[47] In recognition of the higher risk associated with investments in early stage small businesses, the initiative included "several new regulatory provisions intended to reduce the risk that an early stage SBIC would default on its leverage and to improve SBA's recovery prospects should a default occur."[48] For example, early stage SBICs are required to raise more regulatory capital (at least $20 million) than debenture SBICs, impact investment SBICs (at least $5 million), and participating securities SBICs (at least $10 million). They are also subject

opt-into the program if they meet the program's requirements. See SBA, "SBA Expands Impact Investment Fund," September 25, 2014, at https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/sba-expands-impact-investment-fund.

[41] SBA, "Impact Investment Fund Grows Threefold," January 27, 2015, at https://www.sba.gov/content/impact-investment-fund-grows-threefold; SBA, "Directory of Impact SBICs," at https://www.sba.gov/content/directory-impact-sbics; and SBA, "SBIC Directory," at https://www.sba.gov/funding-programs/investment-capital#paragraph-11.

[42] SBA Office of Congressional and Legislative Affairs, "Correspondence with the author," December 20, 2018.

[43] SBA, "Small Business Investment Companies (SBIC); Early Stage Initiative," 83 *Federal Register* 26874, June 11, 2018. Impact investment SBIC applicants would have received a 60% discount on the licensing fee and a 10% discount on the examination base fee. They also could have simultaneously applied as an early stage SBIC not subject to the call and timing provisions identified under 13 C.F.R. 107.300. The proposed rule also imposed certain penalties if an impact investment SBIC did not adhere to its impact strategy or impact investment SBIC rules. See ibid; and SBA, "Small Business Investment Company Program-Impact SBICs," 81 *Federal Register* 5666-5676, February 3, 2016.

[44] SBA, "Small Business Investment Companies (SBIC); Early Stage Initiative," 83 *Federal Register* 26875, June 11, 2018. The SBA indicated that due to the risk associated with this class of SBICs the proposed rule was expected to increase the cost to all SBICs by increasing the annual fee by approximately 6.1 basis points.

[45] Ibid., pp. 26874, 26875.

[46] SBA, "Small Business Investment Companies—Early Stage SBICs," 77 *Federal Register* 25043, 25050, April 27, 2012.

[47] Ibid., pp. 25051-25053.

[48] Ibid., p. 25043.

to special distribution rules to require pro rata repayment of SBA leverage when making distributions of profits to their investors. In addition, early stage SBICs are provided less leverage (up to 100% of regulatory capital, $50 million maximum) than debenture SBICs and participating securities SBICs (up to 200% of regulatory capital, $175 million maximum per SBIC and $350 million for two or more SBICs under common control) and impact investment SBICs (up to 200% of regulatory capital, $175 million maximum).

On May 1, 2012, the SBA published a notice in the *Federal Register* announcing its first annual call for venture capital fund managers to submit an application to become a licensed early stage SBIC.[49] Thirty-three venture capital funds submitted preliminary application materials. After these materials were examined and interviews held, the SBA announced on October 23, 2012, that it had issued Green Light letters to six funds, formally inviting them to file license applications.[50]

The SBA's second, third, fourth, and fifth annual calls for venture capital fund managers to submit an application to become a licensed early stage SBIC took place on December 18, 2012, February 4, 2014, January 12, 2015, and February 2, 2016, respectively.[51]

Five of the 63 investment funds that applied to participate in the program were granted an early stage SBIC license.[52] As of September 30, 2018, the five early stage SBICs had raised $251.3 million in private capital, received $138.4 million in SBA-guaranteed leverage, had $43.7 million in outstanding commitments, and invested $267.5 million in 82 small businesses. In FY2018, early stage SBICs invested $47.1 million in 36 small businesses.[53]

On September 19, 2016, the SBA published a notice of proposed rulemaking in the *Federal Register*, which included proposed changes to the early stage SBIC initiative to "make material improvements to the program" and "attract more qualified early stage fund managers."[54] The

[49] The deadline for completing the four-step application process for applicants with signed commitments for at least $15 million in regulatory capital and evidence of their ability to raise the remaining $5 million in regulatory capital was July 30, 2012. The deadline for all other applicants was May 15, 2013. Applicants must first complete a Management Assessment Questionnaire (MAQ), then, if invited, complete an interview process, then receive a Green Light letter, and, finally, submit the SBIC license application, consisting of SBA Form 2181 and SBA Form 2182. See SBA, "Small Business Investment Companies—Early Stage SBICs," 77 *Federal Register* 25775-25779, May 1, 2012.

[50] SBA, "SBA's Growth Capital Program Sets Record For Third Year in a Row $2.95 Billion in Financing for Small Businesses in FY12," at https://www.sba.gov/content/sbas-growth-capital-program-sets-record-third-year-row; and SBA, "The Small Business Investment Company (SBIC) Program: Annual Report FY2012," p. 20, at https://www.sba.gov/sites/default/files/files/SBIC%20Program%20FY%202012%20Annual%20Report.pdf.

[51] SBA, "Small Business Investment Companies—Early Stage SBICs," 77 *Federal Register* 74908-74913, December 18, 2012; SBA, "Small Business Investment Companies—Early Stage SBICs," 79 *Federal Register* 6665, February 4, 2014; SBA, "Small Business Investment Companies—Early Stage SBICs," 79 *Federal Register 18750*, April 3, 2014; SBA, "Small Business Investment Companies—Early Stage SBICs," 80 *Federal Register 1575-1579*, January 12, 2015; and SBA, "Small Business Investment Companies—Early Stage SBICs," 81 *Federal Register 5508-5511*, February 2, 2016.

[52] SBA, "Small Business Investment Companies–Early Stage," 80 *Federal Register* 14034, March 18, 2015; and SBA, Office of Innovation and Investment, slides, "SBIC Early Stage Innovation Program," at https://www.sba.gov/sites/default/files/articles/OII_Early_Stage_Slide_Deck_January_2016.pdf.

[53] SBA, Office of Congressional and Legislative Affairs, "Correspondence with the author," December 20, 2018.

[54] SBA, "Small Business Investment Companies (SBIC); Early Stage Initiative," 81 *Federal Register* 64075-64080, September 19, 2016. The proposed changes were based in part on feedback received on an earlier, advance notice of proposed rulemaking. See SBA, "Small Business Investment Companies–Early Stage," 80 *Federal Register* 14034, March 18, 2015. The proposed changes would have allowed early stage applicants to apply at any time, similar to other SBIC applicants, instead of only during limited time frames identified in the *Federal Register* (which the SBA has published on an annual basis since 2012); allowed early stage SBICs to obtain an unsecured line of credit without SBA approval under specified conditions; allowed an application from an applicant under common control with an existing

SBA, at that time, indicated its intention to continue the initiative beyond its initial five-year term.[55]

As mentioned previously, the SBA stopped accepting new applications for the early stage SBIC initiative in 2017. In addition, on June 11, 2018, the SBA withdrew the September 19, 2016 proposed rule that included provisions designed to encourage qualified SBICs to participate in the initiative.[56]

Key Features of Regular SBIC Types

Table 1 provides five key features distinguishing the SBA's debenture SBICs, participating securities SBICs, impact investment SBICs, and early stage SBICs

- the minimum amount of capital required to obtain a license;
- the amount of SBA leverage that can be received;
- the nature of the investments provided;
- a description of the requirements for repaying the SBA's leverage; and
- any profit participation requirements.

Table 1. Key Features of the SBA's Debenture, Participating Securities, and Impact Investment Debenture Programs and Early Stage Debenture Initiative

Program Requirement	Debenture SBICs	Participating Security SBICs (no longer accepting new investments)	Impact Investment SBICs (no longer accepting new applicants)	Early Stage SBICs (no longer accepting new applicants)
Private Capital	$5 million minimum	$10 million minimum	$5 million minimum	$20 million minimum
SBA Leverage	200% of private capital up to $175 million per SBIC or $350 million for two or more SBICs under common control[a]	200% of private capital up to $175 million per SBIC or $350 million for two or more SBICs under common control	200% of private capital up to $175 million; limited to 100% of private capital during any 12-month period[a]	100% of private capital up to $50 million
Investments	Broad range of equity investments but generally later stage and mezzanine	Broad range of equity investments	Broad range of equity investments but generally later stage and mezzanine; at least 50% in underserved markets and communities facing barriers to access to credit and capital	Broad range of equity investments; at least 50% in early stage small businesses (no positive cash flow in any fiscal year prior to first financing)

early stage SBIC that has outstanding debentures or debenture commitments; and increased the initiative's maximum leverage commitment of 100% of regulatory capital or $50 million, whichever is less, to 100% of regulatory capital or $75 million, whichever is less.

[55] SBA, "Small Business Investment Companies (SBIC); Early Stage Initiative," 81 *Federal Register* 64075, September 19, 2016.

[56] SBA, "Small Business Investment Companies (SBIC); Early Stage Initiative," 83 *Federal Register* 26875, June 11, 2018.

Program Requirement	Debenture SBICs	Participating Security SBICs (no longer accepting new investments)	Impact Investment SBICs (no longer accepting new applicants)	Early Stage SBICs (no longer accepting new applicants)
Leverage Description	Interest and SBA annual charge payable semiannually through maturity	SBA paid interest to bond holders; SBICs only owed and repaid SBA out of profits	Interest and SBA annual charge payable semiannually through maturity	Standard: 5 years interest reserve required, interest and SBA annual charge payable quarterly through maturity OR Discounted: interest and SBA annual charge discounted for first 5 years plus the "stub" period; interest and SBA annual charge payable quarterly thereafter through maturity
Profit Participation	None	SBA typically received about 8% of any profits	None	None

Sources: U.S. Small Business Administration, Office of Investment and Innovation, "Early Stage Small Business Investment Companies," January 2012; U.S. Small Business Administration, "Correspondence with the author," May 2, 2012; and U.S. Small Business Administration, "SBA Announces $50 Million Increase Match in its SBIC Early Stage Fund and $70 Million Bump in its Impact Investment Fund," June 6, 2013, at https://www.sba.gov/content/sba-announces-50-million-increase-match-its-sbic-early-stage-fund-and-70-million-bump-its.

a. A licensed debenture SBIC or a licensed impact investment SBIC in good standing, with a demonstrated need for funds, may apply to the SBA for leverage of up to 300% of its private capital. However, the SBA has traditionally approved a maximum of 200% of private capital. Also, a debenture SBIC licensed on or after October 1, 2009, may elect to have a maximum leverage amount of $175 million per SBIC and $250 million for two or more licenses under common control if it has invested at least 50% of its financings in low-income geographic areas and certifies that at least 50% of its future investments will be in low-income geographic areas. P.L. 114-113, the Consolidated Appropriations Act, 2016, increased the multiple licenses/family of funds limit to $350 million from $225 million. The act did not address the multiple licenses/family of funds limit for financings in low-income geographic areas. Presumably, SBICs would apply the $350 million multiple licenses/family of funds limit for all of its financings, including those in low-income geographic areas.

SBIC Investments in Small Businesses

SBICs provide equity capital to small businesses in various ways, including by

- purchasing small business equity securities (e.g., stock, stock options, warrants, limited partnership interests, membership interests in a limited liability company, or joint venture interests);[57]
- making loans to small businesses, either independently or in cooperation with other private or public lenders, that have a maturity of no more than 20 years;[58]

[57] 13 C.F.R. §107.800. A SBIC is not allowed to become a general partner in any unincorporated business or become jointly or severally liable for any obligations of an unincorporated business.

[58] 13 C.F.R. §107.810; and 13 C.F.R. §107.840.

- purchasing debt securities from small businesses, which may be convertible into, or have rights to purchase, equity in the small business;[59] and
- providing small businesses, subject to limitations, a guarantee of their monetary obligations to creditors not associated with the SBIC.[60]

SBICs are subject to statutory and regulatory restrictions concerning the nature of their approved investments. For example, SBICs are not allowed to

- directly or indirectly provide financing to any of their associates (e.g., officers, directors, and employees);[61]
- control, either directly or indirectly, any small business on a permanent basis;[62]
- invest, without SBA approval, more than specified percentages of their private (regulatory) capital in securities, commitments, or guarantees in any one small business (e.g., SBICs are not allowed to invest more than 30% of their private capital in any one small business if their investment plan includes two or more tiers of SBA leverage);[63]
- invest in farmland, unimproved land, or any small business classified under Major Group 65 (Real Estate) of the Standard Industrial Classification (SIC) Manual, with the exception of title abstract companies, real estate agents, brokers, and managers;[64]
- provide funds for small businesses whose primary business activity involves directly or indirectly providing funds to others, purchasing debt obligations, factoring, or leasing equipment on a long-term basis with no provision for maintenance or repair;[65] or
- provide funds to a small business if the funds will be used substantially for a foreign operation.[66]

---

[59] 13 C.F.R. §107.815. Debt securities are instruments evidencing a loan with an option or any other right to acquire equity securities in a small business or its affiliates, a loan that by its terms is convertible into an equity position, or a loan with a right to receive royalties that are excluded from the cost of money.

[60] 13 C.F.R. §107.820.

[61] 13 C.F.R. §107.730.

[62] 13 C.F.R. §107.865. The period of time that a SBIC may exercise control over a small business for purposes connected with its investment through ownership of voting securities, management agreements, voting trusts, majority representation on the board of directors, or otherwise is "limited to the seventh anniversary of the date on which such control was initially acquired, or any earlier date specified by the terms of any investment agreement." With the SBA's prior written approval, a SBIC "may retain control for such additional period as may be reasonably necessary to complete divestiture of control or to ensure the financial stability of the portfolio company."

[63] A tier of SBA leverage equals the amount of a SBIC's private (regulatory) capital. A SBIC approved for less than two tiers of SBA leverage must not invest more than 20% of its private capital in any one small business if the SBIC's plan contemplates one tier of leverage and no more than 25% of its private capital if its plan contemplates 1.5 tiers of leverage. See 13 C.F.R. §107.740; and SBA, "American Recovery and Reinvestment Act of 2009: Implementation of SBIC Program Changes," letter from Harry Haskins, acting associate administrator for Investment, to All Small Business Investment Companies (SBICs) and Applicants, May 4, 2009, p. 2.

[64] 13 C.F.R. §107.720.

[65] Ibid.

[66] Ibid. A SBIC may provide venture capital financing to *disadvantaged concerns* engaged in relending or reinvesting activities (except agricultural credit companies and banking and savings and loan institutions not insured by a federal agency). Without SBA approval, these financings, at the end of the fiscal year, may not exceed a SBIC's regulatory capital. A disadvantaged concern is defined as a small business that is at least 50% owned, controlled, and managed, on

The SBA also regulates the interest rates and fees SBICs are allowed to charge small businesses on loans, debt securities, and equity financing.[67]

In 1999, the SBA introduced the low and moderate income investments (LMI) initiative to encourage SBICs to invest in small businesses located in inner cities and rural areas "that have severe shortages of equity capital" because investments in those areas "often are of a type that will not have the potential for yielding returns that are high enough to justify the use of participating securities."[68] This ongoing initiative provides incentives to SBICs that invest in small businesses that have at least 50% of their employees or tangible assets located in a low-to-moderate income area (LMI Zone) or have at least 35% of their full-time employees with their primary residence in an LMI Zone.[69] For example, unlike regular SBIC debentures that typically have a 10-year maturity, LMI debentures are available in two maturities, for 5 years and 10 years, plus the stub period. The stub period is the time between the debenture's issuance date and the next March 1 or September 1. The stub period allows all LMI debentures to have common March 1 or September 1 maturity dates to simplify administration of the program.

In addition, LMI debentures are issued at a discount so that the proceeds that a SBIC receives for the sale of a debenture is reduced by (1) the debenture's interest costs for the first five years, plus the stub period; (2) the SBA's annual fee for the debenture's first five years, plus the stub period; and (3) the SBA's 2% leverage fee. As a result, these interest costs and fees are effectively deferred, freeing SBICs from the requirement to make interest payments on LMI debentures or pay the SBA's annual fees on LMI debentures for the first five years of a debenture, plus the stub period.[70]

In FY2018, SBICs made 609 investments in small businesses located in a LMI Zone, totaling nearly $1.03 billion—about 18.6% of the total amount invested.[71]

In 2007, P.L. 110-140, the Energy Independence and Security Act of 2007, authorized the SBA to issue Energy Saving Debentures for the purpose of making "Energy Saving Qualified Investments," defined in the act as an investment "in a small business concern that is primarily engaged in researching, manufacturing, developing, or providing products, goods, or services that

---

a day-to-day basis, by a person or persons whose participation in the free enterprise system is hampered because of social or economic disadvantages.

[67] The SBA has a general interest rate ceiling of 19% for a loan and 14% for a debt security, with provisions for a higher interest rate under specified circumstances. See 13 C.F.R. §107.855. A SBIC is allowed to collect a nonrefundable application fee of no more than 1% of the amount of financing requested from a small business to review its financing application, a closing fee of no more than 2% of the amount of financing requested from a small business concern for a loan, charged no earlier than the date of the first disbursement, and a closing fee of no more than 4% of the amount of financing requested from a small business concern for a debt security or equity security financing, charged no earlier than the date of the first disbursement. A SBIC is also allowed to charge a small business for reasonable out-of-pocket expenses, other than management expenses incurred to process the small business's financing application. See 13 C.F.R. §107.860.

[68] SBA, "Small Business Investment Companies," 64 *Federal Register* 52645, September 30, 1999.

[69] SBA, "Small Business Investment Companies," 64 *Federal Register* 52641-52646, September 30, 1999. LMI Zones are areas located in a HUBZone; an Urban Empowerment Zone or Urban Enterprise Community designated by the Secretary of the U.S. Department of Housing and Urban Development; a Rural Empowerment Zone or Rural Enterprise Community as designated by the Secretary of the U.S. Department of Agriculture; an area of low income or moderate income as recognized by the Federal Financial Institutions Examination Council; or a county with persistent poverty as classified by the U.S. Department of Agriculture's Economic Research Service. See 13 C.F.R. §107.50.

[70] SBA, "For SBICs: Background Information on Low or Moderate Income (LMI) Debentures," at https://www.sba.gov/content/low-or-moderate-income-lmi-debentures.

[71] SBA, Office of Congressional and Legislative Affairs, "Correspondence with the author," December 20, 2018.

reduce the use or consumption of non-renewable energy resources."[72] Energy Saving Debentures are structured as a discount debenture similar to LMI debentures. For example, there are no interest payments or SBA annual charge for the first five years of the Energy Saving Debenture, plus the stub period between the debenture's issuance date and the next March 1 or September 1 payment date.[73]

Leverage

Leverage Drawdown

A SBIC applies to the SBA for financial assistance (leverage) to secure the "SBA's conditional commitment to reserve a specific amount of leverage" for the SBIC's future use.[74] If the application is approved, a SBIC draws down the leverage as it makes financial commitments.

The SBA accepts draw applications from SBICs twice a month. When the SBA approves the draw, it issues a payment voucher to a SBIC (called an approval notice). The payment voucher has a term of approximately 60 days and provides a SBIC with the ability to draw funds on a daily basis.

A debenture is executed in conjunction with each draw and held by an agent of a bank selected by the SBA (Federal Home Loan Bank of Chicago), which provides interim funding to the SBIC until a "SBIC's debenture(s) can be pooled with others and sold to the public, a process that occurs every six months [each March and September]."[75] During the interim period, the bank charges a SBIC the London Interbank Offered Rate (LIBOR), plus a 30 basis point premium.[76]

The SBA determines the size of the debenture pool two weeks prior to each scheduled pooling date. All of "the debentures scheduled to be pooled are purchased and pooled together by an entity called the Investment Trust which is managed by the Bank of New York Mellon," and, as the pooling occurs, "the SBA signs an agreement with the Trust to guarantee all the interest and principal payments due on each of the debentures in the pool."[77] The trust then securitizes the pool of debentures and issues new securities called trust certificates. Underwriters are hired to sell the trust certificates to investors in the public market. An offering circular is issued to notify investors of the trust certificates' availability, the terms of the securities, and information concerning how they can be purchased.[78]

The SBA operates the SBIC program on a zero-subsidy basis. To recoup its expenses should defaults occur, the SBA is authorized to charge SBICs a 3% origination fee for each debenture and for each participating security issued (1% at commitment and 2% at draw), an annual fee (not

[72] P.L. 110-140, the Energy Independence and Security Act of 2007, §1205. Energy Saving Debentures.

[73] SBA, "Energy Saving Debentures: FAQs," at https://www.sba.gov/content/energy-savings-debentures-faqs.

[74] 13 C.F.R. §107.1100.

[75] SBA, "Funding the SBIC Program: An Overview," at https://www.sba.gov/sbic/funding-sbic-program. The SBA is required by statute to issue guarantees "at periodic intervals of not less than every 12 months and shall do so at such shorter intervals as it deems appropriate, taking into consideration the amount and number of such guarantees or trust certificates." See 15 U.S.C. §687m.

[76] SBA, "Funding the SBIC Program: An Overview," at https://www.sba.gov/sbic/funding-sbic-program.

[77] Ibid.

[78] To view recent SBIC debenture offering circulars see SBA, "SBIC Debentures Offering Circulars," at https://www.sba.gov/category/lender-navigation/sba-loan-programs/sbic-program/program-data-performance/information-tru-1.

to exceed 1.38% for debentures and 1.46% for participating securities) on the leverage drawn, which is fixed at the time of the leverage commitment, and other administrative and underwriting fees that are adjusted annually.[79]

Debenture SBIC Leverage Requirements

A licensed debenture SBIC in good standing with a demonstrated need for funds may apply to the SBA for financial assistance (leverage) of up to 300% of its private capital. However, the SBA has traditionally approved debenture SBICs for a maximum of 200% of their private capital, and no fund management team may exceed the allowable maximum amount of leverage of $175 million per SBIC and $350 million for two or more licenses under common control.[80]

Debenture SBICs obtain leverage from the sale of SBA-guaranteed debenture participation trust certificates. SBA-guaranteed debenture participation trust certificates may have a term of up to 15 years, although only one outstanding SBA-guaranteed debenture participation trust certificate has a term exceeding 10 years and all recent public offerings have specified a term of 10 years.[81] Debenture SBICs are required to make semiannual payments on the interest due on the debenture, semiannual payments on the SBA's annual charge, and a lump sum principal payment to investors at maturity.[82] SBICs are allowed to prepay SBA-guaranteed debentures without penalty. However, a SBA-guaranteed debenture must be prepaid in whole and not in part and can only be prepaid on a semiannual payment date. The debenture's coupon (interest) rate is determined by market conditions and the interest rate of 10-year Treasury securities at the time of the sale.[83] Also, as mentioned previously, LMI debentures are available in two maturities, for 5 years and 10 years (plus the stub period).

Because the SBA guarantees the debenture, investors are more likely to purchase a debenture participation trust certificate as opposed to others available on the market. They are also more likely to accept a lower coupon (interest) rate than what would be expected without the SBA's guarantee.[84] As a result, the SBIC program enhances a SBIC's access to venture capital and reduces its cost of raising additional financial resources.

Because debenture SBICs are required to make semiannual interest payments on the debenture and semiannual payments on the SBA's annual charge, they tend to focus their investments on

[79] 13 C.F.R. §107.1130; and 13 C.F.R. §107.1210. The annual fee for debentures at the time of the leverage commitment in FY2019 is 0.094%. The annual fee was 0.742% in FY2015, 0.672% in FY2016, 0.347% in FY2017, and 0.222% in FY2018. The participating securities program is no longer issuing new leverage commitments. See SBA, "SBIC Program: Annual Charge," at https://www.sba.gov/document/support-object-object-annual-charge.

[80] 13 C.F.R. §107.1120; 13 C.F.R. §107.1150; and SBA, "American Recovery and Reinvestment Act of 2009: Implementation of SBIC Program Changes," letter from Harry Haskins, Acting Associate Administrator for Investment, to All Small Business Investment Companies (SBICs) and Applicants, May 4, 2009, p. 1.

[81] One debenture has a term of 10 years and 29 weeks. See SBA, "Offering Circular, $1,192,235,000, Guaranteed 2.829% Debenture Participation Certificates, Series SBIC 2015-10 B," September 14, 2015, at https://www.sba.gov/content/sbic-2015-10-b-cusip-831641-fe0.

[82] SBA, "Small Business Investment Companies (SBICs)," *Small Business Notes*, 2009, at http://www.smallbusinessnotes.com/business-finances/small-business-investment-companies-sbics.html; and SBA, "For SBIC Applicants: Financing Options Explained," at https://www.sba.gov/content/financing-options-explained.

[83] 13 C.F.R. §107.50; and 13 C.F.R. §107.1150.

[84] The coupon (interest) rate on SBA debentures is based on the 10-year Treasury rate (adjusted to the nearest 1/8th of 1%) plus a market-driven spread, currently about 70-90 basis points. See 13 C.F.R. §107.50; and SBA, "Trust Certificate Rates: SBIC Debenture Pools," at https://www.sba.gov/content/trust-certificate-rates-sbic-debenture-pools. The coupon rate for the most recent sale of a SBA debenture certificate, which took place on March 14, 2016, was 2.507%.

mid- and later-stage small businesses that have a positive cash flow. Businesses with a positive cash flow have resources available to make payments to the debenture SBIC, either in the form of interest payments or dividends. In many instances, small businesses with positive cash flow are seeking capital for expansion.[85]

Participating Securities SBIC Leverage Requirements

Although the SBA is no longer issuing new commitments for participating securities, the SBA is authorized to accept an application from licensed participating securities SBICs for leverage of up to 200% of their private capital.[86] Also, no fund management team may exceed the allowable maximum amount of leverage of $175 million per SBIC and $350 million for two or more licenses under common control.

Participating securities SBICs obtained leverage by issuing SBA-guaranteed participating securities. The SBA pooled these participating securities and sold SBA-guaranteed participating securities certificates, representing an undivided interest in the pool, to investors through periodic public offerings. SBA participating securities may have a term of up to 15 years, but all recent public offerings had a specified a term of 10 years.

There were 35 public offerings of SBA-guaranteed participating securities certificates since the start of the participating securities program, amounting to just under $10.3 billion. The final SBA-guaranteed participating securities certificate, for $332 million, had a term of 10 years and was offered to investors on February 19, 2009, with delivery of the certificates on February 25, 2009.[87]

SBIC participating securities certificates provide for quarterly payments to investors from dividends on preferred stock, interest on an income bond, or a priority return on a preferred limited partnership equal to a specified interest rate on the principal amount and a lump sum principal payment at maturity. A participating securities SBIC is obligated to make these quarterly payments "only to the extent it has sufficient profits available to make such payments."[88] If a participating securities SBIC is unable to make any required payment, the SBA will make the payment on its behalf. Because startup and early stage small businesses often are not initially profitable, the SBA included language in its participating securities' offering circulars that it "anticipates that it will be called upon routinely to make such … payments for the SBICs in the early years of the lives of such SBICs" and that it "expects to be reimbursed [by the SBIC] any amounts paid … under its guarantee over the life of a participating security."[89]

---

[85] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 11; and SBA, "SBIC Program: FAQs: 8. What investment styles and fund types fit best with the SBIC Program?" at https://www.sba.gov/content/faqs.

[86] 13 C.F.R. §107.1170.

[87] 13 C.F.R. §107.1500; and SBA, "Offering Circular, Guaranteed 4.727% Participating Securities Participation Certificates, Series SBIC-PS 2009-10 A," February 19, 2009, pp. 7, 14, at https://www.sba.gov/content/sbic-ps-2009-10-cusip-831641-ep6.

[88] SBA, "Offering Circular, Guaranteed 4.727% Participating Securities Participation Certificates, Series SBIC-PS 2009-10 A," February 19, 2009, p. 2, at https://www.sba.gov/content/sbic-ps-2009-10-cusip-831641-ep6.

[89] Ibid., pp. 2, 3. Also, see U.S. Congress, House Committee on Small Business, *Private Equity for Small Firms: The Importance of the Participating Securities Program*, 109th Cong., 1st sess., April 13, 2005, Serial No. 109-10 (Washington: GPO, 2005), p. 5.

Because the SBA guaranteed the certificate, investors were more likely to purchase a SBIC participating securities certificate as opposed to others available on the market. They were also more likely to accept a lower payment rate than what would be expected without the SBA's guarantee.[90]

In addition, participating securities SBICs are more likely than debenture SBICs to invest in startup and early stage small businesses because the SBA is willing to make a participating securities SBIC's required quarterly payments to investors, at least during the early years of the investment. Because participating securities SBICs are not required to make these quarterly payments, they are encouraged to focus on a small business's long-term prospects for growth and profitability rather than on its prospects for having immediate, positive cash flow.[91]

As of September 30, 2018, the SBA had a guarantee on an outstanding unpaid principal balance of $10.9 billion in SBIC debentures, $18.0 million in SBIC participating securities, and $56.7 million in other, primarily SSBIC, financings.[92] The SBA also had an outstanding commitment on $3.4 billion in SBIC debentures and $2.6 million in other, primarily SSBIC, financings.[93]

Impact Investment SBIC Leverage Requirements

The SBA established the Impact Investment SBIC Initiative in 2011 to "target areas of critical national priority including underserved markets and communities facing barriers to access to credit and capital."[94] On July 26, 2011, the SBA announced that the first impact investment SBIC license had been awarded to InvestMichigan! Mezzanine Fund.[95]

---

[90] The coupon rate for the most recent sale of a SBA guaranteed participating securities participation certificate, which took place on February 25, 2009, was 4.727%. SBA, "Offering Circular, Guaranteed 4.727% Participating Securities Participation Certificates, Series SBIC-PS 2009-10 A," February 19, 2009, p. 1, at https://www.sba.gov/content/sbic-ps-2009-10-cusip-831641-ep6.

[91] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 11; and SBA, "SBIC Program: FAQs 7. What is the status of the Participating Securities Program?" at https://www.sba.gov/content/faqs.

[92] SBA, "SBIC Program: Fiscal Year Data for the period ending September 30, 2018," at https://www.sba.gov/article/2018/nov/16/fiscal-year-data-period-ending-september-30-2018. As of September 4, 2018, the six Specialized SBICs had private capital of $65.7 million. Of these Specialized SBICs, five had no outstanding financings guaranteed by the SBA and one, with private capital of $49.4 million, had $56.7 million of outstanding SBA guaranteed debenture borrowings. See SBA, "Offering Circular, $923,050,000, Guaranteed 3.548% Debenture Participation Certificates, Series SBIC 2018-10 B," September 13, 2018, p. 8, at https://www.sba.gov/article/2018/sep/17/sbic-2018-10-b-cusip-831641-fl4.

[93] SBA, "SBIC Program: Fiscal Year Data for the period ending September 30, 2018," at https://www.sba.gov/article/2018/nov/16/fiscal-year-data-period-ending-september-30-2018

[94] SBA, "Impact Investment Small Business Investment Company ("SBIC") Fund," p. 1, at https://www.sba.gov/sites/default/files/files/Impact_Investment_Call_for_Action.pdf.

[95] SBA, "SBA Licenses First Impact Investment Fund in Michigan," July 26, 2011, at https://www.sba.gov/content/sba-licenses-first-impact-investment-fund-michigan. The license was dated April 25, 2011. Mezzanine financing is a hybrid of debt and equity financing and is typically used to finance the expansion of an existing business. It provides the lender the right to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full. It is generally subordinated to debt provided by senior lenders such as banks and venture capital companies. Another license was awarded to SJF Ventures, which has offices in New York, San Francisco, and Durham. It reportedly will serve a licensing and oversight role and will not receive leverage from the SBA. See "SBA chooses firm with a clean-tech profile as its newest investment partner, *Washington Post*, March 8, 2012, at http://www.washingtonpost.com/business/on-small-business/sba-chooses-firm-with-a-clean-tech-profile-as-its-newest-investment-partner/2012/03/08/gIQAKgmPzR_story.html.

Licensed impact investment SBICs may apply to the SBA for leverage of up to 300% of their private capital, limited to $175 million. In addition, they may receive leverage amounting to no more than 100% of their private capital during any fiscal year (subject to the $175 million limit). The SBA generally limits impact investment SBICs to a maximum of 200% of their private capital, up to $175 million.[96]

Impact investment SBICs obtain leverage in the same way debenture SBICs obtain leverage—through the issuance of SBA-guaranteed debentures with a term of up to 10 years. They are also subject to the same terms and conditions as debenture SBICs, except they were provided an expedited application review process when new applications to the impact investment program were being accepted.

Early Stage SBIC Leverage Requirements

The SBA established the Early Stage Innovation SBIC Initiative in 2012 to "expand access to capital for early stage small businesses throughout the United States."[97] A licensed early stage SBIC may apply to the SBA for leverage of up to 100% of its private capital, limited to $50 million. The SBA does not consider applications for leverage from an early stage SBIC applicant that is under common control with another early stage SBIC applicant or an existing early stage SBIC (unless the existing early stage SBIC has no outstanding leverage or leverage commitments and will not seek additional leverage in the future).[98]

Early stage SBICs obtain leverage in the same way that debenture SBICs obtain leverage—through the issuance of SBA-guaranteed debentures with a term of up to 10 years. However, early stage debentures come in two forms: early stage standard debentures and early stage discounted debentures.

Early stage standard SBIC debentures are similar to standard SBIC debentures, but, instead of requiring semiannual payments on the debenture's interest and on the SBA's annual charge, they require quarterly payments on the debenture's interest and on the SBA's annual charge. In addition, early stage SBICs must maintain a reserve sufficient to pay the interest on the debenture and on the SBA's annual charges for the first 21 payment dates following the date of issuance (five years plus the length of time between the issue date and the next March 1, June 1, September 1, or December 1).[99] Because early stage standard debentures require early stage SBICs to make quarterly payments, they are most appropriate for investments in small businesses that have established a positive cash flow enabling them to pay interest or dividends to the early stage SBIC.

Early stage discounted debentures are issued at a discount (less than face value) equal to the first five years of interest on the debenture and the first five years of annual SBA charges. The discount eliminates the need for early stage SBICs to make interest payments on the debenture and to make payments on the SBA's annual charge for five years from the date of issuance, plus

[96] SBA, "Start-Up America Impact Investment SBIC Initiative Policy Update," September 26, 2012, at https://www.sba.gov/sites/default/files/files/External%20Impact%20Memo%202012-09-26%20final.pdf; and SBA, "SBA Announces $50 Million Increase Match in its SBIC Early Stage Fund and $70 Million Bump in its Impact Investment Fund," June 6, 2013, at https://www.sba.gov/content/sba-announces-50-million-increase-match-its-sbic-early-stage-fund-and-70-million-bump-its.

[97] SBA, "Small Business Investment Companies—Early Stage SBICs," 77 *Federal Register* 25043, April 27, 2012.

[98] Ibid., p. 25052.

[99] 13 C.F.R. §107.1181. The required reserve is reduced on each payment date upon payment of the required interest and charges.

the stub period.[100] Early stage SBICs make quarterly payments on the debenture's interest and on the SBA's annual charge during years 6 through 10. They are also responsible for paying the debenture's principal amount when the debenture reaches its maturity date.

Because early stage discounted debentures do not require interest payments or payments on the SBA's annual charge for five years, they are most appropriate for investments in small businesses that have not established a positive cash flow to pay interest or dividends to the early stage SBIC. As a result, early stage discounted debentures are designed to encourage investments in early stage small businesses, which by definition have not established a positive cash flow.

Reporting Requirements

Once licensed, each SBIC is required to file with the SBA an annual financial report that includes an audit by a SBA-approved independent public accountant. SBICs are also subject to annual on-site regulatory compliance examinations[101] and required to provide the SBA

- a portfolio financing report within 30 days of the closing date for each financing of a small business;[102]
- the value of their loans and investments within 90 days of the end of the fiscal year in the case of annual valuations and within 30 days following the close of other reporting periods;[103]
- any material adverse changes in valuations at least quarterly (within 30 days following the close of the quarter);[104] and
- copies of reports provided to investors, documents filed with the Securities and Exchange Commission, and documents pertaining to litigation or other legal proceedings, including criminal charges against any person required by the SBA complete a personal history statement in connection with the SBIC's license.[105]

SBIC Program Statistics

As of September 30, 2018, there were 305 licensed SBICs in operation (227 debenture SBICs, 25 participating securities SBICs, 47 bank-owned, non-leveraged SBICs, and 6 SSBICs).[106]

As shown in **Table 2**, the number of debenture SBICs has generally increased in recent years. However, the total number of licensed SBICs has stayed relatively the same in recent years, primarily due to the planned reduction in the number of participating securities SBICs and SSBICs.

[100] SBA, Office of Congressional and Legislative Affairs, "Correspondence with the author," May 2, 2012.

[101] 13 C.F.R. §107.630; and 13 C.F.R. §107.690.

[102] 13 C.F.R. §107.640.

[103] 13 C.F.R. §107.650.

[104] Ibid.

[105] 13 C.F.R. §107.660.

[106] SBA, "SBIC Program: Fiscal Year Data for the period ending September 30, 2018," at https://www.sba.gov/article/2018/nov/16/fiscal-year-data-period-ending-september-30-2018.

Table 2. Number of Licensed SBICs by Type, FY2010-FY2018

SBIC Type	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Debenture	140	143	158	175	187	205	216	227	227
Participating Security	107	97	86	63	53	46	41	33	25
Bank-Owned/ Non-Leveraged	47	46	44	43	45	43	47	47	47
Specialized SBICs	13	13	13	11	9	9	9	8	6
Total	**307**	**299**	**301**	**292**	**294**	**303**	**313**	**315**	**305**

Sources: U.S. Small Business Administration, "SBIC Program Overview," September 30, 2013 and September 30, 2018.

The SBA has made it a goal to increase the number of new SBIC licenses issued each year, with an emphasis on new debenture SBICs licenses, "to position the program for continued growth."[107]

Overall, SBICs pursue investments in a broad range of industries, geographic areas, and stages of investment. Some individual SBICs specialize in a particular field or industry and others invest more generally. Most SBICs concentrate on a particular stage of investment (i.e., startup, expansion, or turnaround) and identify a geographic area in which to focus.

Total Financing

From the inception of the SBIC program to December 31, 2017, SBICs have invested approximately $91.5 billion in approximately 178,175 financings to small concerns.[108] As mentioned previously, as of September 30, 2018, the SBA had a guarantee on an outstanding unpaid principal balance of $10.9 billion in SBIC debentures, $18.0 million in SBIC participating securities, and $56.7 million in other, primarily SSBIC, financings.[109] The SBA also had an

[107] SBA, "FY 2012 Congressional Budget Justification and FY 2010 Annual Performance Report," p. 60, at https://www.sba.gov/sites/default/files/aboutsbaarticle/FINAL%20FY%202012%20CBJ%20FY%202010%20APR_0.pdf. The SBA issued 23 new SBIC licenses (21 to debenture SBICs and 2 to bank-owned, non-leveraged SBICs) in FY2010; 22 new SBIC licenses (18 to debenture SBICs and 4 to bank-owned, non-leveraged SBICs) in FY2011; 30 new SBIC licenses (27 to debenture SBICs and 3 to bank-owned, non-leveraged SBICs) in FY2012; 34 new SBIC licenses (29 to debenture SBICs and 5 to bank-owned, non-leveraged SBICs) in FY2013; 30 new SBIC licenses (24 to debenture SBICs and 6 to bank-owned, non-leveraged SBICs) in FY2014; 25 new SBIC licenses (22 to debenture SBICs and 3 to bank-owned, non-leveraged SBICs) in FY2015; 21 new SBIC licenses (17 to debenture SBICs and 4 to bank-owned, non-leveraged SBICs) in FY2016; 15 new SBIC licenses (11 to debenture SBICs and 4 to bank-owned, non-leveraged SBICs) in FY2017; and 25 new SBIC licenses (21 to debenture SBICs and 4 to bank-owned, non-leveraged SBICs) in FY2018.

[108] SBA, "Offering Circular, $923,050,000, Guaranteed 3.548% Debenture Participation Certificates, Series SBIC 2018-10 B," September 13, 2018, p. 7, at https://www.sba.gov/article/2018/sep/17/sbic-2018-10-b-cusip-831641-fl4. The SBA has occasionally provided a selected list of firms that have received SBIC financing, including AOL, Apple Computer, Build-a-Bear, Compaq Computer, Costco Wholesale Corporation, FedEx, Intel, Jenny Craig, Inc., Nutrisystem, Outback Steakhouse, Sports Authority, Staples, and Sun Microsystems, on its website. For example, see SBA, Office of Investment and Innovation, "Early Stage SBIC Program," slide presentation, January 2016, at https://www.sba.gov/sites/default/files/articles/SBIC-Early-Stage-Initiative.pdf.

[109] SBA, "SBIC Program: Fiscal Year Data for the period ending September 30, 2018," at https://www.sba.gov/article/2018/nov/16/fiscal-year-data-period-ending-september-30-2018.

outstanding commitment on $3.4 billion in SBIC debentures and $2.6 million in other, primarily SSBIC, financings.[110]

Including private investment, as of September 30, 2018, the SBIC program had invested or committed about $30.1 billion in small businesses, with the SBA's share of capital at risk about $14.3 billion.[111]

In FY2018, SBICs made 2,711 financings. The average financing amount was $2,029,730.[112]

In FY2018, SBIC funds were used primarily for acquiring an existing business (57.9%) and also for operating capital (18.0%), refinancing or refunding debt (13.0%), a new building or plant construction (0.9%), research and development (0.8%), purchasing machinery or equipment (0.6%), marketing activities (0.6%), plant modernization (0.4%) and other uses (7.8%).[113]

As shown in **Table 3**, the total amount of SBIC financing declined during the recession (December 2007-June 2009), reached prerecession levels in FY2011, and has generally increased since then. In FY2018, the SBA committed to guarantee $2.52 billion in SBIC small business investments. SBICs invested another $2.98 billion from private capital for a total of $5.50 billion in financing for 1,151 small businesses.

In addition, the amount of SBA leverage as a share of total financing provided has generally increased in recent years. For example, the SBA's leverage commitments accounted for 26.7% of total financing in FY2007, compared with 46.6% in FY2014, 40.6% in FY2015, 42.0% during FY2016, 34.2% in FY2017, and 45.8% in FY2018.

Table 3. SBIC Investments, FY2007-FY2018

($ in millions)

Year	SBA Leverage/Guarantee Commitments	Private-Sector Investment	Total Financing	Number of Small Businesses Financed
FY2007	$708	$1,940	$2,648	2,057
FY2008	$1,029	$1,398	$2,427	1,905
FY2009	$788	$1,068	$1,856	1,481
FY2010	$1,165	$882	$2,047	1,331
FY2011	$1,828	$1,005	$2,833	1,339
FY2012	$1,924	$1,303	$3,227	1,094
FY2013	$2,156	$1,342	$3,498	1,068
FY2014	$2,549	$2,916	$5,465	1,085
FY2015	$2,553	$3,733	$6,286	1,210
FY2016	$2,514	$3,478	$5,992	1,201
FY2017	$1,960	$3,767	$5,727	1,077
FY2018	$2,522	$2,981	$5,503	1,151

[110] Ibid.

[111] Ibid.

[112] SBA, Office of Investment and Innovation, "SBIC Program – Financing to Businesses by State, FY2014 to FY2018," at https://www.sba.gov/sites/default/files/2018-11/SBICProgram_FinancingbyState_FYs2014to2018.pdf.

[113] SBA, Office of Congressional and Legislative Affairs, "Correspondence with the author," December 20, 2018.

Sources: U.S. Small Business Administration, "Performance and Financial Highlights, FY2007," February 4, 2008, p. 4; U.S. Small Business Administration, "FY2008 Budget Request and Performance Plan," 2007, p. 23; U.S. Small Business Administration, "SBIC Program Overview," January 23, 2009; September 30, 2015, and September 30, 2018.

The SBA was authorized to issue up to $3.0 billion in SBIC leverage from FY2006 through FY2013. As mentioned previously, P.L. 113-76, the Consolidated Appropriations Act, 2014, increased that annual SBIC-leverage amount to $4 billion. For comparative purposes, private venture capital firms invested $26.0 billion in 3,414 deals in 2010, $36.3 billion in 4,227 deals in 2011, $32.7 billion in 4,676 deals in 2012, $36.3 billion in 5,158 deals in 2013, $60.0 billion in 5,962 deals in 2014, $77.9 billion in 6,048 deals in 2015, $63.3 billion in 5,621 deals in FY2016, $76.0 billion in 5,707 deals in 2017, and $73.7 billion in 4,119 deals in 2018.[114]

In 2008, the Urban Institute released an analysis comparing debenture SBIC investments made from 1997 to 2005 to private-sector venture capital investments made during that time period in second stage business loans, third stage business loans, and bridge loans "because these investments are likely to be of the same character (debt with equity features) as those made by debenture SBICs."[115] The Urban Institute found that debenture SBIC investments accounted for more than 62% of all venture capital financings in second stage business loans, third stage business loans, and bridge loans in the United States during that time period. However, because the average amount of a SBIC debenture investment was much smaller than the industry average, SBIC debenture investments accounted for "only 8% of total dollars invested."[116]

Financing to Specific Demographic Groups

As shown in **Table 4**, in FY2018, SBICs made 130 financings (4.8% of all financings) amounting to $132.4 million (2.4% of the total amount of financings) to minority-owned and -controlled small businesses.

Table 4. SBIC Financing, Minority-Owned Small Businesses, FY2018

Small Business Ownership Demographic	Number of Financings	Percentage of Financings	$ Amount of Financings	Percentage of Total $ Amount of Financings
Black-Owned	52	1.9%	$33,904,388	0.6%
Asian Owned	49	1.8%	$85,681,189	1.6%
Hispanic-Owned	28	1.0%	$12,184,863	0.2%
Native American-Owned	1	0.0%	$600,000	0.0%
Subtotal	130	4.8%	$132,370,440	2.4%
Other (Nonminority)	2,581	95.2%	$5,370,201,839	97.6%
Total—All Financings	2,711	100.0%	$5,502,572,279	100.0%

[114] PricewaterhouseCoopers, National Venture Capital Association, "MoneyTree™ Report, National Aggregate Data," at http://www.pwcmoneytree.com/.

[115] Kenneth Temkin and Brett Theodos, with Kerstin Gentsch, "The Debenture Small Business Investment Company Program: A Comparative Analysis of Investment Patterns with Private Venture Capital Equity," Washington, DC: The Urban Institute, January 2008, p. 3, at http://www.urban.org/UploadedPDF/411601_sbic_gap_analysis.pdf.

[116] Ibid., p. 1.

Source: U.S. Small Business Administration, Office of Legislative and Congressional Affairs, "Correspondence with the author," December 20, 2018.

Notes: Ownership is defined as owning at least 50% of the small business.

In addition, in FY2018, SBICs made 59 financings (2.2% of all financings) totaling $96.0 million (1.7% of the total amount financed) to women-owned small businesses and 25 financings (0.9% of all financings) totaling nearly $16.1 million (0.3% of the total amount financed) to veteran-owned small businesses.[117]

Research concerning private venture capital investment in minority-owned or women-owned small businesses is limited. As a result, it is difficult to find the data necessary to compare the SBIC program's investment in minority-owned or women-owned small businesses to the private sector's investment in these firms.[118]

In 2007, the SBA acknowledged at a congressional hearing on its investment programs that "women and minority representation in [the SBIC program] is low" and has been for many years.[119] The SBA reported at that time that it did not control the investments made by SBICs, but it has tried to increase women and minority representation in the SBIC program by reaching out to venture capital firms, trade organizations, and others to better understand why women and minority representation in the SBIC program is low and by "finding debenture firms with minority representation on their investment committees and in senior management."[120] However, despite these efforts, in 2009, the Small Business Investor Alliance (then called the National Association of Small Business Investment Companies) asserted at a congressional hearing on the SBA's capital access programs that the SBA's SBIC licensing process "has done an abysmal job at attracting and licensing funds led by women and minorities."[121]

During the 111th Congress, S. 1831, the Small Business Venture Capital Act of 2009, was introduced on October 21, 2009, and referred to the Senate Committee on Small Business and Entrepreneurship. No further action was taken on the bill. It would have encouraged SBIC investments in women-owned small businesses and socially and economically disadvantaged small business concerns by increasing the amount of leverage available to SBICs that invest at least 50% of their financings in small business concerns owned and controlled by women or socially and economically disadvantaged small business concerns.

Financing by State

As shown in **Table 5**, in FY2018, SBICs provided financing to small businesses located in 48 states, the District of Columbia and Puerto Rico, with the most financing taking place in California (392 financings totaling over $1.0 billion), Texas (276 financings totaling $427.6 million), and New York (233 financings totaling $482.6 million).

[117] SBA, Office of Congressional and Legislative Affairs, "Correspondence with the author," December 20, 2018.

[118] Kenneth Temkin and Brett Theodos, with Kerstin Gentsch, "The Debenture Small Business Investment Company Program: A Comparative Analysis of Investment Patterns with Private Venture Capital Equity," Washington, DC: The Urban Institute, January 2008, pp. 2, 26, at http://www.urban.org/UploadedPDF/411601_sbic_gap_analysis.pdf.

[119] U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Legislation Updating and Improving the SBA's Investment and Surety Bond Programs*, 110th Cong., 1st sess., September 6, 2007, Serial Number 110-44 (Washington: GPO, 2007), p. 15.

[120] Ibid.

[121] U.S. Congress, House Committee on Small Business, *Full Committee Hearing On Increasing Capital For Small Business*, 111th Cong., 1st sess., October 14, 2009, committee document no. 111-051 (Washington: GPO, 2009), p. 89.

Table 5. SBIC Financing by State, FY2018

($ in millions)

State	# of Financings	Amount of Financings	State	# of Financings	Amount of Financings
Alabama	1	$9.6	Montana	14	$23.4
Alaska	4	$1.7	Nebraska	11	$52.7
Arizona	56	$96.6	Nevada	7	$23.3
Arkansas	13	$53.4	New Hampshire	9	$25.5
California	392	$1,049.1	New Jersey	111	$241.9
Colorado	74	$121.8	New Mexico	4	$2.2
Connecticut	26	$55.4	New York	233	$482.6
Delaware	3	$2.4	North Carolina	72	$138.5
District of Columbia	7	$14.7	North Dakota	21	$10.3
Florida	154	$256.5	Ohio	97	$135.9
Georgia	61	$147.2	Oklahoma	27	$29.8
Guam	0	$0.0	Oregon	40	$118.7
Hawaii	0	$0.0	Pennsylvania	77	$130.0
Idaho	8	$35.3	Puerto Rico	3	$2.8
Illinois	164	$341.5	Rhode Island	9	$10.0
Indiana	45	$96.7	South Carolina	18	$53.6
Iowa	4	$4.1	South Dakota	3	$20.0
Kansas	30	$58.0	Tennessee	48	$123.2
Kentucky	6	$28.7	Texas	276	$427.6
Louisiana	16	$104.1	Utah	49	$75.6
Maine	12	$34.1	Vermont	2	$3.0
Maryland	42	$57.0	Virgin Islands	0	$0.0
Massachusetts	105	$258.5	Virginia	47	$72.1
Michigan	72	$116.6	Washington	33	$37.4
Minnesota	69	$92.7	West Virginia	0	$0.0
Mississippi	7	$26.4	Wisconsin	37	$91.3
Missouri	91	$108.9	Wyoming	1	<$0.1
Total				2,711	$5,502.6

Source: U.S. Small Business Administration, Office of Investment and Innovation, "SBIC Program – Financing to Businesses by State, FY2014 to FY2018," at https://www.sba.gov/sites/default/files/2018-11/SBICProgram_FinancingbyState_FYs2014to2018.pdf.

The previously mentioned 2008 Urban Institute comparative analysis of debenture SBIC financing from 1997 to 2005 found that the dollar volume of investments from debenture SBICs was more evenly distributed across the nation than from comparable private venture capital funds. For example, the Urban Institute found that California (45.8%) and Massachusetts (12.9%)

received the largest share of the total dollar volume invested by private venture capital funds from 1997 to 2005. The two states accounted for more than half (58.7%) of the total dollar volume invested by private venture capital funds. In contrast, New York (18.7%) and California (11.1%) received the largest share of the total dollar volume invested by debenture SBICs from 1997 to 2005. The two states accounted for less than one-third (29.8%) of the total dollar volume invested by debenture SBICs. In addition, the top 10 states in terms of their share of the total dollar volume invested accounted for nearly 84% of the total invested by private venture capital funds, compared with 64% for debenture SBICs.[122]

A comparison of the state-by-state distribution of private-sector venture capital fund investments in FY2018 and SBIC financings in FY2018 (see **Table 5**) suggests the Urban Institute's finding that SBICs investments were more evenly distributed across the nation than private-sector venture capital fund investments from 1997 to 2005 continues to be the case today. For example, during the first three quarters of FY2018, California (53.9%), New York (14.9%), Massachusetts (10.7%), and Washington (2.3%) received the largest shares of the total dollar volume invested by private venture capital funds. The four states accounted for more than four-fifths (81.8%) of the total dollar volume invested by private venture capital funds during that time period.[123] In contrast, the four states with the largest share of the total volume invested by SBICs in FY2018 (California at 19.1%, New York, New York at 8.8%, Texas at 7.8%, and Illinois at 6.2%) accounted for 41.9% of the total dollar volume invested by SBICs.

Legislative Activity

P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA), included provisions designed to increase the amount of leverage issued under the SBIC program by increasing the maximum amount of leverage available to an individual SBIC to 300% of its private capital or $150 million, whichever is less, and by increasing the maximum amount of leverage available for two or more licenses under common control to $225 million.[124] It also encouraged SBIC investment in smaller enterprises by requiring SBICs licensed after the date of its enactment (February 17, 2009) to certify that at least 25% of all future financing dollars are invested in smaller enterprises. ARRA defined smaller enterprises as firms having either a net worth of no more than $6 million and average after-tax net income for the preceding two years of no more than $2 million or meeting the SBA's size standard for its industry classification.[125]

---

[122] Kenneth Temkin and Brett Theodos, with Kerstin Gentsch, "The Debenture Small Business Investment Company Program: A Comparative Analysis of Investment Patterns with Private Venture Capital Equity," Washington, DC: The Urban Institute, January 2008, pp. 3, 18-24, at http://www.urban.org/UploadedPDF/411601_sbic_gap_analysis.pdf.

[123] PricewaterhouseCoopers, National Venture Capital Association, "Venture Capital Investments, Regional Aggregate Data," at https://www.pwcmoneytree.com/Reports/Homepage%20RegionalAgg.xlsx.

[124] 13 C.F.R. §107.1120; and 13 C.F.R. §107.1150. Previously, "the total principal amount of outstanding debentures and participating securities guaranteed by SBA and issued by any SBIC or group of commonly controlled SBICs may not, in general, exceed at any one time an amount equal to three times such SBIC's Private Capital or [in 2008] $130.6 million, whichever is less, of which no more than two times the SBIC's Private Capital may be represented by participating securities." See SBA, "Offering Circular, Guaranteed 5.725% Debenture Participation Certificates, Series SBIC 2008-10 B," September 18, 2008, at https://www.sba.gov/content/sbic-2008-10-b-cusip-831641-en1. P.L. 102-366, the Small Business Credit and Business Opportunity Enhancement Act of 1992, set the maximum leverage amount for SBICs and SBICs under common control at $90 million. Licensees under common control were allowed to have aggregate outstanding leverage over $90 million only if the SBA gave them permission to do so. P.L. 105-135, the Small Business Reauthorization Act of 1997, set the maximum leverage amount for SBICs and SBICs under common control at $90 million and added the requirement that the amount be adjusted annually for inflation.

[125] 13 C.F.R. §107.1150; and 13 C.F.R. §107.710.

ARRA also encouraged SBIC investments in low-income areas by allowing a SBIC licensed on or after October 1, 2009, to elect to have a maximum leverage amount of $175 million, and $250 million for two or more licenses under common control, if the SBIC has invested at least 50% of its financings in low-income geographic areas and certified that at least 50% of its future investments will be in low-income geographic areas.[126]

As part of its Startup America Initiative, on January 31, 2012, the Obama Administration recommended that the SBIC program's annual authorization be increased to $4 billion from $3 billion and that the amount of SBA leverage available to licensees under common control (the multiple licenses/family of funds limit) be increased to $350 million from $225 million.[127] On April 27, 2012, the SBA also published a final rule in the *Federal Register* establishing the $1 billion Early Stage Innovation SBIC Initiative (up to $150 million in SBA leverage in FY2012 and up to $200 million in SBA leverage per fiscal year thereafter until the limit is reached) to encourage SBIC program investments in early stage small businesses. As will be discussed, several bills have been introduced during recent Congresses to expand the SBIC program by increasing its annual authorization to $4 billion (enacted), increasing the multiple licenses/family of funds limit to $350 million (enacted), increasing the individual SBIC fund limit to $175 million (enacted), or authorizing a SBIC program specifically designed to encourage SBIC investments in business startups and other early stage small businesses (introduced).

Legislation to Target Additional Assistance to Startup and Early Stage Small Businesses

Some Members and small business advocates have proposed legislation to establish a "permanent" congressionally authorized SBIC program to target additional assistance to startup and early stage small businesses, which are generally viewed as relatively risky investments but also as having a relatively high potential for job creation. Advocates of targeting additional assistance to startup and early stage small businesses argue that the SBA's participating securities program was created to fill a perceived investment gap resulting from the SBA's debenture program's focus on mid- and later-stage small businesses. Because the SBA is no longer providing new licenses or leverage for participating securities SBICs, several Members have introduced legislation to create a new SBA program that would focus on the investment needs of startup and early stage small businesses.

For example, during the 111th Congress, the House passed, by a vote of 241-182, H.R. 5297, the Small Business Jobs and Credit Act of 2010.[128] Among its provisions, as passed by the House, H.R. 5297 would have authorized a $1 billion Small Business Early Stage Investment Program. The proposed program would have provided equity investment financing of up to $100 million in matching funds to each participating investment company. It would have required participating investment companies to invest in small businesses, with at least 50% of the financing in early stage small businesses, defined as those small businesses not having "gross annual sales revenues

[126] 13 C.F.R. §107.1150.

[127] The White House, "Startup America Legislative Agenda," January 31, 2012, at https://obamawhitehouse.archives.gov/blog/2012/01/31/legislative-agenda-startup-america.

[128] Rep. Edward Perlmutter, "Providing for Further Consideration of H.R. 5297, Small Business Jobs and Credit Act of 2010, Roll No. 368," *Congressional Record*, daily edition, vol. 156, no. 91 (June 17, 2010), pp. H4608, H4609.

exceeding $15 million in any of the previous three years."[129] The proposed program emphasized venture capital investments in startup companies operating in nine targeted industries.[130]

H.R. 5297, as subsequently approved by Congress and signed into law by President Obama on September 27, 2010 (P.L. 111-240, the Small Business Jobs Act of 2010), did not include legislative language authorizing a Small Business Early Stage Investment Program.[131] However, it authorized a three-year Intermediary Lending Pilot Program to provide direct loans to not more than 20 eligible nonprofit lending intermediaries each year, totaling not more than $20 million and $1 million per intermediary at an interest rate of 1%. The intermediaries, in turn, may make loans to new or growing small businesses, not to exceed $200,000 per business.[132] The Intermediary Lending Pilot Program was funded for two years. Thirty-six lenders currently participate in the program.[133]

As mentioned previously, in 2012, the SBA established the early stage SBIC initiative to encourage SBIC investments in early stage small businesses. Also, during the 113th Congress, H.R. 30, the Small Business Investment Enhancement and Tax Relief Act, and S. 1285, the Small Business Innovation Act of 2013, would have authorized the Administration to establish a separate SBIC program for early stage small businesses. The Small Business Innovation Act (of 2016) was reintroduced (S. 3375) during the 114th Congress.

Discussion

Advocates of efforts to encourage capital investment in startup and early stage small businesses, including Members of Congress who have served on the House or Senate Small Business Committees, have argued that the SBA's elimination of the SBIC participating securities program has created a gap "in the SBA's existing array of capital access programs, particularly in the provision of capital to early stage small businesses in capital-intensive industries."[134] As Representative Nydia Velázquez argued on the House floor during congressional consideration of H.R. 5297:

---

[129] H.R. 5297, the Small Business Lending Fund Act of 2010, §399L. Definitions.

[130] Ibid. The nine targeted industries are agricultural technology, energy technology, environmental technology, life science, information technology, digital media, clean technology, defense technology, and photonics technology. A similar $200 million Small Business Early Stage Investment Program was included in H.R. 3854, the Small Business Financing and Investment Act of 2009, which was passed by the House on October 29, 2009, by a vote of 389-32. It is awaiting action in the Senate.

[131] Sen. Al Franken, "Small Business Lending Fund Act of 2010," Rollcall Vote No. 237 Leg., *Congressional Record*, daily edition, vol. 156, part 125 (September 16, 2010), p. S7158.

[132] P.L. 111-240, the Small Business Jobs Act of 2010, §1131. Small Business Intermediary Lending Pilot Program.

[133] SBA, "Small Businesses Have New Non-Profit Sources for SBA-financed Loans," August 4, 2011, at https://www.sba.gov/content/small-businesses-have-new-non-profit-sources-sba-financed-loans; and SBA, "Intermediary Lending Pilot Program (ILP) Intermediaries, FY2011 /FY2012," at https://www.sba.gov/sites/default/files/files/ILP_Intermediaries_150218.pdf.

[134] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315, p. 2. For the arguments presented by various organizations advocating programs to assist early stage small businesses and startups, see U.S. Congress, House Committee on Small Business, *Subcommittee on Finance and Tax Hearing on Legislative Proposals to Reform the SBA's Capital Access Programs*, 111th Cong., 1st sess., July 23, 2009, H.Doc. no. 111-039 (Washington: GPO, 2009), pp. 10-12, 60-67; and U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Increasing Access to Capital for Small Business*, 111th Cong., 1st sess., October 14, 2009, H.Doc. no. 111-051 (Washington: GPO, 2009), pp. 33-35, 50-54, 63-69, 86-99.

> This legislation, Mr. Chairman, also recognizes that capital markets are changing dramatically. Credit standards are stricter, and small businesses are now looking not only to loans and to credit cards to finance their operations, but they are also looking to equity investment to turn their ideas into reality. This has become even more pronounced as asset values have declined, leaving entrepreneurs with less collateral to borrow against. Unfortunately, small firms' access to venture capital and to equity investment has declined. Last year, such investments plummeted from $28 billion in 2008 to only $17 billion last year. This is due, in part, to the previous administration's decision to terminate the SBA's largest pure equity financing program—the Small Business Investment Company Participating Securities program. This has left many entrepreneurs who need equity investment to fulfill their business plans without a source of such financing.[135]

Opponents of efforts to encourage capital investment in startup and early stage small businesses have argued that such efforts could "pile unnecessary risk or costs onto taxpayers at a time when we're dealing with record debt and unsustainable deficit spending."[136] During consideration of the proposed Small Business Early Stage Investment Program, opponents argued that it was untested, that it would likely encourage risky investments, and that the legislation required "only 50% of the funding … to be invested" in early stage small businesses.[137]

Legislation to Increase SBIC Financing Levels

In 2009, the Small Business Investor Alliance characterized the SBIC program as "dramatically underused."[138] It argued that the program's financing levels would increase if (1) the SBA further improved its licensing processing procedures to make them more timely and objective, (2) the percentage of SBIC regulatory capital allowed from state or local government entities was increased from its present maximum of 33%, and (3) the SBIC program's multiple licenses/family of funds limit (at that time $225 million for two or more licenses under common control) was increased to allow SBICs to have a series of investment funds in place, in which, for example, "one fund could be winding down, another could be at peak, and another could just be ramping up."[139]

During the 111th Congress, H.R. 3854, the Small Business Financing and Investment Act of 2009, which was passed by the House on October 29, 2009, and H.R. 5554, the Small Business Assistance and Relief Act of 2010, which was not reported after being referred to five committees for consideration, proposed to encourage greater use of the SBIC program by increasing the maximum percentage of SBIC regulatory capital allowed from state or local government entities to 45% from 33%.[140] Both measures would have also increased the SBIC program's multiple licenses/family of funds limit to $350 million from $225 million; increased the SBIC program's

[135] Rep. Nydia Velázquez, "Small Business Jobs and Credit Act of 2010," House debate, *Congressional Record*, daily edition, vol. 156, no. 90 (June 16, 2010), p. H4516.

[136] Rep. Sam Graves, "Small Business Jobs and Credit Act of 2010," House debate, *Congressional Record*, vol. 156, no. 90 (June 16, 2010), p. H4516.

[137] Ibid; and Rep. Jeff Flake, "Small Business Early Stage Investment Act of 2009," House debate, Congressional Record, vol. 155, no. 171 (November 18, 2009), p. H13083. Note: H.R. 3738, the Small Business Early-Stage Investment Act of 2009, was one of eight bills merged into H.R. 3854, the Small Business Financing and Investment Act of 2009, and was later added to H.R. 5297, Small Business Jobs and Credit Act of 2010, by H.Res. 1436.

[138] U.S. Congress, House Committee on Small Business, *Full Committee Hearing On Increasing Capital For Small Business*, 111th Cong., 1st sess., October 14, 2009, H.Doc. no. 111-051 (Washington: GPO, 2009), pp. 32, 87.

[139] Ibid., pp. 88, 89.

[140] H.R. 3854, the Small Business Financing and Investment Act of 2009, §401. Increased Investment from States; and H.R. 5554, the Small Business Assistance and Relief Act of 2010, §591. Increased Investment from States.

limit of $250 million to $400 million for multiple funds under common control that were licensed after September 30, 2009, and invested 50% of their dollars in low-income geographic areas; and increased the SBIC program's authorization level from to $5.5 billion from $3.0 billion in FY2011.[141]

The Obama Administration also recommended, as part of its Startup America Initiative (which included the SBA's $1 billion early stage SBIC initiative and $1 billion impact investment SBIC initiative), that the 112th Congress adopt legislation to increase the SBIC program's annual authorization to $4 billion from $3 billion. The Administration recommended as well that the 112th Congress adopt legislation to increase the amount of SBA leverage available to licensees under common control to $350 million from $225 million.[142]

During the 112th Congress, H.R. 3219, the Small Business Investment Company Modernization Act of 2011, would have encouraged greater utilization of the SBIC program by increasing the maximum amount of outstanding SBA leverage available to any single licensed SBIC from the lesser of 300% of its private capital or $150 million to the lesser of 300% of its private capital or $200 million if a majority of the managers of the company are experienced in managing one or more SBIC licensed companies. It would also have increased the maximum amount of outstanding SBA leverage available to two or more licenses under common control to $350 million from $225 million.

S. 2136, a bill to increase the maximum amount of leverage permitted under title III of the Small Business Investment Act of 1958, would have encouraged greater use of the SBIC program by increasing the maximum amount of outstanding SBA leverage available to two or more licenses under common control to $350 million from $225 million. It also would have increased the SBIC program's authorization level to $4 billion from $3 billion.

On March 15, 2012, S.Amdt. 1833, the INVEST in America Act of 2012, was offered on the Senate floor as an amendment in the nature of a substitute to H.R. 3606, the Jumpstart Our Business Startups Act, which had previously passed the House. Two of the provisions in the amendment proposed to encourage greater use of the SBIC program by (1) increasing the maximum amount of outstanding SBA leverage available to two or more licenses under common control to $350 million from $225 million and (2) increasing the SBIC program's authorization level to $4 billion from $3 billion. The Senate later passed H.R. 3606 with amendments, which did not address the SBIC program. The House accepted the Senate amendments and passed the bill, which President Obama signed into law (P.L. 112-106).

S. 3442, the SUCCESS Act of 2012, and S. 3572, the Restoring Tax and Regulatory Certainty to Small Businesses Act of 2012, would have, among other provisions, increased the SBIC program's authorization amount to $4 billion from $3 billion, increased the multiple licenses/family of funds limit to $350 million from $225 million, and annually adjusted the maximum outstanding leverage amount available to both individual SBICs and SBICs under common control to account for inflation.

In addition, H.R. 6504, the Small Business Investment Company Modernization Act of 2012, which was passed by the House on December 18, 2012, would have increased the SBIC program's multiple licenses/family of funds limit to $350 million from $225 million.

---

[141] H.R. 3854, §401. Increased Investment From States, §403. Revised Leverage Limitations For Successful SBICs, and §408. Program Levels; and H.R. 5554, §591. Increased Investment from States, §593. Revised Leverage Limitations for Successful SBICs, and §598. Program Levels.

[142] The White House, "Startup America Legislative Agenda," at https://obamawhitehouse.archives.gov/sites/default/files/uploads/startup_america_legislative_agenda.pdf.

During the 113th Congress, as mentioned previously, P.L. 113-76 increased the annual leverage amount the SBA is authorized to provide to SBICs to $4 billion from $3 billion. In addition to increasing the program's authorization amount to $4 billion, S. 511, the Expanding Access to Capital for Entrepreneurial Leaders Act (EXCEL Act) would have increased the program's multiple licenses/family of funds limit to $350 million from $225 million. S. 1285, would have, among other provisions, also increased the program's multiple licenses/family of funds limit to $350 million.

During the 114th Congress, P.L. 114-113, the Consolidated Appropriations Act, 2016, increased the SBIC program's multiple licenses/family of funds limit to $350 million.[143] In addition, H.R. 5968, the Small Business Investment Opportunity Act of 2016, introduced on September 8, 2016, and referred to the House Committee on Small Business, would have increased the maximum amount of leverage available to SBICs to 300% of the SBIC's private capital (200% in practice) or $170 million, whichever is less, from the current maximum of 300% of the SBIC's private capital (200% in practice) or $150 million, whichever is less.

During the 115th Congress, P.L. 115-187, the Small Business Investment Opportunity Act of 2017, increased the maximum amount of leverage for individual SBICs to $175 million from $150 million.

Discussion

In 2010, the SBA announced that one of its goals for the SBIC program was to increase its "acceptance in the marketplace and increase the number of funds licensed and the amount of leverage issued so as to improve capital access for small businesses."[144] The SBA asserted that ARRA's changes to the SBIC program would help it to achieve this goal. ARRA increased the maximum leverage available to SBICs to up "to three times the private capital raised by the SBIC, or $150 million, whichever is less, and $225 million for multiple licensees under common control" and increased "the maximum leverage amounts to $175 million for single funds and $250 million for multiple funds under common control who are licensed after September 30, 2009, and invest 50% of their dollars in low income geographic areas."[145]

As mentioned previously, P.L. 113-76 increased the annual leverage amount the SBA is authorized to provide to SBICs to $4 billion from $3 billion, P.L. 114-113, the Consolidated Appropriations Act, 2016, increased the SBIC program's multiple licenses/family of funds limit to $350 million, and P.L. 115-187, the Small Business Investment Opportunity Act of 2017, increased the maximum amount of leverage for individual SBICs to $175 million.

Advocates of increasing the SBIC program's leverage limits have argued that these actions are necessary to help fill a perceived gap in the SBA's "array of capital access programs."[146] In

[143] Previously, S. 552, the Small Business Investment Company Capital Act of 2015, and its House companion bill, H.R. 1023, would have increased that limit to $350 million. The Senate Committee on Small Business and Entrepreneurship reported S. 552 on June 10, 2015. The bill was placed on the Senate Legislative Calendar under General Orders. The House Committee on Small Business reported H.R. 1023 on June 25, 2015, and the House passed it on July 13, 2015.

[144] SBA, "Fiscal Year 2011 Congressional Budget Justification and FY2009 Annual Performance Report," p. 52, at https://www.sba.gov/sites/default/files/aboutsbaarticle/Congressional_Budget_Justification.pdf.

[145] SBA, "SBA Project Plan, Section 505: SBIC Program Changes," June 16, 2010, at https://www.sba.gov/sites/default/files/recovery_act_reports/sba_sbic_plan.pdf.

[146] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, report to accompany H.R. 3854, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), p. 3.

addition, they argue that the demise of the SBIC participating securities program and the current "underutilization" of the SBIC debentures program is preventing many small firms from accessing the capital necessary to fully realize their economic potential and assist in the national economic recovery.[147] On the other hand, others worry about the potential risk that an expanded SBIC program has for the taxpayer, especially if investments are targeted at startup and early stage small businesses which, by definition, have a more limited credit history and a higher risk for default than businesses that have established positive cash flow.

Concluding Observations

Some Members of Congress have argued that the SBA should be provided additional resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs.[148] In their view, encouraging greater utilization of the SBIC program will increase small business access to capital, result in higher levels of job creation and retention, and promote economic growth. For example, on March 19, 2012, during Senate consideration of the INVEST in America Act of 2012, then-Senator Olympia Snowe argued

> The amendment [S.Amdt. 1833] I and Senator Landrieu introduced would also help small companies access capital by modifying the Small Business Investment Company, SBIC, Program to raise the amount of SBIC debt the Small Business Administration, SBA, can guarantee from $3 billion to $4 billion. It would also increase the amount of SBA guaranteed debt a team of SBIC fund managers who operate multiple funds can borrow. The SBIC provisions in this amendment have bipartisan support, are noncontroversial, come at no cost to taxpayers and will create jobs. We do not get many bills of this kind in the Senate anymore.
>
> One of the most difficult challenges facing new small businesses today is access to capital. The SBIC Program has helped companies like Apple, FedEx, Callaway Golf, and Outback Steakhouse become household names. As entrepreneurs and other aspiring small business owners well know, it takes money to make money. This legislation ensures that our entrepreneurs and high-growth companies have access to the resources they need so they can continue to drive America's economic growth and job creation in these challenging times. There is no reason why Congress should not approve this amendment to ensure capital is getting into the hands of America's job creators.
>
> This amendment will spur investment in capital-starved startup small businesses, which will play a critical role in leading the Nation of the devastating economic downturn from which we have yet to emerge. For those who may be unfamiliar, despite significant entrepreneurial demand for small amounts of capital, because of their substantial size, most private investment funds cannot dedicate resources to transactions below $5 million. The

[147] U.S. Congress, House Committee on Small Business, *Full Committee Hearing on Increasing Capital for Small Business*, 111th Cong., 1st sess., October 14, 2009, H. Doc. no. 111-051 (Washington: GPO, 2009), pp. 88-91; and Rep. Nydia Velázquez, "Small Business Jobs and Credit Act of 2010," House debate, *Congressional Record*, daily edition, vol. 156, no. 90 (June 16, 2010), p. H4516.

[148] Rep. Nydia Velázquez, "Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12074, H12075; Sen. Mary Landrieu, "Statements on Introduced Bills and Joint Resolutions," remarks in the Senate, *Congressional Record*, daily edition, vol. 155, no. 185 (December 10, 2009), p. S12910; The White House, "Remarks by the President on Job Creation and Economic Growth," December 8, 2009, at https://obamawhitehouse.archives.gov/realitycheck/the-press-office/remarks-president-job-creation-and-economic-growth; and The White House, "Startup America Legislative Agenda," at https://obamawhitehouse.archives.gov/sites/default/files/uploads/startup_america_legislative_agenda.pdf.

> Nation's SBICs are working to fill that gap, especially even during these challenging times.[149]

Others worry about the potential risk an expanded SBIC program may have for increasing the federal deficit. In their view, the best means to assist small business, promote economic growth, and create jobs is to reduce business taxes and exercise federal fiscal restraint.[150] For example, Representative Sam Graves, then-chair of the House Committee on Small Business, indicated in the Small Business Committee's FY2013 "views and estimates" letter to the House Budget Committee that the House Small Business Committee supported an increase in the SBIC program's authorization to $4 billion from $3 billion. However, he indicated that the committee opposed funding for the SBA's early stage SBIC initiative and impact investment SBIC initiative because of their potential to generate losses that could lead to higher SBIC fees or to the need to provide federal funds to subsidize the SBIC program. Representative Graves wrote in the FY2013 views and estimates letter that

> The debenture SBIC program is designed to provide equity injections to small businesses that have been operational and have a track record of cash-flow and profits. … The program is financially sound because the structure of repayments ensures that the government will not suffer significant losses. Thus, no changes are needed to the program and it operates on a zero subsidy basis without an appropriation. The SBA budget is fully supportive of this program and we concur in that recommendation, including raising the program level from $3 billion to $4 billion.
>
> Presumably, some of the additional program level (which will cost the federal government no money) will be used to support two new variations in the Debenture SBIC Program [the early stage SBIC initiative and the impact investment SBIC initiative] … Neither initiative has received authority from Congress nor had its operational principles assessed by the Committee prior to implementation. The Committee reiterates its recommendation from last year's views and estimates – no funds should be allocated from the additional debenture program levels for these two programs. The Committee on the Budget also should provide further protection to the existing debenture SBIC program by requiring any modifications to the program, whether a pilot program or not, be based on a new subsidy calculation that ensures the current debenture program will operate at zero subsidy without any increase in fees due to losses stemming from the Impact and Early Stage Innovation programs.[151]

The House Committee on Small Business's FY2016 views and estimates letter reiterated the committee's opposition to the funding of these two initiatives and recommended that any modifications to the SBIC program "whether a pilot program or not, be based on a new subsidy calculation that ensures the current debenture program will operate at zero subsidy without any increase in fees."[152]

---

[149] Sen. Olympia Snowe, "Jumpstart Our Business Startups Act," remarks in the Senate, *Congressional Record*, vol. 158, no. 45 (March 19, 2012), p. S15845.

[150] National Federation of Independent Business, "Payroll Tax Holiday," Washington, DC, at http://www.nfib.com/issues-elections/issues-elections-item/cmsid/49039/; and NFIB, "Government Spending," Washington, DC, at http://www.nfib.com/issues-elections/issues-elections-item/cmsid/49051/.

[151] Rep. Sam Graves, "Views and Estimates of the Committee on Small Business on Matters to be set forth in the Concurrent Resolution on the Budget for Fiscal Year 2013," Washington, DC, pp. 4, 5, at http://smbiz.house.gov/UploadedFiles/Views_and_Estimates_FY_2013.pdf. Also, see Rep. Sam Graves, "Views and Estimates of the Committee on Small Business on Matters to be set forth in the Concurrent Resolution on the Budget for Fiscal Year 2012," Washington, DC, pp. 4, 5, at http://smbiz.house.gov/UploadedFiles/March_17_Views_and_Estimates_Letter.pdf.

[152] Rep. Steve Chabot, "Views and Estimates of the Committee on Small Business on Matters to be set forth in the

As these quotations attest, congressional debate concerning the SBIC program has primarily involved assessments of the ability of small businesses to access capital from the private sector and evaluations of the program's risk, the effect of proposed changes on the program's risk, and the potential impact of the program's risk on the federal deficit. Empirical analysis of economic data can help inform debate concerning the ability of small businesses to access capital from the private sector and the extent of the program's risk, the effect of proposed changes on the program's risk, and the potential impact of the program's risk on the federal deficit. Additional data concerning SBIC investment impact on recipient job creation and firm survival might also prove useful.

Concurrent Resolution on the Budget for Fiscal Year 2016," Washington, DC, p. 6, at http://smallbusiness.house.gov/uploadedfiles/2-12-2015_views_and_estimates_document.pdf.

Appendix. Small Business Eligibility Requirements and Application Process

Small Business Eligibility Requirements

Only businesses that meet the SBA's definition of "small" may participate in the SBIC program. Businesses must meet either the SBA's size standard for the industry in which they are primarily engaged or the SBA's alternative size standard for the SBIC program. SBICs use the size standard that is most likely to qualify the company, typically the alternative size standard for the SBIC program. The current SBIC alternative size standard, which became effective on July 14, 2014, is tangible net worth not in excess of $19.5 million and average net income after federal income taxes (excluding any carry-over losses) for the preceding two completed fiscal years not in excess of $6.5 million.[153] All of a company's subsidiaries, parent companies, and affiliates are considered in determining if it meets the size standard.

In addition, since 1997, the SBA has required SBICs to set aside a specified percentage of their financing for "businesses at the lower end of the permitted size range," primarily because "the financial size standards applicable to the SBIC program are considerably higher than those used in other SBA programs."[154] P.L. 111-5 requires SBICs licensed after the date of its enactment (February 17, 2009) to certify that at least 25% of their future financing is invested in smaller enterprises. A smaller enterprise is a company that, together with any affiliates, either has net worth of no more than $6 million and average after-tax net income for the preceding two years of no more than $2 million or meets the SBA's size standard in the industry in which the applicant is primarily engaged.[155]

A SBIC licensed on or before February 17, 2009, that has not received any SBA leverage commitments after February 17, 2009, must have at least 20% of its aggregate financing dollars (plus 100% for leverage commitments over $90 million) invested in smaller enterprises.[156]

---

[153] SBA, "Small Business Size Standards: Inflation Adjustment to Monetary Based Size Standards," 79 *Federal Register* 33647-33669, June 12, 2014. The previous SBIC alternative size standard, which was established in 1994, was tangible net worth not in excess of $18 million and average net income after federal income taxes (excluding any carry-over losses) for the preceding two completed fiscal years not in excess of $6 million. See SBA, "Small Business Size Standards: Increase Size Standard of Small Business Concerns Eligible for Assistance by Small Business Investment Companies," 59 *Federal Register* 16953-16956, April 8, 1994. The 1994 final rule used net worth, as opposed to tangible net worth. In 1996, the SBA replaced net worth with tangible net worth for both the 504/CDC loan guaranty program and the SBIC program "because items such as goodwill have no tangible value and should not be taken into account during calculation of net worth for loan approval purposes." See SBA, "Small Business Size Standards," 61 *Federal Register* 3282, January 31, 1996. The previous alternative SBIC size standard of no more than $6 million in net worth and no more than $2 million in after-tax net income was established in 1979. The previous alternative SBIC size standard was a small business concern that does not have assets exceeding $9.0 million, does not have net worth in excess of $4.0 million, and does not have after-tax average net income for the preceding two years in excess of $400,000. See SBA, "Small Business Size Standards: Increase Size Standard of Small Business Concerns for Assistance by Small Business Investment Companies or by Development Companies," 44 *Federal Register* 55815, September 28, 1979. Also, see 13 C.F.R. §107.700; 13 C.F.R. §107.710; 13 C.F.R. §121.301(c)(1) and 13 C.F.R. §121.301(c)(2).

[154] SBA, "Small Business Investment Companies – Leverage Eligibility and Portfolio Diversification Requirements," 74 *Federal Register* 33912, July 14, 2009.

[155] 13 C.F.R. §107.710.

[156] Ibid.

A SBIC licensed on or before February 17, 2009, that has received a SBA leverage commitment after February 17, 2009, must meet the 20% threshold (plus 100% for leverage commitments over $90 million) for financing provided before the date of the first leverage commitment issued after February 17, 2009, and the 25% threshold for financing made after such date.[157]

SBICs are not allowed to invest in the following: other SBICs, finance and investment companies or finance-type leasing companies, unimproved real estate, companies with less than 51% of their assets and employees in the United States, passive or casual businesses (those not engaged in a regular and continuous business operation), or companies that will use the proceeds to acquire farmland.[158] In addition, SBICs may not provide funds for a small business whose primary business activity is deemed contrary to the public interest or if the funds will be used substantially for a foreign operation.[159]

Small Business Application Process

Small business owners interested in receiving SBIC financing can search for active SBICs using the SBA's SBIC directory.[160] The directory provides contact information for all licensed SBICs, sorted by state. It also includes the SBIC's preferred minimum and maximum financing size range, the type of capital provided (e.g., equity, mezzanine, subordinated debt, 1st and 2nd lien secured term, or preferred stock), funding stage preference (e.g., early stage, growing and expansion stage, or later stage), industry preference (e.g., business services, manufacturing, environmental services, or distribution), geographic preference (e.g., national, regional, or specific state or states), and a description of the firm's focus (e.g., equity capital to later stage companies for expansion and acquisition or targeting companies with revenues of at least $5 million and profitability at the time of financing).[161]

After locating a suitable SBIC, the small business owner presents the SBIC a business plan that addresses the business's operations, management, financial condition, and funding requirements. The typical business plan includes the following information:

- the name of the business as it appears on the official records of the state or community in which it operates;
- the city, county, and state of the principal location and any branch offices or facilities;
- the form of business organization and, if a corporation, the date and state of incorporation;

[157] Ibid.; and SBA, "Small Business Investment Companies – Leverage Eligibility and Portfolio Diversification Requirements," 74 *Federal Register* 33912, July 14, 2009.

[158] 13 C.F.R. §107.720. SBICs are generally prohibited from investing in passive businesses. SBIC program regulations provide for two exceptions. The first provides conditions under which an SBIC may structure an investment though up to two levels of passive entities to make an investment in a non-passive business that is a subsidiary of the passive business directly financed by the SBIC. The second enables a partnership SBIC, with SBA's prior approval, to provide financing to a small business through a passive, wholly owned C corporation, but only if a direct financing would cause the SBIC's investors to incur Unrelated Business Taxable Income. A passive C corporation formed under the second exception is commonly known as a blocker corporation. The SBA has issued a proposed rule to expand and clarify the use of SBIC passive business investments. See SBA, "Small Business Investment Companies; Passive Business Expansion & Technical Clarifications," 80 *Federal Register* 60077-60082, October 5, 2015.

[159] Ibid.

[160] SBA, "All SBIC Licensees By State," at https://www.sba.gov/content/sbic-directory.

[161] Ibid.

- a description of the business, including the principal products sold or services rendered;
- a history of the general development of the products or services during the past five years (or since inception);
- information about the relative importance of each principal product or service to the volume of the business and its profits;
- a description of the business's real and physical property and adaptability to other business ventures;
- a description of technical attributes of its products and facilities;
- detailed information about the business's customer base, including potential customers;
- a marketing survey or economic feasibility study;
- a description of the distribution system for the business's products or services;
- a descriptive summary of the competitive conditions in the industry in which the business is engaged, including its competitive position relative to its largest and smallest competitors;
- a full explanation and summary of the business's pricing policies;
- brief resumes of the business's management personnel and principal owners, including their ages, education, and business experience;
- banking, business, and personal references for each member of management and for the principal owners;
- balance sheets and profit and loss statements for the last three fiscal years (or from inception);
- detailed projections of revenues, expenses, and net earnings for the coming year;
- a statement of the amount of funding requested and the time requirements for the funds;
- the reasons for the request for funds and a description of the proposed uses; and
- a description of the benefits the business expects to gain from the financing (e.g., expansion, improvement in financial position, expense reduction, or increase in efficiency).[162]

Because SBICs typically receive hundreds of business plans per year, the SBA recommends that small business owners seek a personal referral or introduction to the particular SBIC fund manager being targeted to increase "the likelihood that the business plan will be carefully considered."[163] According to the Small Business Investor Alliance, "a thorough study an SBIC must undertake before it can make a final decision could take several weeks or longer."[164]

[162] Small Business Investor Alliance (formerly the National Association of Small Business Investment Companies), "SBIC Financing: Step-by-Step," Washington, DC, at http://www.sbia.org/?page=sbic_financing.

[163] SBA, "SBIC Program: Seeking Financing for your Small Business," at https://www.sba.gov/offices/headquarters/ooi/resources/4905.

[164] Small Business Investor Alliance (formerly the National Association of Small Business Investment Companies), "SBIC Financing: Step-by-Step," Washington, DC, at http://www.sbia.org/?page=sbic_financing.

Author Information

Robert Jay Dilger
Senior Specialist in American National Government

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.